

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 2006-07, the Australian average expense for this category was - \$155.50 per capita.

Table 1 Debt charges, net average expenses, 2001-02 to 2006-07, 2008 Update

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Average expenses (\$pc)	95.32	63.05	-111.66	-136.49	-162.93	-155.50
% of total State average expenses	1.85	1.18	-2.05	-2.40	-2.72	-2.42

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 differences 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.)

Treatment of interest earnings and debt charges

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 prepared for the 2007 Update, the Commission identified 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 approach applies to 2003-04, 2004-05, 2005-06 and 2006-07.

Assessment structure

11 Table 2 summarises the assessment structure for the 2008 Update.

Table 2 Debt Charges assessment structure, 2008 Update

Expense component	Component weight	Factors	Basis of calculation
	%		
Debt Charges	100.00	Quantity of borrowing	For assessment year 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 2006-07: An EPC assessment was applied.
		Cost of borrowing	For assessment year 2002-03: assessed needs on the basis of bond rates. For assessment years 2003-04 to 2006-07: An EPC assessment was applied.
		ACT phase-in adjustment	For assessment years 2002-03 to 2004-05: The ACT did not take full responsibility for debt relating to its service provision assets at self-government. The adjustment here therefore accounts for the length of time since ACT's self-government. The adjustment is 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. For assessment years 2005-06 and 2006-07: No adjustment.

CALCULATING THE CATEGORY FACTOR

12 Table 3 summarises the components, component weights and factors assessed for this category for the latest assessment year (2006-07) of the 2008 Update.

Table 3 Debt Charges, derivation of category factor, 2008 Update, 2006-07 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 2006-07 assessment year. See paragraph 10.

13 The category factor was calculated as follows:

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

- 14 After factors are multiplied, the resulting category factors usually require rescaling to ensure that the sum of assessed expenses equals the sum of actual expenses. This is not necessary where, as in table 3, the category factors are all set equal to unity.

RESULTS FOR 2006-07

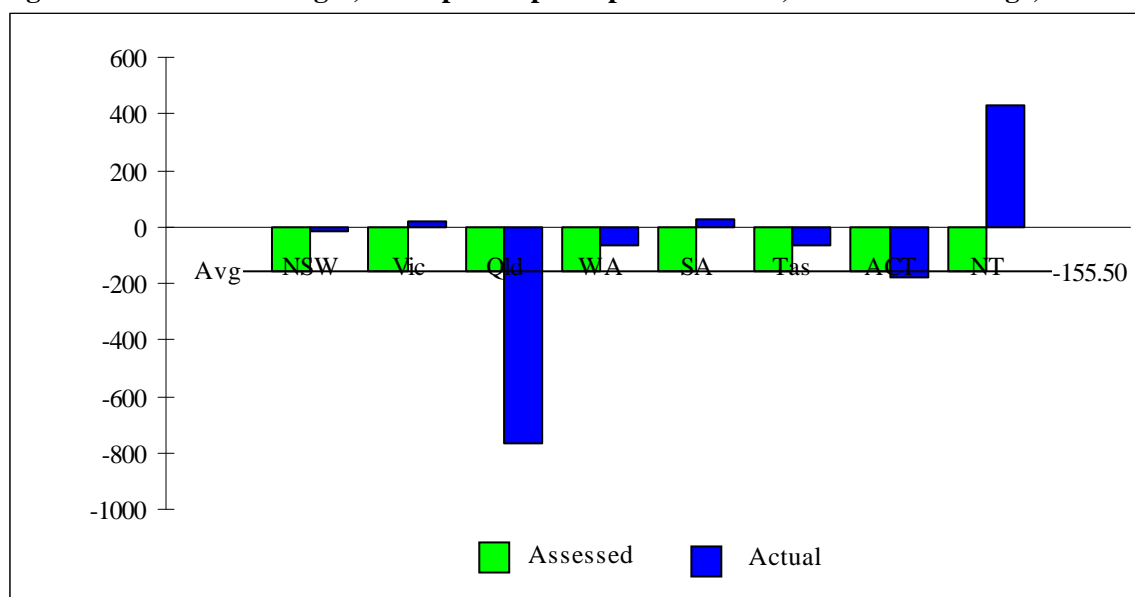
- 15 Table 9 at the end of this working paper summarises the results of the assessment. It shows the average, actual and assessed expenses for each State for all years of the 2008 Update.
- 16 Table 4 shows actual, average and assessed expenses per capita and the assessed cost of debt charges ratios for the assessment year 2006-07. The assessed cost ratio is equivalent to the category factor shown in table 3.

Table 4 Debt Charges, assessment results, 2006-07

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Avg
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Net actual expenses	-12.98	21.15	-765.86	-64.31	23.73	-63.89	-176.88	427.51	-155.50
Net assessed expenses	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50
	%	%	%	%	%	%	%	%	%
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 a State's assessed to the average net expenses per capita.

- 17 Because interest earnings are netted from debt charges, it is possible for States to have low or even negative actual net expenses (indicating a net revenue outcome).
- 18 Figure 1 illustrates this situation, for the per capita actual, assessed and average expenses reported in table 4 for the assessment year 2006-07.

Figure 1 Debt charges, net expenses per capita– assessed, actual and average, 2006-07

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 2008 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, 2008 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	1.6	1.3	0.9	0.5	-1.0	-1.5	0.1	-1.8	4.3
Cost of borrowing	-1.2	-0.9	-0.7	0.5	0.9	0.4	0.6	0.4	2.8
ACT phase in adjustment	0.2	0.2	0.1	0.1	0.1	0.0	-0.7	0.0	0.7
Redistribution from EPC resulting from the 2008 Update assessment	0.8	0.6	0.4	1.1	-0.1	-1.1	-0.1	-1.6	2.9

Differences from an equal per capita assessment 2008 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 redistributed 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 Specific Purpose Payments (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 assessed ability to borrow at a lower rate of interest than the average rate for all States.
- 23 *Western Australia* also 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 need to borrow at a higher rate of interest than the average rate for all 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 assessed need to borrow at a higher rate of interest than the average rate for all States.
- 25 The *Australian Capital Territory* received a below average share of GST revenue. This was due to the cessation of the ACT phase-in adjustment (Table 2 provides the details). The impact of this cessation was partially offset by its assessed need to borrow at a higher rate of interest than the average rate for all States.

CHANGES SINCE THE 2007 UPDATE

Effect of assessment on the distribution of GST revenue

- 26 Table 6 shows the redistribution of GST revenue resulting from assessments in the 2007 and 2008 Updates. It also shows the sources of the changes.
- 27 Changes in GST revenue shares between the 2007 and 2008 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 2001-02 to 2005-06 used in the 2007 Update; and
 - replaced 2001-02 category average expense and factors with those of 2006-07 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, 2007 Update to 2008 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 2007 Update assessment (a)									
	4.0	1.9	0.7	3.7	-0.4	-3.4	-0.9	-5.6	10.4
Effect of revising category averages and factors for 2001-02 to 2005-06									
Category average	-0.2	-0.1	0.0	-0.2	0.0	0.1	0.0	0.2	0.4
Category factors	-1.7	0.2	0.8	-0.3	0.1	0.1	0.0	0.9	2.1
Interactions	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Total	-1.9	0.1	0.8	-0.5	0.1	0.3	0.0	1.1	2.3
Effect of replacing 2001-02 category averages and factors with those for 2006-07									
Category average	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Category factors	-1.4	-1.4	-1.1	-2.1	0.3	2.0	0.8	2.9	6.1
Interactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	-1.4	-1.4	-1.1	-2.1	0.3	2.0	0.8	2.9	6.1
Redistribution from EPC resulting from the 2008 Update assessment (a)									
	0.8	0.6	0.4	1.1	-0.1	-1.1	-0.1	-1.6	2.9
Total effect of revisions and updating (b)									
	-3.2	-1.3	-0.3	-2.6	0.3	2.3	0.9	4.0	7.5

Assuming same pool and a constant population.

This figure shows the change in the amount redistributed among the States between the 2007 Update and the 2008 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 2008 Update assessment distributed \$2.9 million to New South Wales, Victoria, Queensland and Western Australia away from the other States (see also table 5), \$7.5 million less than in the 2007 Update.
- 29 Table 7 shows the changes in GST revenue attributable to changes in each factor. These changes reflect the interactions identified in table 6.

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	-4.8	-2.4	-1.2	-1.4	2.0	3.2	-0.1	4.6	9.9
Cost of borrowing	1.9	1.4	1.1	-1.1	-1.6	-0.7	-0.9	-0.2	4.4
ACT phase in adjustment	-0.7	-0.5	-0.4	-0.2	-0.2	0.0	2.1	0.0	2.1

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

CHANGES DUE TO REVISING CATEGORY AVERAGE EXPENSES AND FACTORS FOR YEARS 2001-02 TO 2005-06

Revising category average expenses

31 There were relatively small downward revisions to the Government Finance Statistics (GFS) data used to calculate assessed expense data in the years 2001-02 to 2005-06. This decreased the amount of GST revenue redistributed for that period by \$0.4 million and slightly decreased the GST revenue shares of the States assessed to have above average costs of providing service ratios (New South Wales, Victoria, Queensland and Western Australia; see table 8).

Revising category factors

32 The impact of revisions here were also generally small, resulting in a decrease of \$2.1 million in the amount of GST revenue redistributed. This small decrease reflects the fact that debt charges were assessed equal per capita for the last three assessment years covered by the 2007 Update (and so the factors here have not changed).

CHANGES IN STATE CIRCUMSTANCES — REPLACING 2001-02 WITH 2006-07 DATA

Changes in the importance of the category

33 Table 8 below shows the actual expenses and assessed costs of service provision for 2001-02 (the year that drops out for the 2008 Update assessment) and for 2006-07 (the year that replaces 2001-02). This table indicates that between 2001-02 and 2006-07, average expenses decreased, and became negative, compared with the corresponding 43.9 per cent increase in the GST pool.

34 In 2003-04 States no longer incurred net debt and so the Australian average expense became negative (positive net interest earnings). In response, the Commission changed the

assessment method to equal per capita (see paragraphs 5 to 10). Consequently, replacing 2001-02 category averages and factors with those for 2006-07 involves replacing the previous debt charges assessment for 2001-02 with an equal per capita assessment for 2006-07.

Table 6 shows this combined change as a category factor change.

Table 8 Debt charges, actual expenses and cost of service provision, 2001-02 and 2006-07, 2008 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Avg
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Net actual expenses									
2001-02	88.14	40.50	187.66	46.39	90.77	134.10	-108.97	705.49	95.32
2006-07	-12.98	21.15	-765.86	-64.31	23.73	-63.89	-176.88	427.51	-155.50
Net assessed expenses									
2001-02	96.05	96.30	96.29	98.92	94.77	80.85	86.48	46.93	95.32
2006-07	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50	-155.50
	%	%	%	%	%	%	%	%	%
Assessed cost of providing services ratio									
2001-02	100.77	101.03	101.02	103.78	99.42	84.83	90.73	49.23	100.00
2006-07	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Changes in the assessed cost of providing services

- 35 An increase (decrease) in the assessed cost of providing services between 2001-02 and 2006-07 (see table 8) reflects an increase (decrease) in the category factor for a State and will lead to a higher (lower) GST distribution to that State.
- 36 As a consequence of assessing debt charges equal per capita in 2006-07 (but not in 2001-02), Table 8 indicates that South Australia, Tasmania, the ACT and the Northern Territory recorded increases in the assessed cost of providing services between 2001-02 and 2006-07. Correspondingly, their GST distributions increased, as indicated in Table 6. The distributions decreased for the other States.
- 37 Overall, replacing the 2001-02 category factors with the 2006-07 category factors resulted in a reduction in the GST redistribution, by \$6.1 million (see table 7). This reflects the fact that the averages of the five years of factors in the 2008 Update were closer to one compared to the five-year averages in the 2007 Update.

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Table 9 Assessment of expense, Debt Charges, 2008 Update

	2002-03		2003-04		2004-05		2005-06		2006-07	
	Amount	Per Capita	Amount	Per Capita	Amount	Per Capita	Amount	Per Capita	Amount	Per Capita
	\$m	\$	\$m	\$	\$m	\$	\$m	\$	\$m	\$
Average Expenses		63.05		- 111.66		- 136.49		- 162.93		- 155.50
New South Wales										
Assessed difference	3.053	0.46	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	422.493	63.50	- 747.305	- 111.66	- 918.933	- 136.49	- 1 106.116	- 162.93	- 1 066.063	- 155.50
Actual	366.904	55.15	- 70.586	- 10.55	- 225.626	- 33.51	- 154.275	- 22.72	- 89.022	- 12.98
Victoria										
Assessed difference	2.314	0.47	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	310.947	63.52	- 553.409	- 111.66	- 685.090	- 136.49	- 829.464	- 162.93	- 803.537	- 155.50
Actual	176.752	36.11	157.876	31.85	81.300	16.20	26.564	5.22	109.308	21.15
Queensland										
Assessed difference	1.289	0.34	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	238.811	63.39	- 431.318	- 111.66	- 540.002	- 136.49	- 659.672	- 162.93	- 643.080	- 155.50
Actual	336.478	89.31	- 2 560.155	- 662.79	- 2 760.801	- 697.81	- 3 233.833	- 798.70	- 3 167.314	- 765.86
Western Australia										
Assessed difference	4.077	2.10	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	126.292	65.15	- 219.776	- 111.66	- 272.974	- 136.49	- 332.146	- 162.93	- 323.753	- 155.50
Actual	84.759	43.72	34.086	17.32	9.928	4.96	- 73.568	- 36.09	- 133.890	- 64.31
South Australia										
Assessed difference	- 0.371	- 0.24	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	95.859	62.80	- 171.545	- 111.66	- 211.098	- 136.49	- 254.246	- 162.93	- 245.165	- 155.50
Actual	156.492	102.53	78.229	50.92	61.233	39.59	98.023	62.82	37.415	23.73
Tasmania										
Assessed difference	- 4.148	- 8.73	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	25.801	54.31	- 53.674	- 111.66	- 66.171	- 136.49	- 79.585	- 162.93	- 76.450	- 155.50
Actual	53.068	111.71	35.983	74.86	- 9.646	- 19.90	- 33.330	- 68.23	- 31.411	- 63.89
Australian Capital Territory										
Assessed difference	- 0.327	- 1.01	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	20.109	62.04	- 36.425	- 111.66	- 44.841	- 136.49	- 54.131	- 162.93	- 52.355	- 155.50
Actual	- 52.360	- 161.53	- 34.911	- 107.02	- 31.959	- 97.28	- 51.475	- 154.93	- 59.553	- 176.88
Northern Territory										
Assessed difference	- 5.888	- 29.52	0.000	0.00	0.000	0.00	0.000	0.00	0.000	0.00
Expenses - Assessed	6.686	33.52	- 22.434	- 111.66	- 27.881	- 136.49	- 34.007	- 162.93	- 33.090	- 155.50
Actual	124.906	626.29	123.592	615.17	108.582	531.56	72.527	347.48	90.974	427.51

Note: Refer to Attachment A of the 2008 Update, *Relative Fiscal Capacity of States* for how these figures are compiled.