Net borrowing

Review outcomes

- No changes were made to the assessment.
- The conceptual basis for the net borrowing assessment was confirmed.
- The Commission considered smoothing the growth in user populations in the investment assessment as a means to reduce volatility in the GST distribution. However, this approach was not adopted as it would have decreased contemporaneity, increased complexity and only have a minimal effect on volatility. To maintain consistency between investment and net borrowing, smoothing will not be applied in the net borrowing assessment.

Introduction

1 On 6 July 2024, the Commission published the Draft Report for the 2025 Methodology Review.

2 The Draft Report included a detailed analysis and response to issues raised by states and territories (states) in their submissions on the Commission's consultation paper.

3 State submissions on the Draft Report can be viewed here.

4 This chapter includes:

- an overview of the issues considered throughout the review
- the Commission's response and decision on each issue.

5 A description of the assessment method can be found in the net borrowing chapter of the *Commission's Assessment Methodology*.

Issues considered

Conceptual basis

6 The Commission proposed that the conceptual basis of the net borrowing assessment remained appropriate.

State views

7 All states, except for Queensland, agreed that the conceptual case for the net borrowing assessment remains unchanged.

8 Queensland did not agree. It said:

- the Commission's other assessments implicitly equalise the financial position of states
- the COVID-19 pandemic response fundamentally shifted the nature of state borrowing and has made it policy contaminated
- population growth is an insufficient driver as different socio-demographic populations have different capacities to service debt
- states with higher population growth need to borrow more to fund infrastructure needs.

9 As a result of these concerns Queensland argued for the assessment to be discontinued or for the assessment to attract a 50% discount.

Commission response

10 The net borrowing assessment has 2 conceptual parts:

- equalising per capita net borrowing in the assessment year (assessed equal per capita)
- equalising states' net debt per capita (allowing for differences in population growth between states).

11 As Queensland pointed out, equalising expense, revenue, and investment needs implicitly equalises the year-on-year change of residual net borrowing needs. This is why the change in net financial position is assessed equal per capita.

12 If the Commission did not allow for the effect of differential population growth on the stock of net debt, then faster growing states would have lower debt per capita than slower growing states. Lower debt per capita would lead to lower interest payments per capita. The impact of changes in state populations on average net financial positions is not implicitly equalised by the other assessments.

13 The Commission considered Queensland's argument that increases in state net borrowing and net debt have fundamentally changed the basis of the assessment. While these increases have made net borrowing a more significant driver of GST distribution, they have not changed the conceptual basis of the assessment. Different states have different levels of net borrowing and net debt. However, averaging what states do provides a policy neutral measure. In total, states had net borrowing of $41 billion in 2022–23. Thus, the average of what states collectively did was to borrow $1,553 per capita in that year.

14 The Commission recognises that state borrowing activities have diverged, and on average, grown. Neither of these changes affects the conceptual basis of the assessment method.

15 The Commission considered Queensland's argument that population growth should be replaced by growth of specific user populations to assess capacities to service debt. States' different fiscal capacities across revenue, expense and investment

assessment are equalised. This means that the requirement to borrow in the assessment year should not be influenced by growth in specific sub-populations.

16 Queensland also argued that growing states need to borrow more to fund increased infrastructure. This need is assessed in the investment assessment. To include this in the net borrowing assessment would represent double counting of this need.

Commission decision

17 The Commission has retained the conceptual basis of the net borrowing assessment.

Population smoothing

18 States have suggested that the capital assessments (investment and net borrowing), particularly the investment assessment, contribute to volatility in GST distribution.

19 In response, the Commission considered population smoothing as a potential means of alleviating volatility in the capital assessments. This issue was considered in the context of the investment assessment.

20 The Commission proposed population smoothing for net borrowing if adopted in the investment assessment to maintain consistency between the capital assessments.

State views

21 All states agreed with the proposal to keep the population growth measure consistent between the investment and net borrowing assessments.

Commission response

22 As outlined in the investment chapter of *Review Outcomes*, the Commission will not smooth population growth in the investment assessment because the additional complexity and reduced contemporaneity from this change would outweigh the benefits. To maintain consistency between the two capital assessments, population will not be smoothed in the net borrowing assessment.

Commission decision

23 The Commission will not smooth population growth in the net borrowing assessment.

GST impacts of method changes

24 There are no method changes to this assessment.