March 2024

CM REF: D24/14677

Victorian response to CGC 2025 Review consultation

Tranche 2 assessment papers

Treasury and Finance

OFFICIAL

The Secretary
Department of Treasury and Finance
1 Treasury Place
Melbourne Victoria 3002
Australia
Telephone: +61 3 9651 5111
dtf.vic.gov.au

Authorised by the Victorian Government
1 Treasury Place, Melbourne, 3002

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1. Introduction

In November 2023, states were provided consultation papers for the second tranche of the Commonwealth Grants Commission's (CGC) assessment topics for the ongoing 2025 review. This response provides Victoria's views on the questions raised by the CGC, as well as other proposals to improve the GST distribution. Victoria thanks the CGC and its staff for continued collaboration through the review process.

Victoria reiterates its preference expressed in its tranche 1 response for simple, readily explainable assessments that are supported by robust evidence. In some of the assessment categories considered in tranche 2, Victoria's view is that these aims are not met. Victoria provides detailed comments to assist achieving these aims in the response below.

2. Summary of Victoria's recommendations

The case for method changes between reviews	
	• Agree there are situations when the CGC should consider alternative methods between review periods. • Agree to the proposed circumstances where flexibility to change methods between reviews however request the wording be amended to include "major policy reforms" as another trigger for flexibility. • Agree any changes to methods should be made in consultation with states using the normal practice for method change proposals. • Suggest that flexibility be established as a condition of the 2025 Review methodology and that there should be a mechanism to monitor implementation and allow for review if required.

Revenue	
Payroll tax	• Support assessing payroll tax surcharges on the same basis as payroll tax. • Support retaining the existing assessment method and data sources, but further exploration of BLADE and PLIDA data is not necessary until underlying limitations of the datasets are addressed. • Support including scope in the assessment method to move to BLADE and PLIDA data in the future, but to be considered in a future methodology review in consultation with states.
Gambling tax	• Agree that there is currently no reliable method of differentially assessing gambling taxes and that they should be assessed EPC in the other revenue category.
Other revenue	• Support the CGC's classification of revenues in the other revenue category, assessed EPC.

Expenses	
Welfare	• Support the simplification of the data collection method if comparative analysis is conducted to confirm it is consistent with state provided data. • Agree that the NDIS assessment is fit for purpose. • Do not support the development of a homelessness services assessment. • If a homelessness services assessment is developed, suggest it should be in the housing assessment. • Suggest RoGS homelessness data is more appropriate than GFS data. • Do not support the proposed drivers to assess homelessness spending. • Support the simplification of the assessment methods, combining other welfare, non-NDIS aged care and the national redress scheme. • Support the CGC ceasing to collect state spending on the National Redress Scheme. • Recommend the CGC accept the case and account for expenditure on multicultural homelessness services and language services, based on CALD populations.
Roads	• Support retaining the 2020 review method of assessing urban road length using population as the driver for large towns. • Agree that the 2020 synthetic rural road network should not be updated, but the CGC should plan to update it at the subsequent review, should an alternative not be found by then. • Agree that traffic volume, and consequently heavy vehicle use continue to be assessed using data from the BITRE and the NTC. A medium discount of 25 per cent should be applied due to the decrease in reliability of traffic volume data from the discontinuation of the SMVU.
Services to industry	• Assess states' COVID-19 business support expenditures APC based on payments under both national partnerships and programs with non-assessable non-exempt (NANE) treatment and separately assess states' COVID-19 business support expenditures as impact. • Retroactively adjust the COVID-19 business support expenditures for 2021-22. • Support replacing total factor income with the chain volume measure of industry value-add as a measure of industry size, but request CGC provide further information on impacts of different options for the choice of base year. • Agree that the number of businesses should be reincluded as a driver in the assessment. • Recommend the CGC provide states a draft data request for comment once it has determined a specific method for assessing net-zero expenditures. • Consider that identifying and providing data on potential drivers of state spending on the net-zero transition would require further work beyond the scope of the 2025 review.

	• Agree that spending on the net-zero transition will continue to increase and, if it can feasibly be separately assessed, will warrant a separate assessment outside of the business development assessment.
Housing	• Agree that the housing assessment remains mostly fit for purpose but suggest that it should include housing affordability and CALD drivers. • Do not agree that there should be a separate assessment of community and public housing as the drivers appear to be the same. • Recommend the CGC explore introducing a separate assessment of affordable housing as part of the 2025 review. • Do not consider long-term health conditions are a suitable proxy for households that have high service needs. • Do not support an assessment of disability as a driver of need for housing based on the ABS Census data on households with members with long-term health conditions. • Recommend the CGC does not adjust the ABS Census data to impact or adjust for ‘not stated’ and ‘not applicable’ responses for the housing assessment. • Recommend assessment be discounted by at least 12.5 per cent to acknowledge issues with cost weightings derived from state provided data. • Recommend the general cost gradient is not applied to the housing assessment. Recommend a discount of at least 25 per cent continues to be applied, if the CGC judges it should be applied. • Recommend that a CALD driver is included for the housing assessment to reflect the higher rate of access to social housing and the additional service costs. • Recommend a housing affordability driver is included in the housing assessment. This should be based on low-income households spending more than 30 per cent of income on rent and account for the additional burden in urban areas.
Other expenses	• Agree with the expenses classified in the other expenses category. • Support continuing to assess other expenses EPC.
Natural disaster relief	• Recommend the assessments of natural disaster relief and mitigation are considered together to account for their complex interrelationships. Request the CGC provide analysis of how these assessments interact if it proposes a separate differential assessment of natural disaster mitigation for the draft report. • Recommend that, if a policy neutral driver cannot be identified, natural disaster relief expenditures are assessed EPC as the policy influence makes an APC treatment inappropriate. • Recommend local government expenses are removed from assessed natural disaster relief expenses.
National capital	• Support the CGC’s view to discontinue the national capital assessment from the calculation of GST relativities if the assessment is immaterial.

Other	
Investment	• Do not support the proposal to smooth user population growth because implementation would overweight the assessment towards a period of historical volatility. • Do not support the proposal to freeze the component shares of the total stock of assets for the life of the 2025 review.
Net borrowing	• Agree that the conceptual basis for the net borrowing assessment remains unchanged.
Geography	• Broadly support the CGC's approach to estimating regional costs and service delivery scale effects. • Recommend the general cost gradient is not applied unless supporting evidence is provided for regional costs in the specific assessment components or be discounted by 50 per cent for all assessments it is applied to. • Assess the potential for double counting of Indigenous, income, remote and regional costs in the housing and welfare assessments. • Victoria does not support the conceptual case for adjusting for differences in non-wage costs between major cities and is not aware of any data sources that would support it.
Administrative scale	• Do not support the continuation of the administrative scale assessment in its current form. Recommend the CGC re-calculate the administrative scale assessment for the 2025 review, reducing the scope to focus on the minimum cost of state government services. • Request for the draft report the CGC examine a potential additional congestion cost disability, to account for evidence of decreasing returns to scale for state services.
Adjusted budget	• Support the CGC's preliminary view to replace the use of state Government Finance Statistics (GFS) state data for year 3 with preliminary ABS GFS data and to continue to use final ABS GFS data for prior years. • Support the continued use of ABS GFS data for the first 4 assessment years. • Request the CGC: ○ discuss in the draft report how it will address potential late requests for state data, if the ABS is not able to provide data on time ○ provide states information on what adjustments the ABS makes to its data before providing it to the CGC for its updates and consult on any significant adjustments as it currently does when ABS data replace state provided data • Support the proposed process for implementing adjustments. Request CGC provide clarity around how it will consult with all states on adjustments.

3. The case for method changes between reviews

Victoria strongly supports the case for the CGC to have flexibility in its methods between reviews. Appropriate management of such flexibility is necessary to ensure that it is accessed judiciously and for extraordinary circumstances, where it is evident that no adjustment would significantly detract from the achievement of horizontal fiscal equalisation (HFE).

The treatment of COVID-19 related expenditures is a clear example of how the current process limits the achievement of equalisation. The COVID-19 pandemic was a once in a century disruption to states' economies and health systems, with significant impacts on budgets and service delivery. States' responses to the unique and varying circumstances presented by the pandemic required changes to the CGC's methods, as the CGC has stated, which were unable to be made due to the current inflexibility.

As a result, the relativities from the 2021, 2022 and 2023 updates could not achieve equalisation. Significant spending was allocated according to drivers that the CGC agreed were not appropriate. As noted in Victoria's tranche 1 response, $10.6 billion was spent on COVID-19 related health measures alone over 2019-20 to 2021-22. The CGC's *2023 Update: New Issues consultation paper* estimated the potential redistribution from using inappropriate drivers as $725 million compared to an equal per capita (EPC) assessment for health and $885 million for business support for Victoria, NSW and the ACT in 2023-24 alone. Due to this experience, Victoria strongly supports development of an agreed process to manage future shocks and ensure that misallocation of funding of this magnitude does not occur again.

This is discussed in further detail in Victoria's tranche 1 response on the health assessment and in this response on the business support assessment in section 5.3.1.

Victoria also agrees the NSW 2021 tax reform proposal provides a useful example of circumstances that could justify application of flexibility between reviews. Jurisdictions are continually assessing their taxation arrangements to identify areas where efficiency and efficacy can be improved. In some instances, the GST distribution can pose high transitional costs, exerting a perverse incentive for jurisdictions not to proceed with the proposed reform. As such, Victoria suggests the potential for future significant tax reforms between reviews is another example where consideration of additional flexibility between reviews is warranted. The current arrangements may present barriers for efficient reform, as Victoria noted in its tranche 1 response on land transfer duty and land tax.

3.1 When to allow flexibility

Victoria acknowledges there are potential risks allowing the methods to change more frequently. There is value in stability and predictability of GST revenues for budget planning. Additional flexibility should not detract from this. However, in the case of the examples provided in the consultation paper, Victoria considers the loss of HFE and policy influence outweigh concerns around predictability.

It is also the case that the GST distribution varies between update years because of the incorporation of new data reflecting changes in circumstances. It is unclear that greater flexibility would increase volatility materially above changes that currently occur, for example from the introduction of significant data revisions from the 2021 Census. A transparent process in consultation with states to manage any changes made with greater flexibility may also assist to mitigate any volatility and support states to anticipate changes to the GST distribution.

Noting there is a trade-off between flexibility and predictability, it will be important for the CGC to recommend appropriate guardrails and parameters around any scope for changes. Victoria suggests the following concepts to assist in setting these parameters:

- Capturing the concept of ‘significant’ changes or materiality to limit when method changes can occur, to balance flexibility and volatility
- Taking into account when there are significant effects on incentives to progress policy reform
- Providing the CGC flexibility to address future unknown changes that cannot be defined in advance, not unduly constraining when changes to methods may be used.

Victoria supports the scenarios and circumstances listed in the consultation paper as triggers for flexibility including:

- When there is a significant and material effect on the GST distribution
- When the existing methods do not appropriately capture states need for spending or revenue raising capacities
- For major external shocks, including economic shocks, natural disasters, pandemics or others that are not captured in the existing methods
- Where there are major policy changes not captured in the current assessments, to remove potential policy influence
- To provide states certainty when implementing policy.

Victoria broadly supports the CGC’s proposed circumstances to extend flexibility where:

> *“major unexpected developments that have a significant impact on state fiscal positions, are not captured in existing assessment methods, and a change in methods is required for the Commission to achieve the objective of fiscal equalisation”.*

Victoria supports this broad approach that does not prescribe set conditions or pre-defined materiality thresholds.

However, Victoria considers the proposed circumstances do not adequately allow for changes in response to policy reforms, by limiting changes in response to ‘unexpected’ developments. This particularly limits achievement of the CGC’s stated aim in the consultation paper to provide certainty when implementing policy changes.

The terms of reference (ToR) for the review also direct that the CGC examine flexibility in response to policy reforms being implemented by states:

> *“where there is a significant unanticipated shock (such as a pandemic) or* ***where major policy reforms*** *are enacted in between reviews.”*

These would not be covered under the current proposed circumstances, which are limited to ‘unexpected developments.’ Major policy reforms are developed over time and ideally in consultation with the CGC to assess any implications for GST revenue. The CGC should revise the wording to allow for major policy reforms to trigger its flexibility. Specific wording must be introduced to allow for changes due to policy reforms, for example:

> *“major* ***policy reforms or*** *unexpected developments that have a significant impact on state fiscal positions, are not captured in existing assessment methods, and a change in methods is required for the Commission to achieve the objective of fiscal equalisation”.*

3.2 Mechanism for flexibility

Victoria broadly supports flexibility operationalised through standing ToR for updates. Victoria interprets the CGC's proposal to be that, in issuing ToR for each annual update, the Commonwealth Treasurer would include set language allowing for flexibility under certain circumstances, similar to the allowance for significant changes to Commonwealth-state relations.

While Victoria acknowledges this would provide impetus to allowing flexibility, Victoria requests the CGC consider whether there are options that may provide greater certainty. More generally, Victoria considers there could be broader improvements to the governance around the CGC's processes, including providing more certainty around the current ad hoc system of issuing annual ToR for updates and reviews.

In addition, the proposal does not incorporate a mechanism for monitoring how well a new flexibility arrangement is working in practice and to allow for future adjustments to fine-tune.

As an alternative to resolve these issues, the CGC should explore whether the 2025 review could action flexibility independently of separate ToR. ToR from the Commonwealth Treasurer typically already include a direction to follow the methods set in the previous review, which have in the past incorporated some degree of flexibility around the CGC's methods.

For example, the 2020 review methods provided the CGC some flexibility to update its methods for the mining assessment to respond to changes in the materiality of separate minerals in updates between reviews. These method changes were able to be implemented through the ToR for individual updates that directed the CGC to follow the 2020 review methods. Victoria suggests that instead of separate wording in ToR, the 2025 review could establish the conditions for flexible method changes, which would then be allowed through the standard direction in ToR to use the 2025 review methods in future updates.

If flexibility were implemented through the direction to use the 2025 review methods, a future review of the arrangements would be inbuilt as part of the 2030 review. It is unclear how a standing direction under the ToR would be reviewed in future. Victoria suggests the CGC ensure any chosen flexibility mechanism be included as part of future reviews. A set review may also provide confidence to jurisdictions that may have more significant concerns with the scope of implementation.

3.3 Managing the process for changes

Victoria considers the CGC should address practical issues with implementation not discussed in the consultation paper, namely timing. The experience with COVID-19 highlighted the challenges in developing methods in a short time period, although Victoria is confident in the methods the CGC suggested in that case.

Victoria suggests early preparation by the CGC where possible may assist to rectify this. Victoria encourages the CGC to continue to be proactive and identify issues with assessments early, outside of the usual annual update process. Identifying the transition to net zero as part of the 2025 review is an example of this. It would be preferable if this early thinking were able to commence well in advance of a review, to enable states time to consult with delivery agencies and collect data.

To supplement this, the CGC could take a scenario planning approach, identifying key risks and potential responses. Clearly not all future shocks or reforms are able to be anticipated and preparation is unlikely to result in exact methods prepared ahead of time. However, it would be a useful tool for preparedness and may alleviate some time pressures to develop methods between update years. The CGC may consider using its occasional or research papers to circulate the outcomes of such work.

There may also be cases where methods are not able to be developed in time for an update but are available later. The CGC should consider its approach in these cases. One option is for backwards adjustments made in future years. For example, if a method is not developed or agreed for the first update an issue is relevant for, an adjustment in subsequent updates could account for this. This would also allow the CGC to make an initial assessment responding to a shock and revising it after more fulsome consultation or data collection. This should only be considered where the circumstances are significant or persist over a number of years, as was the case with COVID-19.

3.4 Decision making and consultation

Victoria agrees that it will be important for the CGC to actively consult states when determining the case for a particular method change, and what those changes will be.

Victoria suggests the process broadly follows the CGC's deliberations for method changes through reviews, which is an established and understood process. This would include the CGC providing a formal written position to enable states to provide fulsome responses. States should be consulted with sufficient time and detail, and the final decision should rest with the CGC.

CGC consultation questions and Victoria's positions

Q1. Do states agree that there may be situations, such as a significant unanticipated shock or major policy reform, such that there is a case to extend the circumstances when the Commission may need to consider alternative methods between reviews?

- Victoria agrees there are situations when the CGC should consider alternative methods between review periods, as demonstrated by the examples of the COVID-19 pandemic and states' major tax reforms.

Q2. Do states agree that the circumstances supporting the case to extend the Commission's flexibility to change methods between reviews should include: major unexpected developments that have a significant impact on state fiscal positions, are not captured in existing assessment methods, and a change in methods is required for the Commission to achieve the objective of fiscal equalisation?

- Victoria agrees to the circumstances where flexibility to change methods between reviews can include those noted in the discussion paper. However, Victoria requests the wording be amended to include "major policy reforms" as another trigger for flexibility, as the current wording may not meet the goals of the ToR.

Q3. Do states agree that any consideration of whether method changes are warranted between reviews be undertaken in consultation with the states and the expectation should be that this flexibility would only be exercised in very limited circumstances?

- Yes, Victoria agrees any changes to methods should be made in consultation with states using the normal practice for method change proposals.

Q4. Should the extended flexibility to change assessments between reviews in certain circumstances be operationalised in standing terms of reference for updates?

- Victoria considers including a standing clause in annual update ToR may be an adequate mechanism to operationalise flexibility. However, Victoria prefers that flexibility be established as a condition of the 2025 Review methodology. There should also be a mechanism to monitor implementation and allow for review if required.

4. Revenue

4.1 Payroll tax

4.1.1 Potential to use BLADE and PLIDA data in the assessment

Victoria shares the CGC's view that Business Longitudinal Analysis Data Environment (BLADE) data cannot viably be used in the payroll tax assessment in its current format. The incompatibility of BLADE data with the assessment is structural in nature, as business activity statements (BAS) data cannot be appropriately disaggregated by state. In addition, business income tax (BIT) data would only be available for the first assessment year on a permanent basis. This contemporaneity issue would need to be resolved before BLADE data could be considered suitable for the assessment. In Victoria's view, the resolution of these incompatibilities would require further development of the data by the Australian Bureau of Statistics (ABS), rather than adjustments made by the CGC. As a general rule, Victoria supports the CGC implementing new datasets to improve its assessments. However, we question whether continued efforts from the CGC would be able to effectively overcome the underlying limitations of the BLADE data.

In principle, Victoria supports moving the assessment to BLADE and Person Level Integrated Data Asset (PLIDA) data in the future if the structural incompatibilities described above are resolved. Victoria considers that this change would require significant consultation with states should the data become more suitable for the assessment.

CGC consultation questions and Victoria's positions

Q1. Do states support assessing revenue from payroll tax surcharges on the same basis as payroll tax?

- Victoria supports assessing payroll tax surcharges on the same basis as payroll tax.

Q2. Do states support retaining the 2020 Review assessment method and data sources, noting that the Commission will continue to explore the feasibility of an assessment based on data from BLADE and/or PLIDA?

- Victoria supports retaining the existing assessment method and data sources. However, Victoria does not consider further exploration of BLADE and PLIDA data to be necessary until the underlying limitations of the datasets have been addressed.

Q3. Do states support the assessment method including scope for the Commission to move to BLADE and/or PLIDA data in a future update, in consultation with states, if those data would improve the assessment?

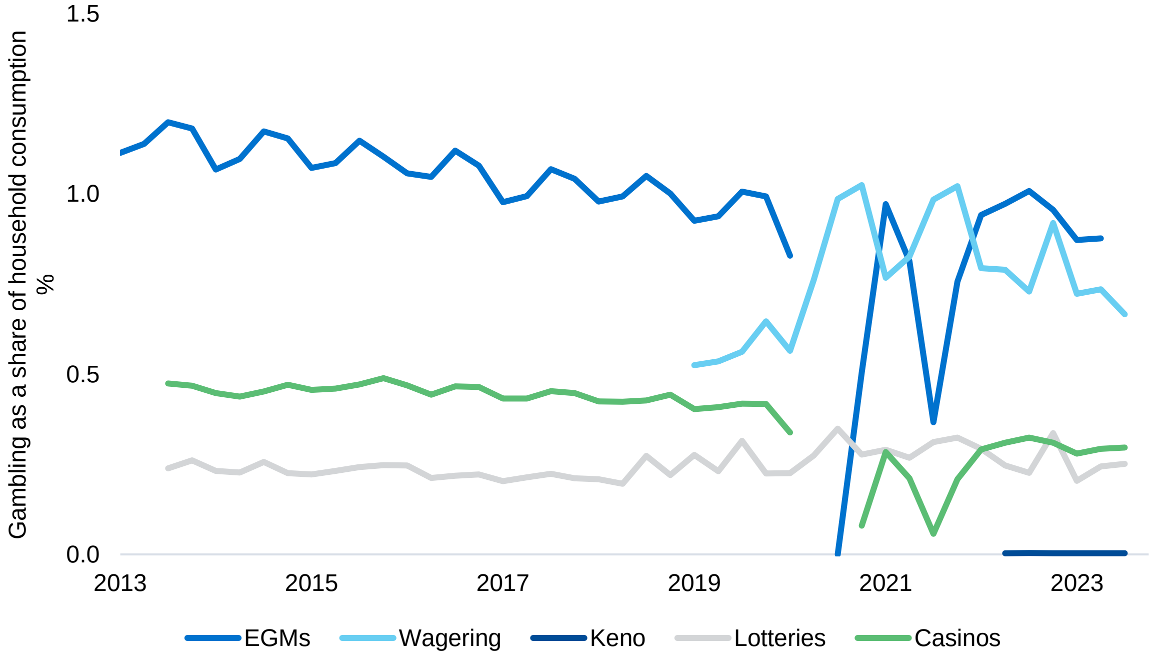
- Victoria supports including scope in the assessment method to move to BLADE and PLIDA data in the future. However, Victoria suggests for this to be considered in a future methodology review in consultation with states.

4.2 Gambling taxation

Victoria agrees that gambling taxes should be assessed equal per capita, as there is no reliable method of otherwise assessing gambling taxes. Victoria supports the CGC's conclusions in the consultation paper that all the proposed options for a differential assessment are not appropriate.

Victoria supports the CGC's conclusion that a broad revenue assessment is not a reliable method of differentially assessing gambling taxes. As noted by the CGC, there is limited evidence of a strongly correlated relationship between household income and gambling consumption. As seen in Figure 1, gambling as a share of household consumption became more volatile following 2020 due to the impacts of COVID-19. The volatility of gambling as a share of consumption suggests that consumption and disposable income are not strongly correlated to gambling activity. Therefore, disposable income is not appropriate as a capacity measure for gambling taxes.

Figure 1: Gambling as a share of household consumption



Source: DTF calculations and state revenue and ABS data

Note: No data available for casinos and EGMs in 2020 due to the COVID-19 pandemic

Victoria also shares the CGC's view that policy differences between states render activity-based approaches to a gambling tax assessment inappropriate. Victoria enforces a statewide gaming machine cap, limiting the maximum number of gaming machines in the state to 30,000. Meanwhile, NSW enforces a gaming machine cap of 99,000. Victoria and NSW also enforce different gaming machine cash input limits of $100 and $500 respectively. As such, the level of gambling activity varies significantly between states due to these policy differences, meaning an activity-based approach to gambling tax assessment would not be a policy neutral measure of states' revenue capacities. Similarly, an actual per capita (APC) assessment of gambling taxes would not be appropriate due to each state restricting gambling activity to varying extents.

Victoria agrees with the CGC's view that a population-based approach to differentially assessing gambling taxes would also not be reliable. Victoria notes that socio-demographic drivers of gambling activity, should they exist, likely vary between different forms of gambling. A study by the Australian Institute of Family Studies using data from the Household, Income and Labour Dynamics in Australia (HILDA) survey revealed that the profile of regular gamblers tends to differ depending on the activity being examined.[1] For example, while lottery participants are overrepresented by elderly couples living without children, sports bettors are more likely to be younger and live in less remote areas. Victoria considers that this complexity and the lack of evidence indicating socio-demographic characteristics as drivers of gambling activity render the development of a population-based assessment unfeasible.

CGC consultation questions and Victoria's positions

Q1. Do states agree there is no reliable method of differentially assessing gambling taxes? If not, what do states consider to be a reliable method of assessing state gambling taxes?

- Victoria agrees that there is currently no reliable method of differentially assessing gambling taxes.

Q2. Do states agree that state gambling taxes should be assessed equal per capita in the other revenue category?

- Victoria agrees that state gambling taxes should be assessed EPC in the other revenue category.

4.3 Other revenue

CGC consultation questions and Victoria's positions

Q1. Do states agree with the revenues classified to the other revenue category?

- Victoria agrees with the CGC's classification of revenues in the other revenue category.

Q2. Do states agree that other revenue should be assessed equal per capita?

- Victoria agrees that other revenue should be assessed EPC.

[1] https://aifs.gov.au/research/research-reports/gambling-activity-australia

5. Expenses

5.1 Welfare

5.1.1 National Disability Insurance Scheme

Victoria agrees with the current approach to assessing National Disability Insurance Scheme (NDIS) contributions. Victoria requests that the CGC undertake a comparative analysis on previous years to ensure that the budget data reporting by the Commonwealth is consistent with previous data collected. Overall, Victoria supports the CGC's efforts to minimise the data request burden on states where more appropriate data sets exist.

CGC consultation questions and Victoria's positions

Q1. Do states agree that the state NDIS contributions can be collected from the Commonwealth Budget papers rather than from the states?

- Victoria supports the proposed simplification of the data collection method if comparative analysis is conducted to confirm it is consistent with state provided data.

Q2. Do states agree that the current NDIS assessment is fit for purpose?

- Victoria agrees that the NDIS assessment is fit for purpose.

5.1.2 Specialist homelessness services assessment

Victoria considers that the assessment of specialist homelessness services (SHS) does not warrant a separate assessment as the proposed assessment does not meet the assessment guidelines.

Nationally, recurrent government expenditure on specialist homelessness services for 2020-21 was $1.2 billion,[2] a relatively small funding amount given the CGC's requirement for materiality. Victoria questions whether a separate assessment of homelessness services would be material or would produce materially different results to continuing to assess these services as part of other welfare.

The homelessness assessment previously included low socioeconomic status (SES) as a driver, however since the 2020 review, it has been assessed on an EPC basis. This decision was made as there is no evidence to support a causal relationship between homelessness and low SES status. Victoria does not consider that the evidence regarding causal drivers of homelessness has developed sufficiently since the 2020 review to warrant a separate assessment.

5.1.2.1 The proposed drivers of spending are not accurate

Homelessness is a complex and multifaceted issue, and various personal and structural factors drive demand for homelessness services. Victoria has the second highest rate of SHS clients according to the Australian Institute of Health and Welfare (AIHW). However, the proposed assessment characteristics (age, Indigenous status, SES and remoteness) would likely result in Victoria's assessed need being significantly lower and not acknowledge a range of other drivers that are critical

[2] Productivity Commission Report on Government Services 2023 Part G, Section 19

in driving spending on SHS. In this regard, Victoria suggests that the proposed drivers do not capture the full conceptual case of this assessment.

Homelessness literature has long argued the ability to causally determine drivers of cost. Various models have been proposed to account for a spectrum of drivers, including housing and labour markets, personal characteristics, Indigenous status, relationships, health etc.[3] Authors debate the prevalence and intersectionality of these drivers highlighting the difficulty to determine causal drivers.[4] Victoria considers that an EPC assessment should be retained in the absence of evidence that can causally prove the drivers of homelessness spending.

The CGC's proposed drivers do not account for important nuances of homelessness spending. The Australian Housing and Urban Research Institute (AHURI) research finds that drivers of homelessness entry and exit are distinct, but both have important cost implications.[5] For example, young people are at high risk of entering homelessness, but face less difficulty transitioning out of homelessness, compared to other high-risk groups. As it currently stands, the proposed assessment does not allow for consideration of these dynamics and associated costs.

AHURI also shows that both structural and personal characteristics can be determinative of homelessness. For some high-risk groups (e.g., individuals with mental health issues), probability of entering homelessness is high regardless of the condition of the housing and labour market. Whereas, for lower-risk groups, challenging housing and labour markets materially increase the risk of homelessness. Family violence and housing stress are the two leading reasons clients access homelessness services (Figure 2), evidencing the importance of both structural and personal factors.

Victoria considers the proposed assessment of homelessness neglects the importance of structural factors driving cost. Victoria considers it prudent that, should homelessness services be assessed separately, it is moved to the housing assessment to capture the clear link between drivers for housing and homelessness. Moving the assessment would allow for important additional drivers to be implemented, for example housing affordability, detailed further in section 5.4.6.

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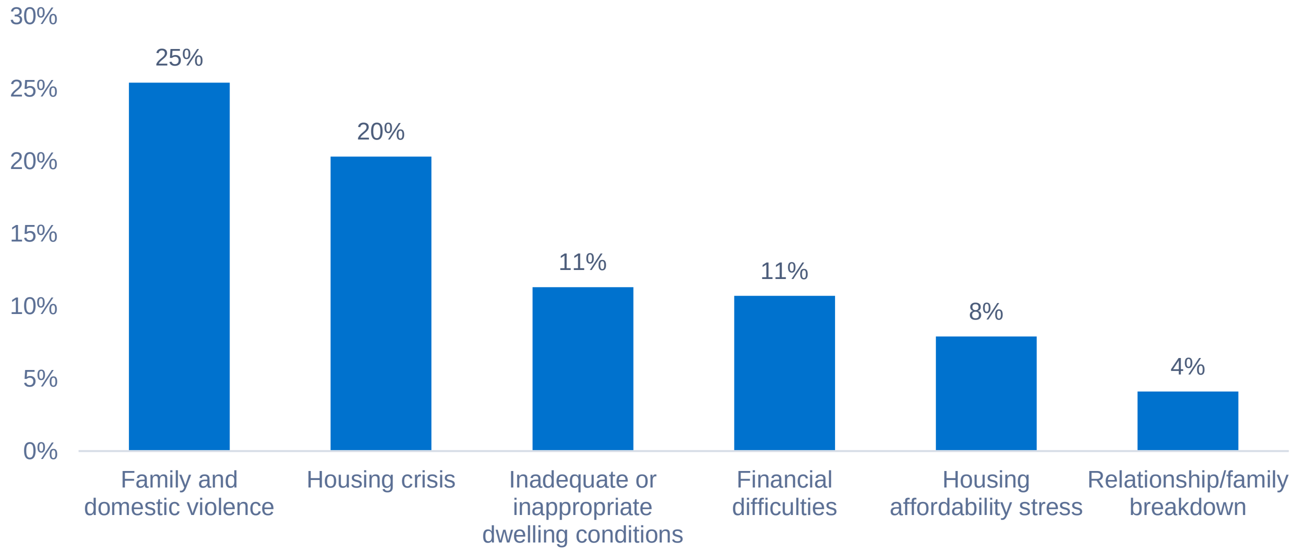
[3] https://www.tandfonline.com/doi/epdf/10.1080/14036096.2017.1408678?needAccess=true
[4] https://www.ahuri.edu.au/sites/default/files/migration/documents/AHURI_Final_Report_No238_The-structural-drivers-of-homelessness-in-Australia-2001-11.pdf
[5] https://www.ahuri.edu.au/sites/default/files/migration/documents/AHURI_Final_Report_No248_Entries-and-exits-from-homelessness.pdf

Figure 2: Main reasons for seeking SHS assistance



Source: Specialist homelessness service annual report 2022-23, AIHW.

There is great difficulty in sourcing data that captures personal determinants accurately with the CGC's suggestion of a mental health driver illustrating this issue. The 2021 ABS Census shows that 9 per cent of Australians have a long-term mental health condition whereas the ABS National Study of Mental Health and Wellbeing finds that 42.9 per cent of Australians experienced a mental disorder in their lifetime, of those 50 per cent had symptoms in the last 12 months, over the period 2020-22.[6] Victoria acknowledges each variable has a different definition but suggests this highlights the difficulty in defining mental health variables and the substantial variability that can occur as a result.

Further, mental health conditions are known to be both a cause and effect of homelessness.[7] The data available does not allow for this reverse causality to be accounted for in the assessment. These issues are pertinent not only for mental health, but other personal characteristics as well, for example substance abuse. As such, Victoria recommends that the EPC approach be retained in the absence of data that can holistically reflect the full set of homelessness drivers.

5.1.2.2 Identifying spending on SHS

As acknowledged by the CGC, it is difficult to fully identify state spending on homelessness services. In Victoria, homelessness services funding falls across a number of portfolios including housing, multicultural affairs, and health.

Difficulty defining homelessness services is one of the reasons collecting data is challenging. Definitions range from narrow, specifically individuals 'sleeping rough', to more fulsome coverage where a range of circumstances are captured, for example, 'couch surfing.' This variation makes it difficult to consistently measure funding.

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[6] https://www.abs.gov.au/media-centre/media-releases/two-five-australians-have-experienced-mental-disorder#:~:text=More%20than%20two%20in%20five,Bureau%20of%20Statistics%20(ABS)
[7] https://www.aihw.gov.au/reports/australias-health/health-of-people-experiencing-homelessness

Given that interjurisdictionally there may differing definitions of homelessness, Victoria suggests it is inappropriate to seek homelessness spending data from the Government Financial Statistics (GFS). GFS data will likely be an inconsistent measure of spending due to differences in how relevant programs are delivered by different government agencies.

The Productivity Commission's annual Report on Government Services (RoGS) is another source of homelessness spending data. While RoGS does not capture all spending on homelessness services, it is reflective of the vast majority. RoGS also has the benefit of clearly defined spending measurement as it is linked to the National Housing and Homelessness Agreement. Victoria considers that RoGS is the most consistent interjurisdictional data available and should be the basis of any national comparison.

Victoria does not agree that homelessness services should be assessed separately but suggests that RoGS is the most appropriate data source when considering interjurisdictional homelessness spending.

CGC consultation questions and Victoria's positions

Q3. Do states support the development of a homelessness services assessment?

- Victoria does not support the development of a separate homelessness services assessment. If homelessness services are assessed separately, Victoria suggests it should be moved to the housing assessment and incorporate housing affordability and CALD drivers.

Q4. Will states be able to identify spending on homelessness services and identify where that spending is reported in the Government Finance Statistics classifications?

- Victoria does not consider the use of GFS reported spending as an appropriate measure for homelessness services. Rather, RoGS is a consistent, interjurisdictional reflection of homelessness service funding.

Q5. Do states support the proposed drivers to assess homelessness spending, noting further work is to be undertaken on mental health conditions as a potential driver?

- Victoria does not support the proposed drivers to assess homelessness spending.

5.1.3 Other welfare and the National Redress Scheme

Victoria considers that simplifying the assessment for the National Redress scheme is appropriate given that its impact is immaterial.

CGC consultation questions and Victoria's positions

Q6. Do states support combining the other welfare, non-NDIS aged care and National Redress Scheme components and assessing spending using the 2020 Review method for other welfare (equal per capita assessment method with regional and wage cost factors)?

- Victoria supports the simplification of the assessment methods combining other welfare, non-NDIS aged care and the national redress scheme into other welfare.

Q7. Do states support the Commission ceasing to collect state spending on the National Redress Scheme?

- Victoria supports the CGC ceasing to collect state spending on the National Redress Scheme.

5.1.4 Culturally and Linguistically Diverse people and welfare services

Victoria has a rich multicultural population, with almost a third of Victorians speaking a language other than English at home.[8]

As discussed in the tranche 1 response, Victoria suggests there is a clear conceptual case that culturally and linguistically diverse (CALD) populations require tailored assistance to access state provided services. Victoria previously provided evidence supporting this in the context of the health assessment, however these issues extend to the welfare assessment as well.

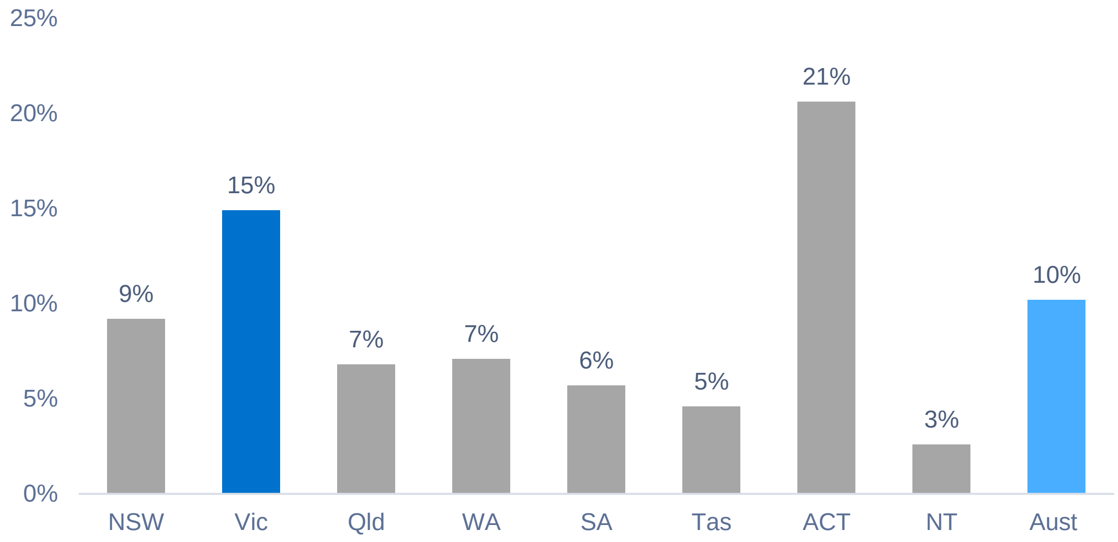
CALD communities have unique demand drivers for homelessness services. For example, CALD communities are found to be less vulnerable to substance abuse, a common homelessness driver for the general population.[9] Rather, Kaleveld et al. suggest CALD demand for homelessness services is driven by difficulties accessing government benefits, employment, and the private rental market due to visa restrictions, language barriers, discrimination and lack of knowledge and capacity to navigate complex systems and services.[10]

These compounding drivers are in some instances also barriers to accessing homelessness services, which require states to provide additional tailored assistance. For example, language barriers push CALD communities towards homelessness, but also make it difficult to access homelessness services. As a result, the state provides additional funding for translation and communications to improve access to homelessness services for CALD communities.

In Victoria, 15 per cent of SHS clients are from non-main English-speaking countries which creates a considerable additional funding burden for the state (see Figure 3). Victoria suggests this burden should be accounted for, either through an aggregate allowance (as done prior to the 2015 review) or, if the assessment of homelessness services is separated, as a driver.

[8] https://content.vic.gov.au/sites/default/files/2023-06/Victorian-Government-report-on-multicultural-affairs-2021-22.pdf
[9] https://www.aihw.gov.au/reports/alcohol/alcohol-tobacco-other-drugs-australia/contents/priority-populations/people-cald-backgrounds
[10] https://apo.org.au/sites/default/files/resource-files/2019-12/apo-nid275996.pdf

Figure 3: Proportion of SHS clients from non-Main English-Speaking Countries, 2022-23



Source: Productivity Commission (PC) Report on Government Services (RoGS)

CGC consultation questions and Victoria's positions

- Victoria recommends the CGC accept the conceptual case and account for expenditures on multicultural homelessness services and language services, based on CALD populations.

5.2 Roads

5.2.1 Road length

Victoria appreciates the CGC's investigation of alternative methods for determining state urban and rural road lengths. However, without information on whether roads are owned and operated by state or local governments, the alternative methods cannot be used.

Victoria therefore supports retaining the 2020 Review methods of assessing urban road length.

Victoria also supports the CGC's proposal not to update the synthetic rural road network for the 2025 review period. However, Victoria recommends the CGC plan an update of the network for the 2030 review, should actual state rural road length data still be unavailable at that time.

CGC consultation questions and Victoria's positions

Q1. Do states support retaining the 2020 Review method of assessing urban road length, using population as the driver for large towns?

- Victoria supports retaining the 2020 review method of assessing urban road length using population as the driver for large towns.

Q2. Do states agree that the 2020 Review synthetic rural road network should not be updated?

- Victoria agrees that the 2020 review synthetic rural road network should not be updated, but the CGC should plan to update it as part of the 2030 review, should an alternative not be found by then.

5.2.2 Traffic Volume and Heavy Vehicle use

The ABS Survey of Motor Vehicle Use (SMVU) was a major source for traffic data but has been discontinued by the ABS. Victoria notes the CGC's comments on the impact of this on Bureau of Infrastructure and Transport Research Economics (BITRE) and National Transport Commission (NTC) data critical to the roads assessment. Victoria notes that BITRE traffic volume data are used in both the traffic volume and heavy vehicle use components.

The CGC consultation paper states that both BITRE and the NTC have noted that the loss of the ABS SMVU may decrease the reliability of traffic volume data in the future. BITRE notes that "estimates for motor vehicle usage are modelled by BITRE, primarily from data compiled by the SMVU."[11] BITRE has also previously stated that "The SMVU is the only reliable time series dataset on urban passenger Vehicle Kilometres Travelled (VKT) in Australia."[12]

Victoria agrees with the CGC's view that alternative data sources such as mass GPS probe data and state traffic count data are not currently suitable for use.

However, given the questionable reliability of the BITRE VKT data as a result of the discontinuation of the SMVU, Victoria recommends a medium discount of 25 per cent be applied to the rural heavy vehicle use, rural traffic volume, urban heavy vehicle use and urban traffic volume assessments.

CGC consultation questions and Victoria's positions

Q3. Do states agree that traffic volume should continue to be assessed using data from the Bureau of Infrastructure and Transport Research Economics and the National Transport Commission?

- Victoria agrees that traffic volume, and consequently heavy vehicle use continue to be assessed using data from the BITRE and the NTC, but a medium discount of 25 per cent should be applied due to the decrease in reliability of traffic volume data from the discontinuation of the SMVU.

5.2.3 Regional costs

5.2.3.1 Quantification of regional costs

As noted in the Geography section, Victoria considers the broad application of the general regional cost gradient, based on schools and health expenditure, to be inappropriate. Although a conceptual

[11] Bureau of Infrastructure and Transport Research Economics – Australian Infrastructure and Transport Statistics Yearbook 2023. https://www.bitre.gov.au/sites/default/files/documents/bitre-yearbook-2023.pdf
[12] Bureau of Transport Economics. Working Paper 38. Forecasting Light Vehicle Traffic. https://www.bitre.gov.au/sites/default/files/wp_038.pdf

case sometimes exists for relatively higher or lower expenditure requirements in different regions, the quantification of those different requirements should be based on appropriate data.

In the 2020 review report, the CGC noted “the Commission considers school and hospital services are delivered in very different ways, and hence have very different regional cost gradients. The Commission considers that the simple average of these two gradients, with a 25 per cent discount, represents an appropriate estimate of the cost gradient for those services where the general gradient is required.”

In the case of roads, in the 2020 review report, the CGC noted “in the absence of category specific regional costs data, this gradient best proxies regional costs relating to road maintenance.”

Victoria agrees that school and hospital services are delivered in very different ways but disagrees that averaging the two produces a suitable proxy for a road maintenance remoteness weighting. Just as school and hospital services are delivered in very different ways, so are justice services and rural road maintenance, and many other service areas.

The most recent regional cost gradient for schools, for 2021-22, included weightings of 1.10 for outer regional and 1.40 for remote and very remote regions. For hospitals, the weightings were 1.07 for remote and 1.14 for very remote areas. Victoria does not agree that using the average of results from two “very different” service types, regardless of the discount, would generate a result that is appropriate to apply to a very different service category like roads.

5.2.3.2 The conceptual case for a remoteness weighting

Victoria considers the conceptual case for a remoteness cost weighting for roads is also weak, particularly since rural and urban roads are already separately assessed. The distinction between urban and rural roads already accounts for the geographical differences in expenditure needs for roads. This is evidenced by the use of this distinction by state grants commissions for local governments and the NTC for their recommendations and analysis, rather than remoteness.

For example, the Tasmanian State Grant Commission includes an Urbanisation Allowance in its Road Preservation model “as recognition that urban roads in the central business districts of councils are significantly more complex, engineered to a much higher standard and have shorter life spans than the standard road profile, and the asset preservation costs are accordingly materially greater.”[13] Similarly, the Western Australian Local Government Grants Commission notes that “roads in built up areas generate greater expenditure needs than roads outside built up areas, because of higher traffic, large numbers of intersections and the need for expensive treatments such as kerbing and longitudinal drainage.”[14] The Victorian Local Government Grants Commission includes a remoteness cost adjustor for allocating general purpose grants to Victorian councils but not for local roads grants, which instead includes cost modifiers for freight loading, climate, materials among others.[15]

If remoteness was a material driver of costs, then it would also likely be included in the NTC cost allocation matrix that informs the roads assessment, instead of or in addition to the current geographic drivers considered. In determining road maintenance cost drivers, the NTC considers geography,

[13] Road Preservation Model methodology review: changing the underlying basis of the RPM. Discussion paper DP22-02. Tasmanian Government. https://www.treasury.tas.gov.au/Documents/Discussion%20Paper%20DP22-02-%20Road%20Preservation%20Model%20Review.pdf
[14] The Asset Preservation Model. https://www.dlgsc.wa.gov.au/docs/default-source/local-government/financial-assistance-grants/walggc---asset-preservation-model---september-2022.pdf?sfvrsn=e573d811_2.
[15] Annual Allocation Report 2022-23. https://www.localgovernment.vic.gov.au/__data/assets/pdf_file/0030/189570/2022-23-VLGGC-ANNUAL-ALLOCATION-REPORT-Sept-2022.pdf

including climate, topography, and the urban vs rural distinction. For example, the NTC notes that "dryer areas (SA and WA) have cheaper construction costs than wetter areas (NSW and Victoria)".[16] The NTC does not include 'remoteness' as a driver of cost.

Victoria considers that the separation of urban and rural components accounts for the main geographical differences in road maintenance costs. Should the CGC wish to include a wider range of geographical drivers it could consider those noted by the NTC such as climate or topography, if data are available to support assessments, rather than remoteness. The fact that a remoteness driver can be quantified in other assessments is not sufficient basis for applying it to the roads assessment.

Victoria therefore considers that the general regional cost gradient should not be applied to the roads assessment.

5.3 Services to Industry

5.3.1 Treatment of COVID-19 business support expenditure

Victoria reiterates its position that the drivers of spending on business support responding to COVID-19 are not adequately captured by an EPC assessment.

As noted in its response to tranche 1 consultation, Victoria continues to support the CGC's conclusions regarding this issue from its 2022 and 2023 updates. However, it does not agree that there are no ongoing implications for the assessment. As discussed in Victoria's response to the tranche 1 consultation in relation to health, this issue still needs to be addressed in the 2025 review as the GST relativities for 2025-26 will incorporate 2021-22 data. This is important as 2021-22 was the most significant year of Victoria's COVID-19 spending.

As such, Victoria recommends the CGC implement Victoria's suggestions from its response to the 2023 New Issues Discussion Paper for the treatment of COVID-19 related business support expenditure:

- An APC assessment of states' COVID-19 business support expenditures based on a combination of payments under both national partnerships and programs with non-assessable non-exempt (NANE) treatment, including similar or precursor programs that were implemented in 2019-20 and 2020-21
- If states' COVID-19 business support expenditures are separately assessed, then the revenue from the Commonwealth under the national partnerships should be assessed as impact
- A retrospective adjustment to the COVID-19 business support expenditures for 2021-22.

While necessary, only resolving this issue through the 2025 review means the vast majority of Victoria's business support spending will have been misattributed through the CGC's methods. Victoria spent $13.9 billion from 2019-20 to 2021-22 through the former Department of Jobs Precincts and Regions on COVID-19 related response and recovery. Even with a method change in the 2025

[16] Productivity Commission Inquiry into road and rail freight infrastructure pricing: National Transport Commission supplementary submission – Classification of the Road Network for Cost Allocation Purposes. September 2006. https://www.pc.gov.au/inquiries/completed/road-rail-freight/submissions/national_transport_commission4/sub076.pdf

review, the significant expenditures from 2019-20 and 2020-21 will never be assessed accurately and 2021-22 will only be assessed accurately one out of three assessment years.

5.3.2 Chain volume measure of industry value-add

Victoria supports replacing total factor income measure sourced from ABS national accounts data with the chain volume measure of industry value-add as a measure of industry size.

Total factor income is compiled by industry and made up of the compensation of employees, gross operating surplus and gross mixed income. Gross operating surplus and gross mixed income depend on the economic position of the industry. As such, total factor income is prone to volatility when commodity prices fluctuate. Since 2020, agricultural and mining commodity prices have increased significantly, inflating the assessed size of the mining and agriculture industries in certain states. As price changes should not impact industry regulation costs, Victoria considers it reasonable to replace total factor income with a measure that is less susceptible to changes in commodity prices.

Victoria requests that the CGC provide additional information on the merits and limitations of using an average of multiple years or single year as a base period. Based on the available information, Victoria is unable to assess whether the two methods would differ in materiality, variability and ease of implementation. Victoria's initial view is that the two methods would not yield materially different results. However, using an average of multiple years may be more appropriate given the nuances and complexities in identifying business-as-usual conditions for a singular base year. Nevertheless, Victoria considers that further analysis into the three factors outlined above would be needed for it to provide an informed response.

CGC consultation questions and Victoria's positions

Q1. Do states support replacing total factor income as measure of industry size with the chain volume measure of industry value-add to assess the need for spending on industry regulation?

- Conceptually, Victoria supports replacing total factor income with the chain volume measure of industry value-add as a measure of industry size.

Q2. Do states support the development of an average or representative base year to index changes in the chain volume of production?

- Victoria considers the CGC has not provided sufficient information on the costs and benefits of using an average or single year, and requests that the CGC provide additional information on the merits and limitations of each approach.

5.3.3 Number of businesses as a driver of spending

Victoria supports the reintroduction of the number of businesses as a driver of regulatory spending.

Victoria argued in the 2020 review that removing the number of businesses as a driver of need would risk oversimplifying the assessment. Intuitively, a state with high industry productivity, measured by the current driver of total factor income, may not necessarily have a high number of businesses. In addition, regulatory costs in states with a higher number of small businesses are greater due to additional administrative complexity and higher costs of outreach and support. Therefore, solely using production measures can overestimate the expenditure needs of states with a small number of more productive businesses and vice versa.

As discussed in the services to communities section of Victoria's tranche 1 response, population density is also a driver of regulatory spending. Since Victoria's businesses tend to operate in closer proximity to communities, the state is required to enforce additional regulations to address environmental concerns, protect public health and safety and manage land use. This increased regulatory intensity is reflected in Victoria's relatively high number of licence types compared to other states. Victoria recommends that the CGC consider population density as a driver of need for regulatory spending.

CGC consultation questions and Victoria's positions

Q3. Do states support the reintroduction of the number of businesses as a driver of need for regulatory spending if it is material?

- Victoria considers that the number of businesses should be reincluded as a driver in the assessment.

5.3.4 Spending under the net-zero transition as a separate assessment

Victoria retains its view from its tranche 1 response that states' increases in spending on the net-zero transition warrant further consideration from the CGC. As it is still unclear whether an assessment of spending on the net-zero transition would be feasible, Victoria recommends that the CGC continue to monitor developments in this area.

Victoria considers that an assessment under the business development component would not adequately reflect the extent of states' spending on the net-zero transition. Although Victoria can identify its spending on specific business development projects, much of the state's net-zero projects, extend to service areas outside of business support. Since 2020-21, Victoria's net-zero initiatives have encompassed support for transitioning low-income and vulnerable households, funding for educational institutions and the establishment of the State Energy Commission (SEC). Victoria recommends that the CGC explores an assessment of spending on the net-zero transition as a separate assessment, including programs beyond the scope of business support.

A potential separate assessment for expenditures relating to the net-zero transition should consider multiple factors. As noted above, such factors may include each state's resource endowments and share of non-renewable energy use. Victoria considers that there may be a conceptual case and some relevant evidence for a separate assessment. However, the potential methodology and feasibility require further exploration.

Victoria does not consider that an appropriate assessment of net-zero-related spending can be developed in time for the 2025 review. Instead, Victoria recommends that the CGC continue to monitor and explore the development of a separate assessment for spending under the net-zero transition in future updates.

5.3.5 Identifying Victoria's net-zero spending

Victoria has committed to making significant investments for numerous projects to support households, businesses and industry during the net-zero transition. These include:[17]

- $540 million to support the accelerated delivery of Victoria's Renewable Energy Zones
- $108 million for an Energy Innovation Fund, an Offshore Wind Strategy and funding to accelerate Victoria's renewable hydrogen industry
- $335.5 million for energy efficient upgrades for 250,000 low-income and vulnerable households
- $112 million for energy efficient upgrades for 35,000 social housing properties.

However, it will likely be difficult to identify spending on the net-zero transition in a comprehensive manner for the CGC's purposes. Expenditure on the net-zero transition is dispersed across various projects spanning different service areas and portfolios. As such, Victoria's spending on the net-zero transition is not accounted for under a unified data set or Classification of the Functions of Government (COFOG) category. Victoria also considers that it may be difficult to determine to what extent programs are driven by the net-zero transition or other drivers. As such, it may be difficult for Victoria to provide the CGC with data that are usable for an assessment. Once the CGC determines a specific assessment method, Victoria recommends it provide states with a draft data request Treasuries can use to engage subject matter experts to identify and define the appropriate data.

5.3.6 Potential drivers of spending on the net-zero transition

Victora provided initial views on a separate assessment of expenditures under the transition to net-zero in its response to tranche 1 consultation. This included a recommendation for the CGC to consider states' share of non-renewable energy use and resource endowments as drivers of state spending on the net-zero transition.

As noted in the services to community section of Victoria's tranche 1 response, Victoria's historical reliance on natural gas is a challenge for the state's net-zero transition. Victorian households have the highest gas consumption compared to households in other states and territories, with an average annual consumption of 54 gigajoules.[18] In addition, Victoria also has the highest percentage of homes connected to the gas network.[19] Meanwhile, for industrial and large commercial users, natural gas is currently an important input in manufacturing processes and electricity generation in Victoria, as renewable alternatives either cannot be produced at scale or are incompatible with existing infrastructure. These circumstances necessitate additional spending from Victoria during the net-zero transition.

Brown coal is used for electricity generation almost exclusively in Victoria. This reliance stems from brown coal being both abundant in the Gippsland Basin and unsuitable for export due to its high moisture content. However, brown coal has a lower energy content and thus generates more emissions than black coal, which other states and territories use more heavily for electricity generation. To illustrate, Victoria's Yallourn power station generates 1.34 tonnes of carbon dioxide for

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[17] https://www.premier.vic.gov.au/making-victoria-renewable-energy-powerhouse
[18] https://www.energynetworks.com.au/resources/fact-sheets/reliable-and-clean-gas-for-australian-homes-2/#:~:text=In%20Victoria%20%E2%80%93%20the%20state%20with,an%20electricity%20and%20gas%20connection.
[19] https://www.energynetworks.com.au/resources/fact-sheets/reliable-and-clean-gas-for-australian-homes-2/#:~:text=In%20Victoria%20%E2%80%93%20the%20state%20with,an%20electricity%20and%20gas%20connection.

each megawatt hour of electricity produced.[20] In contrast, all black coal-fired power stations in Queensland and NSW generate under 1 tonne of carbon dioxide for the same amount of energy. Consequently, Victoria is uniquely required to make expenditures to address the state's use of brown coal during the net-zero transition.

CGC consultation questions and Victoria's positions

Q4. Will states be able to identify spending on the net-zero transition and provide it to the Commission to develop an assessment?

- Victoria can identify spending on specific initiatives relating to the net-zero transition. However, it will likely be difficult for Victoria to provide data that can be used to develop a comprehensive assessment. Victoria recommends the CGC provide states a draft data request for comment once it has determined a specific method for assessing net-zero expenditures.

Q5. Can states identify and provide data on potential drivers of state spending on the net-zero transition?

- Victoria suggests some potential drivers of spending on the net-zero transition, including share of non-renewable energy use and resource endowments. However, it considers that further work beyond the scope of the 2025 review is required to appropriately investigate all potential drivers of spending for an assessment.

Q6. Do states expect there to be a sufficient increase in state net-zero transition spending to warrant a separate assessment, within or outside of the business development assessment?

- Victoria expects that spending on the net-zero transition will continue to increase and if it can feasibly be separately assessed, will warrant a separate assessment outside of the business development assessment.

5.4 Housing

CGC consultation questions and Victoria's positions

Q1. Do states agree that the housing assessment remains fit for purpose notwithstanding recent developments in the housing market?

- Victoria agrees that the housing assessment remains mostly fit for purpose but suggests that it should include housing affordability and CALD drivers.

[20] http://www.cleanenergyregulator.gov.au/NGER/National%20greenhouse%20and%20energy%20reporting%20data/electricity-sector-emissions-and-generation-data

5.4.1 Separate assessments of public and community housing

There are differences in states' funding arrangements between public and community housing as states deliver public housing, whereas they provide grants to external organisations for community housing.

The consultation paper indicates that community housing is funded using specifically capital grants. For clarification, Victoria understands that, for the Housing Australia Future Fund (HAFF) and other state-run programs, multiple funding arrangements are in place. A capital grant may be provided in some instances, but availability payments may be made over longer term operational periods.

Evidence presented in the consultation paper suggests there are not different drivers between public and community housing of spending, in the context of the CGC's assessments. The demographic breakdowns of households in community and public housing appear to be very similar. This suggests a separate assessment is not required.

As noted by the CGC, most states have a single waitlist from which both community and public housing renters are drawn. Victoria appreciates there are nuances to this system, chiefly that public housing renters are allocated from the highest priority category, and then according to date order, whereas in community housing, renters are selected subject to a priority allocations target, but providers are not bound to allocate to renters in the highest priority category. However, Victoria does not consider this justifies splitting the assessments of public and community housing. Renters are subject to the same eligibility criteria and hence the same drivers are relevant.

Victoria does not consider the consultation paper sufficiently explains why a separate assessment for community housing is required, and the potential basis for a separate assessment compared to public housing. It appears the assessments would be the same, only breaking the assessment into two components. Unless the CGC suggests separate drivers for community housing with evidence, Victoria does not support a separate assessment.

CGC consultation questions and Victoria's positions

Q2. Do states agree that there should be separate assessments for public and community housing if it results in a material change in GST distribution?

- Victoria does not consider there should be a separate assessment of community and public housing as the drivers appear to be the same, and the CGC has not provided details of an alternative assessment method.

5.4.2 Affordable housing

Affordable housing programs are emerging across the country in response to increasing rates of housing stress. The *National Housing Accord 2022* defines affordable housing as rental housing provided at below market rent to qualifying renters (usually between 70 and 80 per cent of market rent).[21] As such, renters living in affordable housing are distinct from social housing renters, as eligibility requirements are different and rents are tied to the market rate, rather than income as in

[21] https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2022-10/national-housing-accord-2022.pdf

social housing. If deemed to be material, these differences likely mean a separate assessment of affordable housing would be appropriate.

The Commonwealth is delivering 10,000 new affordable housing dwellings through the HAFF with the potential for state participation. States are also growing their service provision of affordable housing. Victoria is constructing 2,400 affordable housing dwellings through the Big Housing Build, a portion of which completed construction in 2023, while other states begin offering similar programs targeting affordability.

The 2020 review considered a separate affordable housing assessment, however, there was a lack of data on the size of state expenses. Victoria suggests that better data will shortly be available based on the magnitude of current and committed investment in affordable housing.

Victoria recommends that the CGC retain flexibility, similar to the mining assessment, to address this ahead of the 2030 review as this sector matures.

CGC consultation questions and Victoria's positions

- Victoria recommends that the CGC explore introducing a separate assessment of affordable housing as part of the 2025 review, as the sector grows before the expected 2030 review.

5.4.3 People with a disability driver of housing need

Conceptually, Victoria agrees that households with members with disability may require higher contributions from states for social housing.

The Census data provided in the consultation paper indicates a higher prevalence of serious and chronic health conditions in social housing, such as arthritis, cancer, dementia, and heart disease. Long term health conditions do appear to be more prevalent in households in social housing, however this does not mean there are direct additional costs for states.

The consultation paper mentions home modifications as an example cost; however, it is unclear whether and to what extent the medical conditions captured in the Census data typically receive or require modifications. Further, responsibility for funding social housing home modifications due to disability is split between the NDIS and the states. Funding responsibility is dependent on the level of adjustment required and is dealt with on a case-by-case basis.[22] Where more substantial modifications are required, the NDIS is usually responsible for funding.

Victoria agrees that there may be a conceptual case that disability prevalence increases social housing service provision costs. However, the Census conditions are not necessarily reflective of this spending need and better data is unlikely to be available. As such, Victoria suggests that the assessment would not meet materiality requirements.

[22] https://ourguidelines.ndis.gov.au/supports-you-can-access-menu/home-and-living-supports/home-modifications/what-home-modifications-do-we-fund/should-home-modification-be-funded-or-provided-another-service

CGC consultation questions and Victoria's positions

Q3. Is the ABS census data on households with members that have long-term health conditions a suitable proxy for households that have high service needs?

- Victoria does not consider long-term health conditions are a suitable proxy for households that have high service needs.

Q4. Do states have data on the cost of servicing different household types that would enable the calculation of a cost gradient?

- Victoria does not support an assessment of disability as a driver of need for housing based on the ABS Census data on households with members with long-term health conditions.

5.4.4 Robustness of SDC cost weightings

Victoria questions the robustness of the Socio-demographic Composition (SDC) cost weightings in the housing assessment, based on experience from the 2020 review. Victoria considers the 2020 review cost weightings were not based on sufficiently robust evidence and should not have been applied without discounting.

5.4.4.1 Issues with Census data

The Census as a source has a number of issues in the context of housing for the CGC's assessments. Household responses are not subject to the level of revision and adjustment that person counts are to arrive at the estimated resident population (ERP). There is no post-enumeration survey to correct any issues in the raw household Census data. In addition, there is a longstanding issue of inaccurate responses to the Census question on landlord type, with respondents underreporting social housing status.[23]

For the 2020 review, the CGC adjusted the Census data to address some of these issues. In this process the CGC makes a number of imputations Victoria considers are inappropriate, including:

- Imputing 'not stated' responses across all landlord categories by their share of the total
- Adding 'not applicable' responses to the total for 'not social housing'
- Imputing incomes from 'not stated' responses
- Imputing 'not stated' responses for tenure and landlord type for the Indigenous ERP adjustment factor calculation
- Imputing 'not stated' responses to rents paid and household incomes.

These imputations are not appropriate and may introduce bias in the respective statistics. For example, in the case of 'not stated' landlord type, it is unknown what the landlord type is. 'Not stated' responses may be skewed towards certain groups, as some may be less likely to be able or want to respond to certain questions. There is no information to suggest which direction this bias may be in however, and so common practice is to exclude such information.

Victoria considers there was not sufficient justification or robustness for these adjustments and recommends the CGC not make them again for the 2025 review. If the CGC considers it must make

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[23] https://www.rmit.edu.au/news/all-news/2019/aug/fact-check-social-housing and https://www.cgc.gov.au/sites/default/files/2021-11/r2020_report_-_volume_2_-_part_b_ch5-18.pdf

such adjustments, it should consult with the ABS and provide states the outcomes of this. Instead of imputations the assessment should be discounted, given the acknowledged uncertainty and inability to be certain of an accurate adjustment without additional surveys by the ABS as is done for ERP.

The CGC also apply an adjustment to address potential undercounting of the number of Indigenous households. The ABS acknowledge potential undercounting of Indigenous respondents to the Census when counting persons through a post-enumeration survey. However, the ABS make no such adjustments for counting households. The CGC's method relies on the assumptions that there is undercounting of Indigenous households, and that this is in the same proportion as compared to individuals.

Victoria also has concerns with this method given these assumptions which introduce further uncertainty into the assessment, due to the extent to which the adjustment for individuals applies to households. Similarly, to the other imputations Victoria considers there should be a discount on the assessment to recognise the added uncertainty.

5.4.4.2 Indigenous cost weighting

Notwithstanding these issues, Victoria agrees there is indicative evidence that remote and Indigenous residents utilise housing services more. However, the practical issue of how to implement this and the extent of the challenge facing states is open to interpretation.

For the 2020 review, the CGC applied judgement to determine a cost weighting for Indigenous households. State data indicated a cost weighting of 1.06, while RoGS data from the PC had a weighting of 1.27. The final figure chosen by the CGC was 1.20. Victoria supports the CGC's use of judgement where required. However, there is not sufficient justification for the implicit higher weighting towards RoGS data for this assessment.

Victoria hopes for the 2025 review, the CGC can work with states such that their data returns are a satisfactory source without the need for judgement. As the CGC is aware, the housing data return is particularly challenging for states to respond to, given the interaction with multiple government agencies and the community housing sector. Victoria considers it preferable that the effort put into this return is utilised as the basis for assessments.

5.4.4.3 Application of the general cost gradient

Similarly, to the Indigenous cost weighting, Victoria has concerns with the 2020 review method's implementation of regional costs for the housing assessment. The CGC noted reliable data on regional costs from state data returns was not available, so has applied the general regional cost gradient.

In the context of housing, it is unclear why the provision of housing services should have the same remote cost weighting as hospitals and schools. As described later in this response (section 6.3.1), Victoria recommends the CGC not apply a general regional cost gradient in any assessment due to a lack of evidence of its relevance, including in the housing assessment. If the CGC does apply the general regional cost gradient despite these issues to the housing assessment, then it should at a minimum be discounted to account for the lack of robust data to meet the CGC's standards of quality.

CGC consultation questions and Victoria's positions

- For the housing assessment Victoria recommends the CGC does not adjust the ABS Census data to impute or adjust for 'not stated' and 'not applicable' responses.

- The assessment should be discounted by at least 12.5 per cent to acknowledge issues with cost weightings derived from state provided data.
- Victoria recommends the general cost gradient is not applied to the housing assessment. If the CGC judges it should be applied, Victoria recommends a discount of at least 25 per cent is continued to be applied.

5.4.5 Culturally and linguistically diverse people as a driver of housing need

There is significant evidence that CALD people use public housing services relatively more, and have higher costs associated when they do. These costs are driven by translation services, culturally appropriate design (for example number of bedrooms and layout) and additional tenancy management to ensure social cohesion.[24] [25]

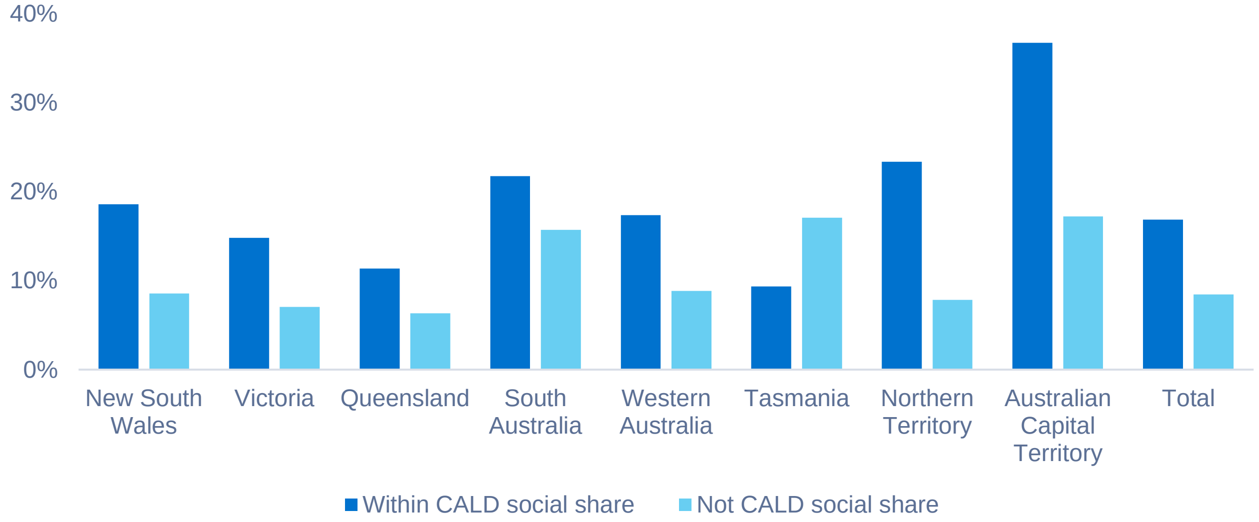
Many factors contribute to the overrepresentation of CALD people in social housing. For example, CALD communities often face discrimination in the private rental market as they are perceived to be high risk renters.[26] These discriminatory practices compounded with language difficulties, limited agency, and unfamiliarity with the Australian housing market drive social housing demand from CALD communities.[27] [28]

In the 2020 review the CGC accepted that CALD people may drive state housing costs, however it did not agree to implement a cost weighting. Victoria recommends the CGC implement a cost weighting for CALD people for housing, consistent with the tranche 1 submission on health and schools.

Data from the 2021 Census show that people with low or no English proficiency were twice as likely to be in social housing than those who spoke English well, see Figure 4.

[24] https://doi.org/10.1080/07293682.2011.530584
[25] https://doi.org/10.1080/02673037.2019.1644296
[26] https://www.pc.gov.au/inquiries/completed/housing-homelessness/report/housing-homelessness.pdf
[27] https://www.ahuri.edu.au/sites/default/files/migration/documents/AHURI_Final_Report_No244_Factors-shaping-the-dynamics-of-housing-affordability-in-Australia-2001-11.pdf
[28] https://academic.oup.com/gerontologist/article/63/1/182/6490197?login=false#393498417

Figure 4: Share of people in social housing by CALD status, 2021 Census



Note: Social housing defined as State or territory housing authority or a community housing provider, CALD is defined as speaks English not well or not at all. Figures exclude Indigenous people to remove potential influence on CALD variable.

The Refugee Council of Australia notes the challenges facing refugees and humanitarian arrivals have increased in recent years in part due to the increasing competitiveness of the housing market.[29] It also notes additional barriers humanitarian arrivals face in the housing market including:

- reliance of income support or difficulties finding employment
- lack of understanding of Australian rental processes
- language barriers
- lack of rental history and documentation
- negative attitudes among real estate agents, landlords and other housing providers.

CGC consultation questions and Victoria's positions

- Victoria suggests that a CALD driver is included for the housing assessment to reflect the higher rate of access to social housing and the additional service costs.

5.4.6 Housing affordability as a driver of housing need

Multiple dynamics contribute to housing affordability issues across Australia, notably a rapidly growing private rental sector, supply shortages, population growth and more middle- and high-income renters.[30] These issues are so severe that both a Victorian Parliamentary Inquiry into the rental and housing affordability crisis and a Commonwealth Parliamentary Inquiry into the worsening rental crisis

[29] https://www.refugeecouncil.org.au/home-stretch-sustainable-housing/
[30] https://apo.org.au/sites/default/files/resource-files/2019-12/apo-nid271271.pdf

in Australia were conducted in 2023. Both inquiries delivered similar sentiments, that the current housing affordability issues are a ‘human crisis.’[31]

There is a clear link between housing affordability and the demand for social housing services. As housing affordability declines, people require more support from governments to stay in housing and rely on public services more. The CGC acknowledge this in the consultation paper, however the assessments do not directly incorporate any measure of affordability driving demand.

Victoria considers such measures are not unduly policy influenced, as state governments do not have direct control over conditions in the private market. Certainly, there is an influence – through tax policy for example – however this is no greater than other measures used in the assessments.

Spending more than 30 per cent of income on housing costs makes it difficult to afford other basic essentials e.g., food, clothing, transport and utilities.[32] AHURI find that low-income renters paying more than 30 per cent of their income on rent is a reasonable measure of housing stress as the data are readily available, the method is logical and communicable, it does not require subjective assumptions and it can and has been observed over time.[33]

For this assessment, it is important that measures of housing stress are restricted by income group to capture cohorts that are most likely to put stress on the social housing system. Victoria suggests that low-income households paying more than 30 per cent of their income on rent are an appropriate indicator of housing affordability as:

- high income households can spend a higher proportion of their income on rent without having a distinct adverse effect on their living standards
- households in mortgage stress are considered more likely to enter the private rental market than social housing if forced to sell their home by virtue of social housing eligibility
- the flow on effects of homeowners selling and entering the private rental market would be picked up via the proposed measure
- low-income private renters are the closest to social housing on the housing continuum.

Housing affordability affects each state uniquely, (Figure 5), and should be accounted for to address the additional pressures facing some jurisdictions.

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[31] https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/RB000257/toc_pdf/TheworseningrentalcrisisinAustralia.pdf

[32] https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6553.0~2017-18~Main%20Features~Housing~4#:~:text=Accordingly%2C%20a%2030%25%20housing%20costs,40%20rule'%20of%20housing%20affordability.

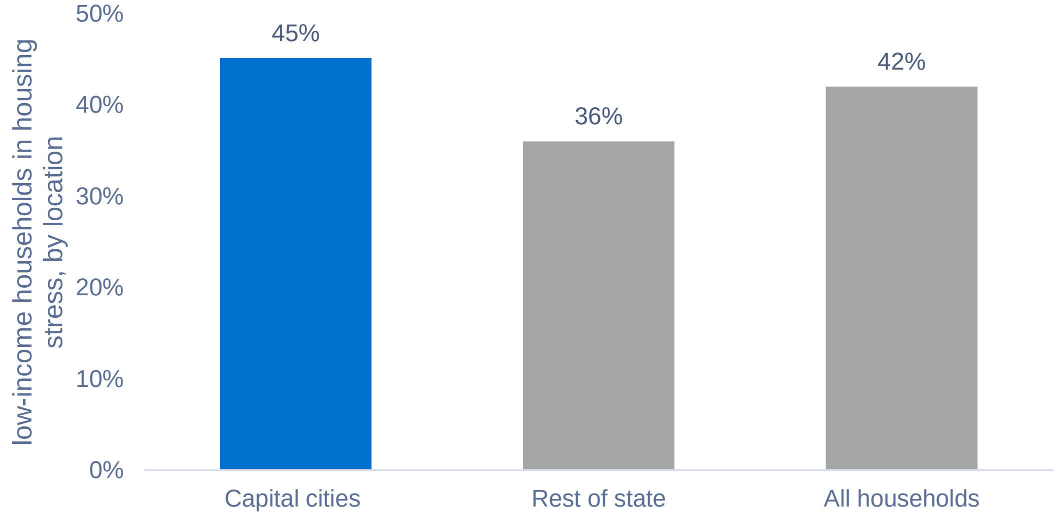
[33] https://www.ahuri.edu.au/analysis/brief/understanding-3040-indicator-housing-affordability-stress

Figure 5: Proportion of low-income households in housing stress, 2019-20

Source: Survey of Income and Housing

There is a spatial element to housing affordability as well, with the proportion of low-income households in rental stress consistently higher in capital cities, see Figure 6. This pattern is asymmetrically driving up spending for states with high proportions of urban populations. Victoria suggests that the CGC consider this in their development of a housing affordability driver.

Figure 6: Proportion of low-income households in housing stress, by location, 2019-20



Source: AIHW[34]

[34] https://www.aihw.gov.au/reports/australias-welfare/housing-affordability

This affordability crisis has necessitated an increase in housing service provision in Victoria, for example, the:

- $5.3 billion *Big Housing Build* is constructing more than 12,000 new homes throughout metropolitan and regional Victoria. More than 7,600 homes have been completed or are underway, and more than 2,800 households have either moved or are getting ready to move into brand new homes.
- $2.1 billion *Victorian Homebuyer Fund* (VHF) is making home ownership more achievable through shared equity contributions. As of February 2024, the VHF has supported more than 7,300 Victorians to secure a home.
- *Social Housing Growth Fund* (SHGF) initially invested $1 billion to provide 2,200 new social housing homes in Victoria. The Big Housing Build provided a further $1.38 billion to fund up to 4,200 homes through the SHGF.
- $1 billion *Regional Housing Fund* will deliver more than 1300 new homes across regional Victoria.
- *Regional Worker Accommodation Fund* is investing $150 million to provide new housing options for regional communities where key workers are struggling to find affordable places to live.
- *Affordable Housing Investment Partnerships* will make available up to $2.1 billion in low interest loans and government guarantees to finance social and affordable housing.

CGC consultation questions and Victoria's positions

- Victoria suggests that a housing affordability driver is included in the housing assessment. This should be based on low-income households spending more than 30 per cent of income on rent and account for the additional burden in urban areas.

5.5 Other expenses

Victoria agrees with the expenses classified to the other expenses category and the use of an EPC assessment for them.

However, Victoria has some concerns about the application of regional and wage costs. In particular, the decision to apply cost adjustments to half of general public services and other expenses is not explained and appears arbitrary. Victoria questions whether this decision aligns with the CGC's standards of transparency and the use of "sound and reliable data methods" under the practicality principle.[35]

[35] https://www.cgc.gov.au/sites/default/files/2023-06/2025%20Methodology%20Review%20-%20Commission%27s%20position%20on%20fiscal%20equalisation%2C%20supporting%20principles%20and%20assessment%20guidelines.pdf

CGC consultation questions and Victoria's positions

Q1. Do states agree with the expenses classified to the other expenses category?

- Victoria agrees with the expenses classified in the other expenses category.

Q2. Do states agree that other expenses should be assessed equal per capita?

- Victoria supports continuing to assess other expenses EPC.

5.6 Natural disaster relief

Victoria does not support the continuation of the current natural disaster relief assessment. Victoria is concerned with the policy neutrality of an APC assessment, as noted in Victoria's tranche 1 response.

The need for relief spending is complex, driven by relationships between risk, past mitigation efforts, policy responses and the need for disaster responses in future. There are also complex interactions between mitigation and relief. These should be thoroughly examined together, once the CGC proposes a specific assessment method for mitigation. Until methods are determined for a coordinated assessment of natural disaster relief and mitigation, Victoria recommends natural disaster relief is assessed EPC.

In the 2020 methodology review, the CGC concluded that an APC assessment would not be appropriate for natural disaster mitigation expenses due to the scope for state policy influence, despite the Natural Disaster Relief and Recovery Arrangements (NDRRA) requiring states to have mitigation strategies.[36] Victoria considers the same logic applies to the assessment of relief expenditure.

The Commonwealth Government has commissioned an independent review of disaster funding arrangements, set for completion in April 2024. The findings of that review may be pertinent to the CGC's assessments of natural disaster relief and mitigation expenses. The CGC should consider the review outcome and consult with states on the potential for resulting changes to its assessments.

5.6.1 Policy differences under the Natural Disaster Relief and Recovery Arrangements

Victoria considers there is scope for states to respond to, and prepare for, natural disasters differently, meaning an APC assessment is inappropriate. Victoria acknowledges all states are subject to a national framework for disaster relief under the NDRRA, and the assessment only considers spending under those arrangements. However, states have scope to implement varied policies within this framework. For example, state governments are responsible for natural disaster prevention, infrastructure, land use planning, building codes and community initiatives and take different approaches that meet particular needs.

The 2014 PC review into Natural Disaster Relief highlighted than an APC assessment may also capture policy incentives inherent in NDRRA arrangements themselves. The current APC assessment

[36] https://www.cgc.gov.au/sites/default/files/2021-11/R2020%20-%202018-01-20-S%20-%20Draft%20assessment%20paper%20-%20Other%20expenses_0.pdf

reinforces the incentives of the NDRRA to focus spending on post disaster relief.[37] In its 2014 review, the PC identified that the primary driver of disaster relief funding was the extent of mitigation and relief policies, which determine the exposure of the built environment to natural disasters.[38]

The PC linked this to the GST distribution, finding that even though the extent to which the degree of equalisation of relief costs affects the incentives for states to effectively manage natural disaster risks were unclear, it may "noticeably influence incentives at the margin."[39]

States differ in their scope and breadth and focus of mitigation policies. Although state mitigation and relief policies may not be directly comparable due to differences in risk profiles and built environment, differences in their approach and scope of governance can be noted.

5.6.2 Insurance policy and natural disaster relief

Differences in states' policies around insurance, including taxes on insurance, can influence natural disaster relief claims under the NDRRA.

Differences in state insurance taxes and levies may result in different levels and affordability of private insurance, influencing the need for disaster relief. In some states insurance tax is charged on top of GST and in other state emergency service levies are added to this. Private non-insurance can impact the fiscal resilience of communities to natural disasters.

Rates of insurance differ across states and could influence the need for disaster relief funding.[40] A Commonwealth Department of Finance review of insurance and the NDRRA from 2012 found there were differences in insurance of assets between states, with some not having sufficient arrangements – for example, for the insurance of road assets.[41]

5.6.3 Removing Local Government expenses

Any local government expenses should be removed from the disaster relief assessment for consistency across assessments. Local government expenses form a considerable proportion of claimed expenses by states under the NDRRA, and under those arrangements these expenses are treated as equivalent to state expenses.[42]

In the 2020 review, Victoria did not support the CGC's 2020 recommendation to include local government expenses in the disaster relief assessment, after being removed previously. As previously stated by the CGC, most local governments cover their expenses using own-source revenue such as rates. Consequently, the financial burdens borne by local governments do not impact state fiscal capacities. Financial assistance grants to councils from the Commonwealth are also excluded from the Commonwealth payments assessment.

In the 2020 review, Victoria noted that the CGC had removed state support for local government from other categories, such as roads, and it should also be removed from natural disaster recovery.

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[37] https://treasury.gov.au/sites/default/files/2019-03/Paula-Claudianos.pdf
[38] https://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume1.pdf
[39] https://www.pc.gov.au/inquiries/completed/disaster-funding/report/disaster-funding-volume1.pdf
[40]ttps://www.monash.edu/__data/assets/pdf_file/0008/925415/uncertainty_of_governmental_relief_and_the_crowding_out_of_insurance.pdf
[41] https://www.finance.gov.au/archive-link/2011-review-insurance-arrangements-states-and-territories-under-natural-disaster-relief-and-recovery-arrangements-ndrra-determination
[42] https://www.disasterassist.gov.au/Documents/Fact-sheets/NDRRA-Factsheet.pdf

Victoria reiterates this position that these changes should be made for consistency across assessment categories and notes appropriate data are readily available from states to facilitate this.

CGC consultation questions and Victoria's positions

Q1. Do states support the continuation of the natural disaster relief assessment in its current form?

- Victoria recommends the assessments of natural disaster relief and mitigation are considered together to account for their complex interrelationships. Victoria requests the CGC provide analysis of how these assessments interact if it proposes a separate differential assessment of natural disaster mitigation for the draft report.
- Victoria considers the policy influence makes an APC treatment inappropriate and recommends that, if a policy neutral driver cannot be identified, natural disaster relief expenditures are assessed EPC.
- Victoria recommends local government expenses are removed from assessed natural disaster relief expenses.

5.7 National capital

Victoria supports the CGC's view to discontinue the national capital assessment if it is immaterial. Victoria also accepts the CGC's view that given the current data, a negative assessment affecting related expense categories is inconsistent with the 2020 review methodology.

The conceptual case for the assessment does not support a negative assessment. Accordingly, the conceptual case and basis for the assessment is no longer supported by the data and is not expected to do so in future. Data does not support that policing in the ACT is more expensive, given the requirement to use the Australian Federal Police, than using average state policy.

Further, Victoria does not support unduly increasing complexity though the retention of an immaterial assessment, with the view that it may become material in future. There is no expectation that this assessment will later become material, and, in the interests of simplicity, Victoria's view is that it be suspended. The CGC may wish to test the materiality of the assessment at the 2030 review.

CGC consultation questions and Victoria's positions

Do states support discontinuing the national capital assessment if the assessment is immaterial?

- Victoria supports the CGC's view to discontinue the national capital assessment from the calculation of GST relativities if the assessment is immaterial.

6. Other

6.1 Investment

6.1.1 Smoothing population growth

In principle, Victoria supports the aim to reduce volatility in the investment assessment. Victoria agrees that investment decisions are driven by longer term trends, rather than annual population changes. Furthermore, infrastructure projects are often planned many years in advance and take multiple years to complete.

However, Victoria cannot support the CGC's proposal to smooth population growth as outlined in the investment consultation paper because the proposed implementation approach is problematic.

The introduction of three-year population growth averaging would overweight the influence of several assessment years over the long term. The use of averaging would commence in the assessment of the 2025-26 relativities, using data from 2019-20 through 2023-24. However, data from 2019-20, 2020-21, 2021-22 and 2022-23 would already have been used in previous relativity calculations prior to then being used again after the introduction of smoothing. This would compound the effect of the variable population changes seen during the pandemic – the very example the CGC cites as the catalyst for this proposal.

Table 1 shows the weightings of each data year over the multiple application years they contribute to, and over the long term, under the current methodology. Because GST relativities are already based on three-year averages (y-1, y-2, y-3), data from each year influences three years of relativities. Defining the full use of one year's data in an assessment year as 100 per cent, this results in a long-term weighting of 300 per cent for each data year. For example, in the application year 2022-23, the 2022 Update, data from 2020-21, 2019-20 and 2018-19 are used because of the three-year averaging of relativities. Data from 2020-21 are then used again for the 2023-24 and 2024-25 application years, resulting in a weighting of 300 per cent for data from 2020-21 over time.

Table 2 shows the weightings of each data year under the CGC's proposed smoothing methodology. Data from 2019-20, 2020-21, 2021-22 and 2022-23 would all be over-weighted in the long-term assessment of relativities. For example, data from 2021-22 would be used in the application years 2023-24 and 2024-25 in the same manner as the example above. But, once the smoothing is introduced from the 2025-26 application year onwards, data from 2021-22 are used on 6 further occasions, but with a weighting of only 1/3 on each occasion due to the smoothing. This results in a total weighting of 400 per cent over time. Data from other years are used a varying number of times, resulting in different weightings for different years. This introduces bias into the assessment.

Table 1. Long-term assessment weighting of data years under 2020 review methodology

Application Year	Assessment Years					
	y-1	Weighting	y-2	Weighting	y-3	Weighting
2020-21	2018-19	100%	2017-18	100%	2016-17	100%
2021-22	2019-20	100%	2018-19	100%	2017-18	100%
2022-23	2020-21	100%	2019-20	100%	2018-19	100%
2023-24	2021-22	100%	2020-21	100%	2019-20	100%
2024-25	2022-23	100%	2021-22	100%	2020-21	100%
2025-26	2023-24	100%	2022-23	100%	2021-22	100%
2026-27	2024-25	100%	2023-24	100%	2022-23	100%
2027-28	2025-26	100%	2024-25	100%	2023-24	100%

Data Year	Long-term Weighting	Normalised Weighting
2018-19	300%	100%
2019-20	300%	100%
2020-21	300%	100%
2021-22	300%	100%
2022-23	300%	100%
2023-24	300%	100%
2024-25	300%	100%
2025-26	300%	100%

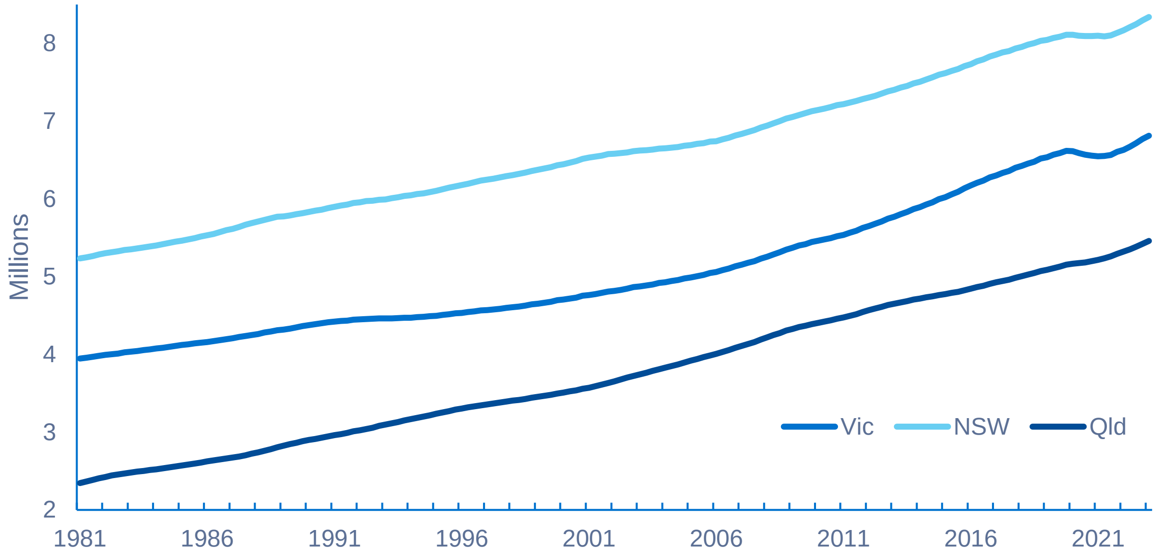
Table 2. Long-term assessment weighting of data years under proposed averaging methodology

Application Year	Assessment Years					
	y-1	Weighting	y-2	Weighting	y-3	Weighting
2020-21	2018-19	100%	2017-18	100%	2016-17	100%
2021-22	2019-20	100%	2018-19	100%	2017-18	100%
2022-23	2020-21	100%	2019-20	100%	2018-19	100%
2023-24	2021-22	100%	2020-21	100%	2019-20	100%
2024-25	2022-23	100%	2021-22	100%	2020-21	100%
3-year averaging for each assessment year commences						
2025-26	2021-22	33%	2020-21	33%	2019-20	33%
	2022-23	33%	2021-22	33%	2020-21	33%
	2023-24	33%	2022-23	33%	2021-22	33%
2026-27	2022-23	33%	2021-22	33%	2020-21	33%
	2023-24	33%	2022-23	33%	2021-22	33%
	2024-25	33%	2023-24	33%	2022-23	33%
2027-28	2023-24	33%	2022-23	33%	2021-22	33%
	2024-25	33%	2023-24	33%	2022-23	33%
	2025-26	33%	2024-25	33%	2023-24	33%
2028-29	2024-25	33%	2023-24	33%	2022-23	33%
	2025-26	33%	2024-25	33%	2023-24	33%
	2026-27	33%	2025-26	33%	2024-25	33%
2029-30	2025-26	33%	2024-25	33%	2023-24	33%
	2026-27	33%	2025-26	33%	2024-25	33%
	2027-28	33%	2026-27	33%	2025-26	33%
2030-31	2026-27	33%	2025-26	33%	2024-25	33%
	2027-28	33%	2026-27	33%	2025-26	33%
	2028-29	33%	2027-28	33%	2026-27	33%

Data Year	Long-term Weighting	Normalised Weighting
2018-19	300%	100%
2019-20	333%	111%
2020-21	367%	122%
2021-22	400%	133%
2022-23	367%	122%
2023-24	300%	100%
2024-25	300%	100%

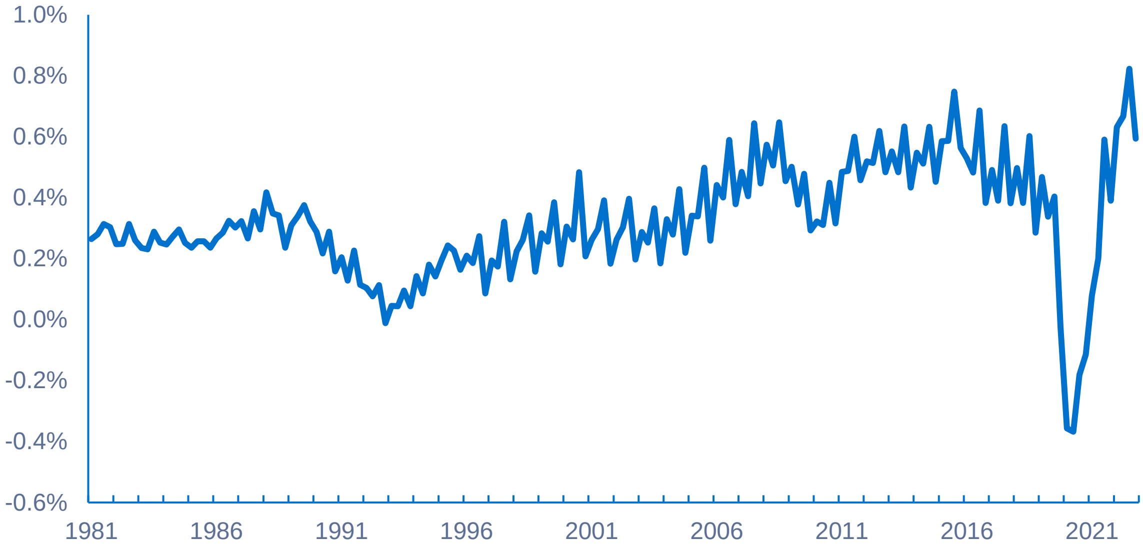
Not only does the CGC's proposed smoothing methodology introduce bias into the assessment by overweighting certain years, introducing it for the 2025 review would bias the assessment with data impacted by a global pandemic. As shown in Figure 7 and Figure 8, state population growth during the COVID-19 pandemic is a historical anomaly. While it is true that the investment assessment would have been less volatile during that period had smoothing been in place at the time, it is now too late to avoid the impact of volatile historical population growth in the assessment.

Figure 7: Estimated Resident Population - Selected states



Source: Australian Bureau of Statistics, 3101.0 National, state and territory population

Figure 8: Quarterly Population Growth - Victoria



Source: Australian Bureau of Statistics, 3101.0 National, state and territory population

CGC consultation questions and Victoria's positions

Q1. Do states support smoothing user population growth to reduce volatility, with an associated reduction in contemporaneity?

- Victoria does not support the proposal to smooth user population growth because implementation would overweight the assessment towards a period of historical volatility.

Q2. If user population growth were to be smoothed, do states support a 3-year moving average of growth rates?

- Victoria does not support the proposal to smooth user population growth.

6.1.2 Freezing the value of asset stocks

Victoria does not support the CGC's proposal to freeze the proportions of component asset stocks for the period of the review.

Collecting annual data on the value of asset stocks in each component is not a significant data collection burden on Victoria because those data are already collected for reporting to the ABS.

Given the volatility of asset valuations claimed by the CGC, freezing asset valuations based on any one particular year could lead to bias in the component proportions based on an anomaly in a particularly volatile year.

As total asset values would continue to be updated each year, under the proposal any volatility from revaluations in one component would be spread across the broader investment assessment. This would introduce errors into the assessment as other components would be overweighted or underweighted.

Furthermore, when component asset valuations are finally updated at the beginning of the next review period, that is 2030, there may be a large change in the component proportions. Therefore, volatility will not have been reduced, simply postponed.

Averaging over multiple years of past data may be a way to reduce this potential bias. Multiple years of data would be required to calculate the average proportions for the period of the next review. This would effectively mean that states would still be required to collect the existing data set to inform the 2030 review thereby undermining the purported reduction in data collection burden during the intervening assessment years.

Victoria considers the potential benefits of the proposal to be limited and outweighed by the likely issues discussed above.

CGC consultation questions and Victoria's positions

Q3. Do states support freezing the component shares of the value of assets for the life of the 2025 Review?

- Victoria does not support the proposal to freeze the component shares of the total stock of assets for the life of the 2025 review.

6.1.3 Brownfields investment

In the 2020 review report the CGC identified that the conceptual case for a brownfields development assessment was strong. Since 2020, densification of the built environment in major cities has increased and is predicted to increase further, putting pressure on the need for costly brownfields investment.

During the CGC's visit to Victoria in 2023, officials from departments presented examples of the cost factors affecting brownfields investment in Victoria. The supporting presentations, which include detail on investment pressures facing Victoria have also been provided to the CGC. For example, officials from the Victorian Department of Transport and Planning noted that significant projects are being delivered within highly constrained and urbanised environments resulting in additional complexity, land costs, and stakeholder, planning and environmental requirements.[43]

Officials from the Victorian Department of Education noted the increasing requirement for multistorey relocatable buildings at metropolitan school sites for both new school builds as well as school expansions. Relocatable buildings are twice as expensive as the equivalent number of single-storey buildings, and vertical schools are 80 per cent more costly to construct than an equivalent school. In addition, compulsory acquisition of land for schools, increasingly required for brownfields sites, adds a price premium of an average of 20 per cent.

In further discussions, officials from the Victorian Department of Health reported increased land costs, with scarcity of land an issue, and increasing use of costly compulsory acquisition.

Victoria considers the CGC should actively monitor the need for a brownfields development assessment and to consider how such an assessment is best implemented, including identifying appropriate drivers such as land prices, so that such an assessment can be efficiently implemented once it becomes material.

6.1.4 Construction costs

Victoria is concerned with the reliance on Rawlinsons indices to assess relative construction cost needs. Officials in Victorian departments have indicated that quantity surveyors can no longer rely on Rawlinsons to estimate construction costs, partly due to contemporaneity issues. Victoria also notes that Rawlinsons indices do not represent policy neutral construction costs as they represent actual costs faced by states in the past, which may be influenced by policy choices.

Victoria recommends the CGC evaluate the suitability of the Rawlinsons construction cost indices and consider replacing them or discounting their use. The CGC should explore more up to date data from private quantity surveyors that may provide a more accurate and contemporaneous picture of costs states face.

6.2 Net borrowing

CGC consultation questions and Victoria's positions

Q1. Do states agree that the conceptual basis for the net borrowing assessment remains unchanged?

- Victoria agrees that the conceptual basis for the net borrowing assessment remains unchanged.

Q2. Do states support smoothing population growth to reduce volatility in the net borrowing category if a change is made to smooth population growth in the investment assessment?

[43] Further costs are added through the need to protect or relocate utility services, adding replacement transport services, and the increased standards and requirements when replacing legacy infrastructure.

- As discussed in 6.1.1, Victoria does not support the proposal to smooth population growth in the investment assessment.

6.3 Geography

Victoria broadly accepts that remoteness and regional costs are drivers of the differences in states' expenditure requirements and should be reflected through the GST distribution.

Victoria generally supports the current methods for estimating regional costs and service delivery scale where there is robust supporting evidence, barring any concerns mentioned in Victoria's comments on specific assessment topics. Victoria supports the use of the Accessibility/Remoteness Index of Australia Plus (ARIA) to measure remoteness. Victoria is not aware of any other nationally consistent sources of data to supplement these assessments.

While Victoria accepts the need for regional and remote drivers, it has concerns with the implementation of these drivers in the CGC's assessments. These include that:

- The interrelationships between remoteness, regionality, Indigenous status and SES may not be fully accounted, for potentially leading to double counting or misattribution of drivers.
- There can be a lack of robust justification or evidence supporting the inclusion or quantification of geographic drivers for some assessments.

Victoria has confidence the CGC is aware of these issues and had taken steps to address them in some assessments. For example, the hospital assessments include service use data disaggregated by remoteness, SES and Indigenous status to avoid misattribution of the effects of those variables, as well as a distinct SDS factor. However, Victoria has some specific suggestions where the approaches do not meet the CGC's standards of quality below.

6.3.1 Implementation of the general regional cost gradient

Victoria has concerns with the implementation of the general cost gradient and considers it does not meet the CGC's standards of evidence. There is not sufficient quantitative or qualitative evidence establishing the rationale to apply the general regional cost gradient for most assessment components.

6.3.1.1 Changes in standards of evidence and data availability over time

Victoria supports the CGC's continued improvements in its assessments to incorporate more specific data to calculate regional costs. Victoria understands the general regional cost gradient comes from older reviews where specific sectoral data was unavailable to calculate regional cost gradients. However, this approach is no longer appropriate in a modern data environment and does not meet the CGC's standards of evidence required to make assessments.

Previously where specific data were only available for two components (police and schools), it may have been reasonable to calculate a general gradient to make up for the data deficiency in other assessment areas. Victoria does not consider this is appropriate where many categories now have specific data, and there is limited or no evidence of regional gradients for those that remain.

The conceptual case for the broad application of the general cost gradient appears to have been developed as part of the 2010 review, where states provided data to support the conceptual case that costs were generally higher in regional areas. These data are now dated and there have been developments in how services are delivered. These include changes to technology that may impact remote service delivery, as Victoria noted in its tranche 1 response for health for example.

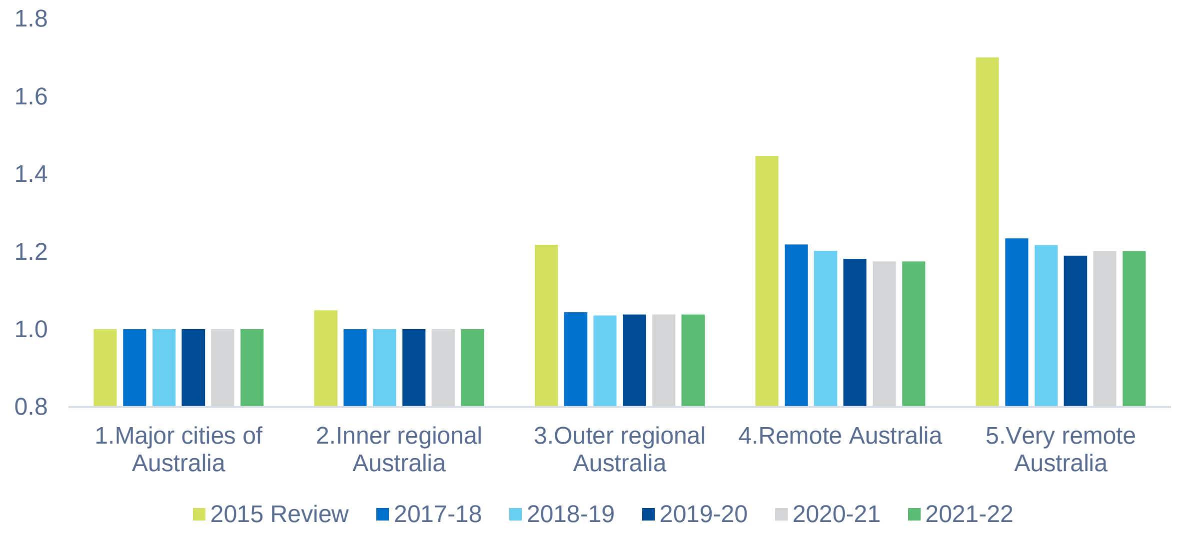
The data presented at the time of the 2010 review was also largely for categories that now have specific data to implement the regional cost gradient including health, schools, and justice. Victoria considers this data no longer justifies implementation of a broad regional cost gradient across a range of divergent service areas over a decade later.

Victoria accepts the conceptual case that costs in regional areas may be higher on average, however, considers this is not the case to the same extent for all services. The CGC should seek state data for assessments where it considers there is a strong conceptual case. At a minimum, there should be some data presented to support a case for higher regional costs even if not robust enough for a cost gradient. For example, Victoria hopes state housing data returns are of sufficient detail and quality to calculate a specific housing cost gradient for the 2025 review.

Generally, the effect of regional costs has trended downwards over time, particularly for remote and very remote areas. Figure 9 shows the general regional cost gradients from the 2015 review, and over recent years following the 2020 review method.

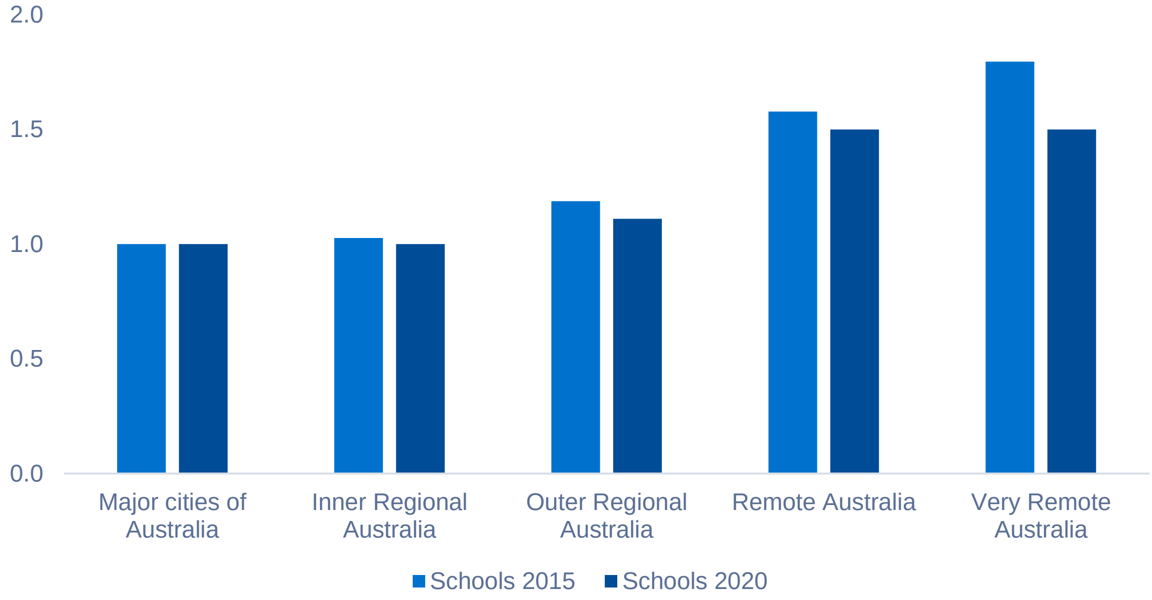
This downward trend may in part be driven by the change in composition of the general cost gradient that included schools and police in the 2015 method, replaced by hospital admitted patients and schools in the 2020 review method. The schools regional cost gradients for the 2015 and 2020 reviews are compared in **Figure 10** below, showing this trend also applies there.

Figure 9: General regional cost gradients 2015 review and 2020 Review method for 2017-18 to 2021-22



Source: CGC 2020 Review, DTF Calculation

Figure 10: Schools regional cost gradient, 2015 and 2020 reviews



Source: CGC 2020 review, DTF Calculation

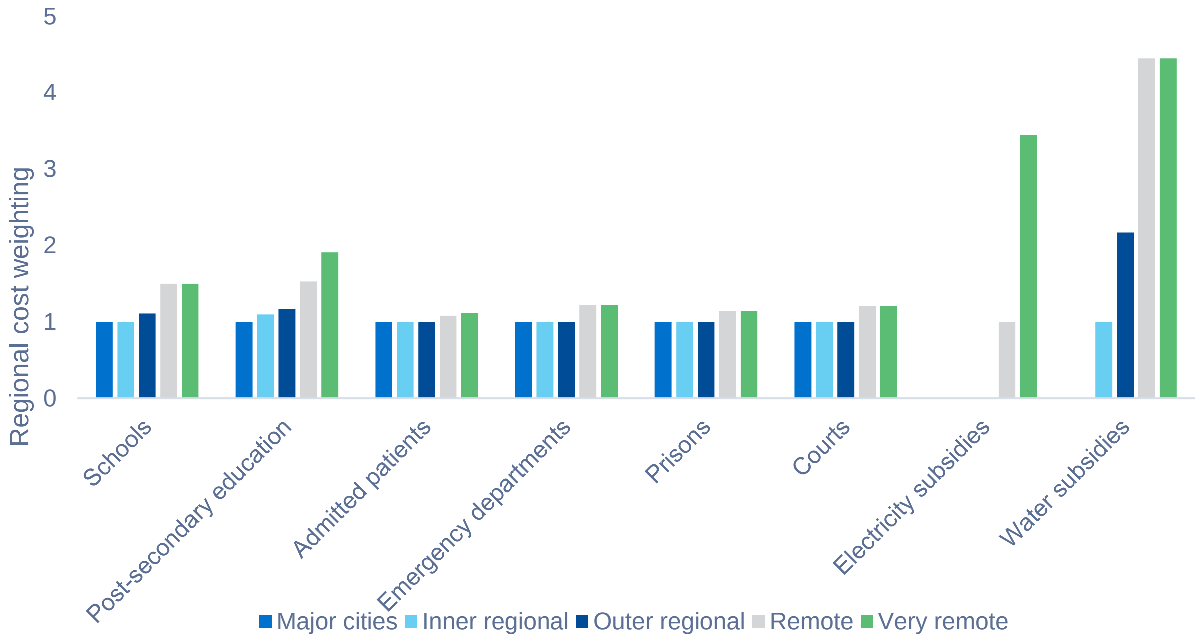
6.3.1.2 Variance between components in regional gradients

As noted in previous reviews, Victoria considers the breadth of services covered by the general cost gradient are unlikely to have the same regional cost pressures as schools and hospitals. As in Figure 11 below, there is a wide variation in the regional costs of assessments where specific data are available.

As an example, Victoria considers it unlikely that services like roads and non-urban public transport face the same regional cost pressures as schools and hospitals. These services use widely different input costs that likely face different cost pressures. For example, the labour markets for health and teaching staff are different to transport workers, with different education requirements, supply, and locational preferences.[44] In addition, non-staff operating costs are likely also different between services – roads and non-urban transport likely include a higher proportion of costs including fuel and energy. These variable cost pressures are unlikely to be captured by the same measure.

[44] Shapiro, J. (2006). 'Smart Cities: Quality of Life, Productivity, and the Growth Effects of Human Capital'. The Review of Economics and Statistics, vol. 88, no. 2, pp. 324–335.
Combes, P., Duranton, G. & Gobillon, L. (2008). 'Spatial Wage Disparities: Sorting matters!'. Journal of Urban Economics, vol. 63, no. 2, pp. 723–742.

Figure 11: Regional cost gradients by assessment components, 2020 review



Source: CGC 2020 review, DTF calculation
Note: This figure is intended for illustrative purposes, noting there are issues with some specific data for regional costs including for water and electricity subsidies, as Victoria raised in response to tranche 1 consultation.

6.3.1.3 Lack of specific evidence

Victoria accepts that in some cases the CGC may decide to support the implementation of a strong conceptual case with approximate data or methods that are not ideal to achieve its broader equalisation objective. Victoria supports the use of appropriate discounting in these instances.

However, the general regional cost gradient is often implemented without a strong conceptual case. As established by the CGC at the outset of the review, drivers must be based on: “sufficient empirical evidence that material differences exist between states in the levels of use or unit costs, or both, in providing services.”[45]

The 2020 review report provides some qualitative justification for most, but not all cases where the general cost gradient is used. The 2025 review consultation papers do not expand on this justification. At a minimum, Victoria considers a conceptual rationale based on examples or case studies from states must be provided for the general regional cost gradient to be implemented to assessment components.

For example, service expenses under the other expenses category include a subset of expenses that have the general regional cost gradient applied, where only 50 per cent of expenses in the ‘general public services and other services’ component is captured. Only limited explanation is provided for why this approach is taken, nor is evidence provided to demonstrate that the cost of these services vary by region.

[45] CGC 2025 Methodology Review, Commissions position on fiscal equalisation, supporting principles and assessment guidelines, June 2023

In some cases where the general regional cost gradient is implemented there is a conceptual case that there are not additional costs in regional areas. For example, as discussed on the roads assessment, in section 5.2 of in this response.

Victoria's view is that the application of the cost gradient is not a minor issue, being applied to many components and redistributing significant GST revenues, as shown in Table 3.

Table 3: Implementation of the general cost gradient in assessment components in the 2020 review methods

Category	Component	Driver	Type of assessment	Evidence provided
Health	Community health	Regional costs and SDS	Extrapolated	Addressed in Tranche 1 consultation Data from AIHW to supports higher remote service use
Housing	Social housing	Regional costs	General gradient	Census data supports higher remote service use
Welfare	Child protection and family services	Regional costs and SDS	General gradient	Conceptual case only
Services to Communities	First Nations community development	Regional costs	General gradient	Conceptual case only
	Other community development	Regional costs	General gradient	Conceptual case only
	Environmental protection	Regional costs	General gradient	Only applied to some components Conceptual case only
Roads	Rural roads	Regional costs	General gradient	Conceptual case only
Transport	Non-urban transport	Regional costs	General gradient	Conceptual case only
Services to industry	Agriculture regulation	Regional costs	General gradient	Conceptual case only
	Mining regulation	Regional costs	General gradient	Conceptual case only
	Other industries regulation	Regional costs	General gradient	Conceptual case only
Other expenses	Service expenses	Regional costs	General gradient	Only applied to some components Conceptual case only

Source: CGC consultation paper, DTF analysis

As noted in the introduction to its response to tranche 1 consultation, Victoria prefers a conservative approach in the face of uncertainty or a lack of information. Given there is not data or strongly established conceptual cases to support the implementation of the general gradient for these components, Victoria recommends they are not applied.

Victoria does not question the materiality of regional costs as a driver, rather the rationale for specific implementation in the components in question. For example, Victoria considers the application of regional costs in the health admitted patients assessment is appropriately based on robust data from the Independent Health and Aged Care Pricing Authority (IHACPA).

Should the CGC continue to apply the regional cost gradient, it will still need to be discounted to recognise its nature as an approximation. Victoria understands that the 2020 review method implemented a 25 per cent discount on the general cost gradient, however this is not discussed in the consultation paper. Victoria requests the CGC clarifies this in the draft report. Victoria recommends a higher level of discounting at 50 per cent is applied given the lack of evidence underpinning the gradient across a number of the components.

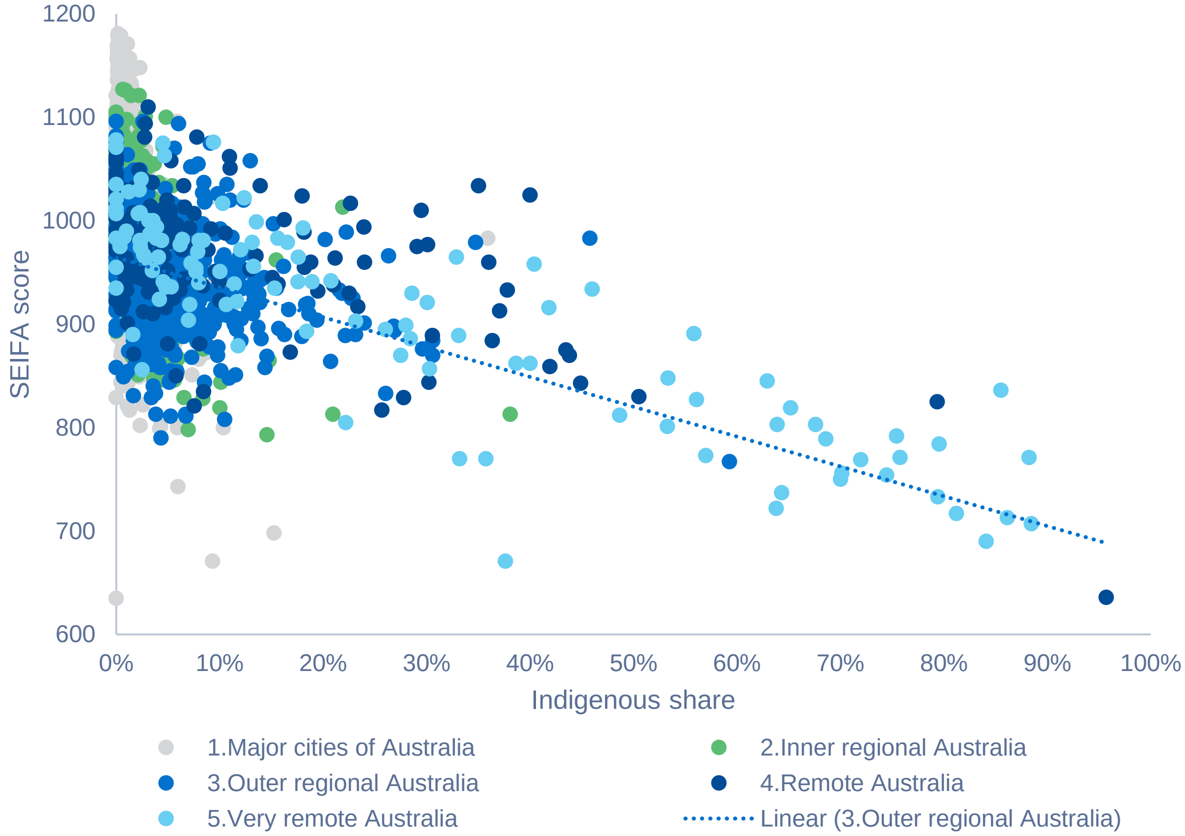
6.3.2 Interrelationships between geographic drivers

The CGC’s drivers of regional cost, service delivery scale, service use by remote residents, SES, and Indigenous status are all based on geography or are heavily influenced by it. These interrelationships may lead to issues with clearly identifying the discrete impact of any one geographically based driver from the others.

The CGC is aware of this issue, and in some places, accounts for the potential effects. However, in Victoria’s view this is not adequately addressed in all assessments. For the assessments to function as intended, the effects of each driver must be uniquely identified. Weightings for higher remote service use from the sociodemographic composition (SDC) drivers are applied directly to the relevant population numbers. If different drivers partly measure the same underlying cost or demand driver, there could be double counting or compounding of effects.

For example, Indigenous status and remoteness of residence are related variables, see Figure 12 below. From the 2021 Census, postcodes with a lower SEIFA score (lower SES) on average had higher Indigenous population shares. In addition, lower SES and higher Indigenous population share postal areas tended to be remote or very remote. The CGC also finds states tend to spend higher amounts per person on both remote and Indigenous people. Observing the additional cost of one group in isolation likely reflects the effect of the other correlated variables.

Figure 12: SES, Indigenous population share and remoteness by post codes in Australia, 2021 Census



Source: ABS 2021 Census

Several assessments address this issue explicitly. For example, for admitted patients, NWAUs are received from the IHACPA disaggregated by sociodemographic group to allow for the identification of the effect of each variable separately. The activity unit data are separated for remote, Indigenous status, SES and age, and costs weightings are then calculated for each group. This ideally removes the effect of any correlation between these factors, allowing them to be applied.[46] However, in other assessments, Victoria questions whether these factors are appropriately disaggregated.

There may also be an issue for social housing, child protection and family services components that implement Indigenous and income (or SES) drivers in addition to the general cost gradient. Regional costs are calculated separately to Indigenous and SES weightings for these assessments, which are likely interrelated.

The social housing assessment includes a cost weighting for Indigenous households derived from RoGS and state provided data. These data support that states spend more on Indigenous households, regardless of location. This cost weighting does not separate out or mitigate the potential effects of remoteness on the higher cost of Indigenous households. It may be the case that some

[46] Noting Victoria's concern noted in its Tranche 1 submission that the SES and remoteness variables may be derived from the same information and so undo this effect.

proportion of the observed Indigenous cost weighting for housing is related to a higher propensity to be located in remote areas. The SDC assessment on service use by group in the social housing assessment is disaggregated using Census data, and so avoids this issue.

Victoria recommends that the CGC address the potential over stating of the impacts of Indigenous status, income (SES), remoteness and regional costs by accounting for their interrelationships in both the social housing and child protection assessments.

6.3.3 Issues with regional costs discussed elsewhere

The CGC should continue to monitor developments in digital service delivery that may affect the cost of regional and remote service delivery. Victoria commented on this issue in its tranche 1 response on health, and in this response on roads and services to industry.

As noted in Victoria's tranche 1 response, and in its 2020 review responses, Victoria is concerned with the implicit assumption in the CGC's assessments that people receive services where they live. This is because the CGC takes regional cost weightings typically based on the place of residence, rather than place of service receipt. Victoria's tranche 1 response raised this issue in relation to hospital and prisons services.

CGC consultation questions and Victoria's positions

Q1. Do states support continuing the current methodology for estimating regional costs and service delivery scale effects?

- Victoria broadly supports the CGC's approach to estimating regional costs and service delivery scale effects.
- Victoria recommends the general cost gradient is not applied unless supporting evidence is provided for regional costs in the specific assessment components.
- At a minimum Victoria recommends the use of the general cost gradient is discounted by 50 per cent for all assessments it is applied to.
- Victoria requests the potential for double counting of Indigenous, income, remote and regional costs is examined in the housing and welfare assessments.

6.3.4 Differences in non-wage costs between major cities

Victoria does not support separate, additional adjustments for 'isolated major cities.' Victoria agrees with the conclusion in the 2020 review that such judgement-based adjustments are not sufficiently robust.

Victoria is not aware of any data sources that would support the potential adjustment described in the discussion paper. Victoria does not accept the conceptual case for such an adjustment and supports the continued use of ARIA as the basis for measuring remoteness, in the absence of a preferred alternative.

CGC consultation questions and Victoria's positions

Q2. Can states identify any data to measure differences in non-wage costs between major cities?

- Victoria does not support the conceptual case for adjusting for differences in non-wage costs between major cities, and it is not aware of any data sources that would support it.

6.4 Administrative scale

Victoria has significant concerns with the 2020 review methods for the administrative scale expenses assessment and does not support their continuation through the 2025 review period.

Victoria considers this assessment reflects concerns highlighted in introductory comments in the tranche 1 response on standards of evidence and simplicity. The assessment is highly complex and redistributes significant GST revenues based largely on assumptions and a complex conceptual case. In the 2023 update, the CGC noted administrative scale redistributed $1.5 billion of GST revenue between the states. If administrative scale were counted as an expenditure category it would have had the third largest redistribution of all, behind only health and schools redistributing $2.7 billion and $1.7 billion respectively. Victoria does not consider the assessment meets the required standards of evidence and should be reconsidered or discounted at a minimum.

Victoria recommends the CGC recalculate the administrative scale assessment, taking a more restrictive view of what to include as the 'minimum' functions of government. The data used in the current method are now outdated, and continuing to index them into future is not valid. If this is not able to be completed as part of the 2025 review, the CGC and states should continue to work together on this issue between the 2025 and 2030 reviews. In the interim, if the current methods are maintained, they should be discounted by at least 25 per cent reflecting the significant judgements and now dated data used for its calculation.

6.4.1 Conceptual concerns

Victoria agrees with the underlying conceptual case for the administrative scale assessment –that there is likely a minimum underlying cost of a state or territory government that does not vary with population.

However, Victoria considers that the minimum unavoidable costs of providing a government have not been well defined, creating issues with the scope of this assessment. What states do is the basis for all assessments, however a 'minimum' cost of government is not an average of what states do. Conceptually a minimum would relate to the functions of government delivered most efficiently to service a population of a very small number of residents.

Further, the CGC's assessment method does not accurately estimate this figure and raises questions whether this number can be estimated practically. To resolve the disconnect between what states do and a theoretical 'minimum', the CGC benchmark to the smallest jurisdictions using judgement and assumptions. This does not recognise that all states have different priorities, histories and drivers that influence how their services are structured and organised.

Small jurisdictions, such as the ACT and NT, pursue their own policy goals and face distinct challenges meaning they may not represent a generic 'minimum' size of government.

For example, the current method assumes staffing numbers and positions for education departments are based on the ACT's structure. Victoria considers this potentially introduces policy influence for small jurisdictions and does not represent a true minimum.

The example used by the CGC to illustrate the conceptual basis of this assessment was that states broadly have the same sized teams working on liaison with the CGC on GST method related issues.

In Victoria’s experience this is not the case, states have different sized teams working on GST related issues, with different functions. This likely relates to the varying priorities of state governments and Treasury departments.

This example as a conceptual illustration represents broader issues with the assessment. Even this simple case, which state Treasuries and the CGC know well, is subject to policy choice and nuance. Victoria does not consider these issues are able to be unpacked to arrive at a ‘minimum’ cost across the breadth of government functions in a way that is implementable for the GST distribution.

6.4.2 Assumptions, judgement, and issues with calculation

The assessment is made based on illustrative or model departments, with model organisational structures. For example, it is assumed the ‘minimum’ education department includes a Secretary, Division and Group heads with personal assistants, two managers per Group with three staff each, for a total of 133 staff required. Determining these structures requires significant assumptions and judgement first on what is ‘average state policy’ and then an adjustment to ensure they represent a ‘minimum.’ It is not clear that these assumed ratios of managers per group and of managers to staff are required for a minimum department. It is also possible some functions can be fulfilled at a minimum with more or less staff than is estimated, as all are assumed to require the same flat ratios.

It is also unclear the organisational structure estimated is required for a minimum department. For example, the assumed ‘minimum’ education department includes a ‘strategy’ group under the schools division, a separate strategy and planning group as well as a planning group under the corporate division. This may be a representation of how states are organised, but it is unclear this is necessary for a model ‘minimum’ department. For example, these planning and strategy functions may be able to be consolidated to meet minimum needs that don’t change with population.

A significant proportion of the model education department’s staffing are for corporate functions, with 6 of the 13 groups allocated to the corporate division. Noting staff are allocated evenly to all groups, nearly half of all staff are for corporate functions. As noted above, this also may not represent a ‘minimum’ as these could be consolidated across departments under a central corporate services department similar to Victoria’s Department of Government Services, under a ‘minimum’ model. It is also questionable whether such significant corporate services are required for very small departments, let alone duplicated across departments.

APS salary data are also used to allocate costs to staffing numbers, which are clearly different from state costs, for different functions and roles. This introduces another element of uncertainty and potential error in the estimation process for this assessment.

Victoria considers the costs in the administrative scale assessment are also likely double counted in other assessments. The CGC takes the total expenditure for each ‘minimum department’ which are the same as those considered in other assessments like schools, health and so on. Expenses for administrative scale are added to assessed expenses through the other expenses category. The need for support staff for these functions are already assessed in the specific categories and do not need to be arbitrarily replicated in the administrative scale assessment. If the administrative scale assessment is to be implemented, it should be netted out from the other assessments.

In addition, other central functions like Treasuries and Cabinet and Parliamentary services are already captured in the other expenses assessment assessed on an equal per capita assessment, which Victoria considers appropriate.

6.4.3 Potential for diseconomies of scale

The administrative scale assessment focusses on the challenges faced by states with small populations but does not consider the diseconomies of scale faced by states with larger populations. A recent academic paper by Chan and Petchey suggests states face additional congestion costs or decreasing returns to scale for servicing larger populations.[47] Victoria requests the CGC examine the potential for a congestion cost weighting in line with the paper and provide its views in the draft report.

> **CGC consultation questions and Victoria's positions**
>
> **Q1. Do states support the continuation of the administrative scale expense assessment in its current form?**
>
> - Victoria does not support the continuation of the administrative scale assessment in its current form. Victoria recommends the CGC re-calculate the administrative scale assessment for the 2025 review, reducing the scope to focus on the minimum cost of state government services. If this is not able to be done as part of the 2025 review, the CGC should discount the assessment by 25 per cent.
> - Victoria requests for the draft report the CGC examine a potential additional congestion cost disability, to account for evidence of decreasing returns to scale for state services.

6.5 Adjusted budget

6.5.1 Data source for the adjusted budget

In principle Victoria supports the CGC's proposal to change the source of data for the adjusted budget for year 3 from state to ABS provided data, noting this should improve consistency and reduce the burden on states to provide data.

The CGC has suggested where the ABS is unable to provide data on time, it will request data from states. Victoria is concerned whether there will be sufficient time for states to respond to a late request for data. Experience through previous updates has shown the CGC may require further engagement with states before data returns can be verified and applied. If data are requested late in the annual update process, this will place additional pressure on already tight timeframes for the update reports. Victoria requests the CGC outline when preliminary data will be requested from the ABS, and address how it plans to manage this potential challenge in its 2025 review draft report.

In addition, the ABS makes a number of adjustments to state data including to COFOG classifications. States do not have visibility over these changes, and they may change final data. Victoria requests the CGC discuss with the ABS what changes it makes and provide this information to states before implementing this new approach.

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[47] The Cost of Congestion for State and Local General Government Services in Australia - Chan - Australian Economic Review - Wiley Online Library, https://onlinelibrary.wiley.com/doi/full/10.1111/1467-8462.12543

6.5.2 Process for implementing adjustments

Victoria supports the CGC's proposed general process for implementing data adjustments. However, Victoria would prefer more clarity around how states will be engaged in the process of reviewing and updating adjustments to ensure transparency.

Greater communication and transparency on adjustments between states may assist others prepare their data returns and revenue forecasts. All states should be made aware of the specific adjustments that are made to ensure transparency. This should be documented through the annual updates, either in the update report, or in the assessment simulator spreadsheets.

CGC consultation questions and Victoria's positions

Q1. Do states agree with the Commission's preliminary view to use:

- ➢ **ABS preliminary Government Finance Statistics data for year 3**
- ➢ **a state's year 3 data if the ABS preliminary data are not available**
- ➢ **the final ABS Government Finance Statistics data for the first 4 assessment years (year minus 1 to year 2).**

- Victoria supports the CGC's preliminary view to replace the use of state Government Finance Statistics (GFS) state data for year 3 with preliminary ABS GFS data and to continue to use final ABS GFS data for prior years. Victoria supports the continued use of ABS GFS data for the first 4 assessment years.
- Victoria requests the CGC discuss in the draft report how it will address potential late requests for state data, if the ABS is not able to provide data on time.
- Victoria requests the CGC provide states information on what adjustments the ABS makes to its data before providing to the CGC for its updates and consults on any significant adjustments as it currently does when ABS data replace state provided data.

Q2. Do states consider the proposed process for implementing adjustments in the 2025 Review adjusted budget is appropriate?

- Victoria supports the proposed process for implementing adjustments however requests the CGC provide clarity around how it will consult with all states on adjustments.