Department of Treasury and Finance

Victoria

Submission on Assessment Structure and Approaches

to the

Commonwealth Grants Commission

as part of the

2010 Review

March 2007

PART A: OVERVIEW

Victoria is generally supportive of the Commission's proposed category structure and its efforts to use broad indicators. However, we consider that the Services to Communities category is unnecessary and that most of the expenses allocated to it are a better fit in the proposed Services to Industry category due to their predominantly regulatory nature.

Victoria sees no conceptual case for further disaggregation of the proposed categories at this stage. Victoria urges the Commission to settle on a category structure so that detailed discussions can begin on the application of disabilities to the categories.

Our main comments concern which broad indicators are most appropriate for the category and a couple of minor changes to the expenses to be included in the proposed categories.

Our comments on indicators are based on the applicability of the proposed indicators and the availability of appropriate and reliable data with which to assess disabilities. Although in some cases we have gone into detail on which disabilities should be assessed, we have generally left detailed input on these issues until the category structure is settled.

This submission sets out Victoria's thoughts on the proposed assessment structure around broad expenditure lines. For example, we discuss the two proposed Education categories under a single heading, rather than individually, since one of the main questions being asked of us is whether we approve of the proposed splits of the major general government service responsibilities.

Part B of the submission discusses the 7 proposed revenue categories, while Part C deals with the expenditure categories.

PART B: REVENUE

Victoria supports the seven revenue categories proposed by the Commission. This section outlines our initial thinking in relation to broad indicators for each category.

1. PAYROLL TAX

Victoria supports the Commission's proposal to use compensation of employees (COE) as a preferred indicator of the revenue base. Victoria also supports the current collection of data as it makes adjustments to the COE data to consider thresholds, exemptions and public/private trading enterprise.

Victoria also supports making a broad allowance for the effect of tax-free threshold using a $1 million or more payroll threshold. Victoria supports this threshold when used in conjunction with the data collection methods currently adopted by the Commission to reflect the common government policy to exempt small employers. Victoria also supports continuing to exclude the government administration, health and education industries.

Victoria has concerns about the decision to use the ABS *Business Register 1369.0* from June 2001 to derive the proposed adjustment weights when in previous years the Commission ceased the use of the register for assessments such as primary industry, tourism, and manufacturing. The age of the data used raises reliability concerns as 2001 data may not reflect current disabilities. Therefore, Victoria does not support the use of the weights proposed if they are to be based on a data source previously deemed unreliable.

The current data sources, such as using *ABS Business Indicators 5676.0,* which is updated quarterly and the annual updates of the *Australian National Accounts State Accounts 5220.0* are likely to be more reliable.

2. LAND TAX

2.1. PROPOSED REVENUE BASE

Victoria recommends that the Commission retains the current actual tax base measure of land values as it is less complicated and more transparent than using indicators such as urban planning policies. Victoria also supports the Commission in reviewing the assessment in terms of using State Revenue Office (SRO) data as opposed to Valuer Generals (VG) data.

A key objective of the review is reducing the complexity of the assessments. Attempting to consider policy indicators such as urban planning actually makes the Commission's proposal more complicated. The current measure of the revenue base for commercial and industrial (CI) land is based on the value of land (actual tax base measure), and the value of total residential land values with adjustments for a non principle place of residence (NPR) (proxy tax base).

2.2. DATA RELIABILITY

Victoria has identified deficiencies in the reliability of data from the VG. Therefore, Victoria has opted to source this data from the SRO because it can isolate out exempt properties in their database, whereas the Victorian VG can not. State land tax policies are comparable because each state allows similar exemptions. For example, each state allows exemptions for charities, principle places of residence (PPR) and primary production land. The Victorian SRO has access to specific land use information from those seeking exemptions that the VG does not have access to, making the SRO data a more reliable, appropriate and policy neutral measure of revenue raising capacity.

Every state's revenue office should have the information for CI and NPR values, making them relatively accessible. This better reflects what states do and is an appropriate data source to satisfy the criteria of data reliability. Sourcing data from the revenue office as opposed to the VG means that Victoria can effectively differentiate between the value of NPR and PPR. Any revenue office upon collection of taxes would obtain this information therefore it should not be an issue for states to also differentiate between NPR and PPR values. Victoria considers that the Commission should fundamentally review this assessment in terms of the examining the credentials of using revenue office data instead of VG data.

2.3. POLICY NEUTRALITY

Victoria notes that land values may be influenced by state policies such as urban planning or amenities created by government, however Victoria questions the materiality of these influences. Therefore Victoria reiterates the appropriateness of maintaining land value as the actual tax base measure.

Victoria suggests that the current actual tax base measure of land values is the most appropriate and reliable approach.

3. MINING REVENUE

In principle, Victoria supports the use of broader indicators such as gross factor income and gross operating surplus. They come from a reliable data source, are therefore consistent across states and are policy neutral regarding royalty regimes. However, we are concerned that in the Mining assessment, they may not be accurate indicators of revenue raising capacity due to the wide variance of labour productivity across the various mining industries, and the concentration of those industries in particular states.

Those states with low productivity mining sectors will be disadvantaged by such an assessment, because the wages paid per dollar of royalties collected will be far higher than that for more capital intensive or high value mining industries.

Victoria considers that some form of industry weighting may be necessary, possibly based on labour productivity, if the proposed data are to be used most appropriately. Even with such weights, the proposed approach would be far simpler and less data intensive than the current assessment.

4. CONVEYANCING DUTY

4.1. PROPOSED REVENUE BASE

Victoria notes that there is a data comparability issue across states under the current measure. This is due to the fact that states adopt quite different exemption and threshold policies. By contrast, land tax policies are similar across states, making the indicators used more comparable. Victoria supports the Commission's efforts in seeking an alternative and more policy neutral indicator of the conveyancing duty base.

Secured housing finance loan commitments (SHFLC) sourced from the Australian Bureau of Statistics (ABS) is a potentially simpler and more policy neutral method of measuring the conveyancing duty base. This method removes policy influences such as exemptions thresholds and concessions (which differ markedly across states). SHFLC works well as a proxy for the cyclical returns in the housing market and hence the historical assessed revenue raising capacity.

However, Victoria considers that SHFLC may not be a relevant indicator of revenue raising capacity from business conveyancing. Victoria would like more information on how the Commission intends accounting for this revenue source.

The proposed weight assumed to capture the gearing behaviour of states is effective as it helps isolate state policy influence. The Commission's adjustment to the weights for transaction intensity is an important determinant of the revenue base in conjunction with gearing ratios. Victoria notes that the weights are driven by transaction intensity more than gearing ratios[1]. The Commission should be cautious not to overweight this adjustment, as the number of transactions in a state will to some extent be affected by the tax rate and a range of other policies. As in all categories the Commission needs to adopt the most policy neutral option possible.

Victoria would appreciate more information about the proportion of the adjustment weights determined by transaction intensity and gearing ratios, and how the Commission determined the relative importance of each.Once these questions have been answered, we will be in a better position to provide a definitive view of our position on the proposed assessment.

[1] Victoria notes the lack of detail in *Discussion Paper 2006/11* regarding these factors. We only discovered the use of transaction intensity after requesting more information about the proposed weights.

5. INSURANCE TAXES

Victoria supports the Commission’s view that insurance premiums remain a good indicator of the revenue base.

5.1. SCOPE OF CATEGORY

The Fire Services Levy is currently assessed in the Public Services Safety User Charges category. Victoria notes that the Fire Services Levy (FSL) and contributions to fire brigades is proposed to be assessed in the land tax category. Victoria understands that currently states adopt different policies to collect this source of funding.

Victoria is concerned that there is a difficulty in identifying the average policy since there seems to be no dominant policy choice for the states. Given this, Victoria does not consider it worthwhile to attempt to ascertain an average policy and recommends that the FSL be assessed in the Miscellaneous Revenue category on an equal per capita basis in order to remove state policy influences.

6. MOTOR VEHICLE TAXES

Victoria supports the Commission’s proposal to disaggregate motor vehicle taxes from the miscellaneous category and use a combination of broad indicators to better reflect common revenue raising policies in each state. The use of broad indicators in this particular category is preferred as it better reflects states’ revenue raising capacities. Victoria also supports the use of the ABS vehicle census data as a reliable measure of states’ vehicle stocks.

However, Victoria questions the magnitude of the weights proposed for heavy vehicles. Based on information provided in the 2006 working papers for heavy vehicle registration fees and taxes and light vehicle registration fees and taxes a weight based on the contribution to revenue for light versus heavy vehicles seems to be closer, on average, to 1:5.

Research shows that the stability of the weights appears to have broken down over recent years. Victoria therefore questions the claim that the weights “appear suitable and very stable over time”. The Commission could consider assessing heavy vehicles on an actual-per-capita basis, since this revenue base is policy neutral, being based on the national vehicle charging policy. Victoria would prefer the Commission still assess Motor Vehicle Revenue as one category, with the heavy vehicle aspect assessed APC.

7. MISCELLANEOUS REVENUE

7.1. GAMING REVENUE

Victoria supports the finding that household disposable income shares a weaker relationship with gaming expenditure than originally thought. The Victorian

Department of Treasury and Finance forecasts gaming revenue mainly as a function of household final consumption expenditure.

The current assessment of revenue raising capacity from gaming does not take account of the heavy influence of policy - particularly the significant regulatory environment, which is intended, in part, to deliver on responsible gaming outcomes. A shift to assessing gaming revenue on an equal per capita basis would more accurately account for these factors. Therefore Victoria also supports placing gaming in the miscellaneous revenue category which should be assessed on an equal per capita basis.

7.2. SCOPE OF CATEGORY

As previously mentioned, Victoria suggests including the Fire Services Levy in the miscellaneous category using equal per capita (EPC) assessment. Victoria supports the abolition of the public service safety user charges category, in which the FSL is currently assessed. User charges assessments are numerous and have minimal impact on redistribution. The inherent difficulty in determining an average policy across states for these charges provides a good case for the use of EPC assessments.

PART C: EXPENSES

Victoria broadly supports the expense category structure proposed by the Commission except for the Services to Communities category. Victoria does not consider it necessary to have a separate category for Services to Communities as the expenses could adequately be assessed under other categories.

1. EDUCATION

1.1. CATEGORY STRUCTURE

Victoria supports the Commission's current view on the proposed category structure for Education. This approach is consistent with the objectives of a reliable assessment. In the Victorian Government's submission on disaggregation we referred to the two category structure for education, namely school education and tertiary education, reflecting the distinction between compulsory and non compulsory education, as well as the distinction between the user populations.

Education data for the two categories is appropriate and will support a reliable assessment of average expenses.

We consider that separating the three-digit GPC of Tertiary education will reliably derive expenses for post-secondary education and all remaining expenses in the two-digit GPC of Education.

1.2. SCHOOL EDUCATION & POST SECONDARY EDUCATION

Victoria considers that enrolments are a more appropriate basis for assessing school education and post compulsory education then adjusted population, because of differences in propensity to use post compulsory services.

Enrolment or retention rates provide a robust, neutral and direct basis for comparing service requirements. These are not overly policy influenced - non-compulsory education in years 11 and year is standard policy in all states. Research also shows that other factors such as socio-economic status, urbanisation, sector (private versus public) and culturally and linguistically diverse (CALD) backgrounds are far stronger influences on participation and cost of provision in non-compulsory education than are differences in state policies. Lamb's 2004 research[2] found that non-policy factors are the main drivers and differences in state policy exert only a weak effect on retention rates.

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[2] Responses to the Commonwealth Grants Commission Discussion Paper: Issues in the Schools Education Assessments for the 2004 Review – Post Compulsory Enrolments, Stephen Lamb 2002.

1.2.1. Proposed Indicators

1.2.1.1. Enrolment/Retention Rates

In the case that population (groups aged four to seventeen) is used, Victoria considers that this should certainly be adjusted to capture differences in the propensity of people in non-compulsory age groups to attend schools and other post compulsory services. Victoria will be preparing further information to support the inclusion of enrolments.

1.2.1.2. Dispersion

Victoria considers that the effects of population dispersion on the costs of service delivery continue to be reduced by the availability of information technology and telecommunications (IT&T). In education, this includes:

- the use of technology as an aid to learning through state programs
- provision of online education services (in both the VET and school sectors)
- use of videoconferencing to deliver school and VET services and staff training, as in the area of telemedicine (discussed in later sections).

For example, virtual campuses enable students and teachers to access all curriculum materials remotely, engage in distance learning, and conduct online examinations and student–teacher tutorials. The use of such technologies has already become widespread in states with highly dispersed populations, reducing costs associated with providing facilities and staff in rural areas.

1.2.2. Additional Indicators

Victorian further considers that there is a strong case for additional indicators of disability, including cultural and linguistic diversity (CALD) and urbanisation.

1.2.2.1. Cultural and Linguistic Diversity

CGC assessment of education categories should consider the disabilities faced by each state in providing CALD and low English fluency groups.

CALD impacts upon unit costs of delivery of education services, due the distinct and complex characteristics of this group.

Victoria's major source countries for refugee and humanitarian entrants are Sudan, Iraq, Afghanistan, Ethiopia and Iran. Refugees from these areas have particularly high levels of poverty, poor and complex health status, frequent experiences of torture and trauma, larger families, more single parent families, low levels of literacy in their first language, lower levels of English proficiency and often no experience of formal schooling. There are costly challenges associated both with facilitating the participation of these groups in education, and providing these services once they are engaged in the system.

Victorian initiatives[3] have successfully promoted greater access amongst this group by Victorian education among migrants. An ongoing implication Victoria faces is higher unit costs for providing effective and equitable level of service delivery. The characteristics described above are associated with significantly higher support needs and costs (for example, provision of intensive one on one instruction, language support and counselling) relative to other CALD, and non-CALD groups.

Victoria will provide further information on the impacts of CALD on education services in future submissions.

1.2.2.2. Urbanisation

CGC assessment of education categories should consider the disabilities faced by each state in providing services for the large, urbanised populations of Sydney and Melbourne.

Urbanisation factors impact on the demand for or the cost of providing education services. For example, providing a safe and secure teaching and learning environment is necessary in government schools and TAFE institutes. Vandalism and security are significantly higher costs associated with maintaining education facilities in large urban areas.

Evidence previously provided by Victoria has demonstrated that the average per institute security or vandalism cost is almost nine times higher in the Melbourne urban area than in non-urban areas. These costs were more than double for TAFE institutes in population centres of more than 100 000 people, compared to institutes in population centres of less than 100 000.

Victoria will provide further information on the impacts of urbanisation on education services in future submissions.

2. HEALTH AND WELFARE

2.1. CATEGORY STRUCTURE

Victoria broadly supports the Commission's disaggregation of the health, welfare, housing and community services expenditure block into:

- Admitted patient services
- Community and other health services
- Welfare, housing and community services.

This approach is consistent with the objectives of simplification and developing a more reliable assessment. Data for these categories is appropriately robust, supporting reliable assessment of average expenses.

[3] For example, *Welcome to Victoria Kits*

Victoria does not, in principle, support further disaggregation of these categories. However, while generally accepting the disaggregation proposed, Victoria considers that further information on the approach to assessing *Community and other health services* is required in order to assess whether the overall approach will improve equalisation, relative to an equal per capita or single health category assessment.

2.2. ADMITTED PATIENT SERVICES & WELFARE HOUSING AND COMMUNITY SERVICES

Victoria considers that:

- There remain issues of validity associated with proposed indicators of disability; and

- There is a case for additional indicators of disability.

These are relevant for all three categories in this block. Assessment approaches for Community and other health services are discussed in Section 2.4.

2.2.1. General Application of Indicators

There is limited information, at this early stage, regarding the way in which factors will be applied. For example, Victoria supports in principle adjustment based on differences in relevant age groups. It is not clear, however, how these age groups will be defined for specific categories.

Other unresolved issues in relation to application of proposed indicators of disability include the application of distance/dispersion factors. The discussion paper states that the effects of where a service is provided on its costs, if proven, will be applied across relevant expense categories, in addition to proposed, category specific indicators. However, distance factors are proposed for several specific categories in the welfare, housing and community services block (see table). Victoria is concerned that this will represent a significant double counting of these effects. Further clarification is sought on the CGC's proposed approach to application of distance factors.

Category	*Proposed adjustment for:*
Admitted patients	Differences in people living in different parts of the State.
Community and other health services	Differences in cost of providing services in remote areas
Welfare and housing services	Differences in people living in different parts of the State.
Services to communities	Impact of distance from the grid on the need for electricity subsidies

2.2.2. Validity of Specific Indicators

2.2.2.1. Location Based Disabilities

Victoria considers that the effects of population dispersion on the costs of service delivery continue to be reduced by the availability of information technology and telecommunications (IT&T). They provide increasing opportunity for states to reduce the average unit cost of service delivery (compared with traditional methods), particularly in rural and remote areas. In the areas of health, welfare, housing and community services this includes new service options such as telemedicine, videoconferencing, and online personal learning and training.

In the area of health, for example, telemedicine has become an important tool in provision of rural services in areas such as mental health, paediatrics, intensive care, ophthalmology and cardiology. This can include clinical consultations, multidisciplinary and specialist support, education, administrative functions and medical image transfers, reducing travel, staffing and other administration costs associated with rural and remote delivery. Many recent examples were included in the Victorian Government submission to the Productivity Commission on the Impact of Advances in Medical Technology on Healthcare Expenditure in Australia (Box 1).

Box 1 Telemedicine and telehealth

There are a number of telehealth/telemedicine networks across Australia that are highly developed and are increasing in number.

Alfred/Medseed Wound Imaging System (AMWIS): AMWIS is a wound management software system designed to enable wound images and assessment data to be securely transmitted via the internet for review or consultation to any site equipped with the wound imaging system. A 2003 study in the Kimberley region in Western Australia examined the clinical outcomes of using AMWIS to undertake remote wound consultation for Aboriginal diabetics with chronic leg ulcers. It found that clinical outcomes were significantly improved and costs reduced when this system was used to gain remote clinical consultation from a wound care expert located 2,500 kilometres from the Kimberley region.

Teleradiology: The cost effectiveness of teleradiology was a focus of a major trial conducted by the Women's and Children's Hospital in Adelaide from February 1998 to February 1999. The primary aim of the project was to evaluate the advantages, limitations, benefits and costs of a teleradiology service for selected country and Northern Territory locations. The project demonstrated that, with the large distances between remote hospitals and metropolitan hospitals, the cost effectiveness of teleradiology in comparison with retrieving remote patients, can be dramatic.

Teleopthalmology: A pilot study conducted on the use of telemedicine ophthalmology in remote Queensland indicated that ophthalmology is well suited to telemedicine for the diagnosis and management of acute conditions and postoperative assessment of patients in remote areas. Many ocular conditions present acutely and require immediate specialist referral. While Mt Isa has a visiting specialist ophthalmology service, the clinics are too infrequent to be useful for acute problems and patients often require transfer to Townsville, 900 kilometres away. In 1996, Mt Isa Base Hospital transferred 196 ophthalmology patients, representing almost 25 per cent of patients transferred under the Patient Transfer Scheme in that year. Based on the cost of a return flight to Townsville of $500 and not allowing for the cost of patient escorts or accommodation, the cost to the hospital was approximately $100,000.

No adverse outcomes related to the use of the technology were identified and patients transferred for urgent assessment fell from 17 for the corresponding period in the previous year to four during the study period. The service for patients seemed to improve, with specialist consultation being provided within 24 hours, allowing appropriate prompt management. Patients within the study seemed to respond well to the technology, with no patient refusing a teleconsultation, and all saying that in future they would prefer such a consultation rather than travelling to Townsville.

Source: Victorian Government submission to the Productivity Commission on the Impact of Advances in Medical Technology on Healthcare Expenditure in Australia 2004

2.2.2.2. Socio-economic Status

As outlined in previous submissions, Victoria considers that any adjustment for socio-economic status (i.e. for welfare and housing services) should use a broad, simple and robust indicator, such as unemployment rates. An income based indicator, as currently proposed (adjustment for ‘low income people’) would need to be adjusted to take account of differing costs of living in each State, making the adjustment complex and less robust.

2.3. ADDITIONAL INDICATORS

Victoria considers there are two key drivers of demand for and costs of providing health, welfare, housing and community services which should additionally be considered in assessment of these expenditure categories.

2.3.1. Cultural and Linguistic Diversity

CGC assessment of expenditure disabilities should consider the disabilities faced by each state in providing for a mix of socio-demographic groups. These should including factors relating to cultural and linguistic diversity and low English fluency, as well as socio-economic status and indigeneity.

The effects of these factors extend to both service demand and service delivery unit costs. Culturally and linguistically diverse (CALD) populations have distinct customs and characteristics which shape the services they require, and the way in which services must be delivered. Equal opportunity legislation and values require that these needs be accommodated. For example, health service needs may be distinct from other population groups due to physiological differences (e.g. uncommon, complex and dangerous diseases among migrant populations), poor general health, different propensities to seek early treatment (e.g. due to communication difficulties) and health behaviours. Non-English speaking populations are also more likely to use supported accommodation and assistance programs, and to have distinct cultural and recreational service needs.

Additional service costs are associated with the provision of services to CALD groups. For example, in public housing these include access to telephone and on-site interpreting, including pre-recorded information in multiple languages and written communications (brochures and newsletters translated into multiple languages). However, additional costs associated with CALD groups are broader than communication expenses. For example, the costs of inpatient pathways for CALD patients may vary in:

- Time taken for medical consultations

- Interpreter fees, including the provision of multiple interpreters to identify one with appropriate gender/ethnicity

- Number and costs of investigations. These may be greater due to cultural factors, including:

    - Lesser propensity to engage with preventative health, leading to more acute presentations;

    - Additional scans and tests to account for missing medical history; and

    - Readmission due to the post-treatment action (or lack of action).

- Other cultural needs, such as provision of prayer rooms and other specific cultural facilities.

Victoria is currently collecting data to demonstrate the additional costs of providing inpatient services to CALD populations. This is anticipated to be available for CGC consideration in late 2007.

2.3.2. Urbanisation

CGC assessment of expenditure disabilities should consider the cost and demand impacts associated with providing services for the large, urbanised populations of Sydney and Melbourne.

Urbanisation directly increases demand for health, welfare, housing and community services. Urban populations present a greater diversity of service needs. In the area of health services, for example, this includes greater exposure to more rare and complex health issues, with implications for population health, preventative care and acute care. Urban centres attract international migrants and travellers, with diverse and often complex health issues. The risk of new and rare disease exposure is a real threat that is costly in terms of prevention and eradication. Identifying these problems, and managing solutions, is more costly in urban areas.

Urbanisation also indirectly increases demand for services by shaping consumer expectations of service availability. The pattern of service delivery has led populations to expect a high and broad level of service accessibility within close proximity, relative to other areas. These expectations drive increased service usage. As urban areas expand, states with highly urbanised populations are required to provide access to a range of services broadly equivalent to capital cities and major metropolitan centres in an increasing number of locations, across a larger area.

Urbanisation additionally increases the average unit cost of providing health and community services. For example, housing costs are typically higher in capital cities than in other areas within states partly due to higher dwelling values. Highly urbanised environments also impose higher costs associated with vandalism, crime, and pollution, resulting in increased maintenance costs for public housing in metropolitan areas.

More generally, urbanisation can be expected to increase unit costs beyond a certain 'optimal level'. As urban populations grow they demand an increasing volume of health and other services. As services are provided on an increasing scale, service providers realise economies of scale (e.g. material costs for construction reduce and division of labour leads to declining labour cost per service unit). Eventually, however, the average cost of providing services to begin to increase. The availability of land for further development may become more limited, while the complexity of a large and diverse system requires complex planning and coordination.

Victoria will provide further information on the impacts of urbanisation on health, welfare, housing and community services in future submissions.

2.4. COMMUNITY AND OTHER HEALTH SERVICES

Consideration of proposed assessment models is constrained by limited information on how these would be applied. This aside, Victoria considers that both a health needs approach, and minimum level of service approach, to be heavily policy influenced.

As a general principle, policy neutral assessments should consider how a state's population shapes needs and costs (in ways which cannot be controlled by states), and not system design, which is inherently a product of policy choice. Administrative data on the average use of services by various groups (health needs approach) will be shaped by State choices about whether and how services are delivered to those groups. Similarly, access to services (minimum services approach), measured by reference to number of service sites, costs per site and access to non-government providers is shaped by historical choices about what and where services will be provided, and how the private sector will be fostered or leveraged. This approach also appears to assume substitutability between public and private sector services that requires greater examination. Given these concerns, Victoria continues to consider that an EPC approach is appropriate.

In the case that other models are pursued, further information regarding the required assessment approach is necessary to assess the validity of the indicators proposed. If these are not clearly valid and robust for all included expenditure, equalisation could be improved by treating these on an equal per capita basis (e.g. health research), adjusted population, or including with admitted patient services (e.g. preventative health), as is appropriate for specific areas.

3. SERVICES TO COMMUNITIES

Victoria considers that this category should not be disaggregated. Many of the expenses proposed for assessment in this category are of a regulatory nature, and therefore fit better in the proposed Services to Industry category. Further, after the Data Working Group meeting on 15 March 2007, it appears that data to assess disabilities across these services could be of limited value. This strengthens the argument for an EPC assessment under Services to Industry.

3.1. WATER, SANITATION AND PROTECTION OF THE ENVIRONMENT

Victoria does not consider there is a strong conceptual case for the inclusion of *water, sanitation and protection of the environment* expenditure in Services to Communities. Regulatory costs included in this item are more appropriately placed with Services to Industry Category and assessed on an equal per capita basis. Where this data can not be divided reliably, the entire item should be placed with Services to Industry.

3.2. ELECTRICITY, FUEL AND OTHER ENERGY

Victoria does not consider there is a strong conceptual case for moving 3-digit GPC expenses on *electricity and other energy* to the Services to Communities category. These expenses are essentially of a regulatory nature and fit better under Services to Industry.

Victoria is concerned that disaggregating 2-digit *fuel and energy* expenses and moving just one component to Services to Communities would introduce additional complexity. At the same time, it would not improve equalisation because the 2-digit GPC *fuel and energy* already comprises activities affected by similar factors and of the same functions, i.e. *outlays on administration, regulation, planning, support, operation* [4].

In addition, this would require splitting 2-digit GPC expenses and there would be data reliability issues associated with reclassifying these expenses to the proposed Services to Communities category.

Therefore, Victoria believes that f*uel and energy expenses* should be assessed under the Services to Industry category in their entirety.

3.3. HOUSING AND OTHER COMMUNITY SERVICES

The remaining assessments, i.e. o*ther community services* and part of *housing and community* development expenses are not likely to have a material effect on the GST distribution. Therefore, Victoria argues they continue to be assessed in their appropriate Health and Welfare category or categories.

[4] Australian System of Government Finance Statistics: Concepts, Sources and Methods, ABS 2005

4. LAW AND ORDER

4.1. CATEGORY STRUCTURE

Victoria agrees with the Commission's proposed two-category structure to assess law and order disabilities. The categories being:

- Public Safety and emergency management services (covering expenses related to State emergency services, fire and rescue services and the community safety and support aspects of Victoria Police; and

- Justice Services (covering expenses related to courts, corrective services and the crime investigation and judicial support and road safety aspects of police).

Victoria considers that it will be able to reliably split out the sub 4-digit GPC police expense between the Justice Services and Public Safety and Emergency Management expense categories. At this stage, we believe the split of Victoria's police expenses to be in the vicinity of 60% Justice Services, 40% Public Safety and Emergency Management Services. This is consistent with data provided by the ACT and the opposite of the Productivity Commission's estimate.

4.2. PUBLIC SAFETY AND EMERGENCY MANAGEMENT SERVICES

4.2.1. Proposed Indicators

Victoria considers that overall population will be the main cost driver for this category. As such we agree with the CGC proposal to use total population as the main indicator for cost drivers for the Public Safety and Emergency Management Services category.

4.2.1.1. Urbanisation

However, Victoria considers that urbanisation should also form a component of the policing expenditure relating to community safety and support.

Victoria is required to undertake policing and emergency service response in Melbourne in regard to fighting terrorism, coordinating major responses (such as the recent G-20 summit and attending major sporting events) and responding to emergencies in densely populated areas. Not only are Victoria Police and our other Emergency Service bodies required to undertake such responses, but extensive training is also required.

The result of which is costly exercises are required to be undertaken that are not faced to the same extent as smaller capital cities.

4.3. JUSTICE SERVICES

4.3.1. Proposed Indicators

Victoria considers that population should also be used as an indicator for the Justice Services category.

Victoria acknowledges that there are certain population groups that will contribute to the cost of these services more so than others. As such, Victoria is willing to consider breaking population down into sub groups, but believes that this should be done at as broad a level as possible.

4.3.1.1. Cultural and Linguistic Diversity

A particular category that Victoria considers should be included in the sub group are offenders from a culturally and linguistically diverse (CALD) background.

Victoria's population comprises around four per cent of people from a low English speaking background, which includes people classified as CALD. However, in 2005-06, over nine per cent of offenders processed by Victoria Police were from a CALD background, over double the Victorian low-english speaking population proportion.

CALD background offenders are also highly represented in certain crimes. For example, in 2005-06, offenders from a CALD background made up around 10 per cent or more of crimes committed in Victoria in relation to homicide, abduction/kidnapping, deception, handling stolen goods, and drug cultivating and manufacturing.

When dealing with CALD offenders as part of the functions included in the Justice Services expense category, Victoria is required to provide certain services such as translators, legal aid (in 2004-05, Victoria Legal Aid's legal information and referral service answered 5,746 calls in languages other than English, which was offered in 14 other languages), religious requirements (e.g. special dietary), as well as additional welfare, educational and psychological services beyond those for the majority of offenders.

Victoria will be preparing further information to support the inclusion of CALD in the assessment for Justice Services.

4.3.1.2. Urbanisation

The other factor that Victoria considers should be used when assessing expenses to justice services is the impact of urbanisation.

Victoria, along with New South Wales, faces additional costs regarding law and order in our capital cities. The size of our respective capital cities (both geographically and population) is far more conducive to crime than smaller capital cities.

In regard to traditional crime, urbanisation provides a number of difficult scenarios for policing and fighting crime in Victoria. It provides offenders with structures, enables groups of certain ethnic backgrounds to reside in the same regions, provides opportunity for greater anonymity, and provides the opportunity to develop extensive networks. This in turn provides opportunities for crimes to be undertaken on a far greater scale than in smaller cities.

As a result, Victoria is required to establish specialist police functions to combat crime stemming from urbanisation. These units include anti terrorism, organised crime investigation/prevention, specific ethnic focus crime taskforces, drugs and drug related crime, traffic policing and major events.

Large capital cities are also major sources of business investment. While this provides economic positives to the state, it also provides opportunities for white collar crime, such as fraud and embezzlement. Such crimes also require specialist policing functions such as major fraud investigations.

While these urbanisation related crimes have an impact on policing, they also have flow-on impacts to our courts and corrections systems. Charges laid for these urbanisation related crimes mean our courts have to consider a significant number of such cases in addition to forms of crime that are general to all states.

While urbanisation affects our courts from a crime perspective, it also has an impact on our courts from the civil side of the legal system. Civil litigants are individuals and corporations who are involved in a dispute that is involving the court as an arbitrator. Given the significant number of businesses that operate in Victoria, increased civil cases arise.

Overall, in the period 2002-03 to 2005-06, the number of civil actions in Victoria's courts rose by two per cent, the second most of any jurisdiction for this period. This is in light of the significant reductions in civil cases flowing from the personal/criminal injury and tort law reforms.

Victoria is also required to incarcerate offenders who are convicted of urbanisation related crimes in addition to forms of crime that are general to all states. In addition to incarcerating offenders for a large number of different forms of crime, Victoria is required to incarcerate a significant number of offenders who are drug dependent. This requires the provision of services beyond traditional prison services, such as rehabilitation and counselling.

Urbanisation also has an impact on our roads, with extensive road networks and congestion leading to a significant number of traffic incidents, which in turn require policing.

Traffic incidents require police to respond to incidents, control traffic around the scene, prepare collision reports, investigate the collision, determine fault and prepare subsequent paperwork and attend court when necessary. All of these tasks lead to increased costs for Victoria.

Victoria will be providing further information on the impacts of urbanisation on law and order expenses in future submissions.

5. SERVICES TO INDUSTRY

5.1. CATEGORY STRUCTURE

Victoria supports performing an assessment of Services to Industry as one category. This expense category represents less than 5 per cent of total states expenditure and therefore further disaggregation of the expenses would not be warranted.

In addition, the proposed approach would be consistent with the Commission's intention to use simpler methods, in this case, to interpret state practice more broadly, to achieve horizontal fiscal equalisation. Further disaggregation is not supported as assessing separately some parts of the category would not help to establish a clearer conceptual case for disabilities for a subset of some of the services and therefore, would not lead to a better equalisation result.

As discussed in section 3, Victoria considers this category should be expanded to include most of the expenses currently included in the Services to Communities category.

5.2. PROPOSED ASSESSMENT

Victoria considers that there are not enough common attributes in the underlying drivers of use and cost across the services and therefore reliable measures of expense and disability would be hard to establish.

It is important to distinguish between disabilities that arise as a result of previous policy choices, e.g. business promotion, and disabilities that arise because of the inherent nature of the economic environment within which services are provided, e.g. the number of locations that needed coverage. In case of Services to Industry it would be difficult to separate out policy choices from underlying needs. There is the lack of relationship between expenses for Services to Industry between States and any indicators of business activity (e.g. factor income) and only policy differences may explain these large variations.

Given the heavy policy influence on this expense category, Victoria considers that Horizontal Fiscal Equalisation for this category should be based upon an equal per capita assessment.

However, Victoria notes the Commission's intention to obtain more information on the Services to Industry category through the survey.

6. TRANSPORT

6.1. CATEGORY STRUCTURE

Victoria recognises the difficulty finding a single broad indicator to assess disabilities arising from very different causes. That is, the road transport disability is caused primarily by road use and length, whilst transport services disabilities are driven mainly by the need to provide subsidised public transport services. A mix of indicators may be required to assess these different disabilities. This could potentially lead to a very complex assessment, so Victoria supports the disaggregation of Roads from other aspects of Transport Services, provided that an improved dataset can be found to assess the Roads category.

6.2. ROADS

6.2.1. Proposed Indicators

Victoria supports the Commission undertaking further work in developing more refined procedures for measuring road use as well as road distance. It is considered that the adoption of proxy measures such as fuel consumption or population weighted distances would require further research to actually validate their use.

6.2.1.1. Road Use

The size of the road maintenance task is currently assessed by measuring road length and use. Conceptually, this is a sound method for assessing this disability. However, as the Commission notes, measuring these cost drivers (particularly road length) in a policy-neutral way has been problematic. Further, Victoria argues that even if both were measured accurately, the Commission currently places far too much emphasis on road length as the main cost determinant, at the expense of road use.

While it is necessary to ensure that accurate data on road length is available for undertaking any roads assessment, the discussion paper has not adequately addressed the notion that traffic volumes on arterial roads are also a strong driver of maintenance expenditure. Studies by the Austroads Assets Research Program indicate that 60 to 70 per cent of road maintenance costs are due to wear and tear, rather than the length of the road in question. As an extreme example, Victoria contends that a 1 km long road carrying 1000 vehicles a day would cost more to maintain than 100 km of road carrying 10 vehicles per day (whether these vehicles are heavy or not), despite the daily vehicle kilometres travelled being the same.

The current emphasis placed by the Commission on dividing roads into two traffic volume groupings fails to adequately address outlays associated with major arterials carrying 20,00 to 40,000 vehicles per day.

Urban Roads carrying over 20,000 vehicles per day will require greater traffic management and street lighting outlays to safely accommodate such traffic volumes compared with roads carrying 15,000 per day. These outlays are primarily associated with the provision of road side infrastructure to accommodate passenger vehicles rather than heavy vehicles.

It should also be noted that in the majority of cases road safety measures incurred along urban arterial roads are aimed providing a safer environment that protects cyclists and pedestrians from motor vehicles, rather than providing roads specifically suited to high volumes of heavy vehicles.

6.2.1.2. Road Length

Turning to road length, Victoria is supportive of ongoing work to improve the consistency of road length data across jurisdictions. However, we note the large increases in the rural road lengths of Queensland and the Northern Territory, relative to other States. We would be interested to learn whether the use of Urban Centres/Localities (UCLs) as defined in point 3 of paragraph 8 of Discussion Paper 2007/02 S have a material impact on relative road lengths compared with using a flat population threshold of say, 400 or 500 persons. If there is minimal impact, we would favour using the single threshold for an important centre for simplicity purposes. If the impact is material, further research is required as to which gives the more accurate measure of the cost of the road maintenance task.

Victoria does not support using a synthetic road network, as this ignores issues of terrain and does not indicate actual road length.

Victoria urges caution in using road depreciation data. Victoria considers that use of accelerated depreciation methods is not consistent across States. Victoria would appreciate the CGC surveying States to ascertain how each state depreciates its road network, and if necessary, make appropriate adjustments for any inconsistencies.

6.2.1.3. Fuel Consumption

Fuel Consumption data, is not readily available in a format that can be easily differentiated between rural and urban environs. While the Survey of Motor Vehicle Usage (SMVU) conducted by the ABS provides estimates of fuel consumption in urban and non-urban areas; the relatively small sample size of the SMVU clearly presents problems in drawing meaningful conclusions for the smaller States.

Another publicly available source on fuel consumption is the Department of Industry, Tourism and Resources, Australian Petroleum Statistics. This publication provides summary data of sales on Petrol, LPG and Diesel Sales by State Sales Region (State Sales Regions differ slightly from actual State Boundaries). However there still remains the issue of devising an acceptable methodology for estimating the amounts consumed in Urban and Rural environments.

Potentially the most useful data set available on fuel consumption would be for the Commission to arrange access to the petroleum datasets held by the Australian Taxation Office. This data would enable the Commission to more accurately appraise sales of petroleum in the urban and rural regions within each States

While either of the two datasets would provide estimates of the supply of fuel it would still be necessary to devise consumption estimates in order calculate travel patterns.

6.3. TRANSPORT SERVICES

6.3.1. Proposed Indicators

Victoria supports the Commission's proposed focus on urban areas for this category. The vast majority of public transport services are provided in large urban areas, with accompanying costs of concessions, pricing and capital subsidies.

Victoria supports the category structure proposed in paragraph 119, with the addition of a weight for population density, which is also an important factor increasing the cost of public transport service provision. Victoria has information that should be helpful to the Commission in devising these weights.

6.3.2. Population Density

Victoria contends that population density is a material factor in increasing the cost of providing a public transport system. In larger cities, the cost of providing transport services rise disproportionately to the population because:

- The costs of addressing congestion are disproportionately higher for roads and for public transport; and

- The role of public transport, which carries higher costs to government, is greater.

In smaller cities a basic transport system is sufficient to meet the capacity demands imposed by concentrated movements of people and goods in peak periods. In larger cities there is a need to overlay additional infrastructure and services. What might otherwise be a 2 lane road needs to be a four or six lane road. What might otherwise be a 20 minute bus service needs to be a 5 minute train service. The associated costs are not proportional to population, but rather are driven by the scale of the concentration of activity in major activity centres, most notably the central business district of the city.

It is essential that governments meet these capacity needs to ensure the economic efficiency of the city, and wellbeing of its inhabitants. Sydney and Melbourne, and more specifically their central business districts (CBD), are home to many of the finance and service industries that are now major drivers of the national economy.

If the total cost of operating a transport system depends on the Basic Transport System (BTS) plus the Capacity Transport System (CTS), we contend that the cost of the BTS is a direct function of the population, whereas the cost of the CTS is a function of activity in the CBD. CBD activity could be reliably proxied by employment. Such data could be gained from the Census, which includes a question on where people went to work that day.

The Victorian Department of Infrastructure estimates that for Melbourne, about 60% of transport costs are due to BTS and 40% due to CTS. Victoria is prepared to undertake further investigation of our transport costs to refine this model and determine the materiality of population density on transport costs.

7. OTHER SERVICES

7.1. CATEGORY STRUCTURE

Victoria agrees that assessment of Other Services as one category is possible and appropriate. Reliable ABS GPC data at the 2-digit level of the total block are available. Since the Commission expressed a preference to use the GPCs at the 2 and 3-digit level to define assessment categories, any further desegregation is not recommended as it would require splitting some 3- and 4-digit GPC classifications (e.g. National Parks, Natural Disaster Relief). This would raise questions about the reliability of the expense data.

7.2. PROPOSED ASSESSMENT

Victoria agrees that the administrative and whole-of-State nature of most of the expenses in this group implies that this group differ from other major categories of expenses. The expenditures included in this category have no unifying theme and therefore Victoria agrees that an equal per capita approach has the benefits of aiding simplicity and transparency.

Victoria considers that there are no cases for differential assessments within this block as no conceptually sound, simple, reliable and material assessment could be made (specific details below).

7.3. DEPRECIATION AND DEBT CHARGES

Victoria considers that the expenses relating to depreciation, leasing costs and asset maintenance should be allocated across the expense categories according to where the relevant assets are used. All States deliver services to their populations using non-financial assets, such as buildings, plant and equipment. Victoria agrees that the level of depreciation expense is related to the use of services and by allocating the expenses to the relevant categories, depreciation would be treated in the same way as other asset related costs.

Victoria considers that the interests of optimising fiscal equalisation are best served by an EPC treatment of all capital expenditures and receipts in the Debt Charges category.

Since States' decisions on the balance between investing and/or borrowing are policy driven, and are not related to need, the expense is calculated on interest paid on borrowings net of interest earnings on non-superannuation investments. Recently, net average debt charges became negative as interest payments are now less than interest earnings, i.e. most states have been earning more interest on investments than they have been paying on their debt portfolios. Victoria agrees with the current approach that it is inappropriate to apply expense disabilities to a revenue category and the needs should be assessed on an equal per capita basis.

Since net interest across all States has always been small or has been heading towards zero or a negative amount, these expenses do not meet the category size threshold and therefore no further disaggregation is recommended. Victoria considers that these expenses should be included in Other Services category and that the appropriate course is to follow the equal per capita approach used in the current methodology.

7.4. NATIONAL PARKS

Data on gross expenses requires detailed 2-digit level GPC classifications and the reliability of the data has been questioned many times by the Commission and most of the States. Victoria considers there is no case for a differential assessment as no conceptually sound, reliable and material assessment could be made for the 2010 Review.

7.5. NATURAL DISASTER RELIEF

These expenses do not meet the category size threshold for separate assessment and therefore it is recommended that they stay as part of Other Services block and consequently be assessed on equal per capita basis.