

DEBT CHARGES

- 1 This working paper describes the expenses assessment for Debt Charges and the results. The development of the assessment method in the 2004 Review is discussed in Volume 6 of the 2004 Review Working Papers.

DESCRIPTION OF THE CATEGORY

- 2 The Debt Charges category comprises expenses on underwriting and floating government loans and interest payments for those functions within the scope of the Commission's adjusted budget, and administrative costs associated with public debt management. It includes all general government debt charges, including debt charges incurred by the general government sector on behalf of public trading enterprises. Interest earnings from investments are offset against expenses in this category.
- 3 Table 1 shows the net average expenses for the last six financial years. In 2005-06, the Australian average expense for this category was -\$153.92 per capita.

Table 1 Debt charges, net average expenses, 2000-01 to 2005-06, 2007 Update

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Average expenses (\$pc)	38.08	96.07	70.38	-104.11	-127.53	-153.92
% of total State average expenses	0.78	1.86	1.32	-1.91	-2.24	-2.55

ASSESSMENT METHOD

Description of the assessment

- 4 The Debt Charges assessment recognises that State expenses are influenced by:
 - the quantity of borrowing –the quantity of assets used in service provision that States need to fund through borrowing. The quantity of borrowing required by each State is derived by adding assessed borrowing expenses (such as purchases of fixed assets, second hand assets and land), and deducting depreciation expenses, receipts from sales of assets, State budget results and actual capital grants;

- the cost of borrowing – bond rates to determine the non-policy influenced difference in interest rates paid by smaller States; and
- the ACT phase-in adjustment – this adjusts for the length of time since the ACT’s self-government. This reduces the ACT’s assessed needs on the basis that it has not been accumulating debt for as long as other States. (This adjustment expired in the 2004-05 assessment year.)

2007 Update new developments

- 5 In reviewing the Debt Charges assessment, the Commission noted that, while interest earnings from most investments were offset against debt charges expenses, interest earnings from superannuation investments were offset against superannuation expenses. This resulted in similar revenues being assessed differently depending on how they were classified.
- 6 In the New Developments Paper the Commission defined two options for addressing the issues:
- offsetting all interest earnings against debt charges and continuing the 2006 Update approach to the Debt Charges assessment; or
 - assessing Debt Charges on a gross basis and all interest earnings by the equal per capita method.
- 7 Most States supported the first option.
- 8 Following consultation with the States, the Commission concluded that the interest earned on superannuation investments was no different from any other interest and could be used for whatever purpose a State chose. It also noted that disaggregating interest earnings according to the source of funds invested was difficult for some States. It decided the simplest and best approach for resolving the anomalies and improving the reliability of the assessments was to offset all interest earnings against debt charge expenses.
- 9 This is consistent with the advice received from Heads of Treasuries during the 2004 Review that offsetting interest earnings against debt charges was the best way of ensuring that State policy decisions on the extent to which they borrow to invest do not affect the relativities.
- 10 The Commission also decided, on the basis of simplicity, to continue the approach in which debt charges are assessed on an equal per capita basis when the interest earnings exceed debt charge expenses. In this update, this applied to 2003-04, 2004-05 and 2005-06.

Assessment structure

- 11 Table 2 summarises the assessment structure for the 2007 Update.

Table 2 Debt Charges assessment structure, 2007 Update

Expense component	Component weight	Factors	Basis of calculation
	%		
Debt Charges	100.00	Quantity of borrowing	For assessment years 2001-02 to 2002-03: assessed needs for the quantity of assets used in service provision that States needed to fund through borrowing by adding the drivers of State needs to borrow and deducting offsetting receipts. For assessment years 2003-04 to 2005-06, an EPC assessment was applied.
		Cost of borrowing	For assessment years 2001-02 to 2005-06: assessed needs on the basis of bond rates. For assessment years 2003-04 to 2005-06, an EPC assessment was applied.
		ACT phase-in adjustment	For assessment years 2001-02 to 2004-05: the adjustment accounts for the length of time since ACT's self-government. The ACT did not take full responsibility for debt relating to its service provision assets at self-government. Calculated as the number of years since ACT's self-government divided by 15 (15/15 in 2005-06) for a 15 year phase in. The adjustment expired in the 2004-05 assessment year.

CALCULATING THE CATEGORY FACTOR

12 Table 3 summarises the components, component weights and factors assessed for this category for the last year (2005-06) of the 2007 Update. It shows the calculation of the category factor for 2005-06.

Table 3 Debt Charges, derivation of category factor, 2007 Update, 2005-06 assessment year only

Factors	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Debt Charges (component weight = 100 %)								
Quantity of Borrowing Factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Cost of Borrowing Factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
ACT Phase-in Factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
Category factor	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000

Note: An EPC assessment was applied for all factors in the 2005-06 assessment year.

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14 The category factor was calculated as follows:

$$\text{Category factor} = \text{Quantity of borrowing} * \text{Cost of borrowing} * \text{ACT phase-in adjustment}$$

15 After the factors were multiplied, they were re-scaled to ensure that the sum of assessed expenses equalled the sum of actual expenses.

RESULTS FOR 2005-06

- 16 Table 9 at the end of the Debt Charges working paper summarises the results of the assessment. It shows the average, actual and assessed expenses for each State for all years of the 2007 Update.
- 17 Table 4 shows actual, average and assessed expenses per capita and the assessed cost of debt charges ratios for the assessment in 2005-06. The assessed cost ratio is equivalent to the category factor shown in Table 3.

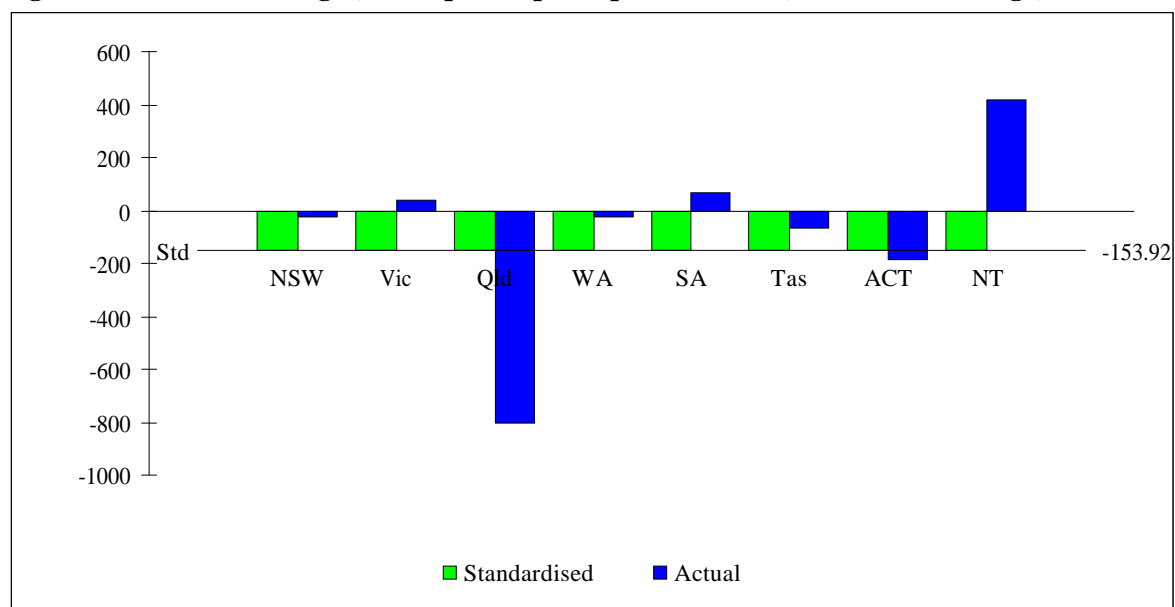
Table 4 Debt Charges, assessment results, 2005-06

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Avg
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Net actual expenses	-21.62	37.22	-805.03	-24.29	63.32	-67.15	-188.87	417.78	-153.92
Net assessed expenses	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92
Assessed cost of providing services ratio ^(a)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

(a) The cost of service provision ratio is the ratio of assessed to average net expenses per capita.

- 18 Figure 1 illustrates the per capita assessed, actual and average expenses for Debt Charges for 2005-06. Because interest earnings have been netted from debt charges, it is possible for States to have low or even negative (indicating a net revenue) actual net expenses.

Figure 1 Debt charges, net expenses per capita– assessed, actual and average, 2005-06



CONTRIBUTION TO GST REVENUE DISTRIBUTION

19 Table 5 shows the category's contribution to the distribution of GST revenue and health care grants (hereafter described as GST revenue) implied by the 2007 Update, using an equal per capita distribution for comparison. It also shows the contributions of each factor to total GST revenue distribution.

Table 5 Debt Charges, contribution of assessment to GST revenue from EPC, 2007 Update

Factor	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total redist'd
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Quantity of borrowing	5.8	3.3	1.8	1.6	-2.8	-4.2	0.2	-5.6	12.6
Cost of borrowing	-1.4	-1.1	-0.8	0.6	1.0	0.5	0.7	0.5	3.3
ACT phase in adjustment	0.6	0.5	0.4	0.2	0.1	0.0	-1.8	0.0	1.8
Redistribution from EPC resulting from the 2007 Update assessment	5.4	3.0	1.5	2.6	-1.7	-3.8	-1.2	-5.7	12.4

Differences from an equal per capita assessment 2007 Update

- 20 Table 5 indicates that the main driver of the assessment was the quantity of borrowing factor, followed by the cost of borrowing factor. The ACT phase-in adjustment distributed the least revenue, but had the biggest impact on the ACT. The main driver of needs in the quantity of borrowing factor was the per capita distribution of capital SPPs. States with below average (per capita) capital SPPs generally had above average needs to fund capital assets through borrowing.
- 21 The key reasons for the distribution of GST revenue compared to an EPC assessment are explained below.
- 22 *New South Wales, Victoria and Queensland* received an above average share of GST revenue. This was mainly because they were assessed to need an above average quantity of assets used in service provision that States needed to fund through borrowing. This was partially offset by their above average ability to borrow at lower rates than other States.
- 23 *Western Australia* received an above average share of GST revenue. This was because it was assessed to need an above average quantity of assets used in service provision that States needed to fund through borrowing. It was also assessed to have a below average ability to borrow at lower rates than other States.
- 24 *South Australia, Tasmania and the Northern Territory* received a below average share of GST revenue. This was because they were assessed to need below average quantities of assets used in service provision that States needed to fund through borrowing. This was partially offset by their below average ability to borrow at lower rates than other States.

- 25 The *Australian Capital Territory* received a below average share of GST revenue. This was due to the effect of the ACT phase-in adjustment. This was partially offset by its below average ability to borrow at lower rates than other States.

CHANGES SINCE THE 2006 UPDATE

Effect of assessment on the distribution of GST revenue

- 26 Table 6 shows the redistribution of GST revenue resulting from assessments in the 2006 and 2007 Updates. It also shows the sources of the changes.
- 27 Changes in GST revenue shares between the 2006 and 2007 Updates were brought about because the Commission:
- used revised financial data in the category average expense and other revised data in factor calculations for the years 2000-01 to 2004-05 used in the 2006 Update; and
 - replaced 2000-01 category average expense and factors with those of 2005-06 to move forward the five-year average on which GST revenue distribution was based. Moving the five-year average forward in this way ensures the assessments reflect recent trends in State priorities on the services provided and recent trends in State demographic, and economic circumstances on the relative costs of those services.

Table 6 Debt Charges, effect of assessment on GST revenue distribution, 2006 Update to 2007 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total redist'd
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Redistribution from EPC resulting from the 2006 Update assessment^(a)	5.0	3.0	1.1	4.1	-0.6	-4.1	-1.7	-6.7	13.2
Effect of revising category averages and factors for 2000-01 to 2004-05									
Category average	-1.5	-0.6	0.1	-1.8	0.1	1.5	-0.1	2.4	4.0
Category factors	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.2
Interactions	1.6	0.3	-0.2	2.0	-0.1	-1.5	0.4	-2.4	4.2
Total	-0.1	-0.3	-0.1	0.2	0.0	0.0	0.3	-0.1	0.5
Effect of replacing 2000-01 category averages and factors with those for 2005-06									
Category average	-4.6	-3.7	-1.7	-3.4	0.7	3.9	2.4	6.4	13.4
Category factors	-1.2	-0.9	-0.4	-0.8	0.2	1.0	0.6	1.6	3.3
Interactions	4.6	3.7	1.7	3.4	-0.7	-3.9	-2.4	-6.4	13.4
Total	-1.2	-0.9	-0.4	-0.8	0.2	1.0	0.6	1.6	3.3
Redistribution from EPC resulting from the 2007 Update assessment^(a)	3.8	1.8	0.6	3.4	-0.4	-3.2	-0.9	-5.2	9.7
Total effect of revisions and updating^(b)	-1.2	-1.2	-0.5	-0.6	0.2	0.9	0.9	1.5	3.5

(a) Assuming same pool and a constant population.

(b) This figure shows the change in the amount redistributed among the States between the 2006 Update and the 2007 Update. It does not necessarily equal the difference in the total re distributions from EPC between the two updates.

28 Compared with an equal per capita assessment, the 2007 Update assessment distributed \$12.4 million to New South Wales, Victoria, Queensland and Western Australia from the other States, \$0.8 million less than in the 2006 Update.

29 Table 7 shows the changes in GST revenue attributable to changes in each factor. These changes are with interactions.

Table 7 Debt Charges, effect of assessment on GST revenue distribution by factor, 2006 Update to 2007 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total redist'd
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Debt Charges									
Quantity of borrowing	-1.5	-1.4	-0.6	-0.2	0.7	1.2	0.0	1.7	3.7
Cost of borrowing	2.3	1.7	1.3	-1.1	-1.7	-0.8	-1.0	-0.6	5.3
30 ACT phase in adjustment	-0.6	-0.5	-0.4	-0.2	-0.1	0.0	1.8	0.0	1.8

31 The main reasons for the changes in GST revenue distribution are as follows.

CHANGES DUE TO REVISING CATEGORY AVERAGE EXPENSES AND FACTORS FOR YEARS 2000-01 TO 2004-05

Changes in category average expenses

32 Revisions to Government Finance Statistics (GFS) data used to calculate assessed expense data in the years 2000-01 to 2004-05 redistributed \$4 million.

Changes in category factors

33 Revisions to the category factors for the years 2000-01 to 2004-05 redistributed about \$0.2 million. This was because the GFS data used to calculate the quantity of borrowing factor was revised for the years 2000-01 to 2004-05.

CHANGES IN STATE CIRCUMSTANCES — REPLACING 2000-01 WITH 2005-06 DATA

34 Table 8 shows the actual expenses and assessed costs of service provision for 2000-01, the year that drops out of the assessment period and 2005-06, the year that comes in, for the 2007 Update assessment.

Change in the importance of the category

35 There was a substantial fall in the importance of debt charges in the budgets of the States — the Australian assessed debt charges expenses fell from \$38.08 per capita in 2000-01 to -\$153.92 per capita in 2005-06. This was due to declines in Australian average levels of State debt and increases in interest earnings.

Table 8 Debt charges, actual expenses and cost of service provision, 2000-01 and 2005-06, 2007 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Avg
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Net actual expenses									
2000-01	84.06	46.98	-143.57	55.06	119.83	209.52	-101.27	639.00	38.08
2005-06	-21.62	37.22	-805.03	-24.29	63.32	-67.15	-188.87	417.78	-153.92
Net assessed expenses									
2000-01	38.71	38.74	38.46	39.57	37.70	30.92	31.66	10.19	38.08
2005-06	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92	-153.92
	%	%	%	%	%	%	%	%	%
Assessed cost of providing services ratio									
2000-01	101.65	101.75	100.99	103.90	99.01	81.21	83.13	26.77	100.00
2005-06	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

36 While there was a decline in the category assessed expense (in 2005-06 compared to 2000-01), there was an increase in the GST pool of 33.7 per cent. This significantly reduced the importance of debt charges in determining the overall relativities.

Changes in the assessed cost of providing services

37 Replacing the 2000-01 category factors with the 2005-06 category factors resulted in a redistribution of \$3.4 million.

38 As outlined earlier in this paper, in the 2005-06 assessment year the category assessed expense was a net revenue. Because the debt charges factor assessments were designed to measure debt, it was not plausible to apply them when, on average, no debt existed. Therefore, in the 2005-06 assessment year, all factors were assessed using an EPC method.

39 The effect of replacing the 2000-01 factors with EPC factors in 2005-06 was to lower the amount of GST distribution between States. This was because the average of the five years of factors in the 2007 Update were closer to one compared to the five year average in the 2006 Update (where no EPC assessments were applied).

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Table 9 Assessment of expense, Debt Charges, 2007 Update

	2001-02		2002-03		2003-04		2004-05		2005-06	
	Amount	Per Capita	Amount	Per Capita	Amount	Per Capita	Amount	Per Capita	Amount	Per Capita
	\$m	\$	\$m	\$	\$m	\$	\$m	\$	\$m	\$
Average Expenses		96.07		70.38		- 104.11		- 127.53		- 153.92
New South Wales										
Assessed difference	8.743	1.32	5.684	0.85	6.727	1.00	0.000	0.00	0.000	0.00
Expenses - Assessed	643.568	97.39	474.379	71.23	- 691.094	- 103.11	- 860.223	- 127.53	- 1 046.791	- 153.92
Actual	582.235	88.11	366.898	55.09	- 70.584	- 10.53	- 225.626	- 33.45	- 147.016	- 21.62
Victoria										
Assessed difference	4.219	0.87	2.558	0.52	4.957	1.00	0.000	0.00	0.000	0.00
Expenses - Assessed	468.421	96.94	346.376	70.90	- 509.216	- 103.11	- 636.984	- 127.53	- 778.607	- 153.92
Actual	209.825	43.42	319.752	65.45	301.876	61.12	245.300	49.11	188.278	37.22
Queensland										
Assessed difference	1.794	0.49	0.393	0.10	3.860	1.00	0.000	0.00	0.000	0.00
Expenses - Assessed	354.266	96.55	264.863	70.48	- 396.529	- 103.11	- 501.425	- 127.53	- 618.071	- 153.92
Actual	689.138	187.82	336.978	89.68	- 2 560.155	- 665.70	- 2 760.801	- 702.19	- 3 232.573	- 805.03
Western Australia										
Assessed difference	7.618	3.98	4.853	2.51	- 3.532	- 1.80	0.000	0.00	0.000	0.00
Expenses - Assessed	191.464	100.05	141.140	72.89	- 208.060	- 105.91	- 254.369	- 127.53	- 312.671	- 153.92
Actual	88.800	46.40	84.759	43.77	45.406	23.11	34.995	17.55	- 49.339	- 24.29
South Australia										
Assessed difference	- 1.006	- 0.66	- 0.508	- 0.33	- 5.559	- 3.63	0.000	0.00	0.000	0.00
Expenses - Assessed	144.559	95.40	106.648	70.05	- 164.828	- 107.74	- 196.066	- 127.53	- 238.329	- 153.92
Actual	137.660	90.85	156.491	102.78	78.229	51.14	61.238	39.83	98.038	63.32
Tasmania										
Assessed difference	- 7.152	- 15.15	- 4.840	- 10.19	- 2.832	- 5.90	0.000	0.00	0.000	0.00
Expenses - Assessed	38.208	80.92	28.572	60.19	- 52.823	- 110.01	- 61.738	- 127.53	- 75.048	- 153.92
Actual	63.335	134.13	53.068	111.78	35.983	74.94	- 9.646	- 19.93	- 32.741	- 67.15
Australian Capital Territory										
Assessed difference	- 2.854	- 8.91	- 0.355	- 1.10	- 1.241	- 3.84	0.000	0.00	0.000	0.00
Expenses - Assessed	27.923	87.16	22.347	69.28	- 34.924	- 107.95	- 41.416	- 127.53	- 50.388	- 153.92
Actual	- 34.969	- 109.15	- 52.360	- 162.33	- 34.911	- 107.91	- 31.959	- 98.41	- 61.828	- 188.87
Northern Territory										
Assessed difference	- 11.361	- 57.34	- 7.786	- 39.28	- 2.379	- 11.96	0.000	0.00	0.000	0.00
Expenses - Assessed	7.673	38.72	6.167	31.10	- 23.089	- 116.07	- 25.698	- 127.53	- 31.575	- 153.92
Actual	140.059	706.87	124.906	630.03	123.592	621.32	108.582	538.88	85.702	417.78

Note: Refer to Attachment A of the 2007 Update, *Relative Fiscal Capacity of States* for how these figures are compiled.