Significant Changes since the Draft Report

2 December 2024

Queensland Government

Contact officer:

Matthew Nalder
Team Lead, GST
Revenue Forecasting and Policy
Economic Strategy Division
Queensland Treasury
(07) 303 51818

Contents

1. Summary

Queensland continues to remain strongly committed to ensuring that horizontal fiscal equalisation (HFE) and all its supporting principles are upheld by the Commonwealth Grants Commission (the Commission).

However, Queensland is concerned that there are substantial aspects of the Commission's proposed positions on assessments, as outlined in the *Draft Report* and *Significant Changes since the Draft Report*, which detract from HFE and its supporting principles. Unfortunately, flawed execution is undermining the rationale for HFE.

These concerns relate to both a range of method changes proposed by the Commission and, in other cases, several assessments where clearly warranted changes have not been made, or where further consideration of an assessment has been put on hold until the 2030 Methodology Review.

As outlined in this submission, these decisions are likely to have substantial detrimental impacts on HFE outcomes and major negative fiscal consequences for Queensland.

Several key positions outlined by the Commission in the *Draft Report* and *Significant Changes since the Draft Report* are not supported by evidence or rigorous analysis and appear arbitrary. In other cases, decisions have been made to maintain existing assessment approaches despite previous submissions from Queensland and other states highlighting severe limitations and issues with the methodologies.

For these reasons, Queensland strongly does not support the Commission's proposed positions on a range of important assessments, with many of the key concerns with the positions proposed on these assessments, as outlined below, having been discussed in detail in previous Queensland submissions:

- **Coal mining revenue assessment** – the proposed use of price bands, an approach that has substantial policy neutrality consequences and could lead to separate actual per capita assessments of policy decisions in New South Wales and Queensland while ignoring actual fiscal capacity. Further, the proposed APC assessment of brown coal (primarily benefitting Victoria) will further erode policy neutrality in the mining assessment.
- **Mining revenue assessment (Onshore Gas and treatment of restricted minerals)** – the Commission's position to continue to assess states who have banned or severely limited gas production as having no or very low potential capacity to raise revenues perpetuates an assessment approach that is clearly policy contaminated and does not reflect the clear case put forward, with strong precedents, to assess these state revenues on an equal per capita basis.
- **COVID-19 expenses** – the proposed actual per capita assessment of COVID expenses for health and service to industry, despite the overwhelming and clear policy decisions that impacted the efficiency and magnitude of this expenditure. Further, this method change will result in a double count of the current service to industry expenses.
- **Health non-state sector (NSS) adjustment** – particularly for admitted patients, where the Commission is continuing to support using a not fit for purpose indicator (private patient separations) despite having acknowledged its severe shortcomings and identifying a superior indicator (private patient benefits paid). The *Significant Changes since the Draft Report* proposes exacerbating the perverse impacts of the NSS adjustment by increasing substitutability levels.

- **Transport assessment** – including the flawed, unreliable urban transport model which assesses policy decisions rather than public transport need, as well as continued use of the inappropriate population squared variable used in transport investment assessment.
- **Roads assessment** – the proposed discounting has been suggested without providing states with any appropriate analysis or evidence to support the position. This change does not address the limitations of the underlying methodology.
- **Wages assessment** – including the proposed change to an hourly wages variable rather than weekly wages further reduces the already questionable justification for using private sector wages as a proxy for public sector wages.
- **Commonwealth Payments** – the 100 per cent impact treatment of payments under the National Health Reform Agreement (NHRA), despite a significant proportion of these payments being reserved and used for Commonwealth-like services such as aged care, is clearly not appropriately aligned with HFE outcomes. These payments should largely be considered as not impacting GST shares.

Further, Queensland is concerned that the Commission's data and quality assurance processes, in particular in developing the *Draft Report*, have been confusing, opaque and lacking in rigour. This has resulted in estimated GST distribution impacts for some key assessments now being far greater and more severe than Queensland would have expected based on the Commission's analysis and estimates in the *Draft Report*.

To ensure the *Final Report* is fit-for-purpose and that final recommendations from this review do not further reduce HFE outcomes, Queensland strongly recommends the Commission urgently reconsider its proposed assessment approach related to the health, COVID-19 expenses, coal mining revenue, revenue from gas and banned minerals, transport and roads assessments.

1.1 Structure and focus of this submission

This submission includes Queensland's detailed response to the positions that the Commission has proposed in its latest consultation paper for the 2025 methodology review, *Significant changes since the Draft Report.*

However, in addition to addressing the specifics of that report, Queensland has a range of broader issues with the proposed outcomes of this review, including concerns regarding data integrity and quality assurance and positions the Commission has taken in relation to key assessments in the *Draft Report* and subsequent changes now being proposed.

As such, the remainder of this submission includes three key sections, outlining Queensland's material concerns and views on specific issues, as follows:

Section 2: Key issues – data integrity and quality assurance

Section 3: Key issues – priority assessments

Section 4: Significant Changes since the Draft Report.

2. Key issues - data integrity and quality assurance

2.1 Data errors

In our submission to the *Draft Report*, Queensland raised concerns about the overall quality of data being used by the Commission and the lack of transparency and testing of the underlying models.

Queensland's concerns have been increased by the outcomes outlined in the *Significant Changes since the Draft Report* and the supplementary advice provided to states at that time about data errors identified and revisions to models and assessments since the *Draft Report*.

Of greatest concern is the substantial volatility in GST distributional outcomes since the *Draft Report* for assessments where there has been no subsequent method change. Relatively small changes to data inputs or revisions to data where errors have been identified have resulted in significant swings in GST distribution resulting from those assessments.

Given the lack of transparency in terms of precisely what has driven those changes, Queensland is unable to appropriately understand and scrutinise the validity of the data and the process undertaken in revising the assessments. Unfortunately, these significant, unexpected and largely unexplained changes undermine the legitimacy of the Commission's assessment.

In particular, highly material changes in GST distribution have resulted from data related adjustments in the wages assessment:

1. **Wages**

The latest estimated impacts provided by the Commission for 2024-25 showed that, for Queensland, the wages assessment has changed materially, from a positive redistribution of $17 million as at the *Draft Report* to a negative redistribution of $56 million in the *Significant Changes since the Draft Report.* This is a $73 million reduction in Queensland's GST share.

It is understood, based on consultation with Commission staff, this substantial change was due to a failure to initially include appropriate data (related to workers who worked less than 5 hours in a week or greater than 60 hours) in the wages regression modelling undertaken to inform the *Draft Report*.

As a result of this revision and other changes made to the wages assessment in this Review, the wages assessment is now re-distributing $634 million away from Queensland as at the 2024 Update, up from $217 million in the 2020 Review. This increase is mainly driven by the change the Commission made during the COVID years to move from weekly wages to hourly wages; a change which this Review is now making permanent.

Given that the structure of Queensland's public sector labour market is largely consistent with that in other states and has not changed materially over the last several years, such a major change in GST redistribution makes no conceptual sense and highlights the limitations of the wages assessment model.

2.2 Quality assurance

The Commission releasing the *Draft Report* to states without appropriate quality assurance processes having been completed is of major concern to Queensland. This resulted in highly misleading estimates of the GST impacts of key assessments being included in the *Draft Report*.

Given the Commission's responsibility for recommending GST relativities which redistribute billions of dollars across states and territories, it is expected that appropriate quality assurance and key checks and balances are undertaken as an essential aspect of the assessments and consultation prior to the publication of major milestone reports, in particular in the *Draft Report*.

Furthermore, this lack of data reliability is at odds with the *Terms of Reference for the 2025 Methodology Review*, paragraphs 8(a) and 8(c) which specifically require the Commission to use quality and fit for purpose data and undertake robust quality assurance.

The Commission's estimates in the *Draft Report* are critical to help states interpret and scrutinise the proposed methodologies, and to understand (and provide advice to their governments on) any potential impacts of proposed changes on their GST share.

This is particularly the case for clearly policy-contaminated assessments such as transport, where any changes in the model coefficients related to different variables can lead to major changes in redistribution and, therefore, suggest very different economic or conceptual foundations underpinning the assessment (i.e. what factors are truly driving the assessment outcomes). The extreme volatility in the transport assessment outcomes highlights yet again the lack of a sound conceptual foundation to this model.

The illustrative impacts from method changes and updated data inputs outlined in the *Draft Report* need to be as accurate as possible, as they are essential for informing states' understanding of the potential revenue impacts of the Review outcomes. These feed into strategic planning and fiscal management considerations for states, including potential implications for state service delivery.

Queensland urges the Commission to recognise the importance of this issue and to ensure the accuracy and reliability of its data and methods is beyond reproach in its *Final Report*. Improvements in this area must be a clear focus of its efforts to ensure a robust methodology review process as part of the next five-year review.

In particular, issues related to the Commission's quality assurance deficiencies have been highlighted in the transport-related assessments, where errors resulted in material changes to the estimated GST distribution between the *Draft Report* and latest estimates provided by the Commission.

2. Transport

Significant data errors and quality assurance issues have occurred with the transport assessment, which were not appropriately identified by the Commission as part of its quality assurance for the *Draft Report*. This has led to the Commission making significant revisions to the indicative GST redistribution impacts of the transport assessment, as advised when the *Significant Changes to the Draft Report* was provided to states.

This has also had additional significant flow-on impacts on the transport investment assessment, to the significant detriment of Queensland's GST share.

The Commission staff initially explained the material changes reflected a data revision related to smaller and less dense urban centres subsequent to the *Draft Report addendum* release. This was incorrect. The Commission subsequently advised the substantial changes were instead due to the Commission applying the wrong logarithmic base to passenger numbers modelled in the *Draft Report addendum*. The result of this error significantly inflated the influence of passenger numbers in the model.

The material change in assessed need for urban transport model as a result of the Commission's error in one parameter further exacerbates Queensland's concerns with the lack of integrity, accuracy, reliability and validity of the transport assessment methodology.

3. Key issues - priority assessments

In addition to the broader data integrity and quality assurance issues already discussed, Queensland continues to have major concerns with the approach proposed by the Commission in relation to several key assessments.

In particular, as outlined below, this includes some major assessments where, despite Queensland and other states having highlighted substantial limitations, inaccuracies and policy-contaminated nature of key assessments, these issues have been largely (or completely) unaddressed and the assessments remain clearly not fit for purpose. This suggests a significant level of arbitrary decision making, disconcertingly at odds with the evidence or application of accepted principles.

As outlined in this section, Queensland's major concerns relate to six key elements of the Commission's proposed assessment methodology:

- Coal mining revenue assessment
- Restricted minerals (including onshore gas) revenue
- Transport and transport investment assessments
- Treatment of COVID-19 related expenses
- Health assessment and treatment of non-state sector adjustment
- Wages assessment.

3.1 Coal mining revenue

Following the release of the *Draft Report,* the Commission released an addendum paper proposing to split the coal mining assessment using price bands. This proposal is concerning, as this approach could result in almost all coal mining revenue being effectively assessed on an actual per capita (APC) basis, despite both New South Wales and Queensland being major global coal producers and exporters. This will not recognise states' *actual* capacity to raise revenue but will rather produce an assessment based purely on policy differences.

Queensland continues to not support any further disaggregation of the mining assessment and in particular the coal mining assessment and instead recommends an aggregated approach for all mining revenues be used.

Queensland's previous submissions have detailed a range of principled and evidence-based arguments, as well as a range of practical barriers, against this proposed change. **The Commission has failed to adequately address any concerns raised by Queensland regarding the unjustified proposed disaggregation of the coal mining assessment.**

Furthermore, through the established HFE arrangements, a significant proportion of Queensland's coal mining royalty revenue is already redistributed to other states. As such, Queensland's coal royalty revenue reforms have improved *other* states' fiscal capacity and budgetary position and have been demonstratively beneficial for the national interest. Overall, these reforms have provided substantial benefits not just for Queenslanders, but for Australians across the nation.

The Commission's proposed methodology is underpinned by clear policy-contamination and suggests that the Commission's assessment reflects a 'judgement call' on the relative merit or appropriateness of state policy decisions related to their royalty regimes.

Further, as outlined in detail in Queensland's previous submissions, this proposed change could have substantially negative and unintended consequences, in terms of disincentivising and undermining the effectiveness of state government policies that are in the national interest.

This change will further create substantial uncertainty for states around the ultimate revenue impacts and GST treatment of any potential future reforms and create an environment which disincentivises meaningful state revenue policy reform with any material revenue implications, ultimately leaving states more dependent on the Commonwealth for revenue.

These proposed changes are particularly concerning given the continued differential assessment of onshore gas and other restricted minerals. These two assessments have completely contradictory treatments of policy decisions. While the Commission is proposing to specifically assess Queensland's, New South Wales', and Victoria's coal mining revenue policy choices using an effective APC assessment, the continued assessment of onshore gas deliberately ignores the policy decisions in New South Wales and Victoria to restrict mineral exploration and extraction and thus limit their revenue bases.

Concerningly, both positions taken by the Commission redistribute GST away from Queensland only because of its policy decisions whilst rewarding other states for their policy decisions.

Queensland reiterates that the only truly principled assessment of coal mining revenue and mining revenue more broadly would be through discontinuing the mineral-by-mineral approach and aggregating the mining revenue assessment.

3.2 Restricted minerals (including onshore gas) revenue

Since the initial rounds of consultation on this assessment, the Commission has reversed its proposed position of applying an equal per capita treatment revenue raised from restricted minerals, most materially onshore gas, and has decided to retain the current unfair differential assessment. This disregards clear evidence that the current methods act against the principle of policy neutrality and erroneously assess states that apply restrictions as having no or little revenue capacity.

As was correctly noted in its original consultation paper, the revenue base for onshore gas is heavily impacted by state policy restrictions. This fact has remained unchanged over the course of this Review. Over a period of more than a decade, several states have implemented various bans on gas exploration, extraction and various practices related to onshore gas industry development and production. Many of these restrictions remain in place or have been extended. Even where moratoriums have been partially relaxed, restrictions remain in place and the industry is unable to have the confidence and security needed to invest in onshore gas exploration or development given policy uncertainty.

Many states, most importantly New South Wales and Victoria, are highly likely to possess onshore gas resources, as data sources show. The overreliance on estimates from Geoscience Australia by the Commission in coming to its decision to continue with the current erroneous approach, completely disregards the fact that reserves cannot be classified without pathways to commercial extraction. **State policies restricting onshore gas extraction or exploration means that these pathways do not exist. Quite simply, bans discourage exploration and, therefore, result in underestimates of actual reserves in jurisdictions that have bans.**

As such, estimates of gas reserves in all states except Queensland are significant underestimations. In most cases, complete information on gas reserves in other states is unavailable due to a lack of exploration and data collection gaps. Therefore, while a detailed understanding of Queensland's gas resources and reserves is readily available, more exploration is likely required in other Australian jurisdictions to achieve comparable knowledge.

The design of the current assessment, which assesses states that do not explore or develop their gas resources as having no revenue raising capacity, does not reflect the potential revenue being foregone directly as a result of policy decisions in those states. **Continuing to apply the current onshore gas methodology rewards states for their policy decision to limit or ban onshore gas development and continues to disincentivise states from developing their gas industries and resulting revenue bases.**

These distortions were clearly highlighted by the Australian Productivity Commission in its previous Review into HFE. The Commission's initial position to change to an EPC treatment of coal seam gas was an entirely appropriate response which adopts a balanced approach to HFE and acknowledges the substantial policy influences on this assessment. The case for then reversing this has not been made.

The policy contamination in the onshore gas assessment is of particular concern, given that the approach proposed to be continued by the Commission conflicts sharply with the conceptual basis and 'logic' underpinning the proposed changes in the coal mining revenue assessment.

While the current onshore gas assessment deliberately ignores policy decisions, the proposed coal mining assessment is designed to reflect differences in state policy frameworks. Concerningly, both of the Commission's decisions substantially reduce Queensland's GST share while rewarding New South Wales and Victoria.

Both assessments should be policy neutral. For onshore gas this would be achieved through an EPC assessment and for coal by an aggregation of minerals approach, or at the very minimum not making the existing situation worse and maintaining the 2020 coal assessment.

The magnitude of this inconsistency highlights the highly policy-contaminated nature of the assessment approaches in both instances, and clearly demonstrates a significant departure from the supporting principles through the 2025 Review.

Queensland strongly recommends the Commission to take appropriate action in assessing onshore gas and other banned minerals by applying an EPC treatment.

Failing this, Queensland considers the Commission should at a minimum apply a 50 per cent discount in order to acknowledge both the policy contaminated nature of this assessment and the reliance of incomplete data sources to justify inadequate assessment methods.

3.3 Transport & transport investment

At the *Draft Report* stage of the 2025 Review Queensland expressed cautious optimism that the Commission was taking steps towards improving the urban transport assessment.

However, as discussed earlier in this submission under Quality Assurance issues, successive data and model updates released by the Commission following the *Significant Changes since the Draft Report* exacerbate concerns that the urban transport assessment is deficient and not fit for purpose.

More importantly, the impact of these errors is of such an extreme magnitude that this highlights the increasing concerns with the validity of the assessment approach and the underlying model.

Significant output variations from these errors clearly illustrate the urban transport model to be invalid and unreliable. The extreme and inexplicable magnitude of this change clearly and undeniably demonstrates that the model is not fit-for-purpose.

This obvious demonstration of data and model inadequacies in the urban transport assessment means **Queensland continues to have no confidence in the integrity of this model and believes that its continued usage undermines HFE outcomes.**

As outlined in detail in Queensland's previous submissions, **Queensland does not support the continued use of the urban transport model in its current form and does not support the continued use of the population squared variable in any form.**

A lack of support for the current urban transport and transport investment methodologies has been expressed by a majority of states throughout the 2025 Review. In addition to Queensland, several other states including Western Australia, South Australia, Tasmania and the Northern Territory have all identified issues in their submissions to the Commission on fundamental limitations with these methodologies.

However, despite the overwhelming analysis and academic evidence being presented to the Commission, there has been a clear lack of meaningful consideration and engagement to address these concerns.

Indeed, the only significant proposed change to these methodologies – changing the measure of population weighted density from SA1s to square kilometre grids – does not adequately address the issue of population weighted density dilution.

As flagged in Queensland's *Tranche 2* and *Draft Report* submissions, the use of square kilometre grids has major limitations as a comparative measure of population density, particularly in major urban areas in Queensland, such as Brisbane, Cairns, or Rockhampton. As outlined by Queensland previously, significant areas of these urban areas are relatively prone to flooding and natural disasters, which means large areas of land cannot be used for residential development. As square kilometre grids combine key residential areas with undeveloped land in the same square unit, they understate the population weighted density and urban transport need of people living in these affected urban areas.

Given the lack of validity and severe deficiencies of the urban transport related assessments, Queensland believes that urban transport and urban transport investment expenses must be more appropriately assessed using urban population shares or EPC until a comprehensive, transparent and truly independent review of these assessments can be made as part of the next five-year review.

Issues related to ferry dummy variable

A further limitation of the transport related assessments is the Commission's proposed approach to assessing the need for ferry transport services.

The Commission initially proposed assessing urban ferry need based on the proportion of commuters using ferries as their main mode of transport. This correctly recognised that different states have different ferry transport tasks. Queensland supports recognising this difference if urban transport needs are to properly be assessed.

However, the Commission has since changed its initial position and now proposes maintaining a ferry dummy variable that will incorrectly redistribute significant volumes of GST towards Significant Urban Areas (SUAs) which only provide minimal amounts of ferry services.

Indeed, the Commission's new model significantly increases the perverse outcomes of the ferry dummy variable, with significant GST being redistributed across states as a result. By its nature, this variable clearly does not recognise the difference in ferry task between different SUAs.

The inappropriateness of this approach is highlighted by the perverse outcome where the Melbourne SUA is allocated the same ferry transport need per capita as Brisbane. This is despite the most recent Bureau of Infrastructure and Transport Research Economics data showing there are negligible ferry passenger kilometres travelled annually in Melbourne while Brisbane has 17 million ferry passenger kilometres each year, based on 2022-23 data.[1] The flawed dummy variable results in the Melbourne SUA being perversely assessed to have almost twice the assessed need for ferry transport as the Brisbane SUA.

Given the severe limitations of the ferry dummy variable, Queensland urges the Commission to adopt a proportional approach towards allocating ferry expenses or assess ferry expenses EPC.

[1] Bureau of Infrastructure and Transport Research Economics 2023. *Australian Infrastructure and Transport Statistics: Yearbook 2023*.

3.4 COVID-19 expenses

Since the initial consultation processes, the Commission has proposed to make changes to treat COVID-19 spending on an actual per capita basis. The proposed APC treatment of COVID-19 spending disregards the policy choices made in Victoria and New South Wales which resulted in the varying levels of expenditure and disregards the fact that **APC treatments should only apply where, as stated in the Commission's own definition from its terminology paper, "the policies of all States are the same and any differences in expenses or revenue per capita are due to differences in State circumstances."**

It is undisputable that this is not the case for COVID-19 related spending. The Commission's assertion that state responses to the pandemic largely reflected circumstances outside of state control is at odds with the very different policy settings implemented across states to control the spread of the pandemic.

Queensland continues to strongly oppose any changes related to the treatment of COVID-19 related expenditure in either the expense or investment assessments.

While Queensland considered that sufficient evidence to illustrate the policy affected nature of COVID-19 spending had already been provided in previous submissions, the recently released COVID-19 Response Inquiry Report[2] prepared on behalf of the Australian Government further reinforces this view. The overall response to the pandemic, which can be summarised in the following quote, shows that factors unrelated to incidences of COVID-19 influenced expenditure, risk, and response to the pandemic throughout Australia.

> "Over time, the unified direction and national leadership began to deteriorate and cracks in the system started to emerge. Decisions became less cohesive and coordinated as the pandemic continued. Differences in levels of local risk and response capacity led to different responses across the country [across different states]."

The report goes on to include examples of specific areas of the health response where different policy responses applied. This clearly demonstrates that the policies of all states were not the same as an APC treatment requires.

Examples were given on quarantine:

> "Each state and territory adopted a distinct approach to mandatory managed quarantine consistent with their differing administrative, clinical governance, policing and health arrangements and their geography."

> "The states and territories adopted different models to accommodate domestic travellers. Some used existing hotel programs while others developed other options, including allowing home quarantine and self-isolation. These state and territory models were also used to manage COVID-19 positive cases and close contacts during local outbreaks."

On contact tracing:

> "Each state and territory also had their own definition of 'close contact' under state legislation for the purposes of contact tracing from early in the pandemic. Different jurisdictions had different ways of implementing contact tracing and different self-quarantine periods for close contacts."

---

[2] Australian Government, Department of Prime Minister and Cabinet, COVID-19 Response Inquiry Report | PM&C, accessed 11 November 2024

On mask mandates:

> "States and territories adopted individual approaches with varying rules on both the mandatory and recommended or voluntary use of masks – rules and exemptions were set out in state and territory public health orders."

On lockdowns:

> "Lockdowns and social distancing measures continued to be applied on a state-by-state basis throughout the pandemic, even after the vaccine rollout had begun (see Figure 3). This included lockdowns of varying stringency and duration, with some implemented across an entire state, while others were localised, targeting particular postcodes."

The report further notes that in some instances the actions taken were found to be over and above what was considered necessary, even at that time.

> "While other countries became more nuanced in their response, some Australian jurisdictions tended to escalate and broaden measures over time."

This greater than necessary approach was found to be particularly prevalent in the support extended to individuals and industry.

> "Following the highly effective economic response during the alert phase, with the benefit of hindsight, the levels of support remained too high during the suppression and vaccine rollout phases. This resulted in overcompensation of both businesses and individuals for losses."
>
> "With the benefit of hindsight, the combined effects of fiscal and monetary policy on aggregate demand were larger than necessary to secure the economic recovery. This increased the fiscal cost and contributed to high inflation coming out of the pandemic."

These statements clearly indicate that the excessive levels of expenditure seen in some jurisdictions was not the result of actual COVID-19 induced need. It was a deliberate policy choice.

To apply an APC assessment to this spending would therefore reward states for excessive spending and punish those who adopted more responsible approaches to their pandemic response. In light of these findings Queensland continues to restate its position that changes to the measures used to assess COVID-19 spending are not required and that an APC treatment is certainly considered to be inappropriate.

Additionally, the *Significant Changes* paper has failed to address the concerns Queensland raised in its response to the *Draft Report* with regards to the potential 'double counting' of COVID-19 business support payments.

Business development payments made during COVID-19 have been previously equalised as industry regulation. Should the Commission decide to proceed with the inappropriate treatment of COVID-19 expenses on an APC basis, then the COVID-19 business development expenses which have been assessed as industry regulation must be reversed out appropriately going forward to ensure no double counting of this expenditure.

3.5 Health & the health non-state sector adjustment

The health assessment has been a key focus for Queensland in the 2025 Review with significant evidence and analysis being provided to support its positions. In particular, Queensland identified shortcomings in the non-state sector (NSS) adjustment. These concerns were accepted by the Commission at the *Draft Report* stage, with the Commission concurring that the NSS adjustment was inadequate in its current form and identifying numerous deficiencies with their data, particularly the use of private patient separations in the admitted patients' component.

However, following this and with no consultation with states, the Commission has now not only decided to revert to the previous method, but has exacerbated the issues with the NSS adjustment. Queensland is disappointed and concerned that the Commission is undoing any improvements made to the adjustment and proposing its expansion, despite the obvious and numerous limitations of the current assumptions, data, and methods.

These changes expose inconsistencies in the Commission's position. In the *Draft Report*, the Commission acknowledged and provided significant analysis and evidence conclusively demonstrating how unsuitable for use private patient separations are as an indicator for substitutability. However, the proposed position of the Commission suggests a complete reversal where they now consider the current method is robust and accurate.

Meanwhile, the Commission has consistently acknowledged the uncertainty of the substitutability indicator and has been provided significant evidence that the existing substitutability levels are already too high. Yet, the Commission's current proposed approach inexplicably expands the application of this element of the assessment and exacerbates the existing issues.

Queensland also considers that the lack of consultation on the proposals to expand the NSS adjustment does not comply with the *Terms of Reference for the 2025 Methodology Review*, specifically paragraph 3, subparagraph (b):

> "The Commission will consult with the Commonwealth and the states on…any substantive changes to the revised methodology following the Draft Report."

Given this, Queensland considers that the Commission must adopt its position in the *Draft Report* or alternatively apply a discount of at least 50 per cent to the NSS adjustment and consider applying a 100 per cent discount if no significant method changes can be enacted.

Unfortunately, once again. the Commission proposed a direction in the *Draft Report* which was appropriate and which states would rightly believe to have been appropriately researched and considered. However, **that position has now been inexplicably reversed in the *Significant Changes since the Draft Report* in the absence of any consultation with states.**

3.6 Wages

Since the *Draft Report* the Commission has including previously excluded data which has significantly changed previous estimates of distributions. **As a result, Queensland holds substantial concerns about the ongoing volatility in assessment outcomes (in spite of changes undertaken in this Review to mitigate this) and consequently the reliability of the wages assessment as a whole.** We therefore recommend that the Commission enact changes to address this issue, specifically their methods of data pooling, while also applying an increased discount.

It has been clear since the first consultation paper was released on the wages assessment that volatility is an ongoing concern, as this clearly does not reflect how wages move over time. The Commission has noted that most of this volatility can be explained by sampling error which could be reduced by expanding the sample size of the data used.

Through actions taken in this Review, the Commission has attempted to address this issue by making changes to the wages regression model and, in particular, 'pooling' the underlying data. While independent analysis has supported this change, the method selected by the Commission (using a weighted average of single year estimates) was not favoured and it was instead recommended that a 'rolling window' sample should be used. Queensland therefore recommends that the Commission reconsider its approach to smoothing and adopt a method in line with what has been recommended by expert advice.

We also continue to advocate for other changes which we consider would improve the quality and reliability of the wages assessment. This includes removing selected industries from the wages regression data that have been heavily impacted by COVID-19 lockdowns (hospitality). Unlike the proposal to base the wages regression on female employees only, the removal of selected industries is more targeted and addresses a specific and legitimate source of bias as analysis provided by Queensland in its Tranche 1 submission demonstrates.

Queensland also encourages the Commission to reinstate weekly wages as the dependent variable in the regression model. An hourly wages variable continues to be seen as a poorer fit for public sector wages. The public sector workforce across Australia is pre-dominantly comprised of full-time workers as data from the Australian Labour Force survey shows.

Queensland is pleased to note that the Commission has agreed to preserve its discount on this assessment. However, we consider that an increased discount is valid in light of significant short-term disruptions to the labour market (COVID-19) which have potentially weakened the validity of using private sector workers as a proxy as well as the ongoing impacts of policies such as lockdowns which have created further sources of difference between states.

Therefore, Queensland recommends the wages assessment discount should be increased to at least 25 per cent.

4. Significant Changes since the Draft Report

The following section outlines Queensland's positions in response to the specific changes the Commission is proposing since the *Draft Report*, including in the subsequent addendums for mining revenue and transport expense.

3. Summary of Queensland's positions

Issue	Commission proposal	Queensland position
Motor taxes – differential assessment of stamp duty on motor vehicles	The Commission will reintroduce a differential assessment of stamp duty on motor vehicle transfers.	**Support**
Schools – classification of socio-educational disadvantage	The Commission will retain the approach used in the 2020 Review for measuring socio-educational disadvantage, using the most socio-educationally disadvantaged 25 per cent of students.	**Support** **Recommend further cost weightings**
Health – retesting socio-demographic groups	The Commission will continue with the 2020 Review approach of not including socio economic status as a driver of expenses in remote and very remote areas	**Support further analysis in the 2030 Review**
Health – non-state sector	The Commission will revert to the 2020 Review approach of using private patient separations as the indicator of non-state sector admitted patient activity.	**Strongly do not support**
	The Commission will use the exact calculated 'midpoint' estimates for the non-state sector adjustment substitutability levels. The Commission will apply a low discount (12.5 per cent) to the non-state sector adjustments	**Recommend increased discount**
Health – non-hospital patient transport	The Commission will incorporate expenses associated with aeromedical services and the Patient Assistance Transport Scheme in the admitted patient assessment before the next Review if all states are providing the required data for the three years of the assessment period.	**Do not support**
Health – community and public health	The Commission will exclude COVID 19 clinics from the list of non-admitted patient allied health services in the proxy indicator for community and public health.	**Do not support**
Health investment – COVID-19 expenses	The Commission will exclude COVID-19 expenses in the health component of the investment assessment.	**Do not support**

Housing – additional costs due to above average overcrowding	The Commission will assess net expenses for social housing on an average household size based approach.	**Do not oppose**
Roads – rural roads to mines, gas wells, ports and national parks	The Commission will retain the 2020 Review method for assessing rural road length, and include routes to mines, national parks, gas wells and ports.	**Support**
Discounting	The Commission will retain the 4 discounts from the 2020 Review at the same levels. New discounts will be applied for the whole of the roads assessment and for the non-state sector adjustments in the health assessment.	**Do not support a roads discount** **Support a non-state sector discount**
Welfare – alternative method for determining homeless spending	The Commission will adopt the average of state spending method to classify data on homelessness spending from the Productivity Commission's Report on Government Services into the housing and welfare categories.	**Do not oppose**
Transport – allocation of V/Line expenses	The Commission will allocate 20.2 per cent of V/Line expenses to urban transport.	**Do not support**
Geography – calculation of the general regional cost gradient	The Commission will not include the gradients calculated for water or electricity subsidies in the general regional cost gradient.	**Support**

4.1 Detailed comments on Significant Changes since the Draft Report

1. Motor taxes – differential assessment of stamp duty on motor vehicle transfers

Commission staff proposal:

- The Commission will reintroduce a differential assessment of stamp duty on motor vehicle transfers. Stamp duty on motor vehicles will be assessed as a separate component within the motor taxes category. The revenue base will be the total dutiable value of vehicle transfers. The dutiable value is the greater of the purchase price or the market value. Data on the revenue raised are separately identified in ABS Government Finance Statistics and, for the last assessment year, from state revenue offices.

Queensland position:

- Queensland **supports** the Commission's proposal to re-introduce a differential assessment on the grounds of materiality.

2. Schools – classification of socio-educational disadvantage

Commission staff proposal:

- The Commission will retain the approach used in the 2020 Review for measuring socio-educational disadvantage, using the most socio-educationally disadvantaged 25 per cent of students. The Commission agrees with those states that indicated that changing the indicator to only the most disadvantaged 10 per cent of students did not adequately capture the costs associated with more moderately disadvantaged students.

Queensland position:

- Queensland **supports** the Commission's proposal to retain the approach used in the 2020 Review for measuring socio educational disadvantage (using the most socio-educationally disadvantaged 25 per cent of students), reverting from its proposal in the *Draft Report* to only use the most socio-educationally disadvantaged 10 per cent of students.
- Queensland **recommends** (as per its submission to the *Draft Report*) that the Commission should consider further cost-weighting categories for moderate socio-economic disadvantage (e.g. the next two lowest deciles of students) to better reflect differences in state needs. This should be explored further in the 2030 Review.

3. Health – re-testing socio-demographic groups

Commission staff proposal:

- The Commission will continue with the 2020 Review approach of not including socio-economic status as a driver of expenses in remote and very remote areas for state and non-state sector services.
- The Commission will use the actual distribution of Commonwealth grants to First Nations community-controlled health services as the estimate of non-state sector expense needs. This means the non-state sector adjustment for Commonwealth grants to community-controlled health organisations will be set to zero.

Queensland position:

- Queensland **supports** the Commission undertaking a comprehensive review of socio-demographic drivers of health and health non-state sector need as a part of 2030 Review.
- Queensland **does not support** making changes to socio-demographic drivers between reviews and maintains that method changes should only occur during a review process.

4. Health – non-state sector

Commission staff proposal:

- The Commission will revert to the 2020 Review approach of using private patient separations as the indicator of non-state sector admitted patient activity.
- The non-state sector adjustment for all health assessment components, including the choice of indicator for non-state admitted patient activity, is included in the Commission's forward work program.
- The Commission will use the exact calculated 'midpoint' estimates for the non-state sector adjustment substitutability levels.
- The Commission will apply a low discount (12.5 per cent) to the non-state sector adjustments for admitted patients, emergency departments, non-admitted patients and community and public health. The discounts reflect uncertainty about the reliability of data and the robustness of the methods for determining the adjustments.

Queensland position:

- Queensland **strongly does not support** the Commission's proposal to revert to the 2020 Review approach of using private patient separations as the indicator of non-state sector (NSS) admitted patient activity.
- Further, Queensland **strongly does not support** the Commission's proposal to use the exact calculated 'midpoint' estimates for the NSS adjustment substitutability levels. This would incorrectly suggest a level of precision in the NSS adjustment which the Commission itself concluded, at the *Draft Report* stage, not to be the case.
- Both proposals disregard the substantial and fundamental issues with the current NSS adjustment, which were outlined in detail in previous Queensland submissions. Queensland is concerned the Commission has ignored the overwhelming evidence against retaining this assessment adjustment, which is undeniably redistributing a significant volume of GST against equalisation. Indeed, the proposed use of midpoints will further exacerbate this issue.
- The Commission itself acknowledged the significant shortcomings with private patient separations as the relevant indicator. Given the high level of uncertainty and the lack of fit for purpose data for the NSS adjustment, Queensland considers the Commission's positions are inconsistent with the principle of HFE.
- Queensland has already provided substantial evidence and analysis supporting our position that the current NSS adjustment overstates Queensland's substitutability levels:
  - **Private patient separations are an inadequate volume indicator** for approximating NSS service provision in each state as it fails to capture acuity, complexity, or hospital efficiency.

- As acknowledged by the Commission in the *Draft Report*, **there are substantially superior alternatives, such as private patient benefits paid**. This indicator is much more able to account for acuity, complexity, and hospital efficiency given the commercial nature of private sector healthcare (which requires charges to correspond with complexity, acuity and resource intensity).
- The Commission's view that "*private patient benefits paid for equivalent hospital services vary among states due to factors other than case complexity*" fails to acknowledge that **private patient separations are more removed from case complexity than private patient benefits**.
- Fundamentally, **the public sector is not a substitute for the majority of NSS services** but is in fact a critical safety net enabling equitable and universal healthcare access for all Australians**.** As outlined in previous Queensland submission to this Review, numerous academic studies suggest that the existence – or enlargement – of the NSS does not significantly reduce public sector activity, wait times, or costs incurred in the public sector. While there may be a link between state and NSS service provision, it exists at the margin and is unlikely to impact most publicly-supported services.

- It is particularly concerning that the Commission has reverted its position in relation to the NSS adjustment after acknowledging and agreeing with Queensland's evidence at the *Draft Report* stage. Even more concerning, given the shortcomings, the Commission is expanding its application.
- Queensland **strongly recommends** the Commission reverts to its position in the *Draft Report* (using private patient benefits paid as the NSS indicator for admitted patients).
  - Private patient separations must be removed as the indicator of NSS admitted patient activity given its lack of connection to complexity, acuity or hospital efficiency.
- Further, Queensland **strongly recommends** that the Commission not use the calculated 'midpoint' estimates for the NSS adjustment substitutability levels.
  - Given the extreme data issues that have been acknowledged by the Commission and the high level of uncertainty surrounding the materiality of the NSS, the Commission should be extremely conservative when estimating NSS substitutability rates.
  - As such, instead of using the 'midpoint' estimates, the Commission could more appropriately use either (i) the lowest estimated value from different methods (giving a substitutability level of 8 per cent for admitted patients and 20 per cent for non-admitted patients) or, if only one method is used to derive the possible substitutability; this figure should be reduced by **<u>at least 50 per cent</u>** (giving a substitutability level of 6.5 per cent for emergency departments and 31 per cent for community & public health).
- Given the substantial uncertainty and limitations of this assessment, application of a 12.5 per cent discount is considered inadequate and does not nearly account for the data inadequacies and uncertainty in the assessment.
- **Queensland strongly recommends that a discount of at least a 50 per cent is applied to the NSS adjustment and that a 100 per cent discount is considered if no significant method changes are enacted.**

5. Health – non-hospital patient transport

Commission staff proposal:

- The Commission will incorporate expenses associated with aeromedical services and the Patient Assistance Transport Scheme in the admitted patient assessment before the next Review if the following conditions are met.
    - First, verification that all states are providing the data that IHACPA needs to incorporate the aeromedical services and the Patient Assistance Transport Scheme activity into the NWAU.
    - Second, the data being available for all 3 years of the assessment period when any such method change is implemented in a future update.

Queensland position:

- Queensland **does not support** making method changes between reviews. Queensland **recommends** that any consideration of this issues should revert to the 2020 methodology and any consideration of further method changes be deferred to the 2030 Review where they can be properly considered.

6. Health – community and public health

Commission staff proposal:

- The Commission will exclude COVID-19 clinics from the list of non-admitted patient allied health services in the proxy indicator for community and public health. Once the separate assessment of COVID-19 expenses ceases (2027 Update) the COVID-19 clinics will be included in the proxy indicator.
- The Commission will retain the 2020 Review method of applying a low discount to the community and public health socio demographic composition assessment. Reliance on a proxy measure of activity for a significant share of community and public health expenses justifies a continuation of a discount. The discount will not apply to the assessment of ambulatory community mental health expenses where a direct measure of activity is used.

Queensland position:

- Queensland **does not support** the Commission's proposal to exclude COVID-19 clinics based on Queensland's strong position against making any changes to assessments due to COVID-19.
- Furthermore, adjustments like this should have been incorporated at the time of the *Draft Report,* with any rationale for the change supported by thorough analysis, at the time that other related matters, including the COVID-19 expense assessment, were being considered.

7. Health investment – COVID-19 expenses

Commission staff proposal:

- The Commission will exclude COVID-19 expenses in the health component of the investment assessment.

Queensland position:

- Queensland **does not support** making any changes related to COVID-19 expenditure in either the expense or investment assessments.
- As has been demonstrated, COVID-19 spending reflects the different health and business support related policy positions of individual jurisdictions and the proposed changes to methods would conflict with the policy neutrality principle. Queensland considers that the non-intuitive impacts of the COVID-19 assessment on health investment are further clear demonstration of the perverse nature of the proposed APC assessment.

8. Housing – additional costs due to above average overcrowding

Commission staff proposal:

- The Commission will assess net expenses for social housing on an average household size based approach. This represents a pragmatic approach, which better reflects what states do while balancing the need to address the most significant problems with the 2020 Review method regarding differences in severe overcrowding between states.

Queensland position:

- Queensland **does not oppose** the Commission's proposed approach to better reflect what states do but remains concerned around adding complexity to assessment methods that do not have a significant impact on GST outcomes. It is noted that the proposed change will result in only a $2 GST per capita change across Australia.

9. Roads – rural roads to mines, gas wells, ports and national parks

Commission staff proposal:

- The Commission will retain the 2020 Review method for assessing rural road length, and include routes to mines, national parks, gas wells and ports.

Queensland position:

- Queensland **supports** the Commission's retention of the 2020 Review method for assessing rural road length, including routes to mines, national parks, gas wells and ports. These routes are necessarily maintained by states to support the delivery of essential state services.
- Queensland strongly **does not support** the Commission's proposal to introduce a 12.5 per cent discount for the roads assessment, which is not justified by appropriate evidence or analysis.
- Queensland **strongly recommends** the Commission reconsiders and removes the application of any discount to this assessment, with a view to a thorough review of the assessment in 2030 to ensure better data and methods.

10. Discounting – use across assessments

Commission staff proposal:

- The Commission will retain the 4 discounts from the 2020 Review at the same levels. New discounts will be applied for the whole of the roads assessment and for the NSS adjustments in the health assessment. The discount for the NSS adjustments is a change since the *Draft Report*.

Queensland position:

- Queensland **does not support** applying a 12.5 per cent discount to the roads assessment which appears unrelated to any specific methodological shortcoming. This is at odds with the Commission's typical approach to determining the appropriateness of discounts.
- Queensland **supports** a discount to the health non-state sector adjustments given the uncertainty around the NSS indicators and lack of quality data, as noted above. However, Queensland considers a 12.5 per cent discount to be inadequate. **Queensland strongly recommends that a discount of at least a 50 per cent is applied to the NSS adjustment.**

11. Welfare – alternative method for determining homeless spending

Commission staff proposal:

- The Commission will adopt the average of state spending method to classify data on homelessness spending from the Productivity Commission's Report on Government Services into the housing and welfare categories. This method is preferred because it removes the need for Commission judgement and the Productivity Commission collects the data using a consistent definition of homelessness services expenses across states.
- The component weights will be updated annually in response to the Commission's annual request for homelessness services spending to the states.

Queensland position:

- Queensland **does not oppose** the Commission's proposal but continues to hold concerns around some of the data challenges in assessing homelessness. This includes a lack of specific classifications within the GFS framework for classifying homelessness service spending as well as questions around the accuracy and appropriateness of using average state spending for non-reporting states.

12. Transport – allocation of V/line expenses

Commission staff proposal:

- The Commission will allocate 20.2 per cent of V/Line expenses to urban transport.
- The Commission will request total weighted patronage data from Queensland and New South Wales to determine if the 2020 Review method of allocating their regional train expenses between the components is suitable. This decision will be made in an update following the 2025 Review following the receipt of additional state data.

Queensland position:

- Queensland **does not support** the Commission's proposal. Increasing the allocation of V/Line expenses to urban transport will further exacerbate issues with the current assessment.
- Further, this allocation is inconsistent with the approach being taken on related elements of the assessment given the Commission continues to refuse to make appropriate adjustments to New South Wales' and Queensland's rail expenses to reallocate a significant proportion of expenses currently assessed as urban transport to non-urban transport.
- Queensland also notes that, in its *Significant Changes since the Draft Report* paper, the Commission has **misunderstood or misrepresented** a key argument outlined in Queensland's transport addendum submission. Queensland **did not suggest in any way** that any non-urban transport expenditure should be reallocated to urban transport.
- In contrast, it is clearly Queensland's view, as outlined in previous submissions, that a significant proportion of expenses assessed **urban** transport are rather more related to **non-urban** transport. As such, Queensland **recommended** that a significant proportion of Queensland's and New South Wales' urban transport should be assessed as non-urban transport; given that these services relate to transporting passengers between urban areas.

13. Geography – calculation of the general regional cost gradient

Commission staff proposal:

- Given limitations with the data, the Commission will not include the gradients calculated for water or electricity subsidies in the general regional cost gradient.
- It will calculate this gradient as the weighted average of gradients for: state funding of government schools; post-secondary education; admitted patients; emergency departments; non-admitted patients; criminal courts; prisons; Rawlinsons cost of construction.

Queensland position:

- Queensland **supports** the Commission's proposal, having previously noted in the *Draft Report* that the water subsidies definition includes communities in inner regional and outer regional areas. Therefore, to include this in the general regional cost gradient would dilute its impacts and result in perverse outcomes across a broad range of assessments.
- Similarly, the proposed cost weighting for remote community electricity subsidies (with a cost weight of 3 for very remote communities) is significantly lower than the general cost gradient and should also not be included.
- Queensland **recommends** that the Commission undertake **a comprehensive analysis of the complete extent of regional costs and reconsider cost weightings as part of a forward work program for the 2030 Review.**

Queensland
Government