

CHAPTER 22

NET LENDING AND INTEREST AND DIVIDEND INCOME

- 1 As explained in Chapters 3 and 5 of Volume 1, the Commission has decided to equalise State net financial worth per capita. Two assessments are required to give effect to this decision.
 - An assessment showing how much States would need to save each year to equalise their per capita net financial worth — a net lending assessment. The assessment is referred to as a net lending assessment but it applies whether States are net lenders or borrowers¹.
 - An assessment showing how the financial consequences of equalised net financial worth per capita are captured in State revenue or expenses — the assessment of interest and dividend income and gross debt charges.

WHAT IS INCLUDED IN THE THESE ASSESSMENTS?

- 2 The net lending assessment covers the acquisition/disposal of financial assets and liabilities by the State general government sector that results in changes in State net financial worth. Net financial worth includes cash, deposits, loans, and equity investments in public corporations less liabilities (such as borrowing and superannuation liabilities). Interest and dividend income is earned on State net financial worth.
- 3 State expenses for the net lending assessment and other relevant transaction and stock data are shown in Table 22-1 to Table 22-4.

¹ The assessment can be of net lending(+) or borrowing(-). In some years, States record net lending outcomes which are shown with no sign. In other years, States record net borrowing outcomes that are shown with a negative sign. A net lending outcome means that States have funded total outlays (expenses plus investment) from revenue and as a result they have added to their stock of net financial worth during the year. A net borrowing outcome means that total outlays have exceeded revenue during the year and as a result States have reduced their net financial worth during the year. For simplicity, the assessment is referred to as the net lending assessment, even in years when State record net borrowing outcomes.

- 4 Table 22-1 shows that total State net borrowing was \$10.5 billion in 2008-09. All States recorded net borrowing outcomes in 2008-09. Net borrowing varied between 10.6 per cent of total State outlays (that is, operating expenses and investment) in Queensland and 0.5 per cent in the Northern Territory.
- 5 Table 22-2 shows that between 2005-06 and 2008-09, on average, States changed from being net lenders to net borrowers. In 2007-08 and 2008-09, on average, total outlays exceeded revenue and as a result States reduced their financial assets or borrowed to fund the shortfall.

Table 22-1 Net lending category expenses, 2008-09

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Category expense (\$m)	-2 807.0	-1 184.5	-4 399.0	-987.0	-819.0	-95.0	-150.0	-21.8	-10 463.3
Category (\$pc)	-398.64	-220.79	-1 011.37	-447.81	-508.06	-189.89	-431.23	-98.34	-483.48
Proportion of total State outlays (%)	-5.3	-2.9	-10.6	-4.8	-5.7	-2.2	-4.2	-0.5	-5.8

Note: State outlays are the sum of total operating expenses and investment.

Source: State provided data.

Table 22-2 Net lending as a proportion of total State outlays, 2005-06 to 2008-09

	2005-06	2006-07	2007-08	2008-09
Total for category (\$m)	3 034.0	1 235.0	-4 311.0	-10 463.3
Total outlays (\$m)	139 535.0	152 894.0	165 844.0	181 645.1
Proportion of total State outlays (%)	2.2	0.8	-2.6	-5.8

Note: State outlays are the sum of total operating expenses and investment.

Source: ABS GFS data. State provided data used for last year.

- 6 Table 22-3 shows the size and relative importance of debt charges, interest and dividend income in 2007-08 and Table 22-4 shows details for the period 2005-06 to 2008-09. Together these transactions comprise net interest and dividend income. As we decided to assess them equal per capita (EPC) for the reasons given later in this chapter, State dividend and interest income has been included in an EPC component of the Other revenue category and gross debt charges have been included in an EPC component of the Other expenses category. They have no impact on the relativities.

Table 22-3 Gross debt charges, interest earnings and dividend income, 2007-08

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Expenses									
Gross debt charges (\$m)	1 299.0	431.0	351.0	121.0	204.0	6.0	66.0	152.0	2 630.0
Gross debt charges (\$pc)	187.07	81.90	82.73	56.59	128.02	12.11	192.94	699.06	123.85
Proportion of total operating expenses (%)	2.7	1.2	1.1	0.7	1.6	0.2	2.1	4.3	1.7
Revenue									
Interest income (\$m)	172.0	438.0	- 275.0	332.0	203.0	74.0	126.0	48.0	1 118.0
Dividend income (\$m)	2 247.0	842.0	1 302.0	878.0	447.0	140.0	224.0	65.0	6 145.0
Total (\$m)	2 419.0	1 280.0	1 027.0	1 210.0	650.0	214.0	350.0	113.0	7 263.0
Total (\$pc)	348.36	243.24	242.06	565.93	407.91	431.99	1 023.17	519.70	342.02
Proportion of total own source revenue (%)	8.9	6.1	6.2	10.6	9.9	14.1	17.1	9.9	8.3

Note: Data for 2008-09 are not yet available. Data shown are for 2007-08.

Source: ABS GFS data.

Table 22-4 Gross debt charges, interest earnings, dividends and net financial worth, 2005-06 to 2008-09

	2005-06	2006-07	2007-08	2008-09
Expenses				
Gross debt charges (\$m)	2 223.0	2 405.0	2 630.0	na
Total operating expenses (\$m)	134 969.0	146 359.0	157 538.0	171 074.5
Proportion of total operating expenses (%)	1.6	1.6	1.7	na
Revenue				
Interest income (\$m)	5 568.0	5 702.0	1 117.0	na
Dividend income (\$m)	5 990.0	6 039.0	6 145.0	na
Total (\$m)	11 558.0	11 741.0	7 262.0	na
Total own-source revenue	78 043.0	86 408.3	87 598.6	87 173.8
Proportion of total own source revenue (%)	14.8	13.6	8.3	na
GFS net financial worth				
Financial assets (\$m)	250 496.0	267 388.0	288 647.0	na
less liabilities (\$m)	145 512.0	141 532.0	156 954.0	na
GFS net financial worth (\$m)	104 983.0	125 856.0	131 694.0	117 885.9

Note: na means not available.

Source: ABS GFS and State provided data for 2008-09.

The average policy

- 7 States hold financial assets and liabilities. The main financial assets held by States are equity in public trading enterprises (PTEs) (70.9 per cent of total State financial assets) and investments, loans and placements (14.7 per cent). The main financial liabilities held by States are unfunded superannuation liabilities (59.3 per cent of total State financial assets) and

borrowing (21.3 per cent).² Transaction based changes in State net financial worth, or net lending, are determined by total State outlays (expenses plus investment) and revenue, including GST revenue. When total State revenue exceeds total outlays a State saves and increases its net financial worth. When total State outlays exceed total revenue a State must borrow or liquidate assets to fund outlays, reducing its net financial worth.

- 8 A State's net financial worth is a key component of its wealth. It is also the driver of its capacity to generate revenue in the form of net interest and dividends.
- 9 For the five years prior to 2007-08, States used surpluses on their recurrent budgets, including GST revenue and other Commonwealth payments, to invest in infrastructure and to accumulate financial assets. In the two years following 2006-07, States have borrowed \$14.8 billion primarily to fund investment in infrastructure. The net borrowing outcomes in 2007-08 and 2008-09 marked a cyclical change in State circumstances.

What is the role of the Commonwealth?

- 10 The Commonwealth Government provides all States with a share of GST revenue and capital grants that can be used to acquire financial assets. The GST revenue can be used to fund PTE infrastructure and create equity in State PTEs through subsidies for capital purposes. It can also feed into net lending which directly increases States' net financial worth, regardless of how it is held. The capital grants paid to the States for the purchase of major infrastructure, such as rail or public transport, owned by PTEs also increases States' net financial worth. The major programs under which these payments are made are the Nation building program and the Nation building plan for the future. As these affect State fiscal capacities, they have been treated so that they impact on the relativities.

ASSESSMENT APPROACH

- 11 States earn revenue from their net financial worth in the form of net interest on non-equity assets and dividends from their equity in PTEs. This revenue is available to fund services, the acquisition of infrastructure or for further savings. This revenue affects States' fiscal capacity and the Commission believes it has to form part of the equalisation process.
- 12 The choice of methods for doing this and the disabilities that should be recognised were major issues for this review.

Method

- 13 Two broad approaches were considered.
 - Equalising the per capita stock of net financial worth. Under this approach, GST would be distributed to give the States the capacity to hold EPC stocks of net financial worth

² Proportions based on latest published ABS *Government Finance Statistics, Australia, 2007-08*.

each year. Net lending would be assessed, recognising population dilution. Net interest and dividend income would be assessed EPC.

- Equalising net lending per capita each year. Under this approach, each State's per capita stock of financial worth evolves at a different rate, reflecting at least their different rates of population growth. Their ability to earn revenue (net interest and dividend income) from those assets would need to be assessed differentially.
- 14 A key consideration in the Commission decision on the approach to be adopted was that disabilities for revenue from net financial worth should be recognised in a simpler way than in the 2004 Review debt charges assessment which involved an accumulation of net operating balances (NOB).

State views

- 15 Queensland, Western Australia and the Northern Territory supported a net lending assessment aimed at equalising net financial worth. They agreed that it was conceptually sound, more contemporaneous, transparent and the simplest way of recognising the impact of population growth on State capacity to generate revenue from net financial worth. Victoria provided qualified support for the Commission's net lending assessment, noting a number of conceptual concerns with the Commission's approach.
- 16 New South Wales, South Australia, Tasmania and the ACT disagreed. They said that the Commission had not demonstrated that a better equalisation outcome is achieved by adopting an approach to equalisation that moves away from NOB equalisation. They were also concerned that not all relevant disabilities would be recognised.

Commission view

- 17 We consider the simplest way of incorporating the impact of net financial worth into the equalisation framework is to give States the capacity to hold the same stock of net financial worth per capita each year. Then each State could be assessed as having the same capacity to earn income from that per capita stock.
- 18 By equalising the per capita stock each year, we do not need to track how that per capita stock would differentially change over time among States, reflecting differential population growth. If we were to equalise their budget outcomes we would need to do that. We have thus avoided part of the complexity inherent in the debt charges approach of the 2004 Review. Nor do we need to distinguish between financial assets held as equity in PTEs and other financial assets. We assume States hold the average share of their net financial worth as PTE equity and the average share as other financial assets. We make this assumption because we cannot discern an average policy on equity in PTEs which would allow us with any confidence to assess State PTE equity differentially.
- 19 We have therefore adopted an approach which equalises State net financial worth per capita through a net lending assessment. This requires:

- an assessment of net lending to enable States to maintain, other things being equal, the same net financial worth per capita, recognising only population growth disabilities on net financial worth; and
 - an EPC assessment of net interest and dividend income because State net financial worth per capita is equalised.
- 20 The net lending assessment gives States the capacity to acquire the average per capita amount of net financial worth held by States at the end of the year for each new person in the State and to fund any change in that amount due to increases in average per capita net lending for each person in their population at the start of the year. GST is not required to fund the revaluations or other non-transaction changes in net financial worth for the existing population. Similarly, States will need lower levels of net financial worth if their populations are decreasing or if the average amount held by States reduces.
- 21 Of the two approaches, we consider that a net lending assessment best achieves fiscal equalisation for the following reasons.
- It is simpler. The net lending assessment only requires current year net lending and net financial worth. The alternative, a net interest and dividend income assessment, is more data intensive because net lending outcomes must be accumulated over time.
 - It is more reliable. A net interest and dividend income assessment would require a decision about the appropriate length of the period over which changes in State net financial worth should be tracked.
 - It uses reliable data. It uses data on GFS net lending, GFS net financial worth and Estimated resident population (ERP) that are reliable and readily available from the ABS. A net interest and dividend income assessment requiring net lending data prior to 1998-99 would require the Commission to derive estimates of net lending.
- 22 The Commission has not accepted arguments for the recognition of other disabilities in this assessment. We do not believe we can reliably do so in a net lending or net interest and dividend income assessment. We explain why below. However, in recognition of some uncertainties relating to some of these disabilities (and also because some concerns have been expressed about data quality), we have applied a discount to this assessment of 25 per cent.

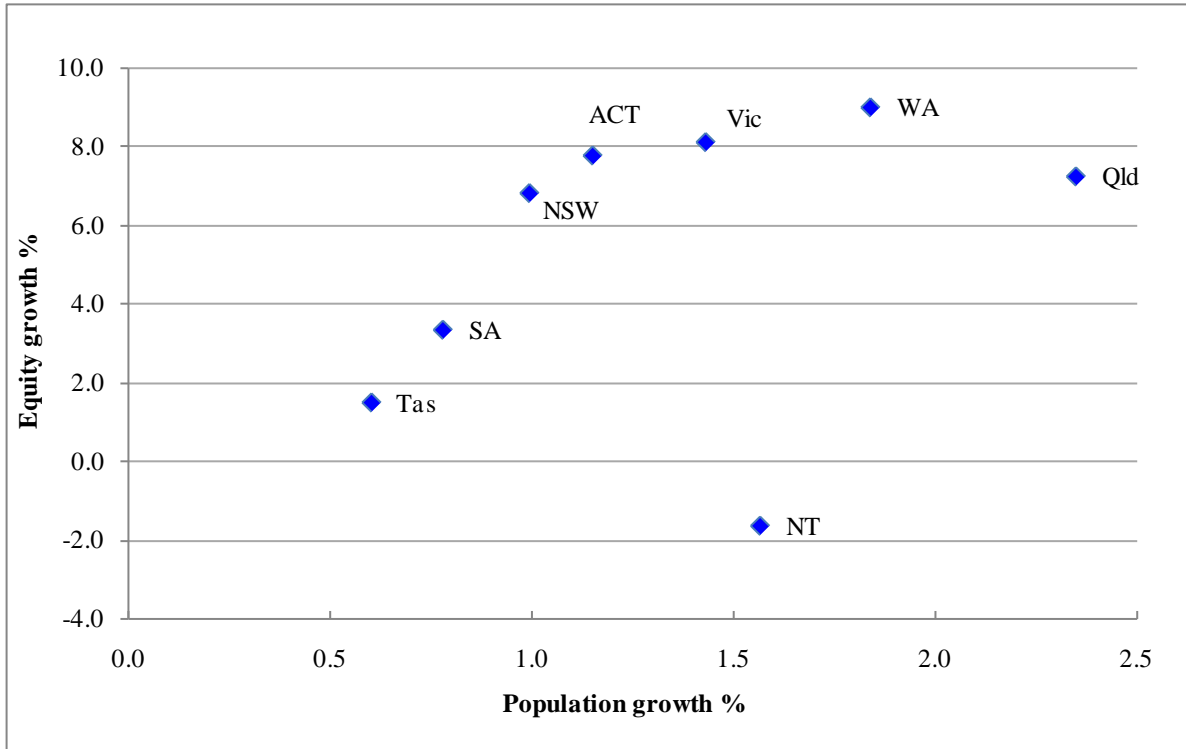
Factors affecting net financial worth and the consequential revenue raising capacity

- 23 *Population growth.* All other things being equal, those States that experience faster than average population growth need to save more per capita if they are to keep their net financial worth per capita in line with the national average. Failing that, their net financial worth per capita would fall relative to others and an interest earning disability would need to be recognised.
- 24 Most States accepted that, all other things being equal, population dilution of net financial worth occurs. However, some States disagreed, arguing that there is no evidence of population dilution of net financial worth. Their view was that, while net financial worth per capita may

fall as a result of population growth, there are many other influences that affect State fiscal outcomes. The impact of population dilution may not be obvious as a result. However, we do not accept the view that, because the impact of population dilution cannot be seen in the ABS GFS figures, it does not exist. We consider it important to recognise the impact of differential population growth on net financial worth.

- 25 *Starting point.* New South Wales and Tasmania said net financial worth has not been fully equalised in the past and so all States start with unequal net financial worth and therefore have unequal capacity to earn or pay net interest. They said that an adjustment was required to recognise this.
- 26 We accept that States may not start the year with EPC net financial worth but note that this is the result of policy and non-policy influences in the past. These would be difficult to untangle. Also from an equalisation perspective, it is not unreasonable to assume that States have equal assessed net financial worth per capita at the start of the year. Dividend income has been assessed EPC since at least the first review of per capita relativities and this is consistent with EPC equity in PTEs. Also, on the advice of Heads of Treasuries, net interest earnings have been assessed EPC in recent updates, again consistent with an assumption of equal per capita non-equity net financial assets.
- 27 *Revaluation disabilities.* Our approach assumes that States revalue their financial assets at the average rate. Under this assumption, differences in per capita net financial worth can only arise from differences in population growth or differences in States net lending per capita.
- 28 New South Wales, South Australia, Tasmania and the ACT said that there is a conceptual case and evidence to support an assessment of a revaluation disability that recognises that faster growing States experience higher rates of PTE revaluations. As this more than offsets any population dilution needs, they consider this influence on State stocks of net financial worth should be recognised.
- 29 The available data do not show conclusively that faster growing States have higher rates of PTE revaluations (as shown, for example, in Figure 22-1). We also consider other influences, such as State land release policies and the impact of price regulation, may have a more important impact on those revaluations. Since there is neither a strong conceptual case nor reliable empirical evidence that States with higher population growth experience greater increases in the value of their per capita equity, we do not consider a revaluation disability appropriate.

Figure 22-1 Average annualised growth in equity in PTEs and estimated resident population, 1998-99 to 2007-08



Source: ABS Government Finance Statistics, Australia (GFS), 2007-08, Cat. No. 5512 and ABS estimated resident population.

- 30 *Rate of return.* Some States said that giving States the same net financial worth per capita would not ensure that all States would have the same capacity to earn interest and dividend income. New South Wales disputed any assumption that the primary objective in owning equity in PTEs is to generate income. New South Wales and Victoria said that because of their service delivery commitments, States cannot earn the same rate of return on all financial assets, particularly equity in PTEs. They argued that even if States are given the capacity to hold EPC net financial worth, they will not have the same capacity to earn revenue from those assets. The ACT said that it was unable to earn dividends from ports and this represented an income earning disability.
- 31 We accept that the primary objective in owning equity in PTEs is not income generation. Nevertheless, we observe that States earn income from their financial assets, including dividends from PTE equity. To achieve fiscal equalisation, all non-policy influences on average State revenue should be recognised.
- 32 We acknowledge that States may hold their net financial worth in different ways and that this may influence the rates of return they earn. However, we do not assume that the rate of return on PTE equity is the same as that on non-equity financial assets, but that States hold the same share of their financial assets in different asset classes. The average rate of return is then equal.

- 33 We have not been able to identify non-State policy influences relating to differential holdings of PTE equity and their possible implications for State capacities to raise revenue from interest and dividend earnings. This is because distinguishing average policy from what States do is not easy — do States need to own PTEs to deliver services or can these services be provided by the private sector? We note New South Wales owns its electricity PTEs but Victoria does not. Some States own their public transport networks; others do not. While it is possible that there are non-policy influences which mean some States need to hold more of their net financial worth as PTE equity, identifying the disabilities which account for these differences would be a major exercise that cannot be undertaken in this review. Among other things, it would require a more detailed accounting of PTEs within the equalisation framework, which might be considered in future reviews. We have therefore not assessed a rate of return disability in the net lending assessment and have continued to assess interest and dividend earnings EPC.
- 34 *Cost of borrowing.* We accept there is a conceptual case for a differential assessment of borrowing costs due to the smaller volumes of debt in the four smaller States. This will reduce the net revenue some States can earn from their net financial worth. Advice from the Reserve Bank of Australia (RBA) indicates that the four smaller States pay about five basis points more than the larger States due to their lower volumes of debt.
- 35 The Commission does not accept the conceptual case that needs should be assessed for higher borrowing costs due to a below AAA+ credit rating. According to the ratings agencies, State government credit ratings are determined by a range of factors including debt levels, strength of the balance sheet, operating performance, economic performance, institutional stability, financial flexibility, liquidity and debt management and off-balance sheet liabilities. We consider that many of these factors are influenced by State policy and therefore are not grounds for assessing a disability.
- 36 The Northern Territory presented recent data on yields on three year semi-government bonds showing that it has been, on average, facing a ten basis point premium compared to the larger States. The Northern Territory attributed the ten basis point premium to lower volumes of debt and a lower credit rating. The Northern Territory did not agree that many of the factors that determine a State's credit rating are policy influenced.
- 37 We concluded that a five basis point premium for the four smaller States would be appropriate to recognise the higher borrowing costs faced by States with smaller volumes of debt. However, materiality tests based on a five basis point premium show a cost of borrowing disability is not material. Sensitivity analysis indicated that State borrowing would need to increase tenfold to make the assessment material. Forward estimates of State borrowing (published in 2009) indicate that State borrowing may triple over the forward estimates period, growing from \$33.5 billion in 2007-08 to \$109.8 billion in 2012-13.³ Accordingly, we have not made an assessment.

³ Based on forward estimates of State borrowing to 2012-13 published in 2009-10 State budget papers.

- 38 *Special circumstances of the Northern Territory.* The Northern Territory argued it faced some special circumstances arising from its stage of development and past Commonwealth policies and, as a consequence, it has higher borrowings and lower net financial worth.
- 39 We make the following observations.
- We acknowledge that the Northern Territory has borrowed heavily in the last ten years but it is not clear whether the recent borrowing was disability or policy driven.
 - The Northern Territory's higher borrowing needs have already been addressed. In the 1980s, it was agreed between the Northern Territory and the Commonwealth that the Commonwealth would give the Northern Territory above average capital grants, and the Commission would assess its debt charges APC.
 - The Commission considered claims relating to the Northern Territory's special circumstances in the 2004 Review, the 2005 Update and the 2010 Review. On all occasions, it found insufficient evidence to support the claims.
- 40 We do not accept that the Northern Territory continues to face special circumstances that warrant an additional disability as a result of past Commonwealth policy and the early stages of the Territory's development and have not assessed any disabilities for those influences.
- 41 *Transitional issues.* In the 2004 Review, State infrastructure needs were assessed through depreciation and debt charges assessments. For this review, we will assess debt charges on an EPC basis. There will be no quantity of borrowing assessment. This will leave some debt charges unequalised because States would have remaining needs to fund debt charges on past borrowings.
- 42 Some States have argued that an assessment should be made to equalise the remainder of States debt charges for debt acquired prior to 2010-11.
- 43 There are, however, some major practical difficulties. The difficulties would be similar to those experienced with the current debt charges assessment. They are:
- to estimate the appropriate average debt charges expenses; and
 - to measure the disabilities reliably.
- 44 In any case, State debt charges needs have been assessed EPC for four out of the last five years because average debt charges exceeded average interest and dividend income in the years from 2003-04 to 2006-07.
- 45 For these reasons, we do not propose to introduce a transitional assessment for remaining unequalised debt charges for the 2010 Review.

THE ASSESSMENT METHOD

- 46 A State's net financial worth changes in a year as a result of its net lending and revaluations. A State's assessed net lending is the difference between:

- its assessed end of year net financial worth (calculated using the average per capita net financial worth at the end of the year and current year State population); and
- its assessed net financial worth at the beginning of the year (calculated using the average per capita net financial worth at the end of the year, net lending in the year and previous year State population).

- 47 The assessment recognises only the influence of the change in State populations on State net lending requirements. No other disabilities are recognised and other changes in net financial worth have not been assessed as GST revenue is not used to fund them. Because we are not confident that we have assessed all the non-policy influences on State's net financial worth, such as starting point and rate of return disabilities, and there were some concerns expressed about data quality, we have applied a 25 per cent discount to assessed net lending needs. We do not consider a larger discount is required because population growth is the main driver of State needs and the ABS data used in the assessment are considered fit for purpose.
- 48 Because a State's net financial worth per capita is equalised, each State is assessed to have the same per capita capacity to earn net interest and dividends. The EPC assessments of debt charges, and interest income and dividends are undertaken in the Other expenses and Other revenue categories.

State views

- 49 States had a number of concerns about the way the assessment is implemented.
- 50 *Revaluations.* Some States said that revaluations have a major influence on State net financial worth and these non-transaction changes in the value of financial assets should not influence the assessment results. Other States disagreed. We considered it appropriate that revaluations are included in the end of year net financial worth because this will then reflect the current costs States face in acquiring average per capita net financial worth.
- 51 *Land.* Some States were concerned that the assessment treats State land assets and State PTE land assets differently. Land owned by the State general government sector is excluded from the investment assessment while land owned by PTEs is included in the net lending assessment, albeit indirectly, through the inclusion of equity in PTEs in estimates of net financial worth.⁴ We decided to ensure that State general government land holdings have no impact on the relativities because there is no consistency across States in what land is included in State balance sheets. This issue does not affect PTE land holdings. PTEs do not own crown land and most PTE land holdings are directly linked to service delivery.
- 52 *PTEs.* Some States said that the different treatments of capital subsidies and equity injections could influence how States make contributions to PTEs in the future because it may affect their GST shares. They also said if the Commission applied a population growth disability to

⁴ Land accounts for about 20 per cent of the total assets owned by public non-financial corporations. Estimate based on ABS *Government Finance Statistics (GFS), Australia, 2007-08*, special data request.

capital subsidies to PTEs in the Transport category and also assessed a population growth disability in the net lending assessment, double counting may result.

- 53 From the perspective of the PTE, both capital subsidies and equity injections can achieve a similar outcome — they can be used to fund the acquisition of infrastructure. However, they are treated differently in the GFS operating statement. For equalisation purposes, capital grants are assessed with expenses in the relevant categories. For the most part, the disabilities that apply to expenses are applied to capital grants⁵. Equity injections, on the other hand are a balance sheet transaction that change the composition of a State's financial assets but do not change its net worth. They are part of the net lending outcome in the GFS operating statement which reflects the net change in financial assets, liabilities and equity arising from transactions. Under our approach to capital related transactions, average net lending is subject to a population change disability only.
- 54 An examination of the nature of capital grants made to State PTEs suggested the problem mainly related to transport PTEs where some States provided large grants and others provided equity injections for the construction of infrastructure. Grants to other PTEs, such as those in the water, electricity and housing areas, appear to be more in the nature of operating subsidies.
- 55 To ensure that net financial worth is equalised, any needs assessed for capital transport subsidies would need to be offset by equivalent needs in the net lending assessment.
- 56 For simplicity, we decided, however, to treat capital grants to transport PTEs like equity injections. They have been assessed EPC in Transport services and their effect on the net lending outcome has been subject to population change disabilities only⁶. In this way we avoid the potential double counting and grant design defect identified by States.
- 57 *Accounting differences.* Some States said differences in accounting treatments of superannuation assets and liabilities could lead to some distortion of the average per capita net financial worth used in the net lending assessment. Where we observe that such differences have a material impact on the relativities, data adjustments will be made to prevent the non-standard policy of one or two States distorting the assessment results. However, our analysis indicates that making adjustments to reflect average policy in this area would not be material.
- 58 In addition, the main data used in the assessments are sourced from annual ABS Government Finance Statistics (GFS). GFS estimates are based on annual audited data reported by State treasuries. Where reported data do not conform to GFS standards, adjustments are made by the ABS if sufficient information is available. From January 2009, States need to comply with

⁵ As an exception, capital grants in Transport services are assessed EPC because the recurrent expense disabilities are not considered appropriate for capital grants in this category.

⁶ This approach is immaterially different from assessing needs in the Transport services category and including the assessed expenses as part of the net lending for each State in the calculation of its assessed net lending requirement.

Australian Accounting Standard (AAS) 1049 Whole of Government and General Government Sector Financial Reporting. Greater comparability should result.

- 59 In general, the ABS considers estimates of net financial worth are more reliable than estimates of the stock of physical assets used in the Investment assessment. The ABS said that the quality of financial assets estimates is generally very good, including estimates of equity in public non-financial corporation's (PNFCs) that are balanced to data provided by State PNFCs. Liabilities are derived using counterparty data.

Implementing the assessment

- 60 Table 22-5 shows the net lending category structure for 2008-09.

Table 22-5 Category structure, Net lending, 2008-09

Component	Component weight	Disability	Influence measured by disability
Net lending	100.00 %	Differential population growth	The disability recognises the impact of population growth on a State's capacity to hold the same per capita level of net financial worth.

Source: Commission calculation.

- 61 Similar to the Investment category, the proposed method for the assessment of net lending derives assessed net lending directly (see Table 22-6), from which the category factor can be derived.
- 62 Table 22-6 shows the derivation of the assessed net lending and the category factors for 2008-09, using the formula shown in Box 22-1. The impact of applying a 25 per cent general discount to assessed net lending to derive the category factor is also shown.
- 63 Table 22-6 shows that in 2008-09, in total, States recorded a net borrowing outcome. This means that the assessment for that year is equivalent to a revenue assessment. States with above average population growth (Victoria, Queensland, Western Australia and the Northern Territory) are assessed as needing to reduce their net financial worth by less than States with below average population growth to ensure they have the same net financial worth per capita at the end of the year and the same capacity to earn interest and dividend revenue.

Table 22-6 Calculation of assessed net lending, 2008-09

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
End of year net financial worth (a)									
Average net financial worth (\$pc)									5 447.20
Population (million)	7.0	5.4	4.3	2.2	1.6	0.5	0.3	0.2	21.6
Assessed net financial worth (\$m)	38 356	29 223	23 693	12 006	8 781	2 725	1 895	1 208	117 886
Start of year net financial worth (b)									
Average net financial worth (\$pc)									6 044.09
Population (million)	6.9	5.3	4.2	2.1	1.6	0.5	0.3	0.2	21.2
Assessed net financial worth (\$m)	41 969	31 806	25 644	12 923	9 631	2 994	2 068	1 314	128 349
Net lending									
Assessed net lending (\$m)	-3 613.6	-2 583.2	-1 951.0	-916.8	-850.3	-269.0	-172.8	-106.6	-10 463.3
Assessed net lending (\$pc)	-513.19	-481.51	-448.56	-415.96	-527.49	-537.67	-496.64	-481.09	-483.48
Undiscounted factor	1.06144	0.99593	0.92777	0.86034	1.09103	1.11209	1.02723	0.99506	1.00000
Discounted category factor	1.04608	0.99695	0.94583	0.89525	1.06827	1.08407	1.02042	0.99629	1.00000

(a) Net financial worth defined as financial assets minus liabilities. It includes all classes of financial assets and liabilities.

(b) Start of year net financial worth is calculated as end of year net financial worth minus net lending.

Source: Net financial worth for 2008-2009 and net lending for 2008-09 provided by States. NFW and net landing data for earlier years obtained from ABS *Government Finance Statistics*. ABS estimated resident population (ERP) estimates.

Box 22-1 Calculation of assessed net lending

Assessed net lending, is calculated as:

$$= [(NFW_1 / P_1) * p_{i1}] - [(NFW_0 / P_0) * p_{i0}]$$

Where p_{i1} and p_{i0} are the populations of State i in time 1 and 0;

P is the Australian population;

NFW_1 is the Australian total net financial worth at the end of time 1; and

NFW_0 is calculated as NFW_1 minus net lending. This method ensures that NFW_0 and NFW_1 are in the same price levels.

WHAT IS THE IMPACT ON THE GST DISTRIBUTION?

64 Table 22-7 shows the extent to which the assessment for Net lending moves the distribution of the GST away from an EPC distribution.

Table 22-7 Impact on the GST redistribution of the Net lending assessment

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redist
Dollars million	-167.7	9.3	138.4	89.8	-47.5	-22.0	-3.7	3.3	240.8
Dollars per capita	-23.51	1.70	31.08	39.71	-29.13	-43.48	-10.44	14.38	10.93

Note: The difference from an equal per capita assessment — derived using 2006-07, 2007-08 and 2008-09 assessed expenses and 2009-10 GST.

Source: Commission calculation.

65 The table shows that New South Wales, South Australia, Tasmania and the ACT are assessed as being able to run down their net financial worth by more than average. This is because their populations grew less than average (see Table 22-8). Consequently, they need less GST to maintain their net financial worth at the national average per capita level.

Table 22-8 Population growth, 2005-06 to 2008-09

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	%	%	%	%	%	%	%	%	%
2005-06	0.86	1.43	2.48	1.93	0.90	0.80	1.29	2.27	1.44
2006-07	1.06	1.67	2.37	2.33	1.10	0.67	1.41	1.88	1.60
2007-08	1.24	1.77	2.49	2.56	1.08	0.73	1.48	2.40	1.75
2008-09	1.40	1.95	2.52	3.09	1.16	0.99	1.69	1.95	1.91

Source: Estimated resident population, ABS.

66 Because of their higher than average population growth, Victoria, Queensland, Western Australia and the Northern Territory are assessed as being able to run down their net financial assets by less than average, requiring more GST to maintain their net financial worth at national average per capita levels.

67 Table 22-9 provides a summary of the main reasons for changes to the net lending assessment since the 2009 Update. As there was no net lending assessment in the 2009 Update, the impact of shortening the review period is zero. The main reason for the redistribution is the introduction of the net lending assessment. Moving forward the assessment period increases the GST shares of New South Wales, Victoria and Western Australia because they recorded stronger population growth in 2008-09 compared with 2005-06. Table 22-8 shows these differences.

Table 22-9 Changes since the 2009 Update – Net lending

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redist
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Shortening the review period	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Method changes	-169.7	4.8	158.0	65.2	-41.2	-19.4	-3.3	5.5	233.5
State circumstances	2.0	4.4	-19.6	24.6	-6.3	-2.6	-0.4	-2.2	31.1
Total	-167.7	9.3	138.4	89.8	-47.5	-22.0	-3.7	3.3	240.8

Source: Commission calculation.

UPDATE PROCESS

- 68 We recommend that data used in this assessment be updated annually to ensure the relativities remain contemporary and consistent with the circumstances of the States. On this basis we expect GFS net lending, GFS net financial worth and State population will be updated annually.

SIMPLIFICATION

- 69 The Net lending assessment is less complex than the 2004 Review Debt charges assessment. That assessment involved large amounts of detailed data, including accumulated transactions data extending back to 1960-61, and complex calculations.
- 70 The 2010 Review approach is simpler and more transparent.

FURTHER INFORMATION

- 71 Background material in support of this assessment is published on the Commission's website. That material includes the following documents, released for comment in the development of this assessment, together with State submissions responding to those documents:
- Staff discussion paper *2007/22-S Building blocks for the assessment of capital related expenses in 2010 Review*;
 - Staff discussion paper *2007/26-S Assessing new capital expenditure*;
 - Staff discussion paper *2007/33-S Assessing capital needs – an alternative approach*;
 - Commission position paper *2008/29 Capital*; and
 - *2010 Review Draft Report*.