



**Response to the
Commonwealth Grants Commission
Discussion Paper 2006/02**

“Location Based Disabilities”

Department of Treasury and Finance

August 2006

INTRODUCTION

1. Tasmania supports the proposed “tops-down” cascading approach to the derivation of location disabilities for the 2010 Review as outlined in paragraphs 37-40 of the CGC’s Staff Discussion Paper 2006/02. This is a logical way to proceed. It is consistent with, and to be implemented in tandem with, the tops-down approach being taken to disaggregation more broadly.
2. The following sections address specific issues raised by the CGC in this Discussion Paper.

APPROPRIATE LEVEL FOR ASSESSING LOCATION-BASED DISABILITIES

The Broad Conceptual Case

3. Tasmania considers there is a valid conceptual case for the continued recognition of most existing locational disabilities.
4. Tasmania rejects the argument that the assessment of location-based disabilities is an impediment to economic efficiency and therefore that such disabilities should be discontinued. To the extent that material locationally-based costs differentials exist between states, these are appropriately assessed within a horizontal fiscal equalisation framework.
5. The broad conceptual pre-conditions for location-based cost differentials to exist were clearly re-validated for the 2004 Review:
 - Services are used more or less than average in different regions of a state (for example, vocational educational services, hospital services and public transport usage patterns differ between regions within states);
 - Operating costs of providing each unit of service vary across the regions of a state or between states (for example, higher unit costs of provision of police stations and schools in rural and remote centres under average polices, the need to provide remote area and other additional allowances to attract and retain staff in more remote/isolated regions); and
 - Differences continue to exist between states in the proportions of the population that live in (and use services in) each region (for example, much lower proportions of Tasmanians and Northern Territorians live in urban centres compared to other states; Western Australia and the Northern Territory have higher than average proportions of their populations living in remote or very remote areas).
6. It is unlikely that conditions have changed in the intervening time period since the 2004 Review such as to alter the conceptual case for assessment.

POTENTIAL AGGREGATED ASSESSMENTS

7. The following comments are based on the assumption that a conceptual case is made to justify the ongoing recognition of all existing location-based disabilities.

Single Assessment

8. The likelihood that a single aggregate could capture the material location-based cost differentials between states seems remote. The location-based disabilities are too disparate in terms of the range of material cost influences to be readily accommodated within a single aggregate. That is:
- dispersion costs are driven primarily by intrastate travel distances;
 - service delivery scale is driven by unavoidable size of centre diseconomies encountered in rural and remote areas;
 - wages input costs (purportedly) reflect interstate wage cost differentials for public sector employees of otherwise equivalent productivity;
 - locational socio-demographic composition captures differences in the use-ratios of services in remote and very remote locations relative to other locations; and
 - isolation costs are driven by distance from the main population centres on the eastern seaboard and size of population effects.
9. A priori, even ignoring its experimental status, Tasmania does not consider the ABS experimental spatial price index is a viable single aggregate measure in this context, although it may provide a base for a sub-grouped measure of interstate price differentials.^{1 2}
10. The experimental spatial price index is based on CPI data and so captures capital-city (potential) price level differentials. Notwithstanding the reference in the recent CGC workshop in June 2006 to an earlier ABS spatial price index study which found relative food prices were stable over time (1960-1990) across some 200 towns, Tasmania is not aware of evidence to suggest this result could be generalised to intrastate-interstate locationally based government cost differentials, or which could be used as a basis to infer these cost relativities.

¹ *Comparing Living Costs in Australian Capital Cities, A Progress Report on Developing Experimental Spatial Price Indexes for Australia*, Alex Waschka, William Milne, Joathon Khoo, Tim Quirey and Shiji Zhao; Analytical Services Branch Methodology Division, ABS for 32nd Conference of Economists, 29 September – 1 October 2003,

² *Measuring Differences in Prices Across Australian Capital Cities*, paper presented at Economic Measurement Group Workshop at the Centre for Applied Economic Research, Sydney, 12-13 December 2005, Keith Woolford, Rob Aitken, Jasmine Cadd, Tanja Naehar, and Melissa Small, Prices Research and Development, ABS

11. For example, the ABS recently released the results of an analysis³ undertaken of household expenditure differences between city and rural areas which found that households in rural areas spend less on housing and food but more on transport than households in city areas. These expenditure patterns can reflect any mix of differences in tastes, demographic composition, income, price, quantity of goods and services consumed and other effects, and so cannot be used to infer intra-regional price differentials.
12. The experimental spatial price index is based on partial measures of capital city household consumption and ignores business expenditure. It is not a good index of government cost differentials. It covers the full range of household based expenditure items, accessed through both the private and the government sectors – for example government and private school fees, public transport (buses and taxis only) and private transport costs, etc. It may even have an inverse relationship to government-based costs within this context in that it is measuring the net consumption cost to the household after any government subsidisation.
13. The index remains very much an experimental measure and is not released for use at this point in time. The housing and miscellaneous components remain problematic. The ABS also has concerns with a number of the other sub-index outcomes (education, health, transport etc).

Several Simpler And Broader Assessments

14. Tasmania agrees that deriving meaningful and reliable assessments using a broader aggregate approach is likely to require location effects to be divided into 2-3 broad sub-groups.
15. The specific sub-groupings outlined in paragraph 44 of the Discussion Paper are supported as providing a possible division. The substantive issue will be finding relevant, robust measures to support such an approach.
16. The structure of the experimental spatial price index is better suited to measuring interstate price effects. For example, cost of living/household consumption measures could be expected to have a more direct relationship with wage level differentials. However, caveats still apply. The index remains experimental and its potential use would be predicated on the ABS progressing it to a useable form within the time frame for the 2010 Review. There are a number of problematic areas within it, specifically housing (as the index is very sensitive to the specific treatment adopted for housing costs). It is also not clear how the location disability component elements (wages index costs, labour-related isolation costs, accommodation costs, electricity costs, and potentially freight and other isolation cost elements) would “map” to the spatial price index structure.
17. There are risks for Tasmania specifically with a broad indicator approach based on combinations of simple measures such as distance or population density. Tasmania fits into none of the more extreme measures – it is not dispersed, it has a

³ ABS catalogue No 1380.0.55.003 – *Perspectives on Regional Australia: Household Expenditure throughout Australia, 2003-04*

below average proportion of its population living in remote regions and yet it is, conversely, one of the least urbanised states and so has a higher than average assessed service delivery scale disability. Such a broad indicator approach could omit to consider the needs of a state such as Tasmania.

18. There is no obvious existing candidate for intrastate price or cost level effects to cover the existing Dispersion, Service Delivery Scale and Urban Influences disabilities. Conceptually it should be possible to construct such a measure using some sort of regional cost centre approach. However, pragmatically, the substantive issue will be getting the regional cost data. This is an issue regardless of the actual derivation method (a spatial relationship model based on regional centres identified within SARIA, regression modelling, etc). To derive such a broad aggregate relies on states being able to provide relevant, robust regional cost centre data within reasonable time frames to allow construction, testing and refinement of a cost index within the Review timetable. However, in the absence of at least some broad specification of cost relationships sought, it is difficult for states to indicate whether or not they could comply with such a special data request/set of special data requests.
19. Another related issue is that while dispersion costs are reasonably global in their coverage, both the service delivery scale and urban influences cost relationships are more functionally specific. Tasmania would argue, particularly in relation to urban influences, that this restricted cost recognition remains appropriate. A danger with moving towards a more grouped measure is that this starts to generalise a specific type of cost differential to a functional area where it is not justified. Tasmania would strongly oppose efforts to apply an aggregate based measure to functional areas where the conceptual and empirical case for such a disability had not been made.
20. Tasmania questions whether it is appropriate to conceptualise the relative cost of services by region using a skewed U-shaped cost curve based on dispersion or concentration of population settlement (refer paragraph 47 of the Discussion Paper). While this form of relationship may be found to be relevant to certain functional service delivery areas (eg public transport) it is far from clear that this is in fact a generalised relationship across the broader government service delivery spectrum.
21. This leads into “chicken and egg” issues in terms of the relationship between the disability indicator and functional structure of the underlying expenditure category (aggregation issues).
22. The SDC locational effects could reasonably be subsumed within the SDC factor and the treatment of items such as isolation related non-labour costs could go into either the interstate or intrastate index.
23. A priori, Tasmania considers distance (as a proxy for travel costs) and remoteness (costs generally increase with remoteness) as important determinants. Density may also be a determinant but in a more limited/restricted range of contexts (for example, transport complexities within densely populated urban centres; service delivery scale effects arise from an inverse density measure). In general, administrative costs will rise with distance. However, labour related costs have a

more complex relationship with distance (potentially offsetting component effects). For example, medical specialists tend to be city-based and are more costly than other medical personnel wherever based. However, in a small city/big city context, specialists practising in smaller/more remote cities require compensation to cover professional isolation, loss of private income, etc.

SIMPLIFICATION OF EXISTING ASSESSMENTS

24. If a robust single broad measure or set of several broad measures cannot be found then it may be necessary to simplify the existing disability assessments structures.

Isolation

Validation of the Conceptual Case

25. A strong conceptual case remains for the continued recognition of isolation costs.

26. The 2004 Review concluded that the south-eastern region of Australia is:

- *“a source of goods and materials – such as consumer durables, perishables and building materials, particularly for Hobart and Darwin;*
- *a source of high level professional services – for example, medical specialists, barristers, bankers and information technology consultants for Hobart, Darwin and possibly Canberra;*
- *a source of skilled labour for Hobart, Darwin and to a lesser degree, Canberra; and*
- *a long way from Perth, Hobart and Darwin, in terms of travel costs.”*

27. Tasmania maintains that isolation costs are material and remain significant. This is despite improved technologies and a greater capacity to source inputs from overseas.

28. In Tasmania’s case, isolation costs cannot realistically be avoided or reduced by importing “inputs” from overseas at lower prices. Moreover, at a practical level, technology costs impacts are effectively already embedded in underlying cost data.

Labour-related Isolation Costs

29. Tasmania faces material additional labour-related expenses due to isolation across a range of functions (particularly in the health sector). These expenses are reflected in higher costs for salary packages, recruitment and incentives, retention and the maintenance of professional skills and professional support infrastructure.

30. While there is interstate competition for labour, which is very intense in some sectors (such as health), Tasmania is at a disadvantage for a number of reasons, which means that it is forced to compete harder to attract the skilled labour required to provide essential services to the community.

31. Tasmania's isolation from major health training and research areas, which attract specialist medical professionals, is one reason why Tasmania has to incur extra costs to attract those persons away from those major centres.

Example – Educational Training Facilities

Tasmania does not have the population base to support the educational facilities to train many allied health professions. Only four of the twenty identified allied health professions are educated and trained in Tasmania. As a consequence, all other allied health professionals must be attracted from mainland institutions at significant cost. These costs include advertising, relocation costs and the provision of professional development assistance to attend national conferences and workshops, which are generally held interstate. Further, due to the limited number of special service providers in Tasmania, professional development training is not available from other staff with the necessary skills.

32. Tasmania utilises interstate consultants across a number of government sectors, as the necessary expertise and skill-sets required are not readily available in the State. This is because there is not sufficient depth of demand in Tasmania for specialist training, university, industry or research-based institutions to support the development of certain specialist expertise.

Example – Public and Environmental Health

The provision of some public and environmental health services is more expensive in Tasmania because of its small population, which cannot support highly specialised services. In the case of the Tasmanian Shellfish Quality Assurance Program, some samples need to be sent interstate and, in some cases, to New Zealand. Tasmania has also incurred extra costs in relation to meeting water quality standards, which have required the Fluoridation Committee to fly in an expert from New South Wales, due to a lack of any recognised experts in Tasmania in urban water supply outside of the water authorities.

33. Tasmania engages interstate consultants predominately within the health sector, however, interstate consultants are also used across education, primary industries, the administration of justice, vocational education and training and in law, order and public safety.

Example – New Prison Construction

The construction of a new prison in Tasmania provides a relevant example of isolation costs faced in Tasmania. The skills associated with the design and construction of the specialised facility are not available in the State and as a result it is necessary to incur additional costs associated with travel, accommodation and time travelling in addition to the normal costs of engaging appropriate professional consultants. While it is recognised that the new prison is a one-off project it would be indicative of other specialised projects in Tasmania and other isolated states.

34. Isolation affects many health professionals in Tasmania. For example, in 2004-05, in the health sector, consultancies related to mental health services, oral health services, disability services and palliative care to name a few.
35. The demand for health services in Tasmania exceeds the level of service that can be provided given the availability of suitably trained and skilled health professionals. Recruitment to health positions can be difficult due to the lack of undergraduate and post-graduate training in Tasmania and the perceived isolation of the State from the mainland.

Example – Allowances for Dentists

The number of dentists available in Tasmania to fill the Nation-wide Oral Health requirements are limited, which has led to a very competitive market when trying to attract dentists to the State. This problem is compounded with no dental school existing in Tasmania. Therefore, to improve the capacity of the publicly funded Oral Health Service to recruit and retain dentists, it has been necessary to increase their salary by paying a 30 per cent allowance.

Example – Locums Launceston General Hospital (LGH) Radiology Department

The Radiology Department at the LGH has been using locum agencies for the past several years, as it has been difficult to recruit radiographers. Currently, Radiology is employing a number of Ultrasonographer locums, at locum rates of between \$50 to \$70 per hour. This compares to the Professional Stream Level 1 Year 8 rate of \$24.63 per hour.

Ultrasonographer locum rate ranges from \$50 to \$70 per hour whilst the Professional Stream Level 2 Year 3 rate is \$28.04 per hour.

36. Tasmania must compete at a national and international level to provide remuneration packages to attract highly skilled people. While this is typical of all states in their need to attract highly skilled staff required to deliver necessary services, the more isolated the state, the harder it is to compete.

Freight Isolation Costs

37. A significant cost of undertaking business in Tasmania is the cost of freight, both in terms of transporting raw materials to the State and transporting finished goods out of Tasmania. Because of its separation from the main manufacturing areas, Tasmania obtains significant levels of supplies and essential inputs for government services from the south-eastern areas of the nation.
38. The Tasmanian Freight Equalisation Scheme (TFES) does provide some financial assistance, however, it does not fully compensate for Tasmania's inherent disadvantage. Not all goods are covered by TFES, including shipments of air cargo, cargoes intended for overseas export, bulk cargoes and goods imported into the mainland of Australia from overseas, which have not undergone a

manufacturing process on the mainland prior to their shipment to Tasmania. While financial assistance is important in reducing this disadvantage, no freight equalisation scheme is able to fully compensate for the problems faced by Tasmanian businesses that are separated from major population centres and markets.

39. Certain maintenance costs are also higher because, in many instances where specialised equipment has been imported to Tasmania, the maintenance expertise must also be brought to the State to service the equipment.
40. Tasmania incurs freight isolation expenses across a number of sectors, including health, law and order and public safety and general public services.

Example – Freight of Medical Equipment

During 2004-05, in the health sector freight expenses related to vaccine distribution, oral health, equipment calibration and freight and microbiology consumables. Freight costs and costs of basic commodities are high in Tasmania. For example, the freight cost to deliver one treatment table is \$360.

Reliability of Data

41. Despite a strong conceptual and an historically well accepted case for the identification of isolation costs, the reliability of data to support the current isolation assessment is low. There is limited data available, and where this does exist the data is not well defined and may not be fully comparable across states. This has traditionally resulted in the Commission exercising judgement in its assessment of isolation costs.
42. Tasmania has limited capacity to provide robust data for labour-related expenses or freight costs. This is particularly constrained by the fact that isolation costs do not sit neatly with any one particular government agency. As part of the recent draft 2007 Update request, Treasury wrote to all agencies examining future options for capturing isolation expenses where these are not currently measured but are believed to be material. Most agencies confirmed that, while they incurred expenses relating to isolation, these were often difficult to accurately identify. For freight costs, for example, these costs are often included in the price of the good and not separately identified via invoice or through accounting systems. This problem is compounded with common-use contracts, where freight of goods is built into the purchase cost.
43. Considerable effort would be required to improve isolation data in Tasmania. Such an exercise would be time-consuming and potentially complex and it is not clear whether complete or reliable results could be achieved.

Broad Indicator of Isolation

44. Given current data constraints, Tasmania considers that there is merit in pursuing the use of a broader indicator (or set of broad indicators) to simplify the current isolation assessment.

45. Tasmania endorses the view expressed in paragraph 57 of the Discussion Paper that the extra cost attributed to isolation primarily relate to:
- the distance of a state from the main sources of supply (the longer the distance, the higher the costs); and
 - the size of a state's population (with a negative relationship between isolation costs and population size).
46. There may also be a case for considering access limitations and the impact this has on costs. Given Tasmania's island status, it does not have the option of importing goods by road or rail, which in other circumstances may be cheaper and more efficient methods of moving certain goods than sea or air transport.
47. Given this, it may be possible to empirically establish a simple conceptual framework to measure isolation costs. It will be necessary to specify and test a relationship between the underlying costs of isolation and these broad indicators.
48. In Tasmania's view, the use of a broad indicator (or set of broad indicators) to measure isolation costs would be a major step forward to simplifying the current assessment. The current data limitations, acknowledged by Dr McHugh in his 2005 report to Heads of Treasuries would also be overcome through the use of an appropriate broad indicator or indicators. Dr McHugh expressed concern with the current isolation assessment in terms of its heavy reliance on state data that could not be independently verified and could be subject to only limited interstate scrutiny.

Dispersion

Conceptual Case for Dispersion

49. A priori, Tasmania considers the conceptual case for dispersion-related disabilities is already established. There is a sound basis in logic, which is well-supported empirically, that, other things being equal, it costs more to provide government services to a dispersed population than to a compact urban one.
50. Technology impacts were examined for the 2004 Review, and the Commission concluded at that time *"that the effects of technology on the Dispersion assessment were not large, consistent with the view that the growing use of technology had many effects which moved in different directions... Technology would not have a large effect on state grant distribution until it had a substantial effect on labour-related costs such as locality allowances and other on-costs associated with staffing remote regions."*⁴
51. Overall, the assessed net distribution effect of technology on dispersion disabilities was small and positive in favour of the most dispersed states (some \$12 million).

⁴ Refer 2004 Review Working Papers, Volume 7, page 258, paragraphs 25 and 26

52. Substantial technology-driven labour-related cost impacts are unlikely to have been realised in the intervening period. Relative to the breadth of issues already confronting the Commission and the states for the 2010 Review, Tasmania views explicitly revisiting the technology impacts as of second-order significance (ie. likely to be immaterial). At a practical level, the technology cost impacts are already imbedded in the underlying cost data.

Reliability of Dispersion Data

53. The current assessment approach is detailed, complex, involves a large number of different bits of data, a lot of judgements and many moving parts. During the 2004 Review, a number of measures/adjustments and/or data inputs were disputed by one or more states. It was also argued that there were serious limitations to the capacity to improve existing data based on administrative data which is not readily collected or consistently recorded in many instances, and that is problematic to standardise across states.
54. In this context, if a Dispersion disability is to continue to be assessed, Tasmania's preference is for a broader dispersion indicator if one can be appropriately established.

Broad Indicator

55. A broader-based dispersion indicator is really a subset of the suggested broader based measure for intrastate price or cost level effects to cover the existing Dispersion, Service Delivery Scale and Urban Influences disabilities. Again, the key will be the capacity to get robust cost centre data to use with whichever broad locational measure is adopted (distance, density, SARIA regional centres, etc). Most of the same caveats apply and the general approach to measurement will need to be similar (that is, the key issue is clarifying cost data available through the states and the process of extracting and testing this data within the timeframes available for the 2010 Review).
56. In terms of the specific locational measures canvassed in paragraphs 65-77 of the Discussion Paper, Tasmania does not favour a LGA-based measure. LGA areas are too variable, subject to policy influence and unlikely to reflect service delivery relationships relevant to state governments. An LGA-based measure is notionally less detailed but is unlikely, in reality, to reduce complexity.
57. In general, the density and distance variants canvassed in the Discussion Paper under this dispersion heading seem to be relatively simplistic and/or arbitrary measures, while the cost relationships examined confuse dispersion, urban influences and service delivery scale effects. In terms of purely dispersion effects, of the measures proposed, Tasmania considers remoteness measures, based on SARIA, to be used in tandem with broad-based measures of labour and administrative cost variations, merit further investigation.
58. If this approach fails, the fall back approach is simplification of the 2004 Review Dispersion method via reductions in moving parts. While Tasmania is supportive

of this as a viable fall-back option, Tasmania has no specific suggestions to offer as to the best way to progress this.

Urban Influences

Conceptual Case for Urban Influences

59. Tasmania believes that the conceptual case for an urban influences disability, as currently assessed, is lacking. This is relevant to the 2010 Review since, as the Discussion Paper notes, the conceptual case for recognising urban influences will need to be re-established.
60. Several observers, including Tasmania, other states, and McHugh and Pincus, have previously questioned the quality and suitability of the data that is used for demonstrating and measuring urban influences. For example, in his 2005 report to HoTs, McHugh wrote that the string of assumptions underpinning the assessment of urban influences in the roads category 'represent a quite tenuous chain of logic'. This is noteworthy because the roads category is one of few based on supporting data.
61. A major flaw previously identified by Tasmania and other states is that the current approach does not fully disentangle socio-demographic and other disabilities from urban influences. The Commission has been careful in attempting to separate these influences in the 2004 Review methodology. However, the potential for some double counting remains. Furthermore, it is questionable whether many 'urban costs' are confined to urban areas.
62. The many other criticisms of the urban influences factor are well documented in 2004 Review papers and associated state submissions. The point is that, unlike most other disabilities, the case for urban influences has never been fully confirmed empirically, so it will not be adequate to take their existence as a given into the 2010 Review just because the CGC currently recognises them.
63. Therefore, the critical task in establishing the conceptual case for urban influences will be obtaining suitable supporting data.
64. Tasmania does not doubt that highly urbanised cities face unique costs in the delivery of certain services. However, this does not necessarily translate into higher *per capita* costs. Large cities, by the nature of their density, enjoy economies of scale in the delivery of services, the provision of infrastructure, and the maintenance and rehabilitation of that infrastructure. In most cases, this is likely to more than offset any extra costs arising from complexity. It is for this reason that Tasmania considers much of the anecdotal data provided in support of urban influences, which usually relates to absolute costs of performing a particular function, to be fundamentally flawed.
65. New South Wales has claimed that it also incurs additional costs as Sydney is a 'global city' and international gateway. Tasmania notes that, despite the large volume of research on this issue, the definition of a global city, and whether any Australian cities meet such a definition, is inconclusive. Phillip Hagan's paper *Urban Influences Reconsidered* examined this question in some detail and also

found mixed results in the research literature. While Sydney is certainly a major transit point for persons and freight travelling to and from Australia, this is also true of several other Australian cities.

66. Moreover, Tasmania questions whether any additional costs that might conceivably arise from global city/gateway status are necessarily borne by states. It is likely that many services are actually provided by the private sector or the Commonwealth Government. Most freight services, for example, are provided by the private sector, are user funded and, if anything, provide an economic boon to the 'gateway' city. Nevertheless, the more relevant issue for the CGC is whether data are available to measure any supposed global city disability. Given that it is difficult to ascertain whether any Australian cities meet global status, obtaining robust data is likely to be problematic.

Simplification of the Existing Urban Influences Assessment

Broad indicators

67. In the event that a single broad indicator or group of broad indicators cannot fully capture the material interstate differences in location based effects, it may be necessary to revert to a simplified version of the existing urban influences assessment. **Tasmania offers the following comments based on the assumption that the conceptual case for this disability is sufficiently made for the 2010 Review.**
68. Use of a broad indicator may not apply to urban influences as readily as to other disabilities. This is because, as the Commission concluded during the 2004 Review, there is no generic relationship between city size and diseconomies of scale.
69. Generally, because the urban influences effect is not universal across categories, attempts to model it are unhelpful and controversial. Most models are also likely to be problematic because they rely on arbitrary judgements of an optimal city population size and the slope of the supposed U-curve. That is, they assume an optimal city size and unsurprisingly find diseconomies of scale in any city that exceeds this. Models will only be useful as an indicator once hard data can be produced with which to compare them.
70. The Discussion Paper effectively dismisses Phillip Hagan's proposed urban effects model, as does Hagan himself, on the grounds that it does not improve simplicity and is no less data-intensive than any other method. Tasmania agrees that the model would not be useful for assessing urban influences.
71. The Paper suggests an alternative approach, involving a comparison between actual state expenses and assessed expenses (excluding urban influences). Tasmania understands that, under this approach, the CGC would test a number of possible indicators (such as city size, density, etc) for their explanatory power against the assessed and actual 'gap'. One problem with this approach is that actual expenditure undertaken by states is partly a matter of policy choice, so this is not a neutral measure. There may be a correlation between, for example, actual police expenditure and city size, but this might reflect the greater or lesser

preferences of urban residents for a police presence rather than an urban influences effect. Tasmania does not support this approach unless all other avenues are exhausted and it can be demonstrated that policy influences are not ‘contaminating’ the result.

72. The other approach suggested in paragraph 88 of the Discussion Paper, comparing the costs of selected services between different sized cities within a state, has more conceptual merit, though it would be highly data intensive to implement. One advantage in comparing cities in the same state is that the Commission can partially control for state policy. Ideally, when comparing costs for a category such as police, the two test cities should also have very similar SDC characteristics to control for these factors.
73. If the Commission decides to pursue the comparisons suggested in paragraph 88 of the Discussion Paper, it will be crucial that data is collected for several states to confirm that any trends are common across states and not just an anomaly and/or a result of intrastate policy decisions. The data collected will also need to be of sound quality and comparable between jurisdictions.

Separate Assessments Across Categories

74. Currently, urban influences are measured differently for different categories. Tasmania considers that urban influences are effectively a collection of separate disabilities with a common theme but which do not “aggregate up”. For example, *population density* might partially drive road maintenance costs, while *city size* might partially drive urban transit capital costs. While city size and population density are often closely correlated, this is not necessarily always the case.
75. If the empirical evidence confirms that the effect is not generic across categories, the Commission may need to assess each sub-disability separately according to the category in question – that is, it will effectively need to disaggregate urban influences. Since Tasmania has little confidence in the current measurement and theoretical basis for urban influences, it does not support the retention of the existing methodology without robust data for each affected category. However, given that the Commission will only proceed to this level of disaggregation subject to the availability of such data, this should not be an issue.

Other Locational Disabilities

76. The paper infers that the Commission is reasonably satisfied with the robustness of the existing Input Costs and Service Delivery Scale assessments, and so they are not so specifically targeted for simplification/revision under the fall-back “simplification of existing assessments” approach.

Input Costs

77. Tasmania does not accept that the current Wages Input Cost assessment is appropriate for retention under a fall-back scenario. Tasmania remains of the view that the purported wages input cost relativities as currently measured do not reflect differences in public sector wages paid to public servants of comparable productivity in different states. In the context of paragraphs 31-33 of the

Discussion Paper, the “explanation” contained in paragraph 32 serves to highlight some of the unanswered fundamental inconsistencies around these purported location-based wage effects (large urban area is used to explain Victoria’s close to average outcome and New South Wales above average outcome; remoteness effects which may result in increased costs of living and wages are used to explain both Western Australia’s below average outcome and Northern Territory’s above average outcome).

78. Tasmania also disputes the statement that “the method is broadly accepted”. The current method is complex and inaccessible. It cannot be readily understood, let alone critiqued by anyone other than an econometric expert. The concerns raised by Pincus are also noted. This does not add to either transparency or confidence in the outcomes generated. More fundamentally, Tasmania does not accept that private sector wages are a good proxy for public sector wages. Related to this, Tasmania considers that the conceptual case for assessment remains flawed.
79. These concerns will be followed up in subsequent submissions.

Service Delivery Scale

80. Conceptually, the Service Delivery Scale assessment is based on the need to provide core services under average policies to population centres with catchment populations below a minimum efficient scale. The conceptual case is well-supported empirically where it is currently assessed (provision of schools and police services in rural and remote locations).
81. Tasmania accepts the computational approach to estimating service delivery scale disabilities is robust, but could also be reviewed as to simplification/reduced moving parts.
82. A priori, Tasmania does not see that there are obvious synergies between the two scale assessments (administrative scale and service delivery scale) as they are effectively measuring different concepts.

Economic and Physical Environment Disabilities

83. A priori, Tasmania considers that the economic and physical environment factors should be treated as a separate exercise to the grouping of “locational disabilities” as suggested in the Discussion Paper. Arguably, if a loose enough definition is adopted virtually all disabilities could be termed “locational”. The economic and physical environment factors as currently assessed are functionally specific, idiosyncratic factors. Trying to incorporate them within the locational disabilities exercise is unlikely to aid simplification.

USE OF EXTERNAL EXPERTISE

84. As a general caveat, Tasmania considers the use of external experts needs to be managed judiciously and, preferably, in consultation with the states. Past use of consultants as ‘experts’ has had mixed results and, in many instances, has only led to further controversy by pitting one ‘experts’ view against another’s.

85. Tasmania is not opposed to the use of economic geographers/demographers or other “experts” to assist the Commission to develop a spatially-based location cost indicator/set of indicators provided this is done within an appropriate framework. The Commission needs to retain “ownership” of the process and product produced. The process and outcome need to be broadly credible with the states, which necessarily entails being accessible. Both the HFE and simplification objectives of the 2010 Review terms of reference need to be respected.
86. As a sanity check, Tasmania would also seek to ensure that any outcome is broadly credible with those in state-based agencies who are at the ‘coalface’ of delivering the services that the Commission assesses.
87. Subject to these caveats, Tasmania is comfortable with the proposed use of external experts to assist with the process of creating more aggregated locational disability measures. However, at this point in time, Tasmania has no specific “names” to suggest.