

Administrative scale

Review outcomes

- No changes were made to the assessment method for administrative scale.
 - The Commission will continue with the 2020 Review estimate of administrative scale costs, indexed by the ABS estimate of the state and local government final consumption expenditure price index and adjusted for wage cost differences between states.
 - The prevalence of outsourcing and shared services does not require a change to the method for assessing administrative scale for the 2025 Review.
 - The assessment will continue to base wage costs on Commonwealth public sector salary levels and assume 60% of the administrative scale expenses are wage related.
- As part of the Commission’s forward work program, it will undertake a re-estimation and broader examination of administrative scale expenses and update the analysis underpinning the administrative scale assessment.

Introduction

- 1 On 6 July 2024, the Commission published the [Draft Report](#) for the 2025 Methodology Review.
- 2 The Draft Report included a detailed analysis and response to issues raised by states and territories (states) in their [submissions](#) on the Commission’s [consultation paper](#).
- 3 State submissions on the Draft Report can be viewed [here](#).
- 4 This chapter includes:
 - an overview of the issues considered throughout the review
 - the Commission’s response and decision on each issue.
- 5 A description of the assessment method can be found in the other expenses chapter of the *Commission’s Assessment Methodology*.

Issues considered

Continuation of the 2020 Review method

- 6 The administrative scale assessment recognises the conceptual case that there are fixed costs associated with running a state government that do not vary with

population size. These represent the minimum cost of establishing a state government administration.

- 7 The Commission proposed to continue with the 2020 Review estimate of administrative scale costs, indexed by the ABS estimate of the state and local government final consumption expenditure price index and adjusted for wage cost differences between states.

State views

- 8 Some states did not support the continuation of the 2020 Review assessment method. They said that the costs were overstated and do not represent the true minimum costs underlying the conceptual case of the assessment. Queensland said that the data and conceptual issues within the assessment warrant a discount of at least 12.5%.
- 9 Victoria said that other assessments, such as schools and health, already account for fixed costs. It said this means the application of the administrative scale adjustment imposes 'double counting issues' and that these costs should be netted out.
- 10 Victoria said that the design of stylised minimum staffing structures guided by administrative structures in smaller jurisdictions does not adequately capture average policy and allows for policy contamination. It argued for a strictly policy-neutral assessment.
- 11 Other states said there was no evidence suggesting that the minimum fixed costs of running state services had changed since the derivation of the costs in the 2020 Review. They supported the continuation of the 2020 Review method and said annual indexation would sufficiently maintain contemporaneity for the 2025 Review.

Commission response

- 12 In response to state views that the administrative scale expenses are overstated, the Commission accepts there is a level of uncertainty in the assessment. However, it is not aware of any systematic bias in the estimates. In the 2020 Review, the Commission undertook a comprehensive process, involving extensive data collection from states, to construct a hypothetical organisational chart reflecting minimum staffing structures for each state function. The Commission is not aware of evidence to suggest that the minimum fixed costs of running core state services have changed since the 2020 Review. Given that the Commission's assessment of the size of the administrative scale task incorporates all relevant, available information, it does not consider a discount is warranted.
- 13 The Commission notes that service delivery scale in specific assessments is distinct from the costs captured in this assessment. For example, service delivery scale in schools accounts for the recurrent fixed costs incurred in running individual schools and allows for the need to establish smaller schools for dispersed populations.

Administrative scale compensates small states for the fixed costs of establishing functions such as a department of education.

- 14 What smaller states do has a greater bearing on the calculation of the administrative task than what larger states do. The Commission does not consider that there are incentives for states to increase the size of certain central functions so as to increase their GST distribution.

Commission decision

- 15 In the absence of evidence indicating material changes since the comprehensive re-estimation of administrative scale costs for the 2020 Review, the Commission will not change the method for assessing administrative scale for the 2025 Review. The Commission will undertake a re-estimation and broader examination of administrative scale as part of its forward work program.

Centralisation

- 16 The Commission considered whether the potential for outsourcing and centralisation of corporate services has a bearing on the minimum administrative task.

State views

- 17 Some states said that the potential for cost reduction through outsourcing and shared service use is not properly accounted for. They said that if the stylised minimum staffing structures were built with regard to the potential for centralisation, the quantum would be reduced.

Commission response

- 18 In the 2020 Review, the Commission examined the prevalence of outsourcing and shared service use in each core head-office function in different states and factored that into the derivation of the quantum.
- 19 The Commission found that in all cases of shared servicing and outsourcing of corporate services, some staff and resources had to be retained to coordinate and manage those services. The amount of shared services required by an agency are largely proportional to the size of its task. The centralisation of human resources, information technology and other services may enhance the efficiency of a department in performing its functions at a significant scale.
- 20 The Commission considers it unlikely that the impact of centralisation on the fixed costs of providing corporate services has materially changed since it was examined in the 2020 Review.

Commission decision

- 21 The Commission considers the method for assessing administrative scale developed in the 2020 Review accounts for the prevalence of outsourcing and shared services and will continue to be applied in the 2025 Review.

Wage-related costs

- 22 The administrative scale assessment is calculated based on an assumed number of staff to perform a function, based on stylised minimum staffing structures. The average wage per employee is multiplied by the total number of staff to estimate the wage-related spend.
- 23 Wage costs are estimated as representing 60% of total costs. These costs are rescaled to account for the remaining 40% (non-wage costs, including accommodation and information technology).

State views

- 24 New South Wales and Victoria said that the Australian Public Service pays higher wages than state public services. Therefore, state public service salaries, rather than Australian public service salaries, should be applied to the Commission's estimated staffing numbers.
- 25 New South Wales said that a larger proportion of the total spend should be attributed to wages. It said in New South Wales, non-service delivery departments (focused on policy design and corporate functions) had approximately 80% of labour-related costs. The service-delivery departments had approximately 60% labour-related costs. Non-service delivery departments more closely align with the concept of administrative scale and the assumption of minimal service volume. It suggested that service volume drives non-wage costs and in the absence of population, costs of running core head-offices would be overwhelmingly labour driven.
- 26 Queensland also disputed the assumption that 60% of the costs are attributable to wages.

Commission response

- 27 In the 2020 Review, the Commission used Australian Public Service classifications and salaries, as there is no single state classification, and significant challenges in reliably identifying an average state classification. The Commission considers the 2020 Review approach is pragmatic and remains appropriate. Differences between the salaries paid to state and Commonwealth public servants to undertake comparable work are likely to be a minor issue in terms of the overall appropriateness of the assessment.

- 28 The Commission’s analysis indicates that about 60% of First Ministers’ department expenses were wage related. The Commission accepts that First Ministers’ departments alone do not validate its estimate on the wage proportion of expenses. However, in the absence of a systematic method of classifying departments’ relevance to administrative scale expenses, it considers the estimate of 60% to be reasonable.

Commission decision

- 29 The Commission will continue using Australian Public Service salary levels and retain the assumption that 60% of the administrative scale expenses are wage related.

Diseconomies of large scale

- 30 The administrative scale assessment is based on the principle of economies of scale. Larger states face lower per capita costs in administration than smaller states.
- 31 The urban transport assessment accounts for diseconomies of large scale in servicing major cities. The Commission does not otherwise account for broader diseconomies of scale or ‘congestion costs’.

State views

- 32 New South Wales and Victoria said that large states face costs associated with diseconomies of scale. They said that assessing unavoidable fixed costs but not assessing unavoidable costs associated with large populations is an asymmetrical approach favouring smaller states. Such costs are most likely associated with delivering services (rather than administration).
- 33 These states referred to academic literature measuring costs associated with diseconomies of scale, most notably the paper by Chan and Petchey (2024), which suggests that congestion is present and material in large states.¹ New South Wales and Victoria said that the findings in the paper warrant examining the impact of diseconomies of scale on state spending.
- 34 Victoria proposed that following further analysis into diseconomies of scale, the Commission should implement:
- an overarching assessment to capture the effects of congestion costs across all assessments, similar to the administrative scale assessment, or
 - an assessment-by-assessment approach, by adding a congestion driver to relevant categories, like the current approach for service delivery scale.

¹ F Chan and J Petchey, ‘[The Cost of Congestion for State and Local General Government Services in Australia](#)’, *The Australian Economic Review*, 2024, 57(3):1–21, doi:10.1111/1467-8462.12543. F. Chan and J. Petchey, [The Cost of Congestion for State and Local General Government Services in Australia](#), *The Australian Economic Review*, 2024, vol. 00, no. 00, pp. 1–21, DOI: [10.1111/1467-8462.12543](#).

- 35 New South Wales also said that due to the evidence of diseconomies of scale presented in the Chan and Petchey paper, a discount should be applied to administrative scale while the Commission investigates this potential driver.

Commission response

- 36 The Commission recognises that economies and diseconomies of scale can exist in service delivery.
- 37 For the provision of urban transport and roads, states provide a whole of city integrated service. Hence, the Commission recognises the impact of large and dense cities in the urban transport assessment. In urban roads, it tested for higher road maintenance costs in cities with greater traffic congestion, but found the effect was not material. It is not aware of evidence for a diseconomies of scale driver systemically across other categories.
- 38 The Commission welcomes discussions with states about the potential impact of congestion on expense assessments (as per urban transport) and the potential to incorporate this in its assessments. It does not consider the administrative scale assessment to be the appropriate place to account for such costs.

Commission decision

- 39 The Commission will not make any adjustment to the administrative scale assessment for diseconomies of large scale or congestion, but will discuss with states the potential impact of a diseconomies of scale driver for individual expense assessments.

GST impacts of method changes

- 40 There are no method changes to this assessment.