



# **COMMONWEALTH GRANTS COMMISSION**

**DRAFT ASSESSMENT PAPER CGC 2003/65**

## **ISOLATION**

Prepared for the Commission's 2003 Conferences on Draft Assessments

**AUGUST 2003**

## **NOTE**

**Included in this paper are the results of preliminary calculations based on the methods proposed throughout the paper and using the data currently available. Those results are indicative only and should be seen as work in progress. Ongoing changes are being made to standards and factor calculations as new data come to hand. Moreover, the calculations have been done using a prototype assessment system and are subject to ongoing revision as checking processes proceed.**

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## INTRODUCTION

1. This paper presents a draft assessment for the Isolation common factor for the 2004 Review. It builds on staff proposals set out in *Discussion Paper CGC 2002/43 Isolation*, and State comments provided in the 2003 Rejoinder Submissions.

2. Table 16 and Table 17 on page 20 provide a summary of the draft assessment proposed for the 2004 Review.

3. This draft assessment does not incorporate any data on isolation-related costs received recently from the States. The proposed assessment will be reviewed in the light of the new data as soon as possible after the September 2003 conferences.

## THE 1999 REVIEW ASSESSMENT

### *Description of the factor*

4. Isolation disabilities relate to unavoidable costs incurred by some States because of their distance from other State capitals and sources of supply, generally considered to be in South Eastern Australia. Isolation-related costs are considered to affect most State functions, and include:

- (i) **labour-related costs** such as leave fares, rental subsidies, recruitment expenses, additional recreation leave and fringe benefits tax associated with attracting staff to the State and retaining them — those expenses are different from those incurred for locality allowances paid to staff who work in remote areas within each State;
- (ii) **freight costs** on the interstate movement of goods and materials used in service provision (including construction materials, plant and equipment) due to distances from the sources of supply in other States — costs associated with the intrastate movement of goods and materials are considered in the dispersion assessment;
- (iii) **airfares and travel allowances** relating to interstate travel by officials to attend meetings and conferences in other State capital cities;
- (iv) **other travel related subsidies** arising from the need to subsidise travel expenses of artistic performers, sports persons, students and hospital patients treated interstate;
- (v) **professional infrastructure** costs arising from the need to bring in professional expertise not available locally; and

- (vi) *commercial isolation costs* which account for higher costs of goods (such as high technology equipment and medical supplies) due to small markets and geographical isolation.

***Importance of assessment***

5. Compared to an equal per capita assessment, the 2003 Update isolation assessment redistributed \$163.1 million in grants from New South Wales, Victoria, Queensland and South Australia to the other States. Table 1 shows the redistribution between States in the 2003 Update.

**Table 1** EFFECT OF ISOLATION FACTOR ON GRANTS DISTRIBUTION — 2003 UPDATE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
<b>Contribution to U2003 relativities</b>	-67.7	-48.9	-35.1	28.9	-11.4	14.6	0.6	119.0	163.1

***Isolation factor assessment method***

6. Isolation disabilities were assessed as a common disability factor for most expenditure categories. The isolation factor was calculated by:

- (i) assessing total isolation-related costs for each State, under standard conditions; and
- (ii) comparing each State’s per capita total isolation-related costs with the Australian per capita average.

7. To prevent double-counting with other cost related disabilities, the isolation factor was applied to a separate isolation-affected expenses component in each relevant expenditure category. This assessment structure was adopted because, unlike the input costs or dispersion factors, which were based on the cost differences per unit of service provided, the basis of the isolation assessment was estimated total isolation-related expenses, which are inclusive of all cost influences. Therefore, if isolation factors were multiplied by other disabilities assessed within a service delivery component, there would be unintended double-counting of cost influences.

### *Costs assessed in the 2003 Update*

8. Table 2 shows the isolation-related costs assessed for each State for the 2003 Update.

**Table 2** ISOLATION-RELATED COSTS, 2003 UPDATE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Labour related costs	0.000	0.000	0.000	2.196	0.000	4.691	0.000	38.235	45.122
Freight costs	0.000	0.000	0.000	29.301	0.000	0.879	0.439	39.416	70.034
Airfares	1.953	2.362	3.203	4.754	2.862	3.703	2.249	5.766	26.853
Travel allowances	0.138	0.119	0.199	0.633	0.359	0.393	0.119	1.386	3.345
Other travel related subsidies	0.000	0.000	0.000	1.153	0.384	0.768	0.329	2.336	4.970
Professional infrastructure costs	0.000	0.000	0.000	0.000	0.000	0.000	0.000	1.546	1.546
Commercial isolation costs	0.000	0.000	0.000	0.000	0.000	4.881	0.000	4.881	9.761
Total isolation-related expenses	2.091	2.481	3.401	38.038	3.605	15.314	3.136	93.566	161.632

Source: State data returns and Commonwealth Grants Commission.

9. Table 3 shows the calculation of the isolation factors, which were used for all the five assessment years of the 2003 Update.

**Table 3** ISOLATION FACTORS, 2003 UPDATE

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Assessed exp (\$m)	2.091	2.481	3.401	38.038	3.605	15.314	3.136	93.566	161.632
Standardised (\$pc)	0.31	0.51	0.93	19.83	2.37	32.36	9.72	467.97	8.25
Isolation factor	0.03819	0.06197	0.11236	2.40453	0.28781	3.92447	1.17836	56.74472	1.00000

Source: Commonwealth Grants Commission.

### *Isolation expense components*

10. Isolation expense components were assessed in the 1999 Review in those categories which were judged to contain isolation-related costs. For each relevant category, the standard proportion of expenses due to isolation was calculated by:

- (i) allocating a share of the isolation-related costs to each category on the basis of the category's expenditure as a proportion of total expenditure in all categories affected by isolation; and
- (ii) expressing the per capita isolation-related costs allocated to each category as a percentage of the total standard per capita expenditure for the category in 1997-98.

11. Isolation-related costs were not allocated to categories where the Commission considered they were not relevant.

12. Table 4 shows the standard isolation-related expense component weights assessed in each of the relevant categories in the 1999 Review. These component weights have remained unchanged in all subsequent updates.

**Table 4** ISOLATION-RELATED COSTS AND ISOLATION COMPONENT WEIGHTS, 1999 REVIEW

ACAT	Expenditure category	Isolation-related Expenses		Component weight	Rounded weight
		\$m	%		
	<b>Education</b>				
4010	Pre-schools	1.156	0.8	0.003443	0.34
4020	Government Primary Education	14.913	9.8	0.002530	0.25
4040	Government secondary Education	9.864	6.5	0.001957	0.20
4060	VET	7.869	5.2	0.002696	0.27
	<b>Health</b>				
4330	Hospitals	28.619	18.8	0.002888	0.29
4350	Nursing Homes	1.496	1.0	0.002997	0.30
4370	Mental Health	2.679	1.8	0.002170	0.22
4390	Community Health	7.540	5.0	0.002113	0.21
4395	Public Health	1.553	1.0	0.002147	0.21
	<b>Law, Order and Public Safety</b>				
4440	Police	9.384	6.2	0.002943	0.29
4450	Administration of Justice	6.056	4.0	0.004085	0.41
4460	Corrective Services	4.297	2.8	0.004339	0.43
4470	Public Safety & Emergency Services	2.697	1.8	0.003080	0.31
	<b>Welfare</b>				
4535	Family and Child Welfare	1.929	1.3	0.001924	0.19
4545	Aged and Disabled Welfare	1.758	1.2	0.000893	0.09
4560	Housing	3.143	2.1	0.001516	0.15
	<b>Concessions and Other Payments</b>				
4620	Concession – Water Supply	1.050	0.7	0.002310	0.23
	<b>Culture and Recreation</b>				
4710	Culture and Recreation	7.172	4.7	0.008752	0.88
4720	National Parks & Wildlife Services	1.997	1.3	0.005290	0.53
	<b>Aboriginal Community Services</b>				
4830	ACS	3.242	2.1	0.021455	2.15
	<b>General Public Services</b>				
5170	Other General Public Services	13.176	8.7	0.007589	0.76
	<b>Services to Industry</b>				
5410	Primary Industry	5.344	3.5	0.004288	0.43
5450	Mining, Fuel and Energy	2.207	1.5	0.008362	0.84
5455	Tourism	3.823	2.5	0.015248	1.52
	<b>Transport</b>				
5510	Roads	4.784	3.1	0.001892	0.19
	<b>Economic Affairs and Other Purposes</b>				
5590	Regulatory & Other Services	4.210	2.8	0.003813	0.38
		151.958	100.0		

Source: Commonwealth Grants Commission.

## 2004 REVIEW PROPOSED ASSESSMENT METHOD

13. In *Discussion Paper CGC 2002/43 Isolation*, the general issues to be addressed for the isolation assessment in the 2004 Review were identified as:

- (i) whether isolation should continue to be assessed as a single factor component in each category, or whether all isolation-related expenses should be combined and assessed in one isolation costs category; and
- (ii) whether capital related isolation costs need to be recognised.

### *Component or category approach to the assessment*

14. **1999 Review Method.** In the 1993 Review, needs arising from isolation were calculated as dollar amounts in a separate category (which had a zero expenses standard), rather than as cost components in most categories. In the 1999 Review, the Commission decided that, to improve transparency and to avoid double-counting, isolation-related expenses would be assessed as a separate component in most expenditure categories. An isolation disability factor would be applied to that component. At the time, there was criticism of the complexity this would add to the assessments — that is, the change to the factor approach would introduce an additional, usually small, expenses component to many categories.

15. The Commission recognised that the spreading of the former lump sum assessment of isolation among the relevant categories resulted in small components. However, it was convinced that this disaggregated method of assessment was more transparent (it identified isolation costs for each category affected) and avoided double counting (the isolation related expenses component was subject to an assessment by an isolation factor alone, and non-isolation related expenses were assessed as other components in each category using other factors).

16. **Preliminary State views.** Although no State specifically suggested reverting to the 1993 Review approach to isolation, *Western Australia*, in commenting on the Commission's standard budget proposals, suggested that the Commission might consider adopting a broader standard budget structure. This would include the adoption of global measures of revenue and expenditure need. Western Australia said the Commission's previous (1993 Review) 'lump sum', or category approach to the isolation assessment was a good example of a global expenditure assessment.

17. **Commission decision.** We think that Western Australia used the isolation assessment as an example of its preferred global expenditure assessment approach more generally. Western Australia did not argue for a 'category approach' to isolation as a stand-alone proposal. In any case, it is conceptually more appropriate to consider isolation as affecting the costs of providing most services — that is, to view it as a common disability factor that affects most services. This is consistent with our preference to as far as possible consider the total costs of providing each service. We agree with the previous Commission

that this approach is more transparent than the alternative approach of creating an isolation category. It is also less likely to result in double-counting. Overall, we have decided to continue the 1999 Review method.

### ***Capital related costs***

18. ***Preliminary State views.*** In their main submissions, some States argued that their distances from other State capitals and sources of supply affected the costs of providing assets used in providing services. It was claimed that this affected both the cost of obtaining building supplies for construction and plant used in construction, and equipment used in service provision.

19. ***Staff views.*** In *Discussion Paper CGC 2002/43: Isolation* staff said that there would be no need to change the scope of the isolation-related costs to include capital costs because they were fully reflected in the depreciation and debt charges assessments.

20. ***Further State views.*** In its rejoinder submission, **Queensland** argued that capital related costs were already reflected in construction costs (captured in depreciation and debt charges), and that the inclusion of a capital component in the assessments would lead to double-counting. **South Australia** and the **ACT** both supported the inclusion of capital costs, with provisos. South Australia supported the inclusion of capital costs as long as it did not involve any double-counting (in the depreciation and debt charges categories). The ACT's support was provisional upon its arguments for a freight allowance being adopted for the ACT (see below).

21. ***Commission decision.*** We consider that capital related costs due to isolation influences are adequately captured in the Depreciation and Debt Charges assessments through the allowances for building material price differences. Double-counting would result if such costs were included in the Isolation assessment. We have decided that there is no need to change the scope of the isolation-related costs to include capital costs

### ***Reconsideration of the isolation assessment***

22. The Commission has reviewed the isolation factor. It concluded that, over time, the underlying intention and purpose of the factor may have become somewhat blurred in the eyes of stakeholders, and that the time was now appropriate for a review of the principles underlying the assessment process.

23. The isolation assessment, as outlined earlier in this paper, accounts for the higher costs incurred by some States in service delivery, resulting from their economic and geographical isolation from the main interstate sources of supply in South Eastern Australia. The assessment is essentially driven by the distances *between* States and their capitals. The cost effects of distances and population spread on service delivery *within* a State are accounted for by the dispersion assessment.

24. Conceptually, the south eastern region is:

- a source of goods and materials — for example, consumer durables, perishable goods, building materials, plant and machinery etc — for Hobart and Darwin (this may apply to a lesser degree to Perth, Adelaide and Canberra);
- a source of high level professional services — for example, medical specialists, barristers, bankers, information technology consultants — for Hobart, Darwin, and possibly Canberra;
- a source of skilled labour for Hobart, Darwin and perhaps, to lesser degree, Canberra; and
- a long way from Perth, Hobart and Darwin in terms of travel costs.

25. In general terms, the assessment is concerned with the relative isolation of the State capitals of Perth, Adelaide, Hobart and Darwin from the eastern seaboard capitals of Sydney, Canberra, Melbourne and Brisbane. However, there may be a case, depending on the type of isolation-related cost, for variations to be made to the overall general rule — some capitals may be deemed isolated for certain isolation-related costs, and not for others. These matters are considered in turn under ‘Specific Issues’ below.

26. For the 2004 Review, in line with the assessment principles set down in *Draft Assessment Paper CGC 2003/12 Assessment Principles*, the Commission proposes to assess isolation-related costs:

- (i) only for those States for which a conceptual assessment case can be made, which means generally Western Australia, South Australia, Tasmania the Northern Territory and possibly the ACT<sup>1</sup>;
- (ii) only when information or data are available that support the conceptual case, demonstrate it is material and allow it to be assessed with an acceptable level of confidence; and
- (iii) on a case by case basis, the Commission will consider making an assessment where either:
  - reasonably robust cost data or information are available to make an assessment which is material and within acceptable margins of error; or
  - patchy but accurate cost data are available to the Commission which can be used as an aid to a judgement based assessment.

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<sup>1</sup> The only exceptions are for the Airfares Costs and Travel Allowances elements, for which notional airfares and travel allowances are estimated for travel to and from all capital cities.

### ***Labour related costs***

27. **1999 Review method.** Various labour-related conditions and benefits were considered necessary for the effective recruitment and retention of staff in the Northern Territory and Western Australia and Tasmania. For the Northern Territory, its labour-related costs were assessed by reference to actual costs which in the 2003 Update amounted to \$38.238 million. The data for 2001-02 are shown in Table 5.

28. In the 1999 Review, the Commission also made judgement based allowances for the higher costs of recruiting and retaining professionals incurred by Western Australia and Tasmania. The allowances were \$2.0 million and \$4.0 million respectively. These allowances were updated each year by using the Consumer Price Index (CPI), and had increased to \$2.196 million and \$4.691 million in the 2003 Update.

**Table 5** NORTHERN TERRITORY LABOUR-RELATED COSTS, 2001-02

Cost Item	(\$000)
Territory Allowance	4 557
Recreation Leave Fares	10 968
Rental Subsidies	1 686
Additional Recreation Leave	13 982 <sup>(a)</sup>
Fringe Benefit Tax	1 907
Recruitment Costs	5 138
<b>TOTAL</b>	<b>38 238</b>

(a) In the 2003 Update, additional recreation leave costs (estimated at \$27 963 million) were reduced by 50 per cent of the payment in lieu of extra recreation leave, to remove double-counting with the input costs – wages factor.

Source: Northern Territory R2004 data return.

29. **Preliminary State views.** The ACT was the only State to comment on this isolation cost element. It said that the Commission should adjust the assessment to reflect the extra costs faced by the ACT in recruiting and retaining specialist medical staff. (The ACT argued for the assessment to be made as part of the Professional Infrastructure element, but the Commission considered the claim to be more applicable to labour-related isolation costs).

30. **Further State views.** The ACT re-iterated its previous arguments for recognising the extra costs of its Visiting Medical Officers (VMOs), and suggested that the a new element — ‘Professional Isolation Costs’ — be assessed. At the workplace discussions, the ACT argued that doctors had not been trained in the ACT until recently, that it missed out on training places as a result of Commonwealth policy, and VMOs found Sydney hospitals more attractive than those in the ACT.

31. **Tasmania** submitted estimates of its isolation related expenses for some of its departments (for other elements as well as labour-related costs), but it indicated that its financial systems generally did not contain the level of detail sought in the Commission’s data request. In the 1999 Review, the Commission estimated Tasmania’s labour-related isolation costs at \$4.0 million — this was twice the \$2.0 million estimated for Western

Australia, and almost 10 per cent of the \$40.174 million assessed for the Northern Territory (based on data provided by the Territory).

32. *Analysis.* Tasmania and the Northern Territory have over many years made strong cases that they face difficulties in recruiting and retaining professional staff who generally come from other States, and south-eastern Australia in particular. They have often found it necessary to offer a range of extra inducements to attract the staff they require. The strength of the case for those States stems from the relatively small local populations and the professional isolation of the States, which result in pools of potential staff that cannot meet the demand.

33. The case for isolation-related disabilities for labour related costs for Western Australia does not appear to be strong as it is for Tasmania and the Northern Territory. Compared to Hobart and Darwin, Perth has a much larger population, and as a result, much larger commercial, industrial, professional educational and cultural infrastructures from which it can draw professional staff.

34. On the issue of the VMOs raised by the ACT, it is not clear that the statistics presented by the ACT measured an isolation disability. The VMO cost per casemix weighted separation for the ACT, over the period 1997-98 to 1999-2000, has been compared with those for Tasmania and the Northern Territory — see Table 6. The latter jurisdictions are, by any measure, substantially more isolated than the ACT. However, the VMO cost per casemix weighted separation for the ACT was, on average over the three years, 180 per cent higher than that for Tasmania, and 334 per cent higher than for the Northern Territory. This would not appear to be totally related to isolation.

**Table 6** VMO COST PER CASEMIX-ADJUSTED WEIGHTED SEPARATION, PUBLIC ACUTE HOSPITALS, BY STATE, 1997-98 TO 1999-2000

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$	\$	\$	\$	\$	\$	\$	\$	\$
1997-98	161	70	60	130	140	96	250	74	122.6
1998-99	165	61	59	153	141	94	208	45	115.8
1999-2000	160	61	63	141	141	54	224	38	110.3
3 year average	162.0	64.0	60.7	141.3	140.7	81.3	227.3	52.3	116.2
<i>State average / Australian average (%)</i>	<i>139</i>	<i>55</i>	<i>52</i>	<i>122</i>	<i>121</i>	<i>70</i>	<i>196</i>	<i>45</i>	<i>100</i>
<i>The ACT average / State average (%)</i>	<i>140</i>	<i>355</i>	<i>375</i>	<i>161</i>	<i>162</i>	<i>280</i>	<i>100</i>	<i>434</i>	

Source: ACT Submission. Australian Hospital Statistics, 1997-98 to 1999-2000, AIHW.

35. While sympathetic to the position of the ACT regarding the difficulties it faced in attracting and retaining specialists medical officers, the Commission remained unconvinced that the extra costs involved could be attributed solely to the effects of isolation from training facilities. Whatever effect isolation had on the ACT's costs, these would be substantially less than the isolation-related cost effects incurred by Tasmania and

the Northern Territory. In the absence of information on the reasons for the cost differentials, it is more likely that the high VMO cost situation in the **ACT** is largely policy-driven, rather than caused by the effects of isolation.

36. **Commission decisions.** For the 2004 Review, the Commission has decided:

- (i) there is a conceptual case that the Northern Territory experiences substantial costs to attract and retain professional staff from other States. The Commission has data to measure the extent of those extra costs and has decided to continue the approach adopted in the previous review. It intends to assess an allowance of \$39.781 million (based on State 2001-02 data return) for labour-related costs for the **Northern Territory**. This includes an amount of \$1.546 million previously assessed for professional infrastructure costs (based on the 2001-02 data return) and since re-classified to this cost element;
- (ii) there is a conceptual case that Tasmania incurs above average costs to attract and retain professional staff from other States. The Commission has sufficient data to confirm that the allowances assessed in the 2003 Update are of an appropriate size. It proposes to continue the approach adopted in the previous review. It intends to assess an amount of \$2.500 million (based on 2001-02 assessment in 2003 Update) for **Tasmania**. This includes an amount of \$0.305 million for professional infrastructure costs (based on the State 2001-02 data return) and since re-classified to this cost element;
- (iii) there is not a compelling conceptual case that **Western Australia** incurs labour-related isolation costs for the 2004 Review and data were not initially provided to support the case. Western Australia has recently provided information on this issue and the Commission will reconsider its conclusions in the light of that information; and
- (iv) the Commission is not convinced that the high VMO costs in the **ACT** are disability driven and in the absence of further information that identifies the various causes of the higher costs cannot assess an allowance.

### ***Freight costs***

37. **1999 Review.** In the 1999 Review, the Commission assessed isolation-related freight costs of \$26.683 million for Western Australia, \$800 000 for Tasmania, \$400 000 for the ACT and \$35.893 million for the Northern Territory. These figures were updated each year using the relevant Consumer Price Index (CPI). In the 2003 Update isolation-related freight costs were assessed at \$29.301 million for Western Australia, \$879 000 for Tasmania, \$439 000 for the ACT and \$39.416 million for the Northern Territory.

38. **Preliminary State views.** **South Australia** said that while freight disability costs were assessed for four States (Western Australia, Tasmania, the ACT and the Northern Territory), the other four States also faced isolation-related freight costs to differing extents. It argued that the geographical separation of Adelaide from the eastern capitals should be recognised in the freight assessments. It suggested that the Commission follow a method similar to that used to estimate Western Australia's isolation-related freight costs for the 1999 Review. No other State commented.

39. **Staff proposals.** Commission staff considered the basis of the allowance sought by South Australia (it was equivalent to about 10 per cent of the Western Australian freight costs allowance) was too high — an allowance of 5 per cent of the Western Australian allowance was thought to be more appropriate. This would have resulted in isolation-related freight costs of about \$1.5 million for South Australia in the 2003 Update.

40. **Further State views.** **South Australia** argued that the freight allowance proposed by staff (estimated at about \$1.5 million and foreshadowed in Discussion Paper 2002/43) should be increased. The **ACT** argued for its freight allowance to be increased to \$924 000, being 61.7 per cent of the preliminary freight allowance estimated for South Australia (61.7 per cent represented the ratio of the ACT's to Adelaide's average distance from all other State capitals).

41. In its data return, the **ACT** pointed out that its original claim of \$924 000 for freight costs was understated, because it failed to recognise that the ACT had virtually no manufacturing or raw materials base. On this basis, it submitted isolation-related freight costs of \$3.63 million should be assessed.

42. **Analysis.** It is the case that Tasmania and the Northern Territory because of their small economies and separation from the main manufacturing areas obtain significant levels of supplies and essential inputs for government services from the south eastern areas of the country. While the population and industrial base for Western Australia is larger than for the other States, the distances materials must be freighted and the costs are higher than for other similar sized States. The Commission considers that the conceptual case for isolation-related interstate freight cost allowances for Western Australia, Tasmania and the Northern Territory remains strong and has not been seriously challenged during this review. Whether or not an allowance is assessed therefore depends on whether the conceptual case is supported by information that demonstrates the amounts are material.

43. **Tasmania** has provided data on its isolation-related freight costs for 2001-02, which indicate that its interstate freight costs amounted to \$0.102 million. The Commission proposes to assess an allowance for this amount for the 2004 Review.

44. The **Northern Territory** has provided data on its isolation-related freight costs for 2001-02, which indicate that its interstate freight costs amounted to \$12.864 million. The Commission proposes to assess an allowance for this amount for the 2004 Review.

45. Initially, **Western Australia** did not provide any data on its freight costs for the 2004 Review. In the absence of data to support the conceptual case, the Commission has not assessed an allowance for the draft assessments. Western Australia, however, has

recently provided some data and the Commission will reconsider its decision in the light of that information.

46. In Discussion Paper 2002/43 the Commission proposed to include **South Australia** as a State with a relative disability for freight costs, and suggested a preliminary assessment based on 5 per cent of the assessment made for Western Australia. Such an assessment would have amounted to \$1.47 million if it had applied in the 2003 Update.

47. However, the Commission has reconsidered that proposal. While Adelaide is not situated within the eastern seaboard region, it does have a large manufacturing and supply base that is considerably larger than those of Hobart and Darwin. The presence of this manufacturing sector substantially reduces the strength of any conceptual case based on the distance of Adelaide from the south eastern capitals.

48. The South Australian State Supply Board (SSB) — the only data source available — estimated that for 2000-01 the value of goods purchased by the South Australian Government under major contracts totalled \$149 million. There is very little information available on the type of goods freighted. SSB officers estimated that about 90 per cent of this amount was for non-capital goods, with capital goods accounting for 10 per cent of the total.

49. The South Australian SSB also indicated that it was unable to provide an estimate of the proportion of the freight costs of the goods (included in the \$149 million) that were obtained interstate.

50. In the absence of information that demonstrates that a significant level of cost is incurred in freighting materials and supplies used to produce general government sector services from suppliers in interstate south eastern regions, the Commission has concluded that it could not assess an allowance for South Australia.

51. Were the Commission to adopt the **ACT** argument based on average distance from all capitals, it would be logical that freight costs should be assessed for all States. We did not think that such an approach to this assessment is justified, because New South Wales, Victoria, Queensland and the ACT are not geographically isolated from the eastern seaboard or sources of supply in that area.

52. The Commission is not inclined to assess a freight cost allowance for the ACT because it is part of the heavily populated, relatively compact eastern seaboard region of New South Wales, Victoria, and Queensland. It cannot be considered geographically isolated relative to Perth, Adelaide, Hobart or Darwin. There is little information that indicates the level of interstate freight costs.

53. **Commission decisions.** The Commission considers there is a conceptual case for assessing interstate isolation-related freight allowances for the Northern Territory, Tasmania and Western Australia. Data are available to support the conceptual case for the Northern Territory and Tasmania. The Commission has decided to assess allowances on the basis of those data. Data were not initially provided by Western Australia and the Commission decided not to assess an allowance. However, data have since been provided and it will reconsider its decision in the light of them.

54. The Commission considers that there could be a conceptual case for an allowance for South Australia but does not have adequate data to support the case and has decided not to assess an allowance. In the case of the ACT, the Commission is not convinced that it is geographically isolated and has not assessed an allowance.

### *Airfares*

55. **1999 Review.** The level of travel and the distribution of meetings among the States adopted in the 1999 Review was retained in the 2003 Update. The number and distribution of trips used in the 1999 Review were based on data provided by the States for the previous review. There had been no evidence of any material change in the level of interstate travel. The airfare per trip was updated using the Qantas October 2002 full fares for both business and economy class trips between Australian capital cities. Table 2 above sets out the results for the 2003 Update.

56. **State views. Victoria** noted that over recent years there was a tendency for interstate conference venues to be rotated more across the capital cities of all States and Territories, rather than mainly among the capitals of the Eastern States only. No other State commented on this element of isolation related expenses in their submissions.

57. The **ACT** stated in its data return that it had information which indicated that the proportion of business/economy class travel was more like 5/95 per cent, rather than the 20/80 per cent ratio used by the Commission in the previous review. The **Northern Territory** said its interstate trip data indicated a ratio of about 32 per cent/68 per cent.

58. **Analysis.** The Commission accepts that participation of State officials in conferences, negotiation sessions and other meetings in other States is an integral part of the way States do business. It also accepts that States send officers to most of these meetings from all States. While the meetings are to some extent shared among the States, there is a preponderance of meetings in the eastern States. This indicates that the geographically isolated States would incur above average per capita expenses. The Commission thus accepts that there is a conceptual case to retain the allowances for interstate travel expenses.

59. In the absence of State comments on the approach adopted in the 1999 Review, it has decided to retain it for this review. Under that approach, it has adopted a notional pattern of interstate meetings. On the basis of that pattern of meetings, it has estimated the costs for each State based on standard representation levels, airfares and other travel costs.

60. In the light of Victoria's observation that there is now a greater rotation of conferences between capital cities, which largely contradicts the data provided by the Northern Territory, the Commission has decided to modify the 1999 distribution of conference participants by striking an average of the 1999 Review interstate distribution of meetings and the distribution proposed by the Northern Territory for the 2004 Review. More particularly, the Commission decided that the assessment would be based on:

- (i) an average of:

- the number and pattern of inter-State conference participants estimated for the 1999 Review; and
  - the number and pattern of inter-State conference participants for 2001-02 provided by the Northern Territory;
- (ii) an assumption that 20 per cent of trips were at the business class level, and 80 per cent were at the economy level (based on a rough average of data provided by the ACT and the Northern Territory);
- (iii) a costing of the trips using the Qantas October 2002 full fares (the latest available for the 2003 Update) for both business and economy class trips between Australian capital cities (these fares will be updated later for the final assessments); and
- (iv) an assumption that the number of trips for the Northern Territory and Tasmania are the same.

61. The data used in the calculations and the assessment for airfares are set out in Tables 6 to 9.

**Table 7** RETURN AIRFARES BETWEEN STATE CAPITALS, BUSINESS CLASS, OCTOBER 2002

Origin	Destination							
	Sydney	Melbourne	Brisbane	Perth	Adelaide	Hobart	Canberra	Darwin
Sydney		1006	1098	2393	1301	1272	589	2308
Melbourne	1006		1547	2145	914	1299	796	2316
Brisbane	1098	1547		2484	1770	1660	1141	2272
Perth	2393	2145	2484		1943	2257	2196	2231
Adelaide	1301	914	1770	1943		1256	1205	2189
Hobart	1272	1299	1660	2257	1256		1097	2459
Canberra	589	796	1141	2196	1205	1097		2347
Darwin	2308	2316	2272	2231	2189	2459	2347	

**Table 8** RETURN AIRFARES BETWEEN STATE CAPITALS, ECONOMY CLASS, OCTOBER 2002

Origin	Destination							
	Sydney	Melbourne	Brisbane	Perth	Adelaide	Hobart	Canberra	Darwin
	\$	\$	\$	\$	\$	\$	\$	\$
Sydney		593	436	1232	595	816	380	1466
Melbourne	593		849	1320	540	1049	623	1677
Brisbane	436	849		1683	1253	1187	859	1753
Perth	1232	1320	1683		1189	1615	1398	1175
Adelaide	595	540	1253	1189		740	871	1423
Hobart	816	1049	1187	1615	740		910	1531
Canberra	380	623	859	1398	871	910		1701
Darwin	1466	1677	1753	1175	1423	1531	1701	

**Table 9** NOTIONAL DISTRIBUTION OF CONFERENCE PARTICIPANTS, 2004 REVIEW

Venue	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Conference participants R1999	850	700	350	350	350	85	700	85	3 470
Conference participants 2001-02 <sup>(a)</sup>	2 194	496	219	121	144	49	180	49	3 452
Average	1 522	598	285	236	247	67	440	67	3 461

(a) Source: Northern Territory data return.

*Commission decision.* **The Commission considers there is a conceptual case for assessing interstate isolation-affected travel costs. There is sufficient evidence to indicate that the per capita level of expenses incurred varies among the States. While the Commission does not have complete data on the level of interstate travel, it does have sufficient information on the patterns of that travel and can obtain information on costs to be able to calculate policy neutral notional expenses. For the 2004 Review, we propose to assess airfares allowances as indicated in**

**Table 10** DERIVATION OF NOTIONAL AIRFARES COSTS, 2001-02

Destination	Origin								
	Sydney	Melbourne	Brisbane	Perth	Adelaide	Hobart	Canberra	Darwin	Australia
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Sydney	0	1028263	865105	2228512	1120496	1380758	641980	2487557	9752672
Melbourne	404009	0	591183	888030	367650	657202	393245	1079270	4380589
Brisbane	161710	281257	0	524390	385896	364615	260431	528260	2506559
Perth	344819	349718	434074	0	315523	410571	366815	326450	2547969
Adelaide	181841	151856	335031	330931	0	208270	231637	389321	1828887
Hobart	60782	73633	85867	116808	56494	0	63476	115012	572073
Canberra	185592	289344	402776	685344	412632	416856	0	805288	3197832
Darwin	109505	120922	124406	92875	105605	115012	122623	0	790948
<b>TOTAL (\$m)</b>	<b>1.448</b>	<b>2.295</b>	<b>2.838</b>	<b>4.867</b>	<b>2.764</b>	<b>3.553</b>	<b>2.080</b>	<b>5.731</b>	<b>25.578</b>

***Travel allowances***

63. **1999 Review Method.** This element of isolation-related expenses covers the travel allowances associated with the meetings and conferences considered for the airfares element above. It allowed for the need for officials from some States to spend an extra night away from home to attend the conferences and meetings and to complete a full day of business in the destination city. Expenses were estimated in the 1999 Review using the airline schedules and some assumptions about the number of extra nights officials from geographically isolated States would be away from home. For subsequent updates, the 1999 Review amounts were updated annually using CPI movements. Table 2 includes the assessment for the 2003 Update.

64. **State views.** The ACT was the only State to comment on this issue. It argued that because all of the trips to Hobart undertaken by its officers required overnight stays (due to flight scheduling), overnight stays for trips to Hobart from the ACT should be included in the assessment.

65. **Commission decision.** The Commission remains convinced that there is a conceptual case that some extra expenses are incurred by the geographically isolated States.

In the absence of comment on the fundamental approach to the calculation adopted in the 1999 Review, the Commission has decided to retain it. Under that approach, the Commission has estimated the notional travel allowance costs for each State based on the pattern of conferences and meetings used for the airfare element. Among other things, this calculation allows for the expenses incurred by officials from the less isolated capitals when they travel to and from the more isolated capitals.

66. In response to the point raised by the ACT, the Commission examined the revised flight schedules from Hobart to the mainland. It concluded it is possible for officials from the ACT (and other eastern capitals) to complete a full day's business in Tasmania and return to the mainland on the same day. It has therefore decided not to assess overnight stays in Hobart for trips by ACT officials.

67. The Commission has decided to retain the method used in the previous review for isolation-related travel allowances. In particular, it intends to base the assessment on:

- (i) an estimate of the annual pattern and number of inter-State conferences; and
- (ii) an updated estimate of the travel allowances now applicable (to be updated using the CPI in future updates).

68. The calculations are set out in Table 11 and Table 12.

**Table 11** NOTIONAL DISTRIBUTION OF EXTRA OVERNIGHT STAYS BY CONFERENCE PARTICIPANTS, 2001-02

Destination	Origin							
	Sydney	Melbourne	Brisbane	Perth	Adelaide	Hobart	Canberra	Darwin
Sydney		0	0	1522	0	1522	0	3044
Melbourne	0		0	598	0	0	0	1196
Brisbane	0	0		285	285	285	0	285
Perth	236	236	236		236	236	236	236
Adelaide	0	0	247	0		0	247	494
Hobart	67	0	67	67	67		67	134
Canberra	0	0	0	440	440	0		880
Darwin	134	134	67	67	67	134	134	

Source: 1999 Review estimates and Northern Territory data for 2001-02.

**Table 12** DERIVATION OF TRAVEL ALLOWANCE COSTS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Travel Allowances	0.100	0.085	0.141	0.680	0.250	0.497	0.156	1.432	3.341

***Other travel related subsidies***

69. **1999 Review.** The other travel related subsidies element covered isolation-related costs arising from the need to subsidise the travel expenses of artistic performers, sports persons, students and hospital patients. Allowances were assessed for all States except New South Wales, Victoria and Queensland. In subsequent updates, the 1999 Review travelled related subsidies for each State were updated using the CPI. Table 2 above shows the results for the 2003 Update.

70. **State views.** No State commented on this issue.

71. **Analysis.** Under the method adopted in the 1999 Review, the allowances for all subsidies other than those for hospital patients were based on assumed numbers of interstate performers and sports people visiting the geographically isolated States. The Commission has examined those estimates and concluded it has no foundation for continuing their underlying assumptions on the number of visitors. It considered travel expenses for sporting teams and artistic performers would be influenced by Government policy decisions regarding State promotion, and unsuited to differential assessment. In addition, there are no data available upon which to base an assessment.

72. In the absence of policy neutral information, it cannot make reliable estimates of the costs incurred by the States and has decided to discontinue the allowances other than those for hospital patients.

73. In the case of hospital patients, the Commission is convinced there is a conceptual case that the geographically isolated States of Western Australia, South Australia, Tasmania and the Northern Territory incur extra costs in transporting patients to and from hospitals in the eastern States. Such transport is generally based on clinical need and there are data available to measure the extent of the travel.

74. **Commission decision.** For the 2004 Review, the Commission has concluded a conceptual case exists for assessing allowances for interstate hospital patients travel expense only. In line with its conceptual view of the Isolation assessment, this assessment would cover patients travelling interstate to New South Wales, Victorian and South Australian hospitals from Western Australia, South Australia, Tasmania and the Northern Territory. Good data are available to measure the extent of interstate patient travel thereby supporting the conceptual case. The data indicate that those expenses are material.

75. State expenses on interstate patient travel were estimated as follows.

- (i) Total numbers of cross-border patients were derived from the 2000-01 Hospital Inpatient Data collection.
- (ii) To remove the effects of differences in State policies on providing or subsidising transport to other States, the details of diagnostic related groups (DRGs) were used to estimate the number of patients whose condition would require treatment in another State (some of the excluded conditions included renal dialysis, chemotherapy, and normal childbirth). The numbers of cross-border transfers estimated by this procedure are in Table 13.
- (iii) The numbers of cross-border transfers were multiplied by the return economy airfare costs between the relevant capital cities and the results rounded. Table 14 sets out the economy fares used.

**Table 13** CROSS-BORDER FLOW OF PATIENTS FOR SELECTED DRGs, 2000-01

State of Patients' residence	State of Hospital			Total
	NSW	Vic	SA	
Western Australia	437	364		801
South Australia	530	1 121		1 651
Tasmania		1 129		1 129
NT			1 760	1 760
<b>TOTAL</b>	<b>967</b>	<b>2 614</b>	<b>1 760</b>	<b>5 341</b>

**Table 14** RETURN ECONOMY AIRFARE COSTS, OCTOBER 2002

State of Patients' residence / State of Hospital	NSW	Vic	SA
	\$	\$	\$
Western Australia	1 232	1 320	
South Australia	595	540	
Tasmania		1 049	
NT			1 423

76. Table 15 shows the estimated cost of interstate patient transport based on this method.

**Table 15** ESTIMATED INTERSTATE PATIENT TRAVEL EXPENSES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Estimated interstate patient travel expenses	0	0	0	1 000	900	1 200	0	2 500	5 600

***Professional infrastructure costs***

77. **1999 Review method.** This allowance, which was assessed for the Northern Territory only, was \$1.373 million in the 1999 Review. It was assessed to cover the costs of engaging interstate consultants and professional advisers (including those involved in judicial processes). The allowance was based on estimates of the actual costs provided by the Northern Territory. The allowance for the 2003 Update was revised to \$1.546 million based on the 2001-02 data provided by the Territory.

78. **State views.** In its rejoinder submission Tasmania argued for the professional infrastructure cost element (which applied only to the Northern Territory) to be discontinued because:

- (i) there was a risk of double-counting (this element was very similar to labour-related costs); and
- (ii) the importation of interstate expertise in preference to the local product could be seen as a matter of policy choice.

79. **Analysis.** The Commission accepts that the use of external professional advice is a feature of the processes of all State governments. It also accepts that there is a limited availability of consultants and professional advisers in the Northern Territory and Tasmania. That strongly suggests that they could not avoid the cost of importing professional advisers from time to time. However, it also accepts the logic of the case made by Tasmania that there is a strong similarity between the labour related costs and professional infrastructure costs.

80. **Commission decisions.** The Commission accepts there is a conceptual case that the less populous and geographically isolated States would incur extra expenses in engaging professional advisers. The data from the States indicates that they incur material costs in this regard. It therefore proposes to combine its assessments for professional advisers with those for other labour-related costs. Accordingly, amounts of \$0.305 million and \$1.546 million (both assessments based on data returns) have been reclassified to the labour-related costs element for Tasmania and the Northern Territory respectively. The allowances assessed will be updated each year based on data provided by Tasmania and Northern Territory for the last year of the assessment period.

### ***Commercial isolation costs***

81. ***1999 Review method.*** The commercial isolation allowances assessed for Tasmania and the Northern Territory allow for the higher costs of some goods and services because their small markets and isolated geographical locations meant they were not able to access economies available to other States on the main freight routes or with larger markets. The allowances for the 1999 Review were based largely on judgement guided by some information on the level of extra expenses incurred. The same amount of \$4.500 million was assessed for each state. In subsequent updates, the 1999 Review estimates were escalated using the CPI. In the 2003 Update the allowance assessed for each State was \$4.881 million.

82. ***State views.*** No States commented on this issue.

83. ***Commission decision.*** The Commission accepts that there may be a conceptual case for this allowance, but it is not compelling and there is no data available to support it. The Commission has decided to discontinue the assessment for commercial isolation for Tasmania and the Northern Territory for the 2004 Review because:

- (i) this assessment was based largely on the Commission's judgement in the 1999 Review, when the difficulties associated with identifying costs were then recognised; and
- (ii) since 1999 the Commission has not had access to any new information or data with which it could revise the original assessment.

### ***Estimate of isolation-related costs for the 2004 Review***

84. Preliminary estimates of isolation-related costs for the 2004 Review are set out in Table 16. These data are subject to revision pending receipt of information on freight costs and other issues from some States. Western Australia has recently supplied some data, but the allowances in the table have not been revised in the light of those data.

**Table 16** ESTIMATED ISOLATION-RELATED COSTS: 2004 REVIEW DRAFT ASSESSMENT, 2001-02

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Labour related costs <sup>(a)</sup>	0.000	0.000	0.000	0.000	0.000	2.196	0.000	39.781	41.977
Freight costs <sup>(b)</sup>	0.000	0.000	0.000	0.000	0.000	0.102	0.000	12.864	12.966
Airfares	1.448	2.295	2.838	4.867	2.764	3.553	2.080	5.731	25.578
Travel allowances	0.100	0.085	0.141	0.680	0.250	0.497	0.156	1.432	3.341
Other travel related subsidies	0.000	0.000	0.000	1.000	0.900	1.200	0.000	2.500	5.600
Total isolation-related expenses	1.548	2.379	2.979	6.547	3.914	7.549	2.236	62.308	89.462

(a) As assessed in the 2003 Update.

(b) As assessed in the 2003 Update except for South Australia.

Source: State data returns and Commonwealth Grants Commission.

#### *Isolation factor for 2004 Review draft assessment*

85. Table 17 shows the calculation of the isolation factors for 2001-02. These factors will be used for all assessment years of the 2004 Review draft assessments.

**Table 17** CALCULATION OF ISOLATION FACTORS, 2004 REVIEW DRAFT ASSESSMENT

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Assessed exp (\$m)	1.548	2.379	2.979	6.547	3.914	7.549	2.236	62.308	89.462
Standardised (\$pc)	0.23	0.49	0.81	3.41	2.58	15.95	6.93	311.63	4.56
Isolation factor	0.05107	0.10737	0.17783	0.74776	0.56469	3.49490	1.51842	68.27218	1.00000

#### *Isolation components for 2004 Review draft assessment*

86. Based on the same method used in the previous review (as described in paragraphs 10 to 12), the estimated isolation component weights for the isolation-related categories, for the 2004 Review draft assessments, are set out in Table 18.

87. The Commission proposes to not update the component weights after the 2004 Review, unless appreciable changes occur in the relevant category standards — given the smallness of the components calculated.

**Table 18** ISOLATION-RELATED COSTS AND CATEGORY EXPENSE COMPONENT WEIGHTS, 2004 REVIEW DRAFT ASSESSMENT

ACAT	Expenditure category	Isolation-related Expenses		Component Weight	Rounded weight %
		\$m	% of total		
	<b>Education</b>				
4010	Pre-schools	0.681	0.8	0.001508	0.15
4020	Government Primary Education	8.780	9.8	0.001145	0.11
4040	Government secondary Education	5.807	6.5	0.000869	0.09
4060	VET	4.633	5.2	0.001226	0.13
	<b>Health and Community Services</b>				
4110	Inpatient Services	18.032	20.2	0.001216	0.12
4115	Non-inpatient and Community Health Services	4.833	5.4	0.001017	0.10
4120	Population and Preventative Health	0.914	1.0	0.000740	0.07
4130	Family and Child Services	0.999	1.1	0.000812	0.08
4135	Aged and Disabled Services	1.916	2.1	0.000626	0.06
4160	Housing	1.850	2.1	0.000395	0.04
4180	Services to Indigenous Communities	1.909	2.1	0.010797	1.08
	<b>Law, Order and Public Safety</b>				
4440	Police	5.524	6.2	0.001355	0.13
4450	Administration of Justice	3.565	4.0	0.002028	0.20
4465	Corrective Services	2.666	3.0	0.001849	0.18
4470	Public Safety & Emergency Services	1.588	1.8	0.001221	0.12
	<b>Culture and Recreation</b>				
4710	Culture and Recreation	4.223	4.7	0.002510	0.25
4720	National Parks & Wildlife Services	1.176	1.3	0.002395	0.24
	<b>Concessions and Other Payments</b>				
5420	Water, Sanitation and Protection of the Environment	0.618	0.7	0.000772	0.07
	<b>Economic Activities</b>				
5430	Roads	2.816	3.1	0.000634	0.06
5440	Primary Industry	3.146	3.5	0.001918	0.19
5450	Mining, Fuel and Energy	1.300	1.5	0.004684	0.47
5455	Tourism	2.251	2.5	0.006789	0.68
	<b>General Public Services</b>				
5525	General Public Services	10.236	11.4	0.001775	0.18
		89.462	100.00		