Government of South Australia
Department of Treasury and Finance

2025 METHODOLOGY REVIEW

DRAFT REPORT

Submission from the South Australian Department of Treasury and Finance

August 2024

Contents

Key Issues

1. A summary of the key issues for South Australia are outlined below.

Method changes to account for COVID-19	
	• South Australia does not support any changes to the treatment of COVID-19 state expenditure on health and business support. • The impact and severity of COVID-19 on jurisdictions was influenced by policy decisions as well as state circumstances. • No policy neutral driver of COVID-19 state expenditure has been identified. Any adjustments to the approach taken in the 2024 Update on the treatment of COVID-19 expenditure and associated Commonwealth payments are therefore inappropriate. • Should the Commission decide to undertake a separate assessment of COVID-19 expenditure based on an actual per capita approach, the maximum discount must be applied to reflect policy neutrality and data quality concerns.
Assessments where South Australia has significant concerns with the proposed assessment approach	
Motor Vehicles	• Analysis undertaken by South Australia indicates that a separate assessment of stamp duty on motor vehicles would be material. • The Commission should seek updated revenue base information from states and territories to accurately determine the impact of a differential assessment and reintroduce it as part of the 2025 Review.
Housing	• South Australia does not support the Commission's proposal to switch from a household-based assessment to an individual-based assessment. • The proposed individual-based approach would not reflect what states do and would potentially double-count the impact of overcrowding in remote Indigenous communities. In addition, a methodology change that adjusts GST shares to address the impacts of historical underinvestment in remote Indigenous housing by the Commonwealth would be inconsistent with HFE. • South Australia considers the Commission should undertake further investigation of this issue as part of the forward work program between Reviews, potentially combined with further investigations into the separate homelessness services assessment, noting that overcrowding has an impact on homelessness service use.

Health	• South Australia recommends that the Commission continues to assess ambulatory mental health expenses with other community health expenses until there is a material improvement in the quality of NCMHCD data. • South Australia recommends that if the Commission decides to expand the proxy for the balance of community and public health component as proposed, the weighting of the non-admitted patients component should be reduced from the proposed 45% to 39% to recognise concerns about the reliability of NAP data at patient level. • South Australia does not support the Commission's proposal to use benefits paid by private health insurance funds as a proxy for private patient activity in the non-state sector adjustment for admitted patients. It is not clear that this data is not policy influenced. The Commission should retain the 2020 Review methodology pending further work to develop a more robust measure of the complexity of private patient separations.
Schools	• South Australia does not support the Commission's proposed changes to the assessment of socio-educational disadvantage for government and non-government students. • The proposed approach for government schools, which is based on a narrow definition of disadvantage, does not reflect what states do. State funding for students from a low socioeconomic background is not limited to students in the lowest decile of socio-educational disadvantage. South Australia recommends that the Commission retain the 2020 Review method of assessing low SES based on the most disadvantaged quartile of students; or alternatively include the second lowest decile. • South Australia recommends that the Commission bases its assessment for non-government schools on just the most disadvantaged quartile, as this approach is based on more intuitive data that better reflects what states do.
Wages	• South Australia continues to have concerns about the conceptual basis for the wages assessment. A shift to the use of female only private sector wages, gender weighted private sector wages, or industry weighted private sector wages, would have represented an improvement in the conceptual basis for the model, but we note the Commission's concerns about the sample size of available datasets. An ongoing discount is appropriate to reflect the conceptual concerns with the assessment. • South Australia supports the Commission's proposal for combining estimates across years to reduce volatility in the assessment.

Response to other assessments	
Mining revenue	• South Australia's position to the mining assessment will be provided in our response to the Mining addendum. • We however have some preliminary concerns that the proposed shift to a volume-based assessment for onshore oil and gas royalties may not reflect what states do.
Land tax	• The Commission should retain the adjustment to the ACT's land tax base for aggregation, to make it consistent with the average policy of all states.
Roads	• South Australia considers the overall rural road network should remain unchanged until a full review of road lengths is undertaken. • The 12.5% discount should be applied to the traffic volume data only noting new data issues, and not the full assessment.
Welfare	• South Australia suggests that further work is undertaken on the proposed homelessness assessment as part of the forward work program before a differential assessment is introduced.
Flexibility to consider method changes between reviews	
	• South Australia does not have any major concerns with the Commission having the flexibility to consider alternative methods between reviews on a case-by-case basis for unexpected developments in very limited circumstances.
Future work program	
	• South Australia looks forward to working with the Commission on the various issues flagged for further work between Reviews as part of the Commission's future work program.

Introduction

2. The South Australian Department of Treasury and Finance (DTF) welcomes the opportunity to make this submission on the Commonwealth Grants Commission's 2025 Methodology Review Draft Report.

3. The content of this submission reflects an official-level view of DTF.

4. The submission is broken into the following sections:

    - Method changes to account for COVID-19
    - Assessments where South Australia has significant concerns with the proposed assessment approach
    - Response to other assessments
    - Flexibility to consider method changes between reviews
    - Future work program

5. This submission provides only limited, preliminary comments on assessments where the Commission has indicated that a supplementary addendum will be issued, namely transport and mining, or assessments that will be considered further in future Updates (Justice). A final response on these issues will be provided once the addendum or updated information papers are released. This will allow for a complete review of the proposed assessment approach and impacts.

6. A response has not been provided on all assessments. Where a response has not been provided South Australia notes the Commission's proposed positions.

COVID-19

Key points

7. South Australia does not support any changes to the treatment of COVID-19 state expenditure in the 2025 Review.

8. The impact and severity of COVID-19 on jurisdictions was influenced by policy decisions as well as state circumstances.

9. No policy neutral driver of COVID-19 state expenditure has been identified. Any adjustments to the approach taken in the 2024 Update on the treatment of COVID-19 expenditure and associated Commonwealth payments are therefore inappropriate.

10. Should the Commission decide to undertake a separate assessment of COVID-19 expenditure based on an actual per capita approach, the maximum discount must be applied to reflect policy neutrality and data quality concerns.

Discussion

11. The COVID-19 pandemic was an unexpected event that had significant financial impacts and affected all states and territories.

12. The Commission has previously considered the impact of COVID-19 in recent Update processes and concluded that in relation to COVID-19 expenditure "*differences in responses between states therefore reflected differences in circumstances rather than policy*". Terms of Reference for prior Updates prevented any method changes.

13. South Australia strongly disagrees with the view that responses to COVID-19 were driven by state circumstances alone. Both state circumstances and policy choices drove COVID-19 impacts.

14. Through submissions to recent Updates, South Australia demonstrated that there were significant and fundamental issues in the Commission being able to base an alternative COVID-19 expenditure assessment on reliable and policy neutral data in the two affected assessment areas - Health and Services to Industry.

15. South Australia (and a number of other jurisdictions) provided examples and independent opinions that supported the view that the policy decisions made by states and territories did have a significant impact on COVID-19 case numbers and associated expenditure.

16. Rating agencies S&P and Moody's publicly stated that:

'South Australia limited the extent of fiscal impacts from COVID on the local economy, relatively to its domestic peers, due to early and effective implementation of border controls.' (Moody's)

'South Australia has to date successfully contained the spread of the virus, allowing its economy to open faster than its peers.' (S&P)

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17. In October 2022, a privately funded independent review into COVID-19 responses, led by Western Sydney University Chancellor Peter Shergold[1], found

'Too many of Australia's lockdowns and border closures were the result of policy failures in quarantine, contact tracing, testing, disease surveillance and communicating effectively the need for preventive measures like mask wearing and social distancing'.

18. These are just limited examples and support the view that expenditure on health and business support was impacted by policy choices at the jurisdictional level, not just state circumstances.

19. As the effects of COVID-19 were impacted by policy decisions, any alternative assessment approach needs to be based on reliable policy neutral data. No alternative policy neutral approach to assessing the impact of state circumstance of COVID-19 has been identified.

20. South Australia also notes that there was no reference to separate assessments of COVID-19 expenditure in the proposed assessment structures for the Health and Services to Industry discussion papers issued as part of the 2025 Review. Providing an earlier opportunity to comment on the proposed changes would have allowed a more detailed examination of the issues and further exploration of potential policy neutral drivers of need.

COVID-19 health expenditure

21. Suppression and restriction of movement/activity approaches were policy choices for each jurisdiction. These decisions had an impact on the level of COVID-19 health expenditure in each jurisdiction.

22. Different approaches regarding the timing, duration, and severity of restrictions were implemented by states and territories. The number of positive cases reported and the number of people needing hospital care and other medical services were, in part, influenced by the length of time it took to put a region under lockdown, the level of activity restrictions, the timing and length of border closures, and decisions to lift restrictions.

23. As an example of the different approaches between jurisdictions, in July 2021, South Australia entered a seven-day lockdown in response to the cluster linked to the Modbury Hospital. The uniform, state-wide lock-down was implemented early and included stay-at-home orders, closure of all businesses (including takeaway food), no exercise beyond 2.5 kilometres of home, school closures and other restrictions on activity. This approach assisted in quickly containing the outbreak.

24. In comparison, New South Wales' Delta outbreak commenced with the identification of cases in June 2021. In response to this emerging outbreak, stay-at-home orders were issued for some immediate local government areas, which were eventually extended to incorporate all of Greater Sydney. A whole-of-state lockdown was not imposed until 14 August 2021. These restrictions initially allowed exercise in groups of ten, leaving home for essential work and education. Many retail shops were allowed to remain open. Case numbers grew to a point where an accelerated vaccination strategy became the most viable solution.

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[1] *Fault Lines, An independent review into Australia's response to COVID-19,* Peter Shergold et al, https://assets.website-files.com/62b998c0c9af9f65bba26051/6350438b7df8c77439846e97_FAULT-LINES-1.pdf

25. The policies on lifting restrictions also varied between states. After the peak of COVID cases during the holiday season in early 2022, New South Wales repealed the indoor mask mandate and density restrictions in hospitality in February 2022. In contrast, South Australia relaxed COVID restrictions in a more gradual manner, eliminating density restrictions in March 2022 while keeping the mask-wearing requirement in place until later that year.

26. Administration of quarantine, the appropriateness of quarantine accommodation and contact tracing policies were also approached differently by states and territories. These decisions impacted on COVID-19 case numbers and associated expenditure.

27. No policy-neutral data source to support an alternative assessment approach has been identified to date.

28. Adoption of an actual per capita assessment approach for health expenditure as proposed by the Commission would only be appropriate if policy choices were consistent. This was not the case during the pandemic years.

29. During the pandemic, our Health Department also raised concerns about the consistency of expenditure being reported under the National Partnership on COVID-19 Response (COVID-19 NP) between states and territories. Although it is not possible to reliably identify and quantify the extent of data inconsistencies, it highlights that the use of the data for an actual per capita assessment approach is inappropriate.

30. While we do not support the proposed approach to separately assess COVID related health expenditure, if the CGC were inclined to consider an actual per capita assessment as outlined in the Draft Report, the maximum level of discount should be applied to reflect the impact of policy choices and the use of data that is not fit-for-purpose.

COVID-19 business support

31. In the Draft Report the Commission:

    - proposes to assess state spending covered by the COVID-19 business support national partnership agreements using an actual per capita treatment from 2021–22; and
    - considers that the National partnership agreements which co-funded state COVID-19 business support programs to be sufficiently homogenous to enable an actual per capita assessment.

32. South Australia does not believe that this approach is fair or appropriate as it fails to address policy influences. While the Commonwealth jointly funded certain state COVID-19 business support payments, the types of payments jointly funded varied based on specific jurisdictional policy choices around the type, size and eligibility for support measures, and also on the decisions of the Commonwealth about which measures it would fund.

33. This can be clearly seen by comparing the eligibility, size and types of payments covered by the national agreements across jurisdictions[2].

34. For example, New South Wales received joint Commonwealth funding for its JobSaver scheme. This provided funding to eligible businesses of up to 40% of weekly payrolls for work performed in New South Wales from 18 July 2021 to late 2021, up to a maximum payment of $100,000 per week. Eligibility criteria included that the applying business must have had an annual turnover of between $75,000 and $250 million and have experienced a reduction in turnover of at least 30% in a 2-week period. Businesses were also required to maintain their employee headcount if they received JobSaver payments.

35. In contrast, the Victorian agreement with the Commonwealth included a number of different appendices outlining support packages announced and agreed at different times with the Commonwealth from 28 July 2021 to 30 September 2021. Each package/appendix contains a number of different grant programs with different eligibility criteria and payment amounts.

36. While the decision to provide relief to support business was influenced by the impact of COVID, this clearly demonstrates that how relief was provided was a state policy choice.

37. As a specific example of policy influences in the funding of business supports, the South Australian submission to the 2023 Update made specific reference to the COVID-19 business support national partnership agreement with Western Australia[3].

38. The attachments to the agreement outline the business support programs that are eligible and other relevant details. Of note is a letter from the Western Australian Premier to the Commonwealth Treasurer supporting an increase in the value of eligible business support payments funded under the agreement in lieu of not providing non-assessable non-exempt (NANE) status for these payments. The letter includes the following:

> The former Treasurer wrote to me on 10 April 2022 offering to fund a 25% increase in the value of relevant COVID-19 Business Support payments to be made to eligible businesses by the Western Australian Government, up to a maximum Commonwealth contribution of $53.9 million. This was in lieu of not providing non-assessable non-exempt (NANE) tax status for these payments as was provided for some grant programs in other States.

39. This appears to have been accepted based on a reply from the Commonwealth Minister for Small Business also contained in the Attachment.

40. It clearly highlights that decisions made around what would be funded through the COVID-19 national partnership and the level of funding made available were impacted by specific policy decisions and are not consistent between jurisdictions.

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[2] See: https://federalfinancialrelations.gov.au/agreement-finder?combine=covid

[3] https://federalfinancialrelations.gov.au/sites/federalfinancialrelations.gov.au/files/2022-07/Agreement%20for%20WA%20Business%20support.pdf

Policy neutral driver

41. As part of the 2023 New Issues Paper, the CGC indicated that it would seek to identify a policy neutral driver of need for COVID support to business. State views on the initial proposal around reductions in hours worked were provided as part of responses to the New Issues paper.

42. The CGC's response to the 2023 New Issues paper did not discuss/respond to the state positions on policy neutral drivers of need. This reflected that method changes were not allowed as part of the annual update. The Commission's response also noted that "*the Commission will further consider its treatment of COVID-19 business support spending in the 2025 Methodology Review*." However, there was no discussion of the treatment of COVID-19 business support in the Services to Industries assessment paper for the 2025 Methodology Review. Instead, in relation to COVID spending on business support the assessment paper noted that:

> *The Commission does not expect states to continue this form of business support with the easing of restrictions around Australia in 2022–23. Therefore, there are no ongoing implications for the assessment methods.*

43. If this issue was included in the assessment paper it would have allowed for a more detailed consideration of potential policy neutral drivers of COVID spending on business support. Instead, the Draft Report now notes that it would be impractical to identify *suitable data to underpin the driver of need*. Instead, the Commission proposes to use an actual per capita assessment based on national co-funded state COVID-19 business support programs.

44. An actual per capita approach is not appropriate due to the significant policy influences on relevant state expenses. This includes policy decisions on the level and size of support, decisions on what programs would be funded by the Commonwealth, and the impact of state policy decisions on the overall severity and impact of COVID-19 within a jurisdiction.

45. Any assessment of COVID-19 business support spending must be driven by a policy neutral indicator of need.

46. South Australia is not aware of any policy neutral indicators that would allow for a differential assessment of state circumstances to provide COVID support to businesses. On this basis there should not be a separate assessment of COVID-19 expenditure.

Other considerations

Contemporaneity

47. The proposed alternative COVID-19 expenditure assessment approach will not have an impact until 2025-26. This will be around five years after the pandemic commenced and around three years since the "end" of significant state and territory measures to address the pandemic. This is not consistent with the contemporaneity principle that the Commission seeks to apply.

Inconsistency with the positions taken by the previous and current Commonwealth Treasurer

48. As part of determining the Terms of Reference (ToR) for the 2022, 2023 and 2024 Updates, the previous and current Commonwealth Treasurers consulted with states and territories on the content of the respective ToRs. A number of states and territories made the case that allowing an alternative approach to assess COVID-19 expenditure was not appropriate given the level of policy influence and data concerns. Other jurisdictions argued for method changes to be introduced. Although reasons for ToR decisions have never been made public, the outcome of the process was to not allow alternative assessment approaches to be adopted.

49. Some jurisdictions have now asked for proposed method changes for COVID related expenditure to be made retrospective. This is inappropriate and would effectively override decisions made to not allow method changes in previous Updates. We agree with the CGC's conclusion that "*The Commission does not consider it has a mandate to apply the assessment retrospectively*"[4].

Application of a discount

50. Given that there were significant differences in policy responses to the COVID-19 pandemic, a simple actual per capita assessment is not appropriate. An actual per capita assessment is only appropriate when there is policy consistency and the data is comparable between jurisdictions. This is clearly not the case with COVID-19. While South Australia does not support the proposed approach to assessment of COVID-19 expenditure, should the Commission wish to proceed with an assessment, the maximum discount available should be applied to reflect both policy and data concerns.

Assessments where South Australia has significant concerns with the proposed assessment approach

Motor Vehicles

51. South Australia does not support the Commission's proposal not to re-introduce a differential assessment of stamp duty on motor vehicle transfers.

52. Analysis undertaken by South Australia indicates that a separate assessment of stamp duty on motor vehicles would be material. The Commission should seek revenue base information from each jurisdiction to accurately determine the impact of a differential assessment and re-introduce it as part of the 2025 Review.

53. It is our understanding that the Commission considered two separate methods to test the potential materiality of a differential assessment. Both methods used ABS data on stamp duty revenue on motor vehicles over the period 2018-19 to 2022-23, but made different assumptions about each jurisdiction's revenue base (the value of motor vehicle transfers):

[4] 2025 Methodology Review Draft Report, Health paragraph 37

- The first test, which was quoted in the draft report, used state data on the value of motor vehicle transfers from the 2019 Update (e.g. 2017-18 data) and held the revenue base constant over the period 2018-19 to 2022-23.

- An alternative method indexed 2017-18 state data on the value of motor vehicle transfers by the cumulative average growth rate (CAGR) in the historic revenue base over the seven years to 2017-18.

54. Both of these approaches did not indicate that a separate assessment would be material at the $40 per capita level. However, these tests do not capture changes in the revenue base that are likely to have occurred since 2018-19.

55. As evidenced by ABS data on stamp duty on motor vehicle transfers, there has been significant growth in the vehicle transfer market since 2018-19 (see table below). Importantly for the materiality of the assessment, this growth has varied between jurisdictions. There would need to be a consequential change in the revenue base to support growth in revenue over this period. This revenue base impact is not being captured in the CGC's materiality tests.

Stamp duty on motor vehicle registrations

	2017-18 $m	2018-19 $m	2019-20 $m	2020-21 $m	2021-22 $m	2022-23 $m	Change 17-18 to 22-23
NSW	834	792	768	969	939	1,076	29%
VIC	947	937	923	958	1,122	1,281	35%
QLD	543	555	533	662	703	791	46%
WA	355	363	375	514	579	671	89%
SA	188	184	190	226	241	266	41%
TAS	47	49	50	48	51	54	15%
ACT	31	30	36	39	36	40	29%
NT	23	22	19	26	28	30	30%
Australia	2,967	2,932	2,895	3,441	3,699	4,209	42%

Source: ABS taxation revenue, cat 5506.0

56. Based on a comparison of historical data to 2017-18, excluding years impacted by state policy changes, growth in ABS stamp duty on motor vehicle data was a strong proxy for growth in the revenue base at a jurisdictional level.

57. Using the CGC alternative method, but indexing each jurisdiction's 2017-18 revenue base by the CAGR in ABS stamp duty revenue over the period 2017-18 to 2022-23, shows that a separate assessment of stamp duty revenue would be material for three jurisdictions at the $40 per capita threshold. The results of this alternative materiality test are shown below.

GST redistribution – stamp duty on motor vehicles – 2024-25

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Total ($m)	111	61	-45	-217	41	24	19	5
Total ($pc)	13	9	-8	-73	22	41	40	20

Source: SA DTF calculation

58. The largest impact under the revised approach is for Western Australia at -$73 per capita. There have been no policy changes relating to stamp duty on motor vehicles in Western Australia since 2017-18 that would impact using the growth in revenue as a potential broad predictor of the revenue base growth.

59. While some other jurisdictions have introduced policy measures impacting revenue collections since 2017-18, adjusting for the impact of these measures still results in a material assessment.

60. On this basis, South Australia recommends that the Commission obtains updated revenue base data from each jurisdiction to accurately determine the materiality of a differential assessment of stamp duty on motor vehicle transfers, and if it is material, implement the differential assessment as part of the 2025 Review.

61. It is noted that as this would just be the reinstatement of a previous assessment, there should be no concerns with the conceptual basis or methodology for the assessment. The Commission has already indicated to states that it would monitor the materiality of the assessment and re-introduce the assessment if it became material, removing any potential concerns about reinstating it for the 2025 Review.

Housing

62. South Australia does not support the Commission's proposal to switch from apportioning national average per capita expenses and revenue between geographic areas on a household-based measure to an individual-based measure at this time.

63. States don't fund housing on an individual basis. They fund housing on a household basis.

64. As part of the analysis on whether there is a case that housing stress is a driver of social housing expenditure, the Commission considered the relationship between rental stress and the growth in state expenditure on social housing and the growth in social housing dwellings. The Commission concluded that it did not present a compelling case for there being a relationship between housing stress and the provision of social housing. No similar analysis was included in the draft report supporting the case for a shift from a household based to an individual based measure. Instead, the analysis just looked at whether there was a difference between the number of households and individuals within each region to determine if there was a difference between the two measures. Noting that states fund housing on a household basis, it is not clear if the Commission has determined that there is a direct relationship between the level of overcrowding and actual delivery of housing by states, that is, is it consistent with what states do?

65. Further work should be undertaken on the impact and significance of overcrowding on the provision of housing and its relationship to actual state spending before any changes are implemented. If there is a relationship, there may be alternative ways to better reflect the impact of overcrowding on the requirement for housing than the adjustment that is proposed in the draft report. For example, an individual based measure does not take into account the different types of household formation between jurisdictions which can be impacted by many factors including age demographics, and the impact this has on the requirement to provide housing.

66. Investigation of this issue should be undertaken as part of the forward work program between Reviews, and potentially combined with further investigations into the separate Homelessness services assessment, noting that overcrowding may have a causal relationship on Homelessness service use.

67. Further to the above, South Australia has the following specific concerns about the individuals-based approach proposed by the Commission.

<u>It does not reflect what states do</u>

68. The Housing assessment predominantly captures state spending on social housing services provided by the public non-financial sector and subsidies to community housing providers. The services provided mainly relate to tenancy management and maintenance services, which may include:

- managing the housing waitlist and supporting the housing allocation process;
- conducting routine tenancy inspections, as well as at the start and end of each tenancy;
- assessing and processing rental rebate applications;
- monitoring and addressing rental arrears and other debts;
- maintaining up to date tenancy information for all dwellings;
- case management of problematic tenancies, including visitor management and anti-social behaviour;
- providing a point of contact for all repairs and maintenance; and
- maintaining a key register and holding spare keys in a secure facility.[5]

69. In South Australia's view, state decisions on how to provide these services are more likely to reflect the number of dwellings/tenancies being managed, rather than the number of occupants. We recognise that in some circumstances, the nature of the tenancy may necessitate additional resources (e.g. where there is overcrowding), however, we do not consider that occupant numbers are more of an influence than dwelling numbers.

<u>Potential double-counting</u>

70. South Australia recognises that states may incur additional costs in managing some public housing tenancies, e.g. higher maintenance costs relating to remote Indigenous households with a high number of occupants. We note that the current household-based assessment already accounts for these additional costs through a 20% loading for Indigenous households, and additional location loadings for remote households.

71. The Commission's decision to apply an Indigenous household loading in the 2020 Review was based on an observation of 2016 Census data showing higher average occupant numbers for Indigenous households than non-Indigenous households, with around 10% of this population residing in a dwelling with seven or more people. At the time, the Commission noted:

[5] Northern Territory Department of Territory Families, Housing and Communities, *Tenancy Management Support Services Handbook*, https://tfhc.nt.gov.au/__data/assets/pdf_file/0005/1092560/tenancy-support-services-handbook.pdf

"Overcrowding increases wear and tear, which requires additional maintenance attendances. In addition, the high mobility of the remote Indigenous population necessitates additional tenancy management services to ensure that users of social housing are known, and are paying rents. The Commission considers there is a conceptual case for including an Indigenous cost weight to recognise the higher cost of providing services to this population group."[6]

72. It is clear from the Commission's reasoning in the 2020 Review that the Indigenous cost weight was intended to capture the types of disabilities the Commission now proposes to capture through an individuals-based assessment.

73. To the extent that the current Indigenous loading is updated in the 2025 Review to reflect 2021 Census data, an individuals-based assessment would therefore not be necessary. Instead, it would result in double-counting of the additional cost of remote Indigenous tenancies.

Inconsistency with HFE

74. South Australia recognises the unique circumstances faced by the Northern Territory in the delivery of public housing in remote Indigenous communities, which partly reflect historical underinvestment by the Commonwealth. As the 2017 *Remote Housing Review* noted:

"In the Northern Territory, there has also been a significant backlog in remote indigenous housing, more significant than in any other jurisdictions, which existed prior to self-government in 1978."[7]

75. The Northern Territory's additional needs are recognised by the Commonwealth through direct funding arrangements outside the HFE system. In March 2024, the Commonwealth and Northern Territory Governments announced a joint $4 billion investment aimed at halving overcrowding in the Northern Territory's remote communities.[8]

76. This investment builds on previous support provided through:

- the *National Partnership on Northern Territory Remote Aboriginal Investment (NTRAI)*, which included funding aimed at "improving housing in remote communities, through increased durability and amenity of existing houses in remote communities to optimise the useful life of the assets and ensure houses are safe and secure;"[9,10]

[6] Commonwealth Grants Commission, 2020 Review Final Report, Vol 2 p.207.
[7] Department of the Prime Minister and Cabinet, *Remote Housing Review: A review of the National Partnership Agreement on Remote Indigenous Housing and the Remote Housing Strategy (2008-2018), https://www.niaa.gov.au/resource-centre/remote-housing-review*
[8] Commonwealth and NT Government media release, 12 March 2024, https://www.pm.gov.au/media/landmark-4-billion-investment-remote-housing-northern-territory-help-close-gap
[9] National Partnership on Northern Territory Remote Aboriginal Investment, Remote Australia Strategies Implementation Plan, https://federalfinancialrelations.gov.au/agreements/northern-territory-remote-aboriginal-investment-ntrai
[10] Funding received by the Northern Territory under this agreement is non-impacting for HFE purposes.

- the *National Partnership Agreement on Remote Indigenous Housing*, under which the Commonwealth committed $1.7 billion to the Northern Territory over 10 years (2008-2018), aimed at "significantly reducing severe overcrowding; increasing the supply of new houses and improving the condition of existing houses; and ensuring that rental houses are well maintained and managed in remote Indigenous communities;"[11,12] and

- a further $230 million committed to the Northern Territory under the *National Partnership Agreement on Stronger Futures in the Northern Territory* (Stronger Futures) for additional upgrades of houses in the Northern Territory to improve their durability and amenity. The investment continued when Stronger Futures was replaced by the NTRAI in 2016.[13]

77. South Australia considers that it is appropriate that the additional needs of the Northern Territory (i.e. beyond what it needs to spend to provide the average standard of services) be addressed and funded outside the HFE system. This reflects that the objective of HFE is to provide states with the capacity to provide the same standard of services. Addressing overcrowding in the Northern Territory's remote Indigenous communities would require a higher than average standard of service, which is beyond the scope of HFE.

78. We agree with the Northern Territory Government's observation in the 2011 GST Distribution Review, that:

> *"A common misconception is that equalisation provides states with the capacity to address unmet needs. This is incorrect. Equalisation provides states with the fiscal capacity to deliver the average level of government services, and not the fiscal capacity to address the backlog in service provision."*[14]

79. On this basis, we recommend that the Commission retains the 2020 Review household-based assessment, as an individuals-based approach would not reflect what states do, would double-count the impact of overcrowding in remote Indigenous communities, and would not be consistent with HFE. Investigation of the impact of overcrowding on housing expenditure and the consideration of any appropriate drivers of need can be considered as part of future work program between reviews.

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[11] National Partnership Agreement on Remote Indigenous Housing, Northern Territory Implementation Plan, https://federalfinancialrelations.gov.au/agreements/national-partnership-agreement-remote-indigenous-housing

[12] In the 2016 Update, the Commission decided to treat 25% of NPARIH funding as non-impacting, to recognise that at least some of this funding is intended to overcome the impact of differential levels of housing stock in remote Indigenous communities among the states.

[13] Commonwealth Government, *Remote Housing Review: A review of the National Partnership Agreement on Remote Indigenous Housing and the Remote Housing Strategy (2008-2018)*, https://www.niaa.gov.au/resource-centre/remote-housing-review

[14] Northern Territory Government, 2011, Submission to the GST Distribution Review Issues Paper, https://treasury.gov.au/review/gst-distribution-review/issues-paper__trashed

Health

<u>COVID-19 related health expenses</u>

80. South Australia's position on the proposed assessment of COVID-19-related health expenses is provided in the COVID-19 section above.

<u>Direct assessment of ambulatory mental health</u>

81. In South Australia's Tranche 1 submission, we provided in-principle support for the consideration of a direct assessment of community mental health services, provided this could be done in a reliable manner and with reliable cost weight adjustments.

82. In the Draft Report, the Commission proposes a direct assessment for ambulatory mental health only, as this is the only component of community mental health for which there is sufficiently reliable data. The proposed assessment would be based on data from the National Community Mental Health Care Database (NCMHCD), published by the Australian Institute of Health and Welfare (AIHW).

83. South Australia does not consider NCMHCD data to be sufficiently reliable for the Commission's purposes at this time.

84. While the AIHW reviews the quality of the NCMHCD data reported by the states, this data has a number of limitations, as indicated by both the Commission and AIHW. This includes that there is some variation in the scope and coverage of data between jurisdictions, quality concerns regarding data on Indigenous status, and potential distortions due to how cross-border service provision is reported.

85. Further information on the nature of the data limitations is provided in the 2021-22 NCMHCD data quality statement[15], including:

- four states reported issues with their data, relating to variations in the way data is collected between local health districts, and the exclusion of certain types of service contacts due to reporting and information system challenges;

- the methodology for the identification of Indigenous status varies both within and between jurisdictions and between services within a jurisdiction, which may result in a different status being recorded among multiple service contacts or between service providers; and

- comparability of NCMHCD data over time can be variable due to inconsistencies in reporting practices, upgrades to information systems and revisions to data. For example, the AIHW notes that 2021-22 data (which is in scope for the 2025 Review assessment) is affected by industrial action in multiple states, which led to reduced recording of contact data during this period. It is noted that industrial action in multiple states also affected data for 2018-19, 2019-20 and 2020-21. While these years are not in scope for the 2025 Review, they provide an indication of the volatility of NCMHCD data.

86. It is not clear how the Commission would address these data quality issues in the proposed ambulatory mental health assessment. Inconsistencies in the way in which

[15] https://meteor.aihw.gov.au/content/780645

jurisdictions collect and report data are of particular concern, given the Commission's objective is the achievement of fiscal equalisation between jurisdictions.

87. On this basis, South Australia recommends that the Commission continues to assess ambulatory mental health expenses with other community health expenses until there is a material improvement in the quality of NCMHCD data.

88. If the Commission decides that, on balance, the proposed direct assessment better captures the relative needs of the states, it should apply at least a 12.5 per cent discount to recognise the current limitations of the underlying data. The discount could be revisited in the next methodology review following a retesting of the NCMHCD data.

Balance of community health – expanded proxy

89. South Australia notes the Commission's proposal to expand the proxy for the balance of the community and public health component to include both emergency department (ED) triage 4 and 5 services (55% weighting) and a subset of non-admitted patient (NAP) allied health services considered to be similar to community health services (45% weighting).

90. As South Australia has previously noted, there continue to be concerns about the quality of patient-level NAP data, and on that basis, we suggested the Commission consider using this data at an aggregate level if it decides to incorporate it into the community health proxy.

91. We recognise the practical constraints of this approach, given the need to assess the relative cost and activity relating to different sociodemographic composition (SDC) groups. However, the problems with NAP data should not be ignored. South Australia recommends that if the Commission decides to expand the proxy as proposed, the share of the NAP component should be reduced from the proposed 45% to 39% (representing a 12.5% discount) to recognise the concerns about the reliability of NAP data at patient level. The ED component of the proxy would therefore have a weighting of 61%.

Separate assessment of public health

92. South Australia supports the Commission's proposal not to assess public health services separately, as the SDC of users of these services does not appear to be sufficiently different from the SDC of community health services users to warrant a separate assessment. The Commission should continue to use the same proxy indicator it uses for community health, subject to South Australia's recommendation above that the ED:NAP weighting for the proxy should be 61:39 due to concerns about the reliability of patient-level NAP data.

Non-state sector assessments

Overall approach

93. South Australia notes the Commission's proposal to continue the current general approach to assessing the influence of the non-state sector. We note the Commission will undertake further work between method reviews to further consider data challenges and conceptual issues such as the relationship between state and non-state sector services. We look forward to working with the Commission on this issue.

Substitutability indicators

94. South Australia supports the Commission's proposal to retain the 2020 Review substitutability indicators and levels for emergency departments, non-admitted patients and community and public health, as the updated underlying data suggests the current settings remain appropriate.

95. However, we have significant concerns about the proposal to change the substitutability indicator for admitted patients. The Commission proposes to change this indicator from private patient separations to private patient expenses (as measured by benefits paid by private health insurance funds), reflecting concerns that data on separations does not capture the relative complexity of different treatments.

96. Admitted Patients is the largest component of the Health category, accounting for around two thirds of assessed category expenses and redistributing over $1 billion in GST in the 2024 Update. Given the significance of this component, any method changes affecting it should be based on high quality, consistent data that is not policy influenced. South Australia is not convinced that the proposed private patient expense data meets this requirement.

97. The Commission's analysis of 2022-23 data on private health benefits paid shows that there are significant differences across states in the average benefits paid for equivalent hospital services. For example, while 86% of private patient separations in Queensland had average benefits paid that were within 90-110% of the national average, only 41% of South Australian separations, 48% of Victorian separations and 53% of Western Australian separations came within a similar ratio to the national average. The variations naturally converge when a larger correlation band is used. However, the large variations within 90-110% suggest a material level of policy influence and should not be ignored.

98. South Australia also notes that the Commission's analysis does not include data for Tasmania, the ACT and the Northern Territory due to confidentiality reasons. It is unlikely that data from the five largest states, which the Commission has used in its analysis, provides a reliable representation of the circumstances of the three states that are not included in the analysis.

99. South Australia does not believe that the proposed methodology change should be adopted without detailed consideration of data that accurately captures the circumstances of all jurisdictions. Based on the available information, it appears significant additional work is required to refine the Commission's proposed approach before it can be adopted.

100. On this basis, South Australia recommends that the Commission retain the 2020 Review methodology for assessing the non-state sector adjustment for admitted patients, pending further work to develop a more robust measure of the complexity of private patient separations. This could be undertaken as part of the Commission's forward work program.

Schools

101. South Australia notes the Commission's draft position to:

- include variables in the schools regression reflecting the differential cost of primary and secondary schools; and primary and secondary school students;
- not include data on students with a disability at this time, due to insufficient consistency of Nationally Consistent Collection of Data on School Students with Disability; and
- not use the Schooling Resource Standard (SRS) in place of the Commission's regression model as the SRS does not, at this time, reflect what states do.

102. However, South Australia is concerned about the Commission's proposed approaches to assessing socio-educational disadvantage for both government and non-government students.

Low SES in government schools

103. For government schools, the Commission proposes to base its low socioeconomic status (SES) assessment on the most disadvantaged decile of student socio-educational advantage, rather than the lowest quartile as decided in the 2020 Review. The Commission notes this proposal is due to unexpected negative cost weights for less disadvantaged students in its regression analysis.

104. While recognising that the most disadvantaged government students are generally allocated a greater proportion of low SES equity resources in states' funding models, South Australia is concerned that the Commission's proposed assessment method would significantly understate the resourcing needs of students who fall within the 11th to the 25th deciles.

105. As the Commission has noted: "…funding needs in government schools arising from socio-educational disadvantage may not be limited to the most disadvantaged decile." This means the proposed approach may not reflect what states do.

106. In this regard, we note that:

- in South Australia, funding supplementation is provided to around 258 government schools that are classified in the four most disadvantaged socio-economic categories (out of a total of seven categories) under the Index of Educational Disadvantage. These schools serve approximately 45 per cent of government school students;
- South Australia also provides 'school card' relief for families on low incomes, under which the annual materials and services charge is waived for an estimated 29 per cent of students;

- under NSW's Resource Allocation Model, an equity loading is provided for government students in the two most disadvantaged socio-economic quarters of the Family Occupation and Education Index, supporting approximately 401,000 students;[16] and

- Western Australia's Student Centred Funding Model provides a social disadvantage allocation for government students in the three most socially disadvantaged deciles of its disadvantage model.[17]

107. It is therefore unlikely that the narrow definition of low SES proposed by the Commission is consistent with what states do. Instead, it likely understates the equalisation needs of states with a larger cohort of disadvantaged students who happen to fall outside the lowest decile of disadvantage. Over time, the inadequate recognition of student disadvantage in determining GST shares could further impact the concentration of disadvantage seen in government schools, with negative education outcomes for disadvantaged students overall.

108. South Australia recommends that the Commission retain the 2020 Review method of assessing low SES based on the most disadvantaged quartile of students, as it better reflects what states do. It is not appropriate for the Commission to adopt an assessment model that effectively ignores the additional needs of a large cohort of disadvantaged students on the basis of a counterintuitive data output. State funding models clearly demonstrate that the proposed narrow definition of low SES need is not appropriate.

109. If the Commission decides to move to a more granular measure of student disadvantage, South Australia considers that the second decile should be included in the model. While we note that the Commission's analysis showed an insignificant cost weight in government schools for the second decile, including it would better align the Commission's model with what states do than the current proposal.

110. Alternatively, if the Commission holds concerns about the appropriateness of the including the second decile, it should apply a discount to the government school low SES assessment to reflect that the regression outputs do not adequately reflect what states do. This would be consistent with the Commission's established approach in other assessments where there is a strong conceptual case but insufficiently reliable data.

Low SES in non-government schools

111. South Australia notes that there is an inconsistency between the Commission's proposed treatment of a counterintuitive regression outcome for government schools and a similarly counterintuitive outcome for non-government schools.

112. The Commission proposes to base its low SES assessment for non-government schools on the two most disadvantaged quartiles, as they returned positive and significant coefficients in the Commission's regression analysis. However, as the Commission has observed, the second most disadvantaged quartile had a larger coefficient than the most disadvantaged quartile. This is a counterintuitive outcome –

[16] NSW Government, https://education.nsw.gov.au/about-us/strategies-and-reports/schools-funding/resource-allocation-model/equity-loadings/socio-economic-background.

[17] Department of Education (WA), https://www.education.wa.edu.au/dl/kgonndd.

it is unlikely that states provide a higher equity loading to less disadvantaged students than they do to the most disadvantaged students.

113. On this basis, South Australia recommends that the Commission bases its assessment on just the most disadvantaged quartile, as this approach is based on more intuitive data that better reflects what states do.

Services to industry (COVID-19 related expenses)

114. South Australia's position on the proposed treatment of COVID-19 related business support spending is provided in the COVID-19 section above.

Transport

115. South Australia's response to the transport assessment will be provided in a supplementary submission responding to the Transport addendum.

Wages

116. South Australia appreciates the approach taken for the review of the wage cost assessment as part of the 2025 Review by the CGC, including the engagement of an external consultant to review the assessment.

117. As noted in previous submissions, South Australia has long standing concerns with the conceptual validity of assessment, particularly:

- that private sector wage movements within a state are a good proxy for public sector wage movements.
- Public sector wages are predominately influenced by wage movements in local or regional labour markets.
- Comparability of public sector workers across jurisdictions.

118. A shift to the use of female only private sector wages, gender weighted private sector wages, or industry weighed private sector wages, would have represented an improvement in the conceptual basis for the model. However, we note the Commission's position that the reduction in sample size increases the standard errors and volatility in the assessment. On this basis the Commission intends to retain the private sector as the wage proxy. While this is the case, we suggest that options to improve the validity of the assessment continue to be explored, including as potential new data sources become available.

119. In relation to combining estimates across years to reduce volatility, South Australia supports the CGC position to smooth data under its proposed method rather than a pooled approach. Volatility within the assessment is a significant issue and, as demonstrated in the draft report, the proposed smoothing approach will result in lower volatility than pooling data over a fixed period.

120. Given the ongoing conceptual issues with the model and broader data concerns, it is important an appropriate level of discounting is retained for the assessment. The Commission notes that on balance it considers that a 12.5% discount remains appropriate and has proposed that this level of discount be retained as part of the 2025 Review.

121. South Australia recognises that the changes to address volatility should improve the assessment, but this is a smoothing issue. Overall concerns around the conceptual validity of using private sector wages as a proxy warrant consideration of a higher level of discount.

Response to other assessments

Mining Revenue

122. South Australia supports the Commission's proposal to continue assessing mining revenue capacity using a mineral-by-mineral approach.

123. South Australia notes the Commission's proposal to continue to examine the dominant state issue and consult on how this could be addressed in the preparation for the next review. There are a range of complex issues to be considered as part of a dominant state adjustment and any examination should not be restricted to the proposal to limit GST effects from policy changes to a percentage of the additional revenue raised.

124. The draft report indicates the Commission's intention to separately assess coal based on price bands if reliable data is available. The report also indicates that splitting the coal assessment by type of coal remains an option if reliable price band data is not available. Comments on the proposed assessment approach for coal will be provided following the release of the mining addendum. This will allow for a full assessment of the proposed approach once it is clear what data is available to support alternative assessment approaches. We reiterate our comments made in response to the supplementary coal assessment paper that if the Commission proposes to split the coal assessment (rather than a price band approach), then a defined set of criteria should be articulated around when a type of mineral can be split under the mineral-by-mineral assessment approach. This will allow for a robust assessment against the principles and will help guide any future decisions, ensuring consistency in approaches.

125. Comments on the proposal to assess onshore oil and gas royalties on a volume basis will be provided once data to support alternative assessment approaches has been provided as part of the mining addendum. It would not be appropriate to determine a change in method until jurisdictions have had the chance to consider what data is available to support an alternative assessment approach and whether it represents an improvement over the current methodology based on value of production.

126. While we will finalise our comments once the addendum is available, we make a number of comments about the proposed changes for consideration.

    - Queensland is the only jurisdiction that applies royalties on a volume basis. While Queensland may be the dominant producer of onshore oil and gas, all other jurisdictions apply royalties on a value of production basis. It is questionable whether it can be said the change to a volume basis would be consistent with what states do.

    - While Queensland applies rates on a volume basis, different rates apply depending on the average sales value. This means that sales values are still required to be identified as part of the royalty calculation in Queensland, and that Queensland's royalty calculations depend on both volume and sales value.

    - The current value-based approach may offer more transparency and consistency compared to a volume-based system. The value of production is a more straightforward measure that reflects market conditions and economic realities, whereas volume measures can be influenced by varying production methods and efficiencies across states.

- Additionally, assessing on a volume basis disregards that resources are not uniform. For example, barrels of oil are not uniform in their quality, owing to differences in elements such as sulphur content and contaminants. Aside from low value and homogenous resources (e.g. extractive minerals on a per tonne basis), sales values are typically the most appropriate and reliable basis for determining royalty revenues.

Land tax

127. The Commission is proposing to remove the adjustment to ACT's land values to recognise its policy choice to not aggregate land holdings. This is proposed on materiality grounds.

128. Aggregation is an important factor in most states' land tax regimes and the impact of aggregation should be reflected in the land revenue assessment.

129. Based on work undertaken in 2016-17, it was estimated that aggregation accounted for around a third of South Australia's private land tax revenue in that year. This is very similar to the work done by New South Wales indicating that aggregation increased its revenue by 33%.

130. We acknowledge that it would be inappropriate to base an adjustment for the ACT on the impact of aggregation in South Australia and New South Wales. We also note the Commission's analysis that there may be reasons why aggregation would have less impact in the ACT, and advice from ACT that the impact of aggregation based on its analysis is 5.2%. However, an adjustment to the ACT's revenue base should be made to make it consistent with the average policy of all states. It should not matter if the adjustment is material or not, as otherwise the ACT is directly benefiting from a policy choice.

Conveyance duty

131. South Australia supports the Commission's decision to not introduce elasticity adjustments as part of the 2025 Review. There is no robust way of estimating appropriate adjustments to the assessment and differentiating the impact of behavioural changes from the impact of general changes in market conditions.

132. South Australia notes the Commission decision to not update value ranges used to calculate the progressivity of state tax rates. While not a specific driver of the choice of value ranges, the Commission has noted that the split of the top value range (over $1.5 million) into 3 value ranges that occurred in the 2020 Review was not material in the 2024 Update. The materiality of this adjustment was based on the $40 per capita materiality threshold. South Australia would suggest that the $12 per capita data adjustment threshold is more appropriate for this analysis.

Payroll tax

133. South Australia notes that the Commission proposes to retain the 2020 Review assessment method for the payroll tax assessment.

134. South Australia supports the proposal to continue to investigate the potential for an assessment based on linked data from BLADE and/or PLIDA but not to implement any alternative assessment method before the next review.

Insurance tax

135. South Australia notes the Commission proposes to make no changes to the assessment of insurance duty. We continue to hold the view that duty on workers' compensation and compulsory third-party insurance premiums should be removed from the general insurance category. For consistency purposes, if workers' compensation premiums and compulsory third-party premiums are removed from general insurance premiums then the associated duty should also be removed.

Roads

136. Given the Commission is not recalculating the rural road network as part of the 2025 Review, it is not clear what has changed between the 2020 Review and the 2025 Review to warrant the removal of routes to mines, national parks, gas wells and ports from the rural road network. The concerns about the inclusion of these items are unchanged from those considered in the 2020 Review.

137. South Australia considers that the overall rural road network should remain unchanged until a full review of road lengths is undertaken. If the Commission retains the proposal to apply a 12.5% discount to the overall assessment (see South Australian view on this below), then the reason for the removal of these roads from the rural road network is less clear, noting that any existing concerns about ownership and quality of the roads would be addressed (at least partially) as part of the overall discount.

138. South Australia notes the Commission's advice that since the release of the roads consultation paper for the 2025 Methodology Review, 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 increasing unreliability of the data. As a result, the Commission is proposing to hold the shares of urban/rural traffic constant until a suitable data source is found. Recognising this specific data issue, South Australia would support the application of the low discount to the traffic volume data, rather than the application of the low discount to the entire roads assessment. The application of the discount to part of the assessment impacted by a data quality concern would appear to address the new issues for the 2025 Review period more directly.

139. As noted above, the Commission is proposing to introduce the low discount for the entire roads assessment. In support of this approach the Commission indicated concerns with the reliability of the assessment, including total actual state spending on roads. It noted South Australia's low share of reported actual expenditure against the assessed level of spending as an example of a potential data quality concerns. Rather than a reflection of data concerns, this may just be reflective of lower overall expenditure levels. The South Australian Auditor-General has raised the issue of low road maintenance expenditure relative to the depreciation of road assets in South

Australia as part its annual reports.[18] This shows it may not be an issue that supports the application of a discount to the assessment. The application of the discount could instead be restricted to the new data issues around traffic volume as previously discussed.

Welfare

140. The Commission is proposing to include a differential assessment of homelessness services spending in the welfare assessment. The proposed drivers include age, indigenous status, socio-economic status, and remoteness.

141. South Australia recognises that a differential assessment of homelessness services is preferable, subject to the development of an assessment based on appropriate and reliable data for all jurisdictions.

142. As outlined in the draft report, there are a range of potential drivers of state spending on homelessness services such as family and domestic violence, mental health conditions, and overcrowding which are not captured as part of the proposed assessment due to data limitations.

143. Noting the exclusion of potential drivers for state spending and concerns around the identification of state expenditure data, South Australia suggests that further work is undertaken on a homelessness assessment as part of the forward work program before a differential assessment is introduced. Alternatively, if the Commission still proposes to introduce a differential assessment, given these concerns, a discount should be applied to assessment while further investigations are undertaken.

Justice

144. South Australia notes the Commission's proposal to undertake further analysis of state data to determine whether certain police costs are unique to major cities, and whether they should be included in the police assessment.

145. South Australia does not believe that the policing costs related to complex crime are unique to major cities. There is a lack of evidence to support the claim that the cost of policing operations related to counter-terrorism and complex crime is higher in major cities compared to other areas. Additionally, many of these services likely fall under the responsibility of the Commonwealth Government, such as the Australian Federal Police.

146. South Australia also notes the Commission's intention to investigate whether there should be an additional cost weight for remote offenders.

147. South Australia considers the current police assessment an appropriate method for determining states' policing costs. Any decision for an additional cost weight should be backed by sufficient evidence that it captures factors not already accounted for in the existing regional cost adjustment. Moreover, if evidence supports the inclusion of an additional cost weight for offenders in remote areas, it should be applied to offenders in both remote and very remote regions, rather than very remote regions only.

[18] Report of the Auditor-General, Report 8 of 2023, Annual report for the year ended 30 June 2023, Part C: Agency audit reports, page 295 to 297 https://www.audit.sa.gov.au/reports/annual-report-year-ended-30-june-2023

148. The Commission has proposed several other areas for further analysis and potential changes including police, criminal courts, and prisons components. South Australia's position on the proposed changes will be provided as part of the 2026 Update after data supporting any proposed changes has been collated. In line with the Commission's usual processes, any change as part of the 2026 Update must be subject to detailed consultation with states and territories.

Post-secondary education

149. South Australia notes the Commission's draft position not to adopt a course mix driver in the Post-secondary education assessment, on the basis that it would potentially neither be policy neutral nor material.

150. South Australia supports the Commission's draft position to retain the variables used in the socio-demographic assessment.

Services to industry (non COVID-19 related expenses)

151. South Australia notes the Commission's proposal to replace total factor income as a measure of industry size with industry output data from the Australian Bureau of Statistics (ABS).

152. State shares of industry input are less volatile than shares of factor income and may provide a more reliable indicator of the industry regulation burden faced by states over the assessment period.

153. South Australia supports the inclusion of the number of businesses as a driver of need for regulator spending, noting the relationship between the number of businesses regulated and cost as outlined in our previous submissions. However, we note the Commission position not to assess business counts due to data limitation concerns, including the treatment of multi-site businesses. This is an issue that may warrant further investigation as part of the 2025 Review.

Services to communities

154. The main change proposed by the Commission in the Services to Communities assessment is an updated community criteria for the water subsidies and electricity subsidies assessments. The Commission proposes removing the minimum population limit of 50 people and the community population density requirement of 60 people per square kilometre.

155. South Australia acknowledges that the existing limits are arbitrary and that the assessment will be simplified by removing these requirements on population and population density. Therefore, South Australia supports the Commission's proposal to update the community criteria by removing these requirements.

156. However, South Australia notes that states and territories report a total of 151 off-grid communities receiving electricity subsidies, which reflects what states do. With the updated community criteria, there are 5,522 remote communities and 5,885 very remote communities being assessed as needing electricity subsidies, which is significantly different from what states do. South Australia understands there are policy neutrality concerns with the state provided data, but further consideration of the variance between what states do and what is captured in the assessment may be an area for future consideration as part of the next Review.

Other expenses

157. South Australia notes the Commission's proposal to continue assessing Other Expenses on an equal per capita basis, with adjustments for regional costs and wages for relevant service expenses.

158. The Commission proposes to revise the share of category expenses for which regional costs are applied, based on a review of state expenses data. South Australia notes that the revised approach results in a large change in the proportion of costs adjusted for regional costs – for example, the Commission now estimates that regional costs apply to 41 per cent of service expenses in the 2021-22 assessment year, significantly lower than the 62 per cent used in the 2024 Update.

159. The revision reflects a proposed change in the Commission's method for estimating the share of expenses for which regional costs apply. In the 2020 Review, the Commission assumed that regional costs applied to public safety, culture and recreation and communications expenses, as well as 50 per cent of the expenses for general public services and other purposes. It is not clear how the 50 per cent assumption for the latter group of expenses was determined.

160. In the 2025 Review, the Commission notes that it has revised its assumptions based on a review of state expense data. Given the large revisions resulting from this analysis, South Australia requests that the Commission share its analysis and the underlying data with the states to assist in better understanding the proposed approach.

Geography

161. South Australia notes the Commission's proposal to improve the representation of services in the general gradient calculation (currently composed of schools and admitted patient data). We recognise that an increased representation of services may result in a better representation of actual costs, but note there is no way to accurately determine if the inclusion of the additional factors will better capture the additional regional and service delivery scale costs incurred in those state services where these costs cannot be directly measured.

162. South Australia does not have alternative suggestions to improve the general cost gradient – this would require considerable additional work which cannot be undertaken in the time available. However, we specially note that while the Commission proposes to include the *Justice – prisons* component into the general gradient calculation, it also proposes further analysis of state data and consultation on whether the assessment of service delivery scale is required in the prisons assessment. These two proposals appear contradictory. A decision on whether to include the *Justice – prisons* component in the general gradient should only be made after further analysis on its appropriateness is undertaken in the prisons assessment.

Investment

163. South Australia notes the Commission's proposals to:

- not smooth user population growth to reduce volatility, on the basis that the additional complexity of this approach outweighs the potential benefits; and

- not freeze component shares of the value of assets, on the basis that this approach would result in a loss of contemporaneity and responsiveness to changes in what states do.

164. As South Australia has previously noted, a greater concern is the volatility caused by large revaluations of some stock values from one update to the next. We recommend that the Commission investigate ways of addressing the underlying causes of these revaluations.

Urban transport investment

165. South Australia's response to the urban transport investment assessment will be included in a separate response to the Transport addendum.

Net borrowing

166. South Australia notes the Commission's draft position to retain the current net borrowing assessment method. We agree with the Commission's view that changes in average state net borrowing and net debt over time have not changed the conceptual basis of this assessment.

167. South Australia also agrees that population growth in this assessment should not be smoothed, to maintain consistency with the proposed approach in the Investment assessment.

Flexibility to consider method changes between reviews

168. South Australia does not have any major concerns with the Commission having the flexibility to consider alternative methods between reviews on a case-by-case basis for unexpected developments in very limited circumstances (as discussed in the Draft Report). Further, South Australia is not opposed to the Commission's proposed criteria for assessing a major unexpected development but highlights that consideration must also reflect the availability of reliable and policy neutral data upon which to base an alternative assessment.

169. New South Wales and Victoria have correctly identified the COVID-19 pandemic as being an example of a major unanticipated shock that affected state and territory fiscal capacities. However, the COVID-19 response is also a clear example of where it was not possible construct an alternative assessment based on reliable, policy-neutral data.

170. Although not opposed, South Australia believes that the case for allowing flexibility for major policy changes, including taxation reform, is less strong as such measures are not unexpected events and usually have a relatively long development timeline. Methodology reviews should be the primary and default process for determining method changes.

171. New South Wales' proposed property tax reform is not a good example to demonstrate the need for an alternative assessment approach between reviews for major policy changes. Any alternative assessment would have needed to be based on untested estimates of anticipated future elasticity impacts. In addition, the timeframe from announcement of the measure to actual implementation, combined with the phased introduction, would have allowed for consideration in a review process. New South Wales ultimately appeared to be seeking assurances in advance of committing to a policy reform for a particular assessment approach, which is a separate issue. Alternative assessment decisions should not be based on proposed legislation or estimated future impacts based on untested assumptions.

172. That said, we support the Commission having the ability to change methods between reviews for policy changes where the proposed guiding principles have been met[19] and, as outlined in the draft report, there is:

- a sound conceptual case for the change supported by sufficient empirical evidence; and
- an alternative method based on reliable and fit for purpose (policy neutral) data can be introduced; and
- the assessment is material; and
- appropriate, detailed consultation has been undertaken with jurisdictions.

These circumstances are likely to be very rare.

173. In relation to having standing provisions in terms of reference for updates that allow flexibility to make method changes, South Australia notes that five-yearly reviews

[19] See point 56 of the Flexibility tio consider method changes between reviews chapter of the Draft Report

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should be the primary vehicle for determining method changes. We are open to the terms of reference allowing method changes between reviews, subject to appropriate processes for the review of any changes as outlined in the draft report. The final wording of any changes to annual terms of reference will be important in this regard.

174. South Australia also strongly supports not making retrospective adjustments to GST relativities for method changes between reviews. It is not appropriate to alter relativities for prior updates.

Future work program

Health

175. South Australia looks forward to working with the Commission on the following issues pertaining to the Health category:

- the appropriateness of using averaged national weighted activity units (NWAUs) in its SDC assessments. South Australia agrees with the Commission's view that the proposal by some states to use actual NWAUs would raise policy neutrality issues;
- considering how cultural and linguistic diversity affects state service costs, noting the Commission has already identified a range of data challenges that would need to be addressed to support a robust, material assessment; and
- continuing to engage with the Independent Health and Aged Care Pricing Authority to test the appropriateness of the current non-hospital patient transport assessment.

Services to industry

176. South Australia notes the Commission's intention to do more work after the 2025 Review on a potential assessment of state spending on the net zero transition.

177. In addition to developing a consistent definition of in-scope expenditure, the Commission should investigate an appropriate policy neutral measure of needs. As South Australia has previously noted, the transition to net zero is a policy driven process, with each state pursuing its own transition objectives.

Elasticity adjustments

178. As noted in previous submissions, South Australia does not support the introduction of elasticity adjustments.

179. South Australia is not aware of any robust way of estimating appropriate adjustments to assessments and differentiating the impact of behavioural changes from the impact of state circumstances and general market conditions.

Transport

180. South Australia's view on the transport assessment will be provided as part of a separate submission following the release of the transport addendum, including the proposed forward work program.

Cultural and linguistic diversity

181. The case for the inclusion of culturally and linguistic diversity as a separate cost driver of state service provision is not clear. As noted by the Commission there will likely be difficulty defining, identifying an assessing how these groups impact costs. Any impacts may already be indirectly captured through existing assessment approaches or may not be material. South Australia will engage with the Commission on these issues are part of the future work program.