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Victorian response to CGC 2025 review consultation

Draft Report

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 June 2024 states and territories (states) were provided the Commonwealth Grants Commission's (CGC) draft report of its 2025 Methodology Review. Victoria thanks the CGC and its staff for the opportunity to provide comments on the CGC's positions described in the report.

This response provides Victoria's views on the draft report. As the draft report did not include specific questions for consultation, this response provides Victoria's views on any aspects considered relevant including on the review work program, high level principles and the assessment methods proposed for each assessment category.

2. Summary of Victoria's recommendations

Work program, consultation and approach to the review

- Victoria recommends the CGC reexamine its data request process for reviews to improve consistency of data collection from states ahead of the next expected review. This should include examining whether quality data are able to be provided for all assessments where necessary and alternatives sought if not.
- Victoria recommends more external consultants are engaged for the 2030 review for select key assessment areas, and that this commences in advance of the official start of the review. The 2025 review report should note which priority topics to be examined ahead of the 2030 review will have consultant projects.
- Victoria recommends for future reviews the CGC provide as much detail as possible on its current and proposed assessment methods to enable states to provide fulsome comments.
- For future reviews, Victoria recommends the CGC make clear in its workplan its position on considering out of cycle state responses and include clear timelines for when positions will and will not be considered.
- Victoria recommends the CGC publish as part of the next review workplan a timeline for its meetings including when it expects to consider certain topics.
- Victoria recommends the format and information for agencies in the review data requests are reconsidered ahead of the next review for ease of interpretation. Victoria recommends the CGC engage with relevant agencies ahead of developing any new data requests to align terminology and test availability of data.
- Victoria recommends the 2025 review report make more prominent caveats around uncertainty and data quality.

Horizontal Fiscal Equalisation and Supporting Principles

- Victoria recommends simplicity and transparency are further elevated among the supporting principles, and that the CGC consider all other proposals in light of these elements.
- Victoria recommends the CGC apply discounting to uncertain conceptual cases and assessments made with judgement.

The case for method changes between reviews

- Victoria supports the conclusion to allow flexibility between reviews and the proposed process for consultation as described in the draft report. Victoria recommends however the CGC reconsider its proposed mechanism for implementing flexibility and rather allows for flexibility as part of the 2025 review methods.

Revenue

Payroll tax	<ul style="list-style-type: none"> • Victoria supports the CGC's draft position to retain the current assessment method. • Victoria supports the CGC's draft position to assess payroll tax surcharges on the same basis as payroll tax. • Victoria supports the CGC's draft position to postpone consideration of an alternative assessment method using BLADE and/or PLIDA data to a future review.
Land tax	<ul style="list-style-type: none"> • Victoria supports the CGC's proposal to retain the discount and recommends the CGC increase the discount to 25 per cent.
Stamp duty on conveyances	<ul style="list-style-type: none"> • Victoria supports the CGC's proposal to maintain the existing methodology, but requests an APC assessment of stamp duty on non-real property transactions. • Victoria supports the CGC's proposal to examine the issue of elasticity adjustments as part of its forward work program.
Insurance tax	<ul style="list-style-type: none"> • Victoria supports the CGC's proposal to leave the Insurance Tax assessment methodology unchanged from the 2020 Review.
Motor tax	<ul style="list-style-type: none"> • Victoria supports the CGC's proposal to maintain the existing methodology. • Victoria supports the CGC's proposal to assess revenue from emissions-based registration fees using the number of light vehicles.
Mining revenue	<ul style="list-style-type: none"> • Victoria supports the CGC's draft position to retain the mineral-by-mineral approach to the mining assessment as it achieves a superior equalisation outcome. • Victoria supports the CGC's draft position to treat brown coal royalties APC. • Victoria agrees with the CGC's decision not to include a dominant state adjustment and does not support revisiting the issue in future reviews. • Victoria supports the CGC's decision to retain the existing approach to assessing state bans and restrictions as it reflects HFE. • Victoria requests further analysis and consultation is conducted relating to changes in the assessment of onshore oil and gas.
Other revenue	<ul style="list-style-type: none"> • Victoria supports the CGC's proposal to retain the existing composition of revenues (including gambling) in the other revenue category and that revenues in this category continue to be assessed EPC.
Gambling tax	<ul style="list-style-type: none"> • Victoria supports the CGC's draft position to continue to assess revenue from gambling taxes EPC in the other revenue category. Victoria agrees that there is currently no reliable method of differentially assessing gambling taxes.

Expenses

Schools	<ul style="list-style-type: none"> • Victoria acknowledges the CGC's draft position relating to the differential assessment of primary and secondary schools. • Victoria notes the CGC's finding that data related to students with disability is not currently fit for inclusion in the assessment. Victoria requests further work and data monitoring ahead of the 2030 review. • Victoria does not support not including a variable to account for the effects of non-English speaking background students. • Victoria requests further analysis be done to assess the materiality of an ECE component. If it is material, an EPC assessment should be introduced while the CGC develops an alternative methodology ahead of the 2030 review.
Post-secondary education	<ul style="list-style-type: none"> • Victoria supports the CGC's draft position to retain the 2020 Review assessment method, including the decision not to introduce a course mix driver on the basis that it is immaterial.
Health	<ul style="list-style-type: none"> • Victoria supports the CGC's conclusion to make a separate assessment of COVID-19 related expenditures for the relevant years in the 2025 review period. • Victoria broadly supports retaining the CGC's current approach to NSS substitutability and supports further consideration as part of the forward work program. Victoria recommends an external expert is engaged as part of the forward work program to review NSS substitutability. • Victoria supports using expenses paid by private health insurance funds as a proxy indicator for AP NSS substitutability. Victoria does not support the use of discretionary judgement to reduce the AP substitutability rate, and rather recommends a standard discount of 12.5 per cent. If the CGC does not implement this change, Victoria recommends the CGC adopt the calculated substitutability rate of 17.5 per cent, rather than rounding to 15 per cent. • Victoria supports the proposed methods for ED NSS substitutability however recommends the CGC implement a rate of 13 per cent, instead of retaining the previous 15 per cent. • Victoria supports the proposed methods for NAP NSS substitutability however recommends the CGC adopt the 28 per cent rate rather than rounding to 30 per cent. In addition, given new data issues Victoria recommends discounting the assessment by 12.5 per cent, resulting in a substitutability rate of 24.5 per cent. • Victoria supports the draft report's proposed methods for community and public health NSS substitutability, however recommends implementing the calculated substitutability rate of 61.9 per cent, rather than 60 per cent. • Victoria supports the draft report's conclusions around culturally and linguistically diverse assessment in the health assessment and looks forward to working further with the CGC to implement an assessment. • Victoria does not support the continuation of the current NHPT assessment, however supports the CGC continuing to engage IHACPA on developments in NWAU data. The 2025 review should allow for method changes to remove this category if it is clear ahead of the next review that NWAU data incorporate these costs.
Housing	<ul style="list-style-type: none"> • Victoria does not support the CGC's draft position to move from a household-based assessment to an individual-based assessment. Victoria considers this change should not proceed as: <ul style="list-style-type: none"> ○ a clear conceptual case has not been made ○ there is not a compelling relationship between overcrowding and social housing expenditure

Expenses

	<ul style="list-style-type: none"> ○ the proposed methodology does not align with incidences of overcrowding in practice ○ the existing drivers in the housing assessment are already proxies for overcrowding ○ it overweights the impact of overcrowding on costs and contradicts other, more prevalent, cost drivers (e.g., single person households). <ul style="list-style-type: none"> ● Further, Victoria does not consider an appropriate level of consultation has been conducted given the magnitude of redistribution this change creates. ● Victoria supports the CGC's decision not to separately assess public and community housing. ● Victoria supports the CGC's decision not to introduce an adjustment for high service needs tenants. ● Victoria does not support the application of the regional cost gradient or Rawlinsons index in the housing assessment.
Welfare	<ul style="list-style-type: none"> ● The proposed homelessness component has cumulatively significant shortcomings. As is precedent in cases of doubt of this magnitude, Victoria requests an EPC assessment be retained for homelessness services. ● Victoria requests that COVID-19 related homelessness expenditure be assessed APC, given the precedent set in the health and services to industry assessments. ● Victoria requests the development of an adjustment for CALD populations is prioritised ahead of the 2030 review.
Services to communities	<ul style="list-style-type: none"> ● Victoria supports the application of a regional cost gradient to water and electricity subsidies, however it recommends discounting the remoteness factor applied to water subsidies by 12.5 per cent to account for data issues. ● Victoria acknowledges the lack of data supporting the relationship between services to First Nations communities and hectares of land managed by traditional owners. It looks forward to further developing the evidence base for the First Nations communities assessment. ● Victoria supports the EPC treatment of environmental protection expenses. ● Victoria does not support the use of the general cost gradient in the biodiversity and landscape assessment, and maintains its position that land prices and farm size should be included as drivers of biodiversity program costs in the environmental protection assessment. ● Victoria supports in-principle further consideration of an assessment of net-zero spending and recommends that the natural resource endowments of states are considered. ● Victoria supports exploring a new natural disaster mitigation assessment, however, it does not support the use of the National Partnership on Disaster Risk Reduction as a policy neutral measure of service needs.
Justice	<ul style="list-style-type: none"> ● Victoria supports the CGC's proposal to postpone changes to the justice methodology and use 2022-23 and 2023-24 data. ● Victoria supports the CGC's proposal to investigate major city effects in the police assessment. ● Victoria recommends the CGC discount the courts assessment if data are not available from all states. ● Victoria recommends the CGC assess criminal courts expenditure EPC as population is a better predictor of expenditure than the number of finalisations.

Expenses

	<ul style="list-style-type: none"> Victoria opposes the CGC's proposal to introduce a juvenile detainee cost-weight in the prisons assessment because state data are not comparable. Alternatively, a high discount of 50 per cent should be applied. Victoria supports the CGC's proposal to postpone decisions regarding regional and service delivery scale costs for the prisons assessment until further analysis of state data has been acquired and consultation undertaken.
Roads	<ul style="list-style-type: none"> Victoria supports the CGC's proposal to retain population as the driver for urban road lengths. Victoria supports the CGC's proposal to remove routes to mines, national parks, gas wells and ports from the rural road network. Victoria supports the CGC's decision to hold constant the urban/rural split for light and heavy vehicle traffic volume for the duration of the review. Victoria recommends the CGC not apply any remoteness cost gradient due to the lack of a demonstrated conceptual case. Victoria recommends the CGC apply a medium discount of 25 per cent to the assessment.
Transport	<ul style="list-style-type: none"> Victoria continues to support the CGC's general approach to assessing urban transport expenses using the model developed in the 2020 review, however, will provide a supplementary response with additional comments in response to the forthcoming addendum on transport. Victoria recommends urban transport is not on the forward work program to balance capacity for other more fundamental issues. Victoria does not consider 2022-23 transport expenditure data reflect a new post-COVID-19 trend and suggests the CGC retain the 2020 Review data. Victoria recommends the CGC make an additional later request for 2025-26 data ahead of the 2030 review for more timely data. Victoria supports retaining the 2020 Review urban transport model, however, does not support: <ul style="list-style-type: none"> indexing 2016 Census passenger numbers using distances travelled from the Bureau of Infrastructure, Transport and Regional Economics adopting 2021 Census distances travelled to work. Victoria reserves the right to comment on the blending between the urban transport model and urban populations once the transport addendum has been provided. Victoria supports the continuation of the econometric model being used to assess urban transport needs, including accounting for population density. Victoria however reserves the right to provide further comments in light of new evidence provided in the addendum. Victoria reserves the right to comment on the calculation of population weighted density until results from the addendum have been provided. Victoria will work further with the CGC on an appropriate adjustment for its urban trip related V/Line expenditures as part of the 2025 review. If an adjustment is not able to be made in time for the final report, Victoria recommends the CGC allow for method changes ahead of the next review for this issue. Victoria supports in-principle retaining the variables in the urban transport econometric model, subject to the results of the addendum. Victoria supports modelling passenger numbers through the new econometric model.

Expenses

Services to Industry	<ul style="list-style-type: none"> Victoria recommends that spending under programs with NANE treatment should be included in the assessment of state COVID-19 business support expenditure. Victoria supports replacing total factor income with the new annual measure but requests the CGC provide more insight on plans to renew the aggregate measure base at future reviews. Victoria considers that the number of businesses should be reintroduced as a driver in the assessment. Victoria requests that the CGC provide the materiality of reintroducing the number of businesses. Victoria expects that spending on the net-zero transition will continue to increase and further exploration of a future separate assessment should be prioritised once current limitations are addressed.
Natural disaster relief	<ul style="list-style-type: none"> 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 that 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.
Native Title and land rights	<ul style="list-style-type: none"> Victoria notes the CGC's positions on native title and Treaty spending and reiterates its concerns that native title spending may be policy influenced, and that its significant investment in Treaty is not being assessed accurately under current methods.
Other expenses	<ul style="list-style-type: none"> Victoria supports the CGC's proposal to maintain the existing composition of expenses classified in the other expenses category. Victoria supports the CGC's proposal to continue to assess other expenses EPC. Victoria supports the CGC's proposal to reduce the share of other expenses to which regional and wage costs are applied.
National Capital	<ul style="list-style-type: none"> Victoria supports the CGC's view to discontinue the national capital assessment from the calculation of GST relativities if the assessment is immaterial.

Other

Administrative scale	<ul style="list-style-type: none"> Victoria recommends the CGC broaden consideration of administrative scale under the forward work program to also consider its conceptual basis and not only update data for the current method. The 2025 review final report should state allow the CGC will develop methods for a congestion disability for use in the 2026 update.
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Other

Geography	<ul style="list-style-type: none"> Victoria does not support the inclusion of the regional cost gradients for investment, or water and electricity subsidies in the calculation of the general cost gradient until better data is available to quantify these gradients. Victoria recommends the CGC revise, clarify and restate the conceptual case for applying a general cost gradient to an assessment at each review process, ideally supported by an example of specific state circumstances or empirical evidence. Where this is not possible, the regional cost gradient should not be applied, or should be discounted by 50 per cent instead of 25 per cent. Victoria considers the application of the regional cost gradient in the social housing assessment should be revised due to the potential for double counting the impact of remoteness on costs.
Socio-economic status	<ul style="list-style-type: none"> Victoria supports the CGC's decision to leave the non-Indigenous socio-economic status assessment unchanged for the 2025 review. Victoria supports further exploratory work toward a potential change in a future review.
Investment	<ul style="list-style-type: none"> Victoria supports the CGC's decision not to smooth user population growth. Victoria supports the CGC's decision not to freeze component shares. Victoria recommends a discount of 12.5 per cent be applied to the non-wage component of the Rawlinsons regional cost gradient.
Net borrowing	<ul style="list-style-type: none"> Victoria supports the CGC's proposal to maintain the existing methodology.
Commonwealth payments	<ul style="list-style-type: none"> Victoria supports the CGC's proposal to apply a default impact treatment for uncertain payments. Victoria supports the CGC's proposal to no longer include Commonwealth Own Purpose Expenditure payments in the assessment.
Adjusted budget	<ul style="list-style-type: none"> Victoria supports the CGC's decision to use preliminary ABS data where available. Victoria supports the proposed process for implementing existing and new adjustments in the 2025 review and subsequent updates.
Wages	<ul style="list-style-type: none"> Victoria supports the changes in the draft report to the wages cost assessment.

3. Approach and work program

3.1 The forward work program

Through the review process Victoria has raised concerns around the lack of time and resource constraints to fully examine the breadth and depth of the current methods. These concerns have been realised with the draft report, where the proposed changes by the CGC are necessarily minimal, and a number of significant issues have not been able to be addressed within the timeframe of the review.

Victoria acknowledges the delay by the Commonwealth Treasurer in providing the review's Terms of Reference (ToR) compared to previous reviews has contributed to the constrained timing. Less time has resulted in Victoria having limited engagement with internal experts in line agencies, potentially leading to poorer outcomes. Victoria makes some suggestions below to manage these issues.

Victoria commends the CGC on establishing a forward work program and looks forward to exploring these issues ahead of the expected 2030 review. Victoria considers having a transparent forward work program will ensure issues that did not receive full consideration as part of this review are able to be examined ahead of the expected 2030 review. It will also avoid historic situations where valid conceptual cases have not been able to be translated into a methodology in the review timeframes.

Victoria agrees the CGC should not wait for explicit ToR from the Commonwealth to begin work on the next review. Given similarities of review ToR, it can develop and consult on its methods with states prior to receiving formal ToR.

Victoria is concerned however with the resources required for the CGC and states to fully engage on all the issues. Victoria considers the forward work program includes too many significant topics to realistically examine in depth ahead of the 2030 review. For example, as the draft report notes, states 'resource up' for reviews, and may have limited capacity after the 2025 review concludes.

In terms of prioritisation, Victoria strongly supports examination of culturally and linguistically diverse people as a driver of need across assessments, and reconsideration of administrative scale.

A re-examination of urban transport may not be practicable in the time provided ahead of the 2030 review. As Victoria noted in consultation on this topic, a 'new normal' travel pattern trend may take years to develop, and relevant data are likely available too late to inform full consideration. For example, detailed geographic Census data required are likely to be provided in 2028 which may be too late for consideration ahead of the 2030 review.

On elasticity adjustments, Victoria specifically supports examination with respect to mitigating the policy influences of land tax reforms. This task is likely the most relevant and material (as concluded by the 2020 consultants). Examining other revenue sources may increase the scope of this work beyond practicality.

Victoria would also like to suggest the CGC consider the case for the additional costs of state investment in brownfields areas and accounting for the impacts of land costs in investment components as part of the forward work program. Victoria considers a conceptual case has been made, however acknowledges relevant data have not been available.

As noted in its response to consultation on the wages assessment, Victoria considers the use of an expert consultant led to a thorough examination of the assessment and positive outcomes. Victoria would have preferred expert consultants were utilised more for the 2025 review, as noted in responses to consultation on a number of assessment topics. In hindsight, further utilisation of external reviewers may have assisted manage the timing constraints for the 2025 review.

Victoria recommends more external review is engaged for the 2030 review, and that this commences well in advance of the official start of the review. The 2025 review report should note which priority topics to be examined ahead of the 2030 review will have associated consultant projects.

3.2 Providing more detail for consultation

For this review, the CGC requested states' views on a number of new assessment areas where it did not provide a proposed method. These include the transition to net zero, natural disaster mitigation and Treaty with First Peoples. In other areas, a description was provided without specific detail, for example the 'dominant state' adjustment for mining.

Victoria considers this approach has not generated meaningful consultation. It potentially increases the difficulty of the CGC implementing approaches in future given the lack of detail and disparate nature of states' responses.

The short timeframes and lack of detailed proposals made it difficult to engage subject matter experts in service delivery agencies. Questions around how new areas for assessments are coded into financial reporting in particular are complex and were not able to be resolved adequately in the limited time provided as part of this review. Again, the lack of detail and variance in states' responses to these questions provides an indication that more guidance and specificity could have been provided. Victoria's experience is these requests are best accompanied by a specific data request, which gives data providers specific guidance on what to source. Even where this information was provided, agencies required significant assistance to understand and complete data requests.

In future, the CGC should provide a detailed proposed assessment for states' consultation, or not consult on these issues. As Victoria noted in earlier stages of the review, due to its constrained nature it considered speculative topics were not able to be included in the scope of the review (for example an assessment of expenses under the transition to net zero). Victoria appreciates the CGC identifying issues early, linking to its comments on flexibility. However, in future consultation could be improved by the CGC providing a clearer view and details on potential methods.

3.3 Clarity on timing and coverage of state responses

Truncated timelines led to states' views being provided out of the set windows, leaving other states with limited ability to respond. For example, Victoria provided a consultant's report on justice after tranche 1 responses were due, New South Wales (NSW) provided two supplementary submissions on transport and health and Western Australia (WA) provided one on Indigenous disadvantage.

In addition, several states devoted significant portions of their responses to tranche 2 consultation to re-canvass issues covered under tranche 1. This led to a disparity in states comments as without specific guidance some states commented on tranche 1 again, whereas some only commented on tranche 2. This created confusion and led to a circular process where states commented on other states' comments. States' additional and supplementary responses were made outside the originally agreed workplan, making it unclear how and if these would be considered by the CGC as part of the review.

For future reviews, the CGC should be clear in the original workplan of how it will handle supplementary submissions and responses received on topics where views were not requested.

For the 2025 review it could have been that supplementary submissions must wait until the CGC's next formal consultation – for example, states' supplementary submissions after tranche 2 could have been held over for inclusion in state responses to the draft report. Further, the CGC could have noted

where it would consider additional submissions made on issues it did not request consultation on, for example tranche 1 topics as part of tranche 2 submissions.

Greater clarity around the CGC's decision-making timelines would also assist states manage their internal timelines. The CGC should publish as part of the review workplan, or provide separately to states, a timeline for its meetings including when it expects to consider certain topics. Victoria understands a driver of the CGC's timelines for states' submissions are CGC meetings on certain topics, however states had no visibility of these.

3.4 Issues with data collection process and quality

Experience with the 2025 review data requests has again highlighted issues with the quality of data used in the CGC's methods, and the potential for over specification and implied precision in the methods that is not supportable by available data. While in theory the CGC's methods may be sound, quality data are often not available to implement them adequately.

Victorian agencies had challenges completing the data requests for the review. Victoria is aware that other states had similar issues, both through the CGC and directly from states. The data requests were often for granular information on topics or in formats agencies do not typically use or collect. This required a number of assumptions, proxies and estimates to ensure the relevant detailed data could be provided in some form. The urban transport, justice, health, services to communities and housing data returns all required clarification, proxies or other estimates to complete.

Victorian agencies responding to the requests also highlighted difficulty interpreting the requests and required significant input from The Department of Treasury and Finance with assistance from CGC staff to understand them. From a process perspective, the data requests could be made clearer, including more guidance for a non-expert audience.

The CGC should consult with data providing agencies (liaising through state Treasuries) ahead of making a new data request to confirm data are available, and to align language and guidance with experts' views. Victoria recommends this involve meetings with agencies in some states to test guidance material and feasibility of new data requests before formally making requests as part of reviews or annual updates.

The CGC's methods are presented with the assumption that underlying data are accurate and collected to the highest, best practice, standards. In practice, data are of differing quality. Data from agencies like the Australian Bureau of Statistics (ABS) are vetted to manage uncertainty in collection, whereas ad hoc state data requests are completed without sufficient guidance by disparate agencies that do not typically respond to such requests. In addition, the data requested by the CGC are typically collected for service administration and not for the kind of analysis the CGC require for horizontal fiscal equalisation (HFE).

While all states make best endeavours to provide accurate data, there is little oversight on the consistency of assumptions or judgements around what is provided. It is unlikely this data is consistent and comparable, in the same way as the data provided by the ABS.

Data collected in reviews is retained for 5 years and has substantial impacts on states' budgets. The data request process must be reformed to provide data providing agencies more time and clarity to respond to requests. A greater emphasis should be placed on collecting quality data for reviews.

Given the current data being used, Victoria reiterates the CGC should take a conservative approach and make greater use of discounting. The CGC's presentation of its methods should also acknowledge the inherent uncertainty.

For the next review, the CGC should re-consider whether certain methods are appropriate given the data constraints. Simpler methods using publicly available data to replace bespoke requests may be more appropriate in many cases.

Victoria's recommendations

- Victoria recommends the CGC reexamine its data request process for reviews to improve consistency of data collection from states ahead of the next expected review. This should include examining whether quality data are able to be provided for all assessments where necessary and alternatives sought if not.
- Victoria recommends more external technical experts are engaged for the 2030 review for select key assessment areas, and that this commences in advance of the official start of the review. The 2025 review report should note which priority topics to be examined ahead of the 2030 review will have consultant projects.
- Victoria recommends for future reviews the CGC provide as much detail as possible on its current and proposed assessment methods to enable states to provide fulsome comments.
- For future reviews, Victoria recommends the CGC make clear in its workplan its position on considering out of cycle state responses.
- Victoria recommends the CGC publish as part of the next review workplan a timeline for its meetings including when it expects to consider certain topics.
- Victoria recommends the format and information for agencies in the review data requests are reconsidered ahead of the next review for ease of interpretation. Victoria recommends the CGC engage with relevant agencies ahead of developing any new data requests to align terminology and test availability of data.
- Victoria recommends the 2025 review report make more prominent caveats around uncertainty and data quality.

4. Horizontal Fiscal Equalisation and Supporting Principles

Victoria accepts the CGC's decisions on HFE and the supporting principles expressed in the paper: "Commission's position on fiscal equalisation, supporting principles and assessment guidelines", released in June 2023. Victoria's comments on these topics in response to the draft report are raised by exception below, however it generally considers these matters were resolved with the CGC's previous position paper.

4.1 Practicality

4.1.1 Reducing complexity and improving transparency

In addition to specific comments on the assessment methods overall, Victoria continues to have concerns with the complexity of the assessments. Victoria reiterates its request for the CGC to prioritise simplicity in its assessments and to minimise the use of uncertain, granular data and methods. Simpler, more robust methods would both reduce the risk of misallocating assessments of 'need' and improve the transparency of the system for decision-makers.

Transparency can be improved as even state officials are unable to fully interrogate the CGC's methods due to data and models not being able to be made available due to confidentiality or bespoke requests from other Commonwealth agencies. When they are, there is often specialist expertise required to interpret the data, including in econometrics, which increases the difficulty for states to comment on the methods. There are over 70 assessment components, each with detailed methods and bespoke data. This involves over 260 excel spreadsheets and over 500 data tables.

Complexity and granularity can also increase volatility, as detailed data inputs may fluctuate causing outsized impacts on the GST distribution when processed through complex models and assessments. This can have a real impact on service delivery, as a minor change in an uncertain variable or statistical model can redistribute hundreds of millions of dollars between states.

The CGC has recognised this as part of the review, for example suggesting methods to smooth variability in the wages cost assessment. The CGC recognised states' labour markets likely do not move as much as its modelled wage factors. Victoria considers this is potentially the case in other assessments, and the CGC should consider whether volatility in its assessments makes intuitive sense.

At other times, the outcomes of an assessment are unintuitive and difficult to explain to decision-makers due to the variety of granular and counteracting drivers. For example, in the proposed homelessness assessment, despite having the highest actual spending on homelessness services and the highest number of specialist homelessness services clients, the CGC's proposed model assesses Victoria as having the second lowest per capita expenditure need.

The complexity of the current system has a significant impact on the public discourse, which in turn influences decision-making around the HFE system. A more transparent and intuitive methodology could result in broader public engagement in issues of HFE, and ensure elected officials are informed and engaged when making decisions related to HFE policy. Victoria has found the complexity of the system has hindered prosecuting principle-based arguments in the public domain. Examples include:

- the Commonwealth's 2018 reforms and advocacy on the no-worse-off guarantee and
- the case for method changes responding to COVID-19 expenditure.

Victoria strongly supports the role of the CGC in educating the public on HFE and its system, but this can be aided by a more explainable system.

Several economists echoed these views and expressed views on the complexity of the CGC's methods in a recent poll by The Conversation:

- Saul Eslake: "... the procedures used to achieve this worthy goal have become complex, obscure and (to many people) incomprehensible.
That is in turn why so few people understand the purpose behind what is the largest single expenditure item in the federal Budget, and why Western Australia was (with the co-operation of both major parties in the federal Parliament) able to corrupt it in the way that they did in 2018."
- Flavio Menezes: "We need to move towards a more transparent and simplified system to implement horizontal fiscal equalisation."
- Rana Roy: "In regard to (2) [that the system is sufficiently transparent to ensure that it is sufficiently understood by all the relevant stakeholders], it seems clear that the pre-2018 formula was not sufficiently understood by all the relevant stakeholders."
- Jeffrey Sheen: "The formula and analysis applied by the Commission for GST revenue has become increasingly complicated..."
- Gigi Foster: "... I would prefer to see a simpler GST revenue distribution rule that is also easy to apply and transparent...".¹

Victoria's comments on the specific assessment methods below are in line with these requests for simpler methods that account for uncertainty and volatility for example through greater use of discounting. Examples include across the justice assessments, where Victoria retains its concerns raised in the first tranche of CGC consultation, and the wage costs assessment where Victoria supports the changes made to simplify the regression model.

4.2 Assessment guidelines

4.2.1 Approach to discounting

Victoria considers the current discounting approach is useful, however often lacks transparency, and is only applied where the CGC has concerns with data quality. Victoria's responses provided to the review highlight a number of cases where there are uncertain or unsupported conceptual cases which also warrant the application of judgement.

The CGC has stated that discounting does not necessarily move assessments towards achieving HFE. However, where there is uncertainty it is not possible to tell which direction improves HFE. In these cases, Victoria prefers discounting as a means of limiting the potential for misallocating GST revenue.

Victoria also considers that where there is uncertainty and the CGC has applied judgement then the assessments should reflect this uncertainty through discounting. It is not always the case that, through judgement, the CGC has "incorporated all relevant information and weighted it according to its reliability".²

¹ <https://theconversation.com/scrap-the-west-australian-gst-deal-set-to-cost-40-billion-leading-economists-227551>

² CGC: Fiscal equalisation, supporting principles and assessment guidelines consultation paper

For example, the prisons regression relies on judgement, but is not discounted despite the model results being acknowledged as unreliable. In this case, the CGC takes the results of an unreliable model which does not address concerns around uncertainty and the potential to misallocate the need for GST. Victoria recommends the CGC also implement discounting in cases where it uses judgement to maintain consistency in the CGC's approach (i.e. to discount with the standard approach rather than 'within' the judgement applied) and to avoid any inappropriate attribution of need.

Victoria's view is the CGC's 2025 review position paper on fiscal equalisation, supporting principles and assessment guidelines does not adequately describe how the CGC decides on the level of discount to apply. The CGC explains that "the level of discount applied depends on the Commission's judgment about the reliability of the data or method" and that "the Commission will use higher discounts when the Commission has greater concerns with the underlying data or assessment method." Victoria seeks further explanation of how the CGC decides the level of discount to apply in each case.

Victoria's recommendations

- Victoria recommends simplicity and transparency are further elevated among the supporting principles, and that the CGC consider all other proposals in light of these elements.
- Victoria recommends the CGC apply discounting to uncertain conceptual cases and assessments made with judgement.

5. The case for method changes between reviews

Victoria supports the draft report's position that it would be beneficial to have flexibility between reviews in limited circumstances. Victoria considers this is an important step to ensuring HFE can be achieved in light of significant, uncertain events, and to not impede efficiency enhancing policy reform.

As noted in Section 7.3.1 below on the health assessment and 7.10.1 on the services to industries assessment, Victoria made extensive arguments that the treatment of COVID-19 related spending during the term of the 2020 Review methods was inappropriate and misallocated the need for spending. Steps to ensure such a significant loss of HFE does not occur again are critical and necessary to ensuring fairness of the system into the future.

5.1 When to allow flexibility

Victoria supports the CGC's conclusion that flexibility only be exercised in limited circumstances, as defined in the draft report in paragraphs 26 and 27.

Victoria welcomes the draft report's clarification that the proposed circumstances would specifically include major policy changes between reviews. Victoria recommends this is similarly made clear in the final report.

Victoria disagrees with comments from other states on the difficulty in defining appropriate wording. Victoria considers broad wording as the CGC has suggested is appropriate to initiate exploration of method changes for external economic shocks or significant policy reforms affecting a particular assessment category. The specific detail can then be determined on a case-by-case basis. As the CGC's consultation paper noted, specific wording or quantitative triggers will be difficult to define, and as such it has opted to take a higher-level approach.

5.2 Process for consultation with states

Victoria supports the draft report's description of the process for consultation with states for potential method changes between reviews, as described in paragraphs 32 and 35.

5.3 Mechanism for flexibility

Victoria broadly supports the mechanism the CGC has chosen to implement flexibility through a standing ToR. However, Victoria reiterates its preference for flexibility to be actioned as a condition of the 2025 review methods, to be refreshed as part of the 2030 review.

Victoria is concerned with some elements of the CGC's proposal. Firstly, the CGC's proposal implies it will direct the Commonwealth Treasurer to amend its ToR, which the CGC cannot. In addition, Victoria considers the draft report's suggestion of the CGC preparing alternative update reports and methods for the Commonwealth Treasurer is an outcome that should be avoided if possible. This suggests the draft report's proposal would result in the Commonwealth Treasurer having to 'pick winners' by deciding whether to implement flexibility in ToR each year, which the draft report notes is not the desired outcome.

Victoria does not support the proposal from another state for the CGC to separately make recommendations to the Commonwealth to alter its ToR, in addition to providing the relativities without those changes. This is not feasible from a practicality perspective as there is not enough time for the CGC to respond to any late direction from the Commonwealth Treasurer by the time it has already prepared an update report. In addition, this process would re-create the current issue with

flexibility where the Commonwealth is the arbiter of CGC method changes and does not wish to choose winners.

5.4 Other proposals for flexibility

Victoria acknowledges the CGC's consideration of its proposal for scenario planning. Victoria accepts this may be difficult to implement practically, especially in light of the significant forward work program the CGC has proposed ahead of the 2030 review.

In response to concerns around the administrative burden on states for flexibility, Victoria considers the significant loss HFE experienced in previous years by the lack of flexibility to consider the impacts of the pandemic greatly outweighs the administrative effort for the CGC and states (both in dollar terms and in-principle). If the CGC is to make recommendations on the GST distribution, it must aim to achieve HFE to the extent possible. Not allowing method changes to respond to such significant recognised distortions as experienced through COVID-19 undermines the basis of the system. Victoria acknowledges states and the CGC may have to alter resourcing arrangements, however, considers this a necessary investment where required to have an accurate, contemporaneous HFE system. In the case of major policy reforms there is likely to be more time for planning and consultation before impacts become material.

Victoria's recommendations

- Victoria supports the conclusion to allow flexibility between reviews and the proposed process for consultation as described in the draft report. Victoria recommends however the CGC reconsider its proposed mechanism for implementing flexibility and rather establishes flexibility a condition of the 2025 review methods.

6. Revenue

6.1 Payroll tax

Victoria's recommendations

- Victoria supports the CGC's proposal to retain the current assessment method.
- Victoria supports the CGC's proposal to assess payroll tax surcharges on the same basis as payroll tax.
- Victoria supports the CGC's proposal to postpone consideration of an alternative assessment method using the Business Longitudinal Analysis Data Environment (BLADE) and/or Person Level Integrated Data Asset (PLIDA) data to a future review.

6.2 Land tax

Victoria supports the CGC's proposal to retain a discount on the land tax assessment. A discount continues to be necessary due to concerns about the reliability and comparability of states' taxable land value data.

The CGC's analysis in the draft report, in response to concerns raised by NSW, demonstrated material and volatile differences between growth in land values provided by state revenue offices and adjusted ABS land values.³

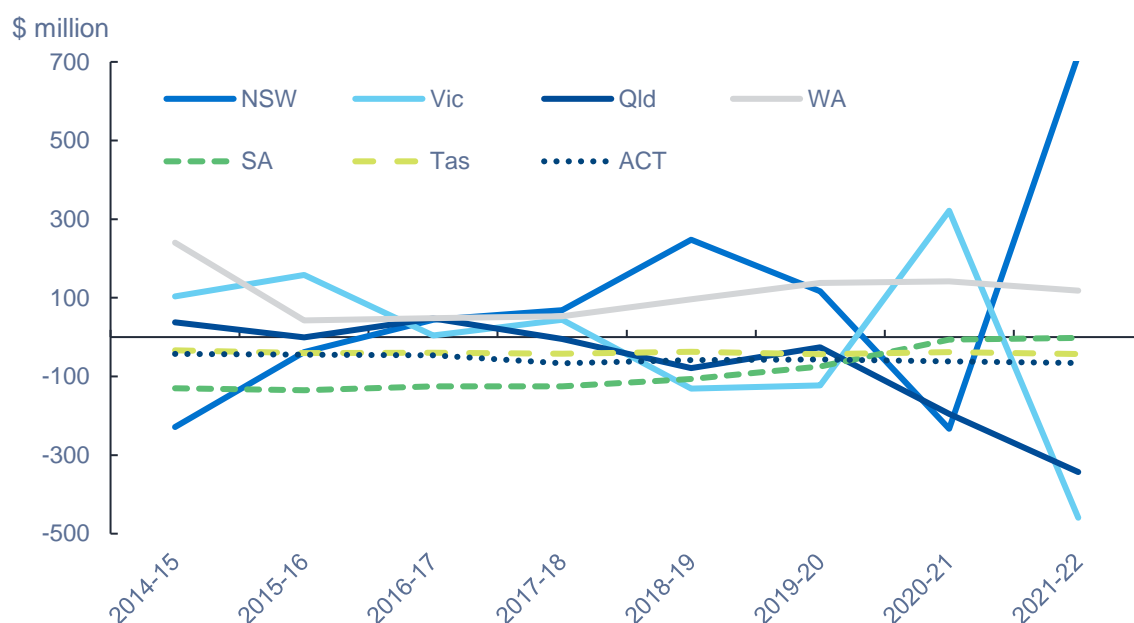
The CGC concluded that "while the quality of the data used in the land tax assessment has not deteriorated since the 2020 Review, a degree of uncertainty as to the accuracy of the adjustments made by states remains."

One of the reasons cited by the CGC for the reduction in discount from 25 per cent to 12.5 per cent in the 2020 Review was "the correlation between assessed revenue (using SRO land holdings data) and actual revenue has become stronger, suggesting assessed revenues are tracking actual revenues better."⁴ However, Figure 1 suggests that the relationship between assessed revenues and adjusted actual revenues has actually become more volatile.

³ CGC 2025 review draft report – Land Tax – Table 2 Difference between growth in adjusted ABS land values and growth in State Revenue Office land values, 2017-18 to 2022-23

⁴ CGC 2020 Review Report Volume 2 Part B (Ch5-18), p44.

Figure 1: Land Tax, assessed revenue minus adjusted actual revenue



Source: CGC simulator files, 2020 Review and 2024 Update

Regardless, Victoria considers that the CGC should consider the required level of discount independently of the 2020 Review methodology.

In its tranche 1 submission, Victoria supported the CGC's proposal to maintain the existing methodology, including the 12.5 per cent discount. However, given the data concerns discussed in the draft report and noted above, Victoria recommends the CGC increase the discount to 25 per cent.

Victoria's recommendations

- Victoria supports the CGC's proposal to retain the discount and recommends the CGC increase the discount to 25 per cent

6.3 Stamp duty on conveyances

Victoria supports the CGC's proposal to maintain the existing methodology for stamp duty on conveyances, with one exception.

6.3.1 Stamp duty on non-real property transactions

Victoria does not support the CGC's proposal to continue to assess revenue from stamp duty on the transfer of non-real property on an equal per capita (EPC) basis. States agreed to abolish these taxes under the Intergovernmental Agreement on Federal Financial Relations (the IGA).

In the draft report, the CGC referenced Victoria's objection to an EPC treatment on the basis that it would not be policy neutral, noting that Victoria preferred an actual per capita (APC) assessment. However, the CGC did not address this objection.

Instead, the CGC provided a rationale for not making a differential assessment. The draft report stated that the CGC “had no reliable way to estimate the value of non-real property in the 6 states that do not impose duties on non-real property. It is more practical and simpler to not assess capacity for the states that do not impose these duties.” Victoria does not consider the CGC has adequately responded to its proposal for an APC assessment.

Victoria does not consider it appropriate to differentially assess capacity for taxes that all states agreed to abolish, simply because two states have failed to fulfill this agreement (regardless of the CGC’s concerns around whether it is practical). An EPC assessment has similar issues to a differential assessment in that it would incorrectly and unfairly attribute revenue raising capacity to those states that have fulfilled their obligations under the IGA.

The only fair assessment methodology that accurately reflects states’ capacity to raise revenue from stamp duty on non-real property transactions is an APC assessment. An APC assessment would also be practical and simple.

6.3.2 Elasticities

Victoria supports the CGC’s proposal to consider how the complexities and uncertainties associated with an elasticity adjustment might be potentially addressed as part of its forward work program. Property tax reform is a current issue and it is important that the assessment is not a barrier to efficient reform.

Victoria’s recommendations

- Victoria supports the CGC’s proposal to maintain the existing methodology, but requests an APC assessment of stamp duty on non-real property transactions.
- Victoria supports the CGC’s proposal to examine the issue of elasticity adjustments as part of its forward work program.

6.4 Insurance tax

Victoria’s recommendations

- Victoria supports the CGC’s proposal to leave the Insurance Tax assessment methodology unchanged from the 2020 Review.

6.5 Motor tax

Victoria’s recommendations

- Victoria supports the CGC’s proposal to maintain the existing methodology.
- Victoria supports the CGC’s proposal to assess revenue from emissions-based registration fees using the number of light vehicles.

6.6 Mining revenue

6.6.1 Coal royalties

Victoria supports the CGC's position to assess brown coal royalties APC.

As noted in Victoria's previous responses to consultation, Victorian brown coal is inferior to black coal due to its high moisture content rendering exportation uneconomic.⁵ As a result, Victorian brown coal is not traded on markets, rather it is used for domestic electricity production which is usually a transfer within mining and generation entities.⁶

As there is no market for brown coal, the CGC estimates a price to determine Victoria's coal revenue raising capacity. The current methodology derives brown coal prices from black coal prices by calculating the per gigajoule market price of black coal and applying it to the energy content of brown coal. Implicit in this approach is an assumption that brown coal is substitutable for black coal. However, likening brown coal to black coal conflates phenotypical features with end use. The current methodological approach disregards the geological, geographic, and logistical factors that distinguish each sector from each other and the market dynamics structuring the trade practices of those sectors.

The Commonwealth Government's Office of the Chief Economist of the Department of Industry, Science and Resources distinguishes coal products into metallurgical and thermal coal.

More than half of Australia's coal mining industry activity is for processing metallurgical products. These products are essential to supply chains, enabling:

- coke production for iron and steel manufacturing
- smelting and casting of other base metals
- primary production and manufacturing requiring high energy, high heat processes such as electricity generation⁷.

Other resources cannot be substituted for metallurgical coal for steelmaking and metal refining.

By comparison, thermal coal is primarily used for electricity generation and both black and brown thermal coal exist. Thermal coal generally contains less carbon than metallurgical coal, making it unviable for steelmaking. Given the greater scope of end uses for metallurgical coal, it trades at significantly higher prices. Victoria's thermal coal operates within an insulated market, and is largely immune to global market fluctuations which normally result in substantial commodity price and demand fluctuations. For example, metallurgical coal was sold at an average premium of 90 per cent compared to the price of thermal coal in the United States of America from 2001 to 2023.⁸

Nearly all of Australia's brown coal is in Victoria, with more than 90 per cent in the Gippsland Basin's Latrobe Valley.⁹ Victoria's brown coal reserves are closer in calorific value to Indonesian thermal coal, which trades at a lower price point, than metallurgical and Newcastle thermal coal. This is demonstrated in Figure 2. S&P Global Platts determine the average calorific value of coal shipped at

⁵ <https://resources.vic.gov.au/geology-exploration/geological-survey-victoria/150-years/coal-powering-victoria>

⁶ https://resources.vic.gov.au/__data/assets/pdf_file/0003/1018191/Earth-Resources-Sector-Indicators-2021-22.pdf

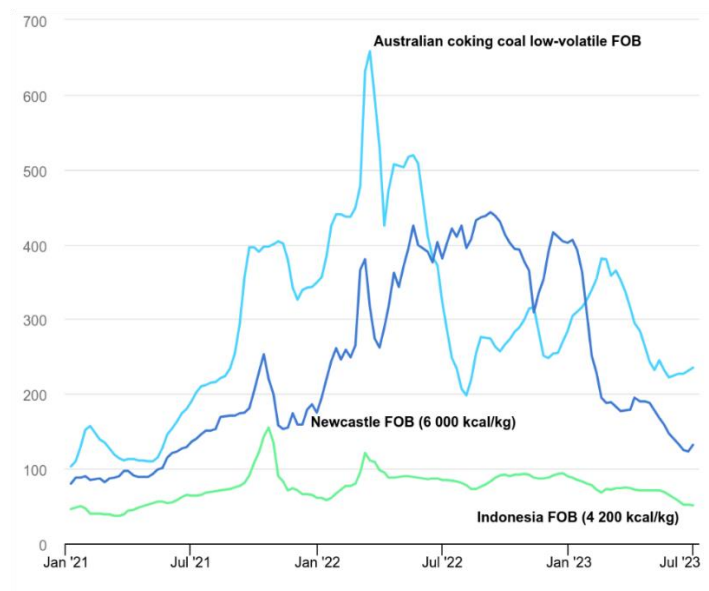
⁷ <https://www.rba.gov.au/publications/bulletin/2019/sep/pdf/the-changing-global-market-for-australian-coal.pdf>

⁸ <https://www.eia.gov/todayinenergy/detail.php?id=61924>

⁹ <https://ecat.ga.gov.au/geonetwork/srv/eng/catalog.search#/metadata/149666>

Banjarmasin (Indonesian) is 3,800 to 4,200 kilocalories per kilogram (kcal/kg), which compares to coal exported from Newcastle with a calorific value of 5,500 kcal/kg.¹⁰

Figure 2: Historical coal prices categorised by calorific value, \$US/t



Source: International Energy Agency, 2023¹¹

Latrobe Valley and Indonesian thermal coal typically contain more moisture than other coal forms. Latrobe Valley's thermal coal has an average moisture content of 50-65 per cent, while the moisture content of Indonesia's thermal coal and Newcastle's thermal coal are typically 38 per cent and 13 per cent, respectively. Differences in coal moisture content substantially impact energy per mass and transportability, hence logistical costs. As such, Victorian thermal brown coal would be considered of lower value than Indonesia's thermal coal.

In November 2023, the London Stock Exchange Group estimated that for the year elapsed, the benchmark grade of Indonesian thermal coal with a calorific value of 4,200 kilocalories per kilogram (kcal/kg) had averaged to roughly US\$65 per tonne throughout the 2023 year, while 6,200 kcal/kg coal shipped from Australia's Newcastle port averaged to roughly US\$184 per tonne.¹²

Metallurgical coal used for coke and premium thermal coal prices are highly volatile, whereas other thermal coal products are considerably more stable, see Figure 2.

Market differences were illustrated through the major coal price surges following Russia's invasion of Ukraine in early 2022. Australian coal export revenue increased by \$73 billion in 2021-22. The Australia Institute estimates that \$20.8 billion of this increase is due to the Russian invasion, \$5 billion of which the NSW and Queensland Governments received as windfall coal royalties.¹³ Immediately following Russia's invasion of Ukraine, the International Energy Agency (IEA) stated in their World

¹⁰ <https://www.spglobal.com/commodityinsights/en/our-methodology/price-assessments/coal/fob-newcastle-5-500-nar-coal-price-assessments>

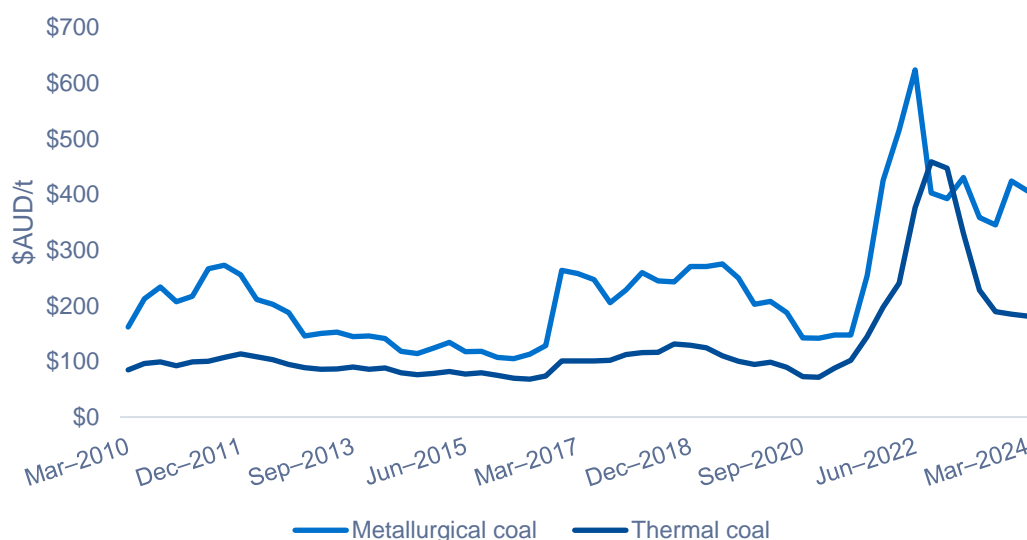
¹¹ <https://www.iea.org/reports/coal-market-update-july-2023>

¹² <https://www.reuters.com/markets/commodities/indonesia-fires-thermal-coal-exports-new-highs-2023-11-09/>

¹³ <https://australiainstitute.org.au/wp-content/uploads/2022/12/From-Russia-with-love-coal-windfall-gains-WEB.pdf>

Energy Outlook 2022 report that “the crisis has stoked inflationary pressures and created a looming risk of recession, as well as a huge US\$2 trillion windfall for fossil fuel producers above their 2021 net income.” By March 2022, the premium hard coking coal spot price peaked at US\$670.50/t (AUD\$924/t) while the premium thermal coal spot price peaked at US\$457.80/t (AUD\$675/t) in September 2022¹⁴.

Figure 3: Historical metallurgical and thermal coal prices, \$AUD/t.



Source: Department of Industry, Science and Resources, 2024¹⁵

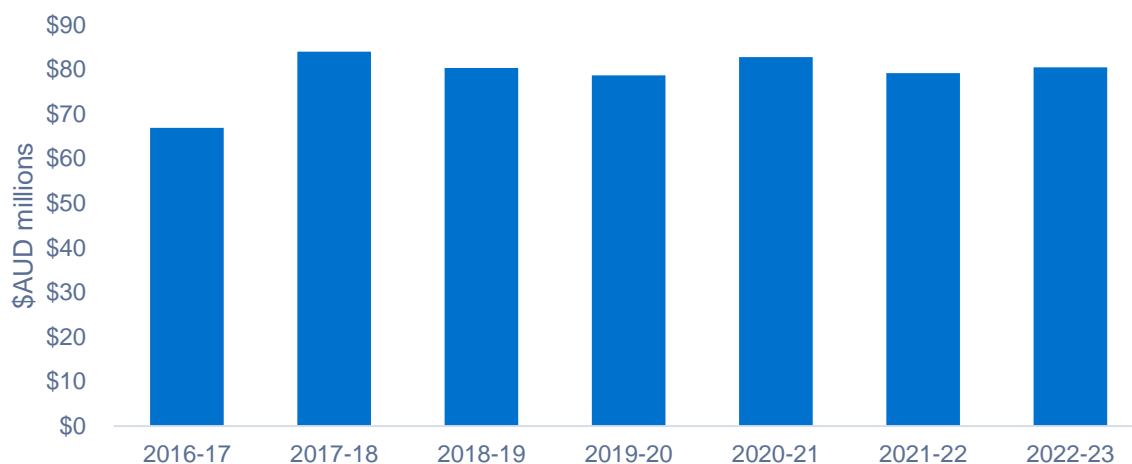
Figure 3 illustrates the highly variable prevailing market prices of metallurgical and premium thermal coal black coal. In states that can charge ad valorem royalties, revenue raising moves in line with these price changes. As such, the recent surges in black coal prices benefited those state governments through increased royalty collections.

In 2022-23, Victoria was assessed to be able to raise \$230 million in coal royalties, however, actual collections were \$81 million. The significant difference between the assessed and actual revenue raising capacity is illustrative of a methodology flaw overestimating the value of brown coal, rather than being policy driven. Figure 4 illustrates that Victorian coal mining revenue royalties did not increase or deviate from the existing trend in resource royalty collections for coal since 2016-17.

¹⁴ <https://www.treasury.qld.gov.au/resource/a-study-of-long-term-global-coal-demand/>

¹⁵ <https://www.industry.gov.au/publications/resources-and-energy-quarterly-june-2024>

Figure 4: Victorian royalties payable for coal industry operations per financial year end.



Source: Department of Energy, Environment and Climate Action, 2024¹⁶

While the average state policy is to charge ad valorem royalties, to imply it is possible for Victoria to charge ad valorem rates disregards fundamental differences in the endowments. Without a market price it is not possible for Victoria to charge rates based on value.

6.6.2 Dominant state issue

Victoria agrees with the CGC's decision not to include a dominant state adjustment in the mining assessment. Policy neutrality is a supporting principle which is subsidiary to the objective of HFE. Introducing a dominant state methodology would undermine the achievement of HFE.

There may be a conceptual argument that states do not increase their royalty rates due to concerns over their GST allocation. However, Victoria agrees with comments from NSW, South Australia (SA) and the Northern Territory (NT), that, in practice, this has not recently appeared to be the case.

The introduction of the *Treasury Laws Amendment (Making Sure Every State Gets Their Fair Share of GST) Act 2018* (2018 legislation) offered a natural experiment to exhibit this point. In recent years WA's strong own source revenue base has, in line with the principle of HFE, resulted in a low assessed relativity. However, under the 2018 legislation, WA's relativity has been consistently raised to the legislated floor. This has created the opportunity for WA to increase its royalty rates with limited recourse for its GST distribution. However, even though there are limited potential impacts from the GST distribution, WA has not increased its royalty rates.

Further, Queensland introduced significant reforms to its coal royalties in 2024.¹⁷ These changes are another example that, in practice, GST impacts have not disincentivised changes to royalty rates (noting Queensland's coal share has not met the CGC's previous definition of 'dominant'). Any actual change in GST distribution in response to changes in royalty rates is the precise purpose of equalisation in a federation.

¹⁶ https://resources.vic.gov.au/__data/assets/pdf_file/0012/996870/Earth-Resources-Regulation-Statistical-Report-2022-23.pdf

¹⁷ <https://statements.qld.gov.au/statements/100390>

As noted in the forward work program section of this response, Victoria considers the forward work program is extensive and that there are other, more pressing key issues that should be prioritised ahead of the 2030 review. Consequentially and given the above evidence, Victoria suggests that this issue does not warrant revisiting given any adjustment would circumvent HFE.

6.6.3 Uranium and coal seam gas royalties

Victoria supports the draft decision to retain the pre-existing approach to state bans and restrictions, assessing the capacity for states that extract, and not assessing capacity for those that do not. This approach most closely aligns with HFE as it accurately reflects states' ability to raise revenue from these resources.

It is not possible to accurately determine what level of production would occur if state bans and restrictions were not in place. Further, it should not be assumed any production would prevail given the presence of a resource is not the only factor determining production. Other factors include project viability, the economic environment, financing and capital availability amongst others. As such, there is no reliable counterfactual comparison that could be used to isolate and estimate the impact of restrictions and bans.

6.6.4 Onshore oil and gas

Victoria considers the CGC's draft position to change the assessment of onshore oil and gas to be based on volume of production data rather than share of weighted value of production is premature. Victoria does not believe appropriate consultation or analysis has been conducted to warrant this change. There has been no assessment of the materiality of this change, nor has there been any consultation as to whether states are able to provide adequate supporting data.

Victoria requests that further consultation and analysis is conducted, and that states are provided another opportunity to comment on any further work before the end of 2024 and ahead of a final decision.

Victoria's recommendations

- Victoria supports the CGC's draft position to retain the mineral-by-mineral approach to the mining assessment as it achieves a superior equalisation outcome.
- Victoria supports the CGC's draft position to treat brown coal royalties APC.
- Victoria agrees with the CGC's decision not to include a dominant state adjustment and does not support revisiting the issue in future reviews.
- Victoria supports the CGC's decision to retain the existing approach to assessing state bans and restrictions as it reflects HFE.
- Victoria requests further analysis and consultation is conducted relating to changes in the assessment of onshore oil and gas.

6.7 Other revenue

Victoria's recommendations

- Victoria supports the CGC's proposal to retain the existing composition of revenues (including gambling) in the other revenue category and that revenues in this category continue to be assessed EPC.

6.8 Gambling taxation

Victoria's recommendations

- Victoria supports the CGC's proposal to continue to assess revenue from gambling taxes EPC in the other revenue category. Victoria agrees that there is currently no reliable method of differentially assessing gambling taxes.

7. Expenses

7.1 Schools

Victoria notes the CGC's findings on the schools' assessment in the draft report, including the decision to introduce a differential assessment of secondary and primary schools.

Victoria appreciates the CGC's decision to monitor improvements with the Nationally Consistent Collection on School Students with Disability. Victoria suggests work to include students with disability within the schools' methodology should progress ahead of the next review as new state-funded foundational support schemes come online.

7.1.1 English as an additional language students

The CGC found that non-Indigenous disadvantaged students who speak a language other than English at home have additional cost requirements. However, these effects will not be included in the schools assessment due to the requirement for all variables within a concept (in this case, advantaged and disadvantaged Indigenous students and advantaged non-Indigenous students who speak a language other than English at home) to be statistically significant.

Victoria does not support this decision and considers the CGC should have regard for the model more holistically when evaluating variables. Victoria suggests the other variables in the non-English speaking background component may have an effect, but that this effect is already being captured by other variables (e.g., Indigenous status).

Given there is a clear conceptual case and measured, statistically significant effect of increased costs associated with disadvantaged non-English speaking background students, Victoria requests the model is adjusted to account for these.

7.1.2 Early childhood education

As discussed in Victoria's tranche 1 response, investment in kinder and early childhood education (ECE) has been substantially growing over recent years, a trend that is expected to accelerate in the lead up to the 2030 review. Given the dissimilarities to school spending discussed in Victoria's tranche 1 response, Victoria considers it is no longer appropriate to include ECE spending with the government and non-government schools' components.

As Victoria noted in its tranche 1 response, there are a mix of organisations providing early childhood services, including government, local council, not-for-profit and the private sector. Early childhood care is not compulsory, and there are subsidies available that depend on income levels. All of these drive differences in service use for different cohorts and are not the same as school education, in the same way that the drivers for post-secondary education are not the same as for schools.

If the CGC is unable to determine a separate robust method for the 2025 review, Victoria considers ECE spending should be assessed EPC. The CGC should then revisit this assessment in the 2030 review, when the CGC will be better placed to understand the drivers of spending and develop an appropriate differential assessment to apply to this component.

The draft report suggests spending on early childhood education is likely not material and that the data is not readily available. Victoria is not satisfied that this analysis is rigorous enough to justify the CGC's findings. The CGC faces similar issues accurately accounting for homelessness spending in the welfare assessment, and in that case a new data request is being issued to states to gather the data. Victoria requests the CGC employ the same approach for ECE to at least assess its materiality.

Victoria's recommendations

- Victoria acknowledges the CGC's draft position relating to the differential assessment of primary and secondary schools.
- Victoria notes the CGC's finding that data related to students with disability is not currently fit for inclusion in the assessment. Victoria requests further work and data monitoring ahead of the 2030 review.
- Victoria does not support not including a variable to account for the effects of non-English speaking background students.
- Victoria requests further analysis be done to assess the materiality of an ECE component. If it is material, an EPC assessment should be introduced while the CGC develops an alternative methodology ahead of the 2030 review.

7.2 Post-secondary education

Victoria's recommendations

- Victoria supports the CGC's draft position to retain the 2020 Review assessment method, including the decision not to introduce a course mix driver on the basis that it is immaterial.

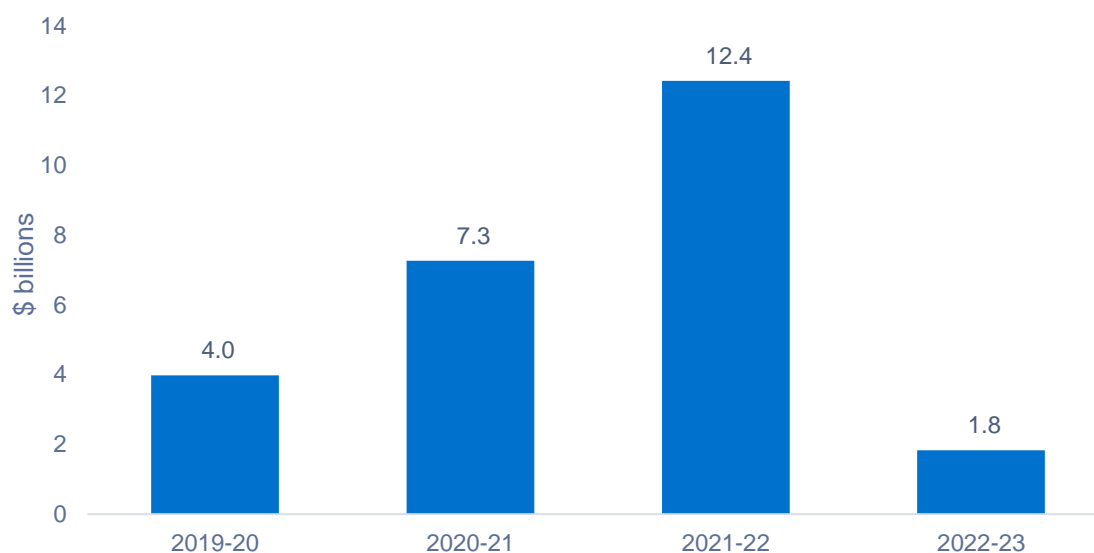
7.3 Health

Victoria is broadly supportive of the changes proposed in the draft report, barring specific comments on issues presented below. Victoria supports the CGC's decision to accept its evidence around the impacts of COVID-19 and culturally and linguistically diverse (CALD) residents. Victoria looks forward to working with the CGC and other states to implement a CALD assessment as part of the forward work program.

7.3.1 Impacts of COVID-19 on the health assessment

Victoria commends the CGC on its decision to separately assess COVID-19 related health expenditures for the 2025 review period. Victoria considers this change is critical to ensure HFE is achieved for assessment years that capture COVID-19 spending, which still significantly impact the 2025 review assessment period (see Figure 5).

Figure 5: Payments to states under the National Partnership on COVID-19 Responses, National Health Funding Body (NHFB)



Source: CGC provided data from the National Health Funding Body

Note: Chart excludes Private Hospital Viability Payments as the draft report suggests it will not assess these payments

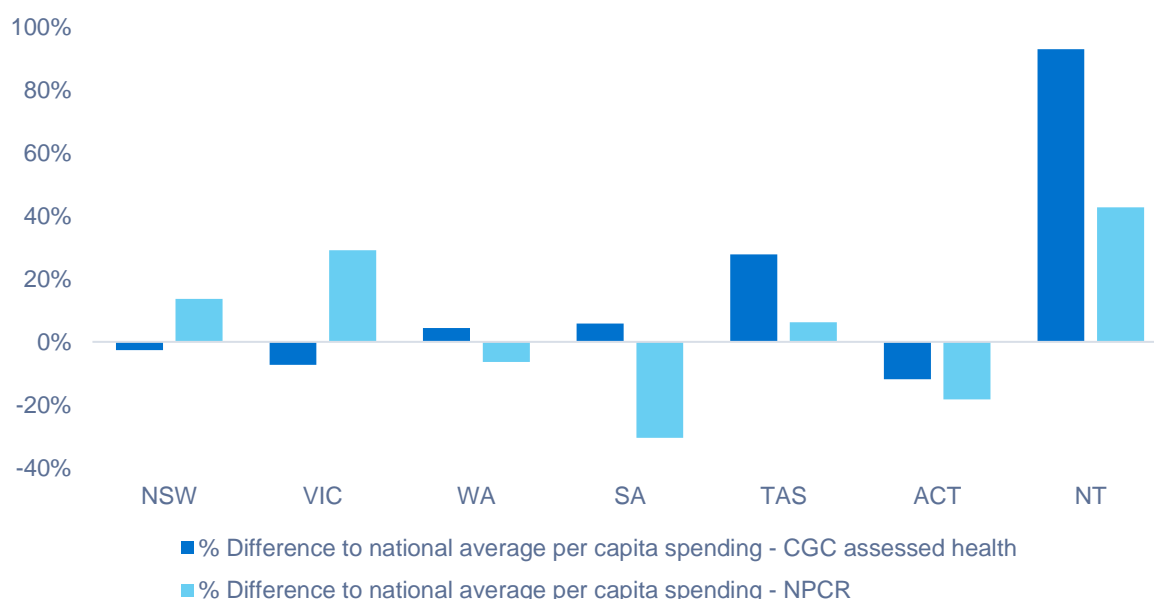
Victoria supports the CGC's proposed method for an APC assessment of states' health spending in line with the National Partnership on COVID-19 Responses (NPCR), as concluded in the CGC's 2023 Update report. Victoria's view, as previously stated, is that states' COVID-19 expenditures were in response to the uncontrollable effects of the virus and were broadly aligned following nationally agreed frameworks.

However, patterns of spending for COVID-19 responses differed greatly from the CGC's health assessments consistently throughout the pandemic, for example as shown in Figure 6 for 2021-22. The CGC assessed Victoria to need to spend 8 per cent less than the national average per person on health in 2022-23, whereas Victoria's payments under the NPCR were 30 per cent higher than the national average per capita. It is positive that the CGC is looking to rectify this misallocation in the 2025 review, albeit restricted to current assessment periods.

Victoria refers to its extensive previous evidence on this issue to support this position, including in its response to tranche 1, and the CGC's 2022 and 2023 New Issues papers. Victoria's 2022 new issues paper response included a paper commissioned by Victoria from academics Scott, Yong and Bai from the Melbourne Institute of Applied Economic and Social Research.¹⁸

¹⁸ Anthony Scott, Jongsay Yong and Tianshu Bai, Review of COVID-19 policy responses for the GST distribution, Melbourne Institute of Applied Economic and Social Research, 2021, [VIC submission Attachment B - Review of COVID Responses – Melbourne Institute Report.PDF \(cgc.gov.au\)](#)

Figure 6: Difference to national average per capita spending under the NPCR and the CGC's health assessment, per cent, 2021-22



Source: CGC draft report simulator files

Note: NPCR funding does not include payments the Private Hospital Viability Payments.

The CGC's position is that it will not consider any backwards adjustments for COVID-19 spending. Victoria notes however its previous responses on this issue did not request backwards adjustments as attributed to Victoria in the draft report.

7.3.1.1 Coverage of states' health spending under the NPCR

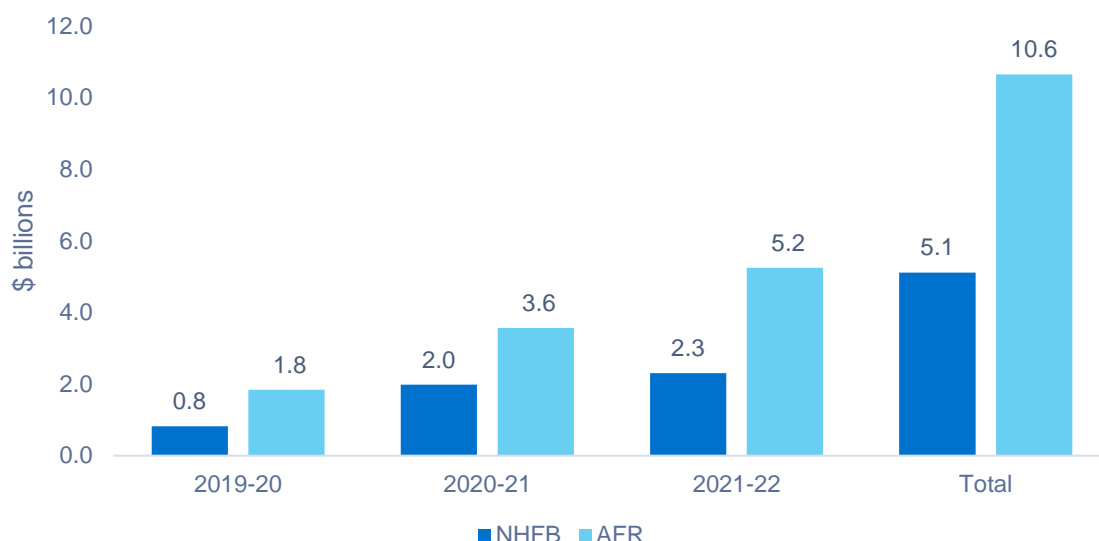
Despite supporting the proposed approach, Victoria notes that significant COVID-19 related health expenditures will not be captured under this method. Victoria noted this in its previous responses to the CGC's 2022 and 2023 New Issues papers.

A significant example of spending that is missed from the NPCR approach are expenses to support hospitals to maintain capacity (despite decreases in activity). Public hospitals rely in part on revenues that are dependent on activity, including carparking fees, lease agreements with cafes and activity-based items under the Medicare Benefits Scheme. As such, they experienced a shortfall to maintain pre-COVID capacity which the Victorian Government provided for. This was not agreed by the National Health Funding Body (NHFB) to be "COVID-19 related" spending under the NPCR.

While the proposed approach by the CGC will undercount states' COVID-19 expenditures, Victoria recognises the practical implementation issues the CGC faces and supports the approach under the NPCR.

Figure 7 below shows the NPCR consistently under-measures Victoria's COVID-19 health response. In total, spending under the Victorian Department of Health (and former Department of Health and Human Services for 2019-20 and 2020-21) was double that reported by the NPCR – \$10.6 billion compared to \$5.1 billion.

Figure 7: Victoria's state COVID-19 related health expenditure as measured by the NPCR and Victoria's Annual Financial Reports



Source: CGC provided NPCR data from the National Health Funding Body and Victoria's COVID-19 reporting from 2019-20, 2020-21 and 2021-22 Annual Financial Reports

Note: NPCR funding includes funding under the Private Hospital Viability Payments component to be comparable with Victoria's reporting which includes payments to private hospitals.

Victoria's recommendations

- Victoria supports the CGC's conclusion to make a separate assessment of COVID-19 related expenditures for the relevant years in the 2025 review period.

7.3.2 Community and public health

7.3.2.1 New assessment of community mental health services

As noted in its tranche 1 response, Victoria supports the CGC's proposal to use Australian Institute of Health and Welfare (AIHW) data for an assessment of community mental health services. Victoria considers this should improve the accuracy of the assessment compared to the current proxy measures.

Victoria accepts the CGC's decision to limit the use of the AIHW data to only a share of community mental health services. Victoria acknowledges the evidence provided by other states that the AIHW data only cover 'ambulatory' services, whereas states provide a broader range of services.

Victoria questions the use of the general cost gradient for the new community mental health services assessment, based on the CGC's judgement that costs will increase with remoteness. Victoria has broader concerns with the general cost gradient being applied to categories without sufficient evidence to motivate it. Victoria considers in this case there has been no evidence provided that costs for these services increase with remoteness. As such the general regional cost gradient should not be applied, or it should be discounted by at least 50 per cent to account for the lack of suitable data.

7.3.2.2 Updating the proxy for the remainder of public and community health

If a hospital-based proxy is to be maintained for the remainder of public and community health, Victoria supports the CGC's conclusion to broaden the proxy to include non-admitted patients (NAP), as well as emergency department (ED) triage categories 4 and 5, weighted by activity data.

Evidence provided by the CGC in the draft report calls into question the use of a hospital-based measure as the proposed proxy. The draft report shows summaries indicating the demographic groups that use or are targeted by public and community health services (replicated below in Table 1). The summary shows the groups that use or are targeted by the selected services are not consistent. The draft report notes considering this evidence that "there is no consistent pattern of usage of community and public health services, or common target population groups for public health activity".

In direct contrast, the CGC's proxy assessment explicitly relates the use and cost of these services to the same factors as NAP and ED: the elderly, remote, low socio-economic status (SES) and Indigenous residents. Victoria does not consider this conclusion follows the presented evidence.

Table 1: Higher use or targeting of community and public health services by socio-demographic group

Group of services	Usage (or targeting) of services by socio-demographic groups			
	Age	Remoteness	SES	Indigenous status
Community health services				
Public dental services	Younger	Urban	Lower SES	First Nations
Alcohol and other drug services	Younger	Remote	-	First Nations
Public podiatry	Older	Urban	Lower SES	-
Child and maternal health clinics	Younger	Urban	Lower SES	Non-Indigenous
Public health services				
Cancer screening	20+	Urban/regional	Higher SES	Non-Indigenous
Organised immunisation (targeting)	Younger	-	-	First Nations
Selected health promotion (targeting)	-	Regional /remote	Lower SES	First Nations
Communicable disease control (targeting)	Older	-	Lower SES	First Nations
Environmental health (targeting)	-	-	-	First Nations

Source: CGC 2025 review draft report

Note: Selected health promotion, communicable disease control and environmental health use indirect measurements of the usage of services. Blank rows indicate either that there was no bias for any population group or that there was conflicting information on the usage of the service.

The targeting of Victoria's community health services does not align with the drivers proposed by the CGC with the proxy hospital-based measure. Victoria's services target access to those with the greatest risk of poor health outcomes and the greatest economic and social need, who may face barriers to accessing care through other services and settings.

The Victorian Government funded Community Health Program prioritises access for families and children, and those at risk of stigma and discrimination, that are socially or economically disadvantaged, experience poorer health outcomes, have complex care needs and/or limited access to appropriate healthcare services.

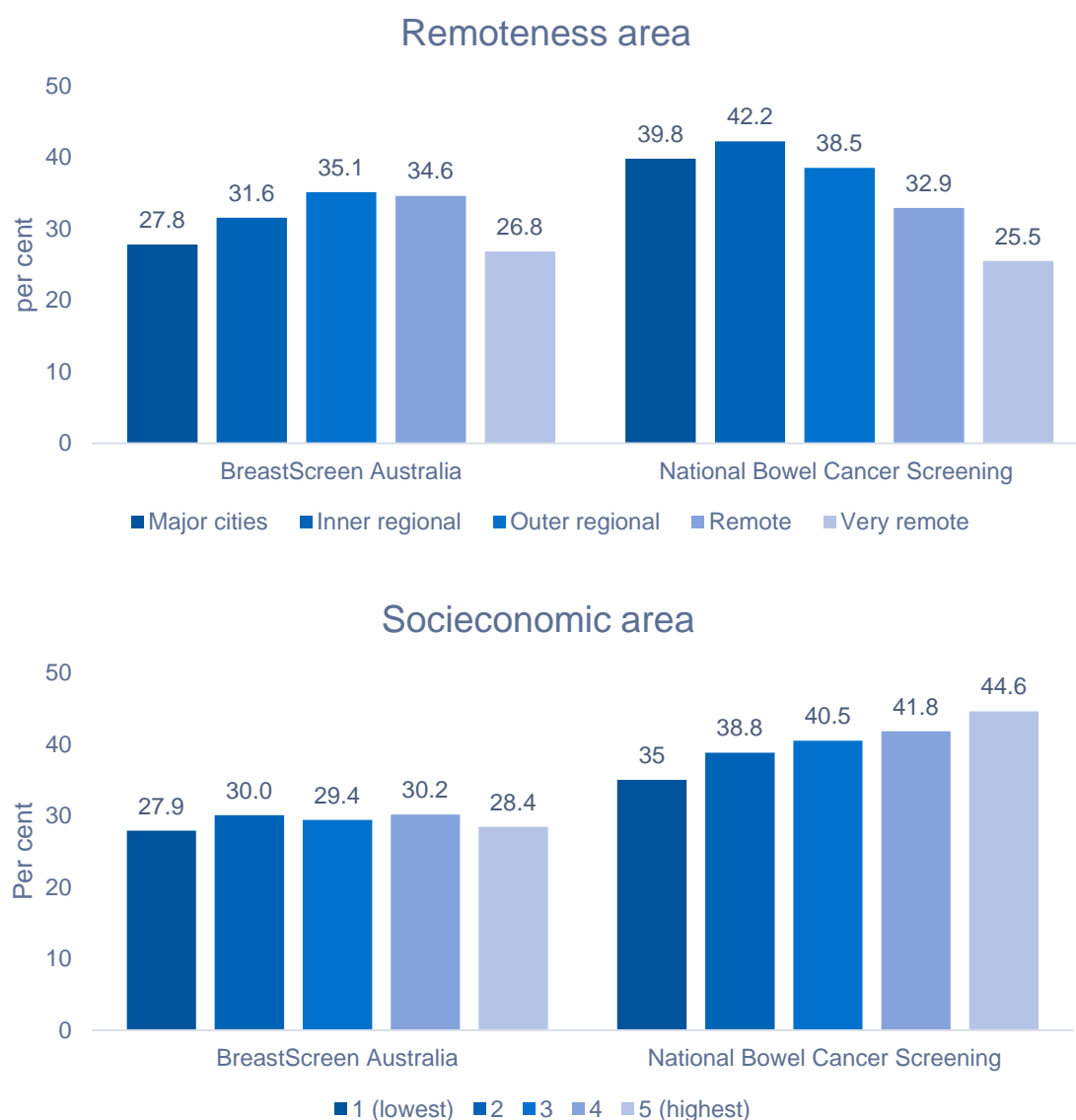
The program's priority population groups are:

- Aboriginal and Torres Strait Islander people
- people with an intellectual disability
- refugees and people seeking asylum
- people experiencing homelessness and people at risk of homelessness
- people with a serious mental illness
- children in out-of-home care.

AIHW data on national cancer screening for breast and bowel cancer presented below show participation follows the opposite trends to the drivers assessed by the CGC for NAP and ED (see Figure 8). Participation was lowest in more remote areas and in the lowest SES areas – areas where the CGC's assessment assumes service use is highest. These programs are implemented by the Victorian Department of Health in Victoria, and BreastScreen Australia is jointly funded with states and the Commonwealth.¹⁹

¹⁹ <https://www.health.vic.gov.au/population-screening/cancer-screening>

Figure 8: Participation by state and territory, remoteness area, and socio-economic area in national cancer screening programs, 2021–2022



Source: Australian Institute of Health and Welfare (2024) National bowel cancer screening program monitoring report 2024, catalogue number CAN 160, AIHW, Australian Government and Australian Institute of Health and Welfare (2023) BreastScreen Australia monitoring report 2023, catalogue number CAN 155, AIHW, Australian Government.

Note: BreastScreen Australia results are for those aged 40+ and National Bowel Cancer screening data are for those aged 50-74.

The draft report notes “the only options available to the Commission at this stage are hospital-based activity measures”. Given the lack of relationship of the hospital-based proxies to public and community health, the CGC should assess these components as EPC. If the CGC must use a hospital-based measure, Victoria recommends the CGC use the broadened proxy using NAP and ED and increase the discount on the assessment from 12.5 to 25 per cent. Victoria believes the increased discount is required to recognise the data issues in the assessment and the unreliability of the proxy.

7.3.2.3 A separate assessment of public health

If the CGC does not accept the recommendation for an EPC assessment of the remainder of community and public health, Victoria reiterates its request for the CGC to assess at least the public health component separately to community health given the distinct nature of these services (as detailed in Victoria and NSW's responses).

7.3.3 Non-state sector substitutability

Victoria supports the draft report's conclusion to retain the current general approach for the period of the 2025 review, noting its specific recommendations provided below.

Victoria also supports further consideration of non-state sector substitutability (NSS) as part of the forward work program. State responses to consultation included considerable debate on the interpretation of the NSS substitutability assessments. Victoria welcomes the draft report's confirmation that the assessment seeks to "provide a broad measure of the differences in the availability of non-state services between states". Victoria notes however this general definition has led to issues with interpretability and can be considered somewhat arbitrary if there is no precise definition of what it is intended to measure. Victoria agrees this is a complex topic that has not been afforded sufficient time and resources for an overhaul as part of this review.

Victoria considers the debate around the interpretation of the NSS substitutability assessment is evidence that the CGC could improve its communication and explanations of how its NSS substitutability assessments works in practice. For example, a number of states produced competing diagrams of how the assessment should be conceptualised. Victoria would appreciate if the CGC provides an authoritative explanation of the NSS substitutability as part of the final report, to support continued discussions as part of the forward work program. This should include what the assessment conceptually aims to measure and a detailed explanation of how it achieves this (as a baseline, separately to discussions of changes from the 2020 Review methods). Victoria does not consider the 2020 Review method for this component included sufficient detail.

7.3.3.1 Evidence for non-state sector substitutability

Other states questioned the conceptual validity of the NSS substitutability assessments. While Victoria welcomes suggestions to improve the implementation of NSS substitutability, it broadly accepts the conceptual case for the assessment. Victoria notes this subject will be open for discussion as part of the forward work program and reserves the right to comment on any changes then. However, some current evidence in favour of the NSS substitutability assessment is noted below.

Victoria agrees non-state (private or Commonwealth) service provision can influence the level of state service provision. Victoria agrees that there are substitutable health services, such that residents would choose) rather than increasing their total health service utilisation.

There is extensive academic evidence of substitution between what the CGC assesses as state and non-state healthcare. This includes study of substitution between the private and public health sectors, as well as substitution between primary and secondary care. Examples of relevant studies include:

- Bai et al. (2020) examine the recent decline in private healthcare utilisation in Australia and the additional pressure this has placed on the public system. They note "Growth in the use of elective surgery in private hospitals fell with some indication of increased waiting times in public hospitals". This was a result of Australians opting away from private health services as

“Since mid-2015, the higher growth in out of pocket costs relative to the growth in wages began to reduce the affordability of private healthcare”.²⁰

- Balqis-Ali et al. (2023) find in Malaysia that private health insurance “provides alternative access to private health care offering preferential choices of providers and care options, as well as shorter waiting times, thus reducing the fiscal burden and improving the operational efficiency of the public sector.”²¹
- Fabbri and Monfardini (2011) find in Italy that private health insurance causes people to ‘opt out’ of the public sector, rather than ‘top up’ public services, services noting: “richer and wealthier individuals consume more private services and concomitantly reduce those services publicly provided through selection into for-profit voluntary health insurance.”²²
- A report by the Organisation for Economic Cooperation and Development (OECD) (2004) notes “Only a few OECD countries have both long waiting times and high levels of population covered by private health insurance” indicating there is a substitutability between public and private, noting “Australia has especially emphasised the role private cover plays as the main mechanism for shifting demand away from overburdened public hospitals”.²³
- Kramer and Schreyögg (2019) examine longitudinal data from German health care and find that “there is significant substitution between [primary care emergency services] PCES and ambulatory ED visits”.²⁴
- Whittaker et al (2016) found a trial extending out of hours access to primary care in Manchester, England “was associated with a reduction in emergency department visits”.²⁵
- Dolton and Pathania (2016), studying the same trial in Manchester found accident and emergency attendances of the pilot fell by nearly 10 per cent.²⁶

²⁰ Bai, T., Mendez, S., Scott, A., Yong, J., The falling growth in the use of private hospitals in Australia, Melbourne Institute Applied Economic & Social Research Working Paper Series, Working Paper No. 18/20, October 2020. https://melbourneinstitute.unimelb.edu.au/__data/assets/pdf_file/0015/3501222/wp2020n18.pdf

²¹ Balqis-Ali, N. Z., Jailani, A-S., Fun, W. H., Jawahir, S., Sararaks, S., Lee, G.H.Y., Effect of supplementary private health insurance on inpatient utilisation: Evidence from Malaysia, Heliyon, Volume 9, Issue 3, March 2023, <https://www.sciencedirect.com/science/article/pii/S240584402301232X?via%3Dihub>

²² Fabbri, D., Monfardini, C., Opt Out or Top Up? Voluntary Healthcare Insurance and the Public vs. Private Substitution, IZA Discussion Paper No. 5952 September 2011, <https://docs.iza.org/dp5952.pdf>

²³ The paper notes also however that increased private health insurance has increased overall demand, in addition to shifting demand from public to private. Colombo, F. and Tapay, N., Private health insurance in OECD countries: the benefits and costs for individuals and health systems, OECD Health Working Papers No. 15, <https://www.oecd-ilibrary.org/docserver/527211067757.pdf?expires=1721269901&id=id&accname=guest&checksum=08CAF2BADD1EC7B6341845A28D1462CE>

²⁴ Jonas Krämer, Jonas Schreyögg, Substituting emergency services: primary care vs. hospital care, Health Policy, Volume 123, Issue 11, 2019, Pages 1053-1060, <https://www.sciencedirect.com/science/article/abs/pii/S0167629616300236>

²⁵ Whittaker W, Anselmi L, Kristensen SR, Lau Y-S, Bailey S, Bower P, et al. Associations between Extending Access to Primary Care and Emergency Department Visits: A Difference-In-Differences Analysis. PLoS Med 13(9): (2016) <https://doi.org/10.1371/journal.pmed.1002113>

²⁶ Dolton, P, Pathania, V, Can increased primary care access reduce demand for emergency care? Evidence from England's 7-day GP opening, Journal of Health Economics, Volume 49, 2016, Pages 193-208. <https://www.sciencedirect.com/science/article/abs/pii/S0167629616300236>

- Van den Berg, Lonen and Westert (2015) review 34 countries including Australia and found that “ED visits show a significant and negative relation with better accessibility of primary care.”²⁷

As a practical example, recently Victoria has opened Priority Primary Care Centres (PPCCs) which aim to provide expanded primary care coverage in Victoria, with the express objective of taking pressure off EDs. The PPCCs have been successful in this aim, with 53 per cent of patients reporting they would have gone to an ED instead if the PPCCs were not available.²⁸

Victoria recognises there is debate on the extent of substitution between private and public sectors in the literature. Private services may induce demand meaning there is not a one-to-one substitution reducing demand for public services. Public and private hospitals in Australia also generally cover different services, with public hospitals taking the majority of complex and emergency care. Limitations in substitutability are discussed for example in a paper by academic Dr Stephen Duckett (2020).²⁹

On balance, Victoria considers the existing evidence supports the CGC’s conceptual case of substitutability between state and non-state sectors. The CGC should continue to make efforts to manage concerns raised in the literature on the extent of substitution.

Other states presented an argument against the concept of NSS substitutability, underpinned by correlations between a measure of non-state activity (e.g., public hospital separations covered by private insurance) compared to a measure of public activity (e.g. public hospital separations). As there was not a strong negative correlation between these measures, other states claimed there was no basis for NSS substitutability.

Victoria does not support this conclusion. In fact, it is not surprising these measures are not negatively correlated comparing states. States with higher demand for health services per capita (i.e. those states the CGC assesses as having higher per capita health needs) would likely have higher demand for both public and private services implying a positive correlation.

7.3.3.2 Admitted patient non-state sector substitutability

Notwithstanding Victoria’s support for the conceptual case for the NSS substitutability assessments, Victoria considers the quantification of both the substitutability levels and assessment NSS activity could be improved.

The NSS substitutability assessments differ from the CGC’s assessments of states’ health activity, as National Weighted Activity Unit (NWAU) data from the Independent Hospital and Aged Care Pricing Authority (IHACPA) are generally not available for non-state activity. The CGC uses a range of other data to make the NSS substitutability assessments and employs significant judgement for the substitutability levels.

Victoria supports the view from other states that the measures used in the NSS substitutability assessments are not as granular as NWAU – for example, using separations for admitted patients

²⁷ van den Berg, M.J., van Loenen, T., & Westert, G.P. (2016). Accessible and continuous primary care may help reduce rates of emergency department use. An international survey in 34 countries. *Fam Prac*, 33, 42-50, <https://pubmed.ncbi.nlm.nih.gov/26511726/>

²⁸ <https://www.premier.vic.gov.au/major-milestone-victorias-priority-primary-care-centres>

²⁹ Duckett, S., Commentary: The Consequences of Private Involvement in Healthcare – The Australian Experience, *Healthc Policy*. 2020 May; 15(4): 21–25. <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7294448/>

(AP) NSS substitutability. Victoria welcomes any improvements to these assessments subject to the quality of the new data.

Victoria supports the CGC's proposal to use expenses paid by private health insurance funds as a proxy indicator for AP NSS substitutability, rather than separations. Expenses should provide a more granular measure that captures the intensity of services provided that separations would not.

However, Victoria questions the CGC's conclusion on the substitutability rate. Firstly, Victoria reiterates its concern with the CGC's use of judgement to decrease the substitutability rate, rather than using its standard discounting process. Victoria is disappointed the CGC did not accept it and WA's recommendation to remove discretionary judgement. Victoria's position remains that the CGC should rather discount the assessment by 12.5 per cent, following its standard practice.

In addition, Victoria does not support the implicit higher weighting towards the CGC's lower bound for the substitutability rate. The draft report notes two data points the CGC considers upper and lower bounds for substitutability:

- 25–29 per cent for the share of AP services that are also undertaken in the NSS, reduced by the share that have private health insurance or self-fund hospital treatment
- 8 per cent for the share of private patient funding of public hospital activity.

The CGC concluded to retain its previous 15 per cent substitutability level. However, this is significantly closer to the 8 per cent lower bound (7 percentage points) than the 25 – 29 per cent upper bound (12 per centage points to the mid-point of 27 per cent). Victoria is unclear on why there is an implicit weighting towards the lower bound. An equal weighting towards the two figures would result in a substitutability share of 17.5 per cent, which Victoria recommends the CGC adopt.

Given the draft report notes “determining the best estimate for the substitutability between the upper bound of 25-29% and the lower bound of 8% is a judgement call”, it is unclear why higher weighting would be given to either. Victoria considers an implied preference to retain the 2020 Review methods should not be a consideration as the CGC has noted it should not be anchored to the previous methods in light of new evidence.

7.3.3.3 Emergency department non-state sector substitutability

Victoria generally supports the CGC's proposed methods for ED NSS substitutability.

As with the AP NSS substitutability rate, Victoria questions the CGC's decision to retain the same substitutability rates from the 2020 Review across the NSS substitutability assessments. Given the updated data and evidence, the CGC should update the figures. Minor differences in these rates have material impacts on the assessment of states' needs which the CGC should account for.

Victoria recommends the CGC implement a NSS substitutability rate of 13 per cent for ED NSS substitutability, decreased from the current 15 per cent.

7.3.3.4 Non-admitted patient non-state sector substitutability

Victoria supports the CGC's proposed methods for NAP NSS substitutability. Victoria welcomes the CGC's conclusion to review NSS substitutability as part of the forward work program, partly in response to Victoria's request for further expert analysis of NAP NSS substitutability given the issues updating the previous approach.

Victoria again questions the CGC's conclusion to retain the same NSS substitutability rate from the 2020 Review of 30 per cent. Both measures of substitutability (the share of comparable state services and share of affordable services) the CGC uses have declined since the 2020 Review:

- The measure of comparable state services was estimated at 50 per cent for the 2020 Review. However, state data provided for the 2025 review draft report estimated a rate of 37 per cent, and the CGC concluded a 30 per cent rate after its sensitivity tests.
- The other measure based on affordable services was calculated at 22 per cent at the 2020 Review, and now 20 per cent for the 2025 review.

The draft report notes the mid-point between these two is 28 per cent, however, concludes that a 30 per cent rate should be retained. Victoria recommends the CGC adopt the 28 per cent rate given the data appear to show the NSS substitutability rate has declined since the 2020 Review.

Victoria considers a rationale has not been presented for why the CGC should retain the 30 per cent figure, other than this was the previously calculated figure, and that it is a round number. Victoria does not consider either a sufficient rationale to not take into account the new evidence provided.

Issues in state data collection for the 2025 review have also created uncertainty with the data quality for this assessment. The CGC requested states provide the share of NAP services that were related to AP services as these were unlikely to be substitutable. Victoria is aware there was significant difficulty in providing consistent data between states given differences in data collection and reporting. As a result, it is unlikely all states have been able to provide consistent data to respond to this request. The draft report notes “the Commission liaised with states to achieve consistency in how the estimates were made, but perfect alignment in approaches was not possible”.

Given this added uncertainty, Victoria considers a more conservative position on NAP NSS substitutability is warranted. Victoria recommends the CGC discounts the results of the data to account for this uncertainty. Victoria recommends discounting the substitutability rate from 28 per cent by 12.5 per cent, resulting in a rate of 24.5 per cent.

7.3.3.5 Community and public health non-state sector substitutability

Victoria supports the draft report's proposed methods for community and public health NSS substitutability, noting its concerns with the assessment of community and public health raised above. As with other NSS substitutability assessments, Victoria questions the CGC's decision to round down the calculated substitutability rate from 61.9 per cent to 60 per cent. Victoria recommends the 61.9 per cent calculated rate is adopted, consistent with adopting the calculated figures for the other NSS substitutability assessments.

Victoria's recommendations

- Victoria broadly supports retaining the CGC's current approach to NSS substitutability and supports further consideration as part of the forward work program. Victoria recommends an external expert is engaged as part of the forward work program to review NSS substitutability.
- Victoria supports using expenses paid by private health insurance funds as a proxy indicator for AP NSS substitutability. Victoria does not support the use of discretionary judgement to reduce the AP substitutability rate, and rather recommends a standard discount of 12.5 per cent. If the CGC does not implement this change, Victoria recommends the CGC adopt the calculated substitutability rate of 17.5 per cent, rather than rounding to 15 per cent.
- Victoria supports the proposed methods for ED NSS substitutability however recommends the CGC implement a rate of 13 per cent, instead of retaining the previous 15 per cent.
- Victoria supports the proposed methods for NAP NSS substitutability however recommends the CGC adopt the 28 per cent rate rather than rounding to 30 per cent. In addition, given

new data issues Victoria recommends discounting the assessment by 12.5 per cent, resulting in a substitutability rate of 24.5 per cent.

- Victoria supports the draft report's proposed methods for community and public health NSS substitutability, however recommends implementing the calculated substitutability rate of 61.9 per cent, rather than 60 per cent.

7.3.4 Cultural and linguistic diversity and health service use

Victoria strongly supports the CGC's acknowledgement of a conceptual case for different use rates of health services for people from different cultures and language backgrounds. Victoria appreciates the CGC's consideration of Victoria's evidence that CALD people face distinct challenges in the health system, among other areas.

Victoria supports the CGC's decision to consider how to incorporate a CALD driver in health, and other service areas, as part of its forward work program. Victoria considers this is a key issue for the work program, and recommends it is prioritised among the areas identified for development. As noted in Victoria's tranche 1 response, Victoria recognises the challenges for implementing an assessment, particularly with identifying the appropriate cohorts. Victoria considers these issues can be explored more thoroughly after the 2025 review.

Victoria acknowledges the CGC's estimation of a separate assessment of discrete multicultural programs by CALD drivers including English proficiency and country of birth. Victoria maintains its view that these costs are inappropriately assessed using the current health assessment, however, recognises the draft assessments were not material. Victoria expects the main influence on health expenses from CALD people is on different costs and use of general health services, including hospital, community and public health services.

Victoria's recommendations

- Victoria supports the draft report's conclusions around culturally and linguistically diverse drivers in the health assessment and looks forward to working further with the CGC to implement an assessment.

7.3.5 Non-hospital patient transport

Victoria appreciates the draft report's consideration of the issues with the non-hospital patient transport (NHPT) assessment, responding to Victoria's comments during tranche 1 consultation. Victoria maintains that the current assessment based on remote population shares does not capture underlying need, as demonstrated by the disconnect between these shares and expenditure, and actual and assessed expenditures.

Victoria supports the CGC draft report's suggestion that if these costs are already included in NWAUs, they are effectively captured in the relevant hospital assessments and a separate assessment is not necessary. Victoria appreciates the draft report's commitment to the CGC continuing to engage IHACPA ahead of the 2030 review to monitor developments in this data as they are currently unclear. Victoria considers the 2025 review should allow for method changes ahead of the next review if it becomes clear these expenses are captured in NWAUs.

Victoria's recommendations

- Victoria does not support the continuation of the current NHPT assessment, however supports the CGC continuing to engage IHACPA on developments in NWAU data. The 2025 review should allow for method changes to remove this category if it is clear ahead of the next review that NWAU data incorporate these costs.

7.3.6 Other issues raised on health in the draft report

Victoria notes the draft report's comments on Victoria's clustered health system design and acknowledges some effects of remoteness are captured in the NWAU from the IHACPA.

Victoria notes the advice provided in the draft report on cross-border adjustments and appreciates the CGC's consideration of this issue.

7.4 Housing

7.4.1 Individual-based housing assessment

Victoria fundamentally disagrees with the CGC's decision to move from a household-based assessment to an individual-based assessment of housing on the basis that:

- a clear conceptual case has not been made
- there is not a compelling relationship between overcrowding rates and social housing expenditure
- on average, the proposed methodology does not accurately account for overcrowding
- the existing drivers in the housing assessment are already proxies for overcrowding
- the magnitude of change in GST distribution is significantly larger than the prevalence of overcrowding.

Further, Victoria does not consider sufficient consultation has been conducted with the states given the magnitude of this methodology change. An additional \$1,074 per capita would have been distributed to the NT had this method been in effect at the 2024 Update. This is an extremely large change which states have not been afforded the opportunity to provide detailed comment on, given the constraints with consultation on the draft report noted in Section 3.

7.4.1.1 Issues with the conceptual case for individual-based assessment

Victoria does not consider that a clear conceptual case has been made to warrant the shift from a household-based assessment to an individual-based assessment. The housing assessment seeks to capture states' recurring expenditure needs and revenue capacities associated with the provision of social housing.

Social housing is a residential tenancy, consequentially service delivery costs accrue at the household or dwelling level rather than the individual. These costs include council rates, water and sewerage charges, maintenance, and management costs. Further, these costs are not usually individually differentiable, rather they are considered part of the overall cost of providing a dwelling.

Additional tenants may contribute some variable costs for households; the bulk of which relate to additional energy costs.³⁰ However, given social housing tenants are responsible for paying their own utilities, these costs do not accrue to the housing delivery agency.³¹ As such, any marginal variable costs that housing agencies bear as a result of additional tenants are very low and likely immaterial.

The proposed methodology directly contradicts this relationship as it assumes the marginal cost of every tenant is equivalent to that of the first tenant. This approach implies a couple living in the same dwelling costs the state the same amount as two individuals living in separate dwellings. Victoria considers this assumption does not reflect the nature of social housing service provision.

Further, the majority of social housing rents are set between 25 and 30 per cent of household income.³² Importantly, income assessable for rent calculation includes primary income (e.g., wages, allowances and pensions) as well as family-related payments (e.g., Family Tax Benefit). Consequentially, larger households pay more in rent, resulting in higher revenue for the service provider. In most cases, this offsets any additional costs associated with extra tenants.³³

Changing the methodology in the housing assessment to accommodate for issues of overcrowding would fundamentally shift the scope of the housing assessment, as it would no longer relate to the practical service delivery costs of social housing. As such, Victoria requests the housing assessment continues to be made at a household level.

7.4.1.2 Relationship between overcrowding rates and social housing expenditure

The move to an individual-based assessment is underpinned by the hypothesis that overcrowding increases the need for state expenditure on social housing operating costs. Given this, it can be reasonably assumed that an increase in overcrowding rates should correspond to an increase in social housing expenses.

This hypothesis does not appear to be proven in practice. Figure 9 compares the per cent change in overcrowding rates and social housing expenditure from 2016 to 2021. The opposite appears to hold in practice, that as overcrowding rates decline, social housing expenditure increases.

Victoria does not consider the relationship between overcrowding and recurring social housing expenditure compelling, particularly given the significant effect this method change will have on the housing assessment. This is reflective of a broader lack of analysis conducted on this proposed methodology change. For consistency, Victoria requests that the CGC provides evidence of this relationship to prove the conceptual case for adjusting the methodology. Given the evidence Victoria has reviewed, it considers such a relationship does not exist, and the assessment should remain at the household level.

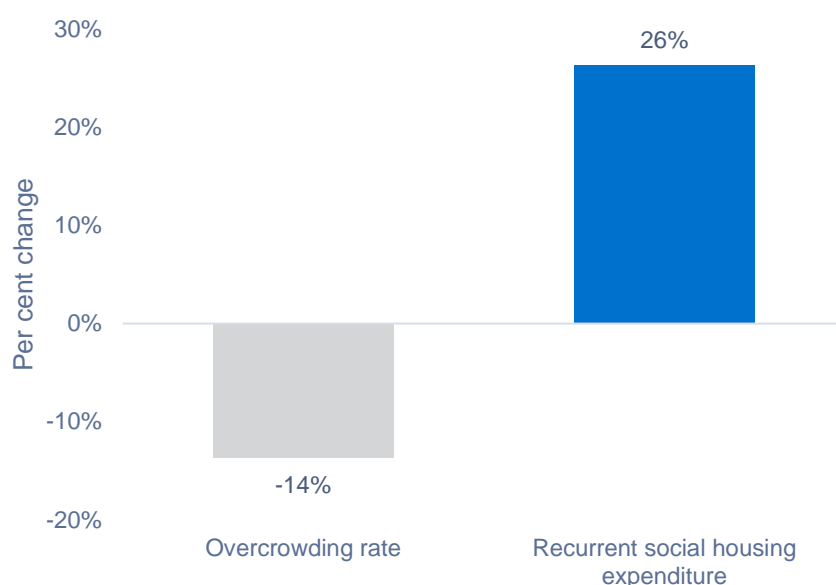
³⁰ https://www.sciencedirect.com/science/article/pii/S1876610217334811?ref=pdf_download&fr=RR-2&rr=8a15ded3c93f29af

³¹ <https://www.housing.vic.gov.au/utilities>

³² <https://www.ahuri.edu.au/analysis/brief/what-difference-between-social-housing-and-affordable-housing-and-why-do-they-matter>

³³ https://chiaviv.com.au/wp-content/uploads/2024/02/Housing-Singles-Successfully-Costs-Report-FINAL_V2.pdf

Figure 9: Per cent change in overcrowding rate and social housing expenditure, 2016 to 2021



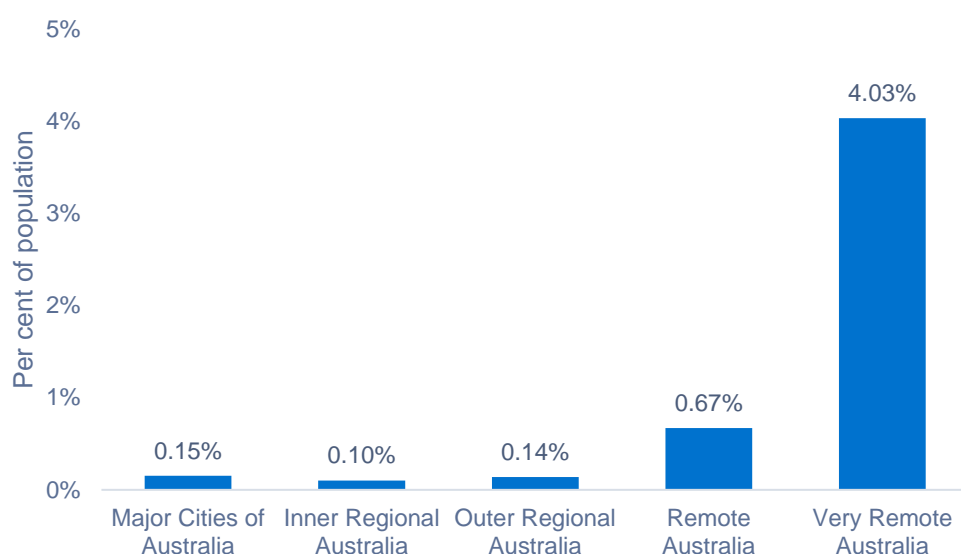
Source: ABS Census and Report on Government Services

The draft report concludes that housing stress will not be included in the assessment as there is not a compelling relationship between housing stress and social housing expenditure (a position Victoria does not agree with). However, Victoria considers the CGC has similarly not provided evidence to suggest that there is a relationship between overcrowding and social housing expenditure.

7.4.1.3 Relationship between existing housing drivers and overcrowding

Victoria considers a move to an individual-based assessment is unnecessary as the existing drivers in the housing assessment are already appropriate proxies for overcrowding. For example, Figure 10 illustrates the above average prevalence of overcrowding in very remote areas. As such, the remoteness driver would already proxy this relationship and capture overcrowding dynamics. Victoria requests that the CGC provide further analysis to demonstrate that this is not the case.

Figure 10: Persons living in ‘severely’ crowded dwellings by remoteness, 2021



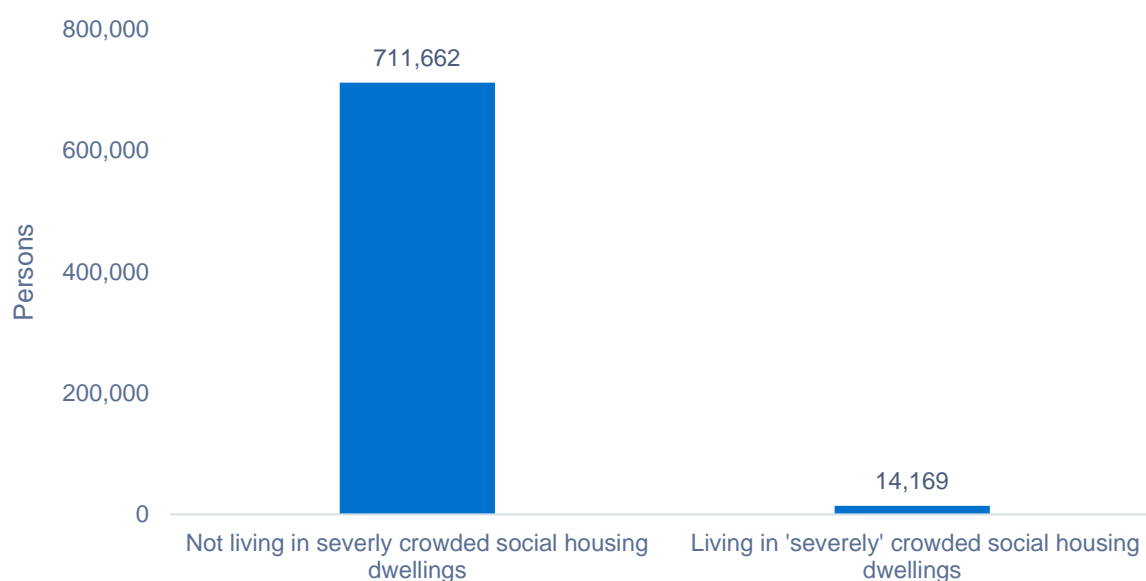
Source: ABS Census 2021

7.4.1.4 Distributive consequences of the proposed methodology

Moving to an individual-based housing assessment significantly changes the distributive effects of the assessment. Victoria considers that this method change and the magnitude of redistribution does not reconcile with the relatively low prevalence of overcrowding in social housing dwellings.

Figure 11, compares the number of people in social housing who live in severely crowded dwellings to those who don't. Importantly, this chart is at an individual level, not the household level, to appropriately capture the magnitude of overcrowding. Social housing tenants living in overcrowded dwellings account for only 1.95 per cent of all social housing tenants. In the 2024 Update \$393 million was redistributed through the housing assessment. However, this methodology change results in a \$325 million distribution change. Victoria does not consider such a substantial change, an over 80 per cent change from the 2020 methods, is warranted given the low prevalence of overcrowding in social housing.

Figure 11: Social housing tenants living in 'severely' crowded dwellings, 2021



Source: ABS Census 2021

In addition to Victoria's view that the proposed methodology does not have an established conceptual case, it also appears not to address the issue of overcrowding for most states. Figure 12 compares overcrowding rates and the distribution effects of the proposed methodology change. Notably, the distributive impact does not appear to align strongly with the prevalence of overcrowding in each jurisdiction.

WA is estimated to receive the second largest per capita distribution as a result of the methodology changes, even though it has one of the lower rates of overcrowding nationwide. There are similar discrepancies for NSW, Victoria, SA, and the Australian Capital Territory (ACT). This outcome suggests the proposed methodology is not fit for the proposed purpose and should not be implemented.

Figure 12: State populations living in 'severely' crowded dwellings vs. distributive impact of housing assessment methodology change

Rank	NSW	Vic	Qld	WA	SA	Tas	NT	ACT
Per cent of population living in 'severely' crowded dwellings	0.18%	0.14%	0.15%	0.11%	0.13%	0.13%	4.26%	0.10%
Indicative impact on distribution, per capita	-\$16	-\$20	\$2	\$15	-\$21	-\$17	\$1,105	-\$14

Source: CGC 2025 draft report, ABS Census 2021

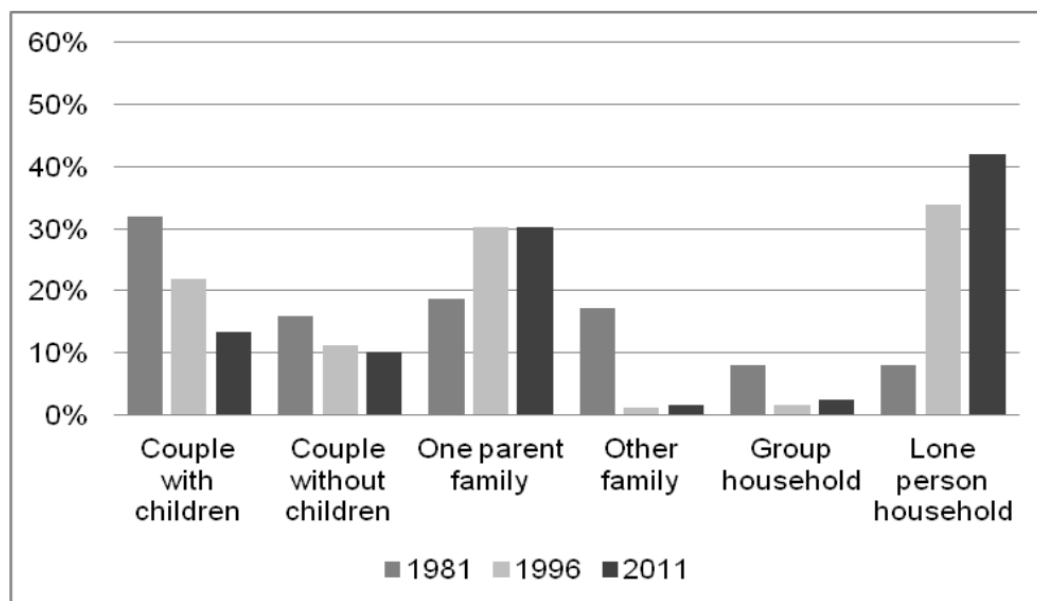
7.4.1.5 Single person households

The individual-based assessment overweights the significance of overcrowding in social housing recurrent expenses while minimising other important cost drivers. For example, the recent influx of

high-cost single-person households is a dynamic the proposed methodology not only disregards but penalises states for.

There have been significant increases in the rate of single person households in public housing, growing from under 10 percent in 1981 to over 40 percent in 2011, see Figure 13.³⁴ Victoria considers that an individual-level assessment disregards this changing dynamic and the additional costs associated.

Figure 13: Household type of residents in public housing, Australia, 1981, 1996 and 2011



Source: Australian Housing and Urban Research Institute, ABS Census, 1981, 1996 and 2011

The effects of this changing demographic are two-fold, with implications for both expenses and revenue collection.

Research from the Unison Housing Research Lab and the Social Equity Research Centre at RMIT University has found that singles are expensive to house for a variety of reasons.³⁵

Figure 14, shows that average weekly tenant initiated service costs are approximately \$10 higher for singles compared to couples, both likely suitable for the same dwelling typology. Further, other property service costs for singles are nearly double those of couples. This reconciles with the fact property related expenses accrue at the household level, not the individual tenant.

³⁴ <https://www.ahuri.edu.au/research/final-reports/231>

³⁵ https://chiaviv.com.au/wp-content/uploads/2024/02/Housing-Singles-Successfully-Costs-Report-FINAL_V2.pdf

Figure 14: Average weekly costs of social housing provision for Unison per tenants, by family type, 2011/12 dollars

	Rent charged (R)	Arrears (A)	Tenant initiated service costs (B)	Other property service costs (C)	Rent charged minus all costs (R-A-B-C)	Market rent (MR)	Oppcost (MR-R)
Couple	199.7	0.1	32.3	46.9	120.4	280.0	80.3
Single persons	157.5	1.1	42.8	89.5	24.1	259.5	102.0
Couple w kids	220.6	1.4	40.0	23.9	155.3	325.8	105.2
Single w kids	208.3	0.7	28.3	53.5	125.8	335.1	126.8

Source: Unison Housing Research Lab and the Social Equity Research Centre, RMIT University

Tenancy breakdown is more common among tenants with complex needs, and complex needs are found at a disproportionately high rate amongst single person households.³⁶ The resulting high turnover rates have direct cost implications due to foregone revenue and tenant acquisition costs. Overall, it has been found that housing singles is 1.7 times more expensive than couples.³⁷

Social housing rents are typically charged as a percentage of household income. As such, smaller households reduce states' and service providers' ability to collect rent. It is estimated that rents of single person tenants are 79 per cent of those of couples, even though the number of bedrooms required is the same.³⁸ Extending this analysis to compare to larger households, the marginal costs of extra bedrooms is offset, over time, by the higher rents generated.³⁹

The proposed changes to the housing assessment directly penalise states with high rates of single person households. Given states cannot control the typology demand of its residents and that there are clear service cost implications, Victoria requests the 2020 housing assessment methodology be retained. Or, at a minimum, adjustments should be made to the proposed methodology to account for these costs.

7.4.2 Housing affordability driver

The CGC accepted the conceptual case that housing stress contributes to demand for social housing. However, the draft report concludes that housing stress will not be accounted for as the CGC suggest there is not a compelling relationship between housing stress and social housing expenditure. Victoria suggests this finding is flawed.

The capital-intensive nature of social housing delivery results in an unavoidable delay between demand for services and construction of dwellings. Recently, construction has been further delayed

³⁶ https://chiaviv.com.au/wp-content/uploads/2024/02/Housing-Singles-Successfully-Costs-Report-FINAL_V2.pdf

³⁷ Ibid

³⁸ Ibid

³⁹ Ibid

due to supply shortages, limiting the ability of service providers to increase their supply of social housing.⁴⁰

In recent years, the decline in housing affordability has required significant new spending by the Victorian Government, 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 1,300 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.

Not accounting for demand for services results in a perverse outcome where states with high levels of demand for social housing are penalised as the dwellings are not yet constructed.

7.4.3 Cost gradients

Victoria does not support the application of the general regional cost gradient or the use of the Rawlinsons construction cost index in the housing assessment. The housing assessment relates to the operation and maintenance of social housing. It has been proposed that the Rawlinson indices should be used in the housing assessment with a 25 per cent weighting. However, given the Rawlinson indices relate to construction costs, Victoria does not consider it relevant to this assessment.

Furthermore, there is limited evidence to suggest that the general cost gradient is an accurate representation of the relationship between remoteness and the cost of providing social housing. Victoria acknowledges that the data provided by two states is insufficient to develop a housing specific cost gradient but maintains that the data could still be used to test whether there is evidence to support a relationship between remoteness and costs. If no relationship is evident in the available data, the general regional cost gradient should not be applied.

Victoria further discusses the shortcomings of the general regional cost gradient in the geography section of this response.

⁴⁰ https://www.infrastructureaustralia.gov.au/sites/default/files/2023-12/Infrastructure%20Australia%202023%20Market%20Capacity%20Report_V1.1.pdf

Victoria's recommendations

- Victoria does not support the CGC's draft position to move from a household-based assessment to an individual-based assessment. Victoria considers this change should not proceed as:
 - a clear conceptual case has not been made
 - there is not a compelling relationship between overcrowding and social housing expenditure
 - the proposed methodology does not align with incidences of overcrowding in practice
 - the existing drivers in the housing assessment are already proxies for overcrowding
 - it overweights the impact of overcrowding on costs and contradicts other, more prevalent, cost drivers (e.g., single person households).
- Further, Victoria does not consider an appropriate level of consultation has been conducted given the magnitude of redistribution this change creates.
- Victoria supports the CGC's decision not separately assess public and community housing.
- Victoria supports the CGC's decision not to introduce an adjustment for high service needs tenants.
- Victoria does not support the application of the regional cost gradient or Rawlinsons index in the housing assessment.

7.5 Welfare

7.5.1 Homelessness assessment

Victoria does not support the development of a separate homelessness assessment on the basis that:

- there are large differences between assessed expenditure and actual expenditure
- a full suite of drivers cannot be confidently identified
- there are significant data limitations
- relevant state expenditure cannot be isolated from other portfolio areas.

These issues, addressed further below, collectively cast significant doubt over the proposed assessment approach. In the 2020 Review, the CGC noted that an EPC allocation should apply where "no reliable assessments could be developed due to data or other limitations". An inability to readily and accurately identify drivers makes deferral to an EPC assessment appropriate and it should be applied in this case.

7.5.1.1 Assessed expenditure compared to actual expenditure

In the health section of the draft report, the CGC acknowledged that large differences in actual and assessed expenses warrants a review of existing assessments.⁴¹ However, the draft report does not

⁴¹ The draft report notes differences in actual and assessed outcomes are an issue to consider in the assessment of health non-hospital patient transport.

address the significant disparity between actual and assessed expenditure in a potential new homelessness category.

The magnitude of these differences is material, with some jurisdictions assessed as requiring half of their actual spend, while others are deemed to need more than double their actual expenditure, see Figure 15. This suggests the proposed drivers are not accurately capturing spending need. Victoria does not consider these differences to be caused by policy, but rather by the assessment not capturing the underlying drivers of need outside states' direct control. These drivers include housing affordability, length of service need and general demand for homelessness services.

Figure 15: Actual vs. assessed homelessness expenditure (2019-20 to 2022-23 average)



Source: CGC 2025 review draft report simulator

Note: Victoria has adjusted the data contained in the 2025 review simulator to remove Victorian housing expenditure which was erroneously included in the homelessness assessment. Assessed expenses were rescaled to reflect the updated national total.

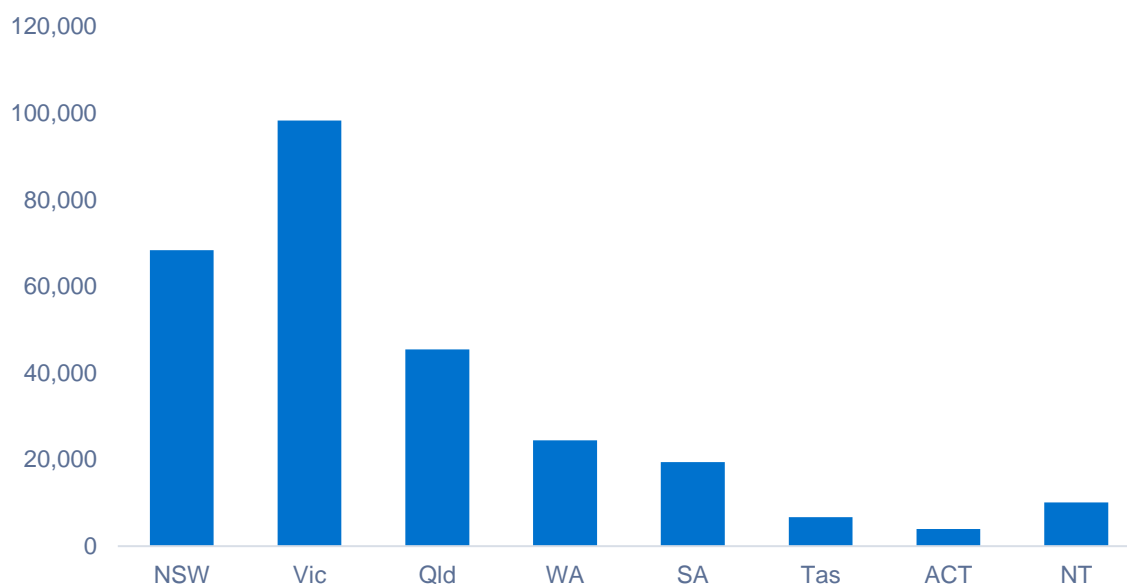
It is estimated that the proposed assessment would have redistributed approximately \$70 million away from Victoria had it been in effect at the 2024 Update. Victoria considers this a perverse outcome given Victoria has the most specialist homelessness services clients, see Figure 16, and the second most on a per 10,000 estimated resident population basis, according to data from the AIHW.⁴² Again, a difference in actual and assessed outcomes of this magnitude cannot be purely policy driven, and there are likely other factors driving spending need that are not being captured by the proposed drivers.

If the CGC is unable to propose an alternative methodology which accounts for these discrepancies, then it should take a conservative approach by retaining the current EPC assessment. This is a

⁴² <https://www.aihw.gov.au/reports/homelessness-services/specialist-homelessness-services-annual-report/data>

similar approach to the CGC's decision to retain an EPC assessment for non-urban transport due to a lack of suitable alternative methodologies.

Figure 16: Specialist homelessness services clients, 2022-23



Source: Australian Institute of Health and Welfare

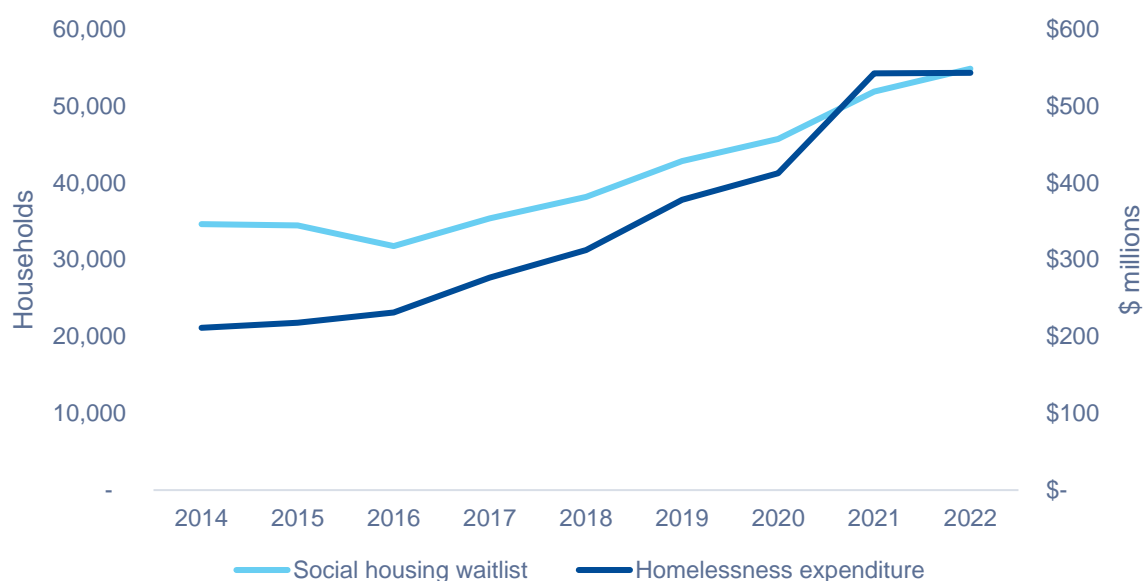
7.5.1.2 Drivers of homelessness spending

The consultation process has highlighted the complexity of identifying drivers of homelessness spending. Arguments from states for which drivers should be included varied substantially. Victoria advocated for additional housing affordability and CALD drivers, while WA argued to remove the low SES driver and the NT contended that homelessness rates should be the sole driver. Like Victoria's argument on distinct entry and exit drivers, Tasmania raised the importance of service use length. There are many more of these nuanced factors, for example whether a client is new or returning, which have direct impacts on service delivery costs and are not acknowledged in the proposed drivers.

Victoria does not consider that sufficient evidence has been provided that the proposed drivers are adequately correlated to these factors to be regarded as proxies. Rather, as highlighted by Tasmania, a number of these factors directly oppose the proposed drivers. For example, median service use length is substantially higher in major cities (54 days) compared to remote areas (16 days) driving up costs in metropolitan areas.⁴³

⁴³ <https://www.cgc.gov.au/reports-for-government/2025-methodology-review/consultation/tranche-2-consultation-papers>

Figure 17: Victorian social housing waitlist against homelessness expenditure



Source: Report on Government Services and Australian Institute of Health and Welfare

Housing and homelessness services are inherently intertwined, and for most states there is a strong correlation between social housing waitlists and homelessness service provision.⁴⁴ Figure 17, above, exhibits this dynamic in Victoria. Similar relationships prevail nationwide with social housing waitlists and homelessness expenditure strongly correlated in a majority of states (see Table 2).

Table 2: Correlation between social housing waitlists and homelessness expenditure, 2019 to 2022

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Correlation between social housing waitlist and homelessness expenditure	0.94	0.97	0.97	0.96	-0.91	0.80	0.81	0.99

Source: Report on Government Services 2024 and AIHW

Note: SA has a negative correlation as a result of changes in social housing waitlist eligibility⁴⁵

Homelessness services seek to link clients with appropriate housing, whether that is temporary accommodation, social housing, or the private market. For that reason, shortages in the housing market prolong and increase demand for homelessness services, as case managers must continue to provide support in the interim.

⁴⁴ <https://www.aihw.gov.au/getmedia/e8645707-b339-4d8e-a930-9bb3af9dfc0/AIHW-HOU-334-Data-tables-Social-housing-households.xlsx.aspx>

⁴⁵ <https://www.abc.net.au/news/2021-08-04/sa-housing-trust-eligibility-restricted-to-people-in-most-need/100348164>

Declining housing affordability exacerbates this issue as the private market becomes an increasingly unviable option for many homelessness services clients. This places more pressure on the social housing system, increasing wait times and extending the period over which homelessness services are needed.

If the CGC does proceed with a differential assessment of homelessness services, it should include social housing waitlists as a driver variable for the purposes of assessing the impact of housing affordability. The time spent on the waitlist translates closely to the additional time states must provide homelessness services and incur these additional costs. Waitlists are also more contemporaneous as they avoid the lag between increases in demand for housing and dwelling construction.

Any meaningful and accurate assessment of homelessness services should include this dynamic given the clear and direct implications this has on homelessness service provision cost. If that is not possible, an EPC allocation should be retained to ensure the assessment remains fit for purpose.

Prior to the 2025 review, the CGC concluded that there was no evidence to support causal drivers of homelessness and as such an EPC assessment was applied. The draft report overturns this previous finding on the basis that the proposed assessment seeks to capture differences in state services by population groups, not causal drivers.

However, as discussed, Victoria considers there are clear shortcomings with the proposed drivers. More specifically, the omission of other important service use drivers, e.g., housing affordability, which are not proxied through the proposed drivers. Victoria considers any assessment of homelessness services that has such significant omissions is not fit for purpose.

7.5.1.3 Data limitations

The CGC cite data limitations as the reason for not including a variety of relevant drivers noted above. Given how fundamental these drivers are to homelessness service use, their absence puts into question the validity of a separate homelessness component. Importantly, the proposed drivers are not proxies for the disregarded drivers, which could be causing the unintuitive outcomes evidenced in Figure 15. For example, while there are housing affordability challenges in remote areas which may be picked up through the remoteness driver, there is no regard for uniquely urban pressures in the proposed methodology. Victoria does not consider the draft report has illustrated that the proposed drivers are proxies for a number of key drivers, e.g., housing affordability and family and domestic violence.

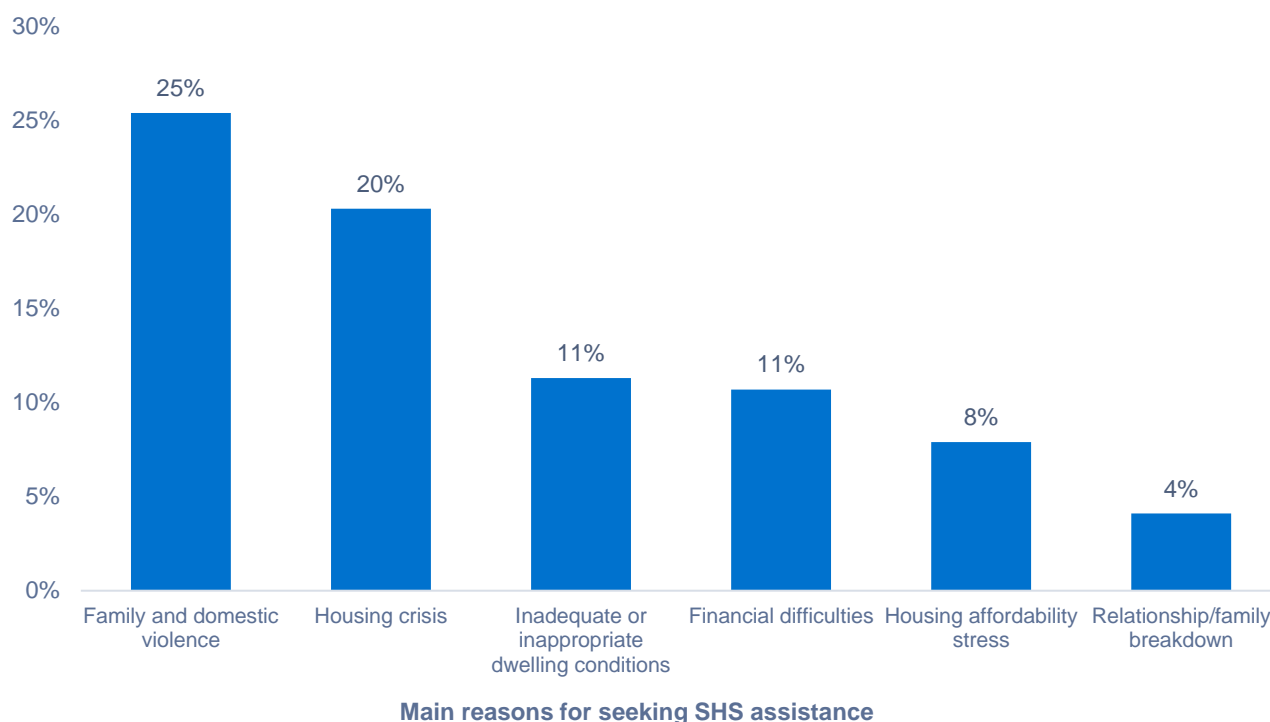
Victoria appreciates that the proposed drivers do have a link to the cost of providing homelessness services, however, they capture only a portion of service use. This is illustrated in Figure 18, which highlights family and domestic violence and housing crisis as the leading reasons for seeking homelessness services. The draft report accepts the factors in Figure 18 are drivers, however, makes no adjustment (e.g., as a driver or through a discount to the accepted drivers) to account for them within the methodology (or differences to the proxy variables proposed to be used in the assessment).

There is also a growing body of research finding a number of new demographic cohorts accessing homelessness services in response to the housing crisis. The Council to Homeless Persons recently reported that homelessness service use amongst employed people has increased in 61 of Victoria's 80 local government areas, translating to a 14 per cent increase statewide with employed women at

higher risk.⁴⁶ This is not the traditional demographic of homelessness services clients, however this does not mean their service use should be disregarded.

To create a component with the proposed drivers overweights the influence of those cost drivers on service use as they are not proxies for service demand in practice. If it is not possible to obtain appropriate data to more fully reflect homelessness expenditure drivers, the CGC should not attempt to create a stand-alone component. This contributes to the argument that homelessness expenditures should be assessed EPC.

Figure 18: Main reasons for seeking specialist homelessness services assistance



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

7.5.1.4 Isolating state expenditure on homelessness services

The draft report acknowledges the difficulty of isolating state expenditure on homelessness services. Victoria suggests this is due to the decentralised nature of support provision, interconnectedness with housing funding and differences in service provision across jurisdictions.

Given there is no consensus to use Productivity Commission Report on Government Services data for the homelessness component, states will be required to submit an annual data return. Victoria is concerned that this will give rise to inconsistency in which service provision is included in this assessment and potential double counting across the housing and welfare assessments.

The draft report indicates if states are unable to provide data returns, the CGC will use data from the Report on Government Services and allocate the funding 50:50 between the social housing and welfare COFOGs. Unless the CGC can produce evidence to support this split, Victoria considers that

⁴⁶ <https://chp.org.au/wp-content/uploads/2024/04/Employed-and-at-risk-FINAL.pdf>

it is an arbitrary allocation and demonstrative of why homelessness services should not be assessed independently.

7.5.1.5 COVID-19 related homelessness expenditure

The only exception to Victoria's view that homelessness services should be assessed EPC is under circumstances related to COVID-19 service delivery. In this case costs should be assessed APC, as is the case in other assessments (e.g., health and services to industry) where the pre-existing drivers are unrelated to COVID-19 related spending. In July 2020, the Homelessness Hotels Emergency Response was set up in Victoria to provide people experiencing homelessness or sleeping rough with a safe place to stay during the COVID-19 pandemic and ensure they could comply with public health directions, including stay at home directions.⁴⁷

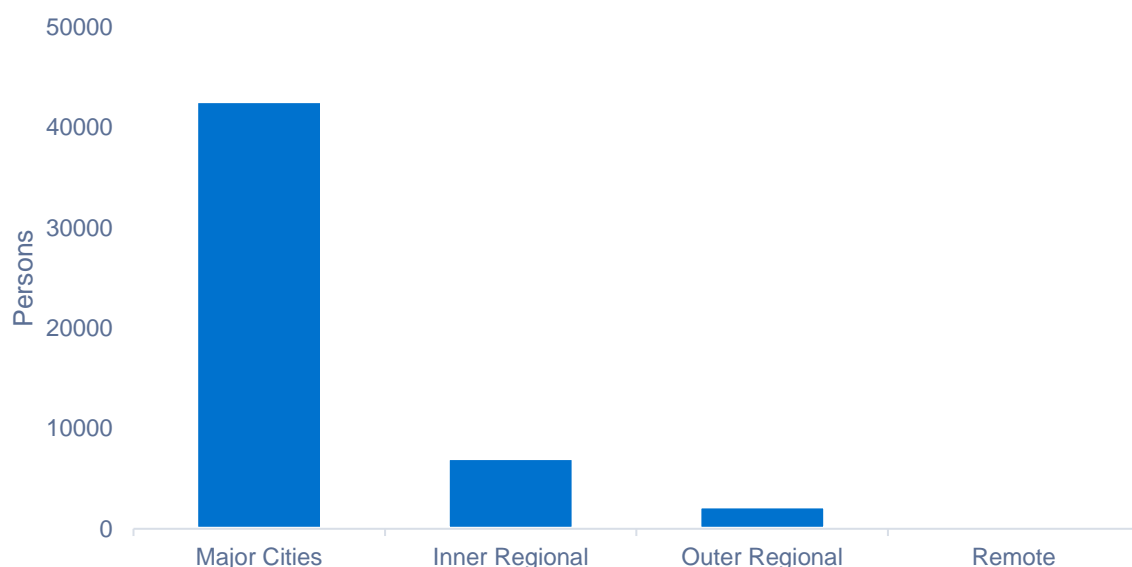
COVID-19 necessitated over \$350 million of additional homelessness expenditure over the period 2019-20 to 2023-24. While this spending is captured within the homelessness portfolio, Victoria does not consider the proposed homelessness drivers to be relevant for this expenditure. Further, an EPC allocation is not appropriate either given the disproportionate effect COVID-19 had on Victoria, as the CGC has already concluded with respect to COVID-19 support for businesses. Victoria will be able to provide data identifying this spending in each assessment year, at the CGC's request.

In direct contradiction to the remoteness driver (and correlated Indigeneity and SES drivers), service provision was more concentrated in metropolitan areas where the impacts of the pandemic were more severe, and health controls were implemented for longer.

As shown in Figure 19 below, most of the homeless population in Victoria reside in major cities. As a result, the cost drivers associated with COVID-19 (e.g., days in lockdown) also applied to the majority of homelessness programs.

⁴⁷ <https://www.dffh.vic.gov.au/sites/default/files/documents/202203/COVID-19%20Amendment%20-%20Homelessness%20Guidelines%20-%20Nov%202021.docx>

Figure 19: Victorian homeless population by remoteness, 2021



Source: ABS Census 2021

The CGC has already concluded states' responses to the pandemic were due to unavoidable circumstances and followed nationally consistent frameworks. Ideally, this COVID-19 homelessness expenditure would be assessed using COVID-19 related drivers. If this is not possible, Victoria requests this spending is carved out and assessed APC.

7.5.2 Other changes in the welfare assessment

Victoria supports the CGC's conclusions for each of the other welfare consultation questions, notwithstanding its concerns on the homelessness assessment. Victoria is disappointed that an adjustment has not been able to be made for culturally and linguistically diverse populations and supports that this is a priority area on the work program for investigation ahead of the 2030 review.

Victoria's recommendations

- The proposed homelessness component has cumulatively significant shortcomings. As is precedent in cases of doubt of this magnitude, Victoria requests an EPC assessment is continued to be applied to homelessness services.
- Victoria requests that COVID-19 related homelessness expenditure be assessed APC, given the precedent set in the health and services to industry assessments.
- Victoria requests the development of an adjustment for CALD populations is prioritised ahead of the 2030 review.

7.6 Services to Communities

7.6.1 Water Subsidies

Victoria accepts the CGC's decision to continue to assess water subsidies provided to small communities using remoteness-weighted state populations in small communities. However, Victoria

maintains that there are factors other than population in remote communities that influence water subsidy cost.

As previously stated, the proposed assessment does not consider factors other than remoteness, such as water quality, availability, investment, and maintenance requirements. Interconnection with other systems including water supply, sewerage, drainage, flood management and natural and built environments raise additional uncertainty around the accuracy of the assessment. Future reviews should continue to consider these drivers of cost.

7.6.2 Community criteria and regional cost gradients for the assessment of water and electricity subsidies

Victoria supports the CGC's decision to simplify the criteria used to define which remote communities are assessed to need electricity and water subsidies.

Victoria notes the CGC has been unable to estimate an updated regional cost gradient for water subsidies for the 2025 review. However, Victoria does not support the draft report's proposed solution to continue to use the un-discounted regional cost gradient estimated for the 2020 Review. The data used are incomplete (calculated on data from only 4 states) and now out of date (collected for the 2020 Review). The calculated gradient is therefore limited in its reliability and appropriateness.

The assessment guidelines state that where the CGC has concerns with the underlying data or assessment method, it may choose to apply a discount. Victoria considers retaining the 2020 cost weights for water subsidies derived from data from only a few states is not a conservative judgement, and therefore warrants discounting.

Prior to the 2020 Review, the regional cost gradient for utility subsidies was discounted at 25 per cent. The revised regional cost weights should be updated and implemented as soon as it is available, and if this is not possible, Victoria recommends discounting the regional cost gradient by 25 per cent.

7.6.3 First Nations Community Development

Service delivery to small and remote First Nations communities classified as discrete Indigenous communities drives expense needs but overlooks those with low and dispersed populations. Victoria, with fewer Indigenous people in such communities due to historical circumstances, argues that needs outside these discrete communities should be considered.

Victoria is not currently aware of additional, readily available data on how expenses vary by land size managed by traditional owners. However, Victoria welcomes the opportunity to collaborate with the CGC ahead of the expected 2030 review to explore this issue further. This could include opportunities to build an evidence base on expenditure for First Nations community development. The evidence base could consider definitions of Indigenous populations, the number of communities with significant Indigenous populations, discrete versus dispersed communities and approaches to measuring and assessing spending in the Victorian context.

7.6.4 Drivers of spending on environmental protection

Victoria generally supports the continuation of an EPC assessment of environmental protection expenses. Victoria notes the draft report's consideration of its proposal to include a measure of population density and the intensity of states' capital programs as drivers for the need for environmental protection spending.

7.6.5 Biodiversity and landscape cost data

Victoria does not support the application of the general regional cost gradient to the otherwise EPC assessment of protection of biodiversity and landscape expenses. The expense data used to apply the gradient are not sufficiently disaggregated, for example there is no data on biodiversity spending disaggregated by remoteness area, and the gradient is therefore limited in its reliability and appropriateness.

Victoria agrees that state biodiversity spending is impacted by the variation of features between each state. However, there is readily available data to support land price and farm size as key drivers of costs. This driver and its interaction with the Commonwealth's National Reserve System (NRS) of biodiversity commitments are common across all states, and is therefore policy neutral.

There is not a strong conceptual case for regional cost weights in the biodiversity assessment. Furthermore, the draft report states that "the general cost gradient cannot be applied directly to expenses because expenses cannot be disaggregated by remoteness area."

In the biodiversity assessment, the CGC calculates a single regional cost weighting for each state based on the general cost gradient weighted by each state's population in each remoteness category.

Victoria does not support this approach, as the CGC acknowledges that state spending on biodiversity "is very diverse and heavily influenced by the features of each state."⁴⁸ This approach represents a decision to allocate costs according to remoteness-weighted population, without evidence or a conceptual case to support the assumption that expenses are affected by regional cost differences.

Conceptually, while there may be reasons why protecting biodiversity in remote areas may be more costly, there are also reasons why a greater intensity of effort may be required to protect biodiversity in areas close to population centres. The encroachment of residential areas or infrastructure, increased tourism and the impact of increased traffic could all potentially suggest an inverse relationship between remoteness and costs.

Furthermore, as outlined below, less remote areas may also have more productive farmland and higher land prices, which increase the cost of protecting biodiversity. Victoria recommends that protection of biodiversity and landscape expenses are treated EPC, without a remoteness weighting, like other environmental protection expenses, or that the CGC incorporate land prices as a cost driver, as outlined below.

In response to the CGC's tranche 1 consultation papers, Victoria advised the CGC to consider land prices and farm sizes as key cost factors for environmental protection. In Victoria, higher productivity and above average land prices increase biodiversity costs by increasing the opportunity cost of using land for biodiversity purposes. Furthermore, below average farm sizes reduce opportunities to achieve economies of scale and increase the number of projects required to protect a given quantity of land. This is particularly relevant because of the Commonwealth's commitment to reserve 30 per cent of land to conservation and biodiversity efforts.

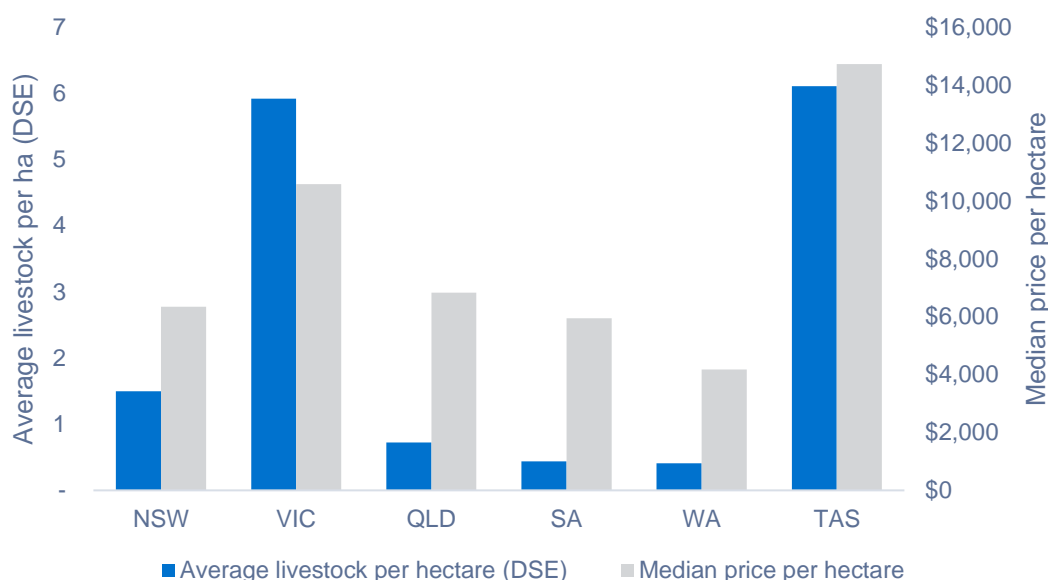
7.6.5.1 Land Prices

The higher cost of land conservation programs and associated higher land prices can be seen in the relationship between land prices and the amount of protected land in a jurisdiction. The temperate

⁴⁸ CGC 2025 draft report – page 241

climate in Victoria and Tasmania results in higher levels of productive agricultural land, shown by livestock numbers per hectare in Figure 20, in turn increasing farmland values. This increases the opportunity cost of reserving or transforming farmland for conservation purposes.

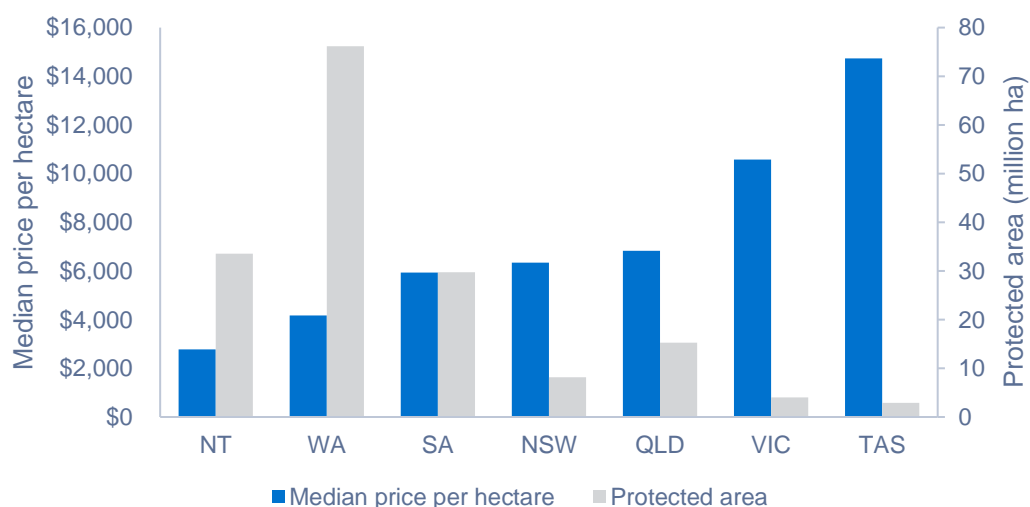
Figure 20. Average livestock (sheep and meat cattle) numbers per hectare, dry sheep equivalent (DSE), and median agricultural land prices by state



Source: ABS (2024) Agricultural Commodities, ABS (2018) Land Management and Farming in Australia-2016-17.
 Note: Data on livestock numbers is from 2022, calculated using a cattle to DSE conversion factor of 8.4.

The use of a general land value (price) can more appropriately reflect differences in costs of meeting biodiversity commitments across states. Figure 21 shows that states with higher median land prices and smaller farm sizes contribute less to the NRS, with Victoria and Tasmania having the lowest contributions to the NRS and the highest land prices.

Figure 21: States with higher median land prices contributed less protected area to the NRS



Source: Rural Bank, Department of Climate Change, Energy, the Environment and Water (DCCEW)

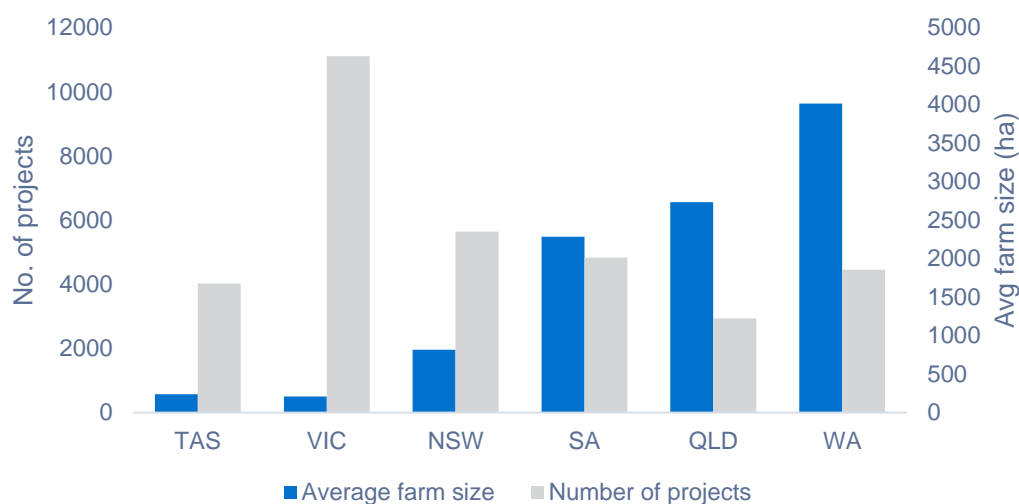
7.6.5.2 Farm size

Conceptually, smaller farms may be less inclined to engage in nature-based solutions due to the high opportunity costs and minimum area requirements for privately owned land. Additionally, under Victoria's Bushbank framework there is a minimum 10-hectare site requirement for privately owned land to be considered in the program which narrows the amount of land available for protection.

For comparable conservation projects that generate Australian Carbon Credit Units many of the transaction costs are reasonably insensitive to project size (e.g., registration, reporting, marketing and audit costs). Therefore, jurisdictions with larger agricultural landholdings allow for proponents to design and initiate larger projects to take advantage of the economies of scale.

In contrast, the small agricultural landholdings in Victoria (Figure 22) mean landholders are less likely to be able to take advantage of these economies of scale, resulting in a higher cost per project. Furthermore, small average landholdings mean that a greater number of projects are required, at a greater cost, to conserve a given amount of land.

Figure 22. Average agricultural landholdings and number of projects, by state, 2021-22



Source: ABS (2024) Agricultural Commodities, Australia, 2021-22. DCCEW

Figure 23 shows that smaller protected areas are associated with smaller average farm holdings, with Victoria and Tasmania having relatively less protected area despite having a high number of projects.

Figure 23: Average farm size and protected area by state, 2021-22



Source: ABS (2024) Agricultural Commodities, Australia, 2021-22. DCCEW

7.6.6 Net Zero

Victoria supports the CGC's decision to continue to monitor state spending to support the transition to net zero emissions and not implement an assessment for the 2025 review. Victoria supports in-principle consideration of a separate assessment for state expenditure under the transition to net zero, however, it is difficult to identify policy neutral drivers of expense.⁴⁹ If a separate assessment is considered in future, it is important that accurate and consistent data are available for the CGC to consider differences between states as drivers of cost. While Victoria supports net zero being on the forward work program, further work should only be done once programs are in place and clear data on expenses are able to be collected.

7.6.7 Natural Disaster Mitigation

Victoria supports the CGC's decision to continue to monitor developments and explore the appropriateness of a differential assessment of natural disaster mitigation needs in consultation with states.

Victoria reiterates its view that the assessment for natural disaster mitigation should be considered in tandem with the assessment of natural disaster relief. The need for mitigation is driven by relationships between mitigation, risk, previous mitigation efforts and the need for disaster responses or upfront investment to minimise or avoid future disasters.

⁴⁹

<https://www.climatechangeauthority.gov.au/sites/default/files/Fact%20sheet%20%28states%20and%20territories%29.pdf>

7.6.8 Other issues raised on Services to Communities in the draft report

Victoria notes the CGC's proposal to engage with the National Water Initiative to determine if Commonwealth-state water pricing initiatives have implications for the assessment and appreciates the CGC's consideration of this issue.

Victoria's recommendations

- Victoria supports the application of a regional cost gradient to water and electricity subsidies, however recommends discounting the remoteness factor applied to water subsidies by 12.5 per cent to account for data issues.
- Victoria acknowledges the lack of data supporting the relationship between services to First Nations communities and hectares of land managed by traditional owners. It looks forward to further developing the evidence base for the First Nations communities assessment.
- Victoria supports the EPC treatment of environmental protection expenses.
- Victoria does not support the use of the general cost gradient in the biodiversity and landscape assessment, and maintains its position that land prices and farm size should be included as drivers of biodiversity program costs in the environmental protection assessment.
- Victoria supports in-principle further consideration of an assessment of net-zero spending and recommends that the natural resource endowments of states are considered.
- Victoria supports exploring a new natural disaster mitigation assessment, however, it does not support the use of the National Partnership on Disaster Risk Reduction as a policy neutral measure of service needs.

7.7 Justice

7.7.1 Postponement of the justice assessment review

Victoria supports the CGC's proposal to postpone changes to the justice assessment methodology until the 2026 update to allow time to gather an additional year of data and for further analysis and consultation.

Victoria's views on the justice assessment expressed in this submission are based on the information available at the time of drafting and may change once additional data are obtained and further analysis and consultation is completed. Victoria will provide further comments on issues in the justice assessment during the coming consultation period, including those raised in Victoria and its consultant's previous submissions.

Victoria supports the CGC's proposal to use 2022-23 and 2023-24 state data because data for 2019-20 and 2021-22 are not considered fit for purpose given COVID-19 related impacts.

Victoria supports the CGC's proposed process and timing outlined in Attachment B to the justice chapter of the draft report.

7.7.2 Police

7.7.2.1 Treatment of central police costs

Victoria supports the CGC's consideration of a more appropriate method of assessing police central costs as part of its 2026 consultation process. Victoria notes that some state police forces may not record information allowing them to attribute central costs to districts and might be required to make strong assumptions to do so. Victoria requests transparency regarding the use of any assumptions by states providing the required data.

If states are unable to robustly attribute central costs to districts, Victoria considers an EPC assessment of police central costs (excluded from the police regression) to be a more appropriate default position than the existing methodology.

7.7.2.2 Police costs regression

Victoria notes the CGC's response to state submissions and Victoria's consultant on the police regression. Victoria will provide further views on the regression once the additional data has been incorporated and states consulted as part of the 2026 Update consultation process.

7.7.2.3 Additional cost weight for remote offenders

In the draft report, the CGC said it "considers that the high cost in remote regions is capturing the higher cost of policing offenders as well as the higher cost of policing the regions". The CGC stated that it would implement a cost-weighting for remote offenders if the analysis of the additional data to be acquired as part of the 2026 Update process supported it.

Victoria requests further information regarding the CGC's conclusion for consideration during the upcoming consultation period, once additional data are acquired and analysed.

7.7.2.4 Major city police expenses and cultural and linguistic diversity

Victoria supports the CGC's proposal to further investigate whether certain police costs are unique to major cities and should be included in the police assessment.

Victoria also supports the CGC's proposal to consider how cultural and linguistic diversity affects state justice service costs as part of its proposed forward work program.

7.7.3 Courts

7.7.3.1 Dealing with an incomplete dataset

Victoria notes that the CGC plans further analysis of state data and consultation before determining the sociodemographic composition calculation and the regional cost gradient in the criminal courts assessment. Victoria will provide a view on any proposals during that process.

However, in the draft report the CGC formed a position in response to concerns from Victoria and its consultants from the Australian National University about the use of data from only a subset of states in the courts assessment, without any discount or imputation.

For the 2020 methodology, data from Victoria, Tasmania and the ACT were not included in the calculations of national rates of defendants for each sociodemographic group. Furthermore, data from only 4 states were used in determining the criminal courts regional costs gradient.

In the draft report, the CGC stated that “given the importance of Indigenous status, limiting modelling to only those data available for every state would be contrary to the objective of horizontal fiscal equalisation.”

Victoria does not dispute the importance of Indigenous status in assessing state expenditure needs. However, the quantification of that driver is what ultimately represents its importance to the assessment.

In its tranche 1 submission Victoria provided evidence that imprisonment rates varied significantly between states and that excluding certain states materially distorts the national averages, based on data from the Productivity Commission’s Report on Government Services (RoGS).

Victoria contends that the Victorian proposal of limiting modelling to *data from only those sociodemographic groups with complete state data* poses a similar quantification problem to the current method of limiting modelling to *data from only those states with complete sociodemographic data*.

Assuming similar variation between states occurs for data on defendants as it does for prisoners, only using data from a subset of states would distort the national average and be contrary to the objective of horizontal fiscal equalisation.

If actual data are not available for all states and for all the drivers of the assessed number of offenders Victoria recommends the CGC discount the Courts assessment. The size of the discount may depend on the completeness of the dataset. If data availability is the same as for the 2020 methodology, Victoria recommends a high discount of 50 per cent.

7.7.3.2 The relationship between finalisations and expenditure

In its tranche 1 submission, Victoria highlighted the variability between states in expenditure per defendant finalisation, based on data from the 2023 RoGS, seen in Figure 24 below, suggesting that the number of finalisations alone does not adequately represent criminal court expenditure needs.

Figure 24: Comparison of finalisation rates and expenditure, RoGS, 2021-22



Source: Productivity Commission, Report on Government Services 2023, Part C, Section 7

Note: Expenditure is real recurrent expenditure.

In the draft report, the CGC noted a number of reasons that could explain the variability between states, including the structure of the court system and other policy differences. However, the CGC considered it “reasonable, and less complex than alternative approaches, to assume there is a relationship between defendant volume and state court expenses” and that “finalised defendants remain the best available data to capture drivers of states’ criminal court expense needs.”

However, further examination of the 2023 RoGS data suggests that population is a better predictor of criminal court expenditure than the number of finalisations. Figures 25a and 25b indicate that a line fitted to a plot of expenditure vs population provides a closer fit than a line fitted to a plot of expenditure vs the number of finalisations.

Figure 25a: Relationship between criminal court expenditure and finalisations, RoGS, 2021-22

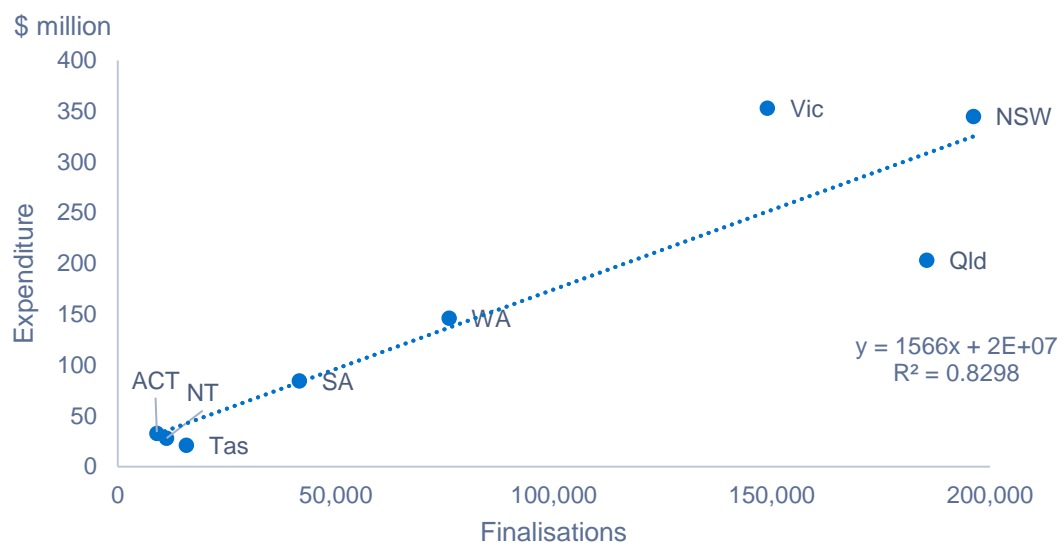
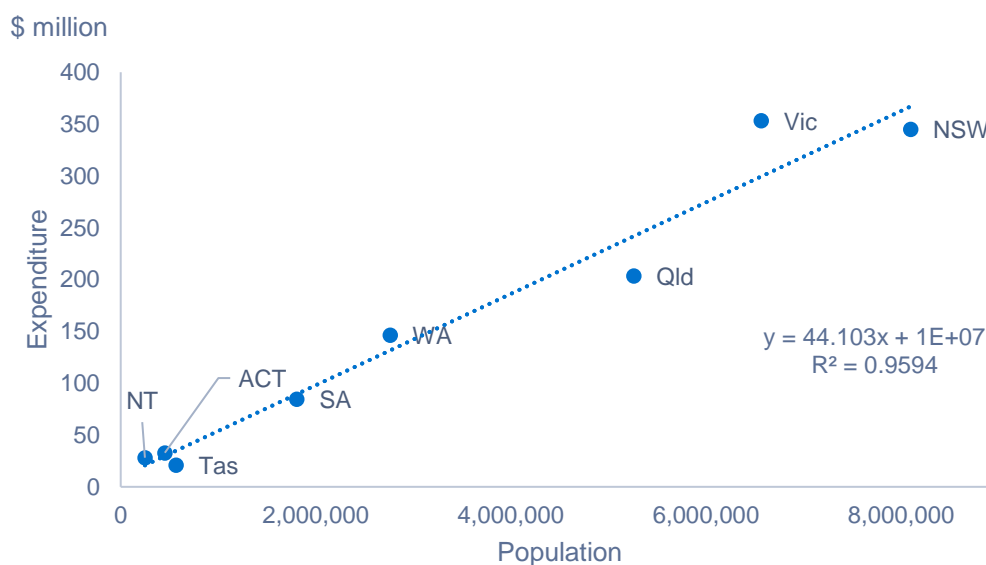


Figure 25b: Relationship between criminal court expenditure and population, RoGS, 2021-22



Source: Productivity Commission, Report on Government Services 2023 Part C Section 7, Commonwealth Budget 2024-25
 Note: Expenditure is real recurrent expenditure.

The more recent 2024 RoGS data tells a similar story in Figures 26a and 26b. Again, population is a better predictor of expenditure than the number of finalisations.

Figure 26a: Relationship between criminal court expenditure and finalisations, RoGS, 2022-23

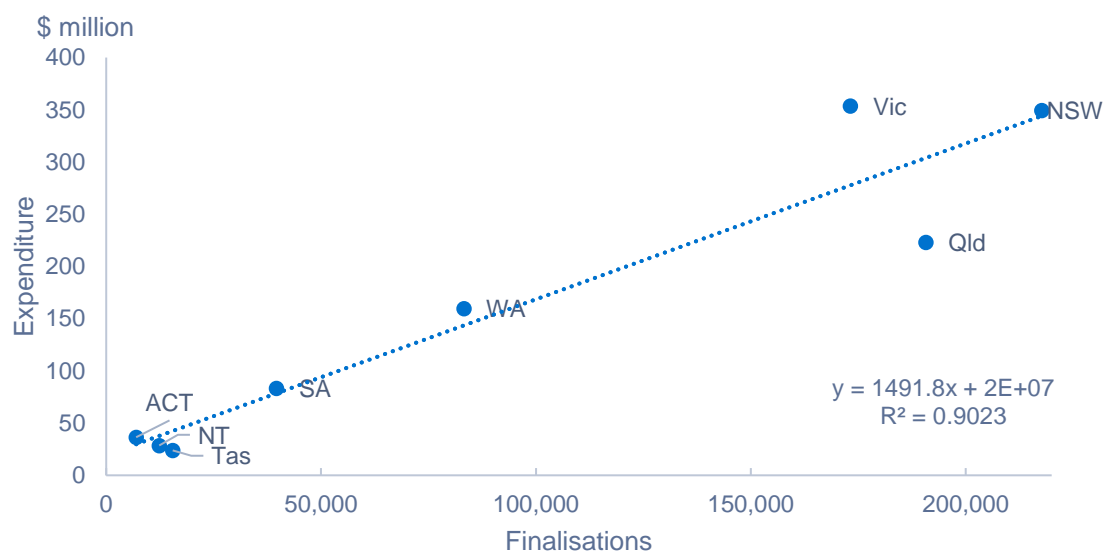
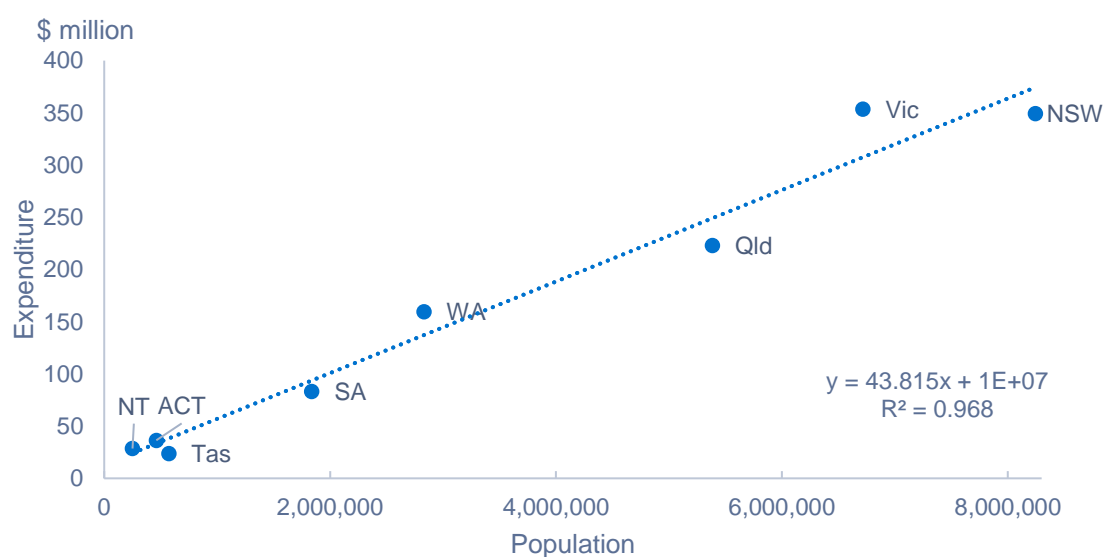


Figure 26b: Relationship between criminal court expenditure and population, RoGS, 2022-23



Source: Productivity Commission, Report on Government Services 2024 Part C Section 7, Commonwealth Budget 2024-25
 Note: Expenditure is real recurrent expenditure.

Given this, Victoria considers it reasonable and less complex than alternative approaches to assess criminal court expenditure on a population basis. Such an approach would also resolve the problem of splitting criminal court expenditure and other legal expenses based on state data – an approach that Victoria noted in its tranche 1 submission was unreliable due to the high variability between states. It would additionally resolve the problem of incomplete state data discussed in Section 7.7.3.1.

Victoria therefore recommends that both criminal courts and other legal expenses be jointly assessed EPC. Such an approach would greatly simplify the complex time-consuming data collection process in the justice assessment but also provide a courts assessment that better represents ‘what states do’.

7.7.4 Prisons

7.7.4.1 Juvenile detainees

Victoria does not support the CGC's proposal to introduce a separate juvenile detainee cost weight.

In the draft report, the CGC noted Victoria's opposition to the proposal and recognised that the RoGS juvenile detention expenditure data are not comparable across states because states have different funding structures for youth justice services. However, the CGC decided to use the data without applying a discount because the data are "currently the best available".

Victoria notes that data being the "best available" does not necessarily mean they are of acceptable quality. Victoria considers that in the case of the RoGS juvenile detention expenditure data there is a clear caveat attached to the data indicating that the data can be used for comparison over time within individual states but not for comparison between states. Applying an average to data that are not comparable, as the CGC proposes to do, does not "smooth out" the incomparability.

Victoria recommends that the CGC not apply a juvenile detainee cost weight at all. However, if the CGC decides to do so, Victoria recommends a high discount of 50 per cent be applied due to the use of data that are incomparable between states.

7.7.4.2 An assessment of community corrections expenses

Victoria requires further time, data, detail and analysis from the CGC before commenting on the proposal to separately assess community corrections expenses. Victoria requests the CGC not take any decisions on justice assessment proposals newly introduced in the draft report until further consultation with states has been done prior to the 2026 update.

7.7.4.3 Regional costs and service delivery scale

Victoria considers it critical that any remoteness or service delivery scale weighting be based on robust statistical methods and justifiable assumptions.

Victoria supports the CGC's proposal to postpone decisions regarding regional and service delivery scale costs for the prisons assessment until further analysis of state data has been acquired and consultation undertaken.

Victoria's recommendations

- Victoria supports the CGC's proposal to postpone changes to the justice methodology and use 2022-23 and 2023-24 data.
- Victoria supports the CGC's proposal to investigate major city effects in the **police** assessment.
- Victoria recommends the CGC discount the **courts** assessment if data are not available from all states.
- Victoria recommends the CGC assess criminal **courts** expenditure EPC as population is a better predictor of expenditure than the number of finalisations.
- Victoria opposes the CGC's proposal to introduce a juvenile detainee cost-weight in the **prisons** assessment because state data are not comparable. Alternatively, a high discount of 50 per cent should be applied.

- Victoria supports the CGC's proposal to postpone decisions regarding regional and service delivery scale costs for the **prisons** assessment until further analysis of state data has been acquired and consultation undertaken.

7.8 Roads

7.8.1 Urban road length

Victoria supports the CGC's proposal to retain population as the driver for urban road lengths in towns of over 40,000 people and to investigate the suitability of using the Infrastructure Australia National Service Level Standards data when they become available.

Victoria agrees with the CGC that negative linear relationships between road length per capita and population claimed in other states' submissions are not reliable for the purposes of the assessment. For example, Brisbane has a population approximately half that of Melbourne, but a lower state road length per capita and Perth has a substantially larger population than Adelaide but a higher state road length per capita.⁵⁰

7.8.2 Rural road length

Victoria supports the CGC's proposal to remove routes to mines, national parks, gas wells and ports from the rural road network. Victoria agrees that such roads are often the responsibility of the private sector or local governments and that roads to national parks are often maintained at a lower standard than other state roads.

7.8.3 Urban and rural traffic volume and heavy vehicle use

Victoria supports the CGC's decision to hold constant the urban/rural split for light and heavy vehicle traffic volume for the duration of the review as there is no feasible alternative at this time. If reliable data were available to update the split prior to the next review, the CGC should consider incorporating that data, in consultation with states.

7.8.4 Regional costs

In the draft report, the CGC noted WA's view that the general cost gradient was unsuitable for the roads assessment and its preference for using the Rawlinsons indices instead. However, the CGC did not respond to any of Victoria's concerns about the conceptual case for a regional cost driver in the roads assessment.

In its tranche 2 submission, Victoria raised concerns about the quantification of regional road costs using the general regional cost gradient. However, Victoria also raised concerns about the conceptual case for a remoteness weighting in the roads assessment.

Victoria argued that the split between urban and rural roads already accounts for most of the geographical differences in expenditure needs for roads. Victoria noted that state grants commissions and the National Transport Commission (NTC) use this urban/rural distinction, rather than remoteness, for their recommendations and analysis. Victoria pointed out that the geography factors

⁵⁰ CGC 2025 review draft report – Roads – Figure 2 – Urban major road length per capita and population in large towns, 2021

considered important by the NTC included climate, topography, and the urban/rural distinction. Victoria supports the CGC's proposal not to add additional cost drivers to reflect rainfall and soil composition to the roads assessment because of the complex relationship between environmental variables and expenses, and issues with data availability.

Victoria notes the prevalence of remoteness, wages, and sociodemographic composition drivers throughout many of the CGC's assessment categories. In some cases, these drivers represent the best available policy neutral measures to differentiate state expenditure needs. However, the inclusion of any of those drivers needs to be justified in each assessment use case.

Attachment A of the CGC's 2025 Methodology Review position paper on fiscal equalisation, supporting principles and assessment guidelines states that the CGC will include a driver in a category when:⁵¹

- A case for a driver is established, namely:
 - A sound conceptual basis exists
 - There is sufficient empirical evidence that material differences exist between states in the levels of use or unit costs, or both, in providing services
- A reliable method has been devised
- Data are available that are:
 - Fit for purpose – they capture the influence the CGC is trying to measure and provide a valid measure of State circumstances
 - Of suitable quality – the collection process and sampling techniques are appropriate, the data are consistent across the states and over time and are not subject to large revisions.

Victoria considers that a remoteness cost driver in the roads assessment does not meet the requirements of the CGC's assessment guidelines for the 2025 review outlined above. The CGC has not demonstrated the conceptual case for the inclusion of a remoteness cost driver in the roads assessment, other than the urban/rural distinction, nor provided evidence to support a conceptual case. Data previously used or proposed are not fit for purpose as they do not relate to state recurrent expenditure assessed in the roads category.

Cost drivers continued from previous assessment methodologies should not be exempt from meeting the CGC's current requirements.

Victoria therefore recommends that the CGC does not include any remoteness cost driver in the roads assessment.

If the CGC decides to proceed with a remoteness cost driver for roads, Victoria requests that the CGC outline the conceptual case, addressing Victoria's points in its tranche 1 assessment and summarised above, and provide empirical evidence that meets the CGC's requirements.

⁵¹ <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>

7.8.5 Discounting the assessment

In its tranche 2 submission Victoria recommended discounting the traffic volume and heavy vehicle use drivers by 25 per cent due to their reliance on data previously derived from the now discontinued ABS Survey of Motor Vehicle Use (SMVU).

In the draft report, the CGC proposed a low discount of 12.5 per cent on the entire roads assessment due to concerns with the reliability of several parts of the assessment, namely:

- Total actual state spending on roads
- The synthetic rural road network as a reflection of state rural road length needs
- Heavy and light vehicle traffic volume data
- The relative importance of road length, heavy and light vehicle traffic as drivers of expense needs
- The comprehensiveness of major drivers of differences in spending need.

Victoria contends that almost the entire roads assessment relies on proxies, inappropriate, unreliable or outdated data.

Table 3 below demonstrates that, other than wage costs (which are derived from the CGC's own assessment and are already discounted), the data underlying every driver of every component in the roads assessment is problematic.

Table 3 Problems with data sources for drivers used in the roads assessment

Component	Driver	Data source	Problems
Rural roads	Length	Algorithmic synthetic network derived by consultants for an earlier review	Does not reflect true travel patterns
	Traffic	Discontinued SMVU	Main data source no longer available
	Heavy vehicles	Discontinued SMVU	Main data source no longer available
	Regional costs	Rawlinsons construction costs	1. No conceptual basis for remoteness as a driver, other than urban vs rural 2. Rawlinsons indices are for investment not recurrent expenditure
	Wage costs	CGC Wage assessment	N/A
Urban roads	Length	Proxied by population	A proxy is the best available option
	Traffic	Discontinued SMVU	Main data source now not available
	Heavy vehicles	Discontinued SMVU	Main data source now not available
	Wage costs	CGC Wage assessment	N/A
Bridges and tunnels	Length	State-provided actual lengths of state responsibility bridges and tunnels	1. Use of actual lengths reflects policy choice, not necessarily need 2. Weighting in assessment relies on the unreliable heavy vehicle use driver
	Heavy vehicles	Discontinued SMVU	Main data source no longer available
	Regional costs	Rawlinsons construction costs	See above
	Wage costs	CGC Wage assessment	N/A

The following sub-sections, including those for issues noted by the CGC, outline reasons for concern.

7.8.5.1 Total actual state spending on roads

In the draft report, the CGC noted that “there is evidence that the Government Finance Statistics for some states are of low quality” and “the variation over time, evident particularly in New South Wales, Victoria and Tasmania, suggests there is a high level of variability in how a particular service is classified. With such variability within individual jurisdictions, there is likely even greater variability between jurisdictions. The Commission is not confident, for example, that the low apparent spending on roads in South Australia reflects low actual spending on roads.” Victoria shares the CGC’s concern with the reliability of state expenditure data on roads.

7.8.5.2 The synthetic rural road network as a reflection of state rural road length needs

In the draft report, the CGC agreed “that the synthetic rural road network is not always reflective of travel patterns on rural roads. Some routes are also now out of date.” Victoria generally supports the

use of the existing synthetic rural road network, particularly after the removal routes to mines, national parks, gas wells and ports. However, the issues noted by the CGC contribute to the overall need for a discount.

7.8.5.3 Heavy and light vehicle traffic volume data

In the draft report, the CGC stated that “the Bureau of Infrastructure and Transport Research Economics and the National Transport Commission data continue to be the most reliable, despite the discontinuation of the Survey of Motor Vehicle Use.” However, the CGC also noted that “the National Transport Commission has advised it will no longer provide highly disaggregated traffic volume data due to the discontinuation of the Survey of Motor Vehicle Use and its concerns with the data’s increasing unreliability.” The consideration of the Bureau of Infrastructure and Transport Research Economics and National Transport Commission data as the most reliable is due to a lack of alternatives, not because of its reliability. The fact the NTC can no longer provide the disaggregated traffic volume data further contributes to the need for a discount to the assessment.

7.8.5.4 The relative importance of road length, heavy and light vehicle traffic as drivers of expense needs

The lack of reliable traffic volume data also affects the ability of the CGC to appropriately weight the relative importance of road length and heavy and light vehicle traffic as drivers of expense needs.

7.8.5.5 The split between urban and rural traffic volume

The NTC’s inability to provide highly disaggregated traffic volume data means the CGC will hold the proportions of urban and rural heavy and light vehicle traffic volume fixed until an alternative data source can be obtained. These proportions were last updated in 2022 and were similar to the previous update in 2020. However, the inability to update this data for the duration of the review mean trends in traffic volume due to population growth in certain areas, for example, will not be reflected in the assessment.

7.8.5.6 Regional costs

Should the CGC decide to include a regional cost gradient, despite the weak conceptual case outlined in Section 7.8.4, all of the proposed options for quantifying those costs would justify a discount.

Neither the 2020 methodology version nor the 2025 draft report proposed version of the general cost gradient include services that reflect expenses for roads thereby making them unsuitable. The proposed use of the Rawlinsons construction cost indices are also unsuitable as these relate to infrastructure construction, not recurrent expenditure (Victoria notes a range of concerns with the Rawlinsons index in Section 8.2 of this response).

7.8.5.7 Recommendation

Victoria supports the CGC’s decision to apply a discount to the roads assessment. However, given the prevalence of data quality issues throughout the roads assessment, Victoria considers the CGC’s proposal of a low discount of 12.5 per cent to be insufficient and recommends a medium discount of 25 per cent.

If an appropriate replacement for the SMVU traffic volume data can be found prior to the next review, the CGC could consider reducing the discount to a low discount of 12.5 per cent at that time.

Given the significant data concerns raised with nearly every driver in the roads assessment, Victoria questions the threshold the CGC applies for medium and high discounts. Victoria is not

aware of any high discounts being applied in the assessments, and there are very few medium discounts. The CGC should utilise this full range to account for differences in the quality of different assessments.

For example, with the CGC's adoption of the consultant's recommendations, the wages cost assessment is now considered relatively robust, but is still discounted due to the data issue of the proxy for private to public sector wages. The issues raised for roads far outweigh the issues in the wages assessment.

As noted in Section 4.2.1, Victoria seeks further explanation of how the CGC decides the level of discount to apply in each case. In particular, Victoria requests further detailed explanation of why the discount for the roads assessment should be low rather than medium or high.

Victoria's recommendations

- Victoria supports the CGC's proposal to retain population as the driver for urban road lengths.
- Victoria supports the CGC's proposal to remove routes to mines, national parks, gas wells and ports from the rural road network.
- Victoria supports the CGC's decision to hold constant the urban/rural split for light and heavy vehicle traffic volume for the duration of the review.
- Victoria recommends the CGC not apply any remoteness cost gradient due to the lack of a demonstrated conceptual case.
- Victoria recommends the CGC apply a medium discount of 25 per cent to the assessment.

7.9 Transport

Victoria supports the draft report's recommendations to largely maintain its approach to assessing urban transport through the econometric model. However, Victoria retains its previously stated concerns with the specific proposals the draft report makes to manage the impacts of COVID-19 influenced data.

Victoria reserves the right to provide further comment on the transport assessment once the CGC provides the addendum with assessment numbers as the draft report notes the CGC's conclusions may change based on outcomes of the data.⁵² Victoria considers states are unable to provide fulsome views without access to this information and looks forwards to a supplementary opportunity to comment.

Victoria continues to have concerns with the assessment of non-urban transport and looks forward to working with the CGC further to resolve issues around classification of its V/Line expenditure.

⁵² This response was drafted before an addendum was provided. It is possible the CGC provide an addendum ahead of its official due date for responses (7 August 2024), however due to internal processes Victoria will not have sufficient time to respond ahead of the due date and will make a supplementary submission once the addendum is provided.

Victoria's recommendations

- Victoria continues to support the CGC's general approach to assessing urban transport expenses using the model developed in the 2020 Review, however, will provide a supplementary response with additional comments in response to the forthcoming addendum on transport.

7.9.1 Urban transport and the forward work program

In light of the fulsome review undertaken as part of the 2020 Review, Victoria does not consider urban transport is warranted as a priority area for the forward work program, and suggests it is not revisited until the expected 2030 review. Victoria considers there are other more pressing issues requiring a more fulsome review compared to re-prosecuting transport which was only recently examined in the 2020 Review.

Victoria recognises there was significant discussion from states on the urban transport assessment as part of the 2025 review. However, Victoria considers the substantive issues around the COVID-19 influence of data are transient and will not persist in the long term although noting it will take time for 'new normal' patterns to emerge. Transient data issues are likely to resolve themselves with the 2026 Census and states expenditure data collected closer to the expected 2030 review.

The fundamental underpinnings of the of the approach to urban transport remain robust, as the CGC concludes in the draft report noting "The Commission considers the regression model, incorporating the proposed changes listed below, remains appropriate for assessing urban transport needs".

Victoria reiterates its concerns around the scope of the forward work program and the opportunity for detailed examination of all issues, both from the perspective of CGC and states' resourcing. Victoria considers there is likely greater value for limited CGC and state resources to be directed towards other areas that are overdue for re-examination.

Victoria's recommendations

- Victoria recommends urban transport is not on the forward work program to balance capacity for other more fundamental issues.

7.9.2 The impact of COVID-19 on the urban transport assessment

7.9.2.1 Transport net expense data

Victoria is disappointed the CGC has not accepted its view that 2022-23 state financial data are not appropriate for use in the urban transport assessments due to the continuing impacts of the COVID-19 pandemic. As stated in its tranche 1 response, Victoria considers expenses data from 2022-23 and 2023-24 are too early to establish a 'post-COVID-19 normal' for transport needs.

As a compromise, and depending on the results presented in the addendum, Victoria suggests the CGC retain the 2020 Review data until a future update with an additional request ahead of the 2030 review. A data update between reviews could both improve timeliness and manage issues with COVID-19 influences. Victoria recommends new data are collected for 2025-26. Even without the pandemic disruption issues, 2020 Review data will be dated by the end of the 2025 review period and would benefit from an update ahead of the 2030 review process.

7.9.2.2 Proxy variables in the regression model

Victoria supports the CGC's conclusion that 2021 Census data are COVID-19 influenced and not fit for purpose to update variables in the regression model. However, Victoria reiterates its concerns with the CGC's proposed adjustments to manage these issues.

Victoria states again its concern with indexing 2016 Census passenger numbers to 2022-23, based on total distances travelled from the Bureau of Infrastructure, Transport and Regional Economics (BITRE). As previously stated, the BITRE data are also likely to be influenced by COVID-19, both in levels and growth to 2022-23. This approach does not remove the issue the CGC is attempting to resolve with the 2021 Census data given the same temporal influences.

In addition, the BITRE data measure distances travelled whereas the Census numbers measure the number of passengers. These are different measures, and indexing based on distance travelled may introduce a data bias.

Changes in the number of passengers are likely not well represented by changes in distances travelled as, for example, certain cohorts may systematically travel greater distances than others. There may also be a disconnect between changes in passenger numbers and distances as some passengers may change distances and travel patterns rather than stopping travelling altogether.

Any bias in the length of travel of those most impacted by COVID-19 may disproportionately impact the results compared to the number of passengers. For example, if relatively longer radial commutes into cities were disproportionately influenced compared to shorter suburban commutes.

Victoria again notes its concern with adopting 2021 Census distances travelled to work due to the disproportionate impact of the pandemic on travel patterns. Victoria requests the CGC confirm with the ABS its view that there are no issues with bias or accuracy in this measure as a result of the pandemic.

7.9.2.3 Blending ratio between the model and the population approach

Victoria notes that the CGC proposes to increase the share of urban populations in the assessment in response to these data issues, in the method's blend with the econometric model. Victoria reserves its views on this issue until data are provided in the addendum.

Victoria's recommendations

- Victoria does not consider 2022-23 transport expenditure data reflect a new post-COVID-19 trend and suggests the CGC retain the 2020 Review data. Victoria recommends the CGC make an additional later request for 2025-26 data ahead of the 2030 review for more timely data.
- Victoria supports retaining the 2020 Review urban transport model, however, does not support:
 - indexing 2016 Census passenger numbers using distances travelled from the Bureau of Infrastructure, Transport and Regional Economics
 - adopting 2021 Census distances travelled to work.
- Victoria reserves the right to comment on the blending between the urban transport model and urban populations once the transport addendum has been provided.

7.9.3 Economies of density

Victoria supports the draft report's conclusion that population weighted density should remain in the model of urban transport expenses, and that economies of scale are adequately captured in the current model. Victoria does not support proposals from other states that argued to remove the model on the basis that there are economies of scale in public transport in the major cities of Australia, and so the significant influence of population weighted density is inappropriate.

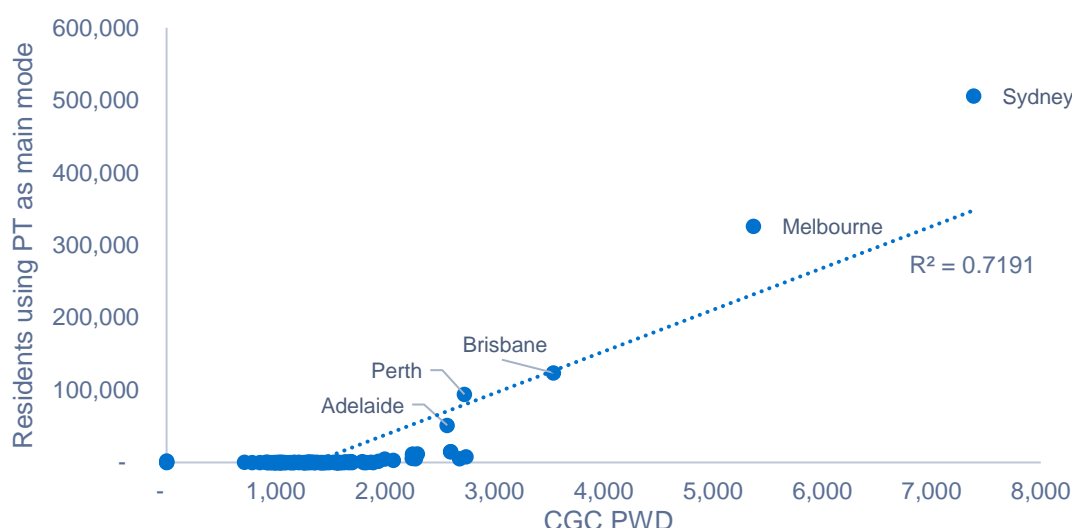
As the draft report notes, the CGC's model uses population weighted density to account for demand for urban transport. It is clear that demand for urban transport increases with population and population density. Significant evidence is presented in this response (see Section 7.9.3.1) and the draft report to support this relationship.

Economies of scale refers to lower unit costs for higher quantities produced. This is a distinct issue from population weighted density in the urban transport model which explicitly measures demand, or the quantity of services delivered. As such, it is the fact that public transport demand increases with population weighted density (PWD) that drives its inclusion in the model, not whether there are economies of scale.

7.9.3.1 Evidence of the link between density and public transport demand

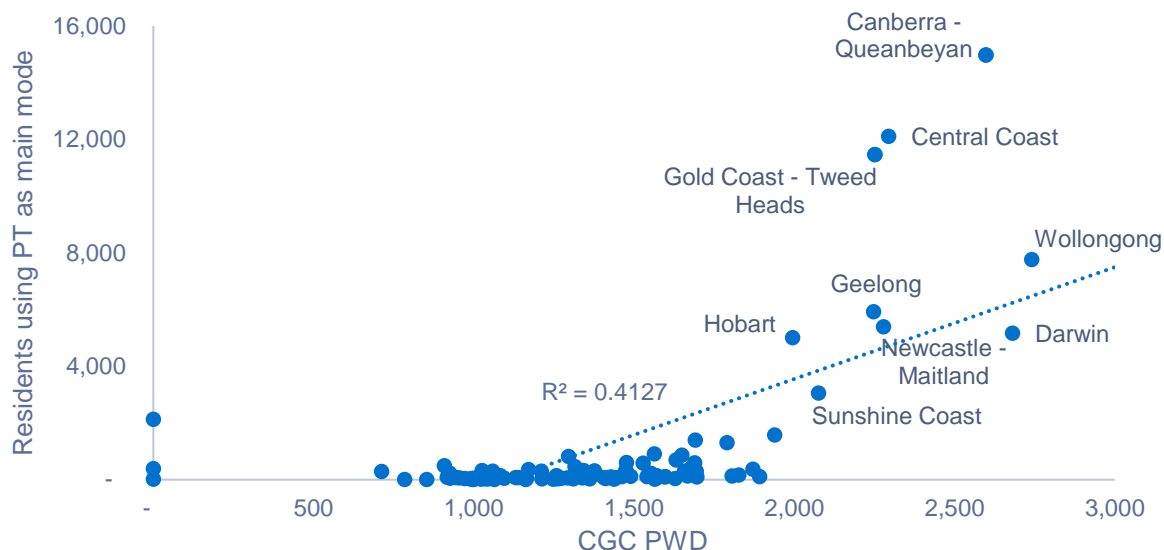
The relationship between PWD and public transport use in Australian cities has been demonstrated in the draft report and previous CGC reviews, however further evidence is presented below. Figure 27 presents CGC data that show the number of residents using public transport as their main mode of travel (i.e. demand) increases with density. Figure 28 additionally shows that even excluding Australia's largest cities, the positive relationship between PWD and public transport use still holds. Excluding the largest cities alleviates concerns around policy neutrality or the influence of Melbourne and Sydney with much higher population density than other urban areas on the results. The same relationships hold when the share of public transport trips is compared to PWD.

Figure 27: Number of residents using public transport as main method of travel to work by population weighted density



Source: CGC 2024 Update

Figure 28: Number of residents using public transport as main method of travel to work by population weighted density – excluding 5 largest cities Melbourne, Sydney, Brisbane, Perth and Adelaide



Source: CGC 2024 Update

Academic theory presents a rationale for the relationship between density and public transport use. As density increases, so do congestion costs for private travel (by car for example) which increases the efficiency for travellers of utilising public transport. Increasing costs of congestion for larger cities are well documented and coincide with any potential efficiency benefits.⁵³

Many academic quantitative studies find a negative elasticity of population density to transportation by car (measured kms travelled by car for example). A literature review by Feyzollahi, Pineau and Rafizadeh (2024) cites a number of papers on this subject.⁵⁴ This substantiates the theory that density drives public transport use by increasing costs to private transport.

The link between larger cities and congestion is also evident in recent Australian data. A recent Infrastructure Australia report notes significant congestion costs from both road congestion and public transport crowding, generally found to be higher for larger cities Sydney and Melbourne and surrounding areas.⁵⁵ The Committee for Melbourne's 2024 Benchmarking report notes challenges

⁵³ Graham, D.; Variable returns to agglomeration and the effect of road traffic congestion; Journal of Urban Economics 62 103–120 (2007): https://www.academia.edu/100283839/Variable_returns_to_agglomeration_and_the_effect_of_road_traffic_congestion?uc-sb-sw=44592791

⁵⁴ Feyzollahi M., Pineau, P-O., and Rafizadeh, N.; Drivers of driving: A Review, Sustainability 2024, 16(6), 2479; <https://www.mdpi.com/2071-1050/16/6/2479>

⁵⁵ <https://www.infrastructureaustralia.gov.au/sites/default/files/2019-08/Urban%20Transport%20Crowding%20and%20Congestion.pdf>

with congestion from car use and crowding of public transport in Melbourne.⁵⁶ A report by the World Bank also notes the increasing road congestion costs of larger cities.⁵⁷

Quantitative evidence from academic literature supports the link between population density and public transport use. Victoria appreciates the extensive literature cited in the draft report, including those that account for population density influencing public transport provision and cost.

Victoria highlights a number of other sources not captured in the draft report below, with explicit reference to the role of population density increasing demand for public transport services. Examples include:

- The Victoria Transport Policy Institute (2024), a Canadian transport think tank, studied transport demand and includes ‘density’ as a factor affecting transport demand that is negatively related to car use.⁵⁸
- Academics Wu, Levinson and Sarkar (2019) looked at data from 48 cities in the USA and concluded there was a positive relationship between public transport use and residential density.⁵⁹
- A literature review by academic Polat (2012) lists population density as a key variable identified in academic studies on the demand for public transport services. They note the influence of higher costs of private transport such as cars resulting from greater density drives public transport use.⁶⁰
- An econometric study by academic Souche (2010) finds density as the most important factor for predicting urban travel demand, along with user costs.⁶¹
- A paper by de Jong and de Riet (2008) finds that population density is linked to lower car ownership and higher public transport use.⁶²
- A National Report on Commuting Patterns and Trends by the Transportation Research Board in the USA (2006) found densely populated areas were “heavily reliant on transit”. The report also makes a link between job density and ‘transit’ (public transport use) noting this is even higher than only to population density.⁶³

⁵⁶ 2024-CFM_Benchmarking-Melbourne_Digital.pdf

⁵⁷ <https://documents1.worldbank.org/curated/en/928301468762905413/pdf/Cities-on-the-Move-A-World-Bank-Urban-Transport-Strategy-Review.pdf>

⁵⁸ Litman, T.; Understanding Transport Demands and Elasticities: How prices and other factors affect Travel Behaviour, VTPI, February 2024; <https://www.vtpi.org/elasticities.pdf>

⁵⁹ Wu, H., Levinson, D. and Sarkar, S.; How transit scaling shapes cities, Nature sustainability, 2, 1142-1148 (2019) <https://www.nature.com/articles/s41893-019-0427-7>

⁶⁰ Polat, C.; The demand determinants for urban transport services: A review of the literature; Journal of Applied Sciences 12(12): 1211-1231 December 2012:

https://www.researchgate.net/publication/258659074_The_Demand_Determinants_for_Urban_Public_Transport_Services_A_Review_of_the_Literature

⁶¹ Souche, S.; Measuring the structural determinants of urban travel demand, Transport Policy, Vol 17, Issue , Pages 127-134 May 2020: <https://www.sciencedirect.com/science/article/abs/pii/S0967070X09001449>

⁶² De Jong, Ge and de Riet, O.A.W.T.. (2008). The Driving Factors of Passenger Transport. EJTI, 8(3). 8. 10.18757/ejti.2008.8.3.3348.

https://www.researchgate.net/publication/27353715_The_Driving_Factors_of_Passenger_Transport

⁶³ Pisarski, A., 2006. Commuting in America III: The Third National Report on Commuting Conditions and Trends, Transportation Research Board, Washington, DC, <https://onlinepubs.trb.org/onlinepubs/nchrp/ciaiii.pdf>

- A report by TRL UK (2004), a transport think tank, reviews the relationship between land-use and public transport and find bus and rail use increase with density.⁶⁴
- Academics Kenworthy and Laube (1999) find population density was negatively related to car ownership and use but positively related to public transport use. They note the public transport share of all kilometres travelled is 25 per cent at the average urban density (5,000 persons per square km) and drops to 7.5 per cent at a lower population density (1,500 persons per square km).⁶⁵
- Buehler and Pucher (2012) find that in Germany and the USA, “public transport’s share of trips increases as population density rises”. They present data from Germany and the USA showing the share of total public transport trips is much higher in urban areas, areas with higher populations and higher populations per square km, see Figure 29.⁶⁶
- Pisarski (2006) presents data analysis showing the relationship between population density and ‘transit’ (public transport) use. Figure 30 shows a greater share of transit travel occurs in areas with higher population density (corresponding to a decreased share of private vehicle use).⁶⁷
- Headicar, Banister and Pharoah (2009, UK Commission for Integrated Transport) shows the total distance travelled in Great Britain is much higher for public transport modes in areas with higher population densities (see Figure 31).⁶⁸

⁶⁴ The demand for public transport: A practical guide, TRL Report TRL593; 2004:

<https://trl.co.uk/uploads/trl/documents/TRL593%20-%20The%20Demand%20for%20Public%20Transport.pdf>

⁶⁵ Kenworthy, J.R. and F.B. Laube (1999) Patterns of automobile dependence in cities: an international overview of key physical and economic dimensions with some implications for urban policy, *Transportation Research A*, 33, pp. 691-723.

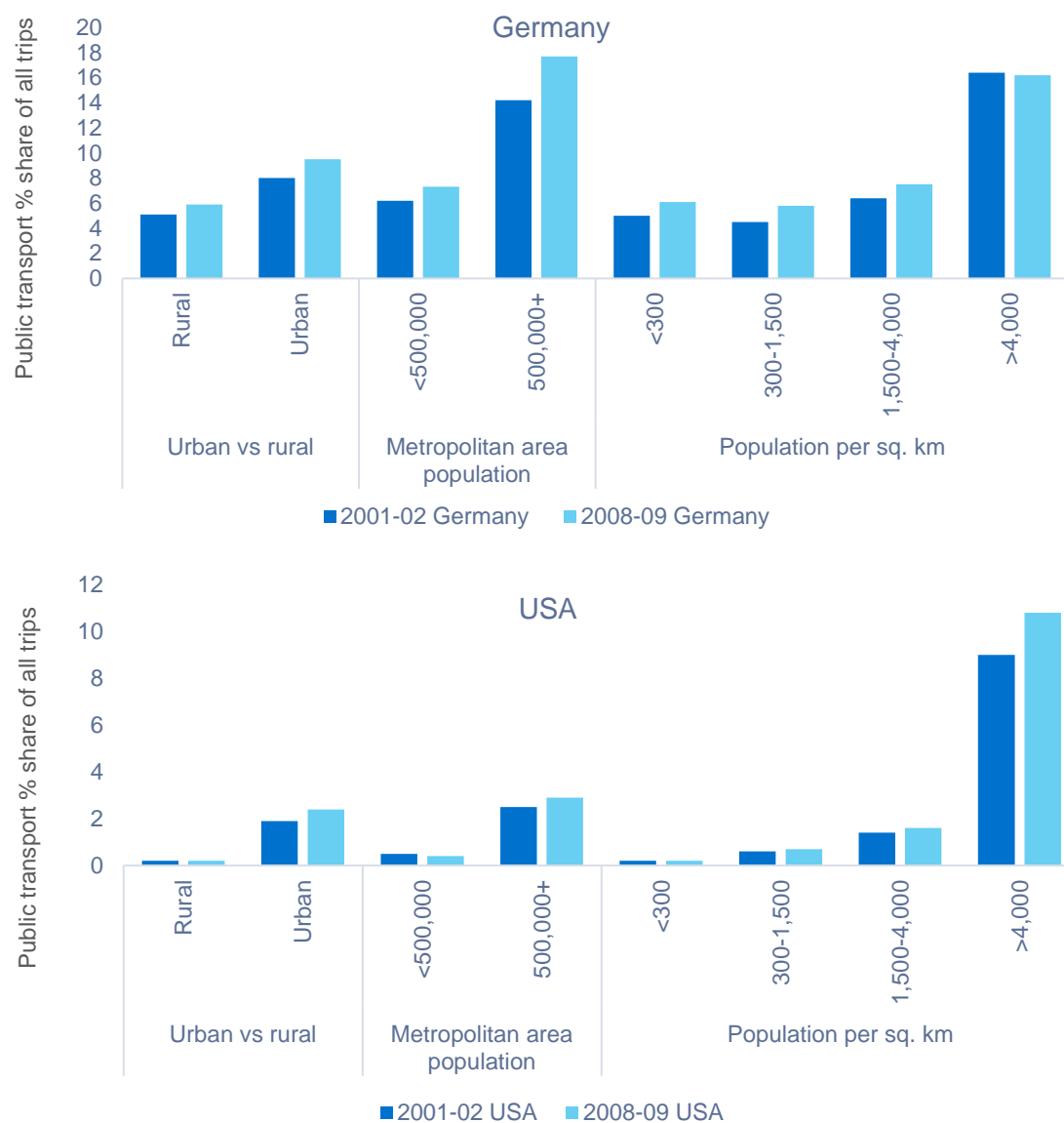
⁶⁶ Buehler, R. and Pucher, J.; Demand for public transport in Germany and the USA: An analysis of rider characteristics; *Transport Reviews*, Vol. 32, No. 5, 541– 567, September 2012:

<http://www.thenewspaper.com/rlc/docs/2012/germantransit.pdf>

⁶⁷ Pisarski, A., 2006. *Commuting in America III: The Third National Report on Commuting Conditions and Trends*, Transportation Research Board, Washington, DC

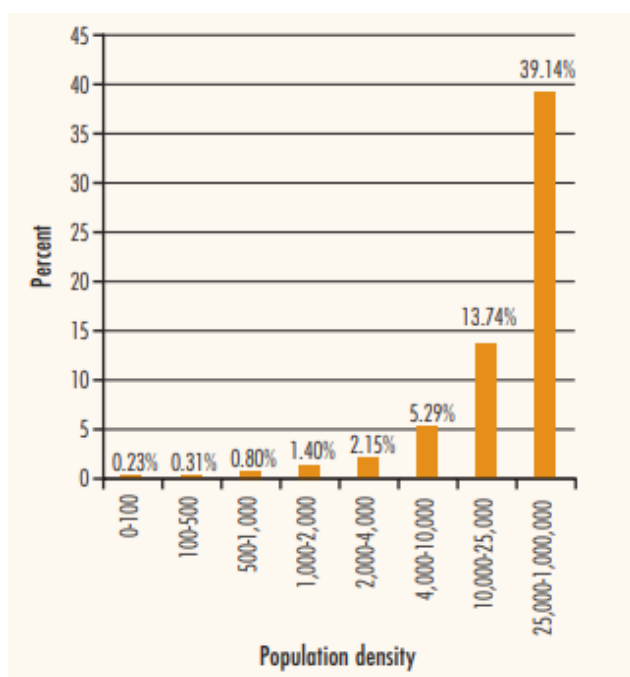
⁶⁸ Headicar, P.; Banister, D.; Pharoah, T.; Land use and transport: settlement patterns and the demand for travel, Halcrow Group Ltd for the Commission for Integrated Transport, October 2009: <https://www.livingtransport.com/library/pdf.php?id=596>

Figure 29: Reproduced chart from Buehler and Pucher (2012): Share of trips by public transport in Germany and the USA



Source: Buehler and Pucher, Transport Reviews, Vol 32, No. 5, p. 541 – 567, September 2012

Figure 30: Chart from Pisarski, A. (2006) on the relationship between density and transport modal use

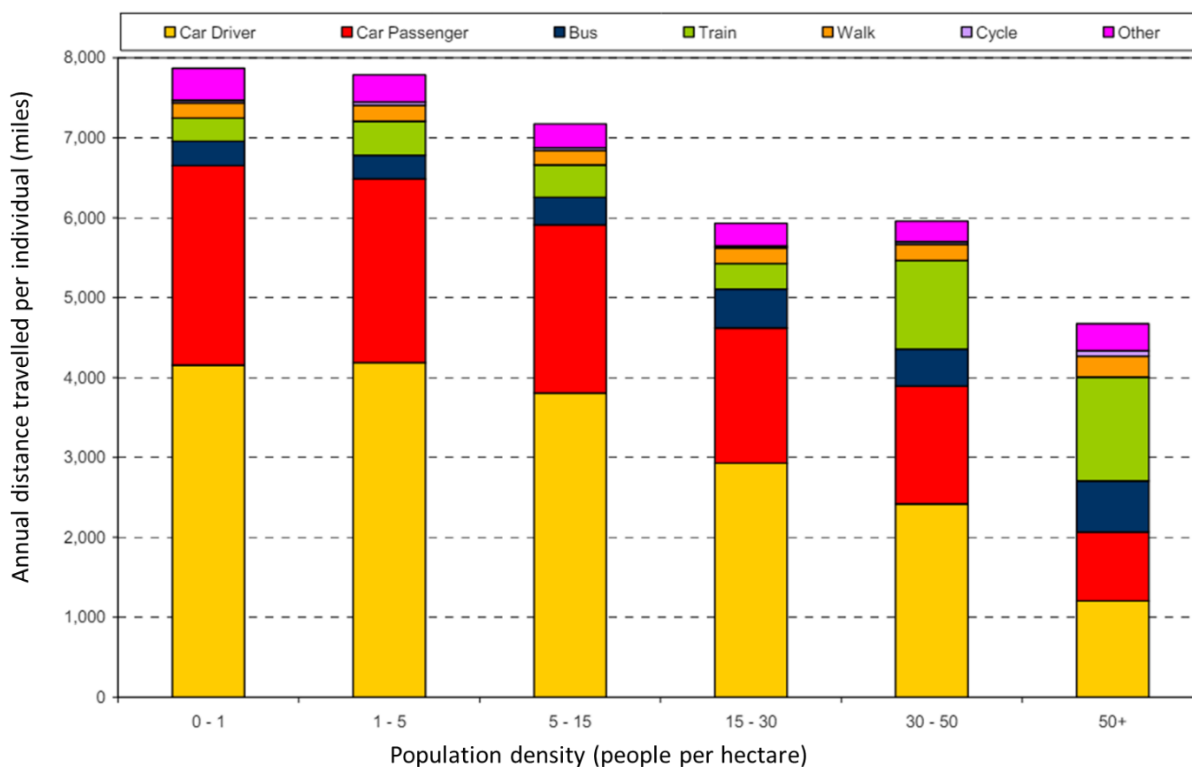


Source: Pisarski, A., 2006. Commuting in America III: The Third National Report on Commuting Conditions and Trends, Transportation Research Board, Washington, DC

Note: Densities were calculated at the Census tract level.

Figure 31: Chart from Headicar, Banister and Pharaoh (2009): Average distance travelled annually per individual by population density band in Great Britain, 2002-2006

The mode share of rail (in green) and busses (dark blue) increases significantly in the highest population density areas, with the mode share of cars decreases (as driver in yellow and passenger in red)



Source: Headicar, P.; Banister, D.; Pharaoh, T.; Land use and transport: settlement patterns and the demand for travel, Halcrow Group Ltd for the Commission for Integrated Transport, October 2009, <https://www.livingtransport.com/library/pdf.php?id=596>

Victoria's recommendations

- Victoria supports the continuation of the econometric model being used to assess urban transport needs, including accounting for population density. Victoria however reserves the right to provide further comments in light of new evidence provided in the addendum.
- Victoria reserves the right to comment on the calculation of population weighted density until results from the addendum have been provided.

7.9.4 Policy neutrality and the urban transport assessment

Victoria supports the draft report's conclusions that there does not need to be any further adjustments to account for any policy differences in the urban transport assessment in relation to the extent of population density or cost recovery.

7.9.4.1 Policy neutrality of population density

Victoria supports the draft report's position that there has not been sufficient evidence provided to change its position that population density is policy neutral.

In the 2020 Review the CGC concluded that "the majority of differences in population density are due to circumstances outside current state control". It added that even if there was a conceptual effect of policies, it does not have the information to make a reliable quantitative adjustment.

Policy neutrality concerns around density do not bear out with the available data. The previous Section 7.9.3.1 provides significant evidence across time and countries that population weighted density is related to higher public transport use. This relationship appears to be independent of the varied policies and circumstances of the different countries reviewed. Figure 28 showed there was still a strong relationship in CGC data between population density and public transport use in Australia, excluding Sydney and Melbourne.

The density of Australian cities is certainly influenced to an extent by state policies. States implement planning policies and make decisions around where to locate services and transport which also influences residential choices. However, these are not influences the CGC should separately account for as they are both:

- consistent between states
- have influence over long timeframes that the CGC does and should not separately adjust for.

The effect of policies made sufficiently in the past that are entrenched are effectively outside current government's control and are as such policy neutral for the CGC's purposes. The CGC already concluded as such in the 2020 Review noting Sydney's high population density was due to "non-policy influences and historical policy" and was therefore policy neutral.

States have generally similar policies of constraining urban sprawl in major cities, recognising the associated benefits for economic output (termed 'agglomeration benefits') and social wellbeing (for example minimising commute times and creating accessible communities).

Infrastructure Australia's 2019 Infrastructure Audit notes that for people living in outer suburbs, urban sprawl creates additional transport costs: "For such people it is harder, and more expensive in proportion to family income, to reach employment opportunities." Bolleter, Edwards and Hooper (2024) summarise views in the academic literature on the "longstanding issues" facing urban expansion including sterilisation of agricultural and biodiverse land and adverse health effects.⁶⁹

The consistency of states' policies around population density and transport provision is well recognised and should be considered policy neutral for the CGC's purposes. Examples where this has been established include:

- Bolleter, Edwards and Hooper (2024) note "Delivering urban infill correlated with transport is a *sine qua non* in Australian urban policy across all levels of government. Since the 1980s, urban consolidation has become a firmly established orthodoxy in Australian spatial planning theory and practice".⁷⁰

⁶⁹ Bolleter, J., Edwards, N. and Hooper, P., In GOD we trust: Tracking density, greenspace, and wellbeing in Australian cities, 2024, Chapter 12 of Australian Urban Policy: Prospects and Pathways, The Australian National University, Canberra, Australia, <http://doi.org/10.22459/AUP.2024.12>

- In the 2020 Review, the CGC noted a BITRE report that found the four largest states (NSW, Victoria, Queensland and WA) had similar policies in terms of limiting urban sprawl for their capital cities and increasing population density in and around activity centres.
- Academics Rogers and Pill (2024) in a recent book *Australian Politics and Policy*, note Australian “Metropolitan plans tend to share a commitment to urban consolidation, seeking compact cities by restricting new land released for development on the urban fringe and implementing plans for densification”.⁷¹

7.9.4.2 Policy neutrality of public transport service provision

The draft report also considers policy neutrality of public transport provision, namely in cost recovery. In previous consultation some states suggested that NSW and Victoria have policies to oversupply public transport, or that their services are inefficient due to their policies, and so skew the data on density and transport use. Victoria considers this is incorrect and supports the draft report’s conclusion that there is no reliable adjustment that can be made for this potential issue.

Victoria supports the draft report’s caveat that it is difficult to compare cost recovery arrangements between cities and internationally, due to differences in many factors that influence service delivery and demographics. The draft report notes Australian cities where data was available all had similar farebox recovery rates between 22 per cent (Melbourne and Sydney) and 30 per cent (Perth). The Committee for Melbourne’s 2024 Benchmarking report also notes Melbourne has internationally relatively high public transport fares, and Melbourne is in the bottom 30 per cent of global cities for the affordability of a public transport ticket. Victoria also notes the Queensland Government’s recent announcement for temporary low fares, which are likely to be well below cost recovery.⁷²

There is significant evidence of unmet demand in Victoria and Melbourne’s public transport system, as well as the impacts of congestion and crowding due to Melbourne’s size. The Committee for Melbourne’s 2024 Benchmarking report referenced earlier notes there is significant congestion in Melbourne’s public transport system, which appears in some areas to have worsened in recent years, potentially due to population growth.⁷³

The Infrastructure Australia 2019 Audit also notes “...for our two largest cities, Sydney and Melbourne, the projected costs of congestion are now greater [than in the 2015 Audit]. This reflects the substantial growth in these two cities since the last Audit, their growing role in the national economy, and the forecast growing gap between travel demand and the supply of new roads and public transport infrastructure.”⁷⁴

7.9.5 Non-urban transport

Victoria accepts the CGC’s draft position that the drivers of non-urban transport and urban transport are distinct and warrant separate assessments. Victoria retains its view that due to issues defining the appropriate spending under each component the split is not accurate and does not advance HFE.

Victoria agrees that under the current framework, expenses on inter-urban transport should be included in the non-urban transport assessment. Victoria is not aware of any evidence of inter-urban

⁷¹ Rogers, D. and Pill, M., *Urban policy*, Chapter 44 of *Australian Politics and Policy*, Sydney University Press, 2024, <https://oercollective.caul.edu.au/aust-politics-policy/>

⁷² <https://translink.com.au/tickets-and-fares/50-cent-fares>

⁷³ https://melbourne.org.au/wp-content/uploads/2024/03/2024-CFM_Benchmarking-Melbourne_Digital.pdf

⁷⁴ https://www.infrastructureaustralia.gov.au/sites/default/files/2020-09/audit_passenger.pdf

expenses being allocated to urban transport incorrectly, as the draft report suggests. Rather, Victoria has presented evidence of a significant issue in the reverse, where expenditure for intra-urban travel is being assessed as non-urban.

Victoria is disappointed with the CGC's conclusion on the current misallocation of its urban V/Line expenditure. While Victoria notes the CGC's intention to revisit the share of Geelong V/Line expenditure that should be urban at the 2026 Census, it considers this still misses a significant proportion of intra-urban transport provided by V/Line. This has been a more significant issue since the completion of the Regional Rail Link project in Victoria in 2015, which added a number of metropolitan stations for V/Line services.⁷⁵

Victoria's view is the current assessment materially detracts from HFE as a significant proportion of expenditure (up to 60 per cent in the Melbourne Significant Urban Area (SUA) and 46 per cent across Victoria based on passenger numbers) is being misallocated to non-urban transport.

Victoria recognises the CGC's request for more detailed data to address this issue, and its suggestion that using only passenger numbers for an adjustment may miss differences in cost between longer and shorter trips for example.

Victoria will work further with the CGC to provide the appropriate data it requires to rectify this issue. Victoria expects to be able to provide the CGC the detailed data it requests within the timeframes of the 2025 review and hopes the CGC will be able to resolve this issue for the 2025 review final report.

If the CGC is unable to resolve this issue for the 2025 review final report, the review should allow for method changes ahead of the 2030 review to rectify it (as the 2020 method did for the materiality of new mining components for example).

Victoria notes the draft report's conclusion to not adopt the share of total non-urban train commuters by state as a driver of non-urban transport need. Victoria reiterates that it considers issues with the classification of non-urban transport expenditure likely contribute to the observed mismatch between this driver and spending. In the case of Victoria, its high non-urban spending compared to share of passengers is likely indicative of the misallocation of significant urban expenditure as non-urban.

Victoria's recommendations

- Victoria will work further with the CGC on an appropriate adjustment for its urban trip related V/Line expenditures as part of the 2025 review. If an adjustment is not able to be made in time for the final report, Victoria recommends the CGC allow for method changes ahead of the next review for this issue.

7.9.6 Urban transport investment requirements

Victoria considers states are unable to provide fulsome comments in response to the draft report on the urban transport investment approach without the CGC's final views and data to be presented in the addendum. Victoria reserves the right to comment after the addendum is provided, and states have sufficient time to interpret its results. Based on previously provided evidence, Victoria supports

⁷⁵ <https://www.victrack.com.au/projects/completed/regional-rail-link>

the use of the urban population squared approach, however, will consider its position in light of any new evidence provided in the addendum.

7.9.6.1 Policy neutrality of public transport investment

As with urban transport recurrent expenses, some states have claimed that higher urban transport investment in Victoria and NSW is not sufficiently policy neutral. Victoria does not support this hypothesis. Victoria supports the draft report's similar conclusion that "Any state expenditure on public transport will be to some extent policy influenced, but this does not mean the data are unsuitable in determining what drives state needs."

Urban transport investment is no different to other expenditure or investment areas in terms of policy influence. The CGC mitigates policy influences through its best approximation of policy neutral drivers based on the average policies of all states. In the case of urban transport this is done through the urban transport model (with variables like patronage by public transport mode and topography) and populations in urban areas.

As discussed under Section 7.9.5, certainly to some extent historic state policies influence these factors. However, they are policy neutral for the purposes of the CGC's assessments, and as neutral as the factors the CGC uses to assess any other area of expenditure or revenue raising capacity.

Victoria's investment in urban transport is in response to significant demand pressures from its growing cities, particularly Melbourne. Victoria's population growth was above the national rate for 16 of the 24 years to June 2023.⁷⁶ Business cases for projects as part of Victoria's current Big Build explicitly link responding to increased demand to this high population growth.

For example, the business case for the Melbourne Metro notes: "Melbourne's population is expected to almost double by 2051 and average weekday boardings on metropolitan trains are forecast to more than double by 2031. To maintain Melbourne and Victoria's liveability and prosperity, Melbourne Metro is designed to alleviate a public transport system that is under considerable strain and provide viable public transport options to Melbourne's growing population."⁷⁷

The investment and business case for the Suburban Rail Loop (SRL) also notes population growth as a driver of need: "As well as delivering significant transport benefits, SRL provides an opportunity to plan the services, amenity and infrastructure Melbourne will need outside of the CBD to accommodate a growing population".⁷⁸

Infrastructure Australia's 2019 Infrastructure Audit notes a "growth in congestion is in spite of significant investments in new transport infrastructure across our largest cities, particularly Sydney and Melbourne. ... Despite their scale, recent investments in transport infrastructure in our fast-growing cities is largely playing 'catch-up' rather providing additional capacity that will support substantial future growth."⁷⁹

⁷⁶ Victorian calculation on ABS National, state and territory population data.

⁷⁷ https://bigbuild.vic.gov.au/__data/assets/pdf_file/0006/40677/MT-Business-Case-Feb-2016.pdf

⁷⁸ https://bigbuild.vic.gov.au/__data/assets/pdf_file/0004/578281/SRL-Business-and-Investment-Case.pdf

⁷⁹ Noting references to growth in congestion focus on road transport infrastructure, Victoria considers the same conclusions apply for public transport. https://www.infrastructureaustralia.gov.au/sites/default/files/2020-09/audit_passenger.pdf

Victoria notes all states consistently invest in urban transport infrastructure responding to the needs of their states, including increased demand.⁸⁰ There is no basis to claim that any state over or under provides transport infrastructure based on influences from the GST system.

7.9.7 Other issues in the transport assessment

Victoria supports in-principle the CGC's position to retain the current variables in the urban transport econometric model, contingent on the results yet to be seen in the addendum. Victoria supports not adding variables for SES, concession users, students or remoteness. Victoria acknowledges the draft report's commentary on the insignificant variables in the model and supports their continued inclusion, as noted in its tranche 1 response (subject to the results of the addendum).

Victoria supports the draft report's conclusion to retain the current approach to assessing ferries and commends the CGC for noting the evidence Victoria provided on the issues with the Census-based approach.

Victoria supports the draft report's decision to use a regression to model passenger numbers, rather than the previous population bands approach.

Victoria's recommendations

- Victoria supports in-principle retaining the variables in the urban transport econometric model, subject to the results of the addendum.
- Victoria supports modelling passenger numbers through the new econometric model.

7.10 Services to Industry

Victoria generally supports the CGC's proposed draft methods for assessing services to industry. Specific comments on individual topics are detailed below.

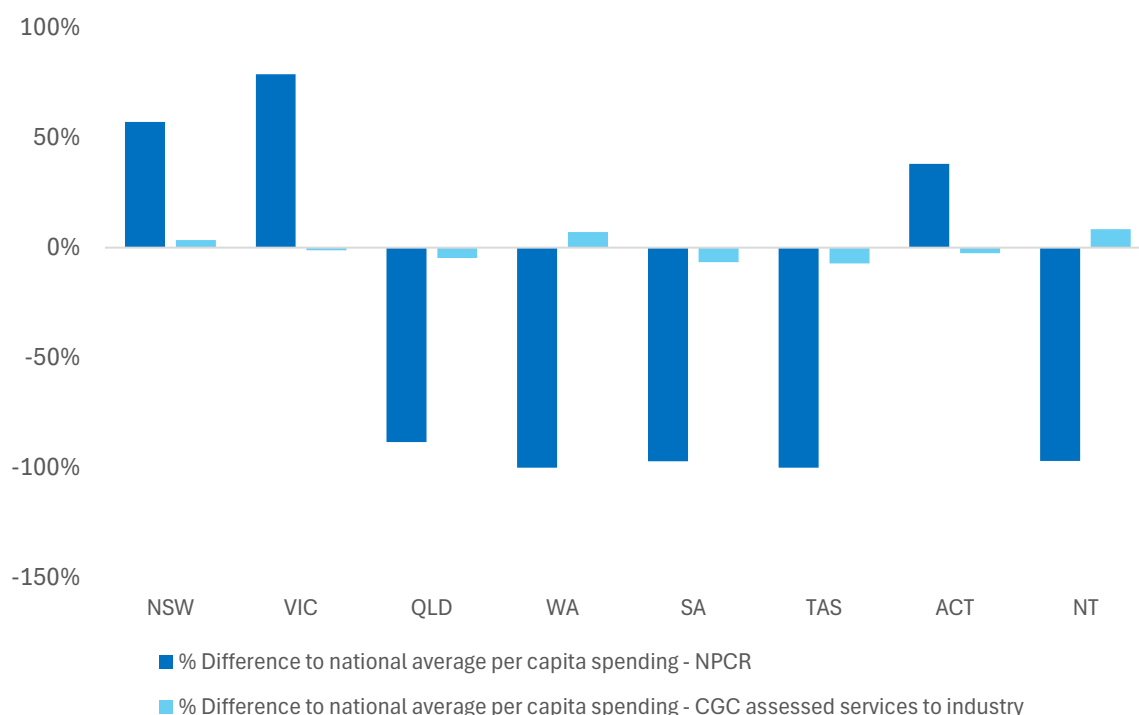
7.10.1 Treatment of COVID-19 business support expenditure

Victoria strongly supports the CGC's proposal to implement an APC assessment of states' spending covered by the COVID-19 business support national partnership agreement. This is an issue that Victoria has provided significant evidence for in both the 2022 and 2023 Updates and covered extensively in its tranche 2 submission. Victoria agrees with the CGC's previous finding that states' responses were driven by the circumstances of the pandemic and not policy decisions.

Victoria reiterates that the drivers of spending on business support responding to COVID-19 are not adequately captured by the EPC assessment of business development. This is demonstrated below in Figure 32, showing payments received under the COVID-19 business support national partnership agreement for Victoria were 79 per cent greater than the national average per capita whereas the CGC assessed Victoria's need to be 1 per cent lower than national average per capita. As such, the drivers for spending for COVID-19 do not align with the current industry assessment.

⁸⁰ [Qld faces \\$188bn debt bomb within four years | The Courier Mail](#)

Figure 32: Difference in 2021-22 COVID-19 payments



Source: CGC 2024 Update, Commonwealth Final Budget Outcomes

Victoria remains of the view that the national support partnership does not provide full coverage of states' COVID-19 business support spending. COVID-19 related expenditure in 2021-22 under the former Victorian Department of Jobs Precincts and Regions was \$8.2 billion.⁸¹ Only \$6.1 billion of this amount represents spending under the national partnership agreement, where \$3.1 billion was funded by the Commonwealth.⁸² This discrepancy still holds in 2021-22 and 2022-23, which are present in the relativity calculation for the 2025 Update.

Given this disparity, Victoria recommends the CGC should consider including spending under non-assessable non-exempt (NANE) programs alongside the national partnership agreement to capture a more accurate measure of states' spending on COVID-19 business support. Inclusion of spending under programs with NANE treatment is sensible as these programs are covered by a Commonwealth national framework that ensures consistency between states. This data can be collected through requests to states with verification by the Commonwealth. Victoria considers this request is not overly onerous for a material assessment issue.

Victoria recommends that the CGC consider a combination of payments under both the national partnership agreement and payments with NANE treatment be used as the basis for the assessment to provide accurate and consistent coverage of state COVID-19 business support payments.

⁸¹ <https://www.dtf.vic.gov.au/state-financial-data-sets/coronavirus-covid-19-reporting>

⁸² <https://treasury.gov.au/>

7.10.2 Chain volume measure of industry value-add

Victoria supports replacing the total factor income measure sourced from ABS Australian National Accounts with the new proposed annual indicator to remove price impacts and reduce volatility in the assessment. Victoria requests the CGC provide additional information on whether the aggregate measure of production from the ABS will be updated at each review.

7.10.3 Number of businesses as a driver of regulation spending

Victoria disagrees with the CGC's decision to not re-introduce the number of businesses as a driver of spending for business regulation given the strong conceptual case acknowledged by the CGC. 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. Furthermore, the CGC has acknowledged that including the number of businesses reduces the artificial volatility induced in the regulation assessment from changes in the industry size measure. Rather than completely excluding the number of businesses as a driver of spending for business regulation, Victoria recommends the CGC consider applying a discount consistent with other assessments where it has identified data uncertainty.

The issues identified by the CGC with the data should not preclude its inclusion and are commensurate with issues facing other data sources used throughout the wider assessment. Where a strong conceptual case is established, and there are relevant data, discounting can be appropriate to mitigate concerns. For example, in the health assessment, an indicator used to assess community and public health is based on proxy data from EDs and now NAP services. In the wages assessment, the CGC proposed to use a smoothing technique to deal with volatility. The wages assessment also includes private sector proxy data which was identified in the consultant's report to address uncertainty.

Victoria believes that the CGC can consider alternative data sources in conjunction with the ABS count of Australian businesses. This could include the use of Australian Taxation Office data on businesses that have lodged their taxes or Australian Business Register data on businesses that have registered for an Australian Business Number. Additionally, the CGC can consider an averaging or smoothing technique across financial years to mitigate potential volatility in the data.

The CGC's preliminary position was to include the number of businesses if it was material. Victoria requests that the CGC provide an updated table showing the materiality of including the number of businesses, alongside the value of industry production in the regulation assessment.

As discussed in the services to communities section above, and Victoria's response in the tranche 2 consultation, population density is also a driver of regulatory spending. Victoria experiences increased regulatory intensity due to businesses operating in closer proximity to communities. This 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.

7.10.4 Net-zero transition spending as a separate assessment

Victoria supports the CGC's decision to continue to monitor state spending to support the transition to net zero emissions, including the need for an agreed consistent definition. While Victoria has committed to making significant investments for numerous projects to support households, business and industry during the net-zero transition, these expenditures are dispersed across different service areas and portfolios. While this highlights the difficulty in disaggregating the data surrounding net-zero transition spending, Victoria encourages collaboration with the CGC to solve this in the forward work program.

As stated in response to tranche 1 consultation, Victoria recommends that the CGC explores a separate assessment of spending on the net-zero transition. A potential separate assessment for expenditures relating to the net-zero transition should consider multiple factors such as each state's natural resource endowments, intensity of effort, and share of non-renewable energy use. The transition to net zero and its implications for HFE requires consideration ahead of the 2030 review. While Victoria supports net zero being on the forward work program, further work should only be done once programs are in place and clear data on expenses are able to be collected.

Victoria's recommendations

- Victoria recommends that spending under programs with NANE treatment should be included in the assessment of state COVID-19 business support expenditure.
- Victoria supports replacing total factor income with the new annual measure but requests the CGC provide more insight on plans to renew the aggregate measure base at future reviews.
- Victoria considers that the number of businesses should be reintroduced as a driver in the assessment. Victoria requests that the CGC provide the materiality of reintroducing the number of businesses.
- Victoria expects that spending on the net-zero transition will continue to increase and further exploration of a future separate assessment should be prioritised once current limitations are addressed.

7.11 Natural disaster relief

Victoria does not support the continuation of the natural disaster relief assessment in its current form, as noted in its response to tranche 2 consultation. Victoria retains its position that there are issues with policy neutrality and the assessment should not be APC.

Victoria does not agree that the Natural Disaster Relief and Recovery Arrangements (NDRRA) provides a policy neutral basis for the assessment of natural disaster relief for the CGC's purposes. Despite the existence of national frameworks for disaster reliance, not all states have the same policy focus, creating information and capacity asymmetries across states. For instance, the NDRRA's requirement of 'reasonably adequate capital' is not clearly defined and open to interpretation, providing further scope for policy influenced relief expenditure.⁸³

Differences in states' policies around insurance, including taxes, can influence natural disaster relief claims under NDRRA. The rate of insurance and associated insurance policy differs across states and could influence the need for disaster relief funding.

In the 2020 Review the CGC determined that insurance and mitigation measures are nationally consistent due to the common national framework. However, the national framework does not establish a benchmark or common standard for insurance, so there is no evidence to determine whether states are maintaining a consistent level of insurance cover.

State responses to natural disaster events are also influenced by the degree of mitigative intervention. The 2014 PC Inquiry found that states falling behind in mitigative infrastructure standards, due to

⁸³<https://knowledge.aidr.org.au/resources/ajem-apr-2012-paying-for-disaster-recovery-australias-ndrra-and-the-united-states-nfip/>

policy choices, become more vulnerable to environmental disasters, increasing the cost and likelihood of relief expense for public assets.⁸⁴

The scope for variation in mitigation and insurance efforts means there are potentially policy driven differences in the level of expenditure under the NDDRA, undermining the conceptual case for an APC assessment.

Victoria recommends that given the interconnectedness between natural disaster mitigation and relief, these assessment categories should both be assessed EPC unless an appropriate policy neutral driver of expense can be identified for disaster mitigation.

7.11.1 Local Government Expenses

Victoria does not support the treatment of local government expenses being retained for the 2025 review. Although most states provide funding to local governments for disaster recovery, Victoria does not report local government out of pocket costs (or own-source revenue) in its provision of data to the CGC. Victoria believes that the CGC's arguments for excluding local government costs in the draft report and the 2019 Update report were robust.⁸⁵ Victoria reiterates the position that this change should be made for consistency across assessment categories and notes appropriate data are readily available from states to facilitate this.

7.11.2 Other issues raised for Natural Disaster Relief in the draft report

Victoria welcomes the CGC's future consideration of outcomes resulting from the Independent Review of National Natural Disaster Governance Arrangements. Consultation with states on the implications of the Commonwealth Government's response for natural disaster relief expenses will be needed to inform future developments within the assessment once the final report is available publicly.

For the assessment of mitigation and natural disaster relief to be adequately considered together in the context of HFE, they should both be prioritised ahead of the 2030 review and included in the forward work program. The 2025 Methodology review should open the door to method changes before the 2030 review for this assessment category.

Victoria's recommendations

- 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 that the scope for policy influence in the NDRRA 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.

⁸⁴ Productivity Commission 2014, Natural Disaster Funding Arrangements, Inquiry Report no. 74, Canberra

⁸⁵ https://www.cgc.gov.au/sites/default/files/2021-11/2019_update_report.pdf

7.12 Native title and Land Rights

In its tranche 1 submission Victoria stated its views that:

- Native title spending is, at least partly, influenced by states' individual policy decisions and should not be assessed APC
- Some of Victoria's Treaty spending is similar to costs incurred in native title settlements, and should be assessed in the same category.

Notwithstanding these concerns, Victoria notes the CGC's conclusion to retain the current native title and land rights assessment on an APC basis and to not include states' spending on Treaty.

Victoria considers the national native title legislation establishes a framework and does not specifically enumerate the compensation that should be paid under each circumstance. In states where alternative mechanisms for settling native title claims are available, some parties may settle claims through state legislation, which introduces policy influence into the assessment.

The draft report's focus on treaties once operational also misses the significant resources states invest to stand up Treaty processes. Ahead of Treaty outcomes, Victoria has invested in supporting First Nations Victorians to prepare for Treaty processes, including for Victoria's Indigenous representative body – the First Peoples' Assembly of Victoria.

If the CGC will not assess this preparatory spending under native title, Victoria considers it must at a minimum be assessed EPC, as needs are not currently assessed. Victoria is concerned the spending may currently be allocated under a category with a differential assessment, misattributing the need. Victoria requests the CGC confirm its Treaty spending is assessed EPC, and if not, that it use Victoria's data returns isolating this spending to make an EPC assessment.

Given the advancement of Treaty negotiations and progression of native title issues nationally, the assessment of Treaty spending should be flagged as a priority area for development ahead of the expected 2030 review.

Victoria's recommendations

- Victoria notes the CGC's positions on native title and Treaty spending and reiterates its concerns that native title spending may be policy influenced, and that its significant investment in Treaty is not being assessed accurately under current methods.

7.13 Other expenses

Victoria's recommendations

- Victoria supports the CGC's proposal to maintain the existing composition of expenses classified in the other expenses category.
- Victoria supports the CGC's proposal to continue to assess other expenses EPC.
- Victoria supports the CGC's proposal to reduce the share of other expenses to which regional and wage costs are applied.

7.14 National Capital

Victoria supports the CGC's view to discontinue the national capital assessment from the calculation of GST relativities if it is immaterial. The current negative assessment is inconsistent with the 2020 Review methodology.

Victoria's recommendations

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

8. Other

8.1 Administrative scale

Victoria notes the CGC's conclusion in the draft report that no changes will be made to the administrative scale assessment. Victoria welcomes that the administrative scale assessment is on the CGC's forward work program, however is concerned the proposed scope of this analysis is to update the previous approach with new data only. Victoria requests the work program in the final report include a holistic re-examination of the administrative scale assessment ahead of the expected 2030 review, including a potential new method of calculation.

Victoria does not support the conclusion that using the baseline of the smaller states is a representation of a theoretical minimum or is policy neutral.

The organisational chart of the model education department for example is defined purely on the case of the ACT. Victoria does not suggest that the ACT is acting on any policy influence in this case. However, the aim of policy neutral assessments is that the incentive does not exist at all, not whether states act upon them. States' policies should also not unduly drive the assessments, which is unavoidable in this case as the assessment is based on the ACT and NT's service levels.

The draft report appears not to respond to Victoria's main critique of the administrative scale assessment, which is that basing it on 'what states do' (or some would do) does not represent a theoretical 'minimum'. The theoretical minimum fixed cost should not vary with population at all. All states have populations above 0 or 1 which the theoretical minimum would be based on (i.e. not varying with population). This is necessarily lower than what any state currently does.

Victoria recommends that the future reconsideration of the assessment take the difference between what any state does and a theoretical minimum into account, and reduces any observed structures in kind. For example, Victoria's tranche 1 response identified that an oversized share of the model departmental structures were made up of corporate functions that are unlikely to be duplicated in line with the size of the relevant departments.

8.1.1 Accounting for density and congestion costs

Victoria and NSW noted in their responses to tranche 2 consultation that there should be further consideration of the costs faced by larger states. Academic evidence suggests the linear relationship the CGC notes in service delivery is often not the case, and costs or delivery increase with population and congestion (increasing growth in costs rather than constant growth).

There is a body of academic literature that suggests larger jurisdictions experience congestion costs or diseconomies of scale that the CGC should consider incorporating into its assessments. As referenced in relation to transport congestion earlier in this response, a recent academic paper by Chan and Petchey (2024) suggests states face additional congestion costs for servicing larger populations.⁸⁶ The paper finds that state provided services in Australia are 'super-congested', and "[mimic] a congested pure private good (consumption rivalry outweighs the publicness inherent in the good)." Previous academic work by Petchey and Shapiro (2009) establish theory for

⁸⁶ Chan, F. and Petchey, J. [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), The Australian Economic Review, vol. 00, no. 00, pp. 1–21, 2024, <https://onlinelibrary.wiley.com/doi/full/10.1111/1467-8462.12543>

‘super-congested’ public goods, which the 2024 paper shows in practice in Australia with supporting data.⁸⁷

More broadly the academic literature has examined congestion and efficiency for services states provide. There are a number of examples that find congestion or diseconomies of scale for relevant services. Studies also consider the efficiency of scale of local governments or cities, suggesting larger local government areas may experience diseconomies of scale. Examples include:

- Blank and Niaounakis (2021) in a literature review find for municipalities with “over 250,000 inhabitants, there is more consistent evidence suggesting that diseconomies of scale persist”, noting there are inconsistent findings in the literature.⁸⁸
- Alda (2020) finds that “smaller jails operate more efficiently than larger ones and, therefore, are closer to the efficiency metafrontier”, defining efficiency as maximising outputs for the least inputs.⁸⁹
- Robertson (2019) notes the consensus in the literature is that larger school districts have higher costs per student and finds that in the US “the data indicates that significant inefficiencies exist in large districts”.⁹⁰
- Coulombel and Moncambert (2019) find public transport services can experience diseconomies of scale or be “hypercongested” if demand exceeds a certain threshold.⁹¹
- Simoes and Marques (2009) find that there are congestion effects in Portuguese hospital services noting: “... significant levels of inefficiency in 68 major Portuguese hospitals for the year 2005 and more than half of them were found to be congested.”⁹²
- In another paper, Simoes and Marques (2009) also find “27 prisons revealed congestion inefficiencies” noting these were specifically larger prisons: “These results were as expected, since it would be predictable that the major prisons with higher complexity and more managerial difficulties would have the most intense signs of congestion.”⁹³
- Bergstrom and Goodman (1973), find ‘super-congestion’ in general government, police and parks and recreation services in the USA. They also find: “as the size of municipalities increases, the advantages of sharing the cost of public services among more persons are countervailed by the costs of sharing the services among more persons” and “over the range

⁸⁷ Petchey, J. and Shapiro, P., Equilibrium in fiscal competition games from the point of view of the dual, *Regional Science and Urban Economics*, Volume 39, Issue 1, January 2009, Pages 97-108, <https://doi.org/10.1016/j.regsciurbeco.2008.05.015>

⁸⁸ Blank, L.T. and Niaounakis T.K., Economies of Scale and Sustainability in Local Government: A Complex Issue, *Sustainability* 2021, 13(23), 13262; <https://doi.org/10.3390/su132313262>

⁸⁹ Alda, E., Does Size Influence Jail Efficiency? An Analysis of Local Jails in the United States, *Corrections*, 7(2), 120–140. <https://doi.org/10.1080/23774657.2020.1731725>

⁹⁰ Robertson, F.W., Economies of scale for large school districts: A national study with local implications, *The Social Science Journal*, 44(4), 620–629. <https://doi.org/10.1016/j.soscij.2007.10.005>

⁹¹ Coulombel, N. and Moncambert, G.; Congestion, diseconomies of scale and subsidies in urban public transportation; HAL open science; HAL Id: hal-02373768, 2019: <https://hal.science/hal-02373768/document>

⁹² Simoes, R. and Marques, R.C., Performance and congestion analysis of the Portuguese hospital services, *Central European Journal of Operations Research*, Volume 19, pages 39–63, (2011), <https://link.springer.com/article/10.1007/s10100-009-0122-2>

⁹³ Simoes, R. and Marques, R.C., How far are Portuguese prisons inefficient? A non-parametric approach, MPRA Paper No. 19565. <https://mpra.ub.uni-muenchen.de/19565/>

of city sizes which we studied, there appear to be no economies of scale to larger municipalities in the provision of public goods”.⁹⁴

- Borcharding and Deacon (1972) conduct quantitative analysis that find public services are ‘super-congested’ in the USA, including in education, highways, hospitals, police, sanitation and parks and recreation services.⁹⁵

Given this evidence, and the recent paper by Chan and Petchey (2024), Victoria considers the CGC should give serious consideration to including congestion as a driver of states’ need for expenditures. Victoria suggests this could be implemented as an overarching assessment, similar to the current assessment of administrative scale, to capture congestion effects across assessments. The paper by Chan and Petchey (2024) for example estimates the additional costs of congestion faced by larger jurisdictions across service areas. Alternatively, the CGC could implement an assessment-by-assessment approach, adding a congestion driver to relevant categories, similarly to the current service delivery scale.

If this is not able to be developed ahead of the 2025 review report’s release, the review should commit to developing this as part of the forward work program. This could coincide with the forward work program’s suggested re-examination of the administrative scale assessment.

Victoria’s recommendations

- Victoria recommends the CGC broaden consideration of administrative scale under the forward work program to also consider its conceptual basis and not only update data for the current method.
- The 2025 review final report should include developing a congestion driver as part of the forward work program ahead of the expected 2030 review.

8.2 Geography

Victoria noted in its tranche 2 response that it has concerns with the implementation of regional cost drivers in the CGC’s assessments. Victoria generally supports the current methods for estimating regional costs and service delivery scale where there is robust supporting evidence. However, Victoria does not support the inclusion of the Rawlinsons index or water and electricity subsidies in the general cost gradient and reiterates its concerns relating to the application of some regional cost drivers.

Specifically, Victoria reiterates its views that:

- There can be a lack of robust justification or evidence supporting the inclusion of geographic drivers for some assessments where data is unavailable.
- Notwithstanding the justification of regional cost drivers in an assessment, there is also uncertainty regarding the applicability of the general cost gradient to specific expense

⁹⁴ Bergstrom, T.C. and Goodman, R.P., Private Demands for Public Goods, The American Economic Review, Volume 63, Issue 3 (Jun., 1973), 280-296. <https://escholarship.org/content/qt11j5d1t4/qt11j5d1t4.pdf>

⁹⁵ Borcharding, T.E. and Deacon, R.T., The demand for services of non-federal governments, The American Economic Review, Vol. 62, No. 5 (Dec., 1972), pp. 891-901, <http://www.jstor.org/stable/1815207?origin=JSTOR-pdf>

categories, given the differences in characteristics between the categories that make up the general cost gradient, and the categories that it is applied to.

- Data to support the application of the general cost gradient in 2010 was based on categories which now have specific cost gradients. It is not clear that the remaining categories collectively demonstrate similar cost drivers that necessitate the application of a general cost gradient.
- 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 are concerns relating to data quality for assessment categories which are proposed to be included in the general cost gradient. These concerns have been raised by Victoria in the relevant assessment categories, but there are similar concerns with including regional cost gradients from these categories in the general gradient.

8.2.1 Calculation of the general cost gradient

Victoria supports in-principle the incorporation of a broader range of regional cost gradients to calculate the general cost gradient, as well as the weighting of cost gradients by their share of national expenditure. However, Victoria is concerned that some of the categories included are subject to data quality issues and considers they should be excluded from the general cost gradient until those issues can be addressed.

As mentioned in Section 7.6, the data used to calculate the water and electricity subsidy regional cost gradient are incomplete and only available from a few states. They are therefore limited in their reliability and appropriateness when applied to water subsidy expenses. By extension, their applicability to other expense categories as a component of the general cost gradient is uncertain, and Victoria does not support their inclusion in the general cost gradient.

Victoria also considers it inappropriate to use the Rawlinsons index of construction costs from the investment assessment in the general cost gradient. Incorporating investment cost drivers into the general gradient is likely to make it less representative of cost drivers for government services expenses. Victoria has consistently raised concerns with the application of the Rawlinsons index in other expenses such as road maintenance in Section 7.8 and housing in Section 7.4, and this also applies to the other categories of expenses to which the general cost gradient is applied.

Victoria does not support including these categories in the general cost gradient, and if they are included, Victoria recommends their weight be discounted to reflect issues of data quality.

8.2.2 Application of the general cost gradient

Victoria noted in its tranche 2 response that the rationale for applying a general cost gradient is becoming less relevant due to improvements in data quality for categories with a strong relationship between remoteness and service costs. The data presented in support of a general gradient at the time of the 2010 Review was largely for categories that now have specific data to implement the regional cost gradient including health, schools and justice. The remaining categories including welfare, housing, services to communities, services to industry, roads transport and other expenses have a limited conceptual case for applying the general cost gradient.

Furthermore, while the broadened general cost gradient may better reflect the regional cost characteristics of government services, there remains uncertainty as to whether the cost pressures included in the general cost gradient are similar enough to be applied to the expense categories

which do not have their own gradient. This is especially the case if categories such as investment are going to be included in the general cost gradient.

At a minimum, Victoria considers a conceptual rationale based on examples or case studies from states, or other supporting data, must be provided for the general regional cost gradient to be implemented to assessment components. Victoria understands that the draft report retains a 25 per cent discount on the general cost gradient, however Victoria recommends a higher level of discounting at 50 per cent is applied given the lack of evidence underpinning the gradient across several assessments.

In many assessments the CGC acknowledges the shortcomings of available data, and in some cases, such as the housing assessment, has attempted to collate data to develop a specific cost gradient. Victoria supports this approach. In cases where data is not available from all states, the results of the available data should be used to aid judgement as to whether the general cost gradient should be used in the first instance. Where the available data does not suggest a relationship between remoteness and service costs, the general cost gradient should not be used. Other specific issues with the application of the general cost gradient have been raised throughout Victoria's response, such as in Section 7.6.5 for biodiversity or Section 7.8.4 for roads.

8.2.3 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. If different drivers partly measure the same underlying cost or demand driver, there could be double counting or compounding of effects.

Victoria appreciates the CGC is aware of this issue and in many places it accounts for the potential effects by disaggregating the data and isolating the relevant impacts. Victoria supports the CGC's commitment to isolating different cost drivers in its assessments. While the CGC addressed the complexity of analysing regional cost drivers in the child protection assessment in the draft report, the double counting of remoteness in the Indigenous cost factor for the social housing assessment remains unresolved. Victoria raised this issue in response to tranche 2 consultation, that in the housing assessment an Indigenous cost weighting is calculated (without controlling for remoteness or SES) that is applied to all remoteness and SES categories.

8.2.4 Other issues

Victoria supports the CGC's decision to retain the ABS standard classification of remoteness. The standard classification is more compatible with other datasets and allows the CGC to test for and estimate a relationship between remoteness and service costs in a broader range of expense categories.

Victoria's recommendations

- Victoria does not support the inclusion of the regional cost gradients for investment or water and electricity subsidies in the calculation of the general cost gradient until better data is available to quantify these gradients.
- Victoria recommends the CGC revise, clarify and restate the conceptual case for applying a general cost gradient to an assessment at each review process, ideally supported by an example of specific state circumstances or empirical evidence. Where this is not possible,

the regional cost gradient should not be applied, or should be discounted by 50 per cent instead of 25 per cent.

- Victoria considers the application of the regional cost gradient in the social housing assessment should be revised due to the potential for double counting the impact of remoteness on costs.

8.3 Socio-economic status

Victoria's recommendations

- Victoria supports the CGC's decision to leave the non-Indigenous socio-economic status assessment unchanged for the 2025 review. Victoria supports further exploratory work toward a potential change in a future review.

8.4 Investment

Victoria supports the CGC's decision not to proceed with either of its consultation paper proposals – smoothing user population growth and freezing component shares.

However, Victoria continues to have concerns about the use of Rawlinsons construction cost indices. In its tranche 2 submission Victoria recommended the CGC consider replacing Rawlinsons construction cost indices or discounting their use. In the draft report, the CGC said "The Commission is not aware of any source of nationally consistent data on construction costs that is likely to rival Rawlinsons for the Commission's purposes." However, the CGC did not comment on Victoria's suggestion of a discount.

A search of alternative city construction cost indices reveals large differences between them, particularly for cities other than Sydney and Melbourne, see Table 4 below. Not only is the size of the differences for some cities concerning, but the relative ranking of cities differs. This variability raises concerns about the reliability of the Rawlinsons data. To account for this uncertainty, Victoria recommends a low discount of 12.5 per cent be applied to the non-wage component of the Rawlinsons regional cost gradient.

Table 4. Comparison of capital city construction indices 2024

	Sydney	Melbourne	Brisbane	Perth	Adelaide	Hobart	Canberra	Darwin
Rawlinsons	100	90	91	100	96	101	103	98
Arcadis	100	91	93	81	74	N/A	N/A	N/A
RLB	100	92	100	91	91	N/A	88	85
BMT	100	100	106	110	102	108	107	123
ABS PPI*	100	90	99	88	93	104	86	85
Average	100	93	98	94	91	105	96	98
Difference from Rawlinsons to Average	0	3	7	-6	-5	4	-7	0

Note: All sources are rescaled for Sydney base 100, ABS data as at June 2023.

Sources:

1. Rawlinsons Australian Construction Handbook 2024. International construction costs regional variation indices.
2. Arcadis International Construction Costs 2024. Regional International Cost comparison Asia Pacific.
3. Rider Levett Bucknall Annual Report 2024. Construction Cost Relativity Index.
4. BMT construction cost calculator. Average of minimum and maximum costs.
5. ABS. Producer Price Indexes. Table 17. Output of the Construction industries, subdivision and class index numbers. Average of building construction, non-residential building construction and road and bridge construction.

Victoria notes the CGC's proposal not to introduce a brownfields assessment because it would be immaterial. Victoria recommends the CGC continue to monitor the materiality of brownfields construction costs and land prices for the investment assessment ahead of the 2030 review.

A discussion of urban transport investment is included in the Transport Section 7.9.7.

Victoria's recommendations

- Victoria supports the CGC's decision not to smooth user population growth.
- Victoria supports the CGC's decision not to freeze component shares.
- Victoria recommends a discount of 12.5 per cent be applied to the non-wage component of the Rawlinsons regional cost gradient.

8.5 Net borrowing

Victoria's recommendations

- Victoria supports the CGC's proposal to maintain the existing methodology.

8.6 Commonwealth payments

Victoria supports the CGC's proposal to apply a default impact treatment for Commonwealth payments where there is substantial uncertainty about whether a payment is for a state service for which needs are assessed.

Victoria supports the CGC's proposal to no longer include Commonwealth Own Purpose Expenditure payments (COPE) in the assessment. In the draft report the CGC said "if there are significant

changes to Financial Relations, or evidence of significant increases in funding paid to states outside of the Federal Financial Relations framework, the Commission may review its position". Victoria supports a review of the CGC's position under those circumstances.

Victoria agrees with the CGC's view that there is scope within the existing guidelines for considering whether payments relating to structural disadvantage should be excluded from the Commonwealth payments assessment. Such payments can also be excluded by the Commonwealth Treasurer in the Terms of Reference. Victoria considers there is no need for additional clarification of the existing guidelines for excluding payments for services for which needs are not assessed.

Victoria's recommendations

- Victoria supports the CGC's proposal to apply a default impact treatment for uncertain payments.
- Victoria supports the CGC's proposal to no longer include COPE payments in the assessment.

8.7 Adjusted budget

Victoria's recommendations

- Victoria supports the CGC's decision to use preliminary ABS data where available.
- Victoria supports the proposed process for implementing existing and new adjustments in the 2025 review and subsequent updates.

8.8 Wages

Victoria supports the changes made to the interstate wage cost assessment in the draft report, including broadening the Characteristics of Employment Survey sample to include multiple years of data, rationalising variables in the regression model, and applying a consistent approach to the allocation of wage and non-wage expenses across category assessments. These changes reduce the volatility in annual estimates of wages, improve the simplicity and statistical robustness of the model and reduce the amount of judgement applied in the assessment. Victoria supports the criteria applied to variable selection and appreciates the CGC's presentation of further statistical testing responding to Victoria's request. Victoria proposes that similar testing for overfitting be undertaken at each review to ensure the model continues to be accurate and fit-for-purpose.

Victoria's recommendations

- Victoria supports the changes in the draft report to the wages cost assessment.

