Australian Government
Commonwealth Grants Commission

2025 Methodology Review

Review Outcomes

March 2025

Acknowledgement of Country

The Commonwealth Grants Commission acknowledges the Traditional Owners of Country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to Elders both past and present.

Copyright

ISBN: 978-0-6485912-7-6

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are detailed on the Department of the Prime Minister and Cabinet website at www.pmc.gov.au/government/commonwealth-coat-arms.

Attribution

The recommended attribution for this document is Commonwealth Grants Commission, *2025 Methodology Review - Review Outcomes*.

Contact us

Inquiries regarding the licence and any use of this document should be directed to:

Secretary
Commonwealth Grants Commission
73 Northbourne Avenue
CANBERRA ACT 2601
Telephone (02) 6218 5700
Email secretary@cgc.gov.au

Internet

A copy of this report can be obtained from the Commission's website www.cgc.gov.au.

Glossary

A glossary is available from the Commission's website www.cgc.gov.au/publications/glossary.

Quality Assurance Framework

The Commission's Quality Assurance Framework is available on the Commission's website www.cgc.gov.au/publications/quality-assurance-framework.

TABLE OF CONTENTS

Letter of transmittal

Australian Government

Commonwealth Grants Commission

Chairperson
73 Northbourne Avenue
CANBERRA ACT 2601

Telephone: 02 6218 5700
Mike.Callaghan@cgc.gov.au
https://cgc.gov.au

28 February 2025

The Hon Dr Jim Chalmers MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

As Members of the Commonwealth Grants Commission appointed under the *Commonwealth Grants Commission Act 1973*, and in response to the terms of reference provided by you, we are pleased to provide you with the outcomes of the Commission's 2025 Methodology Review. This comprises the *Review Outcomes* and the Commission's recommended *GST Relativities 2025-26*. Accompanying these documents is the *Commission's Assessment Methodology* containing a comprehensive description of the methods used by the Commission to assess state fiscal capacities, incorporating the changes from the 2025 Review.

The terms of reference asked the Commission to consider the case for the flexibility to consider alternative assessment methods between methodology reviews where there is a significant unanticipated shock, such as a pandemic, or where major policy reforms are enacted. After consulting the states and territories, the Commission considers that it would be beneficial for it to have additional flexibility to consider alternative methods between reviews in very limited circumstances. Additional detail on the issues raised by states on this matter, and the Commission's responses, can be found in the relevant chapter of *Review Outcomes*.

In accordance with the terms of reference, we will be providing the 2025 Review documents to the states and territories under embargo on 28 February 2025. The documents will remain under embargo until they are published on the Commission's website (www.cgc.gov.au) on Friday 14 March 2025.

Yours sincerely

Mike Callaghan AM PSM
Chairperson

Dr L S Williams AM Member	Dr A Jackson Member	Prof A Tiernan Member

Acknowledgements

The Commission appreciates the co-operation extended to the Commission and its staff during this review by staff of the Commonwealth Treasury, state and territory treasuries and other agencies.

The Commission greatly appreciates the dedication and commitment of its staff, and thanks them for their extensive work in undertaking the 2025 Methodology Review.

Terms of reference

The Commission received terms of reference requiring it to review the methods used to calculate the relativities for distributing Goods and Services Tax (GST) revenue among the states and territories to apply from 2025-26.

List of acronyms

AASB	Australian Accounting Standard Board
ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
AIHW	Australian Institute of Health Welfare
ARIA+	Accessibility/Remoteness Index of Australia Plus
CGC	Commonwealth Grants Commission
COFOG	Classification of Function of Governments
COFOG-A	Classification of Function of Governments - Australia
EPC	Equal per capita
GFS	Government Finance Statistics
GP	General practitioner
GST	Goods and Services Tax
IRSEO	Indigenous Relative Socioeconomic Outcomes Index
NDIS	National Disability Insurance Scheme
NISEIFA	Non-indigenous Socio-Economic Index for Areas
pc	Per capita
PLIDA	Person Level Integrated Data Asset
R2020	2020 Methodology Review
R2025	2025 Methodology Review
SA1 / SA2	Statistical Area Level 1 / Statistical Area Level 2
SEIFA	Socio-Economic Indexes for Areas
U2024	2024 Update

Notes

State(s): Unless the context indicates otherwise, the term ‘state(s)’ includes the ACT and the Northern Territory.

n/a: Unless indicated otherwise, n/a refers to not applicable.

Introduction

On 9 February 2023, the Commission received terms of reference requiring it to review the methods used to calculate the relativities for distributing GST revenue among the states and territories (states), to apply from 2025–26.

The 2025 Methodology Review provided the opportunity for the Commission to ensure that the assessment methods and supporting principles it uses in developing recommendations on GST distribution are appropriate and use the latest fit-for-purpose data.

Review Outcomes includes a chapter for each assessment category the Commission uses to assess states' relative fiscal capacities, covering the Commission's final position on the issues considered in the review. It also includes chapters for the geography, socio-economic status and wage costs drivers, which apply across a number of assessment categories.

Each chapter contains:

- an overview of the issues considered in the review
- a summary of state views raised in the consultation process and the Commission's response
- the Commission's decision on each issue
- the GST impacts of method changes and the basis for their calculation, where applicable.

There are also chapters on:

- the Commission's approach to horizontal fiscal equalisation, supporting principles and assessment guidelines
- flexibility to consider method changes between reviews.

In line with the terms of reference, the 2025 Review provides the Commission's recommendations on GST relativities for 2025-26, which incorporate assessment method changes from the review.

Commission's Assessment Methodology contains a description of the methods used by the Commission, following the 2025 Review, to assess state relative fiscal capacities.

The review was undertaken using a staged approach and involved extensive consultation with the states.

Approach and work program

The Commission issued a discussion paper on the proposed approach and work program on 14 February 2023 and invited state submissions. Following consideration of state views, the Commission released its position on the approach and work program for the review on 21 April 2023.

Fiscal equalisation, supporting principles and assessment guidelines

On 21 April 2023, the Commission issued a consultation paper on fiscal equalisation, supporting principles and assessment guidelines for the 2025 Review and invited state submissions.

On 9 June 2023, the Commission released its position on fiscal equalisation, supporting principles and assessment guidelines. This provided guidance for the Commission's review of its assessment methods.

The Commission decided to retain the approach to horizontal fiscal equalisation articulated in the 2020 Review as the first step in determining GST distributions in accordance with the GST distribution legislation.[1]

The Commission identifies influences, referred to as 'drivers', beyond the direct control of states that cause their relative fiscal capacities to diverge. By assessing these influences, the Commission seeks to estimate the GST share each state requires to have the fiscal capacity to provide a comparable level of services if it makes the average effort to raise revenue. The Commission has developed 4 supporting principles to guide it in designing and evaluating assessment methods. The supporting principles, which are subsidiary to the objective of horizontal fiscal equalisation, are: 'what states do', policy neutrality, practicality, and contemporaneity. The Commission has also developed assessment guidelines to support a consistent approach to developing and applying assessment methods.

In its position paper, the Commission concluded that this set of supporting principles and assessment guidelines remained appropriate. The Commission recognises that trade-offs between principles may be necessary, and judgements are often required in their application.

Review Outcomes contains a chapter outlining the Commission's consultation with the states on fiscal equalisation, supporting principles and assessment guidelines. *Commission's Assessment Methodology* contains a chapter outlining its approach to fiscal equalisation, supporting principles and assessment guidelines.

Consultation

The Commission sought to ensure all states had sufficient opportunity to engage with the review. This was to enable them to convey their views comprehensively and to understand the basis for the Commission's decisions.

A major part of the consultation arrangements with the states on assessment methods and data sources involved the Commission releasing Tranche 1 and Tranche 2 consultation papers which included the Commission's preliminary position on possible changes to assessment methods. The Commission invited and received submissions for both Tranche 1 and Tranche 2 consultations papers.

The Commission visited each state in late 2023 and early 2024 and held online bilateral and multilateral meetings with states in the development of the Draft Report. Numerous discussions were held between states and Commission staff during the review.

The detailed steps and timeline for the review's consultation arrangements are outlined in Figure 1.

Draft Report

The 2025 Methodology Review Draft Report was released in July 2024. The report provided a detailed analysis and the Commission's response to issues raised by the states in their submissions to the Commission's consultation papers, along with the Commission's draft positions on each issue. Following the Draft Report, the Commission released addendums to the transport and mining chapters. The Commission invited and received state comments on the Draft Report and addendums.

[1] *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018 (Cth).*

Significant changes since the Draft Report

Consistent with the terms of reference, the Commission issued a paper in November 2024 outlining significant changes in its positions since the Draft Report. These changes resulted from state comments on the Draft Report and the availability of new data. The Commission received state comments on the paper.

Flexibility to consider method changes between reviews

The terms of reference for the 2025 Review asked the Commission to:

> Consider if there is a case for the Commission to be given the flexibility to consider alternative methods in cases where there is a significant unanticipated shock (such as pandemic) or where major policy reforms are enacted in between reviews.

In August and September 2023, the Commission held a bilateral meeting with each state, seeking views on relevant issues to be included in a consultation paper on this topic. The Commission used the consultation paper and the Draft Report to consult further with states on this matter. It received submissions to the consultation paper and submissions to the Draft Report.

The Commission's response to state comments and its decision on the issues are outlined in the flexibility to consider method changes between reviews chapter of *Review Outcomes*.

GST Relativities 2025–26: New Issues

In advance of preparing its recommendations for the GST relativities for 2025–26, the Commission issued a discussion paper in October 2024 on relevant new issues and Commonwealth payments, including the implications of some of the method changes proposed in the 2025 Review. The Commission sought the views of the Commonwealth and states.

Figure 1: Consultation steps and timeline

The 2025 Methodology Review was undertaken over 2 years. It involved several rounds of formal consultation with the states across a range of topics, as well as ongoing informal dialogue.

9 February 2023

2025 Methodology Review

The Commission received terms of reference to review the methods used to calculate the relativities for distributing the GST and to recommend the per capita relativities for distributing GST revenue among the states in 2025–26.

14 February 2023

Approach and work program

The Commission issued a discussion paper on the approach and work program and invited state submissions.

21 April 2023

Fiscal equalisation, supporting principles and guidelines

The Commission released a consultation paper on fiscal equalisation, supporting principles and assessment guidelines.

Approach and work program

The Commission released its position on the approach and work program.

9 June 2023

Fiscal equalisation, supporting principles and guidelines

The Commission released its position on fiscal equalisation, supporting principles and assessment guidelines.

June 2023

Tranche 1 consultation papers

The Commission released a series of consultation papers and invited state submissions.

August and September 2023

Flexibility to consider method changes between reviews

The Commission held a bilateral meeting with each state.

October 2023

Tranche 2 consultation papers

The Commission released a series of consultation papers and invited state submissions.

19 October 2023

Flexibility to consider method changes between reviews

The Commission issued a paper on the flexibility to consider method changes between reviews and invited state submissions.

5 July 2024

Draft Report

Consultation to date formed the basis of the Draft Report where the Commission responded to state submissions, outlined its draft position on its assessment methods and invited further submissions.

10 October 2024

GST Relativities 2025-26: New Issues

The Commission released a discussion paper on new issues and Commonwealth payments impacting the GST relativities for 2025–26 and invited state submissions.

15 November 2024

Significant changes since the Draft Report

The Commission updated the states on changes since the release of the Draft Report.

14 March 2025

2025 Methodology Review

The Commission released the outcomes of the review and the GST relativities for 2025–26.

Part A

Revenue Assessments

1. Payroll tax

Review outcomes

- No changes were made to the assessment.
- Payroll tax surcharges will continue to be assessed in the payroll tax category.
- The Commission considered the potential for using data from the ABS Business Longitudinal Analysis Data Environment datasets to improve the assessment. The data could not be reliably disaggregated by state, which means it is not fit for the Commission's purpose. The Commission also explored the feasibility of an assessment using data from the ABS Person Level Integrated Data Asset. Neither the Business Longitudinal Analysis Data Environment nor Person Level Integrated Data Asset datasets can support a timely and reliable assessment in their current form.
- The Commission will continue to monitor the potential for data from the Business Longitudinal Analysis Data Environment and the ABS Person Level Integrated Data Asset to be used in the payroll tax assessment but will not introduce any changes before the next review. It will also monitor developments in the ABS's use of Single Touch Payroll data.

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 payroll tax chapter of the *Commission's Assessment Methodology*.

Issues considered

Assessment of payroll tax surcharges

6 The Commission considered the treatment of payroll tax surcharges imposed by 2 states on businesses with large payrolls. Victoria introduced a mental health and wellbeing surcharge from 1 January 2022. It also introduced a COVID-19 temporary

debt payroll tax surcharge, which will apply for 10 years from 1 July 2023. Queensland introduced a mental health levy from 1 January 2023.

State views

7 All states supported assessing revenue from payroll tax surcharges on the same basis as payroll tax. Queensland said there is a relevant nexus between payroll tax surcharges and payroll tax, given those surcharges are levied on taxable wages paid by an employer.

Commission response

8 Payroll tax surcharges are raised under states' payroll tax legislation and are collected on the same basis as payroll tax. Liability is calculated using the same scope of taxable remuneration as payroll tax, but with higher thresholds. The Commission considers the surcharges to be sufficiently similar in nature to payroll tax for the revenue raised to be assessed using its measure of payroll tax capacity. Including revenue from the surcharges in the assessment increases the average tax rate that is applied to each state's revenue base. This is consistent with the treatment of foreign owner surcharges in the land tax and stamp duty on conveyances assessments.

Commission decision

9 The Commission will assess revenue from payroll tax surcharges on the same basis as payroll tax.[1]

Retaining the 2020 Review methodology and data sources

10 The Commission considered the potential for using data from the ABS Business Longitudinal Analysis Data Environment to improve the payroll tax assessment. The Business Longitudinal Analysis Data Environment includes Australian Taxation Office data for all active businesses since 2001–02. These data are more comprehensive than the survey-based data used in the assessment.

11 The Commission engaged the ABS to examine the feasibility of replacing the data used in the assessment with data from the Business Longitudinal Analysis Data Environment. Specifically, the ABS advised on the scope and timeliness of various Business Longitudinal Analysis Data Environment datasets and whether they could be used to exclude remuneration below the average threshold and remuneration paid by the general government sector. Business Activity Statement data were the best candidate when considering both scope and timeliness. However, Business Activity Statement data for multi-state businesses could not be reliably disaggregated by state. The Commission concluded Business Longitudinal Analysis Data Environment data were not fit for purpose in their current form.

[1] Revenue from Victoria's mental health surcharge was assessed in the payroll tax assessment in the 2023 and 2024 Updates.

12 The Commission tested the feasibility of an assessment approach using the ABS Person Level Integrated Data Asset. It concluded that Person Level Integrated Data Asset data alone would not support a timely and reliable assessment. While an approach using Person Level Integrated Data Asset data may have potential in the future, particularly when linked with Business Longitudinal Analysis Data Environment data, this approach will require significant further research and consultation.

13 The Commission proposed retaining the 2020 Review payroll tax assessment method.

State views

14 All states supported retaining the 2020 Review assessment method. All states supported the Commission continuing to investigate the feasibility of an assessment using data from Business Longitudinal Analysis Data Environment and/or Person Level Integrated Data Asset datasets. Most states said any changes should not be implemented until the next review.

Commission response

15 The Commission considers the 2020 Review assessment method reliably captures states' relative capacities to raise payroll tax. The data used in the assessment are fit for purpose and the best available at this time.

16 The ABS will continue to develop the Business Longitudinal Analysis Data Environment and Person Level Integrated Data Asset datasets. The Commission will monitor those developments and their potential for improving the payroll tax assessment. If the datasets reach a level of maturity where they could support an improved assessment method, the Commission will consider commencing consultation with states ahead of the next review. However, it will not introduce new methods prior to the next review.

17 Separately, the Commission will monitor developments in the ABS's use of Single Touch Payroll data from the Australian Taxation Office. From 2022–23, the ABS moved to Single Touch Payroll as its method of collecting the public sector wages and salaries data used by the Commission. The ABS says it is actively pursuing opportunities to augment or replace direct collection from employers.

Commission decision

18 The Commission will retain the 2020 Review payroll tax assessment method.

19 The Commission will monitor the potential for Business Longitudinal Analysis Data Environment and Person Level Integrated Data Asset datasets to be used in the payroll tax assessment and will commence consultation with states if those data reach sufficient maturity. It will not implement any method changes before the next review. The Commission will also monitor the ABS's use of Single Touch Payroll data.

GST impacts of method changes

20 There are no method changes to this assessment.

2. Land tax

Review outcomes

- The following changes were made to the assessment.
  - The Northern Territory's estimate of land values will be distributed across value ranges using the average distribution of South Australia, Tasmania and the ACT instead of the average distribution of all states. This more closely reflects the distribution of Northern Territory land values than the national average.
  - The adjustment to the ACT's land values to recognise it does not aggregate land holdings in applying land tax will be discontinued on materiality grounds.
- The Commission considered but did not change the following.
  - A 12.5% discount will be retained because there remains a degree of uncertainty as to the accuracy of the adjustments made by states to improve the comparability of their land values data. The discount will not be increased as the evidence does not suggest a deterioration in the quality of state land values data.
  - The number of value ranges will be retained because a further split is not expected to make a material difference to the assessment and would require the collection of additional data from the states.
  - Foreign owner land tax surcharges will continue to be assessed in the land tax assessment.
  - Victoria's COVID-19 debt recovery surcharge will be assessed in the land tax assessment.
- As part of the Commission's forward work program, it will consider how the complexities and uncertainties associated with implementing elasticity adjustments in revenue assessments, including land tax, might potentially be addressed in preparation for the next review.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the land tax chapter of the *Commission's Assessment Methodology*.

Issues considered

Data quality and appropriateness of the low (12.5%) discount

6 In response to state comments, the Commission considered the case for a discount to the land tax assessment and its appropriate level. The 2020 Review applied a low (12.5%) discount to recognise concerns with the comparability of the state revenue office land value data. This was a reduction from the 25% applied in the 2015 Review, to recognise improvements in data quality, particularly Queensland's ability to update its land value data across value ranges annually.

State views

7 Some states were supportive of the Commission's proposal to retain the 12.5% discount and some states said it should be removed. Two states said it should be increased to 25%.

8 New South Wales said, while the data had not deteriorated since the 2020 Review, the decision to reduce the discount in the 2020 Review was not justified based on the quality of the data. It said the Commission should reverse the 2020 Review decision and apply a medium (25%) discount in the 2025 Review.

9 In support of its case, New South Wales compared relative growth in Australian Bureau of Statistics (ABS) land values data with the change in the Commission's value distribution adjustment.[1] It said the value distribution adjustment should not remain stable, but instead reflect the changes in states' relative land price growth. It said its analysis inferred state revenue office data understate land price growth in Victoria and Queensland and overstate land price growth in New South Wales and South Australia. New South Wales said it is incumbent on the Commission to verify the integrity of the data in circumstances where the movement in tax revenues does not align with the movement in land values.

10 New South Wales said the percentage variations between states' shares of ABS land values and state provided land values are significant and would have a very large impact on the distribution of GST. It said, on a year-by-year basis, the variations between 2018–19 and 2022–23 suggested significant data anomalies that warrant further investigation.

[1] The Commission's value distribution adjustment recognises the difference in assessed revenue capacity when considering the overall national average tax rate and the national tax rate in each value range. Because states impose higher rates of tax to higher-valued properties, a bigger value distribution adjustment recognises a greater share of values in the higher ranges.

11 In its tranche 1 submission, Victoria supported the continuation of the discount at 12.5%. In its submission on the Draft Report, it said the discount should be increased to 25%, on the basis that the relationship between assessed revenue and actual revenue for the 7 states that impose land tax had become more volatile since the 2020 Review.

12 Queensland said New South Wales made significant unsubstantiated claims in its tranche 1 submission. Queensland said the comparability of the data is likely to have increased since the 2020 Review as state revenue offices have become more practised in making the adjustments aimed at improving comparability.

13 Queensland said state taxable land values and ABS land values were expected to grow at significantly different rates because they were not comparable. It said revenue growth was affected by the frequency of land parcel revaluation and the impact of 3-year averaging in Queensland. Therefore, land tax revenue growth in an individual year was not fully comparable to total taxable land value growth. Queensland also said the New South Wales analysis exacerbated the comparability issues because it used COVID-19 affected years.

Commission response

14 The Commission has undertaken a range of analysis to test the quality of the state revenue office data. The principal alternative source of data on land values is ABS national accounts, albeit with some differences between the 2 collections. The Commission compared growth in state-provided land values to growth in ABS land values (adjusted to remove principal places of residence) since 2005–06. While there was volatility in some years, the 2 data sources showed broadly comparable growth in state land values over the period.

15 New South Wales said averaging states' shares of taxable land values across years can obscure some detail. However, the Commission observes that states' shares in the ABS data and the state revenue office data have been broadly consistent across individual years since 2010–11. Differences between the 2 data sources mean they will not be perfectly correlated over time. These include differences in scope (the ABS data include the value of government owned land and exclude vacant land) and method of compilation.[2] The method for removing principal places of residence from the ABS data, using a census-based estimate, is also less accurate than the state revenue office data.

16 New South Wales analysed the concordance between changes in the Commission's value distribution adjustment and adjusted ABS land values. It said states with above average growth in ABS land values would be expected to have a relatively faster increase in their value distribution adjustment. The Commission has replicated the

[2] State revenue office data are based on valuations by state valuers-general. The ABS models residential land values using the total value of dwellings then removing the improved value of dwellings. Total value of dwellings is calculated using the average sale price of dwellings in the reference period multiplied by the number of dwellings counted in the Census. The improved value of dwellings is modelled using the Perpetual Inventory Model.

New South Wales analysis for rolling 5-year intervals since 2010–11. The relationship between the relative change in ABS data and in the value distribution has strengthened over that period.

17 New South Wales said the Commission should verify data integrity where the movement in tax revenues does not align with the movement in land values. The Commission seeks data quality information with its state data requests and routinely follows up with states on any data anomalies. The Commission has the following observations on New South Wales' comparison of growth in revenue and land values:

- Queensland's comment that differences in states' valuation practices mean the revenue raised will not always align with the land values data provided to the Commission (adjusted to better reflect average policy) is relevant.
- Growth in revenue will reflect changes in states tax rates. It can also reflect administrative issues with revenue collection. For example, New South Wales said its data for 2020–21 incorrectly included revenue that was not accrued in that year and was subsequently reversed.
- New South Wales' analysis used years that were impacted by the COVID-19 pandemic and associated state responses to the pandemic. Some states offered tax rebates or deferrals in 2021–22. Payment of deferred liabilities (or the cessation of rebates) may have inflated the subsequent revenue growth in 2022–23.

18 The Commission considers state revenue office data on the value of taxable land holdings remain the best data for determining states' capacities to raise land tax. Those data capture the average policy to impose land tax on the combined value of a landowner's taxable land holdings (aggregation) and the common exemption for principal place of residence.

19 The Commission recognises those data can be affected by state tax policies that differ from the average. It asks states to make several adjustments to make the data more comparable, including a common date of valuation, consistent treatment of land holdings of joint owners (and of related companies) and exclusion of commonly exempt types of land. It also assesses equal per capita the revenue raised from taxable land holdings below $300,000, since states' land holdings data can be less reliable below their own tax-free thresholds.

20 The Commission has not identified evidence to indicate data quality has significantly deteriorated since the 2020 Review that would warrant an increase in the discount. However, it considers that a 12.5% discount is justified given the degree of uncertainty as to the accuracy of the adjustments made by states to improve the comparability of the land values data.

Commission decision

21 The Commission will retain the discount of 12.5%.

Value ranges

22 In response to state comments, the Commission considered the number, and size, of value ranges in the assessment. In the 2020 Review, the Commission split the highest value range ($3 million plus) into 3 separate ranges. The Commission disaggregated the value of taxable land holdings into these 17 value ranges to account for the progressivity of state land tax rates.

State views

23 Most states either supported or did not oppose retaining the size and number of value ranges. South Australia said the Commission should increase the number of value ranges in the higher ranges to account for recent growth in land values. Queensland said the Commission should review these ranges as part of its forward work program to ensure they are appropriately capturing differences between states on an ongoing basis.

Commission response

24 While average land values have increased in recent years, the split made in the 2020 Review did not make a material difference to the assessment in the 2024 Update. Any further split is not expected to make a material difference to GST distribution but would require the Commission to collect new data to test whether this is the case. Additionally, the choice and number of value ranges was made to ensure the assessment continues to capture the progressivity of land tax in updates until the next review without the need to change those ranges if states change their tax scales. Frequent change of value ranges would make data extraction more difficult for state data providers, without making a material difference to the assessment.

Commission decision

25 The Commission will retain the disaggregation of 17 value ranges.

Elasticity adjustments

26 The Commission considered the case for elasticity adjustments in its revenue assessments, including the land tax assessment. Elasticity adjustments would recognise that a state's tax rate can affect the size of the relevant tax base. A state with an above-average tax rate may have a smaller observed revenue base than if it were to apply the average tax rate, and vice versa. In theory, if the elasticity effects on an observed revenue base could be reliably measured and were material, applying an elasticity adjustment would improve the policy neutrality of the assessment.

27 A more detailed discussion on elasticity adjustments can be found in the stamp duty on conveyances chapter of *Review Outcomes*.

State views

28 Most states supported not introducing an elasticity adjustment in the land tax assessment.

29 New South Wales said the Commission should incorporate an elasticity adjustment into the land tax assessment, as well as more broadly. It said the estimate produced by the Commission's consultants in the 2020 Review did not reflect that land tax is imposed progressively and only on a subset of properties. New South Wales provided analysis as evidence that an adjustment would be highly material. It said that, because the Commission does not have individual estimates for each range, an adjustment should only be applied to land values over $5 million.

30 The ACT said that where there is a material impact, an elasticity adjustment should be made. It did not specify the land tax assessment as an assessment that would benefit from an elasticity adjustment.

Commission response

31 The Commission retested the materiality of applying the elasticity adjustment provided by the consultant to the 2020 Review to taxable land values. The adjustment was not material at the $12 per capita data adjustment threshold. The Commission notes the issues raised by New South Wales regarding the subset of properties liable for land tax.

32 There are significant complexities and uncertainties involved in implementing an elasticity adjustment, and these need to be resolved before an elasticity adjustment could be reliably introduced in any revenue assessment. Further discussion of the issues involved in implementing elasticity adjustments can be found in the chapter on stamp duty on conveyances of *Review Outcomes*.

Commission decision

33 The Commission will not introduce an elasticity adjustment in the land tax assessment. The Commission's forward work program will consider how the complexities and uncertainties associated with implementing elasticity adjustments in revenue assessments, including land tax, might potentially be addressed in preparation for the next review.

Adjustment to the ACT's land value to recognise it does not aggregate land holdings

34 In response to state comments, the Commission considered the appropriateness and level of the adjustment to the ACT's land values to recognise it does not aggregate land holdings when applying land tax. Most states aggregate multiple land holdings of land holders when applying land tax, which moves the taxpayer's land holdings into a higher value range (subject to a higher rate of tax). In the 2020 Review, the

Commission decided to increase the ACT's total land values by 6% based on the ACT's estimate of the effect of aggregation on its revenue.

35 The ACT provided updated analysis that demonstrated its revenue would increase by 5.2% if it aggregated its land holdings in 2023–24. Based on that analysis, the adjustment was no longer material and the Commission proposed discontinuing it.

State views

36 New South Wales said that the effect of aggregation on its land tax revenue was 33%. While it recognised this did not reflect the exact experience of the ACT, it suggested the ACT's effect would be much larger than 6%. It did not oppose the adjustment being discontinued on materiality grounds.

37 Queensland, Western Australia and the ACT supported the Commission's proposal to discontinue the adjustment on materiality grounds. The ACT said removing the adjustment appropriately reflects the ACT's land tax regime which applies a fixed charge.

38 South Australia opposed the discontinuation of the adjustment. It said that aggregation accounted for around one third of South Australia's private land tax revenue in 2016–17, which was similar to the estimate provided by New South Wales. While it noted the ACT is likely to have a lower effect, it said aggregation was an important factor in most states' land tax regimes and the impact should be reflected in the assessment regardless of materiality.

Commission response

39 The Commission accepts the ACT's analysis that the effect of aggregation on its land tax revenue would be 5.2%. While it is lower than New South Wales' estimate, the figure reflects the particular circumstances of the ACT.

40 Land tax in the ACT includes both a variable component, similar to the other states, and a fixed charge. If properties were aggregated in the ACT, the revenue from the variable component would increase, as aggregated properties would be moved into higher tax brackets. If the fixed charge continued to be applied to each property, the total revenue from the fixed charge would not change. Relative to other states, the revenue from the fixed charge represents a large proportion of the ACT's land tax revenue. Therefore, aggregation is likely to have a smaller effect on land tax revenue in the ACT than in other states.

41 In addition, the ACT's land tax rates are above the national average for lower land values but below the national average for higher land values. This is likely to reduce the effect of aggregation in the ACT compared with other states.

42 Using the 2025 Review data adjustment materiality threshold, adjusting the ACT's land values by 5.2% would not have made a material difference in any year since the 2020 Review. The Commission does not expect an adjustment of this size to make a material change in the short to medium term.

Commission decision

43 The Commission will discontinue the adjustment to the ACT's taxable land holdings on materiality grounds.

Estimating the Northern Territory's tax base

44 The Northern Territory does not impose land tax and is unable to provide taxable land values. The Commission estimates the Northern Territory's values by applying its share of adjusted ABS land values to the taxable land values of the other states. The adjustment is updated annually.

45 For the 2024 Update, the Commission estimated the Northern Territory's share of taxable land values as 0.6% of the total land values provided by the other 7 states. It applied its estimate to states' taxable land values after adjusting for the progressivity of their tax rates. This approach implied the Northern Territory had the national average distribution of land values by value range.

State views

46 The Northern Territory said that 2020 Review methods overstated its assessed revenue. It said its distribution of land values across the value ranges more closely matched the distribution of the smaller states than the average distribution. It said the Commission should distribute its land values using the average distribution of South Australia, Tasmania and the ACT.

47 The Northern Territory provided the following supporting evidence.

- Darwin has the lowest median house price of any capital city and should not be expected to have a similar land value distribution to the major metropolitan centres.
- The Northern Territory's assessed stamp duty base is, on average, the lowest per capita, of all states.
- According to Valuer-General data, the Northern Territory has only 7% of its overall property values above $10 million, compared to 14% nationally and 5% in the smaller states. It also has 42% of its land values in properties below $300,000, compared to 15% nationally and 30% in the smaller states.

48 No state opposed the Northern Territory's proposed approach.

Commission response

49 The Commission agrees that the Northern Territory's distribution of land values is more likely to reflect the average distribution of the smaller states than the national average distribution.

Commission decision

50 The Commission will distribute the Northern Territory's estimated land values across the value ranges using the average distribution of South Australia, Tasmania and the ACT.

Land tax surcharges

51 In response to state comments, the Commission considered the appropriateness of including revenue from foreign owner land tax surcharges and Victoria's COVID-19 debt recovery surcharge in the land tax assessment.

52 All states that impose land tax have a foreign owner surcharge or equivalent.[3] Some states increased the surcharge after the 2020 Review.[4] In the 2020 Review, the Commission decided not to separately assess the revenue from foreign owner surcharges on materiality and practicality grounds. A separate assessment would have required state data on the value of foreign owned land by value range, increasing the complexity of the land tax assessment. Published data on the revenue raised from these surcharges suggested a separate assessment would not have been material. Instead, the Commission assessed the surcharges using its land tax revenue base.

53 Victoria introduced a COVID-19 debt recovery surcharge on land tax from 1 January 2024.

State views

54 South Australia said the increases to some states' foreign owner land tax surcharges and the introduction of Victoria's COVID-19 debt recovery surcharge did not require a change to the assessment method. It said Victoria's COVID-19 surcharge appeared to be an increase in the land tax rate and should be treated as additional land tax revenue.

55 Western Australia said the foreign owner surcharge revenue base is different from the land tax revenue base. It said the Commission should assess these revenues separately if material.

Commission response

56 Separately assessing the revenue from foreign owner surcharges is unlikely to produce a materially different assessment. The Commission considers assessing that revenue using the value of taxable land remains appropriate. It considers assessing Victoria's COVID-19 debt recovery surcharge using the value of taxable land is appropriate as it is levied on Victoria's land tax base.

Commission decision

57 The Commission will:

- continue to assess states' foreign owner land tax surcharges in the land tax assessment using the value of taxable land holdings
- assess Victoria's COVID-19 debt recovery surcharge in the land tax assessment using the value of taxable land holdings.

[3] Tasmania introduced a foreign investor land tax surcharge of 2% from 1 July 2022.

[4] New South Wales increased its foreign owner surcharge from 2% to 4% from 1 January 2023.

GST impacts of method changes

58 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, land tax, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
$m	-22	-14	-4	-3	-1	0	4	39	43
$pc	-3	-2	-1	-1	0	0	9	151	2

59 The largest impact on GST distribution was from the change to estimating the Northern Territory's tax base. Allocating its estimated tax base across the value ranges based on the average distribution of South Australia, Tasmania and the ACT increased its assessed GST needs.

60 The ACT's assessed GST needs were also slightly increased by the removal of the adjustment to its land values.

3. Stamp duty on conveyances

Review outcomes

- The Commission considered the following, but no changes were made to the assessment.
  - Revenue from the New South Wales property tax will continue to be assessed with land tax since the scheme is closed and a separate assessment is unlikely to become material. An adjustment will not be made to the value of property transactions in New South Wales because the property tax is unlikely to have materially affected the total value of properties transferred.
  - A separate assessment will not be introduced for Victoria's commercial and industrial property tax since it will not raise revenue until 2034–35. An adjustment will not be made to Victoria's value of property transactions for the reform, but the Commission will continue to monitor for potential elasticity effects after the tax is introduced.
  - There will continue to be no elasticity adjustment for the ACT's stamp duty on conveyances reform as the Commission has not identified a significant elasticity effect flowing from the reform.
  - More broadly, elasticity adjustments will not be introduced in revenue assessments in the 2025 Review, including stamp duty on conveyances. The Commission will consider, in consultation with the states, how the significant complexities and uncertainties associated with the implementation of elasticity adjustments might potentially be addressed as part of its forward work program for the next review.
  - The number of value ranges will be retained because a further split is not expected to make a material difference to the assessment.
  - Revenue from duty on non-real property will continue to be assessed equal per capita in the other revenue category.

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 stamp duty on conveyances chapter of the *Commission's Assessment Methodology*.

Issues considered

New South Wales' property tax revenue

6 From 16 January 2022, New South Wales introduced the First Home Buyer Choice, a scheme that allowed first home buyers to choose to pay an annual property tax instead of stamp duty.[1] The scheme was open to first home buyers who purchased a property valued up to $1.5 million or who purchased vacant land not exceeding $0.8 million in value.

7 New South Wales closed the scheme to new applicants from 1 July 2023. First home buyers who signed contracts before 1 July 2023 and opted-in to the scheme have been 'grandfathered' and will continue to pay the annual property tax until they sell their property. New South Wales raised $2 million in revenue from its property tax in 2022–23 and estimates it will raise $55 million over the 5 years to 2027–28.[2]

8 The ABS Government Finance Statistics classifies revenue from the property tax as land tax. The Commission proposed continuing to assess the revenue from the property tax in the land tax category.

State views

9 Most states supported the proposal to assess the revenue from the New South Wales property tax with land tax. Western Australia said the property tax has a different tax base than other land-based taxes and should be assessed separately if material.

Commission response

10 The New South Wales property tax differs from stamp duty because it is an annual charge. It differs from land tax because it is not applied to a landowner's aggregate land holdings, but it is applied to principal places of residence. Only a subset of properties are liable for the tax – those that opted into the scheme when it was active.

11 The Commission would consider a separate assessment of the property tax if reliable data were available to support that assessment and it was material. However, given the relatively small amount of revenue raised and that the scheme is closed to new applicants, a separate assessment is unlikely to be, or become,

[1] The scheme included a transitional period so that eligible first home buyers who signed a contract of purchase between 11 November 2022 and 15 January 2023 were able to opt-in to the new property tax.

[2] New South Wales Government 'Table 4.4 General government sector – summary of taxation revenue' 2024–25 Budget Paper No. 01 NSW Government, 2024.

material. On practicality grounds, the Commission will continue to assess the New South Wales property tax revenue in the land tax category.

Commission decision

12 The Commission will assess revenue from the New South Wales property tax with land tax.

Elasticity adjustments – existing and recent tax reform

13 The Commission considered the appropriateness of an adjustment to states' stamp duty on conveyances revenue bases in response to reforms to replace stamp duty on conveyances with a property tax. In particular, the Commission considered 3 state reforms:

- New South Wales' First Home Buyer Choice scheme
- Victoria's commercial and Industrial property tax
- the ACT's phased replacement of stamp duty on conveyances with general rates revenue.

State views

14 Most states said the Commission should not adjust states' value of property transferred for the elasticity effects of recent tax reforms because those reforms did not materially affect the assessment.

15 States also commented on the merits of the Commission implementing elasticity adjustments more broadly than in instances of tax reform. The broader case for elasticity adjustments is considered in the next section.

Commission response

16 New South Wales has closed the First Home Buyer Choice to new applicants. It said the scheme would not have a material effect on its taxable property values in the short to medium term.

17 Victoria's reform will have 2 key parts. The first key part is a government-facilitated transition loan. The first time a commercial or industrial property is transacted from 1 July 2024, the property will be subject to stamp duty for one final time. The purchaser will have the choice to pay the stamp duty through self-financing or a government-facilitated loan. If they choose the government-facilitated loan, they will be required to make annual principal and interest repayments over 10 years.

18 The transitional loans will be issued by the Treasury Corporation of Victoria. The Treasury Corporation of Victoria will pay an amount equivalent to the deferred stamp duty to the purchaser. The purchaser will then pay the stamp duty liability to the state revenue office. Repayments of the loan will be outside the scope of the Commission's adjusted budget, which excludes public financial corporations. This will ensure the stamp duty revenue will be counted only once - at the time of

purchase, in the adjusted budget. Victoria will experience a gradual decline in stamp duty revenue from commercial and industrial properties as stamp duty is phased out. All else being equal, this will decrease the total revenue from stamp duty on conveyances. Victoria's revenue raising capacity will continue to be assessed using its value of property transferred.

19 The Commission expects it will take time before any elasticity effect from the Victorian reform becomes material, given commercial and industrial properties are a subset of the revenue base and the full effect of the replacement of stamp duty with a new property tax will occur gradually. The Commission will continue to monitor for potential elasticity effects.

20 The second key part of Victoria's reform is the introduction of a new commercial and industrial property tax. A commercial or industrial property will become liable for the new property tax 10 years after it is first sold (after 1 July 2024). This means Victoria will not receive revenue from the new property tax until 2034–35.

21 Victoria's property tax differs from New South Wales' First Home Buyer Choice scheme, which was an opt-in scheme. Victoria's property tax will automatically apply to all commercial and industrial properties 10 years after they are first sold. Victoria's property tax will be similar to land tax because it is imposed on the unimproved value of land and includes the same exemptions and concessions as land tax in Victoria. However, unlike land tax, it will be imposed as a single flat rate of 1%.

22 The Commission has not identified a significant elasticity effect flowing from the ACT's reform. While growth in taxable property values in the ACT has generally exceeded the national average over the period since 2012–13, it has been similar to Tasmania's growth and a little higher than South Australia's growth. The ACT's consultants found a small to zero effect on the ACT's stamp duty tax base flowing from the ACT's reform.[3] They found a slight increase in property sale prices was more than offset by a decrease in number of sales. Overall, the Commission considers any relevant adjustment for the ACT's reform is unlikely to have a material effect on its assessed revenue capacity.

Commission decision

23 The Commission will not adjust New South Wales' value of property transferred for the effects on values transferred of its First Home Buyer Choice scheme because an adjustment is unlikely to be material.

[3] The ACT's consultants suggested the results should be interpreted with caution. R Breunig, HA La, R Steinhauser and Y Vidyattama, Analysis of the impacts and outcomes of the ACT tax reform, Tax and Transfer Policy Institute, The Australian National University, 2020.

24 The Commission will not make an elasticity adjustment for the Victorian property tax reform because it is unlikely to be material. However, it will continue to monitor for potential elasticity effects after the new property tax is introduced.

25 The Commission will not introduce a separate assessment of Victoria's commercial and industrial property tax since it will not generate any revenue until 2034–35.

26 The Commission will not adjust the ACT's value of property transferred for the effects of its stamp duty on conveyances reform as the Commission has not identified a significant elasticity effect flowing from its reform.

Elasticity adjustments – the broader case

27 In response to state comments, the Commission considered the merits of applying elasticity adjustments to its revenue assessments more broadly. Elasticity adjustments would recognise that a state's tax rate can affect the size of the relevant tax base. A state with an above-average tax rate may have a smaller observed revenue base than if it were to apply the average tax rate, and vice versa. In theory, if the elasticity effects on an observed revenue base could be reliably measured and were material, applying an elasticity adjustment would improve the policy neutrality of the assessment.

28 In the 2020 Review, the Commission engaged consultants to test the feasibility of developing elasticity estimates for each revenue assessment. The consultants produced estimates for 5 revenue categories (see Table 1), 4 of which were statistically significant (land tax, stamp duty on conveyances, insurance tax and motor taxes).[4] The consultants found no measurable behavioural effect of changes in payroll tax rates on labour market outcomes (wages and employment). Due to data limitations and methodological difficulties, the consultants were unable to estimate elasticities for mining revenue.

29 The consultants compared their estimates with those reported in other Australian and international studies. They concluded their estimates were conservative and within the bounds of those other studies.

[4] Due to the national scheme for heavy vehicles, the consultants concluded an elasticity adjustment was not warranted for heavy vehicles.

Table 1 Estimated elasticity effects

Category	Elasticity Estimate	Interpretation
Payroll tax	Statistically insignificant	Not applicable
Land tax	-0.054 to -0.062 (CGC)	A 10 percent increase in the tax rate will reduce the overall unimproved value of taxable properties by about 0.6 percent.
Stamp duty on conveyances	-0.29 to -0.43 (CGC)	A 10 percent increase in the tax rate reduces the overall value of sold properties by 3-4 percent.
	-0.01 to -0.37 (Corelogic)	A 10 percent increase in the tax rate reduces the value of sold properties by 0.1 to 3.7 percent, depending on the specification chosen.
Insurance tax	-0.057 (CGC)	A 1 percentage point increase in the tax rate (equivalent to about a 10 percent increase) reduces expenditure on total premiums by 0.6 percent.
Motor taxes (light vehicles)	-0.056 (CGC)	A 10 percent increase in license fees reduces vehicle ownership by 0.6 percent.
	-0.035 (HILDA)	A 10 percent increase in license fees reduces car ownership by 0.35 percent.
Mining revenue	Could not be estimated	Not applicable

Note: The table above includes estimates based on Commission data, data from the Household, Income and Labour Dynamics in Australia survey, and data from Corelogic.

Source: R Steinhauser, M Sinning and K Sobeck, State tax elasticities of revenue bases, Tax and Transfer Policy Institute, The Australian National University, 2018.

30 Given the significant complexities and uncertainties involved in implementing elasticity adjustments, which were outlined in the Draft Report, the Commission proposed not to introduce them in the 2025 Review. Instead, it proposed to consider how those complexities might be addressed in preparation for the next review.

State views

31 Victoria, Western Australia and the ACT said they supported consideration of elasticity adjustments as part of the forward work program. Victoria said the focus should be on mitigating the policy influence of land tax reforms, as they are the most relevant and material. Western Australia said that the forward work program should consider all policy influences on revenue bases, not just tax rates. The ACT initially said that, given its materiality, an elasticity adjustment should be made for stamp duty on conveyances. It subsequently supported inclusion of elasticity adjustments in the forward work program.

32 Queensland, South Australia and the Northern Territory said they did not support the introduction of elasticity adjustments. Queensland said elasticity adjustments would introduce substantial complexities to the assessments with the results unlikely to have the same rigour as the rest of the assessments. South Australia said there is no robust way of differentiating the impacts of behavioural changes and general changes to market conditions. It said numerous policy changes had occurred over time and only considering future reforms may disadvantage states that had undertaken reforms in the past.

33 The Northern Territory said elasticity adjustments could be policy influenced if they were more responsive to policy changes that have large immediate impacts than more gradual reforms. It said, if an elasticity adjustment were introduced in the stamp duty assessment, the adjustment should account for the impact of the absence of land tax on the Northern Territory's stamp duty base.

34 New South Wales said elasticity adjustments should be introduced in the 2025 Review. It said a decision not to make any elasticity adjustments would represent a significant departure from fiscal equalisation. It said the Commission seemed less tolerant of uncertainty or complexity with respect to elasticity than with respect to other adjustments.

35 New South Wales said not adjusting for known significant effects on the basis that the same adjustment cannot be applied across all taxes implied equalisation was secondary to a desire for completeness. It said elasticity effects in mining revenue were unlikely to be material. It said the Commission should introduce elasticity adjustments in all revenue assessments where they were material.

36 New South Wales said uncertainty over the magnitude of elasticity adjustments was not a valid reason for excluding elasticity adjustments entirely. It said adopting elasticity estimates at the bottom of the range of the estimates produced by the consultants engaged for the 2020 Review would be an improvement over no elasticity adjustment. New South Wales said that while elasticity adjustments can be sensitive to the classification of revenues, the scope for misclassification of revenues is less problematic than for state expenditure. It said, while elasticity adjustments could introduce volatility in successive updates, it was unaware of a decision by the Commission to favour stability over equalisation.

37 New South Wales said the magnitude of divergence of states' rates of land tax and stamp duty did not invalidate the elasticity estimates provided by the Commission's consultants. It said its analysis showed cross-elasticities between the 2 revenue sources were unlikely to be material. It said elasticity adjustments should be applied to revenue bases after any value distribution adjustments to ensure they are applied to differences in tax rates between states for properties of the same value.

Commission response

38 The Commission recognises there is a conceptual case for elasticity adjustments. However, it considers there are several practical considerations in making such adjustments. Each of those considerations would increase the degree of uncertainty in the assessments.

39 A key concern is the sensitivity of elasticity adjustments to the classification of revenues to the Commission's assessment categories. In the absence of an elasticity adjustment, the classification of revenues only affects an assessment through the *average* tax rate. An elasticity adjustment is applied to the difference between a state's actual effective tax rate and the average tax rate. With an elasticity

adjustment, the classification of revenues will also affect a state's assessed revenue capacity via its *actual* tax rate. This places a greater focus on the consistency and appropriateness of revenue classification than in all other assessments.[5]

40 Similarly, decisions on where to assess the revenue from new taxes or surcharges, or misclassification in state reporting, could result in large changes in elasticity adjustments in future updates (particularly for stamp duty on conveyances). The consequent changes in assessment outcomes may be difficult to verify and explain.[6] The Commission is concerned that volatility in those assessment outcomes could arise from the elasticity adjustment, rather than from any actual change in the value of property transactions. This emphasises the importance of detailed consultation with states on the appropriate method and assumptions before an elasticity adjustment is introduced.

41 Leaving aside uncertainties associated with the classification of revenues, the broad direction of an individual elasticity adjustment is clear. A state with an above-average tax rate will have a smaller observed revenue base than if it were to apply the average tax rate. An elasticity adjustment will increase the state's assessed revenue base. However, the magnitude of an elasticity effect is less clear. For example, the consultants engaged for the 2020 Review produced 2 ranges of elasticity estimates for the stamp duty on conveyances assessment.
New South Wales said adopting an elasticity adjustment based on the bottom of the range of estimates produced by the consultants would be an improvement over no elasticity adjustment. However, other states either oppose any adjustment or endorse the need for further work and consultation on dealing with the uncertainties and complexities involved before making such an important decision.

42 The Commission notes there are several other implementation issues that also need to be resolved in consultation with states. These include whether the estimates can be appropriately applied where there are large tax rate differences (such as where a state has abolished a tax), the potential for different parts of a revenue base to be subject to different elasticities, and the possibility of cross-elasticities between different taxes. More detail of these can be found in the Draft Report chapter on stamp duty on conveyances.

43 Given the complexities and uncertainties involved, and the concerns raised by other states, the Commission considers that further work and consultation after the 2025 Review is required before the introduction of elasticity adjustments.

44 Introducing elasticity adjustments may not always be able to deal with future state tax reform. Alternative adjustments may be required depending on the nature and

[5] For example, the Commission decided to assess foreign purchaser surcharges in the stamp duty on conveyances assessment. This increased the average rate of tax in the assessment. If the assessment included an elasticity adjustment, including revenue from those surcharges in the category would increase the effective tax rates of the states that impose them and, therefore, the size of the elasticity adjustment when there had been no change in legislated rates of stamp duty (excluding the surcharge).

[6] For example, Tasmania's effective rate of land tax was above the national average rate in 2021–22 and below in 2022–23. This means an elasticity adjustment would jump between increasing and decreasing Tasmania's assessed revenue raising capacity.

impact of the reform. The Commission would still need to consider the details of each individual reform and consult with states on the appropriate response. More detail on the consultation process the Commission could follow in the event of major state tax reforms can be found in the flexibility to change methods between reviews chapter of *Review Outcomes*.

Commission decision

45 The Commission will not apply an elasticity adjustment to its revenue assessments in the 2025 Review, including stamp duty on conveyances.

46 As part of the Commission's forward work program, it will consider, in consultation with the states, how the complexities and uncertainties associated with elasticity adjustments to revenue assessments might potentially be addressed in preparation for the next review.

Value ranges

47 In response to state comments, the Commission considered the number and size of its value ranges. The assessment disaggregates the value of taxable land holdings into 18 value ranges to capture the progressivity of state stamp duty rates and the different distributions of those values across states.

State views

48 South Australia said the Commission should increase the number of value ranges in the higher ranges to account for recent growth in land values. It said when considering the materiality of applying different value ranges the Commission should use the $12 data adjustment threshold rather than the $40 driver threshold. Other states either said they supported the 18 value ranges or did not comment.

Commission response

49 The Commission captures the average state policy to apply progressive rates of stamp duty by assessing revenue capacity by value range. It has not chosen the number of value ranges based on their materiality. Rather, the size and number of value ranges was intended to ensure the assessment remains sufficiently robust to cover future changes in states' rates and thresholds, without the need for frequent changes to those ranges (which would be impractical for state data providers).

50 To reflect the upward trend in property values, the Commission split the highest value range ($1.5 million plus) into 3 separate ranges in the 2020 Review. The split did not make a material difference to the assessment in the 2024 Update. Any further split is unlikely to make a material difference to GST distribution but would require the Commission to collect additional data to test whether this is the case.

51 More generally, the Commission's assessment guidelines distinguish between driver and data adjustment materiality thresholds. The Commission considers that adding a

subdivision to an assessment (such as an extra age band in an expense assessment) is equivalent to adding a driver that explicitly recognises the expense needs of that subdivision. The $40 per capita threshold is appropriate in those circumstances. In contrast, a data adjustment is intended to improve comparability or reliability of data across states.

Commission decision

52 The Commission will continue to assess stamp duty on conveyances in the 18 value ranges specified in the 2020 Review.

Treatment of non-real property

53 In response to state comments, the Commission considered its treatment of stamp duty on non-real property. States agreed to abolish stamp duty on non-real property as part of the *Intergovernmental Agreement on Federal Financial Relations 2008*. The Northern Territory abolished duty on non-real property from 9 May 2023. Queensland and Western Australia remain the only states imposing non-real duty.[7]

54 The distribution of non-real property across states differs significantly from that of real property. Therefore, revenue from duty on non-real property is assessed equal per capita in other revenue rather than in the stamp duty category. The Commission proposed to continue this treatment.

State views

55 Queensland said it supported assessing the revenue from non-real property duty equal per capita in the other revenue assessment. It said estimating a revenue base for states which do not tax these transactions would not be practical.
South Australia said the Commission should develop a separate capacity measure for non-real property transactions.

56 Victoria said the equal per capita assessment was not policy neutral and incorrectly and unfairly attributed revenue raising capacity to states that had fulfilled their obligations under the *Intergovernmental Agreement on Federal Financial Relations 2008*. It said revenue from these transactions should be assessed actual per capita.

Commission response

57 Two states impose duties on non-real property. The interstate distribution of non-real property transactions across states is very different from the interstate distribution of real property.

58 The Commission has no reliable way to estimate the value of non-real property in the 6 states that do not impose duties on non-real property. It will, therefore,

[7] New South Wales still imposes duty on plant and equipment.

continue to assess revenue from non-real property transactions equal per capita in the other revenue category.

59 The Commission considers an actual per capita assessment of duty on non-real property is not appropriate. An actual per capita assessment would imply the relative capacity to raise non-real duty is proportional to the actual revenue raised. An actual per capita assessment is only appropriate where there are no policy differences between states. Consistent with its supporting principles, the Commission measures revenue raising capacity with reference to what states do on average. It does not make a judgement about what states could or should do.

60 The Commission rejected similar proposals for an actual per capita assessment in the 2015 and 2020 Reviews. It noted that states that had not abolished the duty had not been penalised and concluded the *Intergovernmental Agreement on Federal Financial Relations 2008* could not be regarded as binding.

Commission decision

61 The Commission will continue to assess revenue from duty on non-real property equal per capita in the other revenue category.

GST impacts of method changes

62 There are no method changes to this assessment.

4. Insurance tax

Review outcomes

- No changes were made to the assessment method for insurance tax.
- Duties on workers' compensation premiums and compulsory third-party insurance premiums will continue to be included in the insurance tax category.
- As part of the Commission's forward work program, it will consider how the complexities and uncertainties associated with elasticity adjustments in revenue assessments, including insurance tax, might potentially be addressed in preparation for the next review.

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 insurance tax chapter of the *Commission's Assessment Methodology*.

Issues considered

Elasticity adjustments

6 The Commission considered the case for elasticity adjustments in its revenue assessments, including the insurance tax assessment. Elasticity adjustments would recognise that a state's tax rate can affect the size of the relevant tax base. A state with an above-average tax rate may have a smaller observed revenue base than if it were to apply the average tax rate, and vice versa. In theory, if the elasticity effects on an observed revenue base could be reliably measured and were material, applying an elasticity adjustment would improve the policy neutrality of the assessment. A more detailed discussion on elasticity adjustments can be found in the stamp duty on conveyances chapter of *Review Outcomes*.

State views

7 Most states supported retaining the 2020 Review assessment method and did not support introducing an elasticity adjustment in the insurance tax category.

8 New South Wales noted that an elasticity adjustment based on the estimate produced by the Commission's consultants was not material at the $10 per capita data materiality threshold in the 2020 Review. New South Wales said, however, including revenue from insurance-based fire and emergency levies with insurance tax revenue, would make an adjustment material. It said including fire and emergency services for this purpose only was appropriate since those levies reduce the total insurance premiums paid in the state.

9 New South Wales said it disagreed with the Commission's decision to not implement an elasticity adjustment for specific revenue assessments. It said the Commission should incorporate an elasticity adjustment into the insurance tax assessment, as well as more broadly.

Commission response

10 The Commission does not consider there is a strong conceptual case for including revenue from the insurance-based fire and emergency services levies in the calculation of an elasticity adjustment for insurance tax. This revenue is assessed elsewhere, and New South Wales has announced that its levies are being abolished.[1]

11 The insurance-based fire and emergency services levies collected by New South Wales and Tasmania are not assessed in the insurance category. Instead, those levies are treated as user charges and the revenue raised is offset against emergency services in the other expenses category.

12 There are significant complexities and uncertainties involved in implementing an elasticity adjustment, and these need to be resolved before an elasticity adjustment could be reliably introduced in any revenue assessment.

Commission decision

13 The Commission will not introduce an elasticity adjustment in the insurance tax assessment in this review. The Commission's forward work program will consider how the complexities and uncertainties associated with implementing elasticity adjustments in revenue assessments, including insurance tax, might potentially be addressed in preparation for the next review.

[1] New South Wales has begun consultations with key stakeholders regarding emergency services reform (see NSW Emergency Services Funding Reform - Consultation Paper). Tasmania has paused the reform of its Fire Services Levy (see Minister of Police, Fire and Emergency services press release, 14 February 2024

Duty on workers' compensation premiums and compulsory third-party insurance premiums

14 South Australia said the Commission should remove revenue from duty on workers' compensation insurance and duty on compulsory third-party insurance from the category.

State views

15 Most states supported retaining the 2020 Review assessment method and leaving the revenue from duty on workers' compensation insurance and compulsory third-party insurance in the insurance tax category.

16 South Australia said that it did not support including duty on workers' compensation premiums and compulsory third-party insurance in the category. It said, for consistency purposes, if the premiums for these types of insurance were removed from general insurance premiums in the calculation of the revenue base, then the associated duty should also be removed.

Commission response

17 The Commission removes workers' compensation premiums from the assessed revenue base as they are only taxed by one state (at a concessional rate) but represent a large proportion of total premiums across all states. Including them would misrepresent states' relative capacities to raise insurance tax.[2]

18 The Commission removes compulsory third-party premiums as they are significantly policy influenced. For example, they reflect whether the relevant state scheme is privately or publicly underwritten, the levels of coverage and benefits, and differences in the quality of claims management.

19 While the Commission excludes workers' compensation and compulsory third-party premiums from its measure of the revenue base, it has not removed the revenue raised from duty on these forms of insurance from the category. The revenue raised from these duties could not be reliably separated from other insurance duties in ABS Government Finance Statistics.[3]

20 Moreover, available data suggested that these revenues were likely to be small relative to total insurance tax revenue.[4] The Commission did not consider a separate state data request would be warranted for 2 relatively small data adjustments.

[2] Only Queensland imposes duty on workers' compensation premiums.

[3] Revenue from workers' compensation duty is not separately reported in Government Finance Statistics. Revenue from compulsory third-party insurance duty is not reported consistently across states in Government Finance Statistics.

[4] Four states impose duty on compulsory third-party insurance.

Commission decision

21 The Commission will continue to include duties on workers' compensation premiums and compulsory third-party insurance premiums in the insurance tax category.

GST impacts of method changes

22 There are no method changes to this assessment.

5. Motor taxes

Review outcomes

- The following changes were made to the assessment.
  - A differential assessment of stamp duty on motor vehicle transfers will be reintroduced as a separate component within this category.
- The Commission considered but did not change the following.
  - A separate assessment of distance-based electric vehicle charges will not be introduced. The High Court's decision that distance-based electric vehicle charges levied by a state or territory are constitutionally invalid means a separate assessment is no longer relevant.
  - Electric vehicle incentives will be assessed based on their classification in ABS Government Finance Statistics data (rebates as expenses and tax concessions as reduced revenue). A single assessment of these incentives (either as a separate expense assessment or as part of the motor taxes assessment) will not be made due to their small size and temporary nature. The Commission will continue to monitor the electric vehicle incentives provided by states.
  - Emissions-based registration fees will be assessed using the number of light vehicles, as they are similar in nature to other light vehicle registration fees.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the motor taxes chapter of the *Commission's Assessment Methodology*.

Issues considered

Assessment of stamp duty on motor vehicle transfers

6 The differential assessment of stamp duty on the transfer of motor vehicle ownership was discontinued in the 2020 Review because it was no longer material. In response to state comments, the Commission considered the materiality of reintroducing a differential assessment of stamp duty on motor vehicle transfers.

7 The Commission estimated the materiality of a differential assessment using ABS revenue data and state data on the value of vehicle transfers from the 2019 Update (the latest data it had available). That analysis suggested a differential assessment was unlikely to be material at the driver materiality threshold ($40 per capita). On this basis, the Commission proposed not to reintroduce the stamp duty on motor vehicle transfers.

State views

8 Five states said they supported the proposal not to reintroduce a differential assessment of stamp duty on motor vehicles on the basis that it was unlikely to be material.

9 South Australia did not support the proposal. It said growth in ABS data on revenue from stamp duty on motor vehicle transfers was a strong proxy for growth in each state's revenue base. South Australia said those data suggested there had been significant growth in the value of vehicle transfers since 2018–19 and that a differential assessment would be material.

10 South Australia said the Commission should seek the latest data from states on the value of motor vehicle transfers to test the materiality of a differential assessment. It said the assessment should be reintroduced in the 2025 Review, if it was material. South Australia said because this would be reinstatement of a previous assessment, there should be no concerns about the conceptual basis or assessment methodology.

Commission response

11 In response to South Australia's submission, the Commission collected new data from states on the dutiable value of motor vehicle transfers.[1] Based on those data, the differential assessment was material at the $40 per capita driver materiality threshold.[2]

[1] Stamp duty is collected on new motor vehicle registrations and used motor vehicle transfers. Duty is calculated on the greater of purchase price or the market value (the 'dutiable value').

[2] A differential assessment was material based on data for the 3 assessment years of the 2024 Update.

Commission decision

12 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.

Assessment of electric vehicle charges

13 Noting that Victoria had introduced a Zero and Low Emission Vehicle road user charge and that 3 other states intended to introduce similar charges, the Commission considered the case for a separate assessment of revenue from distance-based electric vehicle charges. On 18 October 2023, the High Court found that Victoria's Zero and Low Emission Vehicle road user charge was an excise and, therefore, constitutionally invalid. The decision prevents other states from imposing similar charges. In light of this development, the Commission proposed that a separate assessment of distance-based electric vehicle charges is no longer relevant.

State views

14 Six states said they supported not introducing a separate assessment of revenue from electric vehicle charges in light of the High Court decision. Two states did not comment.

Commission response

15 Following the High Court decision, Victoria repealed its Zero and Low Emission Vehicle road user charge and refunded the revenue it had previously collected. Other states that announced (or legislated) similar charges were unable to introduce them. Therefore, it is no longer relevant for the Commission to introduce a separate assessment of these charges as part of the motor taxes category.

16 Electric vehicles will continue to be included in data on the number of registered vehicles (light and heavy) used in the assessment. The Commission considers this appropriate since electric vehicle owners will continue to be liable for registration fees, albeit with concessions or time-limited exemptions in some states.

Commission decision

17 The Commission will not include a separate assessment of distance-based electric vehicle charges as part of the motor taxes category.

Assessment of electric vehicle incentives

18 Western Australia said electric vehicle incentives offered by states, in the form of rebates, grants or concessions, could become material in future updates. It said the Commission should consider assessing these in a single place, either as a separate expense assessment or in the motor taxes assessment, to be policy neutral to the type of incentive offered.

State views

19 Three states said they supported assessing electric vehicle incentives according to where they are classified in ABS Government Finance Statistics. Queensland said Government Finance Statistics data were the most appropriate dataset for this purpose.

20 Western Australia said that, if a separate assessment of stamp duty on motor vehicle transfers became material, the Commission should net off electric vehicle incentives from the revenue raised from stamp duty.

21 Other states did not comment.

Commission response

22 States provide a range of incentives to encourage the purchase of electric vehicles.[3]

- Two states offer rebates to purchasers of new electric vehicles, ranging from $2,000 to $3,500 per vehicle. The rebates are available for a limited time period or until allocated funding is exhausted (as at 1 October 2024, Tasmania's rebate funding had been exhausted).
- Three states offer concessional registration fees (or a time-limited exemption) for newly registered electric vehicles.
- Two states offer concessional rates of stamp duty (or an exemption) on transfers of electric vehicles.

23 Electric vehicle rebates are not separately identified in ABS Government Finance Statistics data. However, data published by states suggest rebate expenses are small. A separate expense assessment of these rebates is unlikely to be material.

24 Tax concessions are captured as reduced revenue in the relevant component (light vehicle registration fees or stamp duty on motor vehicle transfers). States' tax expenditure data indicate that the 'foregone revenue' from the 2 types of concessions is small relative to motor taxes revenue.

25 Given the small size and temporary nature of most electric vehicle incentives, the Commission does not consider a separate assessment of these incentives is justified. Further, the Commission notes that 3 states offer (or have previously offered) both rebates and concessions. Therefore, the Commission does not consider it appropriate to assess rebates and concessions together. The Commission will continue to monitor the electric vehicle concessions provided by states.

Commission decision

26 The Commission will assess electric vehicle incentives where they are classified in ABS Government Finance Statistics data (rebates as expenses and tax concessions as reduced revenue).

[3] These incentives apply to electric vehicles and in some cases to other low emissions vehicles, such as plug-in hybrid and hydrogen vehicles.

Assessment of emissions-based registration fees

27 From 1 July 2024, the ACT transitioned from its weight-based registration system for light vehicles to an emissions-based system. Under the new scheme, lower emission vehicles will face lower registration fees. The Commission proposed assessing revenue from emissions-based registration fees using the number of light vehicles.

State views

28 All states said they supported assessing revenue from emissions-based registration fees using the number of light vehicles. New South Wales said the number of vehicles was a simpler and more consistent capacity measure than one that attempts to capture those differences. Queensland said the average policy was to impose registration fees per vehicle and this did not change regardless of the characteristics of the vehicle or its use. Western Australia said a state's capacity to raise revenue from registration fees depends on the number of registered vehicles, not on the method of calculating these fees. The Northern Territory said the 2020 Review method measures the overall taxation intensity on vehicles, rather than how that burden was distributed between vehicle types.

Commission response

29 The Commission notes that the basis on which light vehicle registration fees are collected varies across the states – vehicle weight or engine capacity, private or business use. The assessment does not attempt to adjust for those differences. Instead, it uses the number of registered light vehicles as its proxy measure of states' capacity to raise light vehicle registration fees.

30 The Commission considers that emissions-based registration fees are sufficiently similar in nature to those based on vehicle weight or engine capacity for the revenue from those fees to be assessed using its proxy measure. Both are annual (or periodic) fees to register a vehicle.

Commission decision

31 The Commission will assess revenue for emissions-based registration fees using the number of light vehicles.

GST impacts of method changes

32 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, motor taxes, 2024-25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
$m	51	131	-93	-116	15	-9	21	0	218
$pc	6	18	-16	-38	8	-15	43	1	8

33 Queensland, Western Australia and Tasmania had above-average per capita values of vehicle transfers which reduced their assessed GST needs. The other states had below-average per capita values of vehicle transfers, and this increased their assessed GST needs.

6. Mining revenue

Review outcomes

- The following changes were made to the assessment.
  - Black coal will be assessed using a fixed-price band model with 2 price bands (above and below $200 per tonne). The use of price bands captures the additional revenue capacity available to states producing high-value coal when states impose progressive royalty rates.
  - Brown coal will be assessed using revenue received.
  - Onshore oil and gas will be assessed using volume of production. This is consistent with average policy.
- The Commission considered but did not change the following.
  - The mineral-by-mineral approach will be retained as the preferred method of assessing states' mining revenue capacity.
  - A dominant state adjustment will not be introduced in the 2025 Review. In preparation for the next review, the Commission's forward work program will continue to examine the issue and consult with states on how best to address the disincentive to increase royalty rates faced by dominant states.
  - An adjustment for the effect of state mining restrictions will not be introduced. Given the uncertainties of estimating the impact of mining restrictions on state production, the Commission will continue to use actual production as its measure of mining revenue capacity.

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 and submissions on the supplementary 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
- GST impacts of the method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the mining revenue chapter of the *Commission's Assessment Methodology*.

Issues considered

Retaining the mineral-by-mineral approach

6 Under the 2020 Review approach mining revenue capacity was assessed using a mineral-by-mineral approach. Under this approach, a mineral is separately assessed if doing so materially affects any state's GST outcome. Royalties for the remaining minerals were combined and assessed together in the other minerals component. Revenue from revenue sharing agreements with the Commonwealth were assessed using the revenue received, the same approach used to assess other Commonwealth payments.

7 A key challenge in developing the mining assessment is measuring state revenue capacity, consistent with the objective of fiscal equalisation, while finding an appropriate balance between fiscal equalisation and policy neutrality. The existence of dominant states in the production of certain minerals, including iron ore, means there can be tension between the objective of fiscal equalisation and the supporting principle of policy neutrality.

8 While the Commission continues to seek to reconcile this tension, it considered the mineral-by-mineral approach provided the best measure of state mining revenue capacities.

State views

9 Most states supported the mineral-by-mineral approach. Victoria and South Australia said it best captured state mining revenue capacities.

10 The major mining states (New South Wales, Queensland and Western Australia) disagreed. They sought an assessment that gave more weight to policy neutrality. They said the mineral-by-mineral assessment gave rise to policy neutrality issues and they proposed different assessment methods to address those issues.

11 New South Wales and Queensland favoured assessing all minerals together. Queensland said this provided a superior equalisation outcome and struck a better balance between what states do and policy neutrality.

12 Western Australia had 2 concerns. First, it considered the use of the observed level of taxable activity as the revenue base was policy influenced. Second, it said assessing minerals individually could create large GST effects if a state with a dominant share of production changed its royalty rate. It favoured a single revenue assessment, assessing mining revenue and state taxes together.

Commission response

13 The Commission did not favour either an aggregate mining assessment or a single revenue assessment. Both assessments would give too much weight to the

supporting principle of policy neutrality and insufficient weight to measuring state mining revenue capacities consistent with the objective of fiscal equalisation.

14 Assessing all minerals together calculated mining revenue capacity by applying the average (all-mineral) royalty rate to each state's total mining production. Compared to the mineral-by-mineral approach, it increased the assessed revenue capacity of states with low-value minerals and vice versa. The Commission did not consider this to be a superior fiscal equalisation outcome because it implied states with low-value minerals could apply above-average royalty rates to raise the average revenue.

15 A single revenue assessment used the same capacity measure for each tax and mineral and the chosen measure may be unrelated to the activities the states tax. The 2020 Review revenue assessment methods use different capacity measures for different taxes and minerals. These capacity measures tend to relate to the activities the states tax. This is consistent with the 'what states do' supporting principle and the Commission concluded it produced a better equalisation outcome than a single revenue assessment.

16 States commented on 2 other approaches to measuring mining revenue capacity outlined but not proposed by the Commission – a profitability approach and an external standard approach. There was no support for either approach. New South Wales and South Australia said a profitability approach did not reflect what states do and would likely increase the volatility of the mining assessment. New South Wales also said the lack of available data meant a profitability approach was impractical. New South Wales and Victoria said implementing an external standard would be impractical because of the difficulty of choosing an appropriate and comparable international royalty rate.

17 Given the uneven distribution of minerals, the different royalty rates applying to different minerals and the volatility of commodity prices, the Commission concluded the mineral-by-mineral approach provided the best measure of state mining revenue capacities, consistent with the objective of fiscal equalisation. However, as noted further below, it acknowledged the concerns associated with policy neutrality in certain circumstances.

Commission decision

18 The Commission will continue to assess mining revenue capacity using a mineral-by-mineral approach.

Improving the policy neutrality of the mineral-by-mineral assessment

19 The mineral-by-mineral approach can give rise to policy neutrality concerns in particular circumstances. The Commission explored 2 changes to improve the assessment's policy neutrality. It considered introducing an adjustment when:

- a dominant state increased its royalty rate or
- a state imposed a mining restriction that had a material effect on production.

A dominant state adjustment

20 In most cases, a state has a limited influence on average policy. However, exceptions can arise and these are potentially significant in the case of mining revenue. When a revenue base is concentrated in 1 or 2 states, the policies of those states have a dominant role in determining average policy, particularly when minerals were assessed separately.

21 If a dominant producer of a mineral changed its royalty rate, the change in revenue it experienced would be largely offset by the change in its GST distribution. This could act as a disincentive for it to increase royalty rates, which creates a conflict with the policy neutrality supporting principle.[1] To mitigate the disincentive, the Commission considered introducing an adjustment that would assess equal per capita 50% of the increased revenue from the rate change.

State views

22 Western Australia and Queensland supported introducing a dominant state adjustment. Western Australia suggested the Commission exempt all of the increase in revenue from a dominant state's royalty rate increase, at least for the first 5 years. Queensland said a dominant state adjustment was required if the coal assessment was split.

23 The majority of states did not support the Commission's proposal to assess equal per capita 50% of the increased revenue from a dominant state's royalty rate increase. They were concerned about the practicalities of designing and introducing the Commission's proposed dominant state adjustment and said it was arbitrary, lacked clarity and would reduce the extent to which fiscal equalisation was achieved.

24 New South Wales and Tasmania were concerned the adjustment exempted state revenue from equalisation. South Australia queried the arbitrariness of the amount of revenue that would be exempt. States also noted practical issues that required resolution before introducing an adjustment. They included the choice of benchmark royalty rates, whether an adjustment would be calculated in perpetuity or reset, how it would deal with multiple royalty rate changes by a dominant state, the criteria to define a dominant state and how states that fell just short of the criteria would be treated.

25 Some states said an adjustment was not required because the GST distribution legislation effectively insulated a dominant state from the GST effect of increasing its royalty rates if its assessed relativity was below the relativity floor.[2]

[1] It could also act as an incentive for the dominant state to reduce its royalty rates because the reduction in its royalty revenue would be largely offset by an increase in its GST distribution.

[2] *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) ACT 2018* (Cth).

Commission response

26 The Commission acknowledged that a dominant state could face a disincentive to increase royalty rates. Some states said this would not be in Australia's national interest, particularly if it meant Australia was not receiving an appropriate return on the export of its mineral resources. The tension between the objective of fiscal equalisation and policy neutrality needs to be resolved to ensure equalisation does not act as a disincentive to states increasing revenue by increasing royalty rates. The Commission recognises the importance of incorporating a dominant state adjustment to reduce any disincentive. Some states did not consider the Commission's proposed dominant state adjustment as appropriate. In addition, they said there were implementation issues that needed to be resolved before any adjustment would be practical.

27 Given the importance of the dominant state issue, the Commission will continue to seek to identify a practical dominant state adjustment in consultation with the states in preparation for the next review.

Commission decision

28 The Commission will not introduce a dominant state adjustment in this review. In preparation for the next review, the Commission's forward work program will continue to examine the issue and consult with states on how best to address the disincentive to increase royalty rates faced by a dominant state.

An adjustment for state mining restrictions

29 When the observed level of activity is used as the capacity measure, policy neutrality concerns can arise when some states tax activity others do not. In these circumstances, the Commission may make an adjustment to estimate the missing activity in states that do not tax the activity. In the case of mining, this could entail estimating a state's level of production were it to lift its mining restrictions. If the mining restriction was widespread and had a material effect on national production, it could entail assessing equal per capita the revenue of states taxing the activity where a policy neutral measure of capacity could not be developed.

30 In this review, the Commission investigated whether an adjustment was warranted in relation to coal seam gas production, because of state hydraulic fracturing (fracking) bans, and in relation to uranium production, because of state uranium mining bans. It initially proposed assessing revenue from the affected activities equal per capita.

State views

31 States disagreed on how the Commission should address mining restrictions. Some states said policy neutrality was contravened if states that imposed mining restrictions were assessed to have no revenue capacity in respect of that activity. Other states said the key issue was whether equalisation was better served by continuing to assess a revenue capacity for states taxing the activity.

32 Queensland, Western Australia and the Northern Territory supported introducing an adjustment to estimate the missing activity in states that do not tax the activity. The remaining states either did not support the adjustment or offered qualified support.

33 Queensland said the onshore gas revenue base was policy contaminated. It contrasted the rapid development of its gas industry with the lack of development in other states, which Queensland claimed held substantial proven and probable gas resources and reserves.

34 Western Australia was also concerned about policy neutrality. It supported an adjustment because it did not consider observed revenue bases were a reliable measure of revenue capacity. It said environmental restrictions in some states were functionally similar to New South Wales' exclusion zones where mining was banned.

35 Other states said the key issues were the extent to which production was affected by a mining restriction and whether the effect of the restriction could be separated from other influences that constrained a state's production.

36 South Australia and Tasmania agreed there were inherent difficulties in determining state capacity in relation to minerals subject to state restrictions. They considered an equal per capita assessment might be appropriate if the bans and restrictions were widespread. However, South Australia said not all endowments were economically viable and it doubted whether equalisation would be achieved by applying an equal per capita assessment. New South Wales said an equal per capita assessment was not appropriate if states' value of production closely aligned with their distribution of endowments. Tasmania said the Commission should continue to make an assessment if the states taxing the activity were the biggest producers. It suggested examining the effect of state restrictions on a case-by-case basis.

Commission response

37 For the Commission to introduce an adjustment for a mining restriction, it would require evidence that the restriction had a material effect on national production and its effect was capable of being reliably measured. There were limited data that would allow the Commission to estimate the level of a state's activity were it to remove a mining restriction. The paucity of data made it uncertain how material state mining restrictions were.

38 In the case of coal seam gas, Geoscience Australia data indicated almost all resources and known reserves were located in Queensland, with the remaining endowments in New South Wales. Fracking was required in less than 10% of Queensland's coal seam gas mines, which suggested fracking had limited effect in that state.

39 The Commission accepted states weighed the benefits of competing industries and it noted New South Wales said its exclusion zones were designed to protect residential growth areas and its equine and viticulture industries. The Commission did not

consider a state's choice between competing industries a reason for introducing an adjustment.

40 The Commission concluded an equal per capita assessment was not appropriate in coal seam gas because it did not reflect the extent of Queensland's endowments. It would also set New South Wales' revenue capacity equal to its population share. Based on Geoscience Australia data, this would overstate both its share of national production and the effect of any fracking ban.

41 In the case of uranium, all production was in South Australia. The known endowments in other states were small relative to those in South Australia. If the missing activity in those states aligned with their relative endowments, it would imply uranium bans did not have a material effect on national production.

42 For both coal seam gas and uranium, the Commission was unable to estimate the level of production if a state were to lift its mining restrictions. Given the uncertainties of estimating the impact of mining restrictions on state production, the Commission concluded the observed level of activity remained the best measure of state revenue capacity.

Commission decision

43 The Commission will not introduce an adjustment for state restrictions on uranium and coal seam gas production.

Assessing Victoria's coal capacity

44 Victoria said its brown coal did not have a price as it was largely an internal transfer within mining/generation entities. In the absence of a price, there was no reliable way to derive a measure of the value of its coal production. Victoria also said the Commission's 2020 Review estimation method overstated its value of production.

45 In the absence of a reliable measure of Victoria's value of coal production, the Commission proposed assessing its coal capacity using the revenue received.

State views

46 Victoria and the ACT supported the change. Victoria said it provided a better measure of its capacity because assessing its coal with black coal inflated its coal capacity as it applied the much higher black coal royalty rate to its coal production.

47 Western Australia and South Australia disagreed with the change. Western Australia said its coal was also used for electricity generation. It suggested Victoria's coal revenue capacity was likely closer to that of the low-quality coal in Western Australia and Tasmania than the high-quality coal in New South Wales and Queensland. It proposed assessing all low-quality coal together and said a value of production for Victorian coal could be estimated by applying the average of its and Tasmania's value and volume of production. It also said that if a separate

assessment of low-value coal was not material, the royalties should be assessed with the other minerals component.

48 South Australia said assessing Victoria's coal capacity using the revenue raised was inconsistent with policy neutrality. It said it was effectively an actual per capita assessment, which directly reflected Victoria's policy settings.

Commission response

49 Western Australia's estimation method would use a price for Victorian coal that was the average of its and Tasmania's black coal. Evidence Victoria provided suggested the price of its coal was much lower than the black coal price in Tasmania and Western Australia. Given the divergence in prices, Western Australia's estimation method would overstate Victoria's coal capacity.

50 Since no other state produces brown coal, any capacity measure would deliver the same outcome – it would assess all revenue capacity to reside in Victoria. The Commission considers the use of the revenue Victoria raises to be the simplest way of deriving that capacity. The Commission does not consider this to be a separate coal assessment. It is a way to estimate coal capacity for a state producing coal that has no price. Victoria's estimated capacity would be included with the capacities of other states in the coal assessment. As such, its estimated coal capacity would not be subject to a separate materiality test.

Commission decision

51 The Commission will assess Victoria's coal capacity using the revenue raised.

Assessing coal

52 New South Wales said an aggregate coal assessment did not capture all material differences in state capacities to raise coal royalties. It captured the higher price of coal sold, but not the effect of progressive coal royalty rates.

53 The Commission accepted states with high-value coal had an increased revenue capacity when states imposed progressive rates. It considered measuring the additional capacity by splitting the coal assessment by price band or type of coal.

State views

54 Most states supported splitting coal to capture the effects of progressive royalty rates. New South Wales said the coal assessment should reflect Queensland's additional revenue capacity from producing high-value coal. It said an aggregate coal assessment did not do this, and obscured differences in state revenue capacities.

55 Queensland, South Australia and the Northern Territory did not support splitting coal. Queensland was concerned the mineral-by-mineral assessment was already too disaggregated. In its view, the more granular the mining assessment the greater the departure from policy neutrality. Splitting coal meant coal was assessed

differently to other minerals and it produced outcomes inconsistent with equalisation. Queensland said splitting coal was a retrospective change to the coal assessment, which would penalise it for an enacted policy decision. It said if the Commission changed the coal assessment, the change should commence from the 2025–26 assessment year.

56 South Australia said it doubted the revenue and value of production data required to support a split assessment would be available on a consistent basis.

57 The Northern Territory said favouring greater equalisation over policy neutrality was difficult to justify in the coal context. It favoured an aggregate coal assessment for this reason.

58 New South Wales initially favoured splitting coal by type of coal. Other states did not agree. They questioned whether data were available to enable a reliable assessment by type of coal. Queensland said coal existed along a spectrum with no clear delineation between metallurgical and thermal coal.

Commission response

59 The Commission's task is to estimate mining revenue capacities for the purpose of fiscal equalisation. The supporting principles of what states do and policy neutrality are subsidiary to the equalisation task.

60 An aggregate coal assessment calculates coal mining capacity by applying the average (all-coal) royalty rate to each state's coal production. Compared with a split coal assessment, this increased the assessed revenue capacity of states producing low-value coal and reduced the assessed revenue capacity of states producing high-value coal. This implied states producing low-value coal could apply above-average royalty rates to raise the average revenue. This would be inconsistent with the objective of horizontal fiscal equalisation.

61 The Commission agreed with the majority of states that it would be difficult to split coal by type of coal. It considered a simpler option was to split coal by price band.

62 Since the 2020 Review, Queensland has added additional tiers to its progressive coal regime and international coal prices have risen rapidly. The combination of both changes has led to a significant divergence in the average royalty rates applied to high-value and low-value coal. As a result, the difference between an aggregate coal assessment and a split coal assessment has increased. In this environment, the Commission considered a split assessment would better capture the divergence in state coal capacities that has occurred since the 2020 Review.

63 The Commission also considered the impact that the split assessment would have on policy neutrality given that it could potentially create dominant states for both high-value and low-value coal. While the Commission continues to be concerned about policy neutrality implications of the mining assessment and will continue to seek to identify a practical means to mitigate their impact in preparation for the next

review, it concluded that the objective of achieving horizontal fiscal equalisation was best achieved through a split coal assessment.

64 The Commission also considered whether to introduce the price band assessment from 2025–26 or to make the change in all 3 assessment years applicable to the 2025–26 application year. The Commission's approach since the 2010 Review has been to use the average of the 3 prior assessment years as the best indicator of state circumstances in the application year. In its position paper on fiscal equalisation, supporting principles and assessment guidelines, the Commission concluded the 3-year lagged average assessment period continued to provide an appropriate balance between contemporaneity, predictability and stability. Queensland asked the Commission to change this approach and phase-in the introduction of price bands. Consistent with its long-standing approach, and the approach for implementing all method changes arising from the 2025 Review, the Commission decided to make the change in all assessment years.

Commission decision

65 The Commission will split the coal assessment by price band and will make the change to all 3 assessment years.

Choice of price bands

66 The Commission investigated different price band models:

- 2 price bands and multiple price bands
- price bands based on a fixed coal price and bands based on the average coal price in an assessment year.

67 The Commission proposed using 2 price bands that were based on fixed coal prices.

State views

68 New South Wales said splitting coal by price bands would capture the additional capacity when states applied progressive royalty rates to high-value coal. Victoria agreed. Although New South Wales initially favoured multiple bands, most states supported 2 price bands. Two bands provided an appropriate balance between measuring revenue capacity and minimising dominant state and data confidentiality issues. Queensland suggested fewer, broader bands would better support the Commission's conceptual case for changing the assessment.

69 New South Wales favoured an average-price model where the 2 price bands were based on the average price of coal in an assessment year. It said it more appropriately recognised state coal capacities, was more responsive to changes in coal prices and was less susceptible to data confidentiality issues. It also said that because states could not anticipate the average price in an assessment year, the average-price model did not give rise to genuine policy neutrality issues, even if a dominant state issue did emerge.

70 New South Wales acknowledged a dominant state issue emerged for the 2021-22 assessment year under its preferred average-price approach. However, in choosing a fixed-price model, it said the Commission had incorrectly prioritised the dominant state issue over equalisation. It said an average-price model better captured the differences in revenue capacity arising from price divergences between high-value and low-value coal. It said, had the Commission tested more years, it would have found it more likely for a dominant state issue to emerge under a fixed-price model than an average-price model.

71 While it did not support splitting coal, Queensland said if price bands were introduced, a fixed-price model was preferable. It said an average-price model would increase the burden on collection agencies and lengthen the time taken to finalise data. South Australia also said it would increase the data provision burden on states.

72 Queensland also noted practical concerns with splitting coal by price band. It said it could lead to a price band containing one state's production, defaulting the price band to an actual per capita assessment. This could lead to coal being assessed on a different bases (a differential assessment versus an actual per capita assessment) at different times within a price cycle. It said this could produce large swings in assessed revenue if the assessment switched between the different bases. Queensland said when all coal prices were very high or very low, all production would fall within the same price band. In these circumstances the assessment would default to an aggregate assessment, producing the same outcomes as the 2020 Review assessment but in a more complex way.

73 Queensland also said a fixed-price model embedded a permanent split between high-value and low-value coal, even in years when the price differentials were minimal. It said this increased the complexity of the assessment for limited need.

Commission response

74 The Commission agreed that fewer price bands make it less likely data confidentiality or policy neutrality issues would emerge. It was for this reason the Commission proposed splitting coal using 2-fixed price bands.

75 The Commission considered the benefits of price bands based on a fixed coal price band of $200 per tonne and bands based on the average coal price in an assessment year. The Commission's choice of model was not based on whether one or the other approach was more susceptible to a dominant state issue emerging. There is no way for the Commission to predict whether one or other approach would produce dominant state issues in the future. The reason for splitting the coal is to capture the effect of divergences in the royalty rates applied to high-value and low-value coal. Using a fixed coal price band achieves this in a simpler way than an average price band.

76 The Commission based the choice of a fixed price band of $200 per tonne on past trends in the average price for metallurgical and thermal coal. Department of

Industry, Science and Resources data on coal export prices suggest a price band of $200 provided a reasonable split of low-value and high-value coal over the last 5 years.[3]

Commission decision

77 The Commission will split the coal assessment using a fixed-price band model with 2 price bands (above and below $200 per tonne).

Assessment of onshore oil and gas

78 Queensland said it was the dominant producer of onshore oil and gas and levied its royalties on a volume basis. The Commission considered assessing onshore oil and gas on a volume basis because it was consistent with what states do.

State views

79 Most states supported a volume-based assessment.

80 South Australia did not support a volume-based assessment. Both it and the Northern Territory said states other than Queensland levied royalties on a value of production basis and so a volume-based assessment was not consistent with what states do. It also said a volume-based assessment did not capture differences in the quality of the resource.

81 Western Australia noted other minerals (such as salt, sand and gravel) were also levied on a volume basis.

Commission response

82 In its position paper on fiscal equalisation, supporting principles and assessment guidelines, the Commission said the what states do supporting principle was based on the weighted average policy of all states. For revenue assessments, the weight is based on each state's share of the revenue base. Queensland is the biggest producer of onshore oil and gas production, with its share of production exceeding 75%. It imposed volume-based royalties, implying that what states collectively do (and average policy) was a volume-based approach. For that reason, the Commission proposed changing its capacity measure from value of production to volume of production.

Commission decision

83 The Commission will assess onshore oil and gas royalties on a volume basis.

[3] Department of Industry, Science and Resources, *Resources and Energy Quarterly September 2024*, Historical Prices.

GST impacts of method changes

84 The impact on the GST distribution from the method changes are show in Table 1.

Table 1 Impact on GST distribution of method changes, mining revenue, 2024-25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Changes to coal assessment	60	94	-169	14	0	1	0	0	169
Other changes in mining	0	2	17	-7	-16	0	0	4	23
Total	**59**	**96**	**-152**	**7**	**-16**	**1**	**0**	**4**	**167**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Changes to coal assessment	7	13	-30	5	0	2	0	0	6
Other changes in mining	0	0	3	-2	-8	0	0	14	1
Total	**7**	**13**	**-26**	**2**	**-8**	**2**	**0**	**14**	**6**

85 Splitting the coal assessment reduced Queensland's assessed GST needs and increased the assessed GST needs of other states. Assessing Victoria's coal capacity using the revenue received increased its assessed GST needs.

86 Assessing onshore oil and gas on a volume basis increased Queensland's assessed GST needs and reduced those of South Australia.

7. Other revenue

Review outcomes

- No changes were made to the assessment.
  - Revenue will continue to be included in the residual 'other revenue' category if:
    - states are assessed to have the same per capita capacity to raise the revenue
    - either an assessment method could not be developed or reliable data could not be found to support an assessment, or
    - a differential assessment would not be material.
  - Revenues in this category will continue to be assessed equal per capita.
- The Commission considered but did not change the following.
  - The assessment of gambling taxation revenues.
    - A lack of evidence on the propensities of different population groups to participate in different forms of gambling and the significance of state policy differences meant alternative assessment methods were not sufficiently reliable to support a differential 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 gambling taxation consultation paper and other revenue 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 revenue chapter of the *Commission's Assessment Methodology*.

Issues considered

State revenues to be included in the category

6 The category is a residual category, comprising state revenues not assessed in other categories.

7 The Commission considered the criteria used to determine which revenues should be included in the category. It proposed to retain the 2020 Review approach and include a revenue if:

- states are assessed to have the same per capita capacity to raise the revenue
- either an assessment method could not be developed or reliable data could not be found to support an assessment, or
- a differential assessment would not be material.

State views

8 All states supported using these criteria to determine the revenues to be classified to this category.

Commission response

9 There have been no developments that warrant a change to the 2020 Review criteria.

Commission decision

10 The Commission will continue to apply the 2020 Review criteria when determining the revenues to be included in the other revenue category.

Assessment of state revenues

11 The Commission proposed continuing to assess revenues in the category equal per capita.

State views

12 All states supported the equal per capita assessment.

Commission response

13 There have been no developments that warrant a change in the other revenue assessment method.

Commission decision

14 The Commission will continue to assess revenues in this category equal per capita.

Assessment of gambling taxation revenues

15 The Commission considered different assessment methods for gambling taxation revenues. A lack of evidence on the propensities of different population groups to participate in different forms of gambling and the significance of state policy differences meant it considered none of the alternative assessment methods to be sufficiently reliable to support a differential assessment of state gambling taxation. A detailed analysis of the alternative assessment methods is in the Commission's gambling taxation consultation paper.

16 The Commission proposed to continue to assess gambling taxation revenues equal per capita.

State views

17 Most states supported continuing the equal per capita assessment of gambling taxation revenues.

18 Western Australia and South Australia suggested a mix of assessment approaches. Western Australia suggested assessing its capacity equal per capita and the other states' capacity using an activity-based approach (such as gambling turnover). South Australia suggested an equal per capita assessment for revenue from poker machines and casinos and an activity-based approach for other gambling taxation revenue.

Commission response

19 The Commission did not consider it appropriate to use different assessment methods for different states or for different forms of gambling. It noted that policy influences were not limited to one state but were widespread. The substitutability between different forms of gambling justified using the same assessment method for all forms.

Commission decision

20 The Commission will continue to include gambling taxation revenues in the other revenue category and assess the revenues equal per capita.

GST impacts of method changes

21 There are no method changes to this assessment.

Part B

Expense Assessments

8. Schools

Review outcomes

- The following changes were made to the assessment.
  - A differential assessment of primary and secondary school students has been introduced to capture the additional costs of educating secondary students. Cost weights for secondary students and fixed costs of secondary schools have been introduced in the state funded government schools and state funded non-government schools components.
  - The measure of socio-educational disadvantage has been adjusted to the bottom half of socio-educational advantage in the state funded non-government schools component. This adjustment was made as it best captured state spending on non-government schools.
  - A First Nations variable has been included in the state funded non-government schools regression, replacing remoteness variables, as it better explained non-government school funding.
- The Commission considered but did not change the following.
  - The number of students with disability was not included as a predictive variable in the regression due a lack of comparable state data.
  - Special schools will not be separately assessed from mainstream schools. The pattern of state funding of mainstream schools is a more reliable indicator of funding costs for special schools than an equal per capita assessment.
  - A regression approach (rather than the Commonwealth developed Schooling Resource Standard) will continue to assess state funding of both government schools and non-government schools. The Schooling Resource Standard does not sufficiently reflect state funding practice but it has been retained for Commonwealth funded government schools.
  - The measure of socio-educational disadvantage in state funded government schools will be retained as the lowest quartile of socio-educational advantage.
  - The number of students who speak a language other than English will not be included as a predictive variable in the regression.
  - Spending on early childhood education will continue to be included with spending on schools. The diversity of service delivery models in early childhood education between states contributes to a lack of comparable data.
- Recognising the importance of assessing the additional costs of educating students with a disability, the Commission will monitor the comparability of the Nationally Consistent Collection of Data on School Students with Disability with a view to incorporating it in the regression in a future review.

- The Commission will annually test the extent to which funding for First Nations students differs between identifiable groups of First Nations students (such as those in more remote areas, or those in schools with greater proportions of First Nations students). It will amend the regression, in consultation with states, if supported by the data.
- Recognising the evolving policy environment for early childhood education, the Commission will monitor state spending in this area.
- As part of the Commission's forward work program, it will work with states and relevant data providers to consider how culturally and linguistically diverse students affect states' spending on schools.

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 The Commission decision to retain the measure of socio-educational disadvantage for the government funded schools component as the lowest quartile of socio-educational advantage was made after the release of the Draft Report. The Commission's consideration of this issue can be viewed in Significant changes since the Draft Report.

5 This chapter includes:

- an overview of the issues considered throughout the review
- the Commission's response and decision on each issue
- GST impacts of method changes.

6 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the schools chapter of the *Commission's Assessment Methodology*.

Issues considered

Secondary students

7 Secondary school students are more expensive to educate than primary school students. Similarly, secondary schools have higher fixed costs than primary schools. The Commission considered whether:

- additional per student costs of educating secondary school students should be recognised

- fixed costs of secondary schools should be assessed separately.

State views

8 Most states agreed that the additional per student costs of secondary students and the additional fixed costs of secondary schools should be separately assessed if material.

9 Victoria found the regression coefficient results for secondary schools to be very large and suggested that school size (and hence the effect of fixed costs per school) could be influenced by state policy.

10 South Australia expressed concerns around the classification of year 7 students given its transition to educating year 7 students in secondary schools in 2022.

Commission response

11 The inclusion of the secondary student variable and the secondary school size variable significantly enhanced the explanatory power of the model.

12 While school size is influenced by individual state policies, the national average school size by remoteness areas reflects average policy. Victoria has slightly lower fixed costs than the national average and its school funding model includes additional adjustments that tend to direct funding towards smaller schools. The Commission's model attributed these additional costs to the fixed costs of all schools. While Victoria may have lower fixed costs of secondary schools than the national average, this is not evidence that the Commission's model does not reflect average policy.

13 Historically there have been differences in how states classify year 7 students. The Commission has defined year 7 students or above as secondary students, ensuring consistency in all assessment years.

Commission decision

14 The Commission will differentially assess primary and secondary school students by introducing cost weights for secondary students and fixed costs of secondary schools into the state funded government schools and state funded non-government schools components.

Students with a disability

15 States spend more educating students with a disability than other students. Therefore, differences between states in the number of students with a disability could be a significant driver of state spending needs.

16 The Commission considered whether fit-for-purpose school data were available for assessing the needs of educating students with a disability within the schools assessment. The Commission also considered whether special schools should be assessed separately from mainstream schools.

17 The Commission had concerns that the available data for an assessment of students with a disability lacked comparability between states. To assess the needs of students with a disability, the Commission would require the following:

- aggregate state data indicating the proportion of students with a disability in each state
- school level data to estimate cost weights through a regression model and to assess consistency of the aggregate state data.

State views

18 All states supported the conceptual basis for assessing the needs of students with a disability. However, some had concerns about data comparability between states.

19 As the data from the Nationally Consistent Collection of Data on School Students with Disability are used by both states and the Commonwealth for allocating funding to schools, some states said the data are of sufficient quality to use in the assessment. Victoria said if the Commission did not regard the data as of usable quality, it should use an equal per capita assessment.

Commission response

20 If it can be done reliably, the needs of students with a disability should be assessed given the additional costs of educating these students. The Commission tested the Nationally Consistent Collection of Data on School Students with Disability for comparability (see the Draft Report for details of the testing). This found states' data are not yet sufficiently comparable for equalisation purposes. The publicly available data suggest that students with similar levels of need are identified differently in different states. The Commission will monitor the Nationally Consistent Collection of Data on Students with Disability with a view to using it in a future review.

21 First Nations students and socio-educationally disadvantaged students have much higher rates of disability than other students. As such, states with more First Nations and socio-educationally disadvantaged students would likely have greater enrolments in special schools if all states followed a consistent policy for special schools. Influences such as remoteness are likely to affect the cost of delivering education in special schools. Given these factors, an assessment using patterns in mainstream schools, which reflect these factors already, provides a more reliable reflection of state needs for special school funding than an equal per capita assessment.

Commission decision

22 The Commission will:

- not include the number of students with a disability as a variable within its regressions of the drivers of state spending on schools
- apply the model based on funding of mainstream schools to state spending on mainstream and special schools

- monitor comparability of the Nationally Consistent Collection of Data on School Students with Disability, with a view to incorporating it into the regression in a future review.

Schooling Resource Standard

23 The Commonwealth developed the Schooling Resource Standard as the national funding formula used to allocate Commonwealth funding. The Schooling Resource Standard could be used for the schools assessment if state funding of schools was sufficiently in line with the Schooling Resource Standard's funding levels. However, the Commission had concerns that convergence was not yet sufficient for this purpose, so assessing needs using the Schooling Resource Standard would not reflect what states do.

State views

24 Most states agreed that the Schooling Resource Standard funding model did not sufficiently reflect state funding practices and should not be used to assess spending for schools.

25 Western Australia and the Northern Territory supported using the Schooling Resource Standard, and Victoria supported incorporating elements of it, such as costs relating to students with a language background other than English. The Northern Territory said most other states' funding models came close to the Schooling Resource Standard. The Northern Territory said it was also working towards aligning with the Schooling Resource Standard and that it should replace the current assessment as it included additional drivers of need.

Commission response

26 The Commission aims to reflect what states do. Each state has a different needs-based funding model with similar drivers to those in the Schooling Resource Standard, but with unique loadings and definitions for those drivers. The Commission's regression produces a more accurate model of what states do on average.

Commission decision

27 The Commission will use a regression to model what states do in state funded government schools and state funded non-government schools.

28 It will use the Schooling Resource Standard for Commonwealth funded government schools.

Socio-educational disadvantage

29 In response to state comments, the Commission considered which measure of socio-educational disadvantage would be most appropriate in the schools regression models. It proposed using the most socio-educationally disadvantaged 10% of

students instead of the most disadvantaged 25% of students in the government schools model.

State views

30 The Northern Territory said that using the lowest quartile of socio-educationally advantaged students understates the disadvantage faced by its student population. It suggested using a more granular measure of socio-educational disadvantage.

31 Some states said that using the lowest decile of socio-educationally advantaged students would recognise the most disadvantaged but would fail to address the needs of moderately disadvantaged students. They said that only assessing the lowest decile of socio-educationally advantaged students would underestimate the increased needs of states with an above-average share of moderately disadvantaged students. Tasmania said that while using the lowest decile of socio-educationally advantaged students increased the explanatory power of the model slightly, it would lead to a lower amount of assessed spending being allocated to disadvantaged students. Victoria disagreed, saying favouring variables with a larger impact on GST distribution was not an appropriate basis for variable selection.

32 Western Australia said that costs associated with First Nations students could be attributed to other variables such as disadvantage. It said that this could lead to incorrect assessed expenses if the rates of students for each variable in each state differs.

Commission response

Government schools

33 The most disadvantaged decile of students in government schools attracted significantly higher funding than the rest of the most disadvantaged quartile (the 11^{th} to 25^{th} percentile). This suggested that a more detailed measure of socio-educational disadvantage would better reflect funding at a school level.

34 In government schools, including both the most disadvantaged decile and moderate levels of disadvantage in the regression produced results that were not consistent with the conceptual case. As such, only a single measure of disadvantage could be used. Using the most disadvantaged decile better explained funding at an individual school level, but this was not the case in explaining states' differing funding needs because it did not account for the costs of moderately disadvantaged students.

35 Using the most disadvantaged decile resulted in a lower amount of total assessed spending to disadvantaged students. This was because changing the indicator from the most disadvantaged 25% to the most disadvantaged 10% roughly halves the number of affected students, but the associated coefficient changes by less than double (increasing from 5,067 to 9,719). Additionally, the shares of students in the most disadvantaged quartile differ more between states than the shares in the most

disadvantaged decile. Thus, the larger cohort of moderately disadvantaged students is a more important driver of differences in state spending.

36 Many students who are in the most disadvantaged decile of socio-educational advantage are First Nations students. Therefore, in the model that uses the lowest quartile of disadvantaged students, some of the additional costs of the most disadvantaged 10% of students are captured by the First Nations cost weight.

37 The Commission concluded that the bottom quartile of socio-educationally advantaged students better captures state needs associated with disadvantaged students.

Non-government schools

38 In non-government schools, the second most disadvantaged quartile had a larger coefficient than the most disadvantaged quartile. The Commission aggregated these quartiles such that the bottom half of socio-educationally advantaged students formed one of the explanatory variables in the non-government schools model.

39 Compared to the government sector, a broader group of disadvantaged students appear to drive state spending in the non-government sector. Both the most and second most disadvantaged quartile have positive coefficients in the non-government model. This likely reflects that, in the government sector, it is the educational need of the most disadvantaged that is most important, while in the non-government sector, the capacity of parents to contribute to the cost of education is also important.

Commission decision

40 The Commission will retain the measure of socio-educational disadvantage as the lowest quartile of socio-educational advantage in state funded government schools.

41 It will adjust the measure of socio-educational disadvantage to the bottom half (rather than the lowest quartile) of socio-educational advantage in state funded non-government schools.

First Nations students

42 In response to state comments, the Commission considered whether the inclusion of a First Nations variable in the state funded non-government schools regression model would be appropriate. It also considered whether a variable, accounting for additional costs associated with a high proportion of First Nations students in a school, could be included in the regression models for government and/or non-government schools.

State views

43 Western Australia said that First Nations students require more support regardless of which school sector they attend. It proposed that the First Nations cost weight

used in the government schools regression also be used in the non-government schools regression.

44 Western Australia also noted that the additional costs of educating First Nations students has not decreased. It said that a fall in the First Nations cost weight could be reflective of newly identified First Nations students.

45 The Northern Territory highlighted the increased cost of providing education in schools with a high proportion of First Nations students. Conversely, Victoria said that the costs of educating its dispersed First Nations populations should be recognised.

Commission response

Non-government schools

46 The Commission considered whether a First Nations variable could be included in the non-government schools model. The non-government schools regression model in the 2020 Review included an outer regional and a remote variable, but not a First Nations student variable.

47 Conceptually, outer regional, remote and First Nations variables would be expected to increase costs. However, applying a First Nations cost weight derived from the government schools model, along with cost weights generated from the non-government schools regression, would result in double counting of some influences.

48 In contrast to the regression in the 2020 Review, including a First Nations student variable and excluding the outer regional and remote variables better captures spending in non-government schools. Therefore, a First Nations variable will be introduced, and the remoteness variables will be removed.

Government schools

49 Each state adopts a unique approach to funding First Nations students. The regression showed that, collectively, these approaches did not include an increase in funding per student as the proportion of First Nations students in a school increased. Therefore, a First Nations proportion variable has not been introduced in the model for government schools. However, this will be monitored given indications of states moving towards linking funding per student to the proportion of First Nation students in a school.

50 From 2019 to 2021, the First Nations cost weight decreased from 72% to 49% of the base per student amount, while the cost weights for disadvantaged and remote students increased. Noting that changes in First Nations student identification could affect the schools assessment, the Commission will monitor this area. It will adjust the specifications measuring the additional needs of First Nations students in consultation with states if supported by the data.

51 The Commission considered Victoria's argument that schools incur costs related to First Nations students regardless of the number of such students. If this is the national average policy, the regression model will include these costs as part of its fixed cost coefficients.

Commission decision

52 The Commission will change the state funded non-government schools regression to exclude remoteness and include First Nations students.

53 The Commission will analyse whether different groups of First Nations students in both government and non-government schools receive different levels of funding. This will include annually testing whether the model can be improved by:

- including the proportion of First Nations students in a school
- including separate coefficients for remote and non-remote First Nations students.

54 The Commission will consult with states on any proposals to adjust its regression models if supported by the data.

Students from non-English speaking backgrounds

55 In response to state comments, the Commission considered whether a measure of students from non-English speaking backgrounds could be included in the schools regression models.

State views

56 Victoria and the Northern Territory said they spend more to educate students from a language background other than English and that the Commission should recognise students with English as an additional language as a driver of need.

Commission response

57 The cohort of students from a language background other than English is diverse and may not uniformly attract increased funding. For example:

- a socio-educationally advantaged child of migrants with a strong proficiency in English may attract a different level of funding than a non-English speaking refugee
- a socio-educationally advantaged child with strong English proficiency from a non-English speaking background, may not attract higher funding than a comparable student from an English-speaking background.

58 The cohort of students from non-English speaking backgrounds includes some First Nations students. These students tend to live in more remote areas and attend schools with a high proportion of First Nations students. Therefore, the regression model may already assign some of these additional costs to associated attributes of these students.

59 To test if students from non-English speaking backgrounds could be assessed within the regression, the Commission categorised students who speak a language other than English at home into 4 groups. These groups were defined based on Indigenous status and parental education level (to measure disadvantage). These groupings were based on the classifications used in the Schooling Resource Standard. Of these groups, only the disadvantaged, non-Indigenous students from a language background other than English had a positive coefficient, but it was not material.

60 The Commission will explore the impact of cultural and linguistic diversity on state spending needs as part of its forward work program.

Commission decision

61 The Commission will not include a variable for students who speak a language other than English.

62 As part of the forward work program, the Commission will consider how cultural and linguistic diversity affects state spending. This will include considering the impact of culturally and linguistically diverse students in the context of the schools assessment.

Early childhood education

63 In the 2020 Review, the schools assessment method was applied to spending on early childhood education. In response to state comments, the Commission considered whether early childhood education should be separately assessed.

State views

64 Victoria and Queensland said that early childhood education is likely to grow throughout the 2025 Review period. Victoria said that it was not appropriate to include early childhood education spending with schools spending. It noted that preschool is not compulsory, subsidies depend on income levels, and that different levels of service use for different cohorts make spending on preschools different to spending on schools. It proposed that the Commission establish a component for early childhood education. If a separate method could not be developed, it should be assessed equal per capita and be revisited in the 2030 Review.

Commission response

65 The Commission notes this is an evolving area where policy changes are underway, and spending is growing. Under the Preschool Reform Agreement, the Australian Government and all states committed to further funding for early childhood education.[1] More broadly, the Australian Government is consulting on an overarching

[1] Department of Education, Preschool Reform Agreement, Department of Education, Australian Government, 8 May 2024, accessed 2 September 2024.

Early Years Strategy that will focus on providing a framework to improve outcomes for young children.[2]

66 States are expanding access and increasing quality of early childhood education, with some states introducing an additional year of free universal preschool.[3] While there is a conceptual case for isolating these costs and assessing needs, there is an absence of national data on costs for key groups. The diversity of service delivery models between states also contributes to a lack of comparable data.

67 To investigate whether the schools assessment would provide an appropriate proxy for spending in early childhood education, the Commission considered spending on preschools in the Northern Territory. This was because the Northern Territory has a student profile, and average cost per student, very different from the average. Therefore, if relative spending in early childhood education in the Northern Territory is close to its relative spending on schools, that supports using schools as a proxy. Alternatively, if it is closer to national average spending, that would support an equal per capita assessment of early childhood education. Of course, Northern Territory policies on early childhood education also affect this analysis.

68 The Northern Territory's actual spending on early childhood education averaged 39% more per capita than the national average between 2019–20 to 2022–23. This suggests that just as a large number of remote and/or First Nations students can increase costs for educating students in government schools, it can increase the costs of early childhood education. Therefore, the government schools assessment is likely to be a more reliable proxy for states' needs in early childhood education than an equal per capita approach.

69 There is no readily available data on which to determine the state spending needs for preschools. With only $105 per capita spent on preschools in 2022–23, an assessment is unlikely to be material.

70 Noting that this policy area is evolving and spending on early childhood education is expected to grow significantly, the Commission will continue to monitor developments.

Commission decision

71 The Commission will:

- continue to include spending on early childhood education with spending on schools
- monitor state spending in this area.

[2] Department of Social Services (DSS), The Early Years Strategy 2024-2034, DSS, Australian Government, 2024, accessed 2 September 2024.

[3] For example, Victorian Government, Best Start, Best Life reforms, Victorian Government, 28 May 2024, accessed 2 September 2024; ACT Education Directorate, Set up for Success: An Early Childhood Strategy for the ACT, ACT Government. 2020, accessed 2 September 2024; NSW Government, Start Strong program for preschool children, NSW Government, 12 March 2024, accessed 2 September 2024.

GST impacts of method changes

72 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, schools, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Government schools model	-35	-31	41	-4	5	9	11	6	71
Non-government schools model	-14	-29	32	15	0	2	-4	-3	49
Total	**-50**	**-60**	**73**	**11**	**5**	**10**	**7**	**3**	**110**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Government schools model	-4	-4	7	-1	3	15	22	23	3
Non-government schools model	-2	-4	6	5	0	3	-8	-10	2
Total	**-6**	**-8**	**13**	**4**	**3**	**18**	**14**	**13**	**4**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes*.

73 The inclusion of variables associated with secondary school students in the government schools model has resulted in changes to the other coefficients. This is because the different drivers of costs measured in the models may differ between secondary and primary schools. For example, secondary schools have lower proportions of First Nations students, on average, than primary schools. A differential assessment of primary and secondary school students ensures that the lower costs for primary students do not mask the higher costs of educating First Nations students. This has resulted in higher assessed GST needs for the Northern Territory.

74 Secondary schools have higher proportions of students in the most disadvantaged quartile, on average, than primary schools. This is because parents of younger children tend to have higher levels of education than parents of older children.[4] Parents' education is used as an input to quantify a student's socio-educational advantage level. A differential assessment of primary and secondary school students reduced the cost weight for disadvantaged students, as it was no longer elevated by the higher costs of secondary schooling. This, applied to the ACT's below average proportion of students in the most disadvantaged quartile, resulted in higher assessed GST needs for the ACT.

75 In the non-government schools component, there was a minor impact on GST distribution from changes in model specification.

[4] Educational levels have gone up over time. This has led to 2021 census data showing that 31% of parents of secondary school children (who have an average age of 47) have not completed year 12, compared with 25% of parents of primary school children (who have an average age of 41).

9. Post-secondary education

Review outcomes

- The following changes were made to the assessment.
  - The cross-border adjustment for post-secondary education services between the ACT and New South Wales will be adapted to reflect the bilateral agreement between these jurisdictions.
  - The First Nations and regional cost weights in the socio-demographic assessment were re-estimated using more recent data collected from the states.
- The Commission considered but did not change the following.
  - A course mix driver will not be introduced because a state's course mix is primarily driven by factors not related to its industrial profile, including student preferences as well as state and Commonwealth policy choices.
  - The variables in the socio-demographic composition assessment and the approach for calculating the regional costs adjustment will be retained.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating the changes made in the 2025 Review, can be found in the post-secondary education chapter of the *Commission's Assessment Methodology*.

Issues considered

Course mix driver

6 Differences in the industry structure of states may lead to students enrolling in different courses in different states. Some courses are more expensive to provide

than others. However, the Commission proposed not to include a course mix driver because it was unlikely to be material, and states' course offerings are policy influenced.

State views

7 Most states agreed that course mix was unlikely to be material and should not be introduced as a driver.

8 Western Australia said that course mix could be considered the same driver as the 'industry mix' driver in the services to industry and mining revenue assessments, and that materiality would not need to be separately tested.

Commission response

9 The Commission considered that a state's course mix is primarily driven by factors not related to its industrial profile including student preferences, as well as state and Commonwealth policy choices. Untangling these different influences would be challenging.

10 A further consideration was the differing employment intensity of different industries. While the drivers in the services to industry and mining revenue assessments focus on the value-add of an industry, any driver in post-secondary education would need to incorporate a state's industrial employment profile.

Commission decision

11 The Commission will not introduce a course mix driver.

Socio-demographic assessment

12 The Commission sought state views on whether the variables in the socio-demographic composition assessment remained fit for purpose and re-estimated the associated cost weights.

State views

13 All states agreed that the socio-demographic assessment be retained.

14 Western Australia said that the 2020 Review regional cost gradient does not adequately assess the service delivery scale needs associated with its remote post-secondary education training.

15 New South Wales queried the reliability of Western Australian data on remote and very remote cost weights, given the rapid growth in these cost weights between reviews.

16 Victoria was concerned that the socio-demographic assessment involves measuring the interrelated drivers of First Nations, low socio-economic status, and remote populations. The Commission should ensure it avoided double counting of costs.

Commission response

17 The regional costs adjustment in the assessment is based on state funding formulas, which include allowances for higher costs in more remote areas. Because states do not have a separate additional allowance for small institutions, the Commission will not adjust for this effect. The regional cost adjustment was re-estimated using updated data provided by the states, with the aim of capturing any relevant data improvements.

18 Western Australian data in the 2020 Review reflected the additional costs that Western Australia provided to private training providers but did not reflect the additional costs of public training in remote areas. Its public sector subsidies are much greater.

19 The Western Australian cost gradient is much steeper than for other states. This pattern is evident in other assessments as well. It may reflect a combination of 2 issues.

- In response to the greater economic activity in its remote areas, Western Australia may have a policy of higher levels of service in remote areas than other states.
- Due to the prevalence of mining activity in the state, remote areas of Western Australia have higher private sector wages. To entice staff to work in such areas, Western Australia may need to offer higher allowances than other states to compete with the private sector. This means that Western Australia's regional cost gradient is generally steeper than other states. Applying the national gradient to Western Australia remains appropriate, as the wage costs assessment captures the impact of higher private sector wages in Western Australia.

20 The Commission agrees it is important to avoid double-counting. Regional costs and First Nations cost weights are each calculated in a way designed to reflect the isolated effect of that driver. Thus, it is appropriate that the cost of educating a First Nations student in a remote area would reflect both the remote cost weight and the First Nations cost weight.

Commission decision

21 The Commission will retain the drivers used in the socio-demographic assessment and re-estimate the First Nations and regional cost weights using updated data collected from states.

Cross-border adjustment

State views

22 New South Wales noted that it is negotiating to reimburse the Canberra Institute of Technology for cross-border services in the ACT directly, and that this could require a change to the cross-border adjustment.

Commission response

23 For its post-secondary education assessment, the Commission uses data from the National Centre for Vocational Education Research on the hours of training provided by ACT institutes for New South Wales residents and vice versa. The Commission will use state data to ensure its cross-border adjustment reflects the provision of training that is not covered by the agreement.

Commission decision

24 In each assessment year, the Commission will adapt its cross-border adjustment, so that any training hours covered by the bilateral agreement can be removed to estimate the residual net cross-border service use.

GST impacts of method changes

25 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, post-secondary education, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
$m	-19	-5	3	8	4	3	-2	8	26
$pc	-2	-1	1	2	2	6	-3	32	1

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes.*

26 The change in the GST distribution is due to the re-estimation of the First Nations and regional cost weights used in the socio-demographic assessment. Re-estimating the cost weights reduced the assessed GST needs of New South Wales, Victoria and the ACT. The changed approach to cross border only affected the 2023–24 assessment year, and so is not reflected in Table 1.

10. Health

Review outcomes

- The following changes were made to the assessment.
  - A new, temporary component will be introduced to assess expenses associated with the National Partnership on COVID-19 Response. The usual drivers in the health assessment do not adequately reflect state expense needs for COVID-19–related hospital and public health services.
  - A direct measure of activity for ambulatory community mental health services within the community and public health component will be introduced. This will provide a more accurate estimate of service use by socio-demographic groups than the previous hospital-based proxy indicator. The general regional cost gradient will be used to take account of increased service delivery costs as remoteness increases.
  - The proxy indicator of activity for the remainder of community and public health will be broadened to include a subset of non-admitted patient activity, in addition to triage category 4 and 5 emergency departments activity. As many non-admitted patient services are similar to community health services, this will provide a better estimate of community and public health activity than emergency departments triage category 4 and 5 services alone.
  - Substitutability levels for the non-state sector adjustments for admitted patients, emergency departments, non-admitted patients and community and public health will be updated to reflect new data and minor modifications to the methods.
  - For the non-state sector adjustment associated with Commonwealth-funded First Nations community health organisations, actual expenses will be used to measure non-state sector assessed expenses. This results in no adjustment to socio-demographic assessed expenses from this element of the non-state sector adjustments.
  - A low discount of 12.5% will be applied to the non-state sector adjustments for the admitted patient, emergency department, non-admitted patient and community and public health components. The discount reflects issues with the quality of the data and the robustness of the methods for non-state sector adjustments.
  - Updated data will be used to re-estimate the split between hospital and non-hospital patient transport expenses and the net value of cross-border community health services provided by the ACT to New South Wales residents.
- The Commission considered but did not change the following.
  - The socio-demographic composition assessment of state expenses on hospitals and non-hospital patient transport services will not change, with no ongoing implications from the COVID-19 pandemic identified for these assessments.

- Public health expenses will continue to be assessed together with community health services (other than specialised community mental health) using a hospital-based proxy indicator of activity.
- The low discount of 12.5% will be retained for the socio-demographic composition assessment of state expenses on community and public health, other than expenses on ambulatory community mental health services. The discount recognises that activity is measured by a proxy indicator of activity.
- The separate assessment of expenses on non-hospital patient transport services will continue. However, if the costs associated with these services are incorporated by the Independent Health and Aged Care Pricing Authority in the national weighted activity units before the next review, expenses on non-hospital patient transport services will be assessed in the admitted patient services component.
- The proxy indicators of activity for non-state services will be retained.
- The existing age groups for the socio-demographic assessment of health expenses will be retained. Splitting the oldest age group was tested but it did not have a material impact on GST distribution. The other age groups could not be modified due to limitations with the data.
- The full payment under the National Health Reform Agreement will continue to be treated as impact, in line with the Commission's framework for the treatment of Commonwealth payments.
- No adjustments will be made to the state shares of National Health Reform funding to recognise cross-border service use. Bilateral agreements are in place to compensate states for the services provided to residents of other states.
- Component expenses for the third assessment year will continue to be estimated based on the growth in category level expenses.

• As part of the Commission's forward work program, it will work with the states to:
  - review the health assessment framework in preparation for the next methodology review
  - explore the evidence on the relationship between the provision of health services by the private sector and the Commonwealth government, and the amount of state spending on health services
  - explore in detail the evidence on health service needs of people in similar socio-demographic groups across states
  - consider the basis for cultural and linguistic diversity as a driver of state expenses, including health expenses, and appropriate definitions and data for any measure.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating the changes made in the 2025 Review, can be found in the health chapter of the *Commission's Assessment Methodology*.

Issues considered

Suitability of the hospital and patient transport assessments post-pandemic

6 The Commission sought state views on whether the hospital (admitted patients, emergency departments and non-admitted patients) assessments and the non-hospital patient transport assessments remained fit for purpose following the COVID-19 pandemic. The Commission proposed no ongoing changes to the health assessment in response to the pandemic.

State views

7 States said that there were no ongoing implications for the health assessment from the COVID-19 pandemic.

8 Queensland, Western Australia and the ACT said that the impacts of the pandemic were only temporary. The Northern Territory said that the impacts of COVID-19 were significant, but do not warrant a long-term departure from existing methods.

9 New South Wales said that without a clear alternative data source being both available and reliable, National Weighted Activity Unit data remain the appropriate data source for the assessment. Tasmania said that the assessments use data based on national weighted activity units from different health service settings and continue to be reliable measures of the use and cost of services by socio-demographic group.

Commission decision

10 The Commission will make no ongoing changes to the hospital and patient transport assessments in response to the COVID-19 pandemic.

Improving the responsiveness of the community and public health assessment

11 The Commission sought state views on whether the proposed changes to the community and public health assessment (discussion of the changes starts at paragraph 43) would make it more responsive to significant developments (such as a pandemic) affecting that part of the health system.

12 The Commission assesses GST relativities over 3 assessment years. In expense assessments, for the third assessment year, the Commission usually aggregates state data to the category level and increases component level expenses for the second assessment year by the growth in category level expenses. This is done to limit the size of data revisions in the subsequent update due to changes made to state data by the ABS. The Commission considered alternative approaches to estimating component expenses in the third assessment year to improve responsiveness.

13 In the Draft Report the Commission proposed no changes to make the community and public health assessment more responsive, other than the change to the assessment of ambulatory specialised community mental health services.

State views

14 States were generally supportive of efforts to improve the responsiveness of the health assessment, although some states said they have significant concerns with the specific proposal put forward by the Commission to use a direct measure of activity for ambulatory specialised community mental health services.

15 Western Australia said it did not see any benefit in making an assessment more responsive to poor measures of need.

16 South Australia said any indicator that is based on proxy data would not completely capture what is actually occurring.

17 Tasmania said it agreed that during the COVID-19 pandemic there was a significant public health response by the Australian and state governments. It said the 2020 Review community and public health assessment did not capture the COVID-19 shock because it uses a proxy indicator.

18 The Northern Territory said the assessment should be built assuming medium to long-term stability in the health system rather than to maximise resilience to exceptional shocks.

Commission response

19 If there are significant differences in spending growth between components, it may be better to allow the assessments to try to capture this effect. This has been done for the past 4 updates in the services to industry assessment in response to the large increase in state spending on COVID-19 business support.

20 The Commission could switch to using state-provided year 3 data when a relevant shock occurs. However, events that may lead to significant variation in the growth of component expenses in the health assessment are likely to be rare.

Commission decision

21 The Commission will maintain the 2020 Review approach, which minimises data revisions between updates.

Assessment of state spending on COVID-19–related health services

22 The Commission considered state views on whether expenses related to COVID-19 health services should be assessed differently.

23 The Commission proposed treating the Commonwealth payments for public hospital and public health services under the National Partnership on COVID-19 Response as impact and assessing state spending associated with the national partnership on an actual per capita basis.

State views

24 Most states referred to their previous comments on this issue during consultations on the 2021, 2022 and 2023 updates of GST revenue sharing relativities.

25 New South Wales, Victoria and the ACT said that state spending associated with COVID-19 should be assessed on an actual per capita basis.

26 New South Wales said that state responses to COVID-19 were jointly agreed and aligned to the National Partnership on COVID-19 Response. During the acute stage of the pandemic in 2019–20 and 2020–21, prior to widespread vaccination, all states pursued a zero–COVID-19 policy. New South Wales said differences in responses between states therefore reflected differences in circumstances rather than policy.

27 Victoria said that in responding to COVID-19, state expenses were driven by uncontrollable and random impacts of the virus, following nationally agreed frameworks. It said expenses did not follow the Commission's drivers for health expenditure in the 2020 Review, being more concentrated in major cities and younger, non-Indigenous residents.

28 New South Wales said that COVID-19–related costs should include quarantine expenses incurred by New South Wales on behalf of other states that have not been reimbursed. Victoria said that a resolution to this issue through the 2025 Review is

necessary, as the review will set relativities for 2025–26 which include 2021–22 data, the most significant year for Victoria's COVID-19 spending.

29 Victoria and the ACT said that the COVID-19 pandemic revealed the need for flexibility in assessment methods in response to major shocks in the health assessment. The ACT supported the Commission investigating alternative data sources to identify drivers of the use and cost of services, including due to a public health threat.

30 Some states said an actual per capita assessment of COVID-19–related expenses was not appropriate because state spending was policy influenced. Queensland and Western Australia said the expenses should be assessed equal per capita. South Australia said that if a separate assessment of COVID-19 based on an actual per capita approach was adopted, the maximum discount must be applied to reflect policy neutrality and data quality concerns.

31 Queensland said that an equal per capita assessment for COVID-19–related expenses is appropriate given the lack of evidence on differences in state need. Queensland said a range of factors indicate that the substantial differences in spending across jurisdictions reflect different health-related policy positions by individual jurisdictions. Queensland said to ignore the potential impacts of policy decisions made by individual jurisdictions, in particular New South Wales and Victoria, in the context of COVID-19 responses would clearly violate the horizontal fiscal equalisation principle of policy neutrality.

32 Western Australia said that different state policies contributed to most of the differential impact of COVID-19. Western Australia said the evidence showed that the National Partnership on COVID-19 Response funding bore no relationship to the number of COVID-19 cases in each state, and state baselines on preparedness and equipment were different. Western Australia said various international and national studies and public commentators supported its position that policy differences between states were significant and led to different outcomes.

33 Western Australia said that the Commission had stated in the 2023 Update that it could not identify any drivers of COVID-19 state spending. It said the Commission's gambling tax assessment also struggles with a lack of identifiable drivers and significant policy differences. It suggested COVID-19 spending should therefore be assessed equal per capita like gambling revenue.

34 South Australia said that it 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. South Australia said that in previous consultation processes it (and a number of other states) provided examples and independent opinions that supported the view that the policy decisions made by states did have a significant impact on COVID-19 case numbers and associated expenditure. South Australia said that as the effects of COVID-19 were impacted by policy decisions, any alternative assessment approach would need to be based on reliable policy neutral data but

that no alternative policy neutral assessment approach had been identified. South Australia said that adoption of an actual per capita assessment approach for health expenditure would only be appropriate if policy choices were consistent and this was not the case during the pandemic years.

Commission response

35 There are diverse views among the states as to whether state health spending on COVID-19 largely reflected state policy or state circumstances. The Commission recognises that it is not possible to point to definitive evidence one way or the other, or to separately identify what spending was influenced by policy choices. It ultimately comes down to a matter of judgement, taking into account the circumstances and uncertainties associated with the pandemic.

36 The terms of reference for the 2021, 2022, 2023 and 2024 updates did not provide for a change in assessment method in response to COVID-19. Consequently, Commonwealth payments associated with the National Partnership on COVID-19 Response were treated as no impact since the COVID-19 spending was not specifically assessed. The 2020 Review health assessment was applied to state-funded spending under the National Partnership on COVID-19 Response.

37 With the flexibility to change the health assessment in response to COVID-19 following the 2025 Review, the Commission was able to use an alternative assessment for assessing state spending related to COVID-19.

38 The Commission has stated previously how it would assess COVID-19 related spending if permitted under the terms of reference for an update. For example, in the 2023 Update New Issues discussion paper, it stated:

'If terms of reference allow for a change in method to respond to COVID-19:

- treat the Commonwealth payments under the National Partnership on COVID-19 Response as impact; and
- assess state spending associated with the national partnerships on an actual per capita basis.'

39 The basis of this position was that:

- the differences in spending between states on COVID-19 cannot be fully explained by the Commission's health assessment of state spending needs on health services more broadly
- the Commission considered state responses to the COVID-19 pandemic largely reflected circumstances outside of state control rather than policy choices.

40 States incurred health costs related to the pandemic that were not within the scope of the national partnership. However, the Commission will limit the actual per capita assessment only to the expenses covered by the national partnership because it provides assurance that spending was broadly consistent between states.

41 The National Partnership on COVID-19 Response ceased in 2022–23. The separate assessment of state spending under the national partnership will continue until the

2027 Update when 2022–23 drops out of the Commission's 3-year assessment period.

Commission decision

42 The Commission will treat the Commonwealth payments for public hospital and public health services under the National Partnership on COVID-19 Response as impact and assess state spending associated with the national partnership on an actual per capita basis.

Direct measure of specialised community mental health activity

43 The Commission originally proposed that activity in ambulatory specialised community mental health programs be used to assess state spending needs for all community mental health services. The 2020 Review method used proxy data to estimate activity, namely, lower priority hospital emergency department services.

44 The Commission modified its original proposal to only use activity in ambulatory specialised community mental health programs to assess state spending on community mental health services in an ambulatory setting.

State views

45 States had diverse views on the proposed direct measure of specialised community mental health activity.

46 New South Wales, Victoria and the ACT supported the use of the direct measure of activity. Other states raised a range of issues with the activity data. Specifically:

- the activity and expense data were not reported consistently by states and therefore were not suitable for assessing GST needs
- activity in ambulatory specialised community mental health services was not representative of activity in other forms of community mental health services, particularly in outer regional and remote areas
- the activity data should not be used because of the lack of cost weights.

47 New South Wales said the remoteness gradient should be derived from the remoteness weights for emergency department and non-admitted patient services rather than the general regional cost gradient. Victoria said the general regional cost gradient should not be applied or at least discounted by 50% because there is no evidence that costs increase with remoteness. Western Australia said the general regional cost gradient should not be discounted because a portion of the gradient is derived from health services.

Commission response

48 The Commission concluded that the data on specialised community mental health ambulatory services were not representative of activity for all community mental health services. Although in aggregate ambulatory services represent a sizeable share of total state spending on specialised community mental health services (66%), they

account for a larger share of services in major cities and inner regional areas and a much lower share of services in outer regional and remote areas. Therefore, using this as an indicator of activity for all spending on specialised community mental health services would overestimate spending in major cities and inner regional areas and underestimate spending in other areas.

49 The Commission therefore modified its original proposal and narrowed the use of the activity data to assess spending only on ambulatory specialised community mental health services.

50 The Commission concluded that, notwithstanding concerns raised by states about the activity data on spending for ambulatory specialised community mental health services, these data would likely produce a better estimate of state GST needs than an activity indicator based on hospital activity.

51 The Commission applied the general regional cost gradient to the activity data to take account of increased service delivery costs as remoteness increases. The general regional cost gradient was considered a better indicator of how costs change with remoteness than a hospital-based regional cost gradient. A discount of 25% to the gradient is applied in all assessments where the general regional cost gradient is used, in recognition that the cost components used to calculate the general regional cost gradient are only a proxy for actual service costs.

Commission decision

52 The Commission will introduce a direct measure of community mental health activity for ambulatory services only. The ambulatory community mental health assessment will be a sub-component of the community and public health assessment.

Expanded proxy measure of activity for the residual community and public health services

53 The Commission originally proposed the use of a broader proxy indicator of activity based on a combination of emergency department and non-admitted patient services to assess expenses on community and public health other than ambulatory specialised community mental health.

54 The Commission modified the original proposal to include only a subset of non-admitted patient services in the proxy indicator.

State views

55 Some states welcomed efforts to improve the assessment of community and public health and provided qualified support for broadening the proxy, although they acknowledged there was limited evidence to support the proposal.

56 Some states said that emergency department services are more representative of community health services than non-admitted patient services, particularly in remote and very remote areas.

57 Victoria said that, given the lack of relationship of the hospital-based proxies to public and community health, the Commission should assess these components as equal per capita.

58 South Australia said the weighting of non-admitted patient services in the proxy indicator should be reduced due to problems with the data.

59 Tasmania said the Commission's analysis of similarities between community and public health services and non-admitted patient services did not take account of large variations in access times within community and public health programs. Tasmania said that activity of COVID-19 clinics should not be included in the proxy indicator for community and public health because the Commission had proposed a separate assessment of COVID-19 expenses.

Commission response

60 The diversity of community and public health programs and limited existing information on the socio-demographic usage of the programs make it difficult to determine whether a hospital-based indicator of activity would be a reasonable proxy for community and public health activity (outside of ambulatory community mental health care). However, the only options available to the Commission are hospital-based activity measures or an equal per capita assessment.[1]

61 In the 2015 and 2020 reviews, the Commission decided to use emergency department triage category 4 and 5 services as the proxy indicator of activity for community and public health services based on the similarity of the services in the 2 health settings. At the time of these reviews, non-admitted patient services were not considered for the proxy indicator because the national weighted activity unit data for non-admitted patient services were not sufficiently reliable.

62 Non-admitted patient national weighted activity unit data are now reliable and the Commission has been using these data to assess expenses on non-admitted patient services since the 2021 Update. For the 2025 Review, analysis was undertaken to determine whether including non-admitted patient services would improve the proxy for public health activity (outside of ambulatory community mental health care).

63 The merits of broadening the proxy indicator to include all, or a subset of, non-admitted patient services were assessed on the basis of similarity of service types and level of access to non-admitted patient services compared with community and public health services. This was on the assumption that if service

[1] The socio-demographic use rates for the emergency department triage category 4 and 5 services (the proxy indicator in the 2020 Review method) are broadly similar to the subset of non-admitted patient services most similar to community health services. However, compared with selected non-admitted patient services, usage of emergency department triage category 4 and 5 services increases more with remoteness, is higher among low socio-economic status First Nations people, and is higher for the youngest age group.

types and access levels are similar then socio-demographic usage patterns would be similar.

64 On the information available, there appears to be a reasonably close relationship between community health services and non-admitted patient services provided by allied health professionals and clinical nurse specialists. In terms of access times, community health services were found to be generally more in line with wait times for non-admitted patient services than emergency department services.

65 Given expenses related to the National Partnership on COVID-19 Response will be removed from the community and public health component until the 2027 Update, the proxy indicator of activity would be improved by removing the COVID-19 non-admitted patient services.

66 In regard to the option of an equal per capita assessment, the Commission reviewed available information on the use and targeting of community and public health services by socio-demographic group. It concluded that socio-demographic use rates for emergency department triage category 4 and 5 services and non-admitted patient allied health services are likely to produce a better estimate of assessed expenses for community and public health than assessing the expenses using state population.

Commission decision

67 The Commission will broaden the proxy indicator of community and public health activity (outside of ambulatory community mental health) to include a combination of emergency department triage category 4 and 5 plus a subset of non-admitted patient allied health services similar to community health services (Attachment A, Table A-1). Activity in the COVID-19 clinics will be excluded from the list of non-admitted patient allied health services in the proxy indicator of community and public health while there is a separate assessment of COVID-19 expenses.

Separate assessment of public health

68 The Commission considered state views on public health expenses being assessed separately to community health expenses. In the 2020 Review method, expenses on community and public health were assessed using a proxy indicator (national weighted activity units for emergency department triage category 4 and 5 services).

69 The Commission proposed to continue assessing public health expenses with community health expenses, but to broaden the proxy indicator of activity to include a subset of non-admitted patient services.

State views

70 New South Wales, Victoria and Tasmania said that public health expenses should be assessed separately to community health expenses. New South Wales and Victoria said that public health expenses should be assessed equal per capita.

71 New South Wales said public health services are relatively standardised, with only minor variations for targeted groups. It said there is little evidence that different groups require materially different expenditure or involve varying degrees of complexity. If the Commission decided not to assess public health expenses on an equal per capita basis it should reduce the influence of socio-economic status and age, while retaining an unchanged First Nations driver.

72 Victoria said that public health programs may be targeted to specific groups, however, predominantly are whole-of-state activities. It said public health services are not the same as hospital services.

Commission response

73 The key issue the Commission considered was whether an equal per capita assessment of public health, as proposed by New South Wales and Victoria, or a proxy measure based on hospital activity, is a better measure of drivers of differences between states in spending on public health.

74 The Commission's analysis showed that state-delivered public health programs do not have a consistent pattern of socio-demographic use or targeting across different programs. This makes it difficult to determine whether a hospital-based measure of activity, which would reflect higher use of services by First Nations people, people living in remote and low socio-economic status areas, and older people, is a better proxy for activity in public health programs than state populations.

75 A range of factors determine the targets for, and use of, public health programs and services. Some programs are not necessarily targeted at particular socio-demographic population groups. The priorities for some programs change over time as health priorities change. In some cases, the socio-demographic groups making the most use of public health services do not necessarily align with the target groups for the programs.

76 On balance, the Commission concluded that using the same proxy indicator as for community health (outside of ambulatory community mental health) is simpler and produces a reasonable estimate of state spending needs, given the information available on use or targeting of public health programs.

Commission decision

77 The Commission will use a hospital-based proxy (see previous section for details) for public health activity rather than an equal per capita assessment.

12.5% discount for the community and public health assessment

78 The Commission proposed that the 12.5% discount for the community and public health assessment be retained for the share of the assessment that relies on proxy activity data (covering around 80% of total community and public health expenses).

State views

79 Most states supported the continuation of a 12.5% discount for the community and public health assessment. New South Wales said the reduction in this discount from 25% in the 2020 Review was not clearly evidenced at the time and it would not be appropriate to reduce the discount further.

80 Western Australia said the Commission should not discount the portion of the assessment that uses Australian Institute of Health and Welfare community mental health activity data, as the lack of cost weights means the assessment would already be understated.

81 South Australia said the discount should also cover the assessment of ambulatory community mental health expenses.

82 The Northern Territory did not support the discount as moving the assessment closer to equal per capita was not appropriate.

Commission response

83 The Commission considered that reliance on a proxy measure of activity for a significant share of community and public health expenses justifies a continuation of a discount.

Commission decision

84 The Commission will retain a 12.5% discount. It will be applied only to the share of the assessment that relies on proxy data (covering around 80% of total community and public health expenses). The expenses assessed using the direct measure of activity (ambulatory community mental health) will not be discounted.

Non-state sector adjustment – conceptual framework

85 The Commission proposed that the conceptual basis for the non-state sector adjustments remained appropriate.

State views

86 New South Wales said that there is an absence of robust and reliable data supporting the conceptual case for a non-state sector adjustment for health services. It said the adjustment should be removed or heavily discounted.

87 Victoria supported retaining the current general approach and giving further consideration of the non-state sector adjustment as part of the forward work program. Victoria said this is a complex topic that has not been afforded sufficient time and resources for an overhaul as part of the 2025 Review. It considered the debate around the interpretation of the non-state sector adjustment to be evidence that the Commission could improve its communication of the conceptual basis and operation of the non-state sector adjustment. Victoria did not support discounting the non-state sector assessments, given they considered them to be largely

unchanged or improved from the 2020 Review methods when they were not discounted.

88 Queensland supported reviewing the non-state-sector adjustment in detail before the next methodology review. Queensland said significant problems exist with the non-state-sector adjustment, from data issues to its conceptual foundations, but conceded that the significance of the adjustment warrants a considered reappraisal, which was not feasible before the finalisation of the 2025 Review. Queensland supported discounting of the non-state sector adjustments and recommended a higher discount for the admitted patient adjustment.

89 Western Australia said the Commission's approach to recognising the influence of non-state sector health services provision on state health spending needs was fundamentally wrong and presented an alternative conceptual framework. It said that states respond to the existing level of non-state services. The Commission should therefore be trying to estimate the proportion of non-state services that are substitutable rather than the proportion of state expenses that are substitutable. Western Australia did not support discounts to the non-state sector adjustments on the basis that it is not clear that the data for these assessments are less reliable than for other assessments.

Commission response

90 The non-state sector adjustment was introduced in the 2015 Review on the assumption that states with below-average non-state service provision faced higher costs.

91 A key challenge in determining the appropriate size of the non-state sector adjustment is that it is not possible to quantify how many health services need to be provided. Not all health procedures that are performed need to be performed by the state sector. As such, the provision of a service by the non-state sector does not necessarily mean that fewer state services are needed.

92 Western Australia presented a conceptually valid alternative method for determining the extent to which the non-state sector reduces the need for state health spending. The method proposed by Western Australia is a more direct approach than the Commission's. As a result, it is highly reliant on accurate activity and public cost data being available. The availability of the data needed to implement Western Australia's approach varies across the components in the health assessment, with good data on admitted patient services and poor data on community health services.

93 The Commission considers that the current approach underpinning the non-state sector adjustments is pragmatic and remains appropriate. Given the issues raised by states with the evidence on the extent of the relationship between state and non-state health service provision, problems with the data and the robustness of the method, and the significance of the impact on GST distribution, discounts will be

introduced (see below for details) and further work will be undertaken on this issue as part of the forward work program.

Commission decision

94 The Commission will retain the 2020 Review approach underpinning the non-state sector adjustments, with the introduction of a discount of 12.5% for the adjustment in each component (see discussion below).

95 The Commission will further consider this issue as part of its forward work program.

Non-state sector adjustment – admitted patients

96 The Commission considered a proposal by Queensland to change the indicator of non-state sector activity to private patient bed days to better account for case complexity. Queensland said hospital separations provide no indication of the different costs of treating patients for different types of ailments. Queensland said that bed days provide more information on the relative costs of service provision and therefore provide a better indicator of non-state sector activity than separations.

97 Due to difficulties obtaining bed days data for the 3 smallest states, the Commission proposed to use benefits paid by private health insurance funds as the proxy indicator of private admitted patient activity.

98 The Commission also considered state concerns with other aspects of the admitted patient non-state sector adjustment. The Commission proposed a lower bound for the non-state sector substitutability level based on private patients that are treated in public hospitals.

State views

99 New South Wales, Victoria, Queensland, Tasmania and the ACT supported the proposed use of benefits paid by private health funds as a proxy of private admitted patient activity because it better captured the complexity of hospital procedures. Western Australia and South Australia opposed the proposal.

100 Western Australia said benefits paid by private health insurers vary among states due to factors other than cost driven by complexity. Western Australia said it has high private health insurance benefits, but low private bed days per separation. It said it appears that Western Australian private hospitals charge more than the national average for treatments of the same complexity, reflecting the market dynamics of a fairly concentrated group of private hospital operators, the majority insurance provider being not-for-profit, and possibly higher costs faced by private hospitals.

101 South Australia said that, given the significance of this component, any method changes should be based on high quality, consistent data that are not policy influenced. It was not convinced that the proposed private patient expense data meet this requirement.

102 New South Wales said that non-state sector activity is likely to be policy influenced and separate sources of data should not be used to measure actual and assessed non-state sector activity.[2]

103 Victoria said that judgement should not be used to adjust the substitutability level. If an adjustment is warranted on conceptual grounds, then the standard discounting approach should be applied. Victoria said a discount of 12.5% should be applied, but if not, the calculated substitutability rate of 17.5% should be used. Queensland did not support the use of the calculated rate. Western Australia also supported a discount rather than a judgement-based reduction in the substitutability level.

104 Western Australia said the Commission should include both people with private health insurance and those who self-insure in the group of people that could use non-state health services, when estimating the substitutability level.

Commission response

105 The Commission proposed using private patient benefits paid rather than bed days as the indicator of non-state sector activity for the calculation of the admitted patient non-state sector adjustment. Benefits paid can potentially provide more information than separations or bed days on the relative costs of service provision, and therefore provide a better indicator of non-state sector activity.

106 Benefits paid would only be a reliable indicator of activity if states had comparable average benefits paid for equivalent hospital services. However, states varied in their share of separations that had above or below the national average benefits paid. Victoria and South Australia had a large share of separations below the national average and Western Australia a large share above the national average. The Commission concluded that benefits paid could not be considered an unbiased measure of non-state sector activity.

107 The Commission updated the 2020 Review method estimate of the non-state sector substitutability level with the latest available data and incorporated activity associated with self-funded patients. This method is considered the upper bound of substitutability.

108 The Commission calculated a second method to estimate the substitutability level, where the concept of substitutability was limited to just private patients treated in public hospitals. This second method is considered the lower bound of substitutability.

109 The Commission accepted that rounding substitutability levels to the nearest 5% as proposed in the Draft Report added an unnecessary step to the calculation.

[2] The data to calculate assessed expenses use Australian Institute of Health and Welfare data, while the data on actual activity use Australian Prudential Regulation Authority data (as the Australian Institute of Health and Welfare does not disaggregate data for Tasmania, the ACT and the Northern Territory). To preserve commercial confidentiality for the private hospitals in the Australian Capital Territory and the Northern Territory, the Australian Institute of Health and Welfare data for private hospitals in the Australian Capital Territory and the Northern Territory will be suppressed.

Commission decision

110 The Commission will use private patient separations for private health insurance-funded admitted patients in private and public hospitals as the proxy indicator of non-state sector activity in the admitted patient component.

111 The Commission will include activity associated with self-funded patients, in addition to activity associated with private health insurance-funded patients, to estimate the substitutability level.

112 The Commission will use a substitutability level of 17%, which is the midpoint of the 2 methods used to estimate substitutability.

113 A discount of 12.5% will be applied due to uncertainty with the reliability of the data and the robustness of the method for the admitted patient non-state sector adjustment.

Non-state sector adjustment – emergency departments

114 The Commission sought state views on using the Australian Institute of Health and Welfare-based method to update the estimates of the non-state sector substitutability level for emergency departments. This was because updated estimates were only available for the Australian Institute of Health and Welfare-based method and not the Commission's preferred approach used in the 2020 Review, which was based on Australasian College for Emergency Medicine data.[3]

115 The Commission also considered state views on alternative approaches to estimating the non-state sector substitutability level for emergency departments.

State views

116 Most states broadly supported the Commission's proposed approach for updating the emergency department non-state sector substitutability level.

117 New South Wales said the provision by the non-state sector of specialist services (such as pathology and imaging services) should be taken into account in estimating the non-state sector substitutability level for the emergency department services assessment.

118 Victoria said the Commission should have contracted an expert to review the approach.

119 Western Australia said that separate substitutability levels should be used for each remoteness region.

[3] The Australasian College for Emergency Medicine-based and Australian Institute of Health and Welfare-based methods calculate the proportion of emergency department presentations that are potentially treatable by GPs. The method using Australasian College for Emergency Medicine data is based on self-referred, non-ambulance presentations with a medical consultation time less than one hour. The method using Australian Institute of Health and Welfare data is based on self-referred, non-ambulance, police or community service emergency department presentations classified as triage 4 and 5 (less urgent).

120 New South Wales and Victoria said the Commission should use the exact number produced by the formula for the non-state sector substitutability level rather than round to the nearest 5%.

Commission response

121 The Commission considered that the Australian Institute of Health and Welfare data could be used as a proxy to update the non-state sector substitutability level for emergency departments. It considered it better to update the estimate of substitutability using more recent data.

122 Separate substitutability levels for each remoteness area, as proposed by Western Australia, would add further complexity to an already complex adjustment. It would also require actual non-state sector service provision disaggregated by remoteness area. The proposal will be considered as part of the health assessment element of the Commission's forward work program.

123 The approaches used in the past 2 reviews focus on the proportion of emergency department presentations that are potentially treatable by GPs. Broadening the analysis to include non-state sector specialist services in addition to GP services will also form part of the more detailed consideration of the non-state sector in the Commission's forward work program.

124 The Commission explored the possibility of engaging an external expert to review the non-state sector adjustment for emergency departments, but this was not feasible within the timeframe for the 2025 Review.

125 The Commission accepted that rounding of substitutability levels to the nearest 5% as proposed in the Draft Report added an unnecessary step to the calculation.

Commission decision

126 For the emergency departments component, the Commission will retain the 2020 Review method to determine the non-state sector substitutability level but will use data from the Australian Institute of Health and Welfare to update the calculations. This method produces an estimate of 13%.

127 A low discount of 12.5% will be applied due to uncertainty with the reliability of the data and the robustness of the method for the emergency department non-state sector adjustment.

Non-state sector adjustment – non-admitted patients

128 The 2020 Review used 2 methods to estimate the non-state sector substitutability level for the non-admitted patient component.

- The first method looks at the likelihood of patients using non-state services rather than state services based on how comparable services are in the 2 sectors and whether the non-admitted patient service is connected to a prior admitted patient service. In the 2020 Review, survey data were used in the calculation.

- The second method looks at the likelihood of patients using non-state services rather than state services based on the affordability of non-state services.

State views

129 In relation to the first method for estimating substitutability used in the 2020 Review, Western Australia and South Australia said that the assumption that half of non-admitted patient services are linked to a previous hospital attendance is overstated, while the ACT said the assumption should be reviewed.

130 Victoria said a discount of 12.5% should be applied due to inconsistencies in the assumptions states used in producing data on related non-admitted and admitted patient episodes.

131 Western Australia said the second method used by the Commission for estimating the substitutability level should be dropped as it is a poor method and the first method already reflects affordability of non-state services. If it is retained it should not be given the same weight as the first method.

132 New South Wales and Victoria said the Commission should use the exact number produced by the formula for the non-state sector substitutability level rather than round to the nearest 5%.

Commission response

133 To address states' concerns with the first method for calculating the substitutability level, the Commission asked states for data on the share of related non-admitted and admitted patient episodes. The data provided by 6 states were used to update the estimate of the substitutability level.

134 As regards Western Australia's comments, the Commission recognises that using the proportion of non-state services that are bulk billed will not provide an exact value of state services that are substitutable. However, the objective is to obtain a broad indication of the amount of non-state sector health provision rather than a precise measure of the volume of substitutable services. The rate of bulk billing for these services provides an indication of the extent to which patients may use these services rather than state services if cost is a factor. The higher the bulk billing rate, the more affordable are non-state services, and hence the higher the substitutability between state and non-state services.

135 The Commission accepts that rounding substitutability levels to the nearest 5% adds an unnecessary step to the calculation.

Commission decision

136 The Commission will use a substitutability level for non-admitted patients of 28%, which is the midpoint of the 2 methods used to estimate substitutability.

137 A low discount of 12.5% will be introduced reflecting uncertainty with the reliability of the data and the robustness of the method for the non-admitted patient non-state sector adjustment.

Non-state sector adjustment – community and public health

138 The 2020 Review method for the non-state sector adjustment for community and public health consists of 2 elements. One element assesses differences between states in the provision of services funded by the Commonwealth's Medicare Benefits Scheme. The second element assesses differences between states in the provision of services funded by the Commonwealth's Indigenous Australians' Health Program and delivered by Aboriginal Community Controlled Health Services.

139 The Commission proposed a change to the non-state sector adjustment for grants to First Nations community health organisations and the introduction of a discount for the other element of the non-state sector adjustment.

State views

140 New South Wales and Victoria questioned the Commission's decision to round down the calculated substitutability rate to 60% (the Commission's calculation was 61.9%) for the first element of the non-state sector adjustment.

141 The Northern Territory said that the health services provided by Commonwealth-funded First Nations community health organisations should not be taken into account in the non-state sector adjustment for community and public health (the second element).

142 The Northern Territory said that the assessment of non-state health services is overly simplistic. The predominant purpose of Commonwealth spending in the Northern Territory is to offset the much lower non-government sector spending compared with other states. It said the Northern Territory receives around 30% less Medicare Benefits Scheme funds than the national average.

143 The Northern Territory said that if the adjustment is maintained, assessed non-state sector services should be estimated with socio-economic status as a driver in remote and very remote areas.

144 New South Wales did not support a change to the non-state sector adjustment for grants to First Nations community health organisations. Given the non-state sector adjustments will be considered as part of the forward work program, it said significant changes should not be made ahead of that process.

Commission response

145 The Commission accepts that the proposed rounding of the substitutability level in the first element adds an unnecessary step to the calculation.

146 Commonwealth-funded health services alleviate pressure on state services in the same way as privately funded services.

147 To the extent that the Northern Territory receives less Medicare Benefits Scheme funds than the national average, this will be taken into account in the first element of the non-state sector adjustment.

148 The Commonwealth allocates grants to First Nations community health organisations taking into consideration the socio-economic status and remoteness of the region. Given the Commission does not have reliable data on socio-economic use rates in remote and very remote areas, it is likely that the actual distribution of First Nations Commonwealth grants produces a better estimate of assessed non-state expenses than the method used by the Commission.

Commission decision

149 The Commission will use a substitutability level of 62% for the first element of the non-state sector adjustment for the community and public health component.

150 A low discount of 12.5% will be applied due to uncertainty with the reliability of the data and the robustness of the method for the community and public health non-state sector adjustment.

151 The Commission will use the actual distribution of First Nations Commonwealth grants as the estimate of non-state sector assessed expenses. This means the non-state sector adjustment for Commonwealth grants to First Nations community-controlled health organisations will be zero.

Greater reliance on actual state health activity

152 The Commission considered state proposals to make greater use of actual state health activity to estimate assessed expenses. It proposed exploring this issue as part of the Commission's forward work program.

State views

153 The Northern Territory said that the health assessment should rely less on socio-demographic cohort-averaged national weighted activity units and more on actual state national weighted activity unit shares.

154 The Northern Territory said that the primary reason for differences between the state and the national average national weighted activity units by cohort is uncaptured variation in the underlying health of the population within each cohort.

155 The Northern Territory said the design of national weighted activity units already alleviates policy neutrality concerns through national price averaging and accounting for the complexity of activity. Therefore, assessed needs should be apportioned in line with actual national weighted activity unit shares.

156 Queensland said that the current averaging process masks meaningful variations among states and that actual national weighted activity units are a more genuine reflection of underlying health needs.

157 Queensland said that national weighted activity unit funding caps (targets), as negotiated through the National Health Reform Agreement and calculated by the Commonwealth Contribution Model, are policy-neutral measures of assessed need. These activity targets consider the underlying health need of a state's population. The actual national weighted activity units up to and including the national cap should be considered policy neutral and used as the volume indicator in the calculation of assessed need. The national weighted activity units over and above the national caps should be assessed using national weighted activity units averaging.

Commission response

158 The health assessment uses national weighted activity units, disaggregated by socio-demographic groups, at a national level to estimate a policy neutral average level of state health spending. Underpinning this approach is an assumption that people in similar circumstances are likely to use health services at a similar rate.

159 The Commission accepts it is possible that using national averaging for expense assessments could miss state-specific differences in service needs. This is more likely to be the case for smaller states because they have less influence on the national average. Further work is needed to understand the extent of these issues.

160 One problem with the solution proposed by Queensland and the Northern Territory is that actual state national weighted activity units can be influenced by state policy decisions. This is why the Commission adopts methods that do not rely on actual expenses or activity when assessing state spending needs.

161 The National Weighted Activity Unit was developed by the Independent Health and Aged Care Pricing Authority to allow different hospital activities to be expressed as a common unit of activity and to set the pricing of public hospital services. The national weighted activity unit accounts for differences in the complexity of patients' conditions or procedures and individual patient characteristics that lead to increased costs.[4]

162 Differences between states' hospital activity, as measured by actual national weighted activity units, can occur due to differences in the complexity of procedures performed, differences in the share of higher cost patients treated, and/or differences in the number of procedures performed. The actual number of procedures performed can potentially be influenced by policy choices, for example the resourcing decisions of states. As such, actual state national weighted activity units are not a policy neutral measure of assessed GST needs.

[4] Australian Institute of Health and Welfare (AIHW), Glossary - Australian Institute of Health and Welfare, AIHW website, 2024, accessed 14 June 2024.

163 The issues raised by Queensland and the Northern Territory are fundamental to the reliability of the health assessment. If people in similar circumstances are likely to use health services at significantly different rates, there is a conceptual case for looking at alternative methods for assessing state health expense needs.

Commission decision

164 The Commission will continue to use socio-demographic cohort-averaged national weighted activity units in the health assessment.

165 The Commission will explore the issue of greater reliance on actual state health activity as part of its forward work program.

Culturally and linguistically diverse (CALD) populations

166 The Commission considered state views on expanding the socio-demographic drivers of health expenses to include culturally and linguistically diverse populations and/or the addition of cost weights for service provision to culturally and linguistically diverse populations. The Commission proposed exploring this issue as part of the Commission's forward work program.

State views

167 Victoria said that culturally and linguistically diverse populations use health services more than other population groups and therefore the Commission should work with states to establish a method for taking account of this in the health system.

168 Victoria acknowledged the difficulty in quantifying the impact of diverse residents on state services due to the challenges in identifying and defining culturally and linguistically diverse populations. For assessing health expense needs, Victoria suggested focusing on refugees and people seeking asylum, temporary residents and people with low English proficiency.

Commission response

169 The analysis presented by Victoria justifies retesting the materiality of cultural and linguistic diversity as a driver of need. A more comprehensive analysis can be undertaken of the impact of a culturally and linguistically diverse population driver on the health assessment, using country of birth as the indicator of culturally and linguistically diverse status.

170 However, it is a complex issue that would require consultation with states, including on the choice of countries of birth to include in the analysis.

Commission decision

171 The Commission considers that, while there is a conceptual case that people from different cultures have different use rates of state health services, a substantial amount of work is required to determine how this driver could be reliably

incorporated into the health assessment. The Commission will consider how cultural and linguistic diversity affects state service costs, including health costs, as a part of its forward work program.

Age grouping for socio-demographic assessment

172 The Commission considered state views on changing the age groupings in the socio-demographic assessment of expenses. The Commission proposed no changes.

State views

173 New South Wales said the Commission should consider whether to modify the existing 3 oldest age groups in the health assessment to better capture the effect of age on state health expenses. Given the ageing of the Australian population, New South Wales suggested groups should be 45–69, 70–79 and 80+ rather than the existing 45–64, 65–74 and 75+.

Commission response

174 The impact of splitting the oldest age group was tested using admitted patient activity data. The highest age group was disaggregated into 75–84 and 85+. The other age groups could not be modified as the data currently available do not have a further breakdown. Splitting the highest age group did not have a material impact as the small number of people aged over 85 offset their higher costs. Applying the same analysis to all hospital components did not make a material difference.

Commission decision

175 The Commission will retain the existing age groups for the socio-demographic assessment of health expenses.

Clustered design of Victoria's health system

176 The Commission considered state views on the use of remoteness weights for remote patients treated in major cities.

State views

177 Victoria said that it is not appropriate to apply remoteness weights to national weighted activity units when residents travel from more remote areas for treatment in hospitals located in less remote areas.

Commission response

178 The Independent Health and Aged Care Pricing Authority applies cost weights for patients travelling from regional and remote areas to major cities for treatment because states incur additional costs in providing services to these people. It is appropriate that the Commission recognise these costs in its assessments.

Commission decision

179 The Commission will continue to use cost weights for patients travelling from remote areas for treatment.

Treatment of the National Health Reform Agreement

180 The Commission considered state views on the treatment of Commonwealth payments under the National Health Reform Agreement. The Commission proposed no changes.

State views

181 Queensland said that a portion of the Commonwealth payments under the National Health Reform Agreement are used to fund hospital services that states are providing because of shortfalls in the provision of Commonwealth-funded primary and aged care services.

182 Queensland said the services in question are state services, but demand for them is being increased because of failings in Commonwealth-supported sectors.

183 Queensland said the Commission does not assess differential need to provide state services because of failings of Commonwealth-supported sectors. As such, the proportion of the National Health Reform Agreement payments which go towards managing services that exist because of failings of Commonwealth-supported sectors should also not be assessed. The Commission should treat the Commonwealth payment as 12.5% no impact, 87.5% impact.

Commission response

184 The terms of reference for the annual update of GST relativities require the Commission to treat Commonwealth payments to states under the National Health Reform Agreement as impact. The Commission does not have the discretion to treat a portion of the payment as no impact.

Commission decision

185 In line with the terms of reference, the Commission will treat the full Commonwealth payment under the National Health Reform Agreement as impact.

Non-hospital patient transport

186 The Commission considered state views on the non-hospital patient transport assessment. The Commission proposed no changes at this stage but proposed that the method be changed between reviews to assess non-hospital patient transport costs in the admitted patient assessment if data changes allowed.

State views

187 Victoria said the assessment of non-hospital patient transport costs is flawed because it assesses Western Australia and the Northern Territory to need more than double their actual spending. Victoria said that expenses on non-hospital patient transport should be assessed in the admitted patient assessment.

188 Victoria said the 2025 Review should allow for method changes to remove the non-hospital patient transport category if it is clear ahead of the next review that the national weighted activity unit data incorporate the costs associated with aeromedical services and the Patient Assistance Transport Scheme.

189 Some states supported the proposal but said the Commission should consult with states before making a change between reviews. Queensland said any changes should wait until the next review. Tasmania said it does not provide data on aeromedical services or the Patient Assistance Transport Scheme activity to the Independent Health and Aged Care Pricing Authority and there would be considerable work required to be able to report these data in future.

Commission response

190 Large differences between actual and assessed expenses are not necessarily an indication that the assessment is mis-specified. Actual expenses are affected by state policy choices, the efficiency of service provision and the accuracy of expense reporting. However, large differences can justify a review of the assessment.

191 Aeromedical services and the Patient Assistance Transport Scheme are provided disproportionately to people in remote and very remote regions. This is the main reason why the Commission has assessed expenses associated with these services separately to other hospital expenses.

192 If the activity associated with aeromedical services and the Patient Assistance Transport Scheme were included in national weighted activity units, this would add weight to Victoria's argument that the expenses be included in the admitted patient assessment.

193 The activity associated with some types of patient transport are included in the national weighted activity units, and the remoteness costs weights produced by the Independent Health and Aged Care Pricing Authority include the cost of some types of patient transport.[5] However, states submit patient transport costs inconsistently and the costs associated with aeromedical services and the Patient Assistance Transport Scheme may not be fully reflected in state data submissions.

[5] Independent Health and Aged Care Pricing Authority, Consultation Paper on the Pricing Framework for Australian Public Hospital Services 2022-23, Independent Health and Aged Care Pricing Authority, 2021, accessed 14 June 2024, p 20; Independent Health and Aged Care Pricing Authority, Australian Hospital Patient Costing Standards Version 4.1 - Part 1 - Standards, Independent Health and Aged Care Pricing Authority, 2021, accessed 14 June 2024, p 37.

Commission decision

194 Given the uncertainty about the extent that activity associated with patient transport are included in the national weighted activity units, the Commission decided that costs associated with aeromedical services and the Patient Assistance Transport Scheme will be kept separate and continue to be assessed using the 2020 Review method.

195 However, the 2025 Review health assessment method will allow for the assessment of expenses associated with aeromedical services and the Patient Assistance Transport Scheme as part of the admitted patient component. This is contingent on verification that all states are providing the data that the Independent Health and Aged Care Pricing Authority needs to incorporate the aeromedical services and the Patient Assistance Transport Scheme activity into the national weighted activity units. It is also contingent on the data being available for all 3 years of the assessment period when any such method change is implemented in a future update. The Commission will consult with states as part of an annual update New Issues process before implementing any change.

196 Separately, some data used in the health assessment are only updated in a review on the assumption that the nature of service provision is stable over time. This includes data used to estimate the split between hospital and non-hospital (aero-medical transport and Patient Assistance Travel Schemes) patient transport expenses. Using updated data reduces expenses for non-hospital patient transport compared with the 2020 Review method.

Adjustments for state bilateral cross-border arrangements

197 The Commission considered state views on whether the existing cross-border adjustment in the health assessment fully captures state-to-state cross-border payments. The Commission proposed no changes.

State views

198 Victoria said it supports the Commission's current adjustment for cross-border health flows for Commonwealth payments under the National Health Reform Agreement. However, Victoria questioned the extent to which this fully captures state-to-state cross-border payments.

199 Victoria requested the Commission examine how the state-to-state funding flows for health services impact its assessments and confirm for states they align with the relevant clause of the National Health Reform Agreement.

Commission response

200 The Commission uses cross-border expense data provided by the National Health Funding Body to make cross-border adjustments to the National Health Reform Commonwealth payments. The adjustments ensure that the payment states are recorded as receiving only includes services provided to their own residents. States

that are net providers of health services to residents of other states have their National Health Reform payments reduced, so they are not penalised for their spending on services provided to residents of other states.

201 The Commission does not make any adjustment to the state share of National Health Reform funding. Bilateral agreements are in place to compensate states for the services provided to residents of other states. There is no need for the Commission to do anything about the state share of National Health Reform funding.

Commission decision

202 The Commission will make no changes to the assessment in relation to state-to-state funding flows.

203 Separately, a cross-border adjustment is applied to community and public health services between the ACT and New South Wales. The net value of cross-border services provided by the ACT to New South Wales residents is re-estimated at each review. This amount is added to the ACT's assessed expenses and removed from New South Wales'.

GST impacts of method changes

204 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, health, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
COVID-19 assessment	209	293	-324	-45	-78	-23	-4	-28	502
Community health use indicator	42	49	-22	-26	-4	-11	6	-34	97
New ambulatory community mental health assessment	93	65	-39	-33	-14	-35	14	-52	172
Changes to non-state sector adjustment	-36	53	-85	-1	11	-16	12	63	139
Discounting of non-state sector adjustment	40	-22	48	-40	-8	1	-20	1	90
Cross-border	-10	0	0	0	0	0	10	0	10
Non-hospital patient transport	-58	31	25	-14	-12	16	1	10	84
Total	**280**	**469**	**-398**	**-159**	**-104**	**-68**	**19**	**-39**	**768**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
COVID-19 assessment	24	41	-57	-15	-41	-40	-7	-109	18
Community health use indicator	5	7	-4	-9	-2	-19	12	-130	3
New ambulatory community mental health assessment	11	9	-7	-11	-7	-61	30	-200	6
Changes to non-state sector adjustment	-4	7	-15	0	6	-28	24	244	5
Discounting of non-state sector adjustment	5	-3	8	-13	-4	2	-42	4	3
Cross-border	-1	0	0	0	0	0	21	0	0
Non-hospital patient transport	-7	4	4	-4	-6	29	2	38	3
Total	**32**	**65**	**-69**	**-52**	**-55**	**-117**	**39**	**-153**	**28**

Note: Changes to the wage costs assessment are not included. These are shown in the wage costs chapter of *Review Outcomes*.

COVID-19 assessment

205 The largest source of change is the separate assessment of COVID-19 health expenses. The disaggregated effects of the method change for assessing COVID-19 expenses and the change in treatment of the Commonwealth payment under the National Partnership on COVID-19 Response is shown in Table 2.

Table 2 Impact on GST distribution of the COVID-19 assessment, health, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Commonwealth payment for COVID-19	-154	-206	287	15	67	-7	7	-10	377
State spending of commonwealth payment	154	206	-287	-15	-67	7	-7	10	377
State own source COVID-19 spending	154	206	-287	-15	-67	7	-7	10	377
Moving expenses to the COVID-19 component	55	87	-37	-30	-11	-30	3	-38	145
Net effect of treatment of COVID-19	**209**	**293**	**-324**	**-45**	**-78**	**-23**	**-4**	**-28**	**502**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Commonwealth payment for COVID-19	-18	-29	50	5	35	-12	15	-39	14
State spending of commonwealth payment	18	29	-50	-5	-35	12	-15	39	14
State own source COVID-19 spending	18	29	-50	-5	-35	12	-15	39	14
Moving expenses to the COVID-19 component	6	12	-6	-10	-6	-52	7	-148	5
Net effect of treatment of COVID-19	**24**	**41**	**-57**	**-15**	**-41**	**-40**	**-7**	**-109**	**18**

206 The impact of this method change is limited largely to the distribution of GST in 2025–26. This is because COVID-19 health expenses decline significantly after 2021–22 and this year drops out of the assessment period for the distribution of GST in 2026–27.

207 The change in distributions is the net effect of:

- assessing revenue from the Commonwealth payment under the National Partnership on COVID-19 Response on an actual per capita basis compared with the no impact treatment of the payment in the 2024 Update
- assessing state spending of the Commonwealth payment on an actual per capita basis compared with the exclusion of this spending from the assessment in the 2024 Update
- assessing state spending from own-source revenue on COVID-19 on an actual per capita basis compared with assessing it using the 2020 Review health assessment method in the 2024 Update
- the effect of moving relevant expenses from other components of the health assessment to the COVID-19 component.

208 Over 2021–22 and 2022–23, New South Wales, Victoria, Tasmania and the Northern Territory spent more than their per capita share on COVID-19 related health services.

Under an actual per capita assessment method, these states have higher-than-average assessed expenses for COVID-19 health services. For New South Wales and Victoria, this results in an increase in assessed GST needs because under the 2020 Review method they were assessed to need less than their population share of health expenses. However, for Tasmania and the Northern Territory, their assessed needs were larger under the 2020 Review method than an actual per capita assessment method and so they receive less GST.

Other method changes

209 Two changes are being made to the assessment of community and public health expenses. First, the proxy indicator of activity will be broadened to include a subset of non-admitted patient services, in addition to emergency department triage category 4 and 5 services. The effect on GST distribution from this change is shown in Table 1 against the *community health use indicator* label. Second, ambulatory community mental health services will be separately assessed using a direct measure of service use rather than a proxy indicator based on emergency department triage category 4 and 5 services. The effect on GST distribution from this change is shown in Table 1 against the *new ambulatory community mental health assessment* label.

210 These changes provide a better estimate of ambulatory community mental health activity and the balance of community and public health activity than emergency departments triage category 4 and 5 services. The changes to the community and public health assessment affect the Commission's estimate of the amount states spend on these services for each socio-demographic group. Compared with the proxy measure of activity used in the 2020 Review method, per capita spending at the national level on ambulatory community mental health services and the balance of community and public health services will now be estimated to be relatively higher for people living in less remote areas or in higher socio-economic status cohorts, as well as for non-Indigenous people and younger people. States with relatively larger shares of these socio-demographic groups in their population (New South Wales, Victoria and the ACT) will see an increase in their assessed GST needs.

211 Queensland, Western Australia, South Australia, Tasmania and the Northern Territory are assessed to need more than their per capita share of the GST distribution from the ambulatory community mental health services and the balance of community and public health services. However, under the 2020 Review method their assessed expense needs were even higher. Therefore, the change in method will see a reduction in assessed GST needs for these states.

212 The effect on GST distribution from 2 changes to the non-state sector adjustment are grouped together in Table 1 against the *changes to non-state sector adjustment* label.

213 The first change to the non-state sector adjustments relates to Commonwealth grants to First Nations community-controlled health services. Setting this adjustment to zero increases the assessed GST needs of states that received grants that exceeded what they were assessed to need under the 2020 Review method (Victoria, South Australia, the ACT and the Northern Territory).

214 The second change is to not round non-state sector substitutability levels to the closest 5%.

215 The substitutability levels for admitted patient and community and public health services have been estimated at 17% and 62% respectively. Rounding would have brought these estimates to 15% and 60% respectively, unchanged from the 2020 Review method. A higher substitutability level means an estimated larger contribution from the non-state sector, and therefore a lower estimate of state expense needs. The non-state sector adjustment is calculated as the difference between assessed and actual non-state expenses. Therefore, states that have assessed non-state expenses greater than actual expenses will receive an increase in GST distribution. For admitted patients, these are Victoria, Western Australia and the ACT. For community and public health, it is Western Australia, South Australia, Tasmania and the ACT.

216 The substitutability levels for emergency department and non-admitted patient services have been estimated at 13% and 28% respectively. Rounding would have brought these estimates to 15% and 30% respectively, unchanged from the 2020 Review method. A lower substitutability level means a smaller estimated contribution from the non-state sector and therefore a larger estimate of state expense needs. This increases assessed GST needs for states that had actual expenses exceeding assessed expenses. For both emergency department and non-admitted patient adjustments these are New South Wales, Victoria and Queensland.

217 Applying a 12.5% discount to the non-state sector adjustments reduces the influence of these adjustments on the distribution of GST (*discounting of non-state sector adjustments*).

218 Using updated data on New South Wales residents' use of ACT services increases the assessed GST needs of the ACT and reduces it for New South Wales (*cross-border*).

219 Using updated data on the split between state spending on hospital and non-hospital patient transport reduces expenses for non-hospital patient transport compared with the 2020 Review method. This reduces GST distribution to states that are assessed to need to spend more than their per capita share on non-hospital patient transport (*non-hospital patient transport*).

Attachment A

Table A-1 Non-admitted patient services similar to community health services

Tier 2	Non-admitted patient service	Community and public health service
40.09	Physiotherapy	Allied health services
40.10	Sexual health	Sexual health services
40.13	Wound management	Community/home nursing services
40.23	Nutrition/dietetics	Allied health services
40.24	Orthotics	Allied health services
40.25	Podiatry	Allied health services
40.28	Midwifery and maternity	Family and child health services
40.29	Psychology	Community mental health services
40.30	Alcohol and other drugs	Alcohol and other drug services
40.31	Burns	Community/home nursing services
40.32	Continence	Continence services
40.35	Palliative care	Community/home nursing services
40.36	Geriatric evaluation and management	Community/home nursing services
40.37	Psychogeriatric	Community/home nursing services
40.38	Infectious diseases	Communicable disease control
40.51	Breast	Cancer screening (bundled with main service)
40.55	Paediatrics	Family and child health services
40.56	Falls prevention	Community/home nursing services
40.57	Cognition and memory	Community/home nursing services
40.58	Hospital avoidance programs	Chronic disease management
40.60	Pulmonary rehabilitation	Chronic disease management
40.63	COVID-19 response	Communicable disease control
40.64	Chronic pain management	Chronic disease management

Note: Activity in COVID-19 clinics will not be included in the community and public health proxy for the assessment of GST relativities for 2025–26 and 2026–27 when expenses under the National Partnership would be assessed separately.

Source: Commission decision based on Tier 2 non-admitted services classification 2021-22.

11. Housing

Review outcomes

- The following changes were made to the assessment.
  - Social housing assessed expenses and revenue will be estimated by apportioning national per household spending and revenue using a derived state household count based on the average household size in each socio-demographic group. The change seeks to take account of differences in average rates of overcrowding between states.
  - The Australian Institute of Health and Welfare data on social housing households will be used to adjust and rebalance the social housing/non-social housing split in the Australian Bureau of Statistics (ABS) Census data. The change seeks to address concerns with the accuracy with which tenants categorise their landlord type in the census. This does not affect the assessment of recurrent spending on social housing but affects the assessment of investment in social housing.
- The Commission considered but did not change the following.
  - Housing stress will not be included as a driver because the available data do not support a relationship between housing stress and the provision of social housing.
  - Household income will continue to be used to classify households into low and high socio-economic groups because state eligibility for social housing is based on household income.
  - A combined assessment of state spending on public and community housing will be retained because not all states have the same capacity to choose the mix of public and community housing.
  - A cost weight to account for the higher costs associated with providing services to tenants with a disability will not be introduced because suitable data are not available.
  - Suitable data are not available to develop a housing-specific regional cost gradient. The general regional cost gradient, in combination with the Rawlinsons capital cost gradient, will continue to be used to recognise the effects of remoteness on the cost of providing social housing services.
  - The existing First Nations cost weight, which recognises the additional costs in providing social housing services to First Nations tenants, will be retained and validated with the latest available data.
  - Census responses that are ‘not stated’ or ‘not applicable’ will continue to be apportioned to relevant socio-demographic groups.
- Given the absence of reliable data, a separate assessment of head leasing and other affordable housing expenses is not included. The Commission will monitor whether a separate assessment of the costs of housing people in private accommodation should be implemented.

- The development of an age-based driver or cost weight will depend on accessing reliable data on the additional social housing costs associated with older tenants. The Commission will work with the states between reviews to determine if such data are available.
- As part of the Commission's forward work program, it will work with the states and relevant data providers to consider how culturally and linguistically diverse populations drive state spending in the context of the housing assessment and other expense assessments.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating the changes made in the 2025 Review, can be found in the housing chapter of the *Commission's Assessment Methodology*.

Issues considered

Additional costs due to above-average overcrowding

6 In the Draft Report, the Commission proposed to change the housing assessment to an individuals-based assessment rather than the households-based assessment from the 2020 Review. This was in response to concerns raised by the Northern Territory that the assessment did not appropriately assess expense needs in states with above-average overcrowding. Following state comments on the change to the housing assessment proposed in the Draft Report, the Commission presented an alternative average household size method in Significant changes since the Draft Report.

State views

7 Western Australia and the Northern Territory supported the proposal for an individuals-based assessment. The Northern Territory said the household-based

approach reduces assessed housing expenses in states with above-average overcrowding. The Northern Territory said because the national average use rates are applied to each state's total households, a state with lower housing per capita, with higher overcrowding or homelessness rates, is apportioned less expenses per capita.

8 While most states accepted the conceptual case that overcrowding results in additional costs, most states did not support an individuals-based method as proposed in the Draft Report. They said it does not reflect what states do, which is to provide social housing to households, not individuals. They also said social housing expenses do not increase in a linear way as household size increases, as implied by the individuals-based approach.

9 New South Wales said an above-average-sized household is not necessarily overcrowded and that the individuals-based approach conflated the issue of household undercount with social housing overcrowding. New South Wales said the Commission should consider including a cost weight for household size, though any cost weight must be supported by data.

10 In addition, New South Wales and Victoria presented data on the increasing share of single-person households in social housing and referenced analysis that showed single-person households incur higher costs for tenant-related service requests and other property maintenance and repair requests. They said these additional costs relate to the complex needs of tenants and complex needs are found at a disproportionately high rate amongst single-person households.

11 Victoria said a move to an individuals-based assessment is unnecessary as existing drivers in the housing assessment (for example, remoteness) are already appropriate proxies for overcrowding. Victoria also said larger households pay more in rent, resulting in higher revenue for the service provider. In most cases, this offsets any additional costs associated with extra tenants.

12 Queensland said it accepted that there is a conceptual case that a household approach does not adequately reflect the costs of addressing overcrowding, but it did not support the method change. It said that further changes would add to the complexity in an assessment which already has a very small impact on GST distribution.

13 South Australia said that the additional costs faced by the Northern Territory beyond what it needs to spend to provide the average standard of services should be addressed and funded outside the horizontal fiscal equalisation system. It said this reflects that the objective of horizontal fiscal equalisation is to provide states with the capacity to provide the same standard of services. It said addressing overcrowding in the Northern Territory's remote First Nations communities would require a higher-than-average standard of service, which is beyond the scope of horizontal fiscal equalisation.

14 The Northern Territory said the purpose of horizontal fiscal equalisation is to provide states with the fiscal capacity to deliver an average standard of services to persons. A household approach would only be reasonable where overcrowding and non-state housing stock per capita rates are equivalent between states and regions in states.

15 Victoria said the change to an individuals-based assessment would result in a change in GST distribution disproportionate to the size of the overcrowding problem. Victoria said it did not consider sufficient consultation had been conducted with states, given the magnitude of this change. South Australia and Tasmania suggested the issue should be considered further as part of the forward work program.

16 Most states preferred the average household size-based approach to the individuals-based approach.

17 Western Australia said it did not support the average household size approach as it would result in reduced assessed GST needs for Western Australia even though it has the second highest rate of severe overcrowding.

18 The Northern Territory said the average household size approach results in unintended consequences. It said this is because the Northern Territory has a large influence on the average household size in the very remote, First Nations, low-income socio-demographic group and because expenses to equalise the Northern Territory's household size are limited to being drawn solely from the very remote, First Nations, low-income cohort.

19 The Northern Territory suggested the Commission should assess the Northern Territory as needing to supply a higher rate of social houses to provide a similar average household size to other states in the very remote, First Nations, low-income socio-demographic group. This would inflate the national share of social households in this socio-demographic group, resulting in additional national expenses being apportioned to the group, which in turn would lead to states with a higher share of people in the very remote, First Nations, low-income socio-demographic group being assessed to need more GST.

Commission response

20 The Commission accepted the conceptual case that overcrowding results in higher costs and that there is evidence that the extent of overcrowding is materially different between states.

21 The 2020 Review method apportions national average per household expenses and revenues by socio-demographic group to states based on the number of households states have in each socio-demographic group.

22 However, there are some socio-demographic groups where a state's share of households in the group differs substantially from its share of individuals. In particular, in very remote areas of the Northern Territory, its share of national households is significantly less than its share of individuals. This indicates that

average household size in very remote areas of the Northern Territory is much larger than the national average. This appears to be due largely to the above-average household size of low-income First Nations households.

23 As such, apportioning national average expenses by states' shares of households in each socio-demographic group produces markedly different estimates of assessed expenses compared with apportioning expenses based on states' shares of individuals.

24 In the *Significant Changes since the Draft Report*, the Commission outlined other limitations of the 2020 Review method in taking account of differences in average rates of overcrowding between states. In particular, the 2020 Review method includes a First Nations cost weight, which is intended to account for the difference in costs in servicing First Nations social housing compared with mainstream social housing. These additional costs may include those resulting from overcrowding and high mobility, but other factors could also be increasing costs. However, this national average cost weight is apportioned across states based on their count of First Nations households. If this household count is underestimated due to overcrowding, assessed GST needs will be understated.

25 The Commission agreed with those states that said it would be preferable to retain a method that more closely aligns with what states do, which is to provide services to households rather than individuals. In addition, the Commission recognised that social housing expenses do not necessarily increase in a linear way as household size increases and there are a range of factors that affect the recurrent costs associated with social housing households.

26 In the *Significant Changes since the Draft Report*, the Commission presented an *average household size* method. In this approach, the calculation of national average spending per household by socio-demographic group is the same as the 2020 Review method. However, a different approach is used to apportioning expenses to states. Rather than using census-based household counts, a household count is derived for each socio-demographic group in each state based on the national average household size in each socio-demographic group.

27 The Commission recognises that some issues remain with this approach. Average household size is being used as a proxy for overcrowding. This assumes average household size only differs across states within socio-demographic groups as a result of above-average overcrowding or above-average underutilisation. However, state average household size could vary between states due to differences in the age structure or ethnic mix of state populations, or differences in access to affordable housing. Also, the Commission notes that average expenses per social housing household can vary for reasons other than overcrowding rates, such as an above-average prevalence of high-cost tenants.

28 The Commission determines relative state expense needs for each socio-demographic cohort based on what states actually spend on each

socio-demographic group, and then uses those expenses to derive the national average standard of service for that cohort. If the Commission were to derive an alternative average as suggested by the Northern Territory, it would be akin to the Commission having a judgment on what states should do. The Commission considers it should retain a method that more closely aligns with what states do.

29 Overall, the Commission considers the average household size method is 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.

Commission decision

30 The Commission will assess net expenses for social housing using an average household size-based approach.

31 In preparation for the next review, the Commission will undertake further work to determine if there are alternative ways to more accurately measure the impact on expenses of differences in severe overcrowding between states.

Housing stress as a driver of need

32 The Commission sought state views on whether the assessment remained fit for purpose, given developments in the housing market. It proposed no changes to take account of recent market developments.

State views

33 Most states said that the housing assessment remained fit for purpose.

34 New South Wales said the housing assessment should be revised to remove the use of socio–demographic drivers and instead directly assess the level of housing stress within each state. New South Wales said the demand for social housing derives from an inability of households to find suitable private housing, not from the intrinsic characteristics of certain socio–economic groups within the community. Victoria said as housing affordability declined, people required more support from governments to stay in housing and rely on public services more. New South Wales and Victoria said this driver should be based on low-income households spending more than 30% of their income on rent.

35 New South Wales said that the measure of socio-economic status should take account of differences in housing costs between states.

Commission response

36 While the Commission agrees that housing stress is a driver of demand for social housing, it notes that increased demand does not necessarily lead to increased state provision of social housing. The Commission examined the available data (as discussed in the *Draft Report*), which did not present a compelling case for a

relationship between housing stress and the provision of social housing at the national level. This may change in the future. Commonwealth and state governments have recently announced significant increases in funding for social housing. This issue will be examined again in the next review.

37 While New South Wales suggested an alternative measure of socio-economic status involving some combination of household income and cost in the housing assessment, states determine eligibility for social housing based on household income. Therefore, household income remains the most appropriate measure of socio–economic status in the housing assessment.

Commission decision

38 The Commission will not include housing stress as a driver of state spending on social housing because available data do not support a relationship between housing stress and the provision of social housing.

39 The Commission will not adjust the measure of socio-economic status to account for housing costs given that states determine the eligibility for social housing based on household income.

Separate assessments of public and community housing

40 The Commission consulted states on whether separate assessments of public and community housing would better account for differences in costs to states of funding these alternative forms of social housing. The Commission proposed to retain a single social housing assessment.

State views

41 Some states said that the mix of public and community housing is determined by a complex range of factors, and the differences in states' social housing mix do not reflect genuine differences in need.

42 There was broad concern that the data on public and community housing expenses are not of sufficient quality to support separate assessments.

43 The Northern Territory said the Commission should recognise differing rates of Commonwealth Rent Assistance by state.

Commission response

44 Public housing is state owned and managed. It is mostly provided through state public non-financial corporations. Community housing is managed by not-for-profit organisations, which receive subsidies from state governments. Community housing tenants are eligible to receive Commonwealth Rent Assistance whereas public housing tenants are not.

45 Not all states have the same capacity to choose the mix of public and community housing due to limited availability of community housing providers. This may be particularly the case in remote First Nations communities.

46 It is also not possible to reliably separate public housing and community housing expenses.

47 Using the available data, the materiality of separate assessments was tested. There was a material reduction to assessed GST needs for the Northern Territory, with limited impacts for other states.

Commission decision

48 The Commission will retain a single social housing assessment as states do not have the same capacity to choose the mix of public and community housing and separating expenses for the 2 types of social housing cannot be done reliably.

Cost of servicing tenants with a disability

49 The Commission consulted states on whether data were available to calculate a cost weight for people in social housing with a disability. It also asked states whether new census data on households with long-term health conditions could be used as a proxy to identify social housing tenants requiring additional services. The Commission proposed not to pursue the development of a high-cost tenant cost gradient.

State views

50 Most states said census data on households with members that have long–term health conditions are not a suitable proxy for social housing households that have higher service costs. Most states said they had limited or no data on the cost of servicing different household types.

Commission response

51 In previous reviews, some states said people with a disability require higher levels of servicing compared with other social housing households. However, sufficiently comprehensive data on the use of social housing by people with a disability were not available.

52 The Commission recognises that the census data are not suitable for developing a cost weight for tenants with a disability and most states said they have limited or no data on the cost of servicing different household types.

53 The Commission accepted that insufficient data are available to estimate a cost weight or to identify the appropriate user group in each state.

Commission decision

54 The Commission will not introduce a cost weight for people with a disability because reliable data are not available.

Regional cost gradient

55 The Commission considered concerns raised by states about the use of the general regional cost gradient in the housing assessment. The Commission proposed to retain the 2020 Review regional costs assessment method.

State views

56 Some states said the general regional cost gradient overstates the additional costs of providing social housing services as remoteness increases, while others said it understates costs. States suggested the Commission develop a housing-specific regional cost gradient.

57 Victoria acknowledged that the data provided by 2 states is insufficient to develop a housing-specific cost gradient but maintained that the data could still be used to test whether there is evidence to support a relationship between remoteness and costs.

58 Queensland said the 25% discount to the general regional cost gradient should be removed because it is conceptually flawed. Queensland said that services assessed using the general regional cost gradient usually have costs far exceeding the cost of services used to derive the general regional cost gradient. Applying a discount therefore results in an underestimation of actual state need.

59 Western Australia said housing recurrent expenses should be disaggregated into maintenance expenses and other expenses. It said the Rawlinsons indices should be applied to the maintenance expenses and that other expenses should be further disaggregated, with expenses that would attract regional costs similar to maintenance also having the Rawlinsons indices applied.

Commission response

60 The general regional cost gradient and Rawlinsons capital cost gradient are used to recognise the effects of remoteness on the cost of providing social housing services.

61 The Commission asked states for data on the cost of providing social housing by region to derive a housing-specific regional cost gradient. Only 2 states could provide the necessary data which showed costs increasing with remoteness, by more than for the general regional cost gradient. Data from 2 states is not sufficiently representative for a robust estimate for all states of how costs change as remoteness increases.

62 A discount of 25% is applied to the general regional cost gradient, in recognition that the cost components used in the general regional cost gradient are only a proxy for actual service costs.

63 Tailoring the application of the Rawlinson's and general regional cost gradients to subsets of recurrent housing expenses would only be possible if states could provide the Commission with the disaggregated data.

Commission decision

64 The Commission will retain the general regional cost gradient, in combination with the Rawlinsons capital cost gradient, to recognise the effects of remoteness on the cost of providing social housing services. A discount of 25% will continue to be applied to the general regional cost gradient.

First Nations cost weights – recurrent and capital assessments

65 The Commission considered state concerns with the First Nations cost weights. The Commission proposed retaining the 2020 Review First Nations cost weights used in the recurrent and capital assessments.

State views

66 Victoria said the First Nations cost weight overstated the additional costs of providing social housing services to First Nations people, while Western Australia said it understated the costs.

67 Victoria said that the First Nations cost weight reflected in part remoteness costs associated with the provision of social housing services.

68 The Northern Territory said that the First Nations cost weight in the housing investment assessment should be allowed to vary between jurisdictions and should be applied to all social housing dwellings with First Nations people in First Nations communities, homelands and town camps.

Commission response

69 The provision of recurrent social housing services to First Nations people has higher costs per household than for non-Indigenous households, possibly due to higher rates of overcrowding and the higher mobility of tenants. The assessment takes account of this at the national level through a First Nations cost weight that is applied to First Nations people in all types of social housing.

70 First Nations-specific social housing is often larger and more costly to fit out than mainstream housing. To account for the higher capital costs, a First Nations cost weight is also applied in the social housing investment assessment. The cost weight is used to scale up the number of people living in First Nations-specific social housing. A national average for the share of First Nations people living in First Nations-specific social housing is used in the calculation.

71 The Commission used separate data sources to re-estimate a First Nations cost weight. One approach used data provided to the Commission by states. The other approach used data published in the Productivity Commission's *Report on Government Services*. Both approaches produced a similar result, which was also similar to the First Nations cost weight estimated for the 2020 Review.

72 Both approaches compare the average per capita costs of mainstream and First Nations-specific social housing. The additional costs associated with delivering services in remote areas are included in the numerator and the denominator. The difference in per capita costs can therefore be attributed to the additional costs associated with the provision of services for First Nations-specific social housing.

73 The Commission explored the use of national average shares of First Nations people living in First Nations-specific social housing, disaggregated by remoteness area. However, the Productivity Commission's *Report on Government Services* data do not allow the data to be disaggregated in this way.

74 The changes proposed by the Northern Territory could create an incentive for states to rebalance their mix of mainstream and First Nations-specific social housing. In addition, the First Nations cost weight is calculated based on differences in costs associated with mainstream and First Nations-specific housing. It would not be appropriate to apply this factor for First Nations people living in mainstream housing.

Commission decision

75 The Commission will retain a First Nations cost weight of 1.2 in the social housing recurrent and investment assessments.

76 The Commission will continue to use the national average proportions of First Nations people living in First Nations-specific housing for the calculation of the capital stock factor for the investment assessment. The Commission also decided to continue to apply this factor only to First Nations people living in First Nations-specific housing.

Data issues

77 The Commission considered concerns raised by states with expense and activity data. The Commission proposed to rebalance the social housing/non-social housing split using Australian Institute of Health and Welfare data on social housing households.

State views

78 Western Australia said the Commission should scale the census households count with Australian Institute of Health and Welfare data, which are considered more reliable and accurate. Queensland did not support this adjustment due to large differences between the 2 datasets in the count of social households in remote and very remote areas.

79 Victoria said the Commission's method of imputing 'not stated' households in the census data was inappropriate and may introduce bias in the statistics.

80 Some states said the social housing expenses and revenue data were not reported consistently.

Commission response

81 There are reliability issues with both ABS census and Australian Institute of Health and Welfare data on households in social housing. To address concerns with the accuracy with which tenants categorise their landlord type in the census, the Commission rebalanced the social housing/non-social housing split using the Australian Institute of Health and Welfare data on social housing households. This did not affect the assessment of recurrent spending on social housing because shares of the socio–demographic groups in social housing were being adjusted by the same proportion. However, it affected the assessment of investment in social housing via a change to the capital stock factor.

82 The housing assessment measures the social housing use rates of socio-demographic groups. To do this, the national total of households in each socio-demographic group are used to measure the rate at which each group used social housing. Therefore, adjustments to include responses that are 'not stated' or 'not applicable' are required to measure social housing use rates of each socio-demographic group.

83 The Commission is aware of inconsistencies in how states report their expenses and revenues against classification of the functions of government-Australia (COFOG-A) codes in Government Finance Statistics. Where the Commission can identify material misreporting, it works with states to resolve the issues.

84 One source of inconsistency is with the reporting of expenses on homelessness services. To support the assessment of homelessness services in the welfare assessment, states will provide data on expenses for homelessness services currently recorded against COFOG-A codes that align with the housing category. These expenses will be reclassified to the new homelessness component in the welfare category.

Commission decision

85 The Commission will:

- rebalance the social housing/non-social housing split derived from ABS Census data using Australian Institute of Health and Welfare data on social housing households
- continue to apportion census responses that are 'not stated' or 'not applicable' to relevant socio-demographic groups, given the requirement to estimate social housing use rates for all households
- continue to work with states to improve the consistency of social housing expense and revenue reporting in ABS Government Finance Statistics.

Assessment of expenses on head leasing and affordable housing

86 The Commission considered concerns raised by states with the assessment of expenses on head leasing and affordable housing. The Commission proposed no change but said it would work with states on this issue between reviews.

State views

87 New South Wales said the Commission should separately take account of state expenses on social housing head leasing. Private rental increases impact the costs of head leasing, with the cost of the head lease paid by the state government increasing in line with the private market. In contrast, average state policy is to not increase social housing tenant rents at the same rate as the private market.

88 Victoria and the ACT said the Commission should explore a separate assessment of affordable housing given spending on this form of housing assistance was likely to increase to meet affordable housing commitments agreed to by state and Commonwealth governments. Victoria said eligibility requirements are different in affordable housing, and that rents are tied to the market rate rather than to income as in social housing.

Commission response

89 Head leasing is an option used in both public and community housing, where a private rental property is leased by a provider of social housing and is then on-let to a social housing tenant.

90 Affordable housing measures refer to programs to assist people to find accommodation including social housing, assistance to people in the private rental market, support and accommodation for people who are homeless or at risk of homelessness, and home purchase assistance.

91 Separate assessments of social housing head leasing expenses and affordable housing expenses would require data on the amounts spent on these programs and on the socio-demographic profile of the people being supported by these programs.

92 States support the housing requirements of their residents in a variety of ways. The Commission will work with states to determine whether a separate assessment of support for people in private accommodation should be implemented in a future review.

Commission decision

93 Given the absence of reliable data, the Commission will not include a separate assessment of social housing head leasing or affordable housing expenses. The Commission will monitor, in consultation with the states, whether a separate assessment of the costs of housing people in private accommodation should be implemented in a future review.

Culturally and linguistically diverse tenants

94 The Commission considered views of states to better account for the costs of providing social housing services to culturally and linguistically diverse tenants. The Commission proposed no change but said work on this issue will be undertaken as part of its forward work program.

State views

95 New South Wales and Victoria said the Commission should introduce a driver of use and/or cost weights for culturally and linguistically diverse tenants.

Commission response

96 There is a conceptual case that people from different cultural backgrounds use social housing at different rates and have higher costs when they do. However, a substantial amount of work is required to develop, test and consult with states on a potential culturally and linguistically diverse driver for the housing assessment. This includes developing an appropriate definition of cultural and linguistical diversity in the housing context.

Commission decision

97 Consideration of how cultural and linguistic diversity affects state service costs will be undertaken as part of the Commission's forward work program.

Older tenants

98 The Commission considered views of states to better account for the costs of providing social housing services to tenants of different ages. The Commission proposed no change but said it will work with the states on the issue between reviews.

State views

99 New South Wales said the Commission should investigate the materiality of including social housing tenant age as a driver of service costs and/or investigate a cost weight for older tenants.

Commission response

100 The development of an age-based driver or cost weight would require reliable data on the additional social housing costs associated with older tenants. The Commission will work with the states between reviews to determine if such data are available.

Commission decision

101 The Commission will not incorporate an age-based driver or cost weight. The Commission will work with the states between reviews to determine if data on the additional social housing costs associated with older tenants are available.

GST impacts of method changes

102 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, housing, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Average household size model	16	-11	1	-29	-13	-1	-1	39	56
Spending allocated to homelessness	5	12	-4	-6	-2	0	2	-7	18
Total	**22**	**1**	**-3**	**-35**	**-16**	**-1**	**0**	**32**	**54**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Average household size model	2	-2	0	-10	-7	-2	-2	150	2
Spending allocated to homelessness	1	2	-1	-2	-1	0	3	-26	1
Total	**2**	**0**	**0**	**-12**	**-8**	**-2**	**1**	**124**	**2**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes*.

103 Adopting the average household size model increased the assessed GST needs of states with above-average household size and vice versa. (Table 2 compares state average household size with the national average for each socio-demographic group.)

104 The reclassification of homelessness service expenses from the housing category to the new homelessness component in the welfare category reduced the expenses assessed in the social housing component. Reducing social housing expenses increased the assessed GST needs of New South Wales, Victoria and the ACT due to their below-average spending needs.

105 The changes to the general regional cost gradient are explained in the geography chapter of *Review Outcomes*. The changes increased the assessed GST needs of states with a larger share of their population in more remote areas. This effect is not separately identified in Table 1.

Table 2 Average household size, state and national, by socio-demographic group

			Average Household Size, 2021–22								
Remoteness	SES	Indigenous Status	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
1.Major cities of Australia	1. Low-income	1.First Nations	2.1	1.9	2.2	2.4	2.0	0.0	2.1	0.0	2.2
1.Major cities of Australia	1. Low-income	2.Non-Indigenous	2.2	2.3	2.2	2.1	2.0	0.0	2.0	0.0	2.2
1.Major cities of Australia	2. High-income	1.First Nations	1.9	1.7	1.9	2.0	1.8	0.0	1.8	0.0	1.9
1.Major cities of Australia	2. High-income	2.Non-Indigenous	2.8	2.7	2.7	2.7	2.6	0.0	2.6	0.0	2.7
2.Inner regional Australia	1. Low-income	1.First Nations	2.3	2.0	2.3	2.4	2.1	2.1	0.0	0.0	2.3
2.Inner regional Australia	1. Low-income	2.Non-Indigenous	2.0	2.0	2.1	2.0	2.0	2.0	2.4	0.0	2.0
2.Inner regional Australia	2. High-income	1.First Nations	2.1	1.9	2.0	2.1	1.9	1.8	2.1	0.0	2.0
2.Inner regional Australia	2. High-income	2.Non-Indigenous	2.7	2.6	2.7	2.6	2.6	2.6	3.4	0.0	2.6
3.Outer regional Australia	1. Low-income	1.First Nations	2.3	2.2	2.7	2.6	2.3	2.0	0.0	2.6	2.5
3.Outer regional Australia	1. Low-income	2.Non-Indigenous	2.0	1.9	2.0	1.9	1.9	2.0	0.0	2.2	2.0
3.Outer regional Australia	2. High-income	1.First Nations	2.1	1.9	2.2	2.2	2.0	2.0	0.0	2.1	2.1
3.Outer regional Australia	2. High-income	2.Non-Indigenous	2.6	2.5	2.6	2.5	2.4	2.5	0.0	2.8	2.6
4.Remote Australia	1. Low-income	1.First Nations	2.5	3.7	3.2	2.8	2.3	1.6	0.0	4.1	3.3
4.Remote Australia	1. Low-income	2.Non-Indigenous	2.0	1.9	2.0	2.0	1.9	1.8	0.0	2.1	1.9
4.Remote Australia	2. High-income	1.First Nations	2.2	2.0	2.3	2.4	2.1	1.9	0.0	2.5	2.4
4.Remote Australia	2. High-income	2.Non-Indigenous	2.6	2.2	2.6	2.6	2.4	2.2	0.0	2.6	2.6
5.Very remote Australia	1. Low-income	1.First Nations	2.7	0.0	3.7	3.9	4.1	2.5	0.0	6.1	4.6
5.Very remote Australia	1. Low-income	2.Non-Indigenous	1.9	0.0	2.0	1.9	1.8	1.7	0.0	2.1	1.9
5.Very remote Australia	2. High-income	1.First Nations	2.4	0.0	3.0	2.6	2.9	1.6	0.0	3.5	2.9
5.Very remote Australia	2. High-income	2.Non-Indigenous	2.4	0.0	2.5	2.4	2.3	2.2	0.0	2.2	2.4

Source: ABS 2021 Census, Commission calculations.

12. Welfare

Review outcomes

- The following changes were made to the assessment.
  - A separate assessment for homelessness services will be introduced, using Australian Institute of Health and Welfare data on the use of specialist homelessness services. This is in response to the increase in state spending on homelessness services.
  - Data on state contributions to the National Disability Insurance Scheme (NDIS) will be collected from the Department of Social Services instead of the states.
  - Non-National Disability Insurance Scheme disability services, aged care, National Redress Scheme and other welfare assessments will be combined into a single other welfare assessment. The Commission recognises that if there are substantial changes to non-NDIS disability supports, this could require a different assessment approach.
  - The Commission will no longer collect state expenses on the national redress scheme for institutional sexual abuse because the assessment does not have a material impact on state shares of GST.
- The Commission considered but did not to change the following.
  - The National Disability Insurance Scheme assessment method is considered fit for purpose.
  - There is insufficient evidence to support removing the service delivery scale adjustment from the child protection and family services assessment.
  - There is insufficient data to develop a welfare specific regional cost gradient.
  - There is insufficient data to develop a First Nations child protection cost weight for the child protection and family services assessment.
  - There is insufficient data to include a service delivery scale adjustment in the other welfare services component.
- The Commission will consider the aggregation of remoteness areas in child protection and family services assessment in the 2026 Update. This is because data were not available in time to investigate the change as part of the 2025 Review.
- As part of the Commission's forward work program, it will work with states and relevant data providers to consider how cultural and linguistic diversity affects the cost of services.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the welfare chapter of the *Commission's Assessment Methodology*.

Issues considered

Introducing a homelessness services assessment

6 The Commission proposed to introduce a homelessness services assessment, in response to the increase in state homelessness services expenses.

7 The Commission proposed to define homelessness services using the same definition as reported in the Productivity Commission Report on Government Services.[1]

8 To facilitate the assessment, the Commission proposed to collect state homelessness services expenses by classification of functions of government - Australia (COFOG-A) from the states. If states were not able to provide expense data, the Commission proposed to split homelessness services expenses from the Productivity Commission Report on Government Services 50/50 between the welfare and housing categories. These data would allow the Commission to ensure relevant state expenses are assessed in the welfare category.

9 The Commission proposed to assess state expenses using Australian Institute of Health and Welfare (AIHW) data on the use of specialist homelessness services by remoteness, Indigenous status, socio-economic status and age.

10 The Commission also considered assessing homelessness services expenses using additional drivers such as mental health conditions, family and domestic violence, overcrowding and drug and alcohol use. However, fit-for-purpose data is not available to support the inclusion of these drivers.

11 The Commission also proposed to include regional and wage cost adjustments and maintain the existing homelessness services cross-border cost adjustment for New South Wales and the ACT. The regional cost adjustment recognises that the cost of state service provision increases with remoteness. The wage cost adjustment

[1] Productivity Commission (PC), *Report on Government Services 2024*, Section 19: Homelessness services, PC, Australian Government, 2024, accessed 1 April 2024.

recognises that states have different public sector wage levels. The cross-border adjustment recognises that some services are provided by the ACT to residents of New South Wales and vice versa.

State views

Conceptual case

12 All states except Victoria supported or did not comment on the conceptual case for the development of a homelessness services assessment.

13 Victoria questioned whether there was evidence to overturn the 2020 Review Commission finding that there was no evidence of causal drivers of homelessness.

Identifying Homelessness services expenses

14 Most states supported the Commission's proposal to use the Productivity Commission definition of homelessness services and the proposal to collect homelessness services expenses by COFOG-A code from the states to ensure homelessness expenses are assessed in the welfare category. However, some states said they could not identify their homelessness services expenses by COFOG-A code in the ABS Government Finance Statistics.

15 New South Wales sought clarification on the treatment of its temporary accommodation programs because these are not included in its submission to the Productivity Commission Report on Government Services.

16 Victoria said that it would be difficult to identify homelessness services expenses by COFOG-A. It said it was concerned by the potential for inconsistencies between state definitions of homelessness services.

17 South Australia said that its emergency accommodation and the preventative component of its private rental assistance programs are not included in the homelessness services expenses data in the Productivity Commission Report on Government Services. South Australia proposed a delay in introducing the assessment to ensure consistency of expense data between states, or if the Commission proceeded with an assessment, a discount in recognition of data inconsistency.

18 The ACT considered that expense data limitations prevent a separate assessment of homelessness services. It said its temporary accommodation expenses are included in the Report on Government Services expense data in contrast to New South Wales and South Australia.

19 New South Wales, Victoria and ACT said the proposed 50/50 split seemed arbitrary. New South Wales proposed an alternative method based on a weighted average of state reported expenses to allocate Report on Government Services spending between COFOG-As for non-reporting states.

Identifying users of state services using Australian Institute of Health and Welfare specialist homelessness services data

20 New South Wales, South Australia and the ACT said the AIHW data did not have sufficient coverage of state temporary accommodation programs and state specific circumstances.

21 New South Wales and South Australia said that their temporary accommodation programs were excluded from AIHW specialist homelessness services use data.

22 The ACT said that the AIHW data does not consistently reflect service use across the states. The ACT said that this could result in a mismatch between expenses and service use.

23 The Northern Territory said the Commission should consider using ABS census data on homelessness rather than the AIHW specialist homelessness services data.

Identifying drivers of service use

24 There was mixed support for the drivers proposed by the Commission. However, states accepted that the Commission would include additional drivers if appropriate data became available.

25 New South Wales and Queensland supported the proposed drivers of homelessness services expenses.

26 Victoria said that the proposed drivers are not appropriate because they do not measure the causes of homelessness such as housing affordability and family and domestic violence. It also said other drivers which increase the cost of service provision were not included such as cultural and linguistic diversity. Victoria said the proposed drivers did not consider unique urban pressures on homelessness services. It suggested using social housing waitlists to capture urban pressures because a lack of affordable housing leads to greater demand for social housing and subsequently homelessness services. However, Victoria also acknowledged that the proposed drivers do have a link to the cost of providing homelessness services.

27 Victoria was also concerned by the difference between its assessed and actual homelessness services expenses (based on the proposed assessment). It said that the magnitude of the differences supported the case that the drivers were not capturing all state expense needs.

28 South Australia suggested that the Commission delay the assessment to undertake further work on drivers of state expenses. South Australia suggested that if the Commission proceeds with the assessment, a discount should be included to reflect omitted drivers.

29 The ACT said that the proposed drivers reflect needs for social housing rather than homelessness services.

30 States supported or did not comment on the proposal to include the regional cost, wage cost and cross border adjustments in the assessment.

31 Queensland said that a service delivery scale adjustment should be included in the homelessness services assessment in recognition of the fixed cost of service delivery in regional and remote localities.

Commission response

Conceptual case

32 The Commission notes that the homelessness assessment does not seek to measure the causal drivers of homelessness services. Instead, the proposed assessment seeks to recognise which population groups are more likely to access homelessness services, and the distribution of these population groups across states.

Identifying homelessness services expenses

33 The Commission notes the challenges in collecting homelessness services expenses data across agencies or departments and allocating expenses to relevant COFOG-A classifications.

34 The Commission agrees with states on the need to minimise data inconsistencies. It considers that the proposed approach adequately addresses this issue. In its data request, the Commission will request state expenses by COFOG-A, using the same definition used in the Productivity Commission's Report on Government Services. [2] The consistent definition allows for the Commission to use state homelessness services expenses in the Report on Government Services when states are not able to provide data directly to the Commission. Further, the Commission will cross-check state reported expenses to ensure consistent reporting. State homelessness services expenses which are not reported in the Report on Government Services, such as New South Wales' temporary accommodation program, will not be included in the homelessness services assessment. Instead, these expenses will be assessed in the category where states report these expenses.

35 The Commission does not consider that a discount due to inconsistencies in state expense data is necessary. The use of a consistent expense definition and cross-checking the Report on Government Services will enable the Commission to monitor data quality and adjust for any inconsistencies in expense data, where possible.

36 The Commission acknowledges state concerns on the proposed 50/50 split between housing and welfare expenses reported in the Productivity Commission's Report on Government Services. The Commission agrees that using an average of state reported COFOG-A expenses would be a better approach.

37 For states that are unable to provide COFOG-A expenses data, the Commission will use the available state data to estimate the average share of state expenses for each COFOG-A code. The Commission will then use the average shares to allocate

[2] The Productivity Commission defines homelessness services as 'supported accommodation, counselling, advocacy, links to housing, health, education and employment services, outreach support, brokerage and meals services, and financial and employment assistance.' PC, *Report on Government Services 2024*, Section 19: Homelessness services.

homelessness services spending from the Report on Government Services to each COFOG-A code.

38 For example, a six-state average of state reported expenses may indicate that 10% of state homelessness services spending is reported in the housing category. For states which do not provide COFOG-A classified data, the Commission will assume 10% of reported homelessness services spending from the Report on Government Services is classified in housing.

Identifying users of state services using Australian Institute of Health and Welfare specialist homelessness services data

39 The Commission agrees on the need for nationally consistent data on service use to assess the drivers of state homelessness services expenses.

40 The Commission consulted the AIHW on the coverage of their homelessness services use data. The AIHW said that users of New South Wales' temporary accommodation services which supplements specialist homelessness services are excluded. The Commission considers it should not adjust service use to include New South Wales and South Australia's temporary accommodation programs. This is to be consistent with the Productivity Commission definition of homelessness services, which has been adopted by the Commission.

41 The Commission considers that the count of homeless people from the 2021 Census is not fit for purpose. The census captures the level of homelessness (including overcrowding) on census night. However, the census excludes the population at risk of homelessness which also use services. If the Commission assessed the population that reported being homeless on census night and assumed all people experiencing homelessness used services, 56% of the users of homelessness services would be excluded from the assessment.

Identifying drivers of service use

42 The Commission considers an assessment of homelessness services using Indigenous status, socio-economic status, age and remoteness provides a better assessment of state spending needs on homelessness than the 2020 Review equal per capita assessment.

43 The Commission considered a range of other drivers proposed by states to assess homelessness services expenses (Table 1). Although the Commission considers there is a conceptual case to include housing affordability, family and domestic violence, drug and alcohol use, the presence of a disability and mental health conditions, they cannot be assessed at this stage because of a lack of fit-for-purpose data.

44 For the Commission to be able to include a driver in a socio-demographic assessment, it must satisfy 2 conditions:

- the population of service users must be able to be cross-classified by the proposed driver (i.e. mental health conditions) and other drivers

- the population of each state must be able to be cross-classified by the proposed drivers. This is necessary to derive a national policy neutral level of service use and assess state's different population characteristics.

45 Additional data considerations include broadly consistent definitions to ensure comparability and sufficient sample size to ensure that cross-classification does not result in excessive data loss, confidentiality concerns or null values for variables of interest.

46 Table 1 summarises the Commission's analysis of potential data sources and their limitations.

Table 1 Feasibility of assessing proposed drivers using different data sources

Proposed driver	Available in AIHW data	National data source	Cross-classifiable person level data	Sufficient sample size and data quality	Definition consistent with AIHW definition
Indigenous status	✓	ABS Estimated resident population	✓	✓	✓
Age	✓	ABS Estimated resident population	✓	✓	✓
Socio-economic status	✓	ABS Estimated resident population	✓	✓	✓
Remoteness	✓	ABS Estimated resident population	✓	✓	✓
Overcrowding	✗	Homelessness operation groups (OPGP) — Census of Population and Housing: Estimating Homelessness	✓	✓	n/a
Housing affordability	✓	Rent affordability indicator (RAID) — Census of Population and Housing	✗	✓	✗
Family and Domestic Violence	✓	2021–22 ABS Personal Safety Survey	✗	✗	✓
Drug and Alcohol use	✓	ABS National Health Survey 2020-21	✓	✗	✗
Disability	✓	ABS Survey of Disability, Ageing and Carers	✓	✗	✓
Disability	✓	Core activity need for assistance (ASSNP) — ABS Census of Population and Housing	✓	✗	✗
Disability	✓	ABS National Health Survey 2020-21	✓	✗	✗
Mental Health	✓	ABS National Study of Mental Health and Wellbeing 2020-22	✗	✗	✓
Mental Health	✓	Has mental health condition — ABS Census of Population and Housing	✓	✗	✓
Mental Health	✓	ABS National Health Survey 2020-21	✓	✗	✓

47 The Commission's assessment method does not aim to consider the causal factors of homelessness. Rather, it assesses the factors which influence the use of specialist homelessness services. The Commission also considers that the drivers capture the urban pressures on homelessness services use, as well as new and

emerging cohorts of service users. All users of homelessness services are included in the assessment if data are reported to the AIHW. If the rate of service use in metropolitan areas is higher than in regional or remote areas it will be captured by the classification of service users by remoteness areas.

48 The Commission notes the difference between Victoria's actual and assessed homelessness expenses. The differences between states' assessed and actual spending could be driven by other factors instead of the omission of drivers, such as state decisions to deliver different standards of services or the misclassification of expenses.

49 The Commission does not support South Australia's proposal to include a discount for omitted drivers because this is inconsistent with the Commission's framework for using discounts.

50 The Commission has not identified any evidence to support a specific service delivery scale adjustment for the homelessness services assessment.

Commission decision

51 The Commission will introduce a separate homelessness services assessment in the welfare category using expense data collected from the states. Where some states are unable to provide data to the Commission, the Commission will use a weighted average of data from those states that have provided data to determine the share of state spending assessed in the housing and other category assessments (such as health).

52 The Commission will use specialist homelessness services data from the AIHW to identify the use of services by the identified socio-demographic drivers of need:

- Indigenous status
- socio-economic status
- age
- remoteness.

53 The Commission will also include regional cost, wage cost and cross-border cost adjustments.

54 The Commission will continue to monitor opportunities for improvements in data quality for other drivers of need such as mental health conditions, family and domestic violence, person with a disability, housing affordability and service delivery scale. It will also engage with the ABS and external data agencies on potential data improvements.

Collecting state National Disability Insurance Scheme expenses from the Department of Social Services

55 The Commission proposed to collect state NDIS expense data from the Department of Social Services portfolio budget statement and stop collecting disability services expenses from the states.

State views

56 All states except South Australia supported the Commission's proposal to collect state NDIS contributions from Commonwealth Budget Papers, specifically the Social Services Portfolio Budget Statement.

57 South Australia questioned whether state NDIS funding arrangements would be harmonised after the current funding negotiations. It noted that the states and Commonwealth will work together to implement legislative and other changes to the NDIS following the 2023 Review of the NDIS.

58 Western Australia questioned how the Commission would determine the share of state expenses on non-NDIS disability services, which are currently collected from the states.

Commission response

59 The Commission considers it is unlikely that there will be a significant divergence in Commonwealth-state NDIS funding arrangements over the course of the 2025 Review period which would impact its proposed approach. New funding agreements for 7 states have been negotiated as variations to the existing agreements. The Commonwealth and Western Australia are negotiating an agreement on full NDIS implementation. However, the current agreements have a clause ensuring that should a state negotiate more favourable terms with the Commonwealth, these terms will also be reflected in all other funding agreements. This is expected to maintain harmonisation between states.

60 Since 2021–22, state provided data are around 97% of the total state and in-kind contributions to the NDIS.[3] The remaining 3% represents the in-kind contributions from Commonwealth agencies. The NDIS assessment method in the 2020 Review, based on equal per capita at the most recent census, results in this discrepancy being distributed on a population basis across all states.

Commission decision

61 The Commission will collect state contributions to the NDIS from the Commonwealth Department of Social Services Portfolio Budget Statement.

[3] Department of Social Services (DSS), Budget and Additional Estimates Statements, DSS website, 2024, accessed 5 May 2024. Commonwealth Grants Commission (CGC), 2025 Methodology Review, Draft report, CGC, Australian Government, , 2024, p 201, accessed 5 September 2024.

62 The Commission will derive state spending on non-NDIS disability services as the difference between total state spending on disability services and state NDIS spending from the Commonwealth Department of Social Services Portfolio Budget Statement.

Maintaining the 2020 Review National Disability Insurance Scheme assessment method

63 The Commission proposed to maintain the 2020 Review National Disability Insurance Scheme assessment method.

State views

64 All states except South Australia supported maintaining the existing NDIS assessment.

65 South Australia raised the potential impact of changes to NDIS funding arrangements. It also cited the potential for divergence in the state funding arrangements. The ACT said that the Commission should remain open to changing the assessment method if the NDIS funding allocations change.

Commission response

66 The Commission agrees with South Australia and the ACT that if Commonwealth-state NDIS funding arrangements change, the Commission would reflect the changes in the assessment method.

Commission decision

67 The Commission will maintain the 2020 Review National Disability Insurance Scheme assessment method. If the NDIS funding arrangements change, the Commission will consider the implications for the assessment method. The terms of reference for annual updates of GST relativities typically allow for a change of assessment method when there has been a change in Commonwealth-state relations.

Combining other welfare and non-NDIS disability services, aged care and national redress scheme components.

68 The Commission proposed to combine the non-NDIS disability services, aged care, and national redress scheme component, and the other welfare component because they are both non-deliberative equal per capita assessments.

State views

69 All states except South Australia supported combining the other welfare and non-NDIS disability services, aged care and national redress scheme component assessments.

70 South Australia did not agree because of the potential for expansion in state provided non-NDIS disability services, and uncertainty on the scope of the non-NDIS foundational supports agreed by states and the Commonwealth on 6 December 2023.[4]

Commission response

71 The Commission agrees that if there are substantial changes to non-NDIS disability supports, this could require a change to the assessment.

Commission decision

72 The Commission will combine the other welfare and non-NDIS disability services, aged care and national redress scheme component assessments into a single other welfare assessment that will be assessed equal per capita, with a wage and regional cost adjustment.

Ceasing to collect National Redress Scheme expenses from the states

73 The Commission proposed to stop collecting state expense data on the National Redress Scheme for Institutional Child Sexual Abuse because it does not have a material impact on GST shares.

State views

74 All states supported the Commission's proposal to stop collecting state expenses on the National Redress Scheme for Institutional Child Sexual Abuse.

Commission decision

75 The Commission will stop separately collecting National Redress Scheme expenses from the states because it does not have a material impact on GST shares. These expenses will be assessed where they are reported by states in Government Finance Statistics.

Excluding service delivery scale from the child protection and family services component

76 In response to state comments, the Commission reconsidered the inclusion of service delivery scale as a driver of state child protection and family services expenses.

[4] A Albanese, *Meeting of National Cabinet – the Federation working for Australia* [media release], Australian Government, 2023, accessed 1 April 2024

State views

77 New South Wales said that the introduction of the service delivery scale factor in the child protection and family services assessment was not supported by sufficient evidence in the 2010 Review.

Commission response

78 The Commission considers that, as for many services, there is a conceptual case that the cost of providing child protection and family services in regional and remote communities increases because of the small scale of service provision in these communities. While the adoption of the service delivery scale factor in the 2010 Review was not underpinned by specific data, the Commission has not identified any data that would support discontinuing the recognition of service delivery scale in the child protection and family services assessment.

Commission decision

79 The Commission will continue to apply the service delivery scale factor to child protection and family services expenses.

80 The Commission will continue to monitor the availability of data or other evidence regarding service delivery scale, including working with states to estimate how the scale of service delivery affects the costs of service provision in regional and remote areas.

Introducing a welfare category specific regional cost gradient

81 In response to state comments, the Commission reconsidered if it could use a welfare specific regional cost gradient when estimating the impact of remoteness on state expenses on child protection and family, homelessness, and other welfare services.

State views

82 New South Wales said the Commission should use a welfare specific regional cost gradient instead of using the general regional and service delivery scale cost gradients. New South Wales provided internal research that suggested the general regional and service delivery scale cost gradient overstates the cost of travel to deliver child protection services to regional and remote communities after considering traffic in major cities.

Commission response

83 The research referenced by New South Wales contained analysis for one year only and it did not include analysis for other states. The Commission considers this does not provide sufficient evidence to discontinue the use of the general regional and service delivery scale cost gradient in the welfare assessment. Further, the

Commission has not identified any other sources of fit-for-purpose data that would enable it to develop a welfare specific regional cost gradient.

Commission decision

84 The Commission will continue to use the general regional and service delivery scale cost gradient in the welfare component assessments. The Commission will continue to monitor the availability and quality of data which could be used to develop a welfare specific regional cost gradient.

Introducing cultural and linguistic diversity as a driver of state welfare expenses

85 In response to state comments, the Commission considered the introduction of a cultural and linguistic diversity driver in the welfare assessment.

State views

86 New South Wales and Victoria said the Commission should include a cultural and linguistic diversity cost or use weight, citing the increased cost of providing support to migrants and refugees.

Commission response

87 The Commission considers that there is a conceptual case that states incur additional costs in providing welfare services to culturally and linguistically diverse populations.

88 A substantial amount of work is required to develop, test and consult with states on a potential cultural and linguistic diversity driver for the welfare assessment. This includes the appropriate definition of cultural and linguistic diversity for welfare services as well as identifying fit-for-purpose data. This work will be included in the Commission’s forward work program.

Commission decision

89 The Commission will not introduce a culturally and linguistically diverse cost or use weight in the welfare assessment.

90 The Commission will consider how cultural and linguistic diversity affects state service costs as a part of its forward work program.

Introducing a First Nations cost weight in child protection and family services

91 In response to state comments, the Commission considered introducing a First Nations cost weight in the child protection and family services assessment.

State views

92 Western Australia said the Commission should include a First Nations cost weight to represent the costs associated with providing child protection and family services to First Nations Australians.

93 Western Australia said that the funding model for child protection and out of home care services has differential cost profiles for locations with a high proportion of First Nations children. This is to facilitate the additional staff needed to provide culturally appropriate services.

94 Queensland supported the inclusion of a First Nations cost weight. Queensland said that not applying a First Nations cost weight reinforced the need to remove the discount on the general regional cost and service delivery scale gradient.

Commission response

95 This issue was raised by the Northern Territory in the 2020 Review. The Commission concluded that a First Nations cost weight was not justified because Productivity Commission data showed there are no differences in the average time spent in out of home care by First Nations and non-Indigenous children. The Commission is not aware of a reliable nationally consistent data source that would support the inclusion of a First Nations cost weight.

Commission decision

96 The Commission will not include a First Nations cost weight in the child protection and family services assessment.

Aggregating remoteness areas in the child protection and family services component

97 In response to state comments, the Commission revisited the aggregation of remoteness areas in the socio-demographic assessment of child protection and family services.

State views

98 Queensland said that the higher average substantiation rate for children in non-remote areas, compared to remote areas in the Commissions assessment does not reflect its experience of the pattern of service delivery.[5]

Commission response

99 In the 2020 Review, the Commission aggregated major cities, inner and outer regional areas into a single non-remote grouping and remote and very remote areas into a

[5] A substantiation is the outcome of an investigated notification that has led to the conclusion that there is reasonable cause to believe a child has been, is being or is likely to be abused, neglected, or otherwise harmed. For further details see: PC, Report on Government Services 2024, 16: Child protection services, 2024,accessed 26 August 2024.

remote grouping. This was necessary because of data confidentiality concerns which prevented the Commission accessing disaggregated data from the AIHW.

100 The Commission agrees that the higher average substantiation rate for non-remote children may be counterintuitive. Data from the AIHW will not be available in time to undertake necessary analysis as part of the 2025 Review. When the data are available, the Commission will consider whether there is a need to change the remoteness and socio-economic status aggregation in the child protection and family services assessment in the 2026 Update.

Commission decision

101 The Commission will investigate the aggregation of the remoteness and socio-economic status classifications in the child protection and family services component assessment as part of the 2026 Update.

Introducing service delivery scale in the other welfare services component

102 In response to state comments, the Commission considered the conceptual case for introducing a service delivery scale adjustment in the other welfare services assessment.

State views

103 Queensland said that the Commission should include the general service delivery scale cost gradient in the other welfare services assessment. This was to recognise the fixed costs of providing services in regional and remote areas.

Commission response

104 Queensland did not provide evidence to inform the Commission's decision on the conceptual case for including the general service delivery scale cost gradient in the assessments. In the absence of relevant evidence or data, the Commission is unable to further consider the issue.

Commission decision

105 The Commission will not introduce a service delivery scale factor in the other welfare services component assessment.

Discounting adjustments for regional costs and service delivery scale

106 Queensland questioned whether the current 25% discount on the general regional and service delivery scale cost gradient remained appropriate. Queensland said that the reason for the discounts is conceptually flawed.

107 Discounting of the regional cost gradient and service delivery scale is discussed in the geography chapter of *Review Outcomes*.

GST impacts of method changes

108 The impact on the GST distribution from the method changes is shown in Table 2.

Table 2 Impact on GST distribution of method changes, welfare, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
New homelessness services assessment	-11	-74	52	7	-8	6	-8	36	101
Change in general regional and service delivery scale cost gradient	6	5	-2	-1	-1	-2	0	-5	11
Moving expenses between components	0	-2	-1	3	-1	0	0	1	5
Total	**-5**	**-71**	**48**	**8**	**-10**	**4**	**-8**	**33**	**94**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
New homelessness services assessment	-1	-10	9	2	-4	11	-17	142	4
Change in general regional and service delivery scale cost gradient	1	1	0	0	0	-3	1	-19	0
Moving expenses between components	0	0	0	1	-1	0	0	6	0
Total	**-1**	**-10**	**8**	**3**	**-5**	**7**	**-16**	**128**	**3**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes.*

109 The changes to the welfare assessment increased the assessed GST needs of Queensland, Western Australia, Tasmania and the Northern Territory. The largest driver of change was the introduction of a socio-demographic assessment of state expenses on specialist homelessness services. Under the new method, these states are assessed as having higher expense needs because they have a higher proportion of population groups with a higher use of homelessness services (for example, First Nations people).

110 The changes to the general regional and service delivery scale cost gradient are explained in the geography chapter of *Review Outcomes*. The changes reduced the estimated cost of child protection and family services in inner regional, outer regional and remote Australia. The general regional and service delivery scale cost gradient for very remote Australia was unchanged. The changes to the gradient reduced the assessed GST needs of states with an above average share of populations in inner regional, outer regional and remote Australia including Tasmania and Northern Territory.

13. Services to communities

Review outcomes

- The following changes were made to the assessment.
  - The criteria used to define the communities assessed to need water and electricity subsidies will be changed based on analysis of updated data and to reduce complexity in the assessment.
  - The regional cost gradient for remote communities electricity subsidies was re-estimated using more recent data collected from states.
- The Commission considered but did not to change the following.
  - The population in small communities remains the driver of expenses for small communities water subsidies. Other water subsidies continue to be assessed on an equal per capita basis. Reliable data on other factors that influence the cost of supplying water are not available.
  - The population in discrete First Nations communities continues to be the appropriate driver for the assessment of community development expenses in these communities.
  - Expenses for environmental protection will continue to be assessed on an equal per capita basis as a common policy neutral driver of need for spending was not identified.
  - The variable used to weight the regional cost gradient for converting to state regional cost factors for biodiversity and landscape protection expenses will continue to be based on state population in each remoteness area.
- The Commission will monitor developments on the National Water Initiative to determine if future Commonwealth–state commitments on water pricing have implications for the assessment.
- The Commission will continue to monitor developments on natural disaster mitigation, including any relevant outcomes from the Independent Review of Commonwealth Disaster Funding.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating the changes made in the 2025 Review, can be found in the services to communities chapter of the *Commission's Assessment Methodology*.

Issues considered

Drivers of water supply subsidies

6 The Commission proposed no change to the drivers of subsidies for the supply of water and wastewater services. It considered state suggestions on additional drivers.

State views

7 Victoria said that factors other than community size and remoteness also impact the cost of supplying water, such as distance from water supply, water quality, water availability and ageing assets.

8 Western Australia said that water quality and availability affect the cost of providing water. Western Australia suggested 2 options for assessing states' expenses on water subsidies:

- expand the population used in the small communities assessment to include non-capital towns with poor water quality and availability
- assess water subsidies actual per capita or blend the 2020 Review method with an actual per capita method.

Commission response

9 In the 2020 Review, the driver of state spending on water subsidies for small communities was the population in small communities. Spending on water subsidies for other communities was assessed equal per capita.

10 The Commission considers that an assessment of differences between states in the cost of supplying water should take into account all non-policy drivers of costs.

11 Analysis was undertaken of the data that accompanied the Bureau of Meteorology's *The National performance report 2021–22: urban water utilities*, which incorporate all policy and non-policy factors affecting the cost of supplying water. The data have limitations that mean they are not sufficiently reliable to use in an assessment. However, the analysis showed that if used in an assessment the distribution of GST would not be materially different from an equal per capita distribution for any state. The Commission therefore considers the Bureau of Meteorology's report provides

sufficient support for the continuation of an equal per capita assessment of water subsidies that states provide to locations outside small communities.

12 In the absence of a consistent national water pricing arrangement (or enforcement mechanism), the Commission cannot be confident that water subsidies are not influenced by state policies. As such, an actual per capita assessment is not appropriate.

Commission decision

13 The Commission will continue to assess water subsidies provided to small communities using a driver of need based on the population each state has in communities that meet the criteria of a small community.

14 For water subsidies provided to residents outside of these small communities, state population continues to be the driver of need (that is, an equal per capita assessment).

15 The Commonwealth has committed to work with states to renew the National Water Initiative. The Commission will monitor developments to determine if future Commonwealth–state commitments on water pricing have implications for the assessment.

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

16 The Commission asked states for data on electricity and water subsidies to update the criteria for communities assessed to need these subsidies. The Commission considered suggestions by states to change the criteria and issues raised by states with the calculation of the regional cost gradients.

State views

17 Victoria said the Commission should apply a discount to the small communities water subsidies assessment if, as occurred in the 2020 Review, only a small number of states can provide data to calculate the regional cost weight.

18 Western Australia proposed that communities with populations of fewer than 50 people should be included in the assessments because:

- the lower limit of 50 people is arbitrary
- 60% of regional and remote communities in Western Australia with populations fewer than 50 rely on subsidised state water and electricity services
- many isolated farms and stations are connected to state services, depending on their distance to local centres.

19 Western Australia said it was unable to provide data on 141 remote First Nations communities that receive water and electricity subsidies. It requested the cost gradients be updated annually to enable the assessment method to take account of

the data on these communities if it were able to provide these data before the next review.

20 Western Australia said that the costs of providing water and electricity services to communities are made up of fixed and variable costs. Whilst the variable costs are dependent on the populations of the communities, the fixed costs are dependent on the number of communities, regardless of their population size. The Commission should account for both the fixed and variable costs in its calculation of the regional cost gradients for water and electricity subsidies.

Commission response

21 The criteria in the 2020 Review method for the electricity subsidies assessment was remote and very remote communities with a population greater than 50 and a population density of 60 people per km^2.

22 The criteria in the 2020 Review method for the water subsidies assessment was small communities outside of major cities with a population between 50 and 3,000 and a population density of 60 people per km^2.

23 The Commission asked states for data on electricity and water subsidies to update the criteria for communities assessed to need these subsidies. The updated data were also used to revise the regional cost gradient for remote communities electricity subsidies. States were unable to provide the Commission with sufficient data to update the regional cost gradient for the small communities water subsidies assessment.

24 In the 2020 Review, due to incomplete data, the Commission used a conservative approach to estimating the regional cost gradient for the small communities water subsidies assessment. This meant separate cost weights for remote and very remote areas were not produced. The Commission stated at the time that this approach had a similar effect to a discount.

25 There are elements of many assessments that are only updated in a review. This is usually because the data needed to update the calculation is difficult for states to provide. This is the case with the data needed to update the regional cost gradients for electricity and water subsidies. The annual data states provide on electricity subsidies do not enable the Commission to update the regional cost gradient. Only one state is now able to provide the data needed for the calculation of the water subsidies regional cost gradient, and so it cannot be updated.

26 There is merit in Western Australia’s proposal to distinguish between the fixed and variable costs of supplying water and electricity. However, it cannot be implemented in the small communities water subsidies assessment because only one state can provide the data needed to determine the eligible community criteria and the regional cost gradient.

27 To give effect to the proposal in the remote communities electricity subsidies assessment, 2 separate assessments would need to be developed – one on fixed costs and one on variable costs. Regression analysis could have been used to estimate the proportion of subsidies associated with fixed and variable costs. However, data were only available for 11 remote communities which was not sufficient for a reliable estimate. Implementing Western Australia's proposal would also add more complexity to the assessment of expenses that amounted to less than $500 million per year on average for the 2024 Update.

Commission decision

28 The Commission simplified the criteria used to define which remote communities are assessed to need electricity subsidies and which small communities are assessed to need water subsidies. Population, in all communities in remote and very remote areas, is the driver of need for remote communities electricity subsidies. Population in communities outside major cities with up to 3,000 people is the driver for water subsidies for small communities.

29 For remote community electricity subsidies, updated data were used to set the regional cost gradient at 3. For small community water subsidies, the 2020 Review regional cost gradient will be retained due to insufficient data to support an update. The regional cost gradient for outer regional communities will remain 2.2 and 4.4 for remote and very remote communities.

Drivers of spending on environmental protection

30 The Commission proposed no changes to the environmental protection assessment. It considered suggestions by states for alternative drivers of expenses.

State views

31 Victoria said that it has higher costs associated with protecting the environment for 2 reasons. First, to deliver the potentially conflicting policy objectives of providing infrastructure to support high population growth and protect the environment, Victoria has introduced an expensive regulatory framework. Second, higher land costs and smaller farm size, mean Victoria has to spend more than other states to compensate landowners for land set aside for biodiversity measures.

32 Western Australia said one of the main drivers of spending for national parks and wildlife services is meeting international and Commonwealth obligations and this is the average policy that is applied by states when declaring land to be protected areas. Western Australia proposed that the assessment of national parks and wildlife costs should be based on national park area rather than population. It also said that the costs to control and prevent beach erosion are not correlated to population and should be assessed on the length of beach that needs to be maintained.

Commission response

33 Environmental protection expenses are assessed on an equal per capita basis as they cover a wide variety of activities, including protection of biodiversity and landscape, pollution abatement, and waste and wastewater management. It is not possible to identify a single broad indicator for assessing total spending. The comments from Victoria and Western Australia highlighted the challenges in identifying an appropriate driver for all environmental protection.

Commission decision

34 State spending on environmental protection is impacted by the features of each state and these features vary markedly between states. Some potential drivers of need, such as the land area of national parks, are also policy influenced. A common policy neutral driver of need for spending is not able to be identified. The Commission will continue to assess environmental expenses on an equal per capita basis.

Regional cost gradient for environmental protection expenses

35 The Commission proposed no changes to how the regional cost gradient is applied in the environment protection component. It considered concerns raised by states with the method for calculating regional cost weights for expenses to protect biodiversity and landscape.

36 The Commission also considered views from states on the expenses for which regional costs should be applied.

State views

37 Western Australia said that expenses for the protection of biodiversity and landscape are unrelated to the size of the population in each remoteness area. It said that the regional cost factors being applied to national parks expenses should be weighted by their land area and the regional costs applied to spending that prevents coastal erosion should be weighted by the length of the affected beach.

38 Victoria said that a regional cost gradient should not be applied to the assessment of expenses for the protection of biodiversity and landscape. Western Australia said the gradient should be applied to a broader range of expenses.

Commission response

39 Regional costs are applied to expenses for the protection of biodiversity and landscape in the environmental protection component. The general regional cost gradient cannot be applied directly to expenses because expenses cannot be disaggregated by remoteness area. As such, a state regional cost factor needs to be calculated. In the 2020 Review, to create a state regional cost factor from the general regional cost gradient, population in each remoteness area was used to weight the cost factors for each remoteness area.

40 The variable used to weight the regional cost gradient for converting to a state regional cost factor should relate to the proportion of spending that occurs in each remoteness area. For most assessments, the amount of money spent is broadly in proportion to the number of people in an area and so population is used as the weight (that is, more money is spent in major cities compared with outer regional areas and there are more people in major cities than outer regional areas).

41 State spending on environmental protection, even within the subset for which regional costs are applied (protection of biodiversity and landscape), is very diverse and heavily influenced by the features of each state.

42 While examples exist within the diverse range of state spending on the protection of biodiversity and landscape where most spending is occurring in parts of the state where there are fewer people, this may not be the case for all states and for all types of biodiversity and landscape protection activities.

43 Victoria's arguments relate to drivers of spending rather than the additional cost of providing similar services as remoteness increases (see previous section for the discussion on drivers).

44 Implementing Western Australia's proposal to broaden the expenses for which regional costs are applied would require the states to report their environmental protection expenses on a different basis to the Government Finance Statistics framework. There are likely to be some types of expenses within the 'pollution abatement' expenses area (where regional costs are not applied) that do increase with remoteness. However, the opposite is also likely to be the case for the 'protection of biodiversity and landscape' expense area (where regional costs are applied). It is not clear that the additional complexity and reporting burden on states is justified to try to achieve a more precise application of regional costs.

Commission decision

45 The variable used by the Commission to weight the regional cost gradient for converting to state regional cost factors for biodiversity and landscape protection expenses will continue to be based on state population in each remoteness area.

First Nations community development

46 The Commission proposed no changes to the assessment of expenses on First Nations community development. It considered suggestions by states for additional expenses and additional drivers to be included in the assessment.

State views

47 Victoria said that historical circumstances mean that it has a smaller proportion of First Nations people living in discrete First Nations communities, compared with other states, but did have dispersed First Nations communities living in larger cities

and regional centres. Victoria said it incurs costs to support these communities which should be assessed in the First Nations community development component.

48 Victoria also said the assessment method should be based on hectares managed by traditional owners under settlement agreements or treaties rather than the 2020 Review method based on populations in discrete First Nations communities.

49 Western Australia said that any decisions involving major ground disturbances affecting a site of First Nations importance requires an approval process between First Nations people and the state government. It said the costs associated with these processes should be included in the assessment.

Commission response

50 The Commission considers that population in discrete First Nations communities continues to be the appropriate driver of need for these expenses. The costs states incur on First Nations community development are likely to increase in proportion to the number of people states have in these communities.

51 The expense programs listed by Victoria in its submission have varying degrees of connection to land managed by traditional owners under settlement agreements or treaties. The Commission is not aware of evidence indicating these expenses varied by the size of the land managed by traditional owners.

52 Similarly, the Commission is not aware of evidence that population in discrete First Nations communities is the appropriate driver of need for expenses related to approval processes between First Nations people and the state government for decisions involving major ground disturbances affecting a site of First Nations importance.

Commission decision

53 The Commission will not broaden the type of expenses included in the discrete First Nations communities assessment or change the driver of need.

Assessing spending on natural disaster mitigation

54 The Commission asked states whether the existing equal per capita assessment of natural disaster mitigation expenses remained appropriate.

State views

55 There was general support from states for the continuation of the existing equal per capita assessment of spending on natural disaster mitigation.

56 States discussed potential drivers of need. New South Wales focused on exposure to disasters. Victoria noted that the subject is complex, with the need for mitigation likely driven by relationships between mitigation, risk, previous mitigation efforts and the need for disaster responses. South Australia said that, similar to expenditure on environmental protection, there is no reliable driver of need as each state has its

own unique climatic issues and circumstances. It also noted that the occurrence of natural disasters on its own is not a reliable proxy for mitigation expenditure. The ACT noted that more work is required in order to appropriately capture, measure, and analyse drivers of need as well as report on disaster mitigation spending. The Northern Territory said that matters such as local planning rules and legacy planning decisions can influence both the propensity of a disaster to impact states and the costs which arise from those disasters.

Commission response

57 The Commission agrees that there are significant challenges in developing a separate assessment for mitigation expenses. These include agreeing on a definition of mitigation, separately reporting expenses and determining a reliable driver of state expense needs.

Commission decision

58 The Commission will not introduce a separate assessment of natural disaster mitigation expenses in the 2025 Review. In preparation for the next review, the Commission will continue to monitor developments and will explore, in consultation with states, whether a differential assessment is appropriate and can be measured robustly. The developments that will be monitored include the outcome of the Independent Review of Commonwealth Disaster Funding.[1]

State spending on natural disaster mitigation

59 The Commission asked states whether the definitions used in the National Partnership on Disaster Risk Reduction provide an appropriate basis for describing the type of spending that could be classified as natural disaster mitigation.

60 The Commission also asked states about the reporting of natural disaster mitigation expenses and whether expenses are expected to increase significantly over the next 5 years.

State views

61 States generally agreed on the importance of a shared understanding of what constitutes natural disaster mitigation spending. However, views differed on whether the definition used in the National Partnership is appropriate. New South Wales and Victoria suggested additional expense items be included in any definition used by the Commission. The Northern Territory said the definition used in the national partnership was too broad.

[1] The final report of the Independent Review of Commonwealth Disaster Funding was provided to the Australian Government on 30 April 2024 and released publicly on 25 October 2024.

62 South Australia said that, practically, it may be difficult to distinguish elements of expenditure on general infrastructure/maintenance programs from expenditure with the specific purpose of disaster risk reduction.

63 The ACT suggested the Commission remain open to consider any new developments surrounding the definitions and coverage of natural disaster mitigation.

64 States acknowledged the difficulty in identifying how all mitigation expenses are currently classified. States said that expenses are most likely to be reported against multiple classifications of the functions of government codes.

65 Most states expected spending on mitigation measures to increase.

Commission response

66 The Commission acknowledges the challenges in defining and measuring natural disaster mitigation expenses which might limit the potential for developing a robust assessment of these expenses.

Commission decision

67 The Commission will continue to monitor developments, including outcome of the Independent Review of Commonwealth Disaster Funding, and explore, in consultation with states, whether a differential assessment is appropriate and can be measured robustly.

GST impacts of method changes

68 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, services to communities, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Changes to water subsidies	6	12	-7	-3	-1	3	0	-10	21
Changes to electricity subsidies	8	1	-2	-1	6	4	0	-15	19
Change in general regional cost gradient	0	0	0	0	0	1	0	0	1
Total	**14**	**13**	**-10**	**-4**	**4**	**7**	**0**	**-25**	**39**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Changes to water subsidies	1	2	-1	-1	-1	6	0	-37	1
Changes to electricity subsidies	1	0	0	0	3	6	0	-60	1
Change in general regional cost gradient	0	0	0	0	0	1	0	1	0
Total	**2**	**2**	**-2**	**-1**	**2**	**13**	**0**	**-96**	**1**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes*.

69 The change in the GST distribution due to changes to the water subsidies assessment reflects the combined effect of changes to the share of state population in small communities and the application of the unchanged regional cost gradient to these changed population shares. The largest per capita impact was on the Northern Territory due to a reduction in its relative share of population in very remote areas.

70 The change in the GST distribution due to changes to the electricity subsidies assessment reflects the combined effect of changes to the share of state population in remote and very remote communities and the application of a reduced regional cost gradient to these changed population shares. The largest per capita impact was on the Northern Territory due to a reduction in its relative share of population in remote and very remote areas.

71 The changes to the general regional cost gradient are explained in the geography chapter of *Review Outcomes*. The changes increased the assessed GST needs of states with a larger share of their population in more remote areas.

14. Justice

Review outcomes

- The Commission will maintain the 2024 Update method for recommendations for GST distribution in 2025–26.
- The Commission will implement any 2025 Review changes in the 2026 Update. This will allow for the collection and processing of 2022–23 and 2023–24 data, which are less likely to reflect temporary changes in service delivery made in response to the COVID-19 pandemic. This also enables substantive consultation on potential method changes.
- The Commission will consult states on the justice assessment method during 2025. A revised Draft Report chapter will be released to the states in June 2025 for comment. The use of discounts in the justice assessment will be considered as part of this consultation process.
- The Commission's final position on changes made to the assessment method will be provided in a paper to states prior to the 2026 Update.

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 The Commission will postpone implementing changes to the justice assessment until the 2026 Update. This is to allow for the collection of 2022–23 and 2023–24 data, which are less likely to reflect the temporary changes in service delivery made in response to the COVID-19 pandemic. This will also enable substantive consultation on potential method changes and adequate time for the Commission to process the new justice data for application into the model.

5 This chapter includes:

- an overview of the issues so far considered during the review
- the Commission's response and decisions on issues that are not reliant on further data.

6 State views on the Draft Report are included in this chapter. There will be further consultation with states and Commission responses prior to the 2026 Update (see Attachment A).

7 A detailed description of the assessment method that will be used for the 2025–26 GST distribution can be found in the justice chapter of the *Commission's Assessment Methodology*.[1] The Commission will release a revised description of the justice method (incorporating changes made during the 2025 Review) at the time of the 2026 Update.

Issues considered

Justice model and data issues

8 The Commission sought state views on the appropriateness of the 2020 Review justice model if updated with fit-for-purpose data.

9 Given the change in justice services during the COVID-19 pandemic, the Commission noted the likelihood that 2019–20, 2020–21 and 2021–22 did not reflect long-term patterns of justice service provision, particularly for police and criminal courts. During this time, resources were reallocated to enforce public health directives and lockdowns, crime patterns changed, and some court proceedings were moved online or suspended.

10 The Commission raised the question of whether 2022–23 data should be used to update the justice assessment if they are fit for purpose.

11 It also raised the possibility of updating the assessment with 2022–23 data in the 2026 Update if these were not available in time for inclusion in the 2025 Review.

State views

12 Most states broadly agreed that the 2020 Review justice model remained appropriate, although New South Wales and Western Australia raised issues with elements of the model.

13 Victoria did not support the model. It said there were weaknesses in the conceptual case for some aspects, and that the model was open to policy influence and could be a barrier for reform. Victoria engaged a consultant to review the model. Queensland did not support retaining the model without changes to the police assessment.

14 All states agreed that data from 2019–20 to 2021–22 did not reflect typical justice services and costs. Other than South Australia, all states supported using 2022–23 data in the assessment. South Australia proposed 2022–23 data be analysed for potential COVID-19 influence prior to use.

15 All states that responded supported updating the assessment with 2022–23 data in the update following the review if the data were not available in time for the review.

[1] This is the same method applied in the 2024 Update.

16 Some states raised concerns over using only one year of data.

17 The Northern Territory raised the possibility of using annual data to update the assessment. It considered that annual data would better capture short-term and medium-term trends in justice service use, particularly in remote areas.

18 Western Australia said it would be prudent to include 2023–24 and 2024–25 data, particularly if 2022–23 data were COVID-19 affected but thought an annual data request could be burdensome. Queensland did not support requesting data from states on an ongoing annual basis.

19 Victoria expressed broad concerns regarding the data used to inform the assessment. It said the assessment is unable to adequately capture the drivers of justice expense needs because of data comparability issues. Victoria recommended the Commission discount, or assess components equal per capita, until a nationally consistent dataset is available. Victoria's consultant also said data limitations warranted discounting the assessment.

20 Queensland supported not applying any new equal per capita assessments or discounts due to data concerns, and supported the data used in the assessment.

Commission response

Justice model

21 The Commission notes the broad support for the 2020 Review model, and considers the overall approach remains appropriate if supported by new state data. Although there was broad support for the 2020 Review model, states raised several concerns and made suggestions for improving the model.

Data quality concerns

22 Where possible, the Commission uses data from organisations with nationally consistent frameworks as this increases data comparability and consistency. In the assessment, some data are currently sourced from the Australian Bureau of Statistics (ABS), the Australian Institute of Health and Welfare and the Productivity Commission.[2] However, most data are sourced directly from states.

23 The Commission considers variability in costs across states does not necessarily signify uncertainties in the data that would warrant discounting. This variability is likely due partly to states' different policy choices. Using national average data smooths policy differences across states and provides a benchmark with which to assess needs in the context of diverse approaches to justice administration.

24 The Commission considers the data used in the justice assessment are the best currently available and fit for purpose. The Commission has not identified sufficient

[2] Prisoner data are sourced from the ABS. Juvenile detainee data are sourced from the Australian Institute of Health and Welfare. Courts costs are sourced from the Productivity Commission.

concerns with the data to support a discount or pursue an equal per capita assessment.

Updating data used in the assessment

25 The Commission considers that an annual request for state data would be a significant imposition on states given the size and complexity of the request. Furthermore, the time between receiving the data from all states and processing them is unlikely to be sufficient to meet update deadlines.

26 Commission analysis of national totals in ABS data on proceedings, defendants and prisoners showed that these measures are relatively stable over a 5-year period. The Commission therefore considers updating data annually would increase the burden on states for little benefit.

27 The Commission's analysis of ABS data indicated data for 2022–23 are not unduly affected by COVID-19. Preliminary analysis of state data indicates that they are also largely unaffected.

28 The Commission agrees that incorporating a second year of data (2023–24) would better reflect current and future state justice needs. These data have been requested from states. The average of 2022–23 and 2023–24 data will be incorporated into the new assessment when it is implemented in the 2026 Update. The 2020 Review method and data will be used in the recommendations for relativities for GST distribution in 2025-26.

Commission decision

29 The Commission will:

- broadly retain the 2020 Review model if supported by updated state data
- not apply discounts or equal per capita assessments in response to policy neutrality concerns
- not request data from states on an ongoing annual basis
- maintain the 2020 Review method for recommendations for GST distribution in 2025–26 and implement any 2025 Review method changes in the 2026 Update with data from 2022–23 and 2023–24.

Police assessment – policy neutrality

30 In response to state comments, the Commission considered whether its police assessment could present barriers to policy reform. It also explored the possibility of weighting offences by seriousness.

State views

31 Victoria said a state that implemented policies that reduce offender rates, court attendance and incarceration would be negatively impacted because these are the measures the Commission uses to determine assessed expenses. Similarly, the Victorian consultant said it was important not to disincentivise investments in

evidence-based measures that cut costs and crime. It suggested that if offence numbers are incorporated into the police assessment method, these should be weighted by seriousness or discounted to account for the impact of state policy on offender numbers.

32 Queensland did not support changing the police assessment to account for potential barriers to policy reform.

Commission response

33 The Commission's assessments are based on national average policies. If one or more states experience a reduction in offenders from one of the sub-population groups, the assessment will capture the change relative to the national average. However, one state is unlikely to materially affect the national average rates.

34 The Commission's 2024 Update police assessment method considers all policing costs, not only costs related to offender rates.[3] If a state chooses to increase spending on diversionary programs to reduce offending, these costs will be captured as part of policing costs and inform the national average per capita costs for policing in each region.

35 In relation to the weighting of offences by seriousness, the Commission acknowledges there is a conceptual case that the cost of investigating some crimes is significantly more expensive than other crimes. A state may face higher costs beyond its control if these offences are committed more often within its borders than in other states.

36 However, the Commission is not aware of any national data that would allow it to determine whether, or by how much, more serious crimes cost more than less serious crimes. It is also likely that the costs associated with 2 crimes of the same seriousness may differ dramatically. The Commission therefore considers the weighting of offences by seriousness to be unfeasible given current data availability.[4]

37 The Commission does not consider having an equal weight for offences conflicts with the principle of policy neutrality. With an equal weighting of offences, states may focus police activities on whichever offences they choose.[5] These policy choices form part of the national average policy on what states spend per offender. This cost weight is then applied to each state's assessed offenders rather than its actual offenders. In this way, individual states are only able to influence their assessed GST needs in proportion to how much they affect national average policies.

38 Because the impact of individual state policies is mitigated by using national averages, the Commission does not consider a discount to be warranted.

[3] The 2020 Review method was revised in the 2024 Update to account for the suspension of the national capital assessment and the continued use of 2016 Census-based First Nations populations.

[4] The Commission will continue to explore whether suitable data can be identified for use in weighting offences for the next review.

[5] The Commission does not make judgements on what states could or should do.

Commission decision

39 The Commission will not make changes to the police assessment in response to concerns regarding potential barriers to policy reform.

Police assessment - regression

40 In response to state comments, the Commission considered if the regression used in the police assessment reflects what states do.

41 The Commission proposed investigating whether a remote offender variable should be added to the regression.

State views

42 Victoria said the 2020 Review police assessment was based on reactive police measures, such as offender numbers, which were a poor indicator of need. It recommended that, in the absence of robust preventative policing measures, the Commission should adopt a conservative approach and assess police expenses equal per capita or discount the assessment.

43 Victoria also said that, unless the police regression could be adjusted to account for state policy influences on the size, population and composition of police districts, the regression should not be used, or a discount applied.

44 The Victorian consultant recommended that a population variable be added to the regression model to fully account for differences in police district size. It found that adding a population variable to the model produced different cost weights, meaning that weighting by population was not fully mitigating potential biases.

45 The consultant also recommended using a simplified model based only on police district population and remoteness since it found the offender variable to be ineffective at capturing cost drivers.

46 Queensland said that the cost and time attributed to criminal activity within Queensland police services is significantly higher than the approximately 31% of policing costs attributed to criminal policing in the police regression.

47 Queensland proposed altering the police assessment to recognise expense needs through a socio-demographic composition assessment of assessed offenders that is weighted by regional costs (instead of applying the cost weights to regional populations).[6] It said that spending on preventative policing is driven by crime propensity rather than population.

48 During the state visit, Queensland also presented evidence that policing offenders in remote regions is considerably more costly than in other regions. It supported an

[6] In the 2020 Review method, police regional cost weights are applied to regional populations instead of assessed offender numbers.

additional cost weight for remote offenders but noted that adding a remote cost weight would be inferior to a wholesale review of the policing model.

49 South Australia said the 2020 Review police assessment was an appropriate method for determining states' policing costs. It said if evidence supported 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.

Commission response

Reactive and preventative policing

50 The police regression captures all recurrent expenses in the policing task and estimates a national average policing cost per offender and a policing cost for each regional area. This should not be interpreted as a split between the costs associated with targeting offenders and the cost of general community policing. Rather, the regression estimates the national average per offender policing cost and a policing cost for each region. It does not assign costs to a specific policing task.[7]

51 Assessing all police expenses by only using national average offender numbers or only using police district population characteristics would not adequately recognise all the drivers of police costs.

52 The Commission acknowledges that states have different policies for funding police activities, and that the difference between offender driven costs and other policing costs will vary. The Commission considers the 2020 Review regression model to be suitable for accounting for such policy differences.

53 While testing in the 2020 Review indicated that capturing offender costs by region was not significant, the Commission considers that the high cost weight in remote regions is capturing the higher cost of policing offenders as well as the higher cost of policing the regions. The Commission will test whether state data support an additional cost weight for remote offenders.

District size and population

54 In the police regression, each of the police district costs is weighted by the population in the police district. The regression uses the cost per capita to estimate the national average policing cost in each region and national average cost per offender. Using this type of population weighting negates the bias resulting from states having different numbers and population sizes of police districts.

55 The Commission considers the difference in cost weights produced by adding a population variable to the model is caused by the strong correlation between population and population-weighted police districts.

[7] Accordingly, these proportions are not comparable to the 2015 Review method which split costs between 'specialised' and 'community' policing.

Commission decision

56 The Commission will retain the 2020 Review regression model.

57 Further analysis of state data and consultation with states will determine whether there should be an additional cost weight for remote offenders. The Commission will consider this issue during the consultation process prior to the 2026 Update.

Police and prisons assessment - central costs and global cities

58 In response to state comments, the Commission considered whether the method used to allocate central costs prior to running the police regression was appropriate.

59 The Commission also explored the possibility of a global city assessment.

State views

60 New South Wales said allocating all central policing costs across all police districts/regions in a state overestimates the cost of remoteness. It originally said that central costs should be allocated to police districts on an equal per capita basis, and an additional 25% discount should be applied to the regional cost gradient. New South Wales provided further analyses to suggest that costs in metropolitan areas are greater than an equal per capita share would indicate.

61 Similarly, Victoria said the 2020 Review method overestimates remoteness cost weights and socio-demographic use weights. Victoria said it is more likely that central costs are driven by state population size rather than number of offences or remoteness of the population. It considered that central costs should be excluded from the regression and assessed separately on an equal per capita basis.

62 The Victorian consultant also raised concerns with central costs being allocated across states' policing districts. It recommended assessing some central costs on an equal per capita basis and most police support services costs allocated according to the number of full-time equivalent police officers.

63 Queensland did not support New South Wales' and Victoria's proposals to split central costs. It said that splitting these costs would breach the Commission's what states do, policy neutrality and practicality supporting principles and would be difficult to implement. Queensland noted that regional and remote police services rely more heavily on central services because they lack the capability of metropolitan police stations. It also said that central policing costs are driven by actual policing need and are not detached from other police spending.

64 New South Wales said densely populated and highly globalised cities face costs and pressures that other areas do not. These include terrorism, complex crime, disproportionate rates of federal prisoners, and culturally and linguistically diverse prisoners. It recommended these effects should be assessed jointly to determine materiality. Alternatively, police service use rates could be estimated by remoteness

area, which may allocate higher shares of costs related to complex crime to metropolitan areas.

65 Queensland and South Australia did not view complex crimes to be unique to major cities and said that Commonwealth agencies often investigate these crimes. They said there was a lack of evidence that the operation of justice services in major cities incurs greater expenses than anywhere else.

Commission response

Central costs

66 While some types of police services, such as counter terrorism, state intelligence and cybercrime are likely to be skewed towards metropolitan areas, some types of central costs (for example, those related to human resources, IT, education and financial services) are likely to be used by police services across the whole state and not just major cities. Excluding all central costs from the regression would underestimate costs outside capital cities.

67 The Commission will analyse state data to determine the appropriate treatment of central costs in the police assessment. Any change would be included in the 2026 Update.

Global cities assessment

68 The Commission has requested data from states on policing expenses including those related to counter terrorism and complex crime. The Commission is analysing these data to determine whether certain costs are unique to major cities and whether a reliable, material assessment can be developed.

69 The Commission accepts there is a conceptual case that certain population groups, such as culturally and linguistically diverse prisoners, could drive higher costs in providing justice services. However, there are significant impediments to reliably identifying and quantifying how such groups affect costs across justice services. In preparation for the next review, the Commission will work with states and relevant data providers to examine available data.

Commission decision

70 The Commission will determine the appropriate treatment for central and global cities costs in the police assessment following further analysis of data and state consultation. The Commission will consider this issue during the consultation process prior to the 2026 Update.

71 The Commission will consider how cultural and linguistic diversity may affect state service costs, including justice services, as part of its forward work program.

Police data

72 In response to state comments, the Commission considered the following issues with data, or the treatment of data, used to inform the police assessment:

- the socio-economic status classifications applied to First Nations people
- the exclusion of traffic and breach of bail offences
- the use of proceedings data for assessed offenders.

State views

73 The Victorian consultant recommended the Commission use the ABS's offender counts rather than its proceedings counts to calculate assessed offenders.[8] It considered proceedings to be an inappropriate measure of cost allocation. The consultant also said the non-linear relationship between socio-economic status and offences did not warrant merging the standard 5-tier socio-economic groups into 3.

74 Western Australia said the Commission should determine whether traffic and breach of bail offence data are robust enough to include in the police assessment. It said their inclusion would provide a more accurate representation of police expenses.

75 Queensland said it supported excluding traffic and breach of bail offence data from the police assessment, continuing to use proceedings data in the calculation of assessed offenders and continuing to apply the socio-economic status approach for First Nations people that best reflects a linear relationship with offence rates.

Commission response

Use of proceedings data for assessed offenders

76 The Commission uses proceedings data in the police assessment to ensure it captures costs associated with investigating and charging a single offender on multiple occasions within a single year.[9] Using the ABS's offenders count would not recognise the costs associated with a second (or more) separate instances of offending and their impact on the cost of policing.

Socio-economic status classifications applied to First Nations people

77 Criminologists have identified a relationship between socio-economic status and offence rates.[10] If a socio-economic status structure does not show this relationship, it may mean that the measure is capturing the effects of factors unrelated to socio-economic status which the Commission cannot control for because of data

[8] The Commission scales state-provided data to ABS totals to calculate the Commission's number of assessed offenders.

[9] Each instance of offending would be counted as a separate proceeding regardless of the number of offences an individual is charged with.

[10] L Ellis, DP Farrington and AW Hoskins, *Handbook of Crime Correlates*, 2nd edn, Academic Press, London, 2019, pp 92–102.

limitations. This may include the effects of structural inequalities or being removed from culture and/or family.[11]

Exclusion of traffic and breach of bail offences

78 The Commission sought advice from the ABS about whether the quality and comparability of states' traffic and breach of bail offence data still raised concerns. The ABS indicated that it had not recently reviewed the quality and comparability of traffic and breach of bail offence data across states. In the absence of evidence of improvements in the quality and comparability of the data, the Commission considers that these data are not fit for purpose. The Commission will continue to liaise with the ABS on the quality of the data.

79 The Commission does not consider the exclusion of these offences to raise significant issues with the model since they tend to require fewer resources than other types of crime. Furthermore, it is likely the model used in the police assessment would partially capture the effects of these types of offences.

Commission decision

80 The Commission will continue to use proceedings counts for its measure of assessed offenders and exclude traffic and breach of bail offence data from the assessment.

81 The Commission will determine an appropriate socio-economic structure for First Nations people following further analysis of data and state consultation. The Commission will consult states on its approach prior to the 2026 Update.

Criminal courts assessment

82 In response to state comments, the Commission considered concerns with the use of finalisations in the criminal courts assessment.

83 It also explored whether it should use a regression to quantify regional and service delivery costs.

State views

84 Victoria said finalisations was not an adequate measure of spending needs given the highly variable relationship between criminal courts spending and volume of finalised defendants.

85 Victoria recommended the Commission use population as a measure of spending needs. It provided analyses based on data from the *Report on Government Services* which indicated that population was a better predictor of costs than finalisations.

[11] Australian Law Reform Commission (ALRC), [Pathways to Justice–Inquiry Into The Incarceration Rate Of Aboriginal And Torres Strait Islander Peoples](), ALRC, Australian Government, 2018, accessed 6 February 2024.

86 During its state visit, Victoria also suggested that programs that were used to divert people from the court system, including several of its specialist courts, were not captured in national data.

87 The Victorian consultant said that in the 2020 Review, state-reported data on court expenses showed a wide variance in the proportion of criminal court expenditure across states. This raised doubts about reliability for making accurate comparative assessments or for drawing broad conclusions about state-level spending practices.

88 Western Australia said a criminal courts regression could also be used to account for service delivery scale costs. It suggested that if a regression could not be developed for the criminal courts component, the service delivery scale factor derived from the prisons assessment should be applied to criminal courts.

Commission response

Use of finalisations

89 The Commission acknowledges there are policy differences in how states provide their criminal court services that may affect the number of finalised defendants or courts costs. These differences include the number of court levels in state systems, the types of cases held at each level (and the method used to finalise them) and the number of staff employed. The Commission considers such differences are responsible for the variation between the cost per finalisation in each state.

90 The 2024 Update assessment method uses finalised defendants as a measure of the use of criminal courts. The Commission considers it reasonable to assume there is a relationship between defendant volume and state court expenses, especially with the lack of alternative, measurable drivers.

91 The Commission will investigate the validity of using population as a driver of criminal courts spending needs.

Specialist courts and diversions programs

92 The 2024 Update assessment method includes states' spending for all court-related expenses as defined by Government Finance Statistics data. This enables the Commission to include all criminal courts spending in its assessment, including the costs of running specialist courts and court-based diversion programs.

93 While the number of assessed finalised defendants currently excludes finalised defendants in specialist courts and diversion programs, excluding these data produces a more nationally comparable cost per assessed defendant.[12] Because these defendants are finalised in the court that first heard their case, including any additional finalisations would lead to double counting.

[12] This exclusion is consistent with the ABS's practice of counting defendants.

Regression for regional and service delivery costs

94 The regional cost gradient in the 2024 Update assessment method recognises the combined effect of regional and service delivery scale costs. In the 2020 Review, the Commission decided to adopt a simple approach to calculating regional costs because of data limitations and offsetting cost factors. For instance, while higher courts in remote areas had a greater cost per defendant, remote defendants often travelled to non-remote areas to attend higher courts.

95 A regression could potentially be developed if state data are of sufficient quality and can be disaggregated at the district level. However, a regression may add unnecessary complexity to the model.

Commission decision

96 The Commission will determine whether population should replace finalisations as the driver of criminal court expenses following further analysis and state consultation.

97 The Commission will continue to apply a cost gradient when assessing regional and service delivery scale costs in the criminal courts assessment. Analysis of the updated state data and consultation with states is required to determine if the cost gradient should be changed.

98 The Commission will consider these issues during the consultation process prior to the 2026 Update.

Criminal courts data

99 In response to state comments, the Commission considered concerns that the criminal courts assessment used data from a limited number of states to determine the socio-demographic profile of defendants and the regional cost gradient.

100 The Commission also explored whether its approach to attributing Indigenous status to defendants who had not provided their Indigenous status was appropriate.

State views

101 Victoria said that using data from only 5 states in the socio-demographic composition calculation and 4 states in the criminal courts regional cost gradient failed to accurately capture the average of state policy. It noted that this likely biased the results in the prisons component, which also uses defendants' socio-economic status as a proxy for prisoners' socio-economic status. For this reason, it recommended either that socio-economic status not be used in prisons, or a discount be applied.

102 The Victorian consultant supported using defendant socio-economic status as a proxy for prisoner socio-economic status. However, the consultant recommended limiting modelling to data available in every state (age and socio-economic status) or

imputing data for any missing states rather than excluding them from the national average.

103 Western Australia said Indigenous status should be attributed to the not-stated finalised defendants based on the proportion of stated defendant responses, which the Commission does elsewhere in the justice assessment. It provided data to show the 2020 Review approach (attributing Indigenous status based on population shares) underestimated the number of finalised defendants who identify as First Nations. Western Australia said this change should be implemented in the 2025 Review.

Commission response

Data quality and averaging

104 In the 2020 Review, the Commission used all fit-for-purpose data available to inform the socio-demographic composition calculation and regional cost gradient in courts. The Commission agrees that, where possible, the assessment should be based on data from all states. However, given the importance of Indigenous status and regional costs, limiting modelling to where data are available for every state would limit the assessments that can be undertaken and would be contrary to the objective of horizontal fiscal equalisation.

105 The Commission considers using data from a selection of states provides a reasonable estimate of the national average if these states form a representative cross-section of all states. For example, this would be the case if the cross-section included states with large remote regions, diverse socio-demographic profiles and highly populated major cities.

106 Regarding the use of courts data in prisons, the Commission will use all available and robust data for calculating defendant socio-economic status. It will undertake further analysis and consultation on this issue prior to the 2026 Update, including whether any discounts are warranted.

107 The Commission notes the Victorian consultant supported using defendant socio-economic status as a proxy for prisoner socio-economic status.

Treatment of non-stated Indigenous status

108 In the 2020 Review, the Commission was concerned that attributing Indigenous status to not-stated finalised defendants by shares of stated defendant responses would overestimate the number of First Nations finalised defendants. After analysing Western Australian traffic offence data, it considered most First Nations offenders may have already been identified in the data.

109 Data provided by Western Australia for the 2020 Review showed a large proportion of the state's non-stated defendant responses for traffic offences came from areas where First Nations people make up a smaller proportion of the population.

110 Western Australia's 2022–23 data show 24% of finalised defendants (before attributing Indigenous status to not-stated responses) identified as First Nations.[13] This proportion of First Nations responses more closely aligns with 2020 Review data when not-stated responses are attributed by shares of stated defendant responses (23% First Nations) rather than population shares (16% First Nations).

111 The Commission also noted that the proportion of not-stated defendant responses has fallen to 7% in the 2022–23 data down from 41% in the 2020 Review data.

112 The Commission considers that attributing Indigenous status to not-stated finalised defendants by shares of stated defendant responses would not overestimate the number of First Nations finalised defendants.

113 The Commission considers applying the change in the 2026 Update is appropriate as this will allow consultation with states including the GST impacts of all proposed changes prior to their implementation.

Commission decision

114 The Commission will take the following actions.

- Use data from all states in the criminal courts component. If this is not possible, the Commission will determine the best approach consistent with the objective of horizontal fiscal equalisation in consultation with states.
- Determine the socio-demographic composition calculation for the regional cost gradient in the criminal courts assessment following further analysis of data and state consultation. The Commission will consider this issue during the consultation process prior to the 2026 Update.
- Attribute Indigenous status to not-stated finalised defendants by the proportion of the stated defendant responses for inclusion in the 2026 Update.

Other legal services data

115 In response to state comments, the Commission considered whether the method used to split criminal courts and other legal services was appropriate.

State views

116 Victoria said the expense split between criminal courts and other legal services was unreliable because it relied heavily on state data that were not comparable. It said the data had high levels of variability, likely due to classification inconsistencies between states. The Victorian consultant raised similar concerns.

117 Victoria recommended the Commission use the *Report on Government Services* criminal courts expenditure data for criminal and civil courts and place any remaining difference between expense totals in *Report on Government Services* data and Government Finance Statistics data into the other legal services component.

[13] Western Australia said it made the reasonable assumption that the composition of offenders has not changed structurally from 2016–17 to 2022–23 for traffic offences.

Commission response

118 The Commission has previously explored using *Report on Government Services* data for splitting criminal courts and other legal services but found the data unsuitable. There are some legal services related to both criminal courts and other legal services that are excluded from these data. The Commission considers splitting court expenses in this manner does not provide the best estimate of costs incurred by states' criminal courts and other legal services.

Commission decision

119 The Commission will continue to use data provided by states for the 2025 Review to split other legal services expenses from criminal courts expenses.

Prisons assessment

120 The Commission asked states whether it would be appropriate to apply a juvenile detainee cost weight if it is material. It considered that changes to the age of criminal responsibility did not warrant a change in the age groups used in prisons.

121 In response to state comments, the Commission considered whether the use of regional and service delivery cost weights in prisons was appropriate and proposed a separate assessment for non-custodial services.

State views

Juvenile cost weight and age group

122 Most states supported the application of a juvenile detainee cost weight if it is material. Queensland proposed an alternative method for calculating cost weights, based on cost per bed night in youth detention.

123 Victoria said it did not support the application of a cost weight because the *Report on Government Services 2023* juvenile detention expenditure data were not comparable across states.

124 All states that responded supported not changing the juvenile detainee age groups in response to changes to the minimum age of criminal responsibility across states.

Prison regression, regional cost weights and service delivery scale

125 New South Wales said the presence of remote prisons was not driven by necessity and may not reflect average policy. It also said that while small prisons are more expensive than larger ones, it considered that this effect was not driven by remoteness. It suggested the Commission replace the remoteness dummy variable in the prisons regression with a major cities one because it found that its own major cities prisons cost more (per prisoner) than remote prisons.

126 Victoria said the conceptual case for cost weighting remote prisoners was weak. This was because it considered prisons are not located based on population dispersion, nor are prisoners commonly imprisoned in prisons near to their prior residence.

Victoria said the Commission had not presented a compelling case that there was a material relationship between population remoteness and prison remoteness. It said that in Victoria prison location is independent of prisoner origin and prisons are not built in a particular location to service the imprisonment needs of the surrounding area. It said prison locations are often based on historical circumstances or are a policy choice.

127 New South Wales and Victoria recommended that a discount be applied to recognise the uncertainty associated with the model.

128 Conversely, Queensland and Western Australia said the conceptual case of remote prisons having higher costs per prisoner was very strong. Queensland noted its corrective services aim to place incarcerated people in prisons close to their communities.

129 Western Australia suggested adding more variables into the model to improve its explanatory power. Queensland said this would produce a less meaningful regression, introduce policy influence and increase complexity.

Non-custodial services

130 Given the disproportionate costs of full-time custodial and non-custodial services, New South Wales said a separate assessment was appropriate.

131 Victoria said it requires further time, data, detail and analysis from the Commission before commenting on the proposal to separately assess community corrections expenses. It requested the Commission not take any decisions on justice assessment proposals newly introduced in the Draft Report until further consultation with states has been done prior to the 2026 Update.

132 Queensland did not support the introduction of a non-custodial expenses assessment as it considered it to be policy contaminated. It said their inclusion should be driven by socio-demographic drivers and adjusted for costs associated with regional and remote service delivery.

Commission response

Juvenile cost weight and age group

133 The Commission notes the Productivity Commission's *Report on Government Services 2024* juvenile detention expenditure data are published with a qualifier saying the data are not comparable across states.[14] The Productivity Commission advised that data are not comparable because states have different funding structures for their youth justice services.

[14] This refers to the Steering Committee for the Review of Government Service Provision 2024, *Report on Government Services 2024*, Productivity Commission, Australian Government, 2024, Part F Community services, youth justice data on 'Cost per young person subject to detention-based supervision, 2022-23', table 17A.21. The table notes include the qualifier that data 'are not comparable across jurisdictions but are comparable (subject to caveats) within jurisdictions over time'.

134 Despite the Productivity Commission's caveat, the *Report on Government Services* juvenile detention expenditure data are currently the best available for determining adult prisoner versus juvenile detainee cost differences. The Commission considers that using national average data from the *Report on Government Services* to calculate juvenile detainee cost weights is appropriate and will reduce the impact of state policy influences.

135 The Commission will consider Queensland's proposed method of using cost per bed night in the consultation paper provided prior to the 2026 Update.

136 If the cost weight is material once it has been applied to the final 2025 Review data, the Commission proposes to apply the cost weight to a (revised) 0–17 year age group, instead of trying to split the cost weight over 2 different age groups (the current 0–14 and 15–24 age groups).[15] The 0–17 years age group will include all juvenile detainees derived from Australian Institute of Health and Welfare data.

137 If the juvenile detainee cost weight is not material, the Commission will continue to use a 0–14 age group because it does not consider changing the age group to be warranted to account for changes in the minimum age of responsibility.

Prisons regression

138 In the 2020 Review, the Commission considered that, while greater explanatory power was preferable, the conceptual case for the assessment was strong and the regression approach was the most reliable measure available.

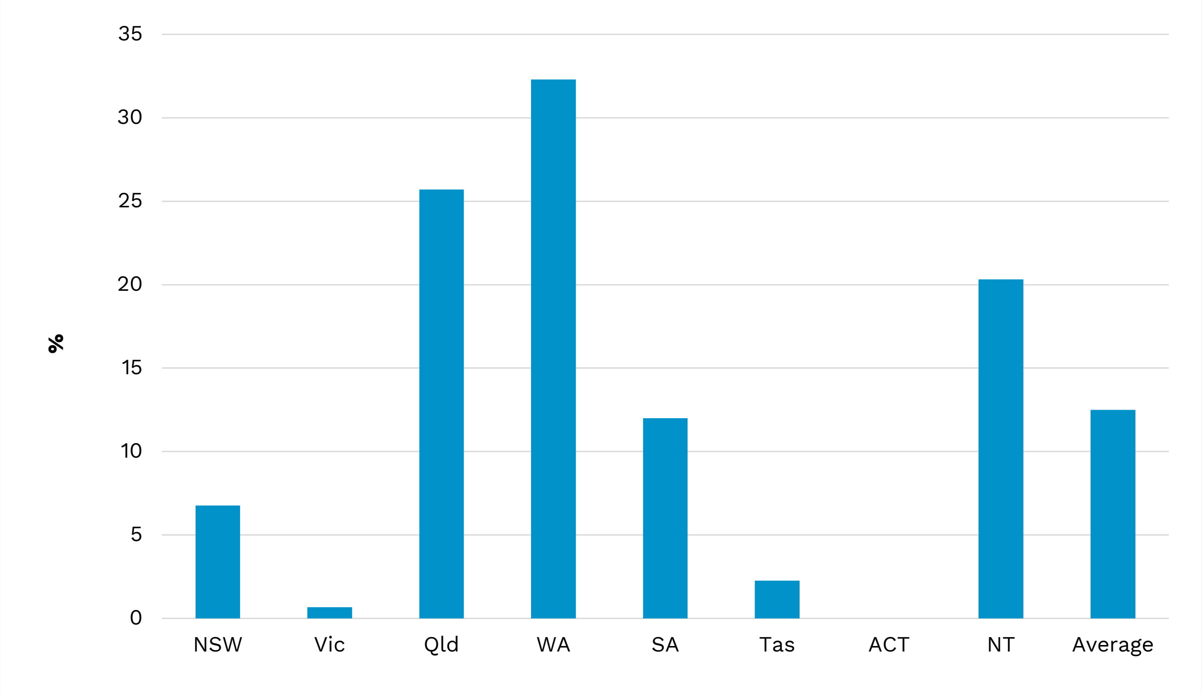
139 The Commission acknowledges state concerns with the regression method and reiterates that a regression model with greater explanatory value is preferred. Data provided by states for the 2025 Review will be analysed to determine whether a regression-based approach remains appropriate.

Regional cost weights

140 The Commission considers there is a conceptual case for recognising remoteness costs in prisons. Of the 4 states that have remote prisons, Queensland, Western Australia and the Northern Territory have above-average remote populations and South Australia's remote population is only slightly below average (Figure 1).

[15] To test the materiality of applying a cost weight, prisoner use rate age groups will be changed from 0–14 years and 15–24 years to 0–17 and 18–24 years. This change will mean all juvenile detainees are grouped together in the 0–17 years age group and a cost weight, applicable only to juvenile detainees, will be applied.

Figure 1 Shares of total remote population, 2022–23



Note: A state's total remote population is a state's combined remote and very remote estimated residential population.

Source: ABS disaggregated estimated residential population data at June 2022 rescaled to total estimated residential population data at December 2022.

141 The Commission's approach to average policy is based on a weighted average of all states, recognising that some states may choose not to provide a service. Therefore, the Commission considers it average policy to have prisons in remote areas to service remote populations.

142 The Commission considers there is a reasonable link between remote prisoners' usual address and their placement in a remote prison. For instance, in Western Australia, remote prisoners are more likely to be sent to a prison in the same region as they were convicted. This indicates that residents of the Pilbara, for example, are likely to be sent to a remote prison at Roebourne.[16] The Commission acknowledges that not all remote prisoners will go to a remote prison, and it adjusts the regional cost weight to reflect this.[17]

143 If data received from states as part of the 2025 Review process show a material relationship between regionality and costs, the Commission proposes to maintain an assessment of the cost of regional prisons. It will examine data to determine the relationship between regionality and costs and investigate whether a regression approach to estimating regional costs remains appropriate.

[16] Corrective Services, Roebourne Regional Prison, Western Australian Government website, 2024, accessed 5 March 2024.

[17] The regional cost weight of remote prisoners is reduced by 60%. This reflects the difference between the assessed number of remote offenders and the actual number of remote prisoners.

Service delivery scale

144 The Commission is not aware of any evidence that suggests states need to have a certain number of small prisons in a specific region. The number of small (or large) prisons each state has across its regions may be due to policy choices and other factors, such as historical circumstances.

145 The Commission will reassess the treatment of service delivery scale costs using 2025 Review data to determine if an assessment of service delivery scale is required.

Non-custodial services

146 The Commission considers there is a conceptual case for community corrections orders to be assessed in the prisons assessment. It notes Queensland’s concerns regarding policy contamination.

147 The Commission tested the materiality of including an assessment for community correction orders based on the 2024 Update prisons assessment and found it to be material.[18] The Commission will retest the materiality of community correction orders using 2022–23 and 2023–24 data. If material, an assessment of these orders will be included for the prisons assessment in the 2026 Update. By using national average policies, the Commission mitigates the impact of individual state policies on community corrections expenses.

Commission decision

148 The Commission accepts the conceptual case for including a regional costs assessment in the prisons assessment. It will determine an approach to regional and service delivery scale costs for the prisons assessment following further analysis of data and state consultation. The Commission will consider this issue during the consultation process prior to the 2026 Update.

149 The Commission will include an assessment of community correction orders in the prisons assessment in the 2026 Update, if it is material.

GST impacts of method changes

150 The Commission has postponed any changes to the justice assessment until the 2026 Update. The GST impacts of any method changes will be included in the 2026 Update.

[18] The Commission used ABS Community correction order data and the Productivity Commission’s *Report on Government Services* data to test materiality instead of ABS non-custodial order data. Australian Bureau of Statistics (ABS), ‘Table 4. Persons in Community-based corrections’ [data set], Corrective Services, Australia, Age Standardised Community-based corrections, ABS website, 2023, accessed 24 November 2023.

Attachment A: Revised process and timing for finalising the justice assessment

Timing	Process
2025	
February	Commission releases the 2025 Review.
May	2023–24 state justice data due.
June	Revised Draft Report chapter for justice released to states.
August	State submissions on revised Draft Report chapter due.
October	Overview of final justice assessment including changes since the revised Draft Report chapter and indicative GST impacts.
November	State submissions on Overview of final justice assessment paper due.
2026	
February	Final justice assessment applied in the 2026 Update. Revised Review Outcomes and Commission's Assessment Methodology chapters released.

15. Roads

Review outcomes

- The following changes were made to the assessment.
  - Regional costs will use the Rawlinsons national construction cost gradient because the drivers of road maintenance costs are more related to construction costs than to service delivery. It will be applied with a 25% discount (as the general regional cost gradient was previously).
  - The split between urban and rural traffic and heavy vehicle use will be held constant until the next methodology review. This is due to the discontinuation of the ABS Survey of Motor Vehicle Use.
  - A low (12.5%) discount will be applied across the assessment. This is due to uncertainty with the use of proxy data for rural road length, the discontinuation of the Survey of Motor Vehicle Use (and hence the ageing of the data being used), and uncertainty surrounding the National Transport Commission's estimates of the relative importance of road length, heavy and light vehicle traffic as drivers of expense needs.
- The Commission considered but did not change the following.
  - The rural road network will continue to include routes to mines, gas wells, ports and national parks, as there was insufficient evidence to remove them.
  - Traffic volume and heavy vehicle use data will continue to be sourced from the Bureau of Infrastructure and Transport Research Economics and the National Transport Commission. These agencies remain the leading authorities for this data.
  - The population in urban centres of over 40,000 people will continue to be used as a proxy for the length of urban roads.
  - Bridges and tunnel lengths will continue to be assessed using state data, updated once during the review period. Culvert and floodway crossing lengths will not be included in the bridges and tunnels assessment.
  - Additional cost drivers will not be included in the urban roads assessment due to the lack of comparable data.
  - Additional drivers will not be added to reflect the impact of soil type and climate on road maintenance and capital costs due to the lack of comparable data.
- The Commission will investigate the suitability of the National Service Level Standards for Roads data when they become available, with a view to using them in the next methodology review.

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 The decision to include roads to mines, gas wells, ports and national parks was made after the release of the Draft Report. The Commission's consideration of these issues can be viewed in Significant changes since the Draft Report.

5 This chapter includes:

- an overview of the issues considered throughout the review
- the Commission's response and decision on each issue
- GST impacts of method changes.

6 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the roads chapter of the *Commission's Assessment Methodology*.

Issues considered

Rural road length

7 In the 2020 Review, the Commission developed a synthetic road network as a proxy for roads that are typically state roads. These included:

- the quickest road distance between adjacent towns of at least 1,000 people[1]
- 2 roads between towns of 200 to 999 people to the nearest 2 towns
- roads from major mines, gas wells, ports and national parks to the network.

8 Since the 2020 Review, some towns have grown above the 1,000 population threshold, or fallen below it, and some mines, gas wells, ports and national parks have closed while others have opened. New South Wales observed that the synthetic rural road network was not always reflective of travel patterns on rural roads, and some routes were out of date.

9 The Commission considered whether to exclude routes to mines, gas wells, ports and national parks, as they complicated the model and some mining roads are

[1] Note that in the Commission's consultation paper and Draft Report, this route was described as forming the shortest distance between towns, but should have been described as using the quickest assessed route. The routing mechanism allocated all minor roads such as access, local and collector roads to have an assessed speed limit of 80 kilometres per hour and used actual speed limits for national roads and highways to calculate the quickest assessed driving route.

owned and maintained by the private sector. Removing these routes would have reduced the rural road network by 43,000 lane kilometres, or 13%.

State views

10 Some states supported removing routes to mines, gas wells, ports and national parks. New South Wales said these routes are often the responsibility of the private sector or local governments, and roads to national parks are also often maintained at a lower standard to other state roads. It also identified several examples of routes it considered to be incorrect, such as using a sub-optimal route or not terminating at the correct junction. It estimated around 5,000 lane kilometres were affected (1.5% of the 2020 Review rural road network).

11 Queensland, Western Australia and South Australia disagreed with removing all routes to mines, gas wells, ports and national parks. Queensland said its routes to national parks were maintained at a similar standard to intra-urban state-type roads. Queensland also recommended including routes to all protected areas such as Indigenous Protected Areas, state forests and nature refuges. It preferred all routes within these areas and within national parks to be included in the network.

12 Western Australia said there was not sufficient evidence that roads to national parks were maintained at a lower standard and did not support removing roads to mines without sufficient information on their private ownership. It also raised issues with the expenses allocated to road length, discussed further in the section Using National Transport Commission data to apportion expenses.

13 States expressed differing views on when the rural road network should be comprehensively updated, with some states preferring the network to be updated when National Service Standards for Roads data become available, and some states preferring to wait until the next methodology review at the earliest.

Commission response

14 Of the routes to mines, gas wells, ports and national parks in the synthetic rural road network, 52% are sealed, which is less than the 83% of sealed rural roads between towns (Table 1).

Table 1 Proportion of sealed roads on the rural road network

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	%	%	%	%	%	%	%	%	%
Roads to mines, gas wells, ports and national parks	40	61	76	36	27	44	69	32	52
Rural roads between towns	86	92	95	76	79	91	98	45	83

Source: Commonwealth Grants Commission, 2020 Review method for the synthetic rural road network and Geoscience Australia, National Roads [ESRI ARC geodatabase file format], Digital Atlas website, 2023, accessed 27 July 2023.

15 In proposing the removal of roads to mines, gas wells, ports and national parks, the Commission noted the potential to simplify the model, given the prospect of the

private sector contributing to the costs of maintaining these roads and the lower likelihood of them being sealed.

16 However, more than half of these roads are sealed. The Commission does not have information on the private funding of roads to mines, gas wells, ports and national parks.

17 On balance, the Commission decided to retain the routes to mines, gas wells, ports and national parks in the rural roads assessment as there was insufficient evidence to remove them.

18 This assessment uses a proxy measure for the length of road each state requires (regardless of whether roads to mines, gas wells, ports and national parks are included). Data from the National Service Level Standards, when available. may provide a better reflection of the actual length required.

Commission decision

19 The Commission will retain the 2020 Review method for the synthetic rural road network, including routes to mines, gas wells, ports and national parks.

20 The Commission will investigate the suitability of the National Service Level Standards for Roads data when they become available, with a view to using them in the next methodology review.

Urban road length

21 The urban roads assessment treats all large urban centres as having the same per capita needs for urban roads. The Commission found some evidence that road length per capita declined with increasing population size for the capital cities, but this relationship was not evident among the other cities.

State views

22 Some states supported using population as the driver for urban road length. Although the ACT supported the proposed assessment if no alternative was available, it also supported allowing for higher road lengths in smaller capital cities due to different levels of dispersion in small capitals compared to similarly sized non-capitals. New South Wales supported the proposed assessment using population but considered that other geographical factors such as topography also affected costs.

23 Most states did not support using urban populations as a proxy for road length in urban areas. They said there is a strong inverse relationship between population density and road length in capital cities, mirroring the relationship the Commission relies upon in its transport assessment. They said that this makes conceptual sense as larger public transport provision reduces the need for road length.

24 South Australia presented findings from international literature and an analysis of Commission data to argue that population-weighted density increases public transport needs and decreases road length by comparable amounts. Although the relationship between population density and road length was not seen in non-capital cities, South Australia said there may be other factors not currently assessed and recommended further work as more data become available.

25 Western Australia and Tasmania supported splitting the assessment of urban road length for large non-capital cities and capital cities.

Commission response

26 While the Commission observed that there is some evidence that road lengths per capita decline with increasing population size for the capital cities, this relationship was not evident among the other cities. This suggested there may be factors other than the size of the capital city influencing road lengths.

27 Sydney has fewer kilometres of major urban roads per capita than other cities, but this may reflect the urban form and historical development of the city. While roads with high traffic volumes in other cities are almost universally arterial roads, Sydney has many suburban streets that attract large traffic volumes. Roads classified as arterials or other major roads form 13% of the total road network in Sydney. This is the lowest proportion in any city, and well below the 17% average across capital cities, or 24% in Canberra and 22% in Darwin. In the absence of a nationally comparable classification of roads, it was not clear that the pattern of arterial road lengths per capita for capital cities was sufficiently reliable for the Commission's purposes.

28 Academic papers from international literature found conflicting evidence of any relationship between road expenses and population density in the United States.[2]

29 Infrastructure Australia is working with states to publish the National Service Level Standards for Roads, which will classify roads on a consistent basis. The Commission will investigate using this dataset in its assessments when it becomes available.

Commission decision

30 The Commission will retain population as the driver for urban road lengths in towns of over 40,000 people and investigate the suitability of using the National Service Level Standards for Roads data when they become available.

[2] For example, see R G Holcombe and D W Williams, 'Urban Sprawl and Transportation Externalities', *The Review of Regional Studies,* 2010, 40(3):257-273.

Unrecognised urban road cost drivers

31 New South Wales proposed that the urban road component should also assess:

- older networks
- high mean slope
- densely populated and congested urban areas.

32 New South Wales noted that congestion in the Greater Sydney area added to costs by requiring all road maintenance to be conducted at night.

State views

33 Other states did not comment on these cost drivers.

Commission response

34 Historical factors such as age of network are not typically assessed across any category. The investment assessment gives states the capacity to replace fully depreciated assets.

35 Slope is one of the factors that affects the cost of road maintenance. While data are available to calculate slope across the national road network, the Commission did not find datasets suitable to quantify the additional expenses related to slope.

36 Congestion affects maintenance and safety costs, with more congested cities requiring strategies, such as scheduling night works, to reduce the impact of road works on traffic. Based on New South Wales' cost estimates, a driver for congestion effects on nightworks maintenance would not be material.

Commission decision

37 The Commission will not add additional cost drivers to the urban roads component.

Influence of rainfall and soil composition

38 In response to state comments, the Commission considered whether it could assess the effect of environmental factors on road construction and maintenance costs. Water weakens the supports underlying road pavements, increasing maintenance costs, and increasing safety costs to maintain landscaping and remove vegetation hazards. States experience different rainfall levels. Soil type also affects maintenance and construction costs. Clay soils, more common in the eastern states, are the weakest soil types.

State views

39 New South Wales provided data showing that both soil type and climate affected road construction costs, with soil type having a higher impact.

40 Victoria noted that the National Transport Commission considers soil and rainfall to drive expense needs, although it does not quantify these needs in its datasets.

Queensland noted these issues and recommended further investigation as part of the next methodology review.

41 Other states did not comment on these issues.

Commission response

42 The Commission agrees there is a conceptual case that rainfall and soil type could affect recurrent and capital costs. While national rainfall and soil type information is available, the Commission would require evidence of the relationship between soil type, rainfall and road maintenance or construction costs. It would also potentially need to explore other related drivers.

43 Although the data from New South Wales supported that rainfall and soil type affect road costs, the data was only for New South Wales. The Commission is not aware of data that would support an assessment of the impact of soil type and climate on road maintenance and capital costs for all states.

44 While the Commission recognises that environmental factors play a role in determining costs, the relationship between environmental variables and expenses is complex. Several national agencies such as Infrastructure Australia and the Bureau of Infrastructure and Transport Research Economics have concluded there are issues with data availability when assessing the impact of climate on the need for road asset maintenance.[3]

Commission decision

45 The Commission will not add additional cost drivers to reflect rainfall and soil composition due to lack of data.

Using National Transport Commission data to apportion expenses

46 In response to state comments, the Commission considered the appropriateness of using National Transport Commission data to apportion expenses between subcomponents in the roads assessment.

State views

47 Western Australia said that the National Transport Commission data do not reflect road expenses, as the purpose of this collection is to allocate costs between light vehicle and heavy vehicle users. It said the National Transport Commission cost allocation matrix should be adjusted to allocate more expenses to road length.

[3] Infrastructure Australia, *An Assessment of Australia's Future Infrastructure Needs: The Australian Infrastructure Audit 2019*, Infrastructure Australia, Australian Government, 2019, accessed 11 April 2024; Bureau of Infrastructure and Transport Research Economics (BITRE), *Road and Rail Supply Chain Resilience Review*: Phase One report, BITRE, Australian Government, 2023, accessed 11/04/2024.

Commission response

48 As noted by Western Australia, the National Transport Commission's cost allocation matrix was developed to apportion costs for heavy vehicle users, and not necessarily to split costs between states. However, the National Transport Commission is the leading authority for these data, and therefore the Commission does not consider it has the data to make changes to the cost allocation matrix.

Commission decision

49 The Commission will continue to use the National Transport Commission data as they are the best available.

Sourcing traffic volume data and holding constant the split between urban and rural traffic

50 The ABS Survey of Motor Vehicle Use was the major source of traffic data, but the survey has been discontinued. The Bureau of Infrastructure and Transport Research Economics and the National Transport Commission both incorporated data from the Survey of Motor Vehicle Use in their traffic and trend data provided to the Commission. However, due to the survey's discontinuation, the National Transport Commission no longer provides disaggregated traffic volume data. This dataset was used to split heavy and light traffic volumes between rural and urban areas.

State views

51 All states supported using Bureau of Infrastructure and Transport Research Economics and the National Transport Commission data as an interim measure.

52 Victoria recommended applying a medium (25%) discount to affected assessments (heavy vehicle use and traffic volume).

53 Western Australia and the ACT encouraged the Commission to explore alternative data sources.

Commission response

54 The Commission considered using the following alternative sources for traffic volume data, but neither was reliable.

- Phone GPS data, sourced from a mobile phone carrier, could not be split by heavy and light vehicles. Mobile phone coverage in more remote areas was likely also to create data accuracy problems.
- State traffic count data, used as an inflator against 2018–19 ABS Survey of Motor Vehicle Use data (the last year of the ABS data prior to COVID-19 lockdowns) would provide disaggregated light/heavy vehicle data, but not end-to-end trip information. Further, the number and location of traffic counters differed widely between states, capturing a very small percentage of the road network overall, with some states being unable to provide long-term trend data.

55 The Bureau of Infrastructure and Transport Research Economics provides data split by capital city/non-capital city and state. However, using these data as a proxy for urban/rural traffic would greatly understate urban traffic volume and misidentify urban traffic as rural traffic.

Commission decision

56 The Commission will continue to use traffic volume data from the Bureau of Infrastructure and Transport Research Economics and the National Transport Commission. It will hold the current shares of urban/rural traffic for light vehicles and heavy vehicles constant until a suitable more contemporaneous data source is found.

Culverts and floodways

57 In response to state comments, the Commission considered whether it should assess the length of culverts and floodway crossings.

State views

58 Western Australia said the bridges and tunnels component was incomplete due to not assessing the length of culverts and floodway crossings.

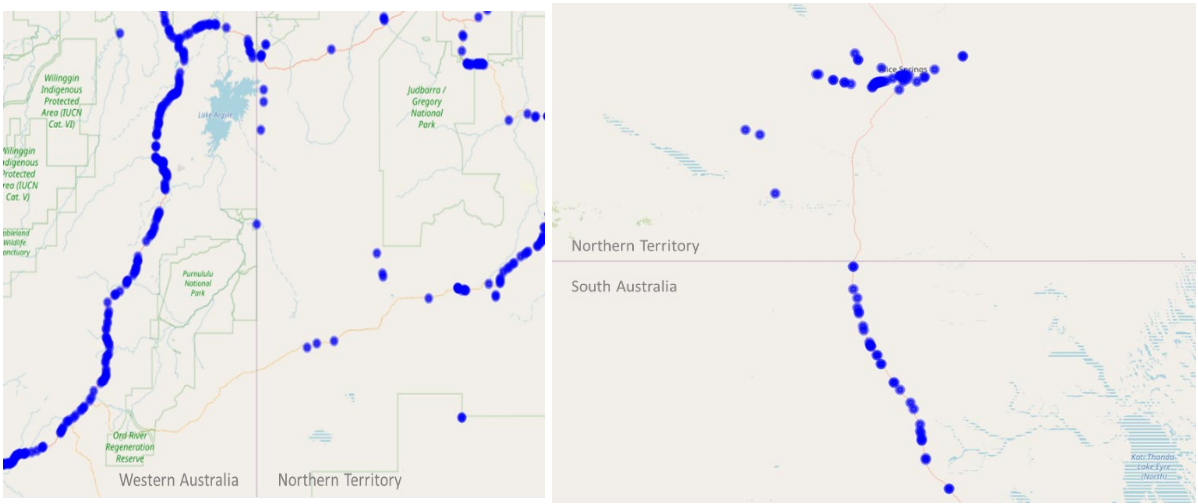
Commission response

59 Based on National Transport Commission classifications, the Commission assesses culvert expenses within the bridges and tunnels component and floodway crossings in the rural roads and urban roads components. Culverts and floodway crossings have lower costs per kilometre than bridges and tunnels, but higher costs than standard roads.

60 The Commission requested data from states on the lengths, and recurrent and capital costs for floodway crossings and culverts. For most states, at least some of these data were not available, and the Commission had concerns about the comparability of the available data.

61 There is some evidence that the location of culverts is policy-driven, or that the recording of culverts varies between states. Figure 1 compares state data on culvert placement along state borders for the Northern Territory/South Australia, and Western Australia/the Northern Territory. Despite comparable environmental conditions along borders, there are clear differences in culvert density between states, reflecting either data classification issues or policy choice in the decision to construct culverts. Any potential assessment of culvert lengths would use actual lengths sourced from state data (as per the bridges and tunnel length assessment), so policy or data comparability issues would have a direct effect on the assessment.

Figure 1 **Culvert placement along the Northern Territory/South Australia and Western Australia/Northern Territory state borders**



Note: Similar differences can be seen along other state borders, such as along the New South Wales/Victoria border.

Source: State treasuries, *Roads - bridges, tunnels, culverts and floodway crossings lengths and expenses* [unpublished data sets], state treasuries, 2024.

Commission decision

62 The Commission will not include culverts or floodways in its assessment of bridges and tunnels.

Regional costs

63 The cost of providing roads can differ across remoteness areas. The 2020 Review roads assessment applied the general regional cost gradient to rural road lengths and bridge and tunnel lengths. In response to state comments, the Commission considered whether Rawlinsons costs indices could replace the general regional cost gradient.

State views

64 Some states said that Rawlinsons cost indices should not be used to assess regional costs in the roads assessment. New South Wales and Victoria said that Rawlinsons was not appropriate because local sourcing of materials was more common in road construction than in building construction. New South Wales suggested implementing a 50% discount should the Rawlinsons cost indices be introduced.

65 Victoria said that regional costs are already captured by the urban/rural split of the roads assessment and that a regional cost adjustment was not necessary.

66 Queensland and Western Australia supported the use of Rawlinsons cost indices for measuring regional costs in the roads assessment. Western Australia suggested using the individual state indices rather than national indices.

Commission response

67 During the 2020 Review, the Commission used a general regional cost gradient (based on the costs of service delivery for schools and hospitals) to assess the impact of remoteness on rural road lengths and bridge and tunnel lengths. Rawlinsons measures the construction costs of various types of buildings. The Commission agrees with Western Australia that while the impact of remoteness on the cost of maintaining roads differs from the costs of constructing a building, it is likely to provide a better indication of costs than the costs of service delivery.

68 Although road maintenance and construction may source some materials locally, specifically quarry materials, these materials only contribute around 13% of road construction and maintenance costs.[4]

69 The general regional cost gradient was discounted by 25% in the 2020 Review because it generalised costs for schools and hospitals to road costs. Similarly, the Rawlinsons gradient will be discounted by 25% in recognition that construction costs for buildings and roads differ from maintenance costs for roads. As discussed below, the whole roads assessment will be discounted by 12.5%, and this will be applied to the assessment before the discounted regional costs (and wage costs) adjustments are applied.

Commission decision

70 The Commission will replace the general regional cost gradient with the Rawlinsons construction cost gradient, which will be applied with a 25% discount in addition to the whole-of-assessment 12.5% discount.

Commonwealth infrastructure payments

71 In response to state comments, the Commission considered the treatment of Commonwealth infrastructure payments. Half of Commonwealth payments for national road and rail networks are treated as having no impact on the GST distribution. This is because roads and transport infrastructure projects can have national objectives relating to the efficient movement of people and goods, which the Commission's assessments do not capture.

State views

72 Queensland supported continuing to include 50% of National Road Network Commonwealth payments, noting the selection of national road and rail network projects is largely determined by the Commonwealth.

[4] Bureau of Infrastructure and Transport Research Economics (BITRE), *Modelled Road Construction and Maintenance Price Index*, Information Sheet no. 83, BITRE, Australian Government, 2017, accessed 25 August 2024, p. 1.

Commission response

73 Roads of national significance are a driver of state spending need that the Commission does not otherwise assess. The best available proxy for state needs to spend on such roads is 50% of the Commonwealth payments for such roads. This is because these roads are also of state significance. Under this treatment, 50% of national network payments and their related expenditure are removed from the adjusted budget. The remaining 50% are assessed under the investment category, applying state needs for roads (for road network payments) and transport (for rail network payments).

74 The Commission considers that nothing has changed since the 2020 Review that would warrant a change to this assessment. However, for the next review, the Commission will consider whether the forthcoming National Service Level Standards for Roads dataset provides a reliable measure of overall state needs for roads.

Commission decision

75 The Commission will retain the 50:50 no impact/impact blended treatment of national road and rail network Commonwealth payments and continue monitoring the development of the National Service Level Standards for Roads.

Overall validity of the assessment and discounting

76 The Commission considered whether the uncertainty around aspects of the roads assessment meant it warranted a discount.

State views

77 New South Wales and Victoria supported a 25% discount.

78 Queensland and Western Australia did not support discounting the assessment. Queensland said the assessment does not meet the Commission's criteria for a discount and Western Australia said a discount would be inconsistent with other non-discounted assessments with incomplete or missing data, such as mining, housing and welfare.

79 South Australia supported discounting the traffic volume and heavy vehicle data only, which are based on the discontinued Survey of Motor Vehicle Use.

Commission response

80 The Commission considers that the assessment of road expenditure is not as robust as some other assessments. There are uncertainties with the reliability of:

- the synthetic rural road network as a reflection of state rural road length needs
- heavy and light vehicle traffic volume data
- the relative importance of road length, heavy and light vehicle traffic as drivers of expense needs
- the comprehensiveness of major drivers of differences in spending needs.

81 Given the range of uncertainties related to both data and method issues, the Commission considers a discount of the assessment is warranted. The level of discount is subject to judgement. In the Commission's other assessments, low (12.5%) discounts are used to recognise proxy data in the health assessment, and concerns with interstate comparability of the value of taxable land holdings in the land tax assessment.

82 Similar magnitudes of uncertainty apply for the roads assessment as for other assessments with a low discount. While the Commission retains its view that the assessment is largely fit for purpose, given concerns with some aspects of the assessment, it considers a low discount of 12.5% is appropriate.

Commission decision

83 The Commission will discount the roads assessment by 12.5%. This discount will be applied to the assessment before regional costs and wage costs are applied.

GST impacts of method changes

84 The impact on the GST distribution from the method changes is shown in Table 2.

Table 2 Impact on GST distribution of method changes, roads, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Use of Rawlinsons to measure regional costs	-9	-9	6	7	0	-1	-1	6	20
Discounting of assessment	30	51	-34	-29	-15	-2	14	-15	95
Total	**21**	**42**	**-28**	**-21**	**-14**	**-3**	**13**	**-10**	**76**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Use of Rawlinsons to measure regional costs	-1	-1	1	2	0	-1	-1	23	1
Discounting of assessment	3	7	-6	-9	-8	-3	29	-60	3
Total	**2**	**6**	**-5**	**-7**	**-7**	**-5**	**27**	**-37**	**3**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter in *Review Outcomes*.

85 The use of Rawlinsons to measure regional costs increased the assessed GST needs of states with more rural roads in remote and very remote locations (Queensland, Western Australia, and the Northern Territory). South Australia has close to the average share of remote and very remote roads and its GST needs remained the same. The assessed GST needs of states with fewer remote and very remote roads (New South Wales, Victoria, Tasmania and the ACT) decreased.

86 The 12.5% discount reduces the effect of the assessment. This increased the assessed GST needs of states with below-average needs for roads expenses (New South Wales, Victoria and the ACT), and decreased the assessed GST needs of states with above-average needs (Queensland, Western Australia, South Australia, Tasmania and the Northern Territory).

16. Transport

Review outcomes

- The following changes were made to the assessment.
  - The regression will be re–estimated using 2022–23 state-provided net expense data to ensure the assessment remains contemporaneous and reflects post-COVID-19 urban transport provision.
  - Population-weighted density will be measured using a square kilometre grid, rather than Statistical Areas Level 1 (SA1) areas, to provide a more consistent and less volatile measure of density.
  - The passenger numbers applied to the regression will be modelled using a regression to account for differences in public transport use rates as cities grow rather than average passenger numbers for all urban areas of similar sizes.
  - A temporary 10 percentage point increase will be applied to the urban population driver (from 25% to 35%) in the blended recurrent urban transport assessment. This recognises data issues arising from COVID-19. Once fit-for-purpose 2026 Census data become available in 2027, the blending ratio will return in the 2028 Update to 75% from the regression model estimates and 25% urban populations.
  - A larger proportion of V/Line expenses will be allocated to urban transport to better reflect Victorian service provision.
  - Pipeline transport expenses will be allocated to the non-urban transport component as they mostly relate to non-urban areas.
- The Commission considered but did not change the following.
  - The urban transport regression model will be retained although some changes (noted above) will be made to improve the measurement and application of selected variables.
  - 2021 Census data will continue to be used to measure the distance to work variable because the ABS made adjustments to mitigate the impact of COVID-19 on the data.
  - A dummy variable will continue to be used to assess ferry transport services. State needs for ferry services in an urban area will not be based on the proportion of commuters using ferry services because this approach produced implausible results and may be subject to policy influence. Ferry expenses will not be assessed equal per capita because the need for ferry services is not consistent across states.
  - There will be no further increase to the weighting of the urban population driver in the blended recurrent urban transport assessment and no discount will be applied in the urban transport investment assessment.
  - Non–urban expenses will continue to be assessed equal per capita as these services are provided for the use of populations within and outside of urban areas.

- Remoteness and non-commuter group variables will not be included as explanatory variables in the urban transport regression model. Some were negatively correlated with expenses and others had significant data limitations.
- Modelled passenger numbers will not be based on population-weighted density. Population-weighted density is already present in the regression so using it to model passenger numbers would be double counting.
- State shares of urban population squared will be retained in the blended urban transport investment assessment.
- The blending ratio for the urban transport investment assessment will remain the same. This reflects that there are not the same data concerns arising from the impact of COVID-19 as for recurrent spending.
- Non-urban school transport will remain in the urban transport component. This reflects issues with separating urban and non-urban school transport expenses.

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 On 5 August 2024, an addendum to the transport chapter of the Draft Report was published on the Commission's website.

5 This chapter includes:

- an overview of the issues considered throughout the review
- the Commission's response and decision on each issue
- GST impacts of method changes.

6 A description of the transport assessment method, incorporating the changes made in the 2025 Review, can be found in the transport chapter of the *Commission's Assessment Methodology*.

Issues considered

Urban centre characteristics model

7 The Commission sought state views on whether the urban centre characteristics regression model (blended with state shares of urban populations) remained

appropriate to assess urban transport needs, given the impact of COVID-19 on transport provision and use.

State views

8 While most states broadly supported the continued use of the urban centre characteristics regression model, there were some concerns.

9 Queensland did not support the use of the regression model, citing concerns with the variables in the regression including the inability to account for non-commuter use. It also raised concerns about the impact of state policy decisions on the model. Queensland said the model had conceptual and practical issues that could not be addressed through re-estimation of the model.

10 Queensland suggested that the model be replaced with an assessment based on urban population shares and concession card holders, as these drivers would not be subject to the policy contamination and reliability issues of the urban transport model. It also suggested school transport be removed from the component and separately assessed.

11 Western Australia questioned why controls for remoteness are not included in the urban centre characteristics model and requested results of the analysis using the updated state net expense data. Western Australia noted that other insignificant variables (such as slope and the ferry dummy) are included in the model.

12 Tasmania supported the proposal to retain the urban centre characteristics regression model but had concerns about the continued use of population-weighted density in the regression. It recommended including additional variables to account for non-commuter use.

Commission response

13 The Commission considers that the regression model remains the best approach to reflect the diverse needs of state transport systems. With the improvements identified in the 2025 Review, the model is more reflective of state needs than an assessment based on urban population and concession shares alone. The use of urban population shares would assume an equal per person cost for people living in different urban areas, which does not reflect what states do. The use of concession card holders would over-estimate the public transport need for smaller urban areas.

14 The Commission tested alternative models, including variables to account for different non-commuter groups (see Appendix A). However, these models resulted in implausible results with negative coefficients for some non-commuter users. [1] This occurs because areas with high numbers of non-commuter passengers have relatively lower per capita costs. The Commission also tested models incorporating

[1] Results of testing have been updated to account for revisions to 2022-23 significant urban area populations. The results provided in Appendix 1 cannot be directly compared to those available in the transport addendum.

remoteness. These also had implausible results, with negative coefficients for all regional dummies (see Appendix A).[2] The inner regional dummy was also negative, as inner regional urban areas spend less per capita than major cities.

15 While noting concerns about the inclusion of population-weighted density in the regression, the Commission considers that any urban transport model needs to account for the higher costs of complex transport networks in more dense areas.

16 Recognising the extent of unease some states had with the urban transport model, following the Review the Commission will seek external advice on its approach for assessing urban transport spending. Most states supported such a review. However, New South Wales considered the 2020 Review assessment method was robust, that the Commission had addressed concerns raised by other states, and as such it was not obvious urban transport required further attention between reviews. Victoria said re-examining the urban transport assessment before the next review would be impractical due to the relevant data not being available. It considered that work on other issues should be prioritised over urban transport in the forward work program.

17 More detail on this issue can be found in the forward work program chapter of *Review Outcomes*.

Commission decision

18 The Commission will continue to use the urban characteristics regression model, retaining the current variables and incorporating identified improvements to their measurement and application. The regression model will continue to be blended with state shares of urban populations.

19 The Commission will not add variables to account for remoteness or non-commuter users.

Re-estimation of the urban transport regression

20 To ensure the model reflects post-COVID-19 transport provision and remains contemporaneous, the Commission sought state views on the appropriateness of updating the urban transport regression model with 2022–23 state net expense data. To improve the reliability of the assessment, the Commission proposed updating the regression with an additional year of data (2023–24) in the 2026 Update, once it becomes available.

[2] Significant Urban Areas were assigned to remoteness categories based on the Australian Bureau of Statistics remoteness areas classifications. These categories included major cities, inner regional, outer regional remote of very remote areas. Australian Bureau of Statistics (ABS), *Australian Statistical Geography Standard (ASGS) Edition 3* [Remoteness Areas], ABS website, 2023, accessed 5 February 2025.

State views

21 Most states that responded supported updating the regression model with more recent net expense data.

22 New South Wales supported updating the regression model but raised concerns that 2022–23 data will not be representative due to residual COVID-19 impacts. It recommended updating the model with data from later years when available.

23 Victoria supported updating the model, but recommended retaining the 2020 Review expense data until state urban transport provision had returned to steady post-COVID-19 levels. Victoria suggested using data from 2025–26 and updating the coefficients in the 2028 Update.

24 While Queensland had concerns about the validity of the regression model, it supported updating the model with 2022–23 data so that it would be more contemporaneous.

25 South Australia supported the use of an additional year of data but noted that the 2023–24 data should be critically analysed before being introduced in the 2026 Update.

Commission response

26 The Commission considers that updating the assessment with 2022–23 net expense data improves contemporaneity and better reflects post-COVID-19 urban transport provision.

27 The Commission acknowledges that transport provision and demand may not have fully reached a post-COVID-19 equilibrium by 2026. However, the Commission considers that urban transport needs post-COVID-19 are better reflected by the 2022–23 data than the 2014–2016 data.

Commission decision

28 The Commission has updated the regression using 2022–23 net expense data.

29 The Commission intends to update the regression with 2023–24 net expense data for the 2026 Update.

Economies of density

30 In response to state comments, the Commission considered whether the population-weighted density variable appropriately reflects economies of density in urban transport provision.

State views

31 New South Wales and Victoria said economies of density are adequately accounted for in the regression through the logarithmic treatment of passenger numbers.

32 New South Wales said that while economies of density exist between fixed transport networks, transport networks change to accommodate increased demand over time.

33 Victoria said that policy neutrality concerns surrounding density are not supported by available data. Victoria considered that differences in density between states were largely a result of historic decisions and non-policy influences.

34 Queensland said that state decisions concerning the density of development (infill development and greenfield development) were influencing the density of individual urban areas, causing bias in the regression model. It suggested that the higher net expenses observed for Sydney and Melbourne were due to an above average provision of public transport services. Queensland acknowledged that an assessment based solely on logarithmic variables would theoretically account for economies of density. However, it said that the assessment does not fully account for economies of density because approximately 60% of the model's distribution is driven by the linear population-weighted density variable.

35 Tasmania considered that the existence of economies of population density meant that urban transport expenses were overstated for large cities, such as Sydney and Melbourne.

Commission response

36 The Commission gave detailed consideration to economies of population density in the Draft Report and addendum to the Draft Report. While the marginal cost per passenger should decline as the number of passengers on public transport increases, evidence from the relevant literature combined with Commission analysis did not indicate that economies of population density exist in Australian urban transport systems.

37 The Commission considers that the logarithmic model of passenger numbers appropriately captures economies of scale from increased passenger use of public transport. Passenger numbers reflect service provision, which becomes more efficient as more passengers buy tickets on a fixed transport service. Population-weighted density represents the demand that drives the size of the overall system. The Commission does not consider economies of population density apply to urban transport networks in Australia. Thus, the linear model of population-weighted density remains appropriate.

38 The Commission considers that differences in density are largely due to historical decisions and non-policy factors such as topography. The Commission analysed ABS-provided state density data since 2001 and found evidence that the density of Sydney and Melbourne has been rising at a similar rate to other capital cities. This confirmed analysis in the 2020 Review that suggested the 4 largest states had similar policies regarding urban sprawl.

Commission decision

39 The Commission will retain the population-weighted density variable in the model.

Measurement of population-weighted density

40 The Commission proposed changing the measure of population-weighted density from a measure based on SA1s to a square kilometre grid. Compared with the SA1 measure, the square kilometre grid approach is consistent in size and shape across urban areas, and addresses state concerns about volatility when SA1 borders are redefined, and compositional differences between Significant Urban Areas. It is also consistent with standard international measures of population density.

State views

41 Most states agreed that population-weighted density should not be calculated using SA1s.

42 New South Wales preferred the square kilometre grid to using SA1s but considered the Statistical Areas Level 2 (SA2) areas to be superior. It said SA2s more accurately reflect the level at which transport decisions are made and can more accurately account for hyper-localised areas of density.

43 Victoria did not support the use of square kilometres, saying this could underestimate density in coastal areas and have lower explanatory power than SA1s. It also said that changing the measure to reduce volatility in the assessment did not justify the large change in the distribution of GST, and the population-weighted density measure was not significantly volatile in the context of other volatility in GST distribution. Victoria questioned why transport was singled out when no method changes were proposed to reduce volatility in the property tax and mining revenue assessments. Victoria also presented its review of the literature, concluding there is no consensus in favour of using a square kilometre grid. It proposed retaining the SA1-based measure.

44 While Queensland did not support the use of population-weighted density it considered the square kilometre grid was an improvement over the SA1-based measure.

45 South Australia supported the use of the square kilometre grid, noting that issues around boundary intersections between the grid and Significant Urban Areas will need to be considered.

46 The ACT did not support replacing the SA1-based measure with the square kilometre grid. It said that it is a departure from the original model and would not reflect true demand for transport services. It argued that under the square kilometre approach, the size of Urban Centres and Localities would have more weight than population concentrations.

47 The Northern Territory supported the use of the SA2-based measure, as the square kilometre grid cannot be mapped directly to Urban Centres and Localities used in the assessment. The Northern Territory considered that the square kilometre measure would under-estimate density for smaller urban areas.

Commission response

Boundary issues

48 The Commission notes that the measures of population-weighted density based on the square kilometre grid requires adjustments to align with geographies used in the assessment. This is also true for SA2s. While the SA2 is part of the Australian Statistical Geography Standard, it does not align to the Urban Centres and Localities measure that is used in the transport assessment.

49 The Commission has designed its approach to calculating population–weighted density based on the square kilometre grid such that it maximises precision at Significant Urban Area boundaries. The Commission has elected to include those square kilometres where more than 50% of it is in the Significant Urban Area. This approach maximises the number of areas included in the calculation of population-weighted density measure without introducing unnecessary bias.[3]

50 The SA1 and SA2 areas better capture smaller parcels of land on the fringes of urban areas, including those in coastal areas. However, these measures, especially SA1s, are subject to high volatility.

51 Due to the need to maintain consistent population ranges for the SA1s and SA2s, boundaries can be split or altered following a census. This can lead to changes in density that are not driven by underlying population changes, limiting the usefulness of SA1s and SA2s in reflecting changing transport demand. This was evident in the 2021 Census, where 8% of the boundary changes for SA2s were necessary to ensure that SA2 populations did not exceed the 25,000 threshold.[4]

52 The Commission considered the trade-off between better capturing smaller parcels of land on the fringes of urban areas with the greater volatility of the measure of population density and concluded that the importance of minimising volatility caused by boundary changes was more important than the benefits of capturing land on the fringes of urban areas.

Consistency in area size and population concentration

53 When calculating population-weighted density, the size and shape of the sub-areas influences the population-weighted density obtained.[5] Given the Commission's focus on comparing the different needs of states, it is preferable that the data for

[3] Only including square kilometres where the centre of the square kilometre lies within the urban area resulted in population-weighted density for some urban areas being unrealistically high which would introduce bias into the assessment.

[4] ABS, Changes from the previous edition of the ASGS, 2021, accessed 9 September 2024.

[5] The smaller the sub-area, the higher its recorded value of density. If 2 Significant Urban Areas have the same population sizes and concentrations, the urban area with smaller sub-areas would have a higher recorded population-weighted density.

each Significant Urban Areas are comparable by having equally sized sub-areas. As shown in Table 1, there is significant variation in the size of SA1s and SA2s between Significant Urban Areas.

Table 1 Average area of capital cities by SA1 and SA2 areas

	Sydney	Melbourne	Brisbane	Perth	Adelaide	Hobart	Canberra	Darwin
	km^2	km^2	km^2	km^2	km^2	km^2	km^2	km^2
Average area-SA1s	0.21	0.29	0.41	0.38	0.35	0.54	0.33	0.80
Average area-SA2s	6.99	8.84	9.67	10.22	9.84	8.66	3.33 (a)	6.09

Note: Only SA1s within the Urban Centre and Locality boundaries have been considered for this calculation to better reflect Commission calculations of population-weighted density.

(a) Canberra has smaller SA2s on average compared to other capital cities as the ABS aims to capture individual suburbs or communities in a single SA2. These SA2s also have smaller populations on average.

54 The Commission considers that the volatility in the recurrent urban transport assessment is different to that in the property tax and mining revenue assessments. The concern with the volatility associated with the SA1 measure of population density is that a significant amount of the volatility can come from changes to the measure of the driver rather than from the driver itself (such as transport demand). In the case of property tax and mining revenue, the volatility in the assessment comes from volatility in the tax base.

Conclusion

55 In terms of the trade-offs associated with SA1s, SA2s and square kilometre grids as the measure of population density, the Commission concluded that the lower volatility and greater consistency of the types of areas included across states associated with the square kilometre grid approach, outweigh the benefits associated with the ability to capture areas on the fringes of Urban Centres and Localities.

Commission decision

56 The Commission will use the square kilometre grid to measure population-weighted density. A square kilometre grid cell will be included if more than 50% of the area of the cell is within the Significant Urban Area.

Modelling passenger numbers

57 To mitigate the impact of individual state policies, the Commission models the passenger numbers applied to the regression coefficients. The 2020 Review method calculated average passenger numbers for all urban areas within a population range, with or without heavy rail. This meant that as the population in an urban area grows, the urban area can move between ranges, resulting in large changes in modelled passenger numbers for the state.

58 To better reflect the variation of transport use that can exist between cities of similar size, the Commission sought state views on modelling passenger numbers using a regression approach based on urban centre population and the presence of heavy rail.

State views

59 New South Wales supported the use of a regression to model passenger numbers but said that an approach based on population and a heavy rail dummy underestimates Sydney's transport task because it does not recognise the impact of observed passengers and the impact of traffic congestion on public transport use.

60 New South Wales recommended the Commission use population-weighted density as an explanatory variable. As passenger numbers are not strongly linked to density for small urban areas, New South Wales analysis indicated that there are differences in public transport use rates for areas with a population-weighted density of more than 1,750 people.[6] It said that if the Commission derived a threshold using reasonable assumptions about transport service use and congestion, the threshold would have statistical validity and would not be arbitrary.

61 New South Wales also considered it appropriate to use density to model passenger numbers because it is already used in the regression to estimate the impact of demand on costs.

62 Queensland and South Australia supported retaining the 2020 Review method of grouping urban areas by the size of population.

63 Queensland said modelling passenger numbers based on population ranges is more effective in reducing the impact of policy decisions. It said that Sydney and Melbourne could influence the strength of the regression and the passenger numbers obtained. It also said the population ranges approach should not be adjusted as it improves policy neutrality.

64 South Australia noted the Commission's position but preferred to use population ranges used to allocate Significant Urban Areas with indexation to account for growth.

Commission response

65 The Commission considers that an approach that allows for population growth effectively captures the changing rate of public transport use as urban areas grow. The use of fixed population ranges assumes a constant use rate for each Significant Urban Area in the group, which may not reflect actual transport provision. The regression approach allows for the numbers of passengers to increase steadily as the size of cities grows, and accounts for the different needs of Significant Urban

[6] This threshold was based on density measured using SA1 areas.

Areas with a heavy rail service. It also results in a less-volatile approach to modelling passenger numbers compared to the population ranges.

66 Commission analysis found that Sydney and Melbourne do not have an undue influence on the regression compared to other capital cities.[7]

67 The Commission does not consider it appropriate to model passenger numbers based on population-weighted density and a dummy for areas with a density over 1,750 people. Testing of this approach did not produce plausible results, with negative modelled passenger numbers for some urban areas.[8] Additionally, as density is already included as a separate variable in the regression model to capture the demand for public transport, this approach would result in double counting.

68 The Commission considers that modelled passengers obtained under the regression approach provide a better fit to the data than a density-based model. The Commission's approach also ensures that high density urban areas do not have an undue influence on the model.

Commission decision

69 The Commission will use a regression to model passenger numbers based on urban population and the presence of heavy rail services.

Indexing passenger numbers

70 The 2020 Review method used actual passenger numbers based on the 2016 Census journey to work data released by the ABS. To address the impact of COVID-19 on the 2021 Census data, the Commission sought state views on whether it was appropriate to index passenger numbers by applying an annual index based on the Bureau of Infrastructure and Transport Research Economics passenger kilometres data until 2026 Census data are available.

State views

71 Most states supported using an index based on Bureau of Infrastructure and Transport Research Economics data compared to the state ticketing data alternative.

72 New South Wales said Bureau of Infrastructure and Transport Research Economics data would be more comparable between states.

73 Victoria did not support the use of the Bureau of Infrastructure and Transport Research Economics adjustment, saying the data were influenced by COVID-19 levels and growth. Victoria also expressed concern about applying a measure based

[7] Cook's distance is an empirical test used to identify the impact of individual data points on a regression. It measures the impact of each observation on the fitted response values. As both Sydney and Melbourne did not have a result for Cook's distance which exceeded the minimum threshold, they were not determined to have a significant impact on the model.

[8] Density calculated using square kilometres.

on distance travelled to passenger numbers, which could introduce bias. It suggested that similar bias may also exist in the distance to work variable.

74 Queensland did not support the use of commuter passenger data to determine urban transport needs, saying it underestimated the student and concession card holder transport task. If the Commission elected to continue using commuter passenger numbers data, Queensland supported using the Bureau of Infrastructure and Transport Research Economics index. Queensland recommended that the index adjustment should continue to be used once 2026 Census data become available.

Commission response

75 The fall and variability in the Bureau of Infrastructure and Transport Research Economics passenger kilometres data post-COVID-19 indicates the changing nature of public transport use patterns. The Commission considers that applying a Bureau of Infrastructure and Transport Research Economics index to 2016 Census passenger numbers better reflects what states do. The Commission found that maintaining 2016 Census data would overstate public transport provision while an index based on state ticketing data contains greater policy influence.

76 In relation to Victoria's concern regarding the influence of COVID-19 on the distance to work variable, the Commission considers the adjustments made by the ABS to be sufficient to support its continued use in the model.[9]

77 The Commission considers that the passenger numbers obtained using ABS data remain the most consistent and reliable measure of public transport use. The Commission also considers that, once 2026 Census data become available, it will reflect post-COVID-19 commuting patterns and transport provision.

Commission decision

78 The Commission will adjust 2016 Census passenger numbers using the Bureau of Infrastructure and Transport Research Economics index until 2026 Census data become available.

79 The Commission will continue to use 2021 Census distance to work data.

Use of the ferry dummy variable in the model

80 In the transport consultation paper an alternative method of assessing ferry services was proposed based on the proportion of total commuters using ferry services. States raised concerns about the inclusion of non-state ferry services in the commuter proportions and the inability to account for the fixed costs of operating ferries. In response to these concerns, in the Draft Report the

[9] To mitigate the influence of COVID-19 restrictions the ABS directed respondents to use their usual place of work over the previous 4-week period, regardless of whether they travelled to the location on the day.

Commission proposed retaining the 2020 Review method of assessing ferry transport expenses using a dummy variable.

State views

81 New South Wales opposed the use of a ferry dummy variable on the basis that it understated the costs of complex ferry services and overstated the costs of simpler ones. It said the ferry dummy would disadvantage states with a relatively higher share of the public transport task undertaken by ferries. New South Wales supported the inclusion of the Newcastle ferry service in the assessment.

82 Queensland was concerned that the 2020 Review did not consider the scale of ferry services, citing differences between ferry services in Sydney and Brisbane compared to Melbourne. Queensland recommended assessing ferry services based on the proportion of trips taken by ferry in each urban area. Queensland said if the Commission did not support this approach, ferry expenses should be removed from the urban transport assessment and assessed equal per capita. If the ferry dummy is retained, Queensland recommended excluding urban areas where fewer than 1% of public transport passengers use ferry services.

83 South Australia said the insignificance of the ferry dummy in the model justifies its removal from the assessment, while recognising the inclusion of the dummy helps to capture all forms of public transport. South Australia said that, if the Commission decided to account for ferries in the assessment, it supported using the dummy variable.

84 The ACT supported retaining the ferry variable and the proposed corrections to the areas identified as having ferry services.

Commission response

85 The Commission considered Queensland's proposal, but notes that the proportion of trips taken on ferries would result in implausibly high levels of spending for some smaller urban areas.[10]

86 The Commission considers that using cutoffs (for example only including areas with more than 1% of public transport users taking ferries to determine need) would not align with the Commission's definition of urban ferry services and would not reflect need in areas with smaller ferry operations.[11]

87 Furthermore, excluding urban areas with fewer than 1% of public transport users taking ferries would only leave 4 Significant Urban Areas with an assessed ferry service. While using the proportion of ferry passengers would result in 3 Significant

[10] Similar results were obtained using the proportion of commuters using ferries.

[11] An urban ferry service is determined to exist in an urban area if it is possible to both board and alight the ferry service at 2 different wharves/ stops in the same urban area.

Urban Areas determining the impact of ferry spending. Both approaches raise concerns about policy influence.

88 The Commission does not consider an equal per capita approach suitable to assess ferry expenditure given that urban areas without bodies of water cannot have ferry services regardless of size.

89 The Commission considers that, although the ferry variable is insignificant in the regression model, it is important to capture all state transport services and to reflect what states do. The omission of the variable would fail to account for the costs associated with operating a ferry network.

Commission decision

90 The Commission will retain the ferry dummy variable.

Blending

91 The Commission sought state views on a proposed temporary 10 percentage point increase in the weight applied to the urban population driver in the blended recurrent urban transport assessment, which would increase the weight from 25% to 35%. This was to recognise data issues arising from COVID-19 necessitating the use of older data until post-pandemic data become available. Once fit-for-purpose 2026 Census data become available in 2027, the Commission proposed the blending ratio would return to the 75:25 split. The ratio for the investment assessment would remain 75:25.

State views

92 New South Wales supported the decision to retain the 2020 Review blending ratio in the investment assessment but did not support an increase to the blending ratio for recurrent expenses. It suggested that the blending ratio does not recognise the robustness and reliability of the urban centre characteristics model, and that in the absence of any data concerns from COVID-19, the Commission should consider reducing or removing blending based on the outputs from the 2025 Review. New South Wales also proposed that the Commission seek authority to review and implement a reduction or removal of blending as part of the 2028 Update.

93 New South Wales also sought confirmation that the temporary increase in the blending ratio for recurrent expenses will be removed once 2026 Census data become available.

94 Victoria did not support increasing the blending ratio for the urban transport component, saying the 75:25 blending ratio sufficiently addresses any data concerns. Victoria supported increasing the blending ratio for investment in urban transport. It considered that if the Commission increased the blending ratio in the recurrent assessment it should also increase the investment assessment blending ratio because the same model is used in both assessments. Victoria also said that

the justification for blending in the investment assessment was stronger because the urban transport regression was designed to model recurrent expenses and does not fully capture investment needs.

95 Queensland supported a permanent increase to the blending ratio to an equal blend between the regression model and urban transport passengers (if the Commission retains its proposed approach).

96 Western Australia supported increasing the blending ratio for investment in urban transport to 50:50. It said that discounting the urban transport assessment to reflect method unreliability would be consistent with the use of discounts in other assessments.[12]

97 Tasmania supported increasing the blending in the recurrent assessment and proposed that the higher blending ratio for recurrent expenses be retained until the next methodology review. Tasmania supported retaining the 2020 Review blending ratio in the investment assessment.

Commission response

98 While improvements have been made to the model, limitations associated with the use of proxies and the use of limited data remain. The Commission considers blending remains appropriate in the 2025 Review.

99 The Commission notes that COVID-19 has caused problems with the quality of the 2021 Census data, justifying a temporary increase to the blending ratio used in the recurrent assessment. The Commission also considers that COVID-19 did not have a significant impact on investment decisions, which are made over a longer timeframe.

100 The Commission notes Victoria's concerns regarding the use of recurrent urban transport expense methods to assess investment needs. The Commission considers that the use and cost of transport services provides a reasonable proxy for transport asset need. In addition, blending the model with urban population squared in the investment assessment recognises the relationship between population growth and transport asset requirements.

101 The Commission considers that the impact of COVID-19 on the assessment is not sufficiently large to support an increase in blending in the recurrent or investment assessments to 50:50. The Commission does not consider that discounting the assessment is warranted. The temporary increase in the blending ratio is in response to data issues associated with COVID-19 and will be removed once fit-for-purpose 2026 Census data become available as part of the 2028 Update.

[12] Western Australia proposed discounting through increased blending in the recurrent assessment and a discount towards equal per capita for the investment assessment.

Commission decision

102 The Commission will temporarily increase the blending in the recurrent urban transport assessment by 10 percentage points, and this will be removed once fit-for-purpose 2026 Census data become available as part of the 2028 Update.

103 The Commission will not increase the blending ratio in the investment assessment.

Use of state shares of squared populations in the urban transport investment assessment

104 The Commission re-examined the appropriateness of modelling investment costs based on state shares of urban populations squared.

State views

105 Most states supported the population squared measure in investment.

106 Queensland did not support the use of squared populations, saying that it incentivises overinvestment in Sydney and Melbourne. Queensland recommended that the population squared driver should be replaced by urban population shares.

107 Western Australia opposed the use of the population squared model because it does not mitigate the impact of the regression model. It proposed that per capita asset costs should be fixed with respect to urban population.

108 South Australia proposed that the population squared model be re-evaluated as part of future reviews.

Commission response

109 The Commission's analysis outlined in the Draft Report provided evidence that the squared population shares in conjunction with the regression model remains the most appropriate measure of state investment needs for urban transport. This relationship has remained mostly unchanged since the 2015 Review. The use of population shares would not accurately reflect state need, or what states do.

110 The Commission re-tested the strength of the relationship between urban transport asset needs and state populations excluding Sydney and Melbourne. Analysis showed that using state shares of urban populations would over-estimate needs for the majority of smaller Significant Urban Areas. The Commission considers squared urban populations continues to be a better predictor of state needs than urban populations.

111 In contrast to blending in the recurrent assessment, the population squared method is not a response to data issues in the transport regression. Rather, the Commission has determined it to be a suitable measure of demand for transport infrastructure which, when blended with the regression, effectively estimates state needs.

Commission decision

112 The Commission will continue to use state shares of urban populations squared in modelling urban transport investment costs.

Allocation of expenses between urban and non-urban transport (V/Line)

113 In response to state comments, the Commission considered the allocation of Victoria's V/line expenses to the urban transport component.

State views

114 Victoria said a greater percentage of V/Line expenses should be allocated to the urban transport component. It sought a further adjustment to account for intra-urban V/Line travel. Analysis by Victoria, using weighted passenger kilometres, indicated that 20.2% of V/Line expenses related to urban transport.

115 Queensland supported allocating V/Line expenses between urban and non-urban transport but did not support the increase in the proportion allocated to urban transport. Queensland considered that a significant proportion of spending on urban services in New South Wales and Queensland is more related to inter-urban travel and should be moved to the non-urban transport component.[13]

116 The Northern Territory did not support an allocation of urban transport subsidy expenses based on passenger numbers. It also said that any adjustment to include such subsidies in urban transport should not be made outside a review year.

Commission response

117 The Commission noted the evidence provided by Victoria, which disaggregated V/Line trips occurring within an urban area weighted by the relative kilometres travelled by these passengers. This analysis indicated that the 20.2% of total weighted patronage on V/line services occurred within a Significant Urban Area. The Commission examined the data provided and concluded this was a reasonable method of calculating inter-urban V/Line travel. While the Commission acknowledges that not all V/Line expenses are driven by passenger use, weighting by kilometres travelled partially offsets the additional costs faced by operating regional train services.

118 The Commission aims to ensure that expenses are allocated to the correct component based on the definitions of urban and non-urban travel. Following the 2025 Review, the Commission will request total weighted patronage data from other states to determine if the 2020 Review method of allocating their regional train expenses between the components is suitable. Any adjustment to transport

[13] The Commission's definition of urban transport is based on the ability to use public transport services to travel within an urban area.

budget data will be made in a future update in accordance with the Commission's process for implementing adjustments to Government Finance Statistics data.[14]

Commission decision

119 The percentage of V/Line expenses allocated to urban transport will be increased to 20.2%.

120 After receipt of additional data, the Commission will consider whether similar adjustments are required in other states.

Non-urban transport

121 The Commission sought state views on using census train passenger numbers to assess non-urban transport in the transport consultation paper. Following feedback from states, this position was changed in the Draft Report to continuing to assess non-urban spending equal per capita.

State views

122 Most states supported retaining the 2020 Review method of assessing non-urban transport spending equal per capita, noting that using actual heavy rail passengers would not be suitable due to policy influence.

123 New South Wales supported using non-urban train commuters as a driver of transport needs but noted that adjustments may be required to align passenger and expense data with the Commission's definition of urban transport.

124 South Australia supported continuing with an equal per capita assessment of non-urban transport in the absence of a suitable alternative.

125 Queensland did not support an equal per capita assessment of non-urban transport. It proposed an assessment based on population dispersion.

126 Western Australia opposed the use of actual passenger numbers in the non-urban transport assessment due to concerns about policy neutrality. It supported retaining the equal per capita distribution.

Commission response

127 The Commission considers that the potential for both urban and non-urban populations to use non-urban train services justifies the use of total state populations.

128 While there may be additional costs associated with providing transport services in remote areas, this needs to be balanced against the additional costs of providing more frequent and higher-capacity services between large urban centres (for

[14] See the adjusted budget chapter of *Review Outcomes*.

example Gold Coast to Brisbane, or Geelong to Melbourne). These competing cost pressures would not be reflected in an adjustment only for remote areas.

129 In addition, for most states, the share of non-urban transport expenses is not consistent with the share of remote populations.

Commission decision

130 Non-urban transport expenses will continue to be assessed equal per capita.

Other issues

131 The Commission sought state views on moving pipeline and other transport expenses from urban transport to non-urban transport.[15]

132 In the Draft Report the Commission proposed retaining all school transport expenses in the urban transport assessment.

State views

133 All states either agreed with the pipeline proposal or did not have specific comments.

134 Western Australia said the Commission should consider a separate assessment of school transport expenses as part of the forward work program.

135 Queensland also recommended the Commission include non-urban school transport services in the non-urban transport category.

Commission response

136 The Commission agrees that pipeline and other transport expenses are better assessed in the non-urban transport component.

137 All student transport expenses were included in the urban transport assessment in the 2020 Review because it was not possible to accurately separate spending on urban and non-urban student transport. The Commission is not aware of any improvements to the data and have no data to support a split.

138 The Commission will investigate alternative methods to assess school transport spending following the 2025 Review in preparation for the next review.

Commission decision

139 The Commission will include pipeline and other transport expenses in the non-urban transport component. Non-urban school transport will remain in the urban transport assessment.

[15] Pipeline and other transport expenses are defined in the Australian System of Government Finance Statistics: Concepts Sources and Methods, 2015. Expenses relate to the operation, construction, and maintenance of pipelines (for example, those used for the transportation of petroleum and natural gas) and other transport systems including funiculars, cable cars and chairs lifts.

GST impacts of method changes

140 The impact on the GST distribution from the method changes is shown in Table 2.

141 Table 2 shows 2 effects from the change to using the square kilometre grid-based measure of population-weighted density. Firstly, states' shares of the new measure differ from their shares of the SA1-based measure. The GST effect of this is shown in the 'change to square km density measure' line in Table 2. The second effect is that the regression coefficients will change when the regression is recalculated with new net expense data and method changes are applied to the independent variables. This effect is captured within the 'recalculate urban centre characteristics regression' line in Table 2.

Table 2 Impact on GST distribution of method and data changes, recurrent urban transport, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Change to square km density measure	-254	-194	132	178	126	16	-7	3	455
Modelling passenger numbers	0	12	-5	10	-14	-2	-2	-1	23
Recalculate urban centre characteristics regression	130	-14	-50	-42	-44	11	10	-1	150
Change blending proportions	-158	-50	90	45	32	16	17	8	208
Changes to allocation of expenses	14	7	-9	-4	-4	-2	-1	-1	22
Other changes	1	2	-3	1	0	1	0	-2	5
Total	**-267**	**-235**	**155**	**188**	**96**	**40**	**17**	**6**	**502**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Change to square km density measure	-29	-27	23	58	66	27	-15	13	16
Modelling passenger numbers	0	2	-1	3	-7	-3	-4	-3	1
Recalculate urban centre characteristics regression	15	-2	-9	-14	-23	19	20	-3	5
Change blending proportions	-18	-7	16	15	17	28	35	32	7
Changes to allocation of expenses	2	1	-2	-1	-2	-4	-2	-5	1
Other changes	0	0	-1	0	0	2	0	-9	0
Total	**-31**	**-33**	**27**	**61**	**50**	**69**	**35**	**25**	**18**

Note: The allocation of expenses relates to changes to the allocation of V-line expenses, moving pipeline expenses to the non-urban component and the removal of adjustments that are no longer material.
Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes*.

142 The change in the GST distribution compared to the 2024 Update was due largely to the change to a square kilometre-based measure of population-weighted density. Using the square kilometre grid reduced the densities of large cities relative to smaller regional cities. Sydney and Melbourne have lower relative densities under the square kilometre-based measure which has reduced the assessed needs of New South Wales and Victoria as shown in Table 2. Conversely, smaller cities have a higher relative density than before, increasing the assessed needs of all other states for recurrent expenses and investment.

143 The GST impact from recalculating the urban centre characteristics regression reflects the increased influence of population–weighted density and the reduced influence of passenger numbers.[16]

144 The increase to the blending ratio reduced the assessed needs of New South Wales and Victoria.

145 The impact on the GST distribution from the urban transport investment assessment is shown in Table 3. This results from the recurrent method changes flowing through to the investment assessment. For a detailed explanation of these changes see the investment chapter of *Review Outcomes*.

Table 3 Impact on GST distribution of method changes, transport investment, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
$m	5	-40	-193	198	57	26	-49	-3	285
$pc	1	-6	-34	65	30	44	-101	-11	10

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcomes*.

16 The regression was re-estimated using updated net expense data, incorporating method changes to population-weighted density and indexing actual passenger numbers.

Appendix A

Table A-1 Impact of remoteness variables on the urban transport regression model

Variable	R2025 model coefficients	R2025 model – including remoteness categories
Intercept	-197.22	-40.46
Population-weighted density	0.16	0.17
Heavy rail passengers	9.08	-4.42
Bus and light rail passengers	10.74	5.31
Distance to work	2.08	1.60
Mean slope	12.51	12.60
Ferry	40.45	72.92
Inner regional		-146.69
Outer regional		-132.46
Remote and very remote		-116.11
Adjusted R-squared	0.7774	0.7824
Residual standard error	78.07	77.18

Note: major cities are used as the reference category in the models incorporating remoteness categories.
2022-23 net expense data and square kilometre population-weighted density has been used to estimate the regression.

Population-weighted density in the literature

146 Victoria referred to evidence of a variation in the definition of population-weighted density in the literature. While there is substantial variation in the sub-areas used to calculate population-weighted density, there is a preference for consistency in size where such data are available.[17] SA1s are designed to be consistent in population, not area, so cities that are denser have smaller SA1s on average compared with areas which are not as dense. An example of this is the Sydney Significant Urban Area, which has an average SA1 size of 0.21km^2, compared to 0.29km^2 in Melbourne and 0.41km^2 in Brisbane.

[17] J Ottensmann, 'The Use (and Misuse) of Population-Weighted Density', ResearchGate, 2021, accessed 5 February 2025.

17. Services to industry

Review outcomes

- The following changes were made to the assessment.
  - The indicator of industry size in the business regulation assessment will change from total factor income to state industry output from the ABS to reduce the sensitivity of the assessment to changes in commodity prices. The indicator will be updated annually using the chain volume measure of industry value added.
  - A new, temporary component will be introduced to assess expenses associated with the COVID-19 business support national partnerships. The usual drivers in the services to industry assessment do not adequately reflect state expense needs for COVID-19 business support.
  - The business development and regulation expense weights were re-estimated using the latest data provided by the states.
- The Commission considered but did not to change the following.
  - Business counts will not be included as a driver of need for state expenses on business regulation because there are data limitations that may lead to perverse outcomes.
  - Regional costs will not be introduced as a driver of state expenses in the business development assessment given the lack of evidence to support such a change.
- As part of the Commission's forward work program, it will work with the states and other Commonwealth agencies on the development of a net-zero transition assessment because the transition to net-zero is an emerging cost for states.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the services to industry chapter of the *Commission's Assessment Methodology*.

Issues considered

Change in the measure of industry size and determining a base year for the business regulation assessments

6 The Commission considers industry size is the appropriate driver of states' regulation expenses. The 2020 Review method uses total factor income as the measure of industry size. However, total factor income has been sensitive to changes in commodity prices that do not affect regulatory expenses. To address this issue, the Commission proposed to change the measure of industry size to a volume-based measure of industry output.

7 The Commission initially considered replacing total factor income with the chain volume measure of industry value added, published annually by the ABS. This method required the Commission to determine an appropriate base time period to measure annual changes.

8 To avoid the issue of determining a base year, the Commission proposed to instead use the industry output measure produced by the ABS for the national and state accounts which does not require the annual rebasing of the indicator to assess changes over time.

State views

9 All states supported or did not comment on the Commission's proposal to change the measure of industry size.

10 New South Wales reiterated its preference that the Commission use a 3-year average rather than a single year of industry output from the ABS, to measure industry size.

Commission response

11 The Commission noted New South Wales' preference for a 3-year average, rather than 2021–22 as the first year. The Commission considers the New South Wales proposal would introduce unnecessary complexity into the assessment as it would diverge from ABS national and state accounts methods, which use the year-on-year annual change in industry output rather than the change from an average year.

Commission decision

12 The Commission will replace total factor income as the measure of industry size with the aggregate measures of industry output, provided by the ABS. This measure does not require rebasing for each update.

13 The Commission will update the aggregate measures of state industry output for years after 2021–22 using the percentage change in chain volume of industry value added published annually for each state by the ABS.

Number of businesses as a driver of state regulation expenses

14 In the 2020 Review the Commission accepted the conceptual case that the number of regulated businesses influenced the cost to states of undertaking regulatory activities. However, the business regulation assessment was simplified by removing the number of businesses as a driver of need because it was not material. In the 2025 Review, the Commission investigated reintroducing the number of registered businesses as a driver in the business regulation assessments.

State views

15 Most states were supportive or did not comment on the reintroduction of business counts as a driver of regulation assessment expenses. This was on the basis that there are likely to be increased costs for regulating a greater number of businesses.

16 New South Wales and Victoria supported the inclusion of business counts as a driver of state regulatory expenses. They said the Commission should consider data sources including Australian Taxation Office, Business Longitude Analysis Data Environment data (available from the ABS) and Australian Business Register data to enable inclusion of the driver.

17 South Australia reiterated its support for the inclusion of business counts but noted that it was not practical on data quality grounds.

Commission response

18 The Commission accepts the conceptual case that the cost of regulating many small businesses is higher than regulating fewer large businesses. The Commission proposed using ABS data on the number of businesses by industry classification by state. ABS data are based on Australian Taxation Office and Australian Business Register data. However, there are data limitations and challenges with implementing the driver:

- National companies, such as retailers, have one Australian Business Number (ABN), linked to a head office in a capital city even though they may have regulated business across states. Alternative data sources suggested by New South Wales and Victoria, including the Business Longitudinal Analysis Data Environment (BLADE), do not overcome the multi-location business limitations because they are based on the same data sources used by the ABS.
- To implement business counts in the assessment, the Commission must determine the share of state regulatory spending which is influenced by the number of businesses or industry output. The Commission can either use judgement or ask states to disentangle regulatory expenses driven by industry output or the number of businesses.

19 Given these limitations, the Commission concluded that implementing the driver could lead to perverse outcomes that outweigh the benefits of including it.

Commission decision

20 The Commission will not include business counts as a driver of need when assessing business regulation expenses because of the limitations of the ABS business count data.

Net-Zero transition

21 The Commission identified net-zero transition expenses as an emerging cost for states. The Commission sought state views on the potential for developing an assessment of net-zero transition expenses. The Commission consulted with states on the following issues:

- the identification of state expenses on the transition
- potential policy neutral drivers of state expenses
- state expectations of future expenses as the transition progresses.

State views

22 All states except South Australia said they could identify most of their specific net-zero transition expenses. South Australia noted that it is reviewing its current net-zero activities, which will enable it to identify expenses in the future. Some states also indicated that it would be useful if the Commission provided a consistent definition of net-zero expenses to help them in identifying relevant expenses.

23 All states considered it a challenge to identify policy neutral drivers of state net-zero expenses citing a complicated mix of structural factors and state policy choices (both historical and current).

24 Some states suggested that any drivers of state expenses on the net-zero transition must also consider the potential for cost sharing between industry and governments.

25 All states except Tasmania expected there to be increases in state expenses on the net-zero transition, which would warrant a separate assessment if possible. Tasmania said that it is unclear whether expenses will be material, and notes that any assessment should not disadvantage states that have already invested heavily in the transition.

Commission response

26 The Commission acknowledges the challenges in reliably identifying net-zero transition expenses and identifying policy neutral drivers of expenses. The Commission agrees with states that further work beyond the 2025 Review is required to explore whether a net-zero transition assessment is possible.

Commission decision

27 The Commission will work with the states to explore whether a reliable net-zero transition assessment can be developed. The Commission's proposal is outlined in the forward work program chapter of *Review Outcomes*.

COVID-19 business support expenses

28 The Commission considered the treatment of COVID-19 business support in the 2021, 2022, 2023 and 2024 updates. It said the methodology used in these updates did not capture the drivers of COVID-19 state expenses, which differed from the usual drivers of business development expenses. In the 2023 Update, the Commission noted that it considered state responses to the COVID-19 pandemic were largely driven by circumstances outside of state control rather than policy choices. However, the terms of reference for these updates did not provide the Commission with the flexibility to change the assessment method in response to state COVID-19 expenses. The 2025 Review provided the opportunity to change assessment methods. As a result, the Commission proposed an actual per capita treatment of COVID-19 business support expenses, instead of an equal per capita treatment.

29 The Commission also proposed to define relevant state expenses as expenses covered by the 8 COVID-19 business support national partnership agreements which were co-funded with the Commonwealth.[1]

State views

30 New South Wales and Victoria supported the Commission's proposal to assess state COVID-19 business support expenses under the national partnerships actual per capita. They said an equal per capita treatment was not appropriate because state expenses were driven by state circumstances.

31 New South Wales asked for a retrospective adjustment to compensate it for the treatment of COVID-19 business support expenses in the 2022, 2023 and 2024 updates.

32 Some states disagreed with the proposed actual per capita treatment of national partnership agreement COVID-19 expenses. They said that an actual per capita assessment of COVID-19 expenses was not appropriate because state expenses were policy influenced.

33 Queensland said that there were differences between state health, quarantine and lockdown policies as well as differences in the scope and extent of business support payments made under the 8 Commonwealth-state national partnership agreements.

[1] The 8 agreements are available on the federal financial relations website. The 8 agreements are Business support payment (JobSaver) – New South Wales; Business support payments – Victoria; Business support payments – Queensland; Business support payments – Western Australia; Business support payments – South Australia; Business support payments – Tasmania; Business support payments – Australian Capital Territory and Business support payments – Northern Territory.

It said that an equal per capita assessment is appropriate because of the lack of differential drivers of state needs.

34 Western Australia said that state policy differences contributed to most of the differences in state business support spending. It said that the Commission had said it could not identify any drivers of COVID-19 state expenses in the 2023 Update. Western Australia also supported an equal per capita treatment because of a lack of identifiable drivers.

35 Western Australia also said the Commission's proposal is contrary to the findings of international and national studies. It said comments from the then Prime Minister, other prominent political leaders, and the Secretary of the Federal Treasury supported the position that there were significant policy differences between states that led to different outcomes.

36 South Australia disagreed with the view that responses to COVID-19 were driven by state circumstances alone. It said both state circumstances and policy choices drove COVID-19 impacts. South Australia said that if a separate assessment of COVID-19 was adopted, the maximum discount must be applied to reflect policy neutrality and data quality concerns.

37 Although it was supportive of the Commission's proposal, Victoria said that any assessment of COVID-19 expenses should also include state COVID-19 expenses that are not covered by the National partnership agreements.

38 Queensland and South Australia also said that because the assessment approach will not have an impact until 2025–26, it is not contemporaneous and should not be assessed.

39 All states either supported or did not comment on the Commission's proposal to not retrospectively adjust the 2022, 2023 and 2024 updates with the proposed COVID-19 method. Although New South Wales supported an adjustment, it noted that the Commission is unable to retrospectively adjust past updates.

Commission response

40 The Commission considers the drivers of state COVID-19 business support expenses differed from the usual drivers of business development expenses. As such, there is a case for a different assessment method.

41 There are diverse views among the states as to whether state expenses on COVID-19 related business support largely reflected state policy or state circumstances. The Commission continues to hold the view that state responses to COVID-19 largely reflected specific state circumstances arising from the pandemic, rather than state policy choices.[2]

---

[2] Commonwealth Grants Commission (CGC) Report on GST Revenue Sharing Relativities 2021 Update, CGC, 2023, accessed 4 September 2024; Commonwealth Grants Commission (CGC) New Issues in the 2022 Update, Commonwealth Grants Commission, 2023, accessed 4 September 2024; Commonwealth Grants Commission (CGC) New Issues in the 2023 Update, Commonwealth Grants Commission, 2023, accessed 4 September 2024.

42 Although there were differences in the Commonwealth-state COVID-19 National partnership agreements, the Commission does not view the differences as significantly affecting state expense decisions. The agreements were all struck with a common policy objective, specifically to support businesses through local or statewide lockdowns in response to the pandemic.

43 While accepting that states had COVID-related business support expenses outside the national partnership agreements, the Commission considers it is impractical to include these expenses in the assessment. Spending outside of the agreements is not expected to be consistently characterised in ABS Government Finance Statistics.

44 The proposed assessment is contemporaneous in that all relevant expenses will be included in the 3 assessment years applicable for the GST distribution for 2025–26.

45 The Commission does not view a discount as appropriate in the COVID-19 assessment. The Commission typically discounts assessments in response to method and data uncertainty but does not discount for policy neutrality. The Commission does not consider there to be method or data uncertainty in the proposed COVID-19 business support assessment.

Commission decision

46 The Commission will assess state expenses covered by the COVID-19 business support national partnership agreements using an actual per capita treatment from 2021–22.

47 The Commission will not retrospectively adjust the GST distribution for the 2022, 2023 and 2024 updates.

Regional costs in business development

48 In Western Australia's submission to the welfare consultation paper, it said that the Commission should reconsider the conceptual case for regional costs as a driver of state expenses in the business development assessment.

State views

49 Western Australia said that the Commission should include the additional costs from remoteness when assessing state expenses on business development. It said that although many grant processes and tenders are administered from a centralised location (usually a capital city), the level of funding for projects in regional and remote locations is greater than in a capital city. Western Australia also said that when applying for business development grants, the applicant includes the additional costs of provision in remote areas in their cost estimates.

Commission response

50 While there may be additional costs associated with business development activities in regional and remote areas, the Commission is not aware of consistent data or

other evidence to support the inclusion of regional costs in the business development assessment.

Commission decision

51 The Commission will not include regional costs in the assessment of business development expenses.

Regional costs discount

52 Queensland questioned whether the 25% discount on the general regional cost gradient in the 2020 Review methods remained appropriate for the business regulation assessments. Discounting of the general regional cost gradient is discussed in the geography chapter of *Review Outcomes*.

Update to business regulation and development weights

53 The Commission requested updated business development expense data from states to update the business regulation and business development weights. All states provided data to the Commission on their expenses. Table 1 shows the updated weights for all states and the national average. These weights will be held constant until the next review.

Table 1 Revised business regulation and development weights

	2025 Review								2025 Review Ave	2020 Review Ave
	NSW	Vic	Qld	WA	SA	Tas	ACT	NT		
	%	%	%	%	%	%	%	%	%	%
Agriculture										
Regulation	15	73	49	97	58	27	na	6	44	50
Business development	85	27	51	3	42	73	na	94	56	50
Mining										
Regulation	81	97	96	94	90	79	na	81	91	80
Business development	19	3	4	6	10	21	na	19	9	20
Other industries										
Regulation	53	38	66	68	25	28	80	48	51	53
Business development	47	62	34	32	75	72	20	52	49	47

Note: na- not available.
Source: Commission calculation using state and ABS Government Finance Statistics data.

GST impacts of method changes

54 The impact on the GST distribution from the method changes is shown in Table 2.

Table 2 Impact on GST distribution of method changes, services to industry, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
COVID-19	456	577	-478	-330	-176	-38	17	-28	1,050
Changed component weights	-130	-107	21	251	-27	-12	-5	8	280
Change in measure of industry size	-30	1	46	-15	-6	-5	-3	13	59
Total	**296**	**471**	**-411**	**-94**	**-209**	**-55**	**9**	**-7**	**776**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
COVID-19	53	80	-83	-108	-93	-66	36	-108	38
Changed component weights	-15	-15	4	82	-14	-21	-9	31	10
Change in measure of industry size	-4	0	8	-5	-3	-8	-7	50	2
Total	**34**	**66**	**-72**	**-31**	**-110**	**-95**	**19**	**-27**	**28**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter of *Review Outcome*. COVID-19 effects are net of the changes in the treatment of Commonwealth COVID-19 business support payments.

COVID-19 assessment

55 The largest driver of the change in assessed GST needs is the temporary actual per capita assessment of state expenses on COVID-19 business support as show in Table 3. This increased the GST distributed to New South Wales, Victoria and the ACT.

Table 3 Impact of the COVID-19 business support component on GST distribution, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Commonwealth payment for COVID-19	-501	-580	509	322	195	47	-18	26	1,099
State spending of Commonwealth payment	501	580	-509	-322	-195	-47	18	-26	1,099
State own source COVID-19 spending	501	580	-509	-322	-195	-47	18	-26	1,099
Moving expenses to the COVID-19 component	-45	-3	31	-8	19	9	-1	-1	59
Net effect of treatment of COVID-19	**456**	**577**	**-478**	**-330**	**-176**	**-38**	**17**	**-28**	**1,050**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Commonwealth payment for COVID-19	-58	-81	89	105	102	82	-38	102	39
State spending of Commonwealth payment	58	81	-89	-105	-102	-82	38	-102	39
State own source COVID-19 spending	58	81	-89	-105	-102	-82	38	-102	39
Moving expenses to the COVID-19 component	-5	0	5	-3	10	16	-2	-6	2
Net effect of treatment of COVID-19	**53**	**80**	**-83**	**-108**	**-93**	**-66**	**36**	**-108**	**38**

56 The impact of this method change will be largely limited to the 2025–26 GST distribution because COVID-19 business support expenses decline significantly after 2021–22. However, residual state expenses and reimbursement payments to states from the Commonwealth may be recorded in future years because of delays in state final reimbursement claims.

57 Table 3 shows the offsetting revenue and expense effects of the Commonwealth payments as well as the impact of assessing the matching state expenses actual per capita. The net impact of the COVID-19 business support assessment also includes the effect of moving expenses from the business development component to the COVID-19 business support component.

Other method changes

58 Increasing the mining regulation component expense weight increased the assessed expense needs of states with relatively large mining sectors including Queensland, Western Australia and the Northern Territory.

59 Changing the industry size indicator for assessing agriculture and mining regulation expenses also increased the assessed GST needs of Queensland and the Northern Territory due to an increase in its share of national agricultural and mining production.

18. Natural disaster relief

Review outcomes

- No changes were made to the assessment method for natural disaster relief.
  - The long–standing treatment of natural disaster relief in the GST distribution arrangements was considered to remain appropriate and the actual per capita treatment of relief expenses has been retained.
  - The Commission is unaware of any evidence to suggest the GST distribution arrangements create a disincentive for states to reduce their exposure to natural disasters.
- The Commission will consider the outcome of the Independent Review of Commonwealth Disaster Funding and consult with states on any implications of the Government response for the assessment of natural disaster relief expenses.

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

Method for assessing natural disaster relief expenses

6 The Commission sought state views on whether an actual per capita assessment method remained appropriate for assessing state expenses on natural disaster relief.

State views

7 Most states said that an actual per capita assessment remained appropriate.

8 New South Wales and South Australia said it was important for the Commission to recognise the interaction between natural disaster relief and natural disaster mitigation expenses when considering the assessment of mitigation and relief expenses in future reviews. Some states also noted that it would be important to take account of the outcome of reviews into Australian disaster funding arrangements.

9 Victoria did not support the continuation of the actual per capita natural disaster relief assessment because:

- the 2014 Productivity Commission Inquiry Report on Natural Disaster Funding Arrangements highlighted policy influences on spending on natural disaster relief
- differences in states' rates of insurance of state assets could influence the need for disaster relief funding
- local government expenses are included in the assessment and should be removed for consistency across assessments.

10 Victoria recommended the assessments of natural disaster relief and mitigation should be considered together to account for their complex interrelationship. Victoria recommended that, if a policy neutral driver could not be identified, natural disaster relief should be assessed equal per capita.

Commission response

11 Sharing the cost among the states of responding to natural disasters is a long-standing feature of the GST distribution arrangements. Consistent with the objective of horizontal fiscal equalisation, it helps ensure that a state's capacity to provide services is not adversely affected by experiencing and responding to natural disasters. The Commission is not aware of any evidence to suggest that the GST distribution arrangements create a disincentive for states to reduce their exposure to natural disasters. Whilst the Productivity Commission suggested the GST distribution arrangements could marginally influence incentives for mitigation spending, its conclusion was not to recommend changes.

12 The treatment of local government expenses was considered in the 2020 Review. The Commission concluded that "it is average policy for states to fund a significant proportion of the local government out-of-pocket expenses." No new evidence to the contrary was provided in the 2025 Review.

13 Under the Disaster Recovery Funding Arrangements, local government expenses are treated as equivalent to state expenses and are equally eligible for Commonwealth reimbursement.[1]

14 Victoria's concern about inconsistent treatment of state support for local government across assessments was also addressed in the 2020 Review.

[1] Disaster Recovery Funding Arrangements 2018 (disasterassist.gov.au), p10

> "While financial assistance grants, including local roads grants, are removed from the adjusted budget, other payments to local government are included. These payments contribute to the average expenses to which disabilities apply. Therefore, it is not inconsistent for the Commission to assess state payments to local government for disaster recovery. The Commission considers this does not amount to local government equalisation. It recognises an unavoidable cost that all states fund."[2]

Commission decision

15 The Commission considers the long-standing treatment of natural disaster relief expenses in the GST distribution arrangements remains appropriate. The Commission is not aware of any evidence that the GST distribution arrangements create a disincentive for states to reduce their exposure to natural disasters.

GST impacts of method changes

16 There are no method changes to this assessment.

[2] 2020 Review Final Report, Vol 2, Part B (Ch19-33), p373

19. Native Title and land rights

Review outcomes

- No changes were made to the assessment method for Native Title and land rights.
- The actual per capita treatment of Native Title and land rights expenditure will be retained on the basis that states continue to have consistent obligations under Commonwealth legislation and costs are driven predominantly by state circumstances rather than state policy.
- Treaty-related expenses will not be included in the assessment because they are different in nature to Native Title and land rights expenditure and could be policy influenced.
- The Commission will monitor Native Title compensation expenditure for significant changes, and for the impact of Treaty processes on the negotiation of Native Title and land right claims.
- Compensation in the form of a revaluation of state government land assets will not be included in the assessment. This is because revaluations of land assets are out of scope of the fiscal equalisation process.

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

Actual per capita approach

6 An actual per capita assessment method is appropriate when states' policies have negligible influence on expenditure. Given increases in state expenditure on

Native Title matters, particularly compensation, the Commission re-examined the appropriateness of the method.

7 The key consideration was whether states followed a common policy approach, with differences in expenditure due to circumstances beyond their control. The existence of a national framework is highly relevant.

State views

8 Most states said that the actual per capita assessment remained appropriate, given their consistent obligations under Commonwealth legislation. Some also noted the impact of the National Guiding Principles for Native Title Compensation, which call for 'consistency within and across jurisdictions and with national best practice in approaches to assessing, valuing and resolving Native Title compensation'.[1]

9 Victoria said Native Title expenditure was policy influenced and an actual per capita assessment was not appropriate. It cited its own *Traditional Owner Settlement Act 2010* (Vic) as evidence of state policy influence on Native Title administration. Victoria also said the Timber Creek case had introduced policy influence into Native Title compensation. Conversely, Queensland said that the Timber Creek case established a structure and formula for calculating Native Title compensation in certain cases.

Commission response

10 Most states continue to act in broadly the same way when addressing their obligations under the *Native Title Act 1993*. Furthermore, the National Guiding Principles for Native Title Compensation and the Native Title Act ensure there is a high degree of uniformity between jurisdictions. This includes Native Title matters settled under Victoria's Traditional Owner Settlement Act.

11 The Commission does not agree that the Timber Creek case introduced policy influence into the assessment. While states may choose to settle compensation claims through different mechanisms and provide different forms of compensation, the costs associated with settling Native Title claims continue to reflect state need. Inconsistencies in the size or volume of claims are due to historical circumstances outside state control.

12 The actual per capita treatment of Native Title expenditure reflects the Commission's judgement that costs are driven predominantly by state circumstances rather than state policy. As such, the Commission does not consider an equal per capita assessment would provide a better fiscal equalisation outcome.

[1] National Indigenous Australians Agency (NIAA), National Guiding Principles for Native Title Compensation Agreement Making, NIAA, Australian Government, 2021, accessed 23 October 2023.

Commission decision

13 The Commission will retain the actual per capita assessment and continue to monitor whether state policies have a significant influence on Native Title compensation expenditure.

Impact of Treaty processes

14 Some states have established, or are in the process of establishing, Treaty processes. This raises the question of whether they affect the negotiation of Native Title and land rights claims. The Commission explored whether the operation of Treaty processes leads to a divergence in how states finalise claims. Divergence could affect the appropriateness of the actual per capita assessment method.

State views

15 Most states said it was too early to say whether the negotiation of Native Title and land rights claims would be affected. They suggested the Commission monitor the development of Treaty processes throughout the next review cycle.

16 There were mixed views on whether Treaty processes would impact Native Title claims. Most states that said Treaty processes would affect Native Title claims also suggested that any impact on expenditure would be policy influenced.

Commission response

17 The effects of Treaty processes on the negotiation of Native Title and land rights claims will only be able to be assessed once Treaties are operational. The Commission considers that recent developments in Treaty processes do not warrant a move away from an actual per capita assessment at this time.

Commission decision

18 The Commission will monitor the impact of Treaty negotiations on Native Title and land rights expenditure.

Treaty-related expenses

19 In response to state comments, the Commission considered whether Treaty-related expenses should be included in the Native Title and land rights assessment.

State views

20 Victoria said its Treaty processes aligned with both the Native Title Act and land rights legislation. It suggested its Treaty expenses would be most appropriately assessed alongside Native Title and land rights. Other states noted the potential for Treaty-related expenses to be policy influenced.

21 Victoria was concerned Treaty expenses may be allocated under a category with a differential assessment. If these expenses were not included in the assessment, it

requested the Commission confirm its Treaty-related expenses are being assessed on an equal per capita basis or use its data returns to ensure that these costs are assessed in this manner.

Commission response

22 Given the differences in function, scope and purpose between Native Title and land rights legislation and Treaties, the Commission considers that Treaty-related expenses are separate from expenditure assessed in the Native Title and land rights assessment.[2]

23 Including Treaty-related expenses would introduce policy influence into the assessment. With no nationally consistent approach to developing or implementing Treaty processes, the Commission considers that an actual per capita assessment of Treaty-related expenses would not be appropriate.

24 The Commission acknowledges that this is an emerging area of state spending that is not explicitly recognised in 2020 Review methodology. However, data provided by Victoria for the 2024 Update indicate its Treaty-related expenses would have to increase substantially for a differential assessment to become material. The Commission notes that other states have Treaty-related expenses, and these also appear to be relatively small.

25 It may be that the expenses are allocated across several different categories. However, given the relative size of these expenses, it is unlikely that an adjustment would meet the $12 per capita materiality threshold for data adjustments.

26 As Treaty processes progress, and Treaty-related expenses increase, the Commission will work with states to determine whether comparable data are available to inform analysis in the next review.

Commission decision

27 The Commission will not include Treaty-related expenses in the Native Title and land rights assessment. The Commission will work with states to determine whether comparable data on Treaty-related expenses are available to inform analysis in the next review.

Land rights compensation

28 In response to state comments, the Commission considered whether compensation in the form of the revaluation of state land assets should be included in the assessment.

[2] The Commission understands that Native Title and land rights are linked to land (and marine) tenure and associated rights (these relate to Articles 25–28 of the United Nations Declaration on the Rights of Indigenous Peoples), whereas Treaties seek to achieve broader goals including self-determination (Articles 3–5) and ongoing relationship frameworks (for example, Article 15). United Nations Human Rights Council, United Nations Declaration on the Rights of Indigenous Peoples, United Nations, 2007.

State views

29 New South Wales noted that land rights claims affect the fair value of land that is subject to claims. It considered this reduction in value to be a form of compensation. New South Wales said that the Commission is not recognising this change in the asset's revaluation reserve as a cost incurred by the state.

Commission response

30 The Commission acknowledges that Native Title and land rights processes affect the value of state land assets. However, the Commission considers these revaluations to be out of scope of the fiscal equalisation process. Only land that is bought or sold affects states' fiscal capacities and is captured in the Commission's adjusted budget.

31 The Commission does not consider it appropriate to include imputed compensation expenditure representing a reduction in land values in the assessment, especially since there are differences between states in how they value and account for land assets.

Commission decision

32 The Commission will not assess the revaluation of land assets within the Native Title and land rights assessment.

GST impacts of method changes

33 There are no method changes to this assessment.

20. 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.

21. Wage costs

Review outcomes

- The following changes were made to the assessment.
  - The dependent variable in the regression model has changed from weekly to hourly wages. This appropriately reflects that workers who work longer hours receive higher weekly wages.
  - The model has been simplified, with the following changes:
    - 11 distinct 5-year age categories have replaced a derived measure of experience
    - variables for usual working part-time, or more than full time, were simplified
    - Over 200 detailed industry variables were replaced by 19 industry divisions
    - gender interaction variables, that reflect that women and men have different labour market experiences, were removed.
  - A weighted average of several years of data has been used to increase effective sample size and reduce volatility in the wage cost estimates.
  - The way state expenses are designated as wage-related or not wage-related has been revised so as not to overestimate wage-related costs.
- The Commission considered but did not change the following.
  - Differences in private sector wages are used as a policy neutral proxy for the market pressures faced by public sector employers.
  - The ABS Characteristics of Employment survey data is used for the assessment, because of its sample size, reliability and availability of control variables.
  - The full sample of private sector employees survey data is used, as data are not sufficient to select a sub-set that more closely resembles the public sector.
  - A 12.5% discount is applied to reflect some uncertainty in the strength of the proxy and the underlying data.
- The Commission will validate the regression results from each annual Characteristics of Employment survey before including them in its measure of wage costs. The Commission will continue to investigate alternative data sources both for validation and as potential alternatives to the Characteristics of Employment surveys.

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, and the addendum, following a review by an external consultant.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the wage costs chapter of the *Commission's Assessment Methodology*.

Issues considered

Use of the private sector proxy

6 The Commission aims to measure the underlying wage pressures faced by states to employ similar staff in a way that is not influenced by state policy. As public sector wages are influenced by state policy, direct measurement of public sector wage differentials is not appropriate. The Commission measures private sector wage differentials across states as a proxy for underlying wage pressures that are shared by the public sector.

State views

National markets

7 Some states said they compete primarily in a national market and do not refer to private sector wages when negotiating wage rises with employees. These states argued that private sector wage levels are not a good proxy for public sector wage levels, as there is no direct competition for labour between private and public employers locally.

Controlling for differences in private sector labour markets

8 Some states argued that incomplete controls mean that states can be recognised to have higher wages for similar individuals due to having a prevalence of high-income industries.

9 Some states argued that there are differences between state private sector labour markets that are not controlled for in the model. These include differences such as

the size of workplaces, health factors, regionality, non-wage benefits and different responsibilities for workers with the same occupations and qualifications.

Sector specific drivers

10 Some states said that there are fundamental differences between private and public sector labour markets. The private sector workforce is male dominated, while the public sector workforce is female dominated. Some industries are overrepresented in the public sector, while other industries are virtually non-existent in the public sector.

Commission response

National markets

11 States compete for labour in both the local private sector market and national and international markets. Where national labour markets exist, the validity of the proxy measure only requires that some factors beyond a state's control (such as cost of living) affect worker relocation decisions and wage negotiations in a similar manner in both the public and private sectors. When workers choose to move between jurisdictions, they consider these factors in addition to wages. There is no evidence that factors like cost of living or climate are weighted differently by workers in a particular sector or industry.

12 Any drivers of differences in wages between states (beyond causes that are controlled for in the model) will be reflected in the state regression coefficients. The Commission considers that such drivers are likely to reflect general local labour market conditions.

Controlling for differences in private sector labour markets

13 Measured wage differentials should not reflect differences in industry mix as this is controlled for in the model.

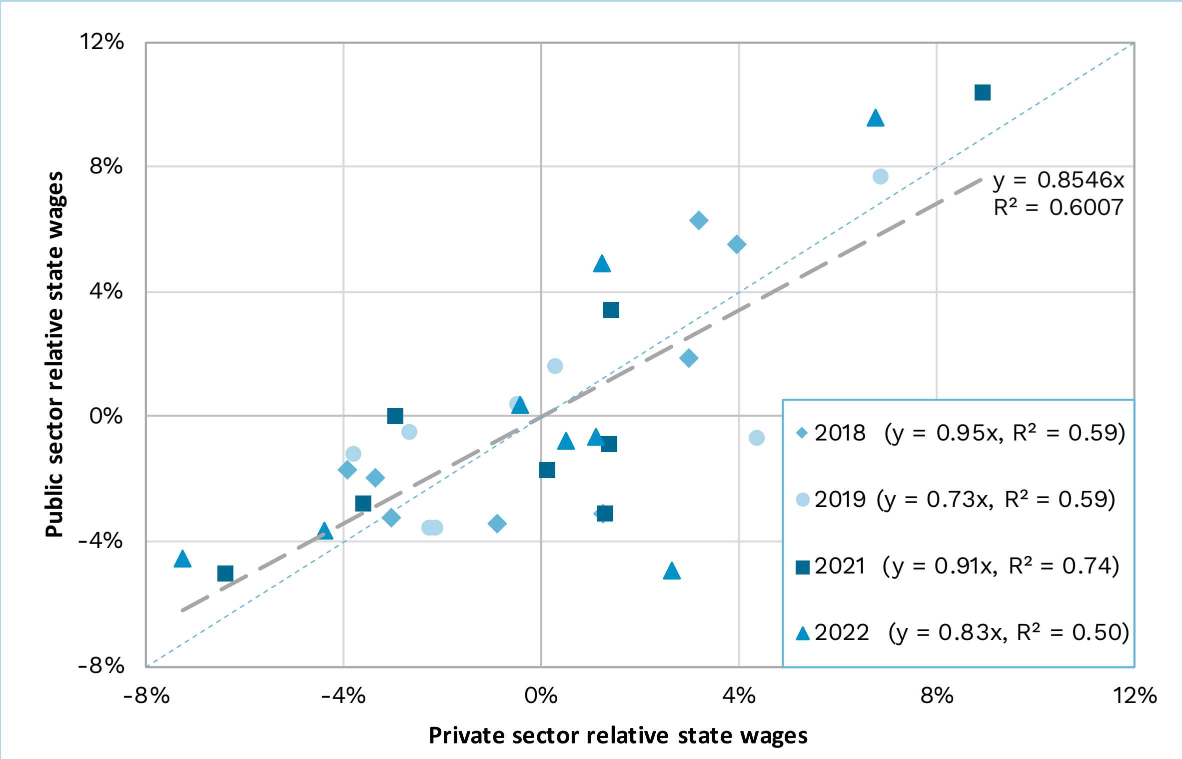
14 Analysis of a similar model using Household Income and Labour Dynamics in Australia and Person Level Integrated Data Asset data showed that including additional variables not available in the ABS Characteristics of Employment Survey did not systematically and consistently change any state coefficients.

15 Regional and remote effects are accounted for separately in the Commission's assessments, for that reason it is unnecessary to include the effects of remoteness on relative state wages. Remoteness variables have therefore not been included in the model.

Sector specific drivers

16 While there are significant differences between the public and private sector labour markets, these do not necessarily mean that they respond differently to local factors. There is a strong correlation between the measured relative wage levels in the public and private sectors, see Figure 1.

Figure 1 Relative state wage levels, public vs private



Notes: Four years of data from the Characteristics of Employment surveys are included.
Each point represents a single state in a single year.
The slope and strength of the relationship between public and private sector state wage levels are shown for each year within the legend, and across all 4 years with a line of best fit on the chart.

17 The Commission recognises differences in the differential between wages in states' public and private sectors. This may be due to differences in the responsiveness of the public and private sectors, labour markets of different industries varying, and state wage setting policies. There is also imperfect measurement in both sectors. These issues do not preclude the proxy being an unbiased estimate of state-specific pressure on public sector wages.

18 While noting that public and private labour markets are distinct, Professor Preston (who was engaged by the Commission in 2023 as a consultant to review the wages assessment) recommended the continued use of relative private sector wages as a policy neutral proxy for public sector wage costs.[1]

Commission decision

19 The Commission will continue to use relative private sector wage levels as a proxy for relative public sector wage costs.

[1] A. Preston, *Wage Costs Consultant Report*, report to the Australian Government, Commonwealth Grants Commission, 2023.

Choice of survey data source

20 The Commission proposed to continue to use the ABS Characteristics of Employment survey for the wage costs assessment because of its superiority in terms of sample size (relative to the Household Income and Labour Dynamics in Australia survey), reliability, and availability of control variables.

21 Several states encouraged investigation of other data sources for the purposes of validating the results, or to support potential alternative assessment methods.

State views

22 Several states expressed an interest in investigating other data sources as a potential alternative method or for validating results. Victoria suggested using the Household, Income and Labour Dynamics in Australia Survey. Victoria and Queensland suggested using the Person Level Integrated Data Asset.[2]

23 Western Australia expressed concerns that a household survey, such as the Characteristics of Employment Survey, is significantly affected by measurement error. It said this may be alleviated by an employer survey such as Average Weekly Earnings. It said that the reduced range of variables included in this survey would be more than offset by the increased quality of labour cost data. The ACT suggested considering the Monthly Employee Earnings and Weekly Payroll Jobs or the Linked Employer-Employee Database.

24 Tasmania expressed concern over the Tasmanian sample size in the Characteristics of Employment survey resulting in high standard errors. It also noted that variables on workplace size and employee health are not available in the Characteristics of Employment Survey and considered their absence may bias state coefficients.

25 Most states supported the continued use of the Characteristics of Employment survey, given the shortcomings of the suggested alternatives.

Commission response

26 For use in the wages assessment, a dataset should:

- have a large sample size in all states to estimate all state coefficients with a reasonable level of reliability
- have sufficient information about factors that determine differences in wages between individuals
- reliably measure the data it purports to capture.

[2] Formerly known as the Multi-Agency Data Integration Project.

27 Each of the proposed datasets has relative strengths and weaknesses in these domains. The Commission aimed to identify the data source with the best overall combination of the above attributes. Its analysis found the following.

- The Household, Income and Labour Dynamics in Australia survey allows for the control of endogeneity through a range of employee information, however it has an extremely small sample size. For example, it follows largely the same sample of fewer than 50 private sector employees in the Northern Territory every year. By comparison, the Characteristics of Employment Survey creates independent samples of over 500 private sector employees in the Northern Territory each year.
- The Person Level Integrated Data Asset (or other linked administrative datasets) has a much larger sample than survey-based data, however the comprehensiveness of the data is lower. It would be necessary to relate total income earned in a financial year (as reported to the Australian Taxation Office) to the occupation, hours and other attributes described for one week in August in the census. This weak link between the outcome of interest (annual income) and the predictors (employment status and occupation at a point in time) reduces the reliability of the model. This issue was accentuated with the 2021 Census which was undertaken while many workplaces were affected by COVID-19 emergency measures.
- Employer-based collections (such as Average Weekly Earnings, Single Touch Payroll data, or the Linked Employer-Employee Dataset) may provide a more precise estimate of labour costs. However, they only allow limited controls such as industry and hours. This means they cannot be used to adjust for key differences in state labour markets, such as level of education and mix of occupations.

28 The Commission built models using the Person Level Integrated Data Asset and the Household, Income and Labour Dynamics in Australia survey data. These models showed the same basic pattern of wage costs between states as found with the Characteristics of Employment survey.

29 The Commission considers that using an employer survey for the wages cost assessment would create omitted variable bias. Differences within industries between states due to workforce characteristics cannot be controlled for using employer survey data.

30 Analysis of Tasmania's concerns with potential bias due to omission of workplace size and employee health controls was conducted using the Household, Income and Labour Dynamics in Australia survey data and the Person Level Integrated Data Asset. The inclusion of health controls does not affect state coefficients. The effects of including controls for workplace size are inconsistent between datasets and inconclusive, although this issue warrants further investigation.

Commission decision

31 The Commission will continue to use the ABS Characteristics of Employment survey as the data source to measure differences in wage costs between states.

32 The balance of evidence does not provide a compelling case that there is bias in the model due to the omission of workplace size as an explanatory variable. However, the possibility of such bias cannot be ruled out, and the Commission will continue to investigate this issue after the 2025 Review as further data become available.

Use of the full sample of private sector employees

33 Some states suggested restricting the sample of private sector employees used in the regression to improve comparability with the public sector on the basis of gender or industry.

State views

34 Most states supported the use of the full sample of private sector employees. South Australia said that female private sector workers are more representative of pressures on public sector salaries than male private sector workers. It suggested using a weighted average of female and male estimates, combined in proportion to their share of the public sector.

35 Tasmania and South Australia also recommended the Commission consider removing industries where public sector employment was low, such as mining.

Commission response

36 The Commission saw merit in the idea that the accuracy of the model might be improved by either selecting a sub-sample of private sector workers more closely resembling the public sector workforce, or by reweighting the sample to better reflect the public sector profile. However, the Characteristics of Employment survey does not have a sufficiently large sample to support these options. The Commission considered the reduction in sample size from a female only model would outweigh any potential gains in accuracy, particularly given the objective to mitigate volatility in the assessment.

37 The Commission tested models reweighted by gender, and by industry, to better reflect the gender or industry makeup of the public sector. Both of these models had similar reductions in explanatory power and precision of estimates, without improving correlation to public sector relative wage levels.

38 The Commission does not consider that the added complexity of creating custom weights in the survey data is justified. Reducing the sample by omitting individuals based on their industry, occupation or gender is likewise hard to justify and greatly reduces the reliability of estimates.

Commission decision

39 The Commission will continue to use all the private sector employees survey data and will not exclude groups or apply custom weights in an effort to improve comparability with the public sector.

Choice of dependent variable

40 The model uses a range of variables to predict the logarithm of wages. In the 2020 Review, the Commission determined the dependent variable in its regression model would be the logarithm of weekly wages.

41 In the 2025 Review, the Commission proposed the use of hourly wages as the dependent variable to reflect that not all workers in the sample are paid fixed salaries. Weekly wages vary with hours of work, while hourly wages are more stable and comparable.

42 In the 2020 survey data, the Commission removed individuals who earned exactly $750 in the survey week, as these individuals were likely to have been receiving JobKeeper payments, leading to biased results. When using hourly wages as the dependent variable, those individuals who earned their full salary while working reduced hours in the survey period would also bias the model. The Commission therefore proposed to remove the 2020 survey data and not have it contribute to Commission estimates of relative state wages as it was an outlier which biased the results.

State views

43 Most states supported the use of hourly wages rather than weekly wages. Following advice from a report it commissioned, Queensland preferred weekly wages, saying the following.[3]

- The use of hourly wages is better suited to samples in which workers vary their hours of work, while weekly wages are more appropriate where workers' hours are comparable. The rationale of the assessment is to measure differences in the earnings of comparable private sector workers, which is better aligned with the 2020 Review approach (estimating weekly wages).
- Hourly wages may lead to spurious correlation, especially if measures of hours or other variables correlated with hours of work are included as regressors.
- A switch to hourly wage from weekly wage decreases the explanatory power of the model.

44 Queensland argued that most public sector workers are employed on a salary basis, rather than an hourly rate. It considered that this means any competition for state employees is based on weekly pay rather than an hourly wage.

45 No state disputed the necessity of removing the 2020 survey data, affected by JobKeeper payments, to avoid it biasing the Commission's estimates.

[3] C. Rose, L. Yu and A. Rambaldi, 'Modelling Public Wages Expenses Across States and Time Using Survey data', University of Queensland, 2023.

Commission response

46 The weekly hours worked in the Australian labour market vary considerably. In 2023, 29% of public and 31% of private sector workers usually worked less than 35 hours a week, while 12% of public and 16% of private sector workers usually worked more than 40 hours a week. Such differences mean an hourly wage-based model is preferred. Similar models in the academic literature generally use hourly wages unless no information on hours worked is available.[4] In such cases, those models are usually restricted to full-time workers, to ensure workers are comparable along the lines of hours of work.

47 Queensland workers, on average, have a longer working week than the Australian average, increasing their weekly wage. In the 2020 Review approach, part of this weekly wage was attributed to working in Queensland. Changing to hourly wages appropriately reflects that workers who work longer hours receive higher weekly wages.

48 The lower R^2 associated with an hourly wage model than a weekly wage model reflects that there is greater variation in weekly than hourly wages, and much of this variation in weekly wages is directly related to variation in hours worked. Hourly and weekly wage models can be functionally equivalent and have the same level of unexplained variation.

Commission decision

49 The Commission will use hourly wages rather than weekly wages as the dependent variable and will not use the COVID-19 biased estimates from 2020 when constructing relative state wage costs.

Simplification of the model

50 Most states argued that the regression model was overly complex and included too many controls. The consultant engaged by the Commission, Professor Preston, agreed and made suggestions for control selection.

51 In its investigation into the appropriate functional form for the model, the Commission applied the following criteria for inclusion of a control variable in the model.

- There should be a strong conceptual case that it more appropriately affects an individual's wages.
- It should materially affect state coefficients on average.
- It should improve the overall fit of the model.
- It should not increase the average standard error of state coefficients.

[4] A. Preston, *Wage Costs Consultant Report*, Commonwealth Grants Commission, 2023.

52 Following these criteria, these groups of changes were made:

- 11 distinct 5-year age categories replaced a derived measure of experience
- variables for usual working part-time, or more than full time were simplified
- over 200 detailed industry variables were replaced by 19 broad industry divisions
- gender interaction variables that reflect that women and men have different labour market experiences were removed, halving the total number of controls in the model.

State views

53 Most states agreed with the Commission's proposed approach. South Australia said that the criteria for inclusion of a control variable should be weighed against each other as a trade-off, rather than a list of requirements that must all be satisfied. New South Wales said that a variable must change state coefficients and have a strong conceptual basis. It disagreed that it must improve overall fit and decrease standard errors of state coefficients.

54 While agreeing with the criteria for inclusion of a variable, some states queried the treatment of specific variables. Queensland was concerned with the inclusion of usual hours indicators, while New South Wales and Victoria queried the changes to the level of detail in the industry and occupation variables.

Commission response

55 The Commission's criteria for control variables are applied as guiding criteria, rather than requirements. The Commission does not formally weight the relative importance of these criteria. However, the criteria to change state coefficients and have a strong conceptual basis are more important in model selection than improving overall fit and decreasing standard errors.

Usual hours worked variables

56 There are conceptual reasons for including a usual hours worked control. For example, an individual who usually works fewer hours is likely to accrue lower job-specific human capital with the same level of tenure, and therefore may have lower hourly earnings. Conversely, an individual who regularly works overtime is likely to experience more rapid human capital accumulation.

57 Part-time and long-hours effects have been identified in the literature.[5] These effects display a similar pattern to coefficient estimates from the model, where part-time workers earn a lower hourly wage and long-hours workers earn a higher wage. The coefficients for these variables differ significantly, indicating that these workers have significantly different wage levels, after controlling for all other differences.

[5] A. Bick, A. Blandin and R Rogerson, 'Hours and Wages', *The Quarterly Journal of Economics*, 2022, 137(3):1901-1962.

Industry and occupation specification

58 The Commission found that the inclusion of controls for detailed categories of industry as opposed to broad categories was not warranted. It increased standard errors for all states, and led to worse fit as measured by statistics which penalise overfitting. Changes to state coefficients were significant but inconsistent across years.

59 While there is a conceptual case for including detailed industry categories as controls, it does not consistently affect state coefficients and increases the uncertainty of the model.

60 Detailed occupation has a strong conceptual case for inclusion. It affects state coefficients, reduces average standard errors for all states and improves model fit based on all the statistics considered. As such, it was kept in its full detail. Detailed industry did not meet these criteria, and since industry and occupation are separate variables, they do not need to be included at the same level of detail.

Commission decision

61 As part of simplifying the regression model to measure relative state wage levels, the Commission applied guiding criteria for determining the inclusion of control variables in the model.

Reducing volatility in the assessment

62 The assessment has displayed significant volatility, yet wages are not characteristically volatile. The volatility of the assessment is instead related in large part to sampling variation between years of data.

63 To reduce this volatility, the Commission considered 2 methods of smoothing the estimates.

- A pooled approach where 3 years of the sample are combined in the regression and the sample would be centred on the assessment year.
- A weighted average approach that uses all the available historic data. Annual survey estimates would be indexed to current wage levels using the ABS Wage Price Index. These estimates would be averaged using weights according to their reliability for estimating wages in the assessment year of interest.

64 The Commission proposed to use the weighted average approach, on the basis that it allows for more data to be included in the assessment and it is robust to breaks in series.

State views

65 All states agreed with the proposal to implement some method to reduce volatility and improve the reliability of annual estimates, however, states were divided on which approach was superior. Most states supported the weighted average approach

due to the greater reduction in volatility of the estimates compared with the pooled approach.

66 New South Wales, Queensland and Western Australia opposed the weighted average approach on the grounds that it is overly complex. New South Wales and Tasmania were concerned that the weighted average approach was less contemporaneous. Queensland said that when using the same number of years of data, pooling generates more stable estimates than the weighted average approach.

Commission response

67 Table 3 shows that the weighted average approach reduces volatility more than using a 3-year pooled sample. It does this by using a sample that covers a longer time period than in the 3-year pooled sample, including all the historic estimates from 2016–17.

Table 1 State GST effects from annual updates to wage costs assessment

	Average absolute change			Largest change		
	U2021 to U2022	U2022 to U2023	U2023 to U2024	U2021 to U2022	U2022 to U2023	U2023 to U2024
	$pc	$pc	$pc	$pc	$pc	$pc
R2020 methods	46	37	57	112	109	184
Pooled model	34	30	39	129	70	68
Weighted averages	21	9	13	105	24	23

Note: All measures included in the table use the R2020 regression model

68 Regarding the view that the proposed method compromises contemporaneity, the Commission recognises that estimates become less influenced by newer years of data. However, insofar as wage movements are reflected in the ABS's Wage Price Index, all indexed estimates for a single year are reflective of the relative wage levels for that year.

69 Using additional years increases the statistical power and indexation ensures the data are contemporaneous. The Commission considers that pooling more than 3 years of data is not a viable option, as it is not possible to include more than 3 years in a pooled approach and remain centred on the assessment year. While Queensland pointed out that 3-year pooling may be more reliable than 3-year averaging, the averaging approach allows for a longer time series.

Commission decision

70 The Commission will smooth data over time using a weighted average approach, incorporating data from 2016–17 onwards.

Discounting assessed relative wage costs

71 The Commission has applied a 12.5% discount in the wage costs assessment reflecting uncertainty around the reliability of the survey-based coefficient estimates, the precision of the model and the strength of the correlation between private and public sector wages.

State views

72 State views on the appropriate level of discounting were mixed. Victoria said that a 12.5% discount remains appropriate. Some states said no discount is required. Others said a 25% discount is appropriate.

73 Some states argued to remove the discount on the grounds that:

- the Characteristics of Employment Survey and the Commission's model are reliable
- the relationship between public and private sector wage levels is conceptually and statistically strong
- the approach is supported by independent consultants
- the Commission has improved its methods
- the approach already under-estimates wage differences.

74 Other states argued to increase the discount on the grounds that:

- the Characteristics of Employment Survey and the Commission's model are unreliable
- the relationship between public and private sector wage levels is not conceptually or statistically strong
- independent consultants have differing views on aspects of the Commission's approach
- COVID-19 has highlighted weaknesses in the Commission model.

Commission response

75 The changes to the method for assessing wage costs in the 2025 Review are expected to improve the reliability and reduce the volatility of the wages assessment. However, uncertainty from the use of private sector proxy data, as identified in the Commission's consultant's report, remains. There are also some differences between state private sector labour markets that are not fully controlled for in the Commission's model. This continues to justify some discounting. On balance, the Commission considers the existing 12.5% discount remains appropriate.

Commission decision

76 The Commission will maintain a 12.5% discount on the wage costs assessment, reflecting continuing uncertainty about measurement issues and the strength of the private sector wages proxy.

Wage to non-wage costs

77 The wage costs assessment is only applied to wage-related expenditure. The Commission classifies spending as 'wage related', 'non-wage related' or 'other'. The wage related proportion of the 'other' (unattributed) spending is estimated using the proportion of 'wage related' to 'non-wage related' costs.

78 In the 2020 Review, the Commission considered that these classifications were unreliable for housing, roads and transport due to relatively low 'wage related' costs and relatively high 'other' costs. For these categories, the wage related proportion of all costs was estimated as the average wage related proportion of all other categories.

79 Victoria raised concerns with this approach, stating that it greatly overestimated the wage related proportion of expenses in those categories. Housing, roads and transport are more capital intensive than other assessments and have a lower wage related proportion of expenses than the average.

80 In response to concerns, the Commission proposed to impute 'other' costs in all categories based on the ratio of total 'wage related' and 'non-wage related' spending.

State views

81 No state raised objections to changing the way housing, roads and transport wage shares of expenses are imputed.

Commission decision

82 The Commission will treat all categories in the same manner and estimate wage costs by applying the ratio of overall total wage to non-wage expenses to the 'other' (unattributed) expenses in every category.

GST impacts of method changes

83 The impact on the GST distribution from the method changes is shown in Table 2.

Table 2 Impact on GST distribution of method changes, wage costs, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Changes to model	-79	211	-237	-104	118	77	60	-46	465
Smoothing	-83	85	139	-243	47	53	0	2	326
Changes to wage proportions	-33	-1	40	-24	23	7	-9	-3	69
Total	**-194**	**295**	**-58**	**-370**	**187**	**136**	**51**	**-47**	**669**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Changes to model	-9	29	-41	-34	62	133	124	-180	17
Smoothing	-10	12	24	-79	24	91	0	8	12
Changes to wage proportions	-4	0	7	-8	12	12	-19	-11	2
Total	**-22**	**41**	**-10**	**-121**	**98**	**236**	**105**	**-182**	**24**

84 Wage costs are assessed in all expense categories and represent a very large proportion of total state expenditure. As such, even relatively small changes to the wage costs assessment method can have large effects on the GST distribution.

85 The largest effects of changing the model were due to the shift from usual hours to paid hours resulting in a closer relationship between wages and hours worked. The new model more appropriately captures the effects of hours worked on wages, preventing the higher weekly wages of individuals working longer hours being inappropriately attributed to other factors, such as their state of residence.

86 New South Wales and Western Australia had average estimated relative wages in 2020–21, 2021–22 and 2022–23 above their trend levels, and so smoothing has reduced their assessed GST needs.

87 The assessed wage shares of costs in housing, transport and roads have been reduced (changes in wage proportions in Table 2). The effect of these changes varies for each state depending on their relative needs for spending in these areas and their relative wage levels.

22. Geography

Review outcomes

- The following change was made to the assessment.
  - The general cost gradient will be based on a wider range of component-specific cost gradients. It will be the weighted average of the cost gradients for schools, admitted patients, emergency departments, non-admitted patients, prisons, criminal courts, post-secondary education, and investment (Rawlinsons). The weights will be based on shares of national spending.
- The Commission considered but did not change the following.
  - Regional and service delivery scale costs will continue to be estimated using the general cost gradient where a service-specific cost gradient cannot be reliably measured. The general cost gradient will only apply where there is a strong conceptual case that there are higher costs in servicing more remote areas. The 25% discount on the general cost gradient will be retained.
  - Regional cost and service delivery scale cost adjustments will apply to the same assessments as in the 2020 Review.
  - An interstate non-wage costs assessment will not be introduced due to a lack of evidence supporting the conceptual case for an assessment.
  - The ABS classification of remoteness will be retained.
  - Remoteness gradients will continue to be based on where services are delivered and applied to where people live.
  - Aware of the potential for double counting of First Nations and regional costs, the Commission will continue to take measures to avoid double counting.

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
- GST impacts of method change.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the geography chapter of the *Commission's Assessment Methodology*.

Issues considered

Where the general cost gradient is applied

6 There is a conceptual case for a regional costs adjustment where there is a higher cost in maintaining or supplying a service in more remote areas. In addition, there is a conceptual case for a service delivery scale costs adjustment if fewer people will be serviced per staff member in smaller centres. This can occur because:

- the indivisibility of labour means a small user-population requires a high staff to client ratio
- there can be high travel times between visiting clients in sparsely populated areas.

7 For expense components where a conceptual case for regional costs or service delivery scale exists, but costs cannot be directly measured, the general cost gradient is applied.

State views

8 New South Wales expressed concern about applying remoteness costs from one assessment to another. It accepted using the general cost gradient when specific cost data cannot be identified.

9 Victoria considered the general cost gradient was no longer appropriate in its current form because the data that supported its application were based on categories that now have specific cost gradients. Victoria said there was a lack of robust evidence supporting the application of the general cost gradient where service-specific cost data are unavailable.

10 Victoria said where data that can measure the relationship between costs and remoteness are available from some states, but not enough to form the basis of a specific cost gradient, the available data should be used to determine whether there is a relationship between costs and remoteness.

11 Queensland suggested using the general regional cost gradient in the urban transport assessment.

Commission response

12 Across a range of services, the Commission has found substantial evidence that the cost of delivering services is higher in more remote locations and has developed several assessments using service-specific data on remoteness costs. The consistently positive gradient (although with varying slopes) supports the conceptual

case that costs can reasonably be expected to be higher in more remote locations for other services.

13 The Commission investigated a component-specific regional cost gradient in the social housing assessment. A robust calculation of a cost gradient was not possible because only 2 states could provide data. These data showed a positive relationship between remoteness and costs, supporting the conceptual case for remoteness being a driver of state spending in social housing. Further analysis of these data is discussed in the housing chapter of *Review Outcomes*.

14 The Commission considered the suggestion to include a regional costs adjustment in the urban transport assessment. The general regional cost gradient is calculated based on the costs of delivering services across the full range of locations within each remoteness area. Urban transport is only provided in significant urban areas. A regional cost gradient that incorporates the higher costs in small towns and rural areas of outer regional or remote Australia is unlikely to be a reasonable proxy for the higher costs in cities in those areas. The Commission also notes that increased congestion and night maintenance in less remote areas could also influence costs. As such, the Commission has not applied the regional cost gradient to the urban transport assessment. Other prospective approaches to considering the effect of remoteness on urban transport are considered in the transport chapter of *Review Outcomes*.

Commission decision

15 The Commission will continue to estimate regional and service delivery scale costs by using a general cost gradient where there is a strong conceptual case that there are higher costs in servicing more remote areas, but a service-specific gradient cannot be reliably measured.

16 The services to which the general cost gradient will be applied are shown in the geography chapter of the *Commission's Assessment Methodology*.

Data used in the calculation of the general cost gradient

17 In the 2020 Review, the general cost gradient that was applied to a range of services was based only on schools and admitted patients costs data. In response to state comments, the Commission considered whether additional service-specific cost data could improve the representativeness of the general cost gradient.

State views

18 Most states supported the inclusion of more service-specific cost gradients into the general cost gradient calculation, noting this approach allows the general cost gradient to be more representative of a broader range of state services. Most states supported weighting these cost gradients according to their share of total national spending on the relevant services.

19 States considered that component-specific cost gradients should reflect the likely remoteness costs of the state services to which it is applied and should not be included in the general cost gradient if:

- the service is more centralised or more decentralised than typical state services
- the service is not similar to other state services
- they reflect capital (for example, construction) rather than recurrent costs
- they produce an outlier result
- they are based on limited or poor-quality data.

20 Western Australia proposed the Rawlinsons cost gradient for measuring regional costs in some assessments. It said there was no need to use the Rawlinsons averaged state gradients because policy influence was not an issue. This was based on the view that Rawlinsons data primarily came from the private sector and therefore, acts as a proxy for the public sector in the same way as the Commission's wage costs factors.

Commission response

21 States provide services in a range of different ways. Some services, such as welfare, housing and policing, involve state officers travelling to a client's address. Other services are delivered from a centralised location. The extent of centralisation varies, with primary schools being relatively decentralised, whilst hospitals and prisons are much more centralised. This, along with other differences between service delivery models is likely to affect remoteness costs. However, the Commission has no information on the appropriate proxy for the average of all services to which the general cost gradient is applied.

22 The Commission agrees with Western Australia that the Rawlinsons cost gradient could be used to capture some remoteness costs. While Rawlinsons measures construction costs, state services involve repairs and maintenance of infrastructure, especially in housing. Since construction-related costs are likely to be relevant to several areas of service delivery, it is appropriate to include the Rawlinsons cost gradient in the general cost gradient calculation.

23 The Rawlinsons cost gradient includes differences in wage costs in the construction industry in different areas. The Commission's wage costs assessment includes differences in wages paid in different parts of the state. Using a state-specific Rawlinsons measure could potentially double count some interstate wage effects. Therefore, the Commission uses the national average Rawlinsons cost gradient.

24 The Commission agrees with states that the general cost gradient should reflect likely remoteness costs of the state services to which it is applied. Remoteness gradients for water and electricity subsidies capture 2 concepts:

- it is more expensive to provide subsidies in more remote areas (remoteness costs)

- people are more likely to receive subsidies in more remote areas (use rate).

25 The general cost gradient aims to capture the first of these (the added costs of delivering a service in a remote location) only. Higher use rates associated with remoteness are not intended to be captured by the general cost gradient. Therefore, the Commission agrees with New South Wales and Victoria that it would be inappropriate to include water and electricity subsidies in the general cost gradient as these cost data are not representative of other state services.

Commission decision

26 The Commission will improve the representation of the general cost gradient by expanding the number of specific cost gradients in the general cost gradient calculation. The weighted average of the cost gradients for the following assessments, based on their share of national spending, will be used to calculate the general cost gradient:

- schools
- admitted patients
- emergency departments
- non-admitted patients
- prisons
- criminal courts
- post-secondary education
- investment (Rawlinsons).

27 Data used in the general cost gradient will be updated annually where possible.

28 The cost gradient for the justice assessment method will be finalised in consultation with states and applied in the 2026 Update. If regional costs or service delivery scale costs are removed from the prisons or courts assessments, they will be removed from the calculation of the general cost gradient.

Discounting the general cost gradient

29 In the 2020 Review, the general cost gradient was discounted by 25% to reflect uncertainty around the reliability of the gradient. In response to state comments, the Commission considered whether the discount remained appropriate.

State views

30 New South Wales and Victoria recommended a larger discount to the general cost gradient be applied if service-specific gradients were not available. New South Wales said a larger discount could be applied broadly or to specific components.

31 Queensland and Western Australia suggested less (or no) discounting of the general cost gradient. They noted that discounting could be removed from all components or from specific components.

32 The Northern Territory said discounts to cost gradients should only be applied with supporting evidence.

Commission response

33 The general cost gradient is discounted to reflect uncertainty around the strength of the gradient when it is applied to areas where a specific cost gradient cannot be measured. The Commission has no reliable basis to determine whether the general cost gradient is more appropriate for some services than others. As such, it has no basis to apply different levels of discount to the general cost gradient when applied to different services as proposed by New South Wales and Queensland.

34 The additional cost data included in the calculation of the general cost gradient makes the general cost gradient more representative of the range of state services. However, the Commission does not consider that the level of uncertainty associated with the application of the general cost gradient has changed sufficiently to warrant a reduction in the level of discount.

Commission decision

35 The Commission will retain the 25% discount on the general cost gradient.

Category-specific measures of regional costs and service delivery scale costs

36 For assessments that have a conceptual case for including regional cost and service delivery scale cost adjustments, a component-specific or category-specific cost gradient which uses data relevant to the specific service is preferred to the general cost gradient. In response to state comments, the Commission considered whether more category-specific measures of regional costs and service delivery scale costs could be developed. Where category-specific measures are potentially available, they have been considered in the relevant chapters of *Review Outcomes*.[1]

State views

37 Queensland said regional costs and service delivery scale costs should be applied more broadly. Queensland recommended applying service delivery scale to all components where regional costs are measured. It said the Commission should prioritise applying service delivery scale to:

- Indigenous community development
- other community development and amenities
- biodiversity and landscape protection
- agriculture regulation
- mining regulation

[1] See the schools, post-secondary education, health, services to communities, housing and justice chapters of *Review Outcomes*.

- other business regulation
- post-secondary education
- homelessness services
- other welfare
- social housing
- service expenses.

Commission response

38 There is a conceptual case for a regional costs adjustment where there is a higher cost in maintaining or supplying a service in a more remote area.

39 There is a conceptual case for a service delivery scale costs adjustment if fewer people will be serviced per staff member in smaller centres.

40 These 2 concepts of regional costs and service delivery scale costs are separate, and their conceptual cases should be considered individually within each component. Consequently, service delivery scale should not be applied to all components where regional costs are measured. The Commission considered it remained appropriate to apply regional and service delivery scale costs to components as it did in the 2020 Review.

Commission decision

41 The Commission will apply regional costs and service delivery scale costs to the same assessments as in the 2020 Review.

Cost differences between major cities

42 The Commission captures some cost differences between major cities. For example, wage pressures are recognised through the wage costs assessment and differences in construction costs are recognised in the investment assessment. Higher costs in Hobart and Darwin are reflected in their classification as inner regional and outer regional cities respectively.

43 There is a conceptual case that differences in freight costs and travel costs could lead to more isolated major cities, especially Perth, having materially higher costs than other major cities. However, the Commission has not been able to identify reliable evidence supporting this conceptual case.

State views

44 Most states said they were unaware of changes in the conceptual case or new data that would allow for a reliable assessment of non-wage costs. New South Wales and Victoria raised concerns over a judgement-based approach.

45 Western Australia and the ACT proposed reintroducing the 2015 Review's isolation adjustment. Western Australia said the additional costs associated with the isolation

of Perth are not currently captured. It said that Perth had fewer Tier 1 builders than other major cities because shorter travel distances to other major cities allows for more choice in where builders take projects. Western Australia said its isolation has led to a thin market, increasing prices.

Commission response

46 Perth is more geographically isolated than other major cities. However, the Commission is not aware of evidence that indicates this consistently and materially increases overall costs. For example, data suggest that petrol in Perth costs less than in other major cities. Many of the inputs states use to provide services are available in major cities through national supply chains with nationally consistent pricing policies.

47 The 2020 Review found interstate travel was likely the largest driver of differences in major city non-wage costs, although it was unlikely to be material. As technology reduces the need for in-person meetings, these costs are likely to become less significant.

48 Canberra can have higher costs for some inputs, such as fuel. However, there is not evidence that the ACT consistently faces increased costs for delivering services compared to other major cities.

49 The Rawlinsons index provides an estimate of the relative cost of construction across all projects. In 2022-23, Perth was 3% cheaper than Sydney. It also provides the relative costs of specific projects. For large construction projects, Perth is also generally slightly cheaper than Sydney. For a general hospital, it is about 8% cheaper, an indoor arena around 1% cheaper, and a partly suspended, single tier grandstand, around 6% cheaper. Perth does not appear to have higher costs than are measured by the Commission's existing assessments.

Commission decision

50 The Commission will not introduce an interstate non-wage cost assessment.

Remoteness classification

Definitions of remoteness

51 The Commission uses the ABS' 5 remoteness areas to group populations by remoteness. The ABS remoteness areas are based on the Accessibility/Remoteness Index of Australia Plus (ARIA+). This measure aims to group locations which face similar circumstances in accessing services. In response to state comments, the Commission considered the appropriateness of the ABS classifications for the Commission's purposes and whether another classification would be suitable.

State views

52 Victoria supported retaining the ABS remoteness classification. It noted using standard definitions of remoteness allowed for costs to be measured across a large range of categories and allow for comparability with other datasets.

53 Some states said that the ABS ARIA+ remoteness definitions do not allow for differences in service delivery costs to be accurately captured.

54 Queensland said the ARIA+ model does not fully recognise differences in service delivery, particularly for dispersed regions, and recommended the Commission review its remoteness classification in advance of the next review.

55 Western Australia raised concerns that towns with different accessibility profiles can be classified in the same remoteness classification. It raised 3 concerns with the ABS' approach.

- The ABS allows for a centre in another state to be taken into account in the assessment of a location's remoteness.
- The ABS assumes that distance from differently sized service centres are equally important (each receiving a 20% weight in the calculation of ARIA+ scores).
- The ABS assumes that costs increase linearly to a point, before plateauing.

56 Western Australia raised concerns that the Commission assesses a higher cost for providing services due to remoteness for Tasmania than for Western Australia. This seems counterintuitive given that Western Australia covers a land area 36 times larger than Tasmania, with over 5 times the population.

57 Western Australia noted costs are higher in locations further from major cities and said averaging of expenses across remoteness areas was inappropriate unless the classifications can be made more comparable. Western Australia noted that the ABS' remoteness classifications, which cap the relative distances to service centres at 3 times the national average, limit the ability to capture costs in highly isolated areas. It said that petrol prices and time costs for travelling continue after travelling further than 3 times the average distance.

58 Western Australia recommended the Commission consider a range of possible alternative measures of remoteness (see Draft Report for details).

59 The Northern Territory said that road quality and seasonal impassability meant that not all road distances were equivalent. It said remoteness is dramatically underestimated for much of the Northern Territory. It suggested the Commission consider accessibility and road conditions when classifying remoteness areas.

Commission response

60 The aim of remoteness classifications is to group areas that share broadly comparable circumstances in access to services. Not all towns within a classification have identical characteristics or face identical costs of service provision. However, to

measure remoteness impacts in assessments, towns need to be grouped in some way.

61 The Commission noted that using the ABS classifications allows for remoteness impacts to be measured across many assessments and ensures classifications are consistent with other datasets.

- For locations near interstate service centres, such as Tweed Heads in northern New South Wales, some services (such as state services provided from head office) would be provided from Sydney. Other services provided privately may be sourced from Brisbane. Expenses to attract and retain staff in remote areas is a major driver of remoteness costs. The difficulty in attracting and retaining staff in the area would reflect its proximity to Brisbane, not Sydney.
- There is a lack of evidence to determine whether distance from a larger centre is significantly more important than distance to smaller centres when measuring costs. The Commission considered that the ABS assumption of a 20% weight for each service centre size remained appropriate in the absence of evidence for change.
- While travel costs continue after travelling more than 3 times the national average distance, the cost per distance is likely to diminish as distance increases. For example, the added cost of travelling 110km rather than 10km may be substantial. However, the added cost of travelling 1300km rather than 1200km may not be as high. Assuming the diminishing cost of distance is more reasonable than assuming no diminution of costs with distance.

62 The Commission assesses Tasmania as having higher costs in providing services due to remoteness than Western Australia. Western Australia does have 11 times the remote population of Tasmania, and 26 times the very remote population. However, the cost effect of this remote population is offset by the large proportion of Western Australians living in Perth. The proportion of Western Australians living in a major city is 79%, the second highest of any state, after the ACT.

63 The ABS remoteness areas classification is a simplification of the effect that distance has on state budgets. To develop a superior classification that grouped areas with similar cost profiles across the country would require states to provide nationally comparable data on the cost of service delivery at a granular level, so that different aggregations of areas could be tested. Aggregations could include areas that are seasonally inaccessible, areas close to regional centres but distant from major cities, or areas distant from a sealed road. States have not been able to provide such data in the past.

64 Much of the Northern Territory, northern Western Australia and Queensland experience seasonal impassability. Most of these areas are already classified as very remote so adjusting for seasonal impassability would not change their classification. Noting the Commission's preference for nationally consistent classifications, the Commission will continue to use the ABS remoteness classifications.

Commission decision

65 The Commission will retain the ABS standard classicisation of remoteness.

Classification of Hobart

66 Under the ABS' remoteness classifications, Hobart is defined as an inner regional area. In response to state comments, the Commission considered whether Hobart's population was approaching that of a major city, and the potential consequences.

State views

67 Tasmania raised concerns that Hobart's population may reach 250,000. While this would not significantly change the actual cost profile of services in Tasmania, it would significantly change the Commission's assessed cost profile.

68 Western Australia said that Hobart's significant urban area has a population approaching 250,000, and therefore, its cost profile is approaching that of a major city.

69 Western Australia said that there needs to be evidence to show that Hobart is quantitatively different to other major cities. It said that there was quantitative evidence that Western Australia faces different costs due to remoteness.

Commission response

70 The Commission concluded that Hobart is unlikely to be reclassified as a major city following the 2026 Census. It considered that it is appropriate to group cities and towns of similar sizes. ARIA+ allows grouping of such towns and therefore, the Commission considered that Hobart should be grouped with other cities of about the same size using the ARIA+ model.

71 The Commission uses the ABS remoteness area classification and assumes that areas within each remoteness area are broadly comparable.

Commission decision

72 The Commission will retain the ABS remoteness classifications.

Where people receive services

73 Remoteness gradients are calculated based on where services are delivered and applied based on where people live. In response to state comments, the Commission considered whether this remained appropriate.

State views

74 Victoria expressed concerns that remoteness loadings are based on where people live rather than where services are delivered.

Commission response

75 Where services are delivered is the attribute that drives the cost of delivering services. Where people live is the demographic attribute that is measurable and differs between states. Therefore, remoteness gradients are measured based on

where a service is delivered and applied to where people live, taking account that people do travel for services.

76 This principle can be seen in the 2025 Review health assessment. In the admitted patients component, the additional costs of remote hospitals are calculated. These additional costs are then applied to the extent to which people who live in remote areas use remote hospitals. This is equivalent to measuring the national spend on a service delivered remotely, and allocating it in proportion to each state's remote population.

Commission decision

77 The Commission will retain measuring remoteness gradients based on where services are delivered and applying remoteness gradients to where people live.

Potential misallocation of regional cost effects

78 First Nations people live disproportionately in more remote areas. It is therefore possible that costs attributed to First Nations populations could be attributed to remoteness. In response to state comments, the Commission considered if misallocations of regional cost effects could be present in its assessments, and whether there is any potential double counting of influences.

State views

79 Victoria raised concerns about double counting, noting multiple drivers are heavily influenced by geography. It said compounding effects could be present if drivers are measuring the same underlying cost. It said this could lead to issues in accurately identifying the discrete impact of one driver from the others. Victoria highlighted the importance of identifying the unique impact of each driver in isolation from others. Victoria raised particular concerns in the social housing assessment.

Commission response

80 The Commission generally measures disaggregated effects to avoid double counting. For example, total spending on remote First Nations populations will be allocated to states based on their proportion of First Nations people in remote locations. For analytical purposes the Commission allocates this spending between the remoteness driver and the First Nations driver. This analysis helps to explain the drivers of GST but does not affect the GST distribution.

81 Concerns surrounding the social housing assessment are addressed in the housing chapter of *Review Outcomes*.

Commission decision

82 The Commission will continue to apply its methods to avoid double counting in assessments.

GST impacts of method changes

83 The Commission included more component-specific cost gradients in its general cost gradient calculations. This resulted in minor changes to the slopes (slightly steeper for regional costs and slightly flatter for service delivery scale costs). Overall, this increased the assessed GST needs of New South Wales, Victoria and Tasmania and decreased the assessed GST needs of Queensland, Western Australia, South Australia, the ACT and the Northern Territory.

84 The GST impacts of these changes are reflected in the relevant category chapters of *Review Outcomes*. Where possible, they have been separately identified from other changes.

23. Socio-economic status

Review outcomes

- No changes were made to the assessment method for socio-economic status.
  - The Indigenous Relative Socioeconomic Outcomes index and the Non-Indigenous Socio-Economic Indexes for Areas measure will be retained to assess socio-economic status.
  - Socio-economic status of First Nations and non-Indigenous populations will continue to be measured in as much detail as can be supported by the data. For cases where the cost and use patterns shown in the data do not align with the conceptual case, the Commission will aggregate the data or not differentially assess socio-economic status.
- Following the completion of the 2025 Review, the Commission will work with states to:
  - initiate, as part of its forward work program, a review of measures of First Nations socio-economic status, including the Indigenous Relative Socioeconomic Outcomes index, to ensure Commission's methods appropriately capture differences in socio-economic status among the First Nations population, including the impact of changing identification patterns
  - investigate the appropriateness of using newly available data from the Person Level Integrated Data Asset (PLIDA) to measure socio-economic status among the non-Indigenous population.

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 socio-economic status chapter of the *Commission's Assessment Methodology*.

Issues considered

Granularity

6 Within each assessment where socio-economic status is measured, the Commission considers what level of granularity is appropriate. There can be a trade-off between more granular population measures, which allow cost differences to be estimated between groups, and the reliability of those estimates. In response to state comments, the Commission considered whether its approach to balancing these trade-offs remained appropriate.

State views

7 The Northern Territory said the Commission's use of quartiles and quintiles in classifying populations understates levels of disadvantage because the Northern Territory's First Nations populations cluster at the lower end of each band. It said existing assessment methods do not account for this appropriately.

8 The Northern Territory said in remote areas the Commission does not necessarily disaggregate by socio-economic status and that this further understates its level of disadvantage.

Commission response

9 The Commission aims to balance data disaggregation with reliability. There is a trade-off between having a large enough population to produce a reliable estimate of national spending on each population group and having a small enough population with the granularity to measure differences between heterogenous groups.

10 The Commission endeavours to have the most detailed disaggregation that can support reliable patterns of state spending. For example, if disaggregated data show higher use rates in the middle quintile compared with a lower quintile (contrary to the overall trend), the Commission may combine the quintiles. This reflects 3 considerations:

- estimates based on small samples can be volatile
- some geographic data are aggregated from ABS Statistical Area Level 2 or postcodes and do not perfectly align with population data aggregated from Statistical Area Level 1
- the measure of socio-economic status may not be an accurate proxy for the underlying driver of differential use.

11 As part of each review, the Commission retests each assessment to ensure the most granular data possible are used.

12 As part of the 2025 Review, the Commission considered the measures of socio-economic status used in the schools assessment. It investigated if more granular measures of socio-educational disadvantage would be appropriate. It compared using the most disadvantaged 25% of students (the approach used in the

2020 Review) with splitting the bottom quartile into 2 sub-groups comprising of the most disadvantaged 10% of students and the most disadvantaged 11–25% of students. The Commission found that using the more granular approach (the most disadvantaged 10% and 11–25% of students) led to inconsistent results in the model. Therefore, the Commission concluded that on balance, to ensure more reliable estimates, it was appropriate to continue using the most disadvantaged 25% of students. More information on this issue is included in the schools chapter of *Review Outcomes*.

Commission decision

13 The Commission decided to retain the 2020 Review approach of measuring the socio-economic status of First Nations and non-Indigenous populations in as much detail as can be supported by the data. For cases where the cost and use patterns shown in the data do not align with the conceptual case, the Commission will aggregate the data or not differentially assess socio-economic status.

First Nations Socio-economic status

14 The Commission uses the Indigenous Relative Socioeconomic Outcomes index to assess the socio-economic status of First Nations populations. It measures socio-economic status separately for First Nations and non-Indigenous people because the socio-economic status of First Nations people in a location is often different from that of the non-Indigenous population living there. The Commission proposed no changes to this approach.

State views

15 The Northern Territory said given the significant non-demographic growth in the First Nations population, the Commission should review the Indigenous Relative Socioeconomic Outcomes index. It said the Commission should ensure the Indigenous Relative Socioeconomic Outcomes index remained a suitable measure of Indigenous socio-economic status. The Northern Territory noted this might occur after the 2025 Review has been finalised.

Commission response

16 The Indigenous Relative Socioeconomic Outcomes index was developed in 2001 by the Centre for Aboriginal Economic Policy Research at the Australian National University and has been updated using census data every 5 years.[1] Throughout these updates, socio-economic outcomes for First Nations populations have differed markedly between areas. There has been relative stability in the ranking of regions over time.

[1] Centre for Aboriginal Economic Policy Research, *Area-level socioeconomic outcomes for Aboriginal and Torres Strait Islander Australians in the 2016 and 2021 Censuses*, Australian National University Website, 2023, accessed 16 September 2024.

17 Non-demographic growth in the First Nations population, led by an increasing propensity to identify as First Nations, has been strongest in the south-eastern states. Newly identifying First Nations people may not have the same level of disadvantage as First Nations people who continually identify as First Nations in the same area. Newly identifying First Nations people would reduce the average level of disadvantage of First Nations people in an area. The Commission's use of the Indigenous Relative Socioeconomic Outcomes index and remoteness is designed to ensure the socio-economic status of different groups of First Nations people are captured.

Commission decision

18 As part of its forward work program, the Commission will seek to review the appropriateness of measures of socio-economic status for the First Nations population.

Non-Indigenous Socio-Economic Index for Areas

19 In the 2020 Review, the Commission used the Non-Indigenous Socio-Economic Indexes for Areas to measure socio-economic status for the non-Indigenous population. This measure is updated 5-yearly using ABS census data.

20 The Person Level Integrated Data Asset (PLIDA), coordinated by the ABS, allows for linking of personal level data across a range of agencies. These data have matured since the 2020 Review and offer the potential to produce a measure of socio-economic status for the non-Indigenous population.

21 The Commission identified a preliminary approach using these data, combining 3 measures of socio-economic status. The measures included the proportion of people:

- receiving selected Department of Social Services pensions
- with prescriptions for certain lifestyle related conditions
- with a high income.

22 This combined measure predicts independent outcomes driven by socio-economic status with similar accuracy to census-based measures in the census year. It is available annually and in intercensal years may represent a better measure of socio-economic status.

23 The Commission considered whether these data should be used to produce a more contemporaneous (annual) measure of socio-economic status. The Commission considered the accuracy, robustness, coverage and policy influence of the data as well as the implications on simplicity and stability of the measure.

State views

Annual measure of socio-economic status for non-Indigenous people

24 Most states supported investigating an annual measure of socio-economic status. New South Wales suggested including additional variables, such as housing stress.

25 Some states said the Socio-Economic Indexes for Areas was the more accurate measure at census time but that PLIDA could be used to update these measures annually.

26 Some states had strong concerns about PLIDA being used to measure socio-economic status. Western Australia and South Australia emphasised the need for rigorous testing of the measure, with any discrepancies from ABS measures or unexpected volatility being thoroughly examined.

27 All states supported working with the Commission on further analysis going forward.

Reliability

28 Some states felt that 3 indicators would not be sufficient for a comprehensive index. Victoria was particularly concerned by the lack of employment and education indicators.

29 Some states had concerns over the use of medical indicators, noting that policy differences and access to services could bias the results. Queensland and the Northern Territory expressed concerns that individuals in remote areas faced barriers to accessing prescription drugs and Department of Social Services pensions.

30 Some states were concerned by the inclusion of a high-income indicator. They felt that it would not be helpful in distinguishing levels of need among disadvantaged populations and would miss disadvantaged individuals in areas with diverse incomes.

Simplicity and stability

31 Victoria said that using PLIDA data could increase inconsistencies between measures of socio-economic status of First Nations populations and non-Indigenous populations.

32 Queensland said any new measure should be tested against the Non-Indigenous Socio-Economic Indexes for Areas and be rescaled to this every 5 years.

33 Some states noted a trade-off between contemporaneity and stability. Western Australia cited the potential volatility impact of using only 3 indicators. South Australia noted the benefits of stability in assessments.

Commission response

34 The Commission considers there is potential for PLIDA data to allow for material improvements to socio-economic status measures by allowing for a higher level of contemporaneity. However, there is a need for further analysis and testing of the PLIDA data before implementing any change. The Commission will continue to

investigate the appropriateness of PLIDA data in consultation with states with a view to incorporating it in a future review.

Commission decision

35 The Commission will retain the Non-Indigenous Socio-Economic Indexes for Areas measure to assess socio-economic status in Australia. The Commission will undertake further work on PLIDA data in consultation with states following the 2025 Review to inform consideration of using the data in a future review.

GST impacts of method changes

36 There are no method changes to this assessment.

24. National capital

Review outcomes

- The assessment was discontinued because an assessment based on the available data was no longer material and was unlikely to become material before the next review.
- The additional costs required for capital projects to meet the requirements of the National Capital Plan (including the light rail and Canberra Theatre redevelopment projects) were not able to be included in an assessment because of data limitations.
- If robust data on the additional costs for capital projects become available, the Commission will investigate in a future review whether an assessment for national capital expenses can be developed and is material.

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.

Issues considered

Materiality

5 The Commission considered whether the assessment should be discontinued on materiality grounds.

6 The 2020 Review national capital assessment method captured additional costs related to the operation of the National Capital Plan and for the use of Australian Federal Police. The assessment moves less than $40 per capita distribution away from an equal per capita distribution and is therefore not material based on the Commission's 2025 Review materiality thresholds. This is largely driven by a decrease in the ACT's actual average police salary, which has fallen below its assessed average

police salary.[1] This resulted in negative assessed expenses for the assessment's police allowance. This allowance was designed to recognise that the wages of Australian Federal Police, whom the ACT must use as its police force, were historically higher than state police wages.

7 In the 2024 Update the assessment was suspended because the negative police allowance more than offset the planning allowance. Consistent with the 2020 Review method, the ACT was assessed to have no additional costs related to national capital matters.

State views

8 Most states supported discontinuing the assessment, with some noting that it would be consistent with the Commission's materiality thresholds and supporting principles.

9 The ACT did not support discontinuing the assessment. It recommended the Commission include the additional costs that some of its capital works projects incur because of the need to meet the National Capital Plan's requirements. It noted the impact the plan had on the Canberra Theatre redevelopment and light rail projects' costs. It said that including these costs would likely make the assessment material.

10 The ACT also requested the planning allowance be continued and the police allowance suspended temporarily. The ACT expected its average actual police salary to revert to being higher than its average assessed police salary in the future.

Commission response

11 While Australian Federal Police wages may increase in the future, the Commission does not consider it likely that they would increase faster than state wages such that an assessment would become material before the next review. The ACT's average actual police salary would have to be substantially higher than its average assessed police salary for the assessment to be material.

12 While the Commission acknowledges the ACT incurs additional costs in ensuring its capital works projects meet the requirements of the National Capital Plan, it is not aware of any data that would allow it to determine what costs are involved in meeting the plan's requirements. Therefore, the Commission is unable to quantify the impact of the plan on the ACT's capital works projects.

13 If suitably robust data on the additional costs involved in the ACT's capital works projects become available, the Commission will investigate in a future review whether an assessment for national capital expenses can be developed and is material.

[1] The ACT's assessed average police salary is calculated as the state average actual police salary multiplied by the ACT's wage cost factor.

Commission decision

14 The Commission will discontinue the national capital assessment because an assessment based on the available data is no longer material.

15 The additional costs required for capital projects to meet the requirements of the National Capital Plan were not included in any potential assessment because of data limitations.

The ACT's special circumstances

16 In response to state comments, the Commission considered the ACT's special circumstance in relation to Commonwealth legislation and concerns about the nature of the national capital assessment in the 2020 Review.

State views

17 The ACT raised the issue of its special circumstances in the context of section 59 of the *Australian Capital Territory (Self-Government) Act 1988*. It considered this act provides that the ACT is not liable for certain expenses related to its special circumstances. The ACT said that it would work with the Commission to determine what these additional costs were.

18 New South Wales said that the ACT's treatment in the 2020 Review's national capital assessment was not consistent with the methodology for any other state in any other assessment. It held concerns that the assessment treated the ACT as a GST-recipient or GST-neutral state.

19 South Australia suggested that any national capital assessment should also consider the cost advantages of Canberra's status as the national capital. It suggested that the assessment should be based on the relative advantages and disadvantages of both planning and police costs.

20 During the state visit, ACT officials said that Canberra's status as the national capital brought added amenities but not cost advantages. The ACT noted that there is no mechanism to compensate it for the additional costs associated with its special circumstances other than through the process of horizontal fiscal equalisation.

Commission response

21 The Commission interprets the ACT's self-government act as providing measures to ensure that its special circumstances are considered as part of federal financial relations. However, for its purpose of undertaking horizontal fiscal equalisation, the Commission needs to consider these special circumstances within the framework of its principles and methodology, including materiality thresholds.

22 Given the data limitations mentioned above, the Commission does not have robust data to inform an assessment of national capital expenses that would be fit for purpose and material for this review.

23 Regarding national capital cost advantages, the Commission had recognised some cost advantages in the assessment for the ACT in the 1980s and early 1990s. For example, the state-type services offered by the Australian National Botanic Gardens previously reduced the ACT's national capital allowances. However, the Commission has found defining and quantifying cost advantages to be both practically and conceptually difficult.

24 An assessment of national capital costs based on the available data would not be material even if the Commission chose to recognise negative assessed GST needs for the ACT. For this reason, the Commission did not need to develop an assessment to address any national capital costs (or potential advantages) in this review.

Commission decision

25 The Commission will discontinue the assessment to address national capital cost disadvantages because it is no longer material. The Commission will not develop an assessment to address cost advantages because of data limitations.

GST impacts of method changes

26 The national capital assessment was suspended in the 2024 Update. Therefore, there are no GST impacts of discontinuing the assessment.

25. Other expenses

Review outcomes

- The following changes were made to the assessment.
  - The approach for estimating expenses to which regional costs are applied will be based on a detailed examination of the type of service likely to be more expensive to deliver as remoteness increases.
  - The approach for estimating expenses to which wage costs are applied will correct for an error used in the previous approach and will be based solely on actual data provided by states on the wages component of expenses in the other expenses category.
- The Commission considered but did not change the following.
  - The type of expenses included in the other expenses category will not change, due to the absence of any significant developments that warrant a change.
  - The assessment of other expenses on an equal per capita basis will continue, as states' population remains the likely best driver of these expenses.

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.

- Natural disasters, administrative scale, and Native Title and land rights, which are part of the other expenses assessment, were consulted on separately. For details see the relevant consultation papers and Draft Report chapters.

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
- GST impacts of method changes.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the other expenses chapter of the *Commission's Assessment Methodology*.

Issues considered

Expenses included in the category

6 The Commission proposed no changes to the list of expenses in the assessment.

State views

7 All states agreed that there have been no significant developments that warrant a change in the expenses classified in the other expenses category.

Commission decision

8 The Commission will not change the expenses classified to the other expenses category.

Drivers of assessed expenses

9 The Commission proposed no change to the drivers of assessed.

State views

10 All states agreed to assessing other expenses on an equal per capita basis, as state population is likely to be the best driver of these expenses.

11 Victoria raised concerns with the application of regional and wage cost adjustments to a subset of expenses in the other expenses category. It said that the Commission had not explained the decision and it appeared arbitrary to make the adjustments to only a subset of expenses.

12 Victoria and South Australia supported the Commission's proposal to change the approach for estimating expenses to which regional and wage costs are applied.

Commission response

13 To determine if costs are likely to change with remoteness, the Commission reviewed information on service delivery arrangements for the services included in the other expenses category.

14 Where the nature of the service suggests service delivery would likely involve transporting equipment and/or public servants from less remote to more remote areas (with associated accommodation costs for the public servants), or service delivery would likely require more travel within a region on a regular basis, the Commission considers that costs are likely to increase with remoteness.

15 The general regional cost gradient is used because it is not practicable to directly measure the effect of remoteness on each of the service expenses for the category.

16 Differences in wage costs between states have a differential effect on the cost of providing services. The 2020 Review method contained an error in the application of wage costs. The Commission's revised approach is based only on the information

provided by states each year with their expense data, which provides a disaggregation of wage and non-wage costs.

Commission decision

17 The Commission will retain an equal per capita assessment of expenses in the other expenses category.

18 The Commission will change the approach to estimating the share of expenses for which regional and wage costs are applied. For regional costs, the changed approached involves a more detailed examination of the type of services that are likely to be more expensive to deliver as remoteness increases. For wage costs, the changed approach uses only actual data provided by states on the wages component of expenses in the other expenses category.

GST impacts of method changes

19 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, other expenses, 2024-25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Reduction in proportion of expenses to which regional costs apply	11	11	-5	-7	-3	-1	1	-7	23
Correction of error in application of wages	22	-6	-19	21	-17	-8	5	2	50
Total	**34**	**5**	**-24**	**14**	**-20**	**-8**	**6**	**-6**	**58**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Reduction in proportion of expenses to which regional costs apply	1	2	-1	-2	-2	-1	1	-28	1
Correction of error in application of wages	3	-1	-3	7	-9	-13	11	6	2
Total	**4**	**1**	**-4**	**4**	**-11**	**-14**	**12**	**-22**	**2**

Note: Changes to the wage costs assessment are not included. They are shown in wage costs chapter of *Review Outcomes*.

20 The reduction in expenses to which regional costs are applied increased the assessed GST needs of states with a larger share of their population in less remote areas. The increase in the share of expenses to which wage costs are applied, due to the correction of an error, increased the assessed GST needs of states with above-average wage costs.

21 The changes to the general regional cost gradient are explained in the geography chapter of *Review Outcomes*. The changes increased the assessed GST needs of states with a larger share of their population in more remote areas. This effect is not separately identified in Table 1.

Part C

Capital Assessments

26. Investment

Review outcomes

- No changes were made to the general investment assessment method. However, National Disability Insurance Scheme expenses will be removed from the measure of welfare investment need, as this spending has no associated capital expenditure.
- Changes to recurrent expense assessment methods will flow through to the investment assessment.
- The Commission considered but did not change the following.
  - To reduce volatility in the assessment, the Commission considered smoothing the period over which growth in user populations are calculated and freezing component shares of total asset values. These changes will not be made because the additional complexity of introducing population growth smoothing outweighed the likely benefits, and the freezing of component shares of asset values would potentially introduce bias.
  - Alternatives to the use of Rawlinsons construction cost indices were considered but the Commission decided that other measures are less comprehensive and not fit for purpose. Engaging private sector quantity surveyors is not considered practical. The Commission will continue to use Rawlinsons as an input to its measure of construction costs and will not introduce a discount. The appropriateness of Rawlinsons cost indices will continue to be monitored.
  - Recognising the higher costs associated with brownfield investments, the Commission considered introducing a new assessment to recognise these higher costs However, the Commission concluded that a separate brownfield assessment is unlikely to be material given the current level of these investments.

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
- GST impacts of method changes to other assessments that have had flow-on effects to investment.

5 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the investment chapter of the *Commission's Assessment Methodology*.

Issues considered

Population growth smoothing using a 3-year moving average

6 States have raised concerns in previous reviews that volatility in the investment assessment has been a significant contributor to volatility in GST distributions.

7 Annual changes in user populations are a major driver in the investment assessment. To reduce GST volatility associated with the investment assessment, the Commission proposed smoothing population growth by introducing a 3-year moving average for user populations.

State views

8 Some states supported the proposal, noting that investment decisions reflect long-term population growth, rather than annual changes in growth.

9 Some states did not support the proposal. They noted the potential for double-counting of the COVID-19 affected years and also that, outside of COVID-19 affected years, the volatility in population growth is not a substantive concern.

Commission response

10 Over time, both a smoothed and unsmoothed approach to population growth should give similar results. Smoothing would add complexity to the assessment method.

11 During the transition to a smoothed approach, population growth in some years would influence GST distribution more than growth in other years. This could distort the assessment. Phasing in smoothing would mitigate this but would add further complexity.

12 The Commission also found that even with smoothing user population growth, significant volatility in the assessment could still arise from large fluctuations in investment spending.

13 On balance, the Commission decided the additional complexity involved in smoothing population growth outweighed the benefits of reduced volatility.

Commission decision

14 The Commission will not smooth user population growth.

Freezing the component shares of the value of assets for the life of the 2025 Review

15 The Commission also proposed freezing the component shares of the value of total assets until the next review. This would be another way to alleviate assessment volatility stemming from asset revaluations, while also reducing the data provision burden on states.

State views

16 While some states supported the proposal, others said that any reduction in volatility would be minimal and that the burden of providing data was not significant. They also said that freezing this data would mean the assessment did not reflect changes in what states do.

Commission response

17 Freezing the component shares of asset stock would result in a loss of contemporaneity and responsiveness of the assessment to investment trends. It could potentially introduce bias into the assessment due to the implied assumption that asset stocks grow at the same rate among all components, when in reality, some grow much faster than others. Component shares for urban roads and urban transport have increased significantly since the 2020 Review, while the share for rural roads has fallen. Analysis also showed that the volatility reduction would be marginal.

Commission decision

18 The Commission will retain the 2020 Review method and update component shares of total asset values annually.

Cost of construction

19 The Commission uses the Rawlinsons construction cost indices (the regional cost and the capital city indices) as a key input into several cost of construction measures used in the investment assessment.

20 In response to state concerns, the Commission proposed retaining the 2020 Review method while continuing to monitor the appropriateness of Rawlinsons cost indices.

State views

21 Some states raised concerns regarding the use of the Rawlinsons construction cost indices.

22 Victoria questioned the contemporaneity and policy neutrality of the Rawlinsons indices, suggesting the Commission explore the use of data from private quantity surveyors to provide a more accurate and contemporaneous picture of states' costs.

23 Queensland and Victoria raised particular concerns about the reliability of the Rawlinsons capital city index. Queensland argued that Rawlinsons underestimates construction costs in Queensland compared to other construction cost indices, noting the consistency between the other measures as evidence that Rawlinsons is an unreliable outlier. As a result, Queensland argued for a 50% discount to be applied to the Rawlinsons capital city index while supporting the Commission's proposal to monitor the appropriateness of Rawlinson's cost indices going forward. Victoria also identified alternative cost of construction indices, arguing that the variability between them raised sufficient doubts for a 12.5% discount be applied to the Rawlinsons capital city index.

24 Tasmania raised concerns that the blending of the Rawlinsons construction cost indices with the wage costs assessment potentially double-counted wage impacts as the Rawlinsons measures include wage costs.

Commission response

Contemporaneity

25 While the Commission agrees that Rawlinsons may not be as contemporaneous as directly engaging quantity surveyors, it does not consider this to be a major concern. State departments building new projects require highly contemporaneous, or even forward-looking, data on prices. The Commission's requirements for contemporaneity are less stringent. Analysis included in the Draft Report suggested that, while construction costs have increased nationally in recent years, the difference between states is marginal.

Policy neutrality

26 The Commission accepts that construction costs may be affected by state policies, for example, if a state has a very high level of investment projects driving up prices. Rawlinsons' estimates of inflation since 2020 show inflation being relatively consistent across all locations, therefore not indicating any substantial divergence in costs in different cities over time. This supports the assumption that there are no major individual state policy influences on construction cost differentials.

Alternatives

27 The Commission notes that Rawlinsons data are publicly available, widely used, and increase the transparency of the investment assessment. The Commission is not aware of any superior practical alternative. Victoria's suggestion of engaging quantity surveyors to provide a more contemporaneous estimate of costs may provide a better estimate of such costs. However, to produce such estimates for all states would not be practical, requiring the engagement of quantity surveyors in all states and developing a mechanism to ensure their estimates were comparable.

28 Rawlinsons is one of at least 3 regional construction cost guides in Australia. Alternatives include the Cordell Construction Cost Index and BMT's Construction

Cost Calculator.[1] These guides do not appear to be as comprehensive as the Rawlinsons construction cost guide. The Commission is not aware of any source of nationally consistent data on construction costs that is likely to rival Rawlinsons for the Commission's purposes.

29 The other commercially published construction cost indexes cited by Victoria and Queensland measure different things to Rawlinsons, from providing forecasts as opposed to estimates, and having different industrial scopes and levels of detail to Rawlinsons. No commercial provider publishes its methodology, making conclusions as to the most appropriate measure difficult. The Commission considers Rawlinsons to be the most comprehensive in terms of detailed construction inputs observed, and is a backward-looking measure of construction costs, thereby being consistent with the other data in the assessment, so remains the most appropriate measure for the Commission.

30 The Australian Bureau of Statistics Producer Price Indexes, also cited by Victoria and Queensland as showing divergent trends to Rawlinsons, are time series indexes and cannot be used as regional indexes as they are not benchmarked geographically at any point in time. Higher inflation over time, in a place, does not necessarily mean that costs are higher between the locations.

31 The Commission continues to regard Rawlinsons as fit for purpose and not warranting a discount.

Blending with wage costs

32 The Commission considered Tasmania's argument that blending Rawlinsons with the wage costs assessment leads to double counting. All investment costs are subject to local labour costs. The Commission has 2 approaches to measuring this: using the Rawlinsons estimates and using the wage costs assessment. The Commission effectively applies Rawlinsons factors to half of assessed state investment and the wage costs factors to the remaining half of assessed state investment. This means that every dollar of state spending has an adjustment for local labour costs, without any dollar having both factors applied.

Commission decision

33 The Commission will continue to use Rawlinsons as an input to its measurement of construction costs and will not introduce a discount. It will continue to monitor the appropriateness of Rawlinsons cost indices.

[1] Cordell Construction Cost Index (CCCI) | CoreLogic Australia; Construction Cost Calculator & App | BMT Tax Depreciation (bmtqs.com.au)

Brownfield investment

34 In response to state comments, the Commission considered whether investment in brownfield developments increased the cost of constructing state assets, and should therefore be differentially assessed.

State views

35 Victoria asked the Commission to monitor the potential for assessing states' land purchase costs and brownfield investment needs and associated higher costs.

Commission response

36 In the 2020 Review, the Commission found that some investment, such as in schools, is more expensive to provide for growing populations in established urban areas – that is brownfield sites. However, available data did not support these additional costs as being material.

37 For the 2025 Review, the Commission investigated whether the prevalence of brownfields investment has significantly increased since the 2020 Review. Schools are the major service that require construction in brownfield areas, as they are highly localised, so need is responsive to local population growth. Only 3 of the 74 new schools built or under construction in Victoria since 2020 are in a brownfield area. This suggests that construction in brownfield areas is unlikely to be significantly larger than when the Commission found it to be immaterial in the 2020 Review.

Commission decision

38 The Commission will not introduce a brownfields assessment.

Impacts of changes to recurrent assessment methods

39 In each component of the investment assessment, the Commission assesses each state's share of need for capital. It generally measures these in a similar way to how it measures each state's share of the related recurrent expenses, although there can be differences between the recurrent and capital measure of need.

40 In response to state comments, and as a result of changes to expense assessments in the 2025 Review, the Commission reviewed the measures of state shares of need for capital. The measures that attracted particular attention included urban transport, health, and welfare.

Urban transport

41 The measure of need for urban transport investment is considered in the transport chapter of *Review Outcomes*.

Health

42 In the 2020 Review, the health measure of capital needs included all health components, in proportion to their share of recurrent expenses. The Commission

considers that states build infrastructure for mental health services, a new sub-component of the health assessment, and so proposed to include mental health needs in the calculation of health capital needs.

43 The Commission recognised there was an issue over the appropriateness of using the recurrent spending on COVID-19 as part of the proxy for health capital requirements.

Welfare

44 In the 2020 Review, the capital needs for welfare excluded spending on concessions. In the 2025 Review, the Commission considered that states do not provide infrastructure for the National Disability Insurance Scheme, and proposed that this component also be removed from the calculation of welfare capital needs, a change from the 2020 Review.

45 Homelessness services, a new component in the welfare assessment for the 2025 Review, are more capital intensive than other welfare services, with soup kitchens and homeless shelters requiring capital. However, states contract non-government organisations to provide some homeless services, and in these cases do not build capital assets. On balance, the Commission proposed that homeless services be included in the calculation of welfare capital needs in proportion to their share of recurrent spending.

State views

Urban transport

46 State views on urban transport investment are covered in the transport chapter of *Review Outcomes*.

Health

47 Victoria said that it was inappropriate to measure the effect of Victoria's declining COVID-19 payment in the health infrastructure assessment when the increase in the earlier years had not been included. It also said that the temporary nature of the response meant that it had not been as capital intensive as assumed by the Commission's assessment.

48 South Australia said that including a driver in recurrent assessments but not the corresponding investment assessment was inconsistent with the conceptual framework of the investment assessment.

49 The Northern Territory said method changes leading to 'step-changes' in investment assessment outcomes are to be expected during reviews, thereby questioning the conceptual case for not including this component.

Welfare

50 No state opposed the changes to the welfare assessment flowing into investment.

Commission response

Urban transport

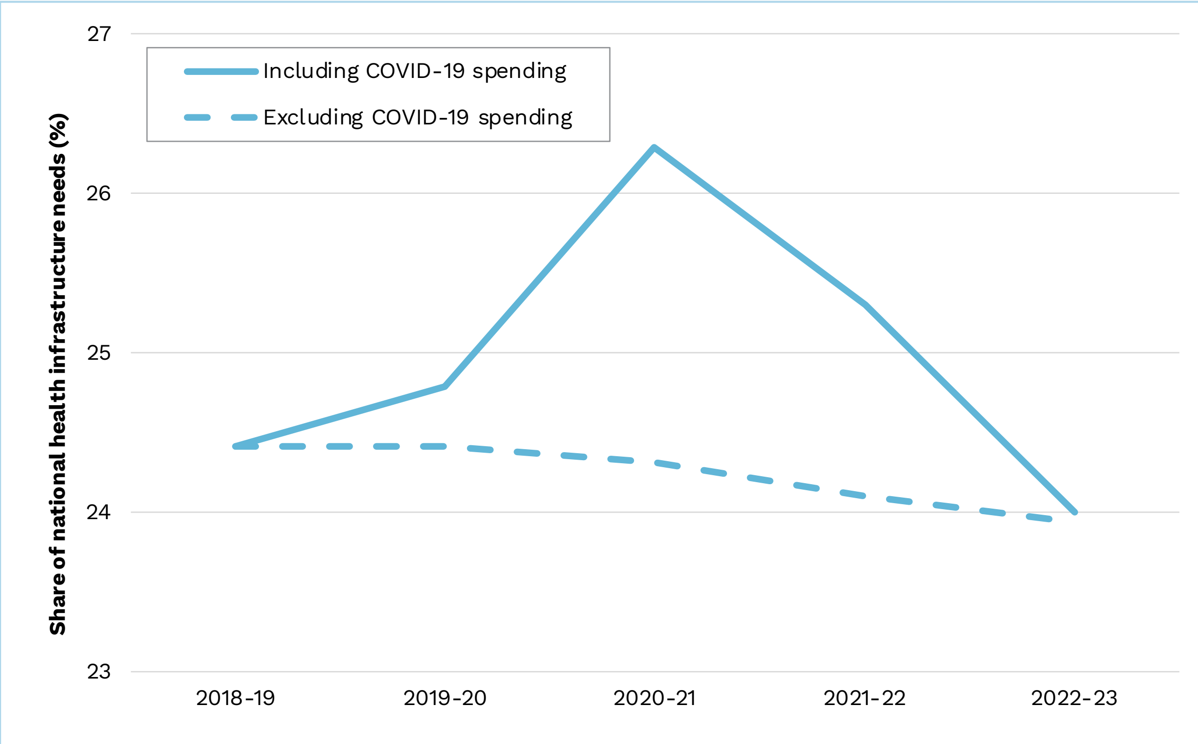
51 The Commission's consideration of state arguments is included in the transport chapter of *Review Outcomes*.

Health

52 The Commission agrees with Victoria that the COVID-19 related spending should not affect the assessment of health infrastructure.

53 The Commission's assessment method estimates that in 2018–19 Victoria required 24.4% of the national stock of health infrastructure, and by 2022–23 it required about 24% (Figure 1). In the intervening years, Victoria's share of assessed recurrent health spending had peaked at 26.3%, due to the effects of COVID-19. The Commission agrees that this does not reflect Victoria's changing capital needs because the state generally did not construct COVID-19 specific health infrastructure. Given that the COVID-19 related increases in recurrent spending were not used in the health infrastructure assessment in previous years, it would be inappropriate to include COVID-19 spending in the assessment of capital needs when this spending is decreasing. To do so would represent a significant asymmetry in the treatment of COVID-19 spending on health infrastructure.

Figure 1 Victoria's share of assessed health infrastructure



54 The investment category contains many instances where the driver of recurrent expenses differs from the corresponding driver of investment. This occurs when the driver of recurrent costs is not a relevant driver of its corresponding investment needs. This is the case for COVID-19 recurrent expenses.

55 Most COVID-19 related spending was not capital intensive because, states largely repurposed other infrastructure for COVID-19 related services. As such, the most appropriate indicator of health-related investment should exclude COVID-19 related spending, particularly in light of the short-term nature of a separate COVID-19 specific response.

56 The Commission agrees with the Northern Territory that method changes can result in a step change in investment assessments. Where the investment is ongoing, such a change is generally appropriate. However, given the short-term nature of COVID-19 specific spending, incorporating COVID-19 related spending in investment needs would not reflect relative state needs.

Commission decision

57 For the health component of investment, the Commission will include assessed mental health service use. It will not include COVID-19 related spending.

58 For the welfare component of investment, the Commission will include assessed homeless services expenses. It will remove the impact of National Disability Insurance Scheme expenses, which were previously included.

59 For the remaining investment components, including housing, the Commission will retain the approaches from the 2020 Review. Where changes have been made to methods, these flow through to the investment assessment.

GST impacts of method changes

60 There are no method changes to the investment assessment. However, changes to recurrent category methods flow through to investment. These are shown in Table 1.

Table 1 Impact on GST distribution of flow through to investment of recurrent method changes, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Changes to urban transport assessment	5	-40	-193	198	57	26	-49	-3	285
Discounting of recurrent roads assessment	12	68	-21	-21	1	2	13	-53	95
Other changes to recurrent assessments	59	-40	-21	31	4	-19	-10	-4	94
Total	**76**	**-13**	**-235**	**208**	**61**	**9**	**-46**	**-60**	**354**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Changes to urban transport assessment	1	-6	-34	65	30	44	-101	-11	10
Discounting of recurrent roads assessment	1	9	-4	-7	0	4	26	-206	3
Other changes to recurrent assessments	7	-6	-4	10	2	-34	-20	-14	3
Total	**9**	**-2**	**-41**	**68**	**32**	**15**	**-95**	**-232**	**13**

Note: Changes to the wage costs assessment are not included. They are shown in the wage costs chapter in *Review Outcomes*.

61 States that receive an increase in GST due to method changes to recurrent assessments generally receive an increase in GST due to the resultant changes in the associated investment. For example, the discounting of the roads assessment increased recurrent and investment needs in New South Wales, Victoria and the ACT, and reduced recurrent and investment needs in Queensland, Western Australia and the Northern Territory.

62 In some instances, the GST impacts of changes to investment needs and recurrent needs are not consistent. This is because the drivers of recurrent assessments relate to the relative level of need while the investment assessment also includes a driver reflecting the relative growth in this level of need. This is particularly the case in urban transport for Queensland and the ACT. For both states, method changes increase assessed GST needs in the recurrent assessment and reduce assessed needs in the investment assessment.

63 For Queensland, the flow through decrease can be explained primarily by the change in the method used to model passenger numbers. In the 2024 Update, passenger numbers were modelled using average passenger use in similar sized cities. In 2022–23, the population of Brisbane passed 2.5 million. This meant that passenger numbers for Brisbane were modelled based on the average passenger use across cities of more than 2.5 million (Sydney, Melbourne and Brisbane) in 2022–23. This was a large increase from previous years, where Brisbane's passenger numbers were modelled based on the average rate of passenger use in cities of 1 to 2.5 million people (Brisbane, Adelaide and Perth). The method for modelling passenger numbers in the 2025 Review no longer groups cities of similar size. Passenger numbers are modelled using individual city size. Changing to the 2025 Review method of modelling passenger numbers based on individual urban centre population size has moderated the growth in modelled passenger numbers for Brisbane compared to the growth used in the 2024 Update.

64 Moving to a population-weighted density measure based on a square kilometre grid from the 2020 Review method that used Statistical Area 1s (SA1), has reduced the rate at which Queensland and the ACT's population-weighted density grew over the assessment period. Urban SA1s are generally much smaller than a square kilometre, and SA1 based population weighted density is more sensitive to local individual developments. Canberra and Brisbane had greater population growth rates in very small SA1s than other cities. The change to a square kilometre-based measure has moderated this measure of growth, and in turn the ACT's investment needs.

65 Table 2 disaggregates the impact on the GST of method changes on the transport investment assessment. Each state's share of assessed transport needs drives the capital deepening driver. This is largely proportional to the method changes to the recurrent transport assessment, although there are some differences between the

recurrent and investment measures of need.[2] The change in share of transport needs reflects how each state's share of assessed transport needs changes over time. The states with the largest change in share of transport needs are Queensland and the ACT.

Table 2 Impact on GST distribution of method changes, urban transport investment, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Change in share of transport need	123	131	-261	57	-5	2	-45	-2	313
Capital deepening	-116	-168	64	134	62	25	0	-1	285
Cost of construction	-2	-3	4	6	-1	0	-4	0	10
Total	**5**	**-40**	**-193**	**198**	**57**	**26**	**-49**	**-3**	**285**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Change in share of transport need	14	18	-46	19	-2	3	-93	-8	11
Capital deepening	-13	-23	11	44	33	42	0	-2	10
Cost of construction	0	0	1	2	-1	-1	-7	-1	0
Total	**1**	**-6**	**-34**	**65**	**30**	**44**	**-101**	**-11**	**10**

66 For more details of method changes to modelling passenger numbers and population-weighted density see the consultation paper on transport.

[2] The measure of investment need includes an urban population squared measure, and the blending proportion is 25%, rather than 35% used in the recurrent assessment.

27. Net borrowing

Review outcomes

- No changes were made to the assessment.
- The conceptual basis for the net borrowing assessment was confirmed.
- The Commission considered smoothing the growth in user populations in the investment assessment as a means to reduce volatility in the GST distribution. However, this approach was not adopted as it would have decreased contemporaneity, increased complexity and only have a minimal effect on volatility. To maintain consistency between investment and net borrowing, smoothing will not be applied in the net borrowing 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 net borrowing chapter of the *Commission's Assessment Methodology*.

Issues considered

Conceptual basis

6 The Commission proposed that the conceptual basis of the net borrowing assessment remained appropriate.

State views

7 All states, except for Queensland, agreed that the conceptual case for the net borrowing assessment remains unchanged.

8 Queensland did not agree. It said:

- the Commission's other assessments implicitly equalise the financial position of states
- the COVID-19 pandemic response fundamentally shifted the nature of state borrowing and has made it policy contaminated
- population growth is an insufficient driver as different socio-demographic populations have different capacities to service debt
- states with higher population growth need to borrow more to fund infrastructure needs.

9 As a result of these concerns Queensland argued for the assessment to be discontinued or for the assessment to attract a 50% discount.

Commission response

10 The net borrowing assessment has 2 conceptual parts:

- equalising per capita net borrowing in the assessment year (assessed equal per capita)
- equalising states' net debt per capita (allowing for differences in population growth between states).

11 As Queensland pointed out, equalising expense, revenue, and investment needs implicitly equalises the year-on-year change of residual net borrowing needs. This is why the change in net financial position is assessed equal per capita.

12 If the Commission did not allow for the effect of differential population growth on the stock of net debt, then faster growing states would have lower debt per capita than slower growing states. Lower debt per capita would lead to lower interest payments per capita. The impact of changes in state populations on average net financial positions is not implicitly equalised by the other assessments.

13 The Commission considered Queensland's argument that increases in state net borrowing and net debt have fundamentally changed the basis of the assessment. While these increases have made net borrowing a more significant driver of GST distribution, they have not changed the conceptual basis of the assessment. Different states have different levels of net borrowing and net debt. However, averaging what states do provides a policy neutral measure. In total, states had net borrowing of $41 billion in 2022–23. Thus, the average of what states collectively did was to borrow $1,553 per capita in that year.

14 The Commission recognises that state borrowing activities have diverged, and on average, grown. Neither of these changes affects the conceptual basis of the assessment method.

15 The Commission considered Queensland's argument that population growth should be replaced by growth of specific user populations to assess capacities to service debt. States' different fiscal capacities across revenue, expense and investment

assessment are equalised. This means that the requirement to borrow in the assessment year should not be influenced by growth in specific sub-populations.

16 Queensland also argued that growing states need to borrow more to fund increased infrastructure. This need is assessed in the investment assessment. To include this in the net borrowing assessment would represent double counting of this need.

Commission decision

17 The Commission has retained the conceptual basis of the net borrowing assessment.

Population smoothing

18 States have suggested that the capital assessments (investment and net borrowing), particularly the investment assessment, contribute to volatility in GST distribution.

19 In response, the Commission considered population smoothing as a potential means of alleviating volatility in the capital assessments. This issue was considered in the context of the investment assessment.

20 The Commission proposed population smoothing for net borrowing if adopted in the investment assessment to maintain consistency between the capital assessments.

State views

21 All states agreed with the proposal to keep the population growth measure consistent between the investment and net borrowing assessments.

Commission response

22 As outlined in the investment chapter of *Review Outcomes*, the Commission will not smooth population growth in the investment assessment because the additional complexity and reduced contemporaneity from this change would outweigh the benefits. To maintain consistency between the two capital assessments, population will not be smoothed in the net borrowing assessment.

Commission decision

23 The Commission will not smooth population growth in the net borrowing assessment.

GST impacts of method changes

24 There are no method changes to this assessment.

Part D

Other

28. Commonwealth payments

Review outcomes

- The following changes were made to the assessment.
  - A default impact treatment will apply in the small number of cases where there is substantial uncertainty about whether a Commonwealth payment is for a state service for which needs are assessed. In these cases, states will continue to have the opportunity to provide evidence in support of a no impact treatment.
  - Revenue paid to states in the form of Commonwealth-own purpose expenses will not be included in the assessment.
  - Several existing payments will be treated as impact instead of no impact since the associated expense needs will be assessed in the 2025 Review.
- The Commission considered but did not change the following.
  - The 2020 Review guideline for the treatment of Commonwealth payments will be retained. Commonwealth payments that support state services and for which expenditure needs are assessed will continue to impact GST relativities.
  - In the absence of clear evidence that a payment (or part payment) is for pre-existing structural disadvantage and needs are not assessed, the payment will continue to be treated as impacting the GST distribution.
  - The Commission will continue to take into account advice of Commonwealth Treasury and the states, as well as considering published national agreements, when determining which payments are facilitation or reward payments.

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 The treatment of new Commonwealth payments in 2023–24 are discussed in New Issues for the 2025–26 GST Relativities.

5 This chapter includes:

- an overview of the issues considered throughout the review
- the Commission's response and decision on each issue
- GST impacts of method changes.

6 A description of the assessment method, incorporating changes made in the 2025 Review, can be found in the Commonwealth payments chapter of the *Commission's Assessment Methodology*.

Issues considered

Deciding the treatment of Commonwealth payments

7 The 2020 Review guideline for deciding whether a payment should affect the GST distribution stated that:

> payments which support state services, and for which expenditure needs are assessed, will impact the relativities.

8 In considering whether needs are assessed for the activity that the payment funds, the Commission considers the main purpose of the payment. Where the purpose of the payment broadly aligns with the Commission's expense assessments, the Commission considers that needs are assessed for the payment.

9 Experience suggests that, while the guideline works well for most payments, for a minority of payments making decisions on the appropriate treatment can be difficult and contentious.

10 The Commission proposed retaining the 2020 Review guideline, with additional guidance that a default impact treatment would be adopted in the small number of cases where there is substantial uncertainty whether a Commonwealth payment is for a state service for which needs are assessed. It would remain open to states to make the conceptual case and provide evidence to support a no impact treatment for those payments.

State views

11 All states supported retaining the 2020 Review guideline. Most states supported the proposal to apply a default impact treatment for Commonwealth payments where there is substantial uncertainty about whether a payment is for a state service for which needs are assessed. Queensland said its support was subject to states having the opportunity to present a case for a no impact treatment. Victoria and Queensland said the Commission should provide additional information for payments where there is uncertainty around how the payment will be treated.

12 South Australia proposed an alternative approach. It said payments where the Commission is uncertain could be treated 50% impact and 50% no impact. It said this approach would moderate the redistribution compared to a default impact treatment.

Commission response

13 The Commission will continue to consider Commonwealth payments on a case-by-case basis. Where it is clear that a payment is not for a state service or that needs are not assessed, the payment will be treated as no impact. The default impact treatment is only intended to apply to the minority of payments where the Commission is uncertain if they fund a state service or if they fund expenditure for which the Commission assesses needs. All states will continue to have the opportunity to present a case for no impact treatment as part of consultation on new issues for the annual update of GST relativities.

14 The Commission notes the South Australian proposal to adopt a 50% impact/no impact treatment to deal with payments where there is substantial uncertainty as to their treatment. However, the Commission considers that defaulting to an impact treatment, with states having the opportunity to argue for a no impact treatment, is more consistent with the objective of equalisation than an arbitrary 50/50 split.

Commission decision

15 The Commission will retain the 2020 Review guideline for deciding the treatment of Commonwealth payments. Where there is substantial uncertainty about the payment's purpose, or whether relative state expenditure needs are assessed, an impact treatment will be the default. States will have the opportunity to provide evidence in support of a no impact treatment for those payments.

Excluding revenue from Commonwealth own-purpose expenses

16 Commonwealth own-purpose expense payments are payments by the Australian Government in the conduct of its own general government sector activities. Most are, by definition, likely to relate to Commonwealth functions, but some can be for state-type services.

17 In the 2020 Review, the Commission included several Commonwealth own-purpose expenses that supported state services for which needs were assessed.[1] However, in the absence of comprehensive data on Commonwealth own-purpose expenses, the assessment only included those that were easily identifiable or had been brought to the Commission's attention by states.

18 The total value of these payments has declined over the past 10 years, halving since the 2020 Review. They represented about 0.2% of total Commonwealth payments treated as impact in 2022–23. While the Commission does not apply a materiality threshold to Commonwealth payments, most of the remaining included Commonwealth own-purpose expenses would not be material at the $40 per capita materiality threshold.

[1] The Commonwealth own-purpose expenses included in the 2020 Review assessment were a 'rural and other health' grant made by the Department of Health and Aged Care, and multiple small Commonwealth own-purpose expenses for First Nations programs managed by the National Indigenous Australians Agency.

19 The Commission proposed to cease the assessment of Commonwealth own-purpose expenses.

State views

20 Most states supported discontinuing the assessment of Commonwealth own-purpose expenses. New South Wales said only Commonwealth own-purpose expenses that did not meet a materiality threshold should be excluded.

21 Victoria supported the proposal but said the issue should be revisited if there are significant changes to the Federal Financial Relations framework or evidence of significant increases in funding outside that framework.

Commission response

22 In keeping with the Commission's guideline for the treatment of Commonwealth payments, all payments that support states services, or that relieve a state from providing a service, should be included as impact. However, in the absence of comprehensive data on Commonwealth own-purpose expenses, the Commission is only able to consider those payments which are easily identifiable. In addition, the Commission does not have visibility of Commonwealth own-purpose expenses paid to non-government organisations, some of which may reduce the amount a state needs to spend on a service.

23 There has been a significant reduction in the value of included Commonwealth own-purpose expenses since the transition to the Federal Financial Relations framework in 2009. It is unclear whether this reflects an overall reduction in Commonwealth own-purpose expenses by the Commonwealth, or a shift towards funding activities through non-government organisations rather than state governments.

24 The Commission could continue to assess single material Commonwealth own-purpose expenses. However, given the possibility of unidentified Commonwealth own-purpose expenses paid to states, the Commission considers excluding all Commonwealth own-purpose expenses from the assessment is a more consistent and equitable approach.

25 If there are significant changes to the Federal Financial Relations framework, or evidence of significant increases in state funding outside that framework, the Commission may review this position.

Commission decision

26 The Commission will exclude revenue paid to states in the form of Commonwealth own-purpose expenses from the assessment.[2]

[2] The Commission notes that, to the extent Commonwealth own-purpose expenses are captured in ABS Government Finance Statistics data, they will be reflected in the Commission's 'balancing item'. The balancing item ensures the sum of individual Commonwealth payments sourced from the Commonwealth Final Budget Outcome matches total Commonwealth payments in Government Finance Statistics data. The balancing item does not move states' relative fiscal capacities away from an equal per capita assessment.

Treatment of Commonwealth payments related to structural disadvantage

27 The Northern Territory raised the treatment of Commonwealth payments that address pre-existing structural disadvantage. It said funding agreements with the Commonwealth increasingly include elements aimed at addressing structural disadvantage, especially entrenched disadvantage for First Nations peoples. The Northern Territory said it was important that the GST treatment of Commonwealth payments does not impede the objectives of such funding.

28 The Commission proposed that it should apply its guideline for deciding the treatment of all Commonwealth payments, including those that might contain elements addressing pre-existing structural disadvantage. It noted however, that the guideline provided the scope to consider whether payments for structural disadvantage should be excluded from the GST calculation.[3] If needs for structural disadvantage were not assessed, payments for such purposes would be excluded from impacting the GST distribution under the guideline.

State views

29 Most states supported the application of the treatment guideline to all payments, including those aimed at addressing structural disadvantage. The Northern Territory said that while it supported retaining the 2020 Review treatment guideline, there could be additional clarification that payments aimed at addressing structural disadvantage fall into the category of services for which the Commission does not assess need.

30 Queensland said, while it supported the application of the guideline to all payments, payments relating to socio-demographic disadvantage should be comprehensively examined in the next review. It said a material proportion of those payments may be related to pre-existing structural disadvantage.

Commission response

31 The Commission considers there is scope within the existing guideline to consider whether payments relating to structural disadvantage should be excluded from the GST calculations. Where payments are identified as relating to structural disadvantage and needs are not assessed, the payment will not impact the relativities.

32 The Commission considers it would be preferable for the terms of reference for an update to exclude payments for structural disadvantage. If the terms of reference do not quarantine such payments, it will not necessarily preclude the Commission from making a no impact decision in accordance with its guideline.

[3] Payments quarantined by terms of reference will continue to be treated as no impact.

Commission decision

33 The Commission will assess payments for structural disadvantage on the same basis as other payments by applying its treatment guideline. If there is clear evidence that a payment (or part payment) is for pre-existing structural disadvantage and needs are not assessed, it will be treated as no impact.

Commonwealth-state disagreements about the nature of a payment

34 New South Wales said it had concerns about cases where the Commonwealth Treasury and a state disagree on the nature of a specific payment. It cited the example from the 2020 Review of a payment under the Skilling Australia Fund that New South Wales considered a reward payment, but the Commonwealth Treasury did not. It said, in such cases, the Commission should come to a decision on the matter through its own analysis, rather than solely relying on the Commonwealth Treasury's position.

State views

35 Other states did not comment on this issue.

Commission response

36 Terms of reference specify a default no impact treatment for National Partnership facilitation and reward payments. The Commission may not always be well placed to determine whether a payment meets the definition of a facilitation or reward payment. It notes that facilitation and reward National Partnership Payments have not been separately identified in the Commonwealth Budget since 2014–15.

Commission decision

37 The Commission will continue to take into account advice of Commonwealth Treasury and the states, as well as considering published national agreements, when determining which payments are facilitation and reward payments.

Changes to the treatment of existing payments

38 Changes to assessment methods resulted in the Commission reconsidering the treatment of existing payments in the following areas:

- Social Impact Investments/People at risk of homelessness
- Perth City Deal/Homelessness Projects
- COVID-19 public health response
- Support of businesses impacted by COVID-19.

Commission decision

39 The Commission will change the treatment of these payments from no impact to impact.

40 The change to the treatment of the homelessness payments reflects the introduction of an assessment of homelessness services in the welfare category.

41 More information on the decision to change the treatment of the COVID-19 payments from no impact to impact is in the health and services to industry chapters of Review Outcomes.

GST impacts of method changes

42 The impact on the GST distribution from the method changes is shown in Table 1.

Table 1 Impact on GST distribution of method changes, Commonwealth payments, 2024–25 to 2025–26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
$m	-23	-26	-11	-1	3	-1	2	57	62
$pc	-3	-4	-2	0	2	-1	3	222	2

43 Removing Commonwealth own-purpose expenses from the assessment increased the Northern Territory's assessed GST needs, since it received an above average share of this revenue. Removing this revenue from the assessment reduced the assessed GST needs of the other states. The change in the treatment of the homelessness payments changed assessed GST needs by less than $1 per capita.

44 Table 1 does not include the impact of changing the treatment of the Commonwealth payments *COVID-19 public health response* and *Support for businesses impacted by COVID-19* from a no impact treatment to an impact treatment.

29. Adjusted budget

Review outcomes

- The following changes were made to the adjusted budget compilation process.
  - Preliminary ABS Government Finance Statistics data will be used for the latest assessment year (year 3). Where these data are unavailable, state-provided data will continue to be used. This process will be monitored to ensure using preliminary ABS data for year 3 remains appropriate.
  - A defined process has been introduced for making any adjustments to Government Finance Statistics data.
- The Commission considered but did not change the following.
  - Final ABS Government Finance Statistics data will continue to be used for the other assessment years.
  - Non-confidential data will continue to be provided to states to allow for reconciliation of preliminary ABS or state data and final ABS Government Finance Statistics data.
  - When data errors are discovered for previous assessment years, these will continue to be corrected in the corresponding assessment years of the current update. Additional adjustments will not generally be made to correct for errors in GST distribution as a result of a data error in previous updates.
- The Commission will work with states and the ABS where appropriate to improve alignment of ABS Government Finance Statistics and state budget data.

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
- GST impacts of method changes.

5 A description of the adjusted budget method, incorporating the changes made in the 2025 Review, can be found in the adjusted budget chapter of the *Commission's Assessment Methodology*.

Issues considered

Use of ABS final and preliminary Government Finance Statistics data

6 The Commission sought state views on using preliminary ABS Government Finance Statistics data for the latest assessment year (year 3) and state-provided year 3 data in cases where preliminary ABS data are not available.

7 The Commission considered that the use of preliminary ABS data (when available), instead of state-provided data, may improve comparability of data between states, reduce the number of adjustments and provide more stable budget estimates over time. While preliminary ABS Government Finance Statistics data are not subject to the same validation and consolidation processes as the final ABS data, they have undergone some basic standardisation processes.

8 The Commission also sought views on continuing to use final ABS Government Finance Statistics for the first 4 years of data.

State views

9 There was broad support from most states for the Commission's proposal. The ACT did not support the use of preliminary ABS data.

10 Some states raised concerns about the late availability of the preliminary ABS data. New South Wales questioned the appropriateness of using a mix of ABS and state-provided data if ABS data are not available in time for an update or review process. Victoria sought more clarity on the process for collecting and verifying state data if ABS data are not available in time and on the adjustments made by the ABS to state data. South Australia proposed the use of preliminary ABS data be reviewed if there are ongoing delays resulting from the use of state-provided data.

11 Victoria and the ACT raised concerns regarding the transparency of adjustments made by the ABS to states' raw data when preparing the preliminary ABS year 3 data. Victoria asked the Commission to provide more details on the ABS' adjustments.

12 The ACT had a further concern with the observed volatility of category totals for the ACT between state raw, preliminary and final Government Finance Statistics data, and with the treatment of Australian Accounting Standard Board (AASB16) Leases accounting standard in the preliminary ABS Government Finance Statistics data. It supported using final ABS Government Financial Statistics for the first 4 years of data.

Commission response

13 The Commission considers that final ABS Government Finance Statistics data are the most reliable and fit-for-purpose source of state budget data. This is because the

ABS audits data for consistency and quality across all states. While preliminary Government Finance Statistics are not subject to the same processes, they undergo basic standardisation, formatting and some basic recoding processes.[1] As a result, the Commission considers the use of preliminary ABS data for year 3 will improve the consistency of ABS Government Finance Statistics data between states and reduce the number of adjustments and revisions.

14 While the use of preliminary ABS Government Finance Statistics data from all states is preferred, the Commission acknowledges that data may not be available in time for use in the yearly update. If this is the case, the Commission considers it appropriate to use a mix of preliminary ABS data and state-provided data to ensure the highest level of consistency and to reduce the data burden on states. If state-provided data are required, these will be requested through the annual data request process.

15 The use of preliminary ABS data will be monitored. If issues are encountered, its use will be re-examined.

16 The Commission notes that the ABS does not make changes to the preliminary ABS data in relation to AASB16. If a state has included the effects of AASB16, this will remain in the preliminary ABS data which means that no adjustment needs to be made to year 3 data.[2]

Commission decision

17 The Commission will use preliminary ABS Government Finance Statistics data from states for year 3 where they are available and state-provided data in cases where they are not available. This process will be monitored to ensure using preliminary ABS data remains appropriate for year 3.

18 The Commission will continue to use final ABS Government Finance Statistics data for the first 4 assessment years.

Implementing adjustments in the 2025 Review and future updates

19 The Commission proposed a process for implementing adjustments to Government Finance Statistics data. This included only implementing adjustments that meet the $12 per capita materiality threshold for data adjustments and testing the materiality of all adjustments during a review year.[3]

[1] More details are provided in the adjusted budget chapter of the Draft Report.

[2] Any state treasury coding relating to AASB16 is not changed by the ABS in the unit record creation process. For example, if states code their Government Finance Statistics file so that the effect of AASB16 is removed, or if states leave in the effect of applying the AASB16 accounting standard, both types of coding will remain in the preliminary unit record files. The AASB16 accounting standard is only removed by the ABS in the final ABS Government Finance Statistics data.

[3] The $12 per capita materiality threshold refers to the impact on GST distribution of a data adjustment. See the Review Outcomes chapter on fiscal equalisation, supporting principles and assessment guidelines for more information.

State views

20 There was broad support from all states for the proposed process. Some states said states should be consulted if adjustments are made.

21 Victoria asked for further clarity on the adjustment consultation process and considered all states should be made aware of adjustments that are applied to ensure transparency.

22 New South Wales asked the Commission to clarify whether adjustments found to be immaterial in one update will be tested again in subsequent updates.

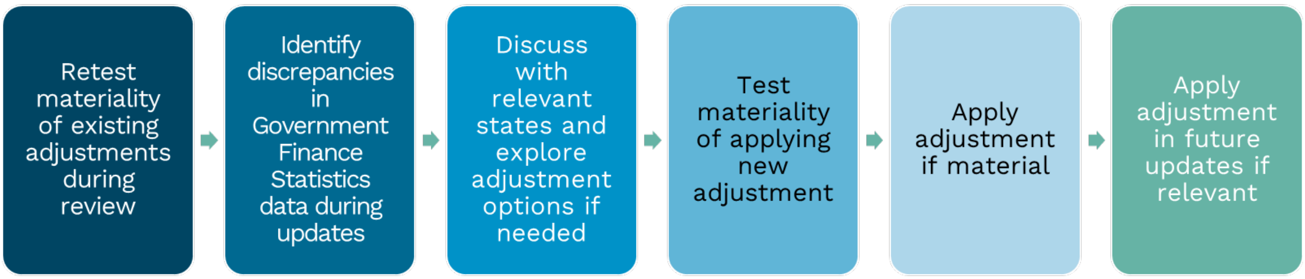
23 New South Wales and Western Australia said some adjustments should be made regardless of materiality, such as where obvious errors are found or when required to align with the Commission's assessment structure.

24 The Northern Territory noted that the continued divergence of state and Government Finance Statistics accounting rules may lead to a proliferation of potential adjustments that might not be able to be reliably applied. The Northern Territory considered that the issue of divergence may be an issue for the ABS and states to consider through the Heads of Treasury Accounting and Reporting Advisory Committee rather than a method change for the Commission.

Commission response

25 The Commission developed a process for implementing existing and new adjustments in the 2025 Review and subsequent updates, see Figure 1.

Figure 1 Adjustment process for the 2025 Review



26 **Existing adjustments** – A $12 per capita materiality will be applied to existing adjustments.[4] If these adjustments are found to be material, they will be retained for the period of the review. Materiality will not be re-tested in future updates. States can raise any issues concerning potential changes to an adjustment's materiality status in future updates.

27 **New adjustments** – If the Commission or any state identifies a new issue with Government Finance Statistics data, the Commission will consult with the relevant

[4] Existing adjustments are those that were applied in the update prior to a review. For the 2025 Review this is the 2024 Update.

state(s) and determine materiality ($12 per capita) before applying any new adjustments.[5]

28 The Commission agrees that it would be optimal to ensure the adjusted budget for each state aligns perfectly with the Commission's category structure regardless of the materiality of any required adjustments. However, the Commission also sees value in reducing the manual manipulation of Government Finance Statistics data to avoid introducing complexity and reducing transparency of the calculations.

29 The Commission seeks to provide all calculations to states in the assessment system simulator.[6] Where confidential data prevent the calculation from being shared in its entirety to all states, the Commission will provide as much detail in the calculation as possible without compromising data confidentiality protocols. A state can also separately request data on the adjustments made to its budget data.

30 The Commission acknowledges that the use of final ABS Government Finance Statistics data and preliminary ABS or state-provided data will result in some inconsistencies between years that require adjustment. While it would be preferable for both sources to align, the Commission acknowledges that state financial data and Government Finance Statistics data serve different purposes, and states and the ABS have different reporting obligations. The Commission is open to working with states and the ABS to better understand these differences.

Commission decision

31 The Commission has followed a defined process (outlined above) for implementing adjustments in the 2025 Review and will follow this process for subsequent updates.

Process for correcting data errors in prior years

32 In response to state comments, the Commission considered the issue of whether it should introduce a defined process for correcting prior year data errors, as well as correcting the GST distribution for the impacted year.

State views

33 New South Wales said the Commission should clearly articulate its position on retrospective data adjustments, including whether there is a materiality threshold or other factors that influence the Commission's assessment of whether a retrospective adjustment is fair and appropriate.

[5] Any new adjustments are made to all relevant assessment years in the current review or update. New adjustments are not applied retrospectively.

[6] The assessment system simulator is a copy of all non-confidential calculations that contribute to the relativities. It allows for states to view data and methods providing greater transparency of the Commission's methods.

Commission response

34 Given the unknown nature and impact of data errors, the Commission considers retrospective data adjustments (to correct errors in GST distribution in previous updates) should only be applied in very rare circumstances. In these instances, the Commission considers it appropriate to exercise judgement on a case-by-case basis.

35 The standard process for correcting data errors from previous updates is to only correct them in the corresponding assessment year of the current update.[7]

Commission decision

36 When data errors are discovered in previous assessment years, the Commission will continue to correct these errors in the corresponding assessment years of the current update. The Commission will generally not make an additional adjustment to correct for errors in GST distribution as a result of data errors in previous updates.

Improving the quality and transparency of data used to inform the adjusted budget

37 In response to state comments, the Commission considered concerns about the quality of the classification of the functions of government – Australia (COFOG-A) data from ABS Government Finance Statistics. It also noted concerns that states had trouble reconciling adjusted budget data back to original state data.

State views

38 New South Wales said that providing a reconciliation of adjusted budget, including all adjustments, and state data would assist states in understanding the data used by the Commission.

39 New South Wales also said there are a number of implausible actual to assessed expenditure ratios for individual states. These imply there are significant issues with the quality of the COFOG-A data provided by states to the ABS, or fundamental errors in the assessment of drivers in these expenditure categories. New South Wales noted the misclassifications will impact the distribution of GST between states.

40 New South Wales said that even putting aside differences between state-provided and final ABS data, the per capita revisions to assessment year data for individual states significantly exceed the materiality threshold. It suggested the Commission, along with the ABS and states, should engage in a structured process to improve the data.

41 Queensland recommended a review of the reliability and comparability of state Government Finance Statistics data be included as a priority in the forward work

[7] For example, an error identified in year 2 of a previous update will be corrected in year 1 of the current update.

program. Queensland said that Government Finance Statistics data for some assessments are not reliable because of differences in the way states classify data. As a key data user, Queensland considers it imperative that the Commission is actively involved in improving these data to ensure outcomes are not compromised.

42 Queensland proposed adding a review of ABS Government Finance Statistics data and state budget data quality and reliability to the forward work program.

Commission response

43 The Commission seeks to provide all calculations to states in the assessment system simulator. A state can also separately request data on the adjustments made to its budget data if these are not visible due to confidentiality concerns.

44 Currently, disaggregated ABS Government Finance Statistics data are confidential and cannot be shared with states. Therefore, only aggregated Government Finance Statistics data can be provided in the simulator, which limits the extent to which states can reconcile data. The ABS has informed the Commission that each state can be provided with its own disaggregated Government Finance Statistics data as this is covered under the return-to-source provisions.

45 The Commission acknowledges there are differences in data classification across states. However, analysis undertaken by the Commission to identify differences (at the category level) between preliminary year 3 and final ABS Government Finance Statistics data indicates that there are very few differences that are material. Where a material revision occurs more than once, the Commission works closely with the relevant state to identify the source of the issue and explore options for resolving it.[8]

46 To mitigate differences across states, the Commission uses final ABS year 2 data proportions to create the component level splits in most expense categories for year 3, which smooths data differences between states and the ABS.[9]

47 It is difficult to disentangle why assessed and actuals diverge as differences may be attributed to a variety of causes including state policy differences. The Commission considers the ABS Government Finance Statistics data are the most comparable data available and notes the ongoing work between the ABS and state treasuries to ensure accuracy and transparency.

8 For example, the ABS might make a revision to preliminary year 3 data due to ad-hoc classification differences. If this has a material impact on GST distribution the Commission will follow up with the ABS and the relevant state to understand the cause of the revision. If the ABS makes a similar revision in 2 consecutive updates the Commission will investigate a potential adjustment to year 3 data in consultation with the ABS and the relevant state to avoid material revisions in the following update.

9 Preliminary ABS data are used to derive investment component expenditure because investment is too volatile to estimate using year 2 ABS data, and any COVID-19 business support payments are large and need to be reflected in the correct component in the year they occur. Preliminary ABS data are used to create the component split for services to industry year 3 in the 2025 Review as the 2023–24 data may still contain residual amounts of COVID-19 payments. If no COVID-19 payments are being included in the preliminary ABS data going forward, components can revert to being based on final ABS year 2 proportions.

48 The Commission will continue to monitor data for inconsistencies and assist the states and the ABS with any projects aimed at improving the consistency and accuracy of state Government Finance Statistics data.

Commission decision

49 The Commission will continue to provide non-confidential data to states to allow for reconciliation of state and ABS Government Finance Statistics data. It will continue to monitor data for inconsistencies and work with states and the ABS where appropriate to improve consistency and accuracy of Government Finance Statistics data used in the Commission's assessments.

GST impacts of method changes

50 Table 1 shows the GST impacts of removing adjustments that were not material.

Table 1 Impact on GST distribution of method changes, adjusted budget, 2024-25 to 2025-26

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total effect
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Payroll Tax	-4	0	6	-9	4	2	0	0	13
Land tax	-29	-9	19	7	7	3	2	1	39
Motor Taxes	1	0	0	0	0	0	0	0	1
Other Revenue	0	0	0	0	0	0	0	0	0
Schools	-3	-7	7	3	-2	0	0	2	12
Post-secondary education	2	3	-3	-1	1	-1	0	-2	6
Services to communities	0	0	0	0	0	0	0	0	0
Roads	-4	-8	5	5	1	0	-2	3	14
Other Expenses	0	1	0	-1	0	0	0	0	1
Investment	7	-10	-3	5	0	0	0	1	13
Net Borrowing	0	1	0	0	0	0	0	0	1
Total	**-31**	**-29**	**31**	**9**	**12**	**4**	**0**	**4**	**60**
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc
Payroll Tax	0	0	1	-3	2	3	1	0	0
Land tax	-3	-1	3	2	4	5	4	2	1
Motor Taxes	0	0	0	0	0	0	0	0	0
Other Revenue	0	0	0	0	0	0	0	0	0
Schools	0	-1	1	1	-1	0	-1	9	0
Post-secondary education	0	0	0	0	0	-1	0	-8	0
Services to communities	0	0	0	0	0	0	0	0	0
Roads	0	-1	1	2	1	0	-5	10	1
Other Expenses	0	0	0	0	0	0	0	-1	0
Investment	1	-1	-1	2	0	0	1	4	0
Net Borrowing	0	0	0	0	0	0	0	0	0
Total	**-4**	**-4**	**5**	**3**	**7**	**6**	**0**	**15**	**2**

Note: The impact of changes to adjustments in health, housing, welfare, transport, and services to industry are presented within the corresponding table in the relevant category assessment chapter of *Review Outcomes*.

30. Fiscal equalisation, supporting principles and assessment guidelines

Review outcomes

- The Commission will retain its approach to horizontal fiscal equalisation as the first step in determining the GST distribution in accordance with GST distribution legislation.
- The Commission will retain its 4 supporting principles ('what states do', policy neutrality, practicality and contemporaneity) and will not introduce new supporting principles.
- The Commission will retain its assessment guidelines, while increasing the materiality threshold for drivers to $40 per capita and for data adjustments to $12 per capita.
- The Commission will retain its discounting framework and will apply 6 discounts.

Introduction

1 On 21 April 2023, the Commission published a consultation paper outlining its preliminary views on horizontal fiscal equalisation, supporting principles and assessment guidelines and invited state submissions.

2 On 9 June 2023, the Commission published its position on horizontal fiscal equalisation, supporting principles and assessment guidelines. This provided guidance for the Commission's review of its assessment methods.

3 The Commission reviewed the consistency of its use of discounting across assessments and published its outcomes in November 2024 in Significant changes since the Draft Report.

4 This chapter includes:

- a high-level overview of the issues considered throughout the review
- the Commission's response and decision on each issue.

5 More detail on these issues can be found in the Commission's position paper on horizontal fiscal equalisation, supporting principles and assessment guidelines. It includes a detailed analysis and response to the issues raised by states and territories (states).

6 A description of the Commission's approach to horizontal fiscal equalisation, supporting principles and assessment guidelines, incorporating the changes made in the 2025 Review, can be found in the *Commission's Assessment Methodology*.

Horizontal fiscal equalisation

7 The Commission provides independent advice to the Commonwealth on how GST revenue should be distributed among the state and territories (states). The distribution of GST revenue is governed by legislation and terms of reference issued by the Commonwealth Treasurer.

8 The terms of reference require the Commission to take into account the *Intergovernmental Agreement on Federal Financial Relations*. This agreement provides that GST revenue will be distributed in accordance with the principle of horizontal fiscal equalisation.

9 The GST distribution legislation includes an equalisation benchmark linked to the fiscally stronger of New South Wales or Victoria, a GST relativity floor, and transitional arrangements. Under this benchmark, the concept of horizontal fiscal equalisation remains relevant to the first step in determining states' GST distributions — calculating states' relative fiscal capacities, or 'assessed relativities'. This first step is necessary to identify the fiscally stronger of New South Wales or Victoria, which is the benchmark set by the legislation.

10 The Commission's preliminary view was that the approach to horizontal fiscal equalisation articulated in the 2020 Review remained appropriate for the first step in determining GST distributions, including the calculation of transitional 'no worse off relativities'.[1] In line with the conclusion in the 2020 Review, it proposed that the assessment of state relative fiscal capacities continues to be determined such that:

> 'after allowing for material factors affecting revenues and expenditures, each state would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own-sources and operated at the same level of efficiency.'

11 In assessing each state's GST needs in line with horizontal fiscal equalisation, the Commission assesses the amount the state would need to spend to provide all-state average services and infrastructure, and the revenue it could raise from its own sources if it made the average effort. The Commission also takes into account payments other than GST that each state receives from the Commonwealth.[2]

[1] Terms of reference ask the Commission to provide the relativities that would have applied if the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018* had not been enacted. Horizontal fiscal equalisation is also relevant to calculating 'no worse off' relativities in accordance with Section 5 of the *Federal Financial Relations Act 2009*.

[2] Not all Commonwealth payments are taken into account. Some payments are excluded by the Treasurer's terms of reference ('quarantined payments'). In the case of payments that are not quarantined, the Commission includes those that relate to state-type services for which the Commission assesses states' expenditure needs. The Commission's approach to other Commonwealth payments will be covered in a subsequent paper.

State views

12 All states supported the view that the approach articulated in the 2020 Review is the appropriate first step in determining the GST distribution.

13 Victoria said that, while horizontal fiscal equalisation should be the primary objective, it would like to see a reweighting towards the supporting principles. Western Australia noted that the horizontal fiscal equalisation objective was only ever aspirational because it is not possible to calculate true horizontal fiscal equalisation.

14 Several states said that horizontal fiscal equalisation is no longer achieved in practice as a result of the legislation requiring the distribution of GST being linked to the fiscally stronger of New South Wales or Victoria. The role of assessed relativities in informing the transitional 'no worse off relativities' that are included in legislation was also noted. Tasmania said a permanent extension to the no worse-off guarantee is needed.

15 The Northern Territory said equalisation gives states the fiscal capacity to deliver state-average services but does not provide additional capacity to address persistent pre-existing structural disadvantage. It sought consideration of changes to the Commission's framework for the treatment of Commonwealth payments to ensure the GST distribution does not impede the objectives of such funding.

Commission response

16 The Commission has consistently stated that equalisation is not an exact science — it depends on the availability of appropriate data and requires the Commission to undertake estimates, apply judgement, and make trade-offs. In making these judgements, the Commission will continue to follow the processes outlined in its assessment guidelines and will seek to make its reasoning as consistent, transparent and understandable as possible.

17 While the Northern Territory did not seek to amend the definition of horizontal fiscal equalisation, it sought to clarify the treatment of Commonwealth payments provided to a state to address pre-existing structural disadvantage. These issues are discussed in the Commonwealth payments chapter of *Review Outcomes*.

Commission decision

18 The Commission will retain the 2020 Review approach to horizontal fiscal equalisation as the first step in determining the GST distribution in accordance with GST distribution legislation.[3]

[3] *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018 (Cth).*

Supporting principles

19 The Commission identifies influences ('drivers') beyond the direct control of states that cause their relative fiscal capacities to diverge. By quantifying these drivers, the Commission estimates the GST share each state requires to have the capacity to provide the same (average) level of services — that is, each state's relative fiscal capacity as represented by its 'assessed relativity'.[4]

20 Since the 2010 Review, the Commission has developed and refined a set of supporting principles.[5] These are guiding considerations for the Commission in designing and evaluating alternative assessment methods and are subsidiary to the objective of horizontal fiscal equalisation. They are:

- 'what states do' — the Commission’s methods should, as far as possible, reflect what states collectively do, not what they could or should do
- policy neutrality — a state's policy choices (in relation to the revenue it raises or the services it provides) should not directly influence its GST share; and the Commission's assessments should not create incentives to choose one policy over another
- practicality — assessments should be based on sound and reliable data and methods and should be as simple as possible, while capturing the major influences on state expenses and revenue
- contemporaneity — to the extent reliable data will allow, the distribution of GST in a year should reflect state circumstances in that year.

21 The Commission’s preliminary view was that the 4 supporting principles remained appropriate.

State views

22 All states supported the ‘what states do’ principle, with assessments being based on the weighted average policy of all states. However, several states noted the difficulty of determining an average policy when an assessment is dominated by one state (such as in the case of mining), or when what states do is changing (for example, tax reform), or where a state is trying to address structural disadvantage.

23 All states supported the policy neutrality supporting principle as being appropriate, with assessments being based on the weighted average policy of all states. However, many recognised the difficulty of determining an average policy when an assessment was dominated by one state. Some states also asked the Commission to provide greater clarity and consistency on how it weighed the primary objective of horizontal fiscal equalisation and supporting principles in reaching its decisions on assessments that involved a trade-off between supporting principles.

[4] Assessed relativities are calculated for each assessment year by comparing each state’s relative ability to raise revenue with its relative cost of providing services. See Box 1-1 in GST Revenue Sharing Relativities 2023 Update.

[5] The supporting principles evolved from the ‘3 pillars of equalisation’ first articulated in the 2004 Review: capacity equalisation, internal standards, and policy neutrality.

24 All states supported the practicality principle. Several states said simplicity, transparency and quality assurance were central to trust in, and understanding of, horizontal fiscal equalisation. They called for a greater focus on each of these aspects of the practicality principle.

25 All states broadly supported the Commission's approach to contemporaneity, noting that the 3-year lagged average approach will achieve equalisation over time. There were differing views on the use of forecasts as well as historical data.

26 Western Australia proposed 2 new principles (policy consistency and conservatism).

Commission response

27 The Commission notes that significant experience, expertise and effort have gone into developing, refining and improving the supporting principles since they were introduced. In particular, the 2020 Review involved extensive consultation on, and consideration of, the supporting principles.[6] The Commission's view is that there are no developments that require the need to introduce new principles.

28 The Commission acknowledges the challenges in determining average policy and the limitations of the 'what states do' principle in some circumstances. These issues are addressed in the relevant chapters of *Review Outcomes*.[7] Overall, the Commission is satisfied that 'what states do' continues to be the best way to determine average policy.

29 The Commission recognises that the supporting principles can often be in conflict. For example, there may be cases where the Commission needs to balance the trade-off between 'what states do' and policy neutrality. Where trade-offs are required, the Commission will outline the reasons for its decisions.

30 The Commission endorses many of the points raised about the practicality principle, particularly the importance of its consistent application and the role of transparency. The Commission recognises that assessed relativities provide an approximation of horizontal fiscal equalisation and that false precision needs to be avoided. Nevertheless, the primary objective of assessed relativities is to minimise as far as possible differences in the fiscal capacities of the states to deliver services.

31 With respect to the contemporaneity principle, the 3-year lagged moving average provides an appropriate balance between contemporaneity, predictability and smoothing the impact of fiscal shocks. The Commission does not support the use of forecasts because it would require an ex-post adjustment to address inaccuracies in

[6] Further detail on the Commission's consideration of supporting principles and their implementation in the 2020 Review can be found in Vol 2 Chapters 2 and 3 of the [Report on GST Revenue Sharing Relativities, 2020 Review].

7 Concern that the GST distribution arrangements can be a disincentive for some tax reforms is covered in the stamp duty on conveyances and flexibility chapters of *Review Outcomes*. The issue of determining the average policy when one state dominates expenditure or revenue is covered in the mining chapter of *Review Outcomes*. The Northern Territory's views on pre-existing structural disadvantage are addressed in the Commonwealth payments chapter of *Review Outcomes*.

those forecasts. This would add an additional layer to the equalisation process, with the Commission updating its relativities when final data become available.

32 The Commission does not support the introduction of a 'policy consistency' principle. While there will be a range of different policies affecting a state's revenue capacity, it would be impractical to identify and make reliable adjustments for every difference. The Commission considers that calculating a weighted average tax rate for each state's tax base, across all states, is the most practical approach to assessing a state's own source revenue capacity (with some adjustment to the tax base as required and the application of the policy neutrality principle). The Commission also does not support a conservatism principle – which would require the Commission to err on the side of smaller GST redistributions in the face of uncertainty by moving towards an equal per capital distribution. There is an element of uncertainty with all assessments, but it is not evident that such general uncertainty materially affects the assessment of state fiscal capacities. The Commission seeks to reduce differences in the fiscal capacity of the states in all assessments and the degree of uncertainty will depend on the circumstances of each assessment. The Commission's approach to discounting assessments is discussed below in the section on assessment guidelines.

33 The Commission maintains its position that there should not be an explicit weighting or hierarchy of the supporting principles. It considers that wherever possible, assessment methods should be chosen having regard to all the supporting principles.

Commission decision

34 The Commission will retain the 4 supporting principes and will not introduce new principles. There will not be a weighting or hierarchy of the supporting principles.

Assessment guidelines

35 Since the 2004 Review, the Commission has used assessment guidelines to support a consistent approach to developing assessment methods and to ensure conceptual soundness, reliability, transparency and simplicity with the application of those methods. The guidelines are a key part of the Commission's quality assurance process.

36 The Commission has applied materiality thresholds to its assessments since the 2010 Review, increasing the level of the thresholds in the 2015 and 2020 Reviews. The materiality thresholds help to simplify the assessments.

37 In the 2025 Review, the Commission considered 2 options for basing an increase in the thresholds:

- the State and Local Government Final Consumption Expenditure chain price index — the approach used in the 2020 Review
- state expenditure per capita.

38 The Commission proposed that the thresholds be increased broadly in line with state spending per capita. This would increase the threshold for assessing drivers to $45 per capita and the data adjustment threshold to $15 per capita.

State views

39 Victoria, Queensland, Western Australia, South Australia and Tasmania supported the continued use of the 2020 Review guidelines.

40 New South Wales, the ACT and the Northern Territory raised concerns about materiality thresholds, discounting and the timeliness and use of data.

41 Victoria supported the guidelines while seeking a more transparent decision-making process for how a proposed method change meets each element of the assessment guidelines. It said quality assurance and transparency could be improved through peer review and periodic external review of calculations and documenting the reasons for Commission decisions.

42 The ACT broadly supported the assessment guidelines but suggested they include a reference to the timeliness of data in the definition of fitness for purpose. The ACT also suggested amending the guidelines to reflect that the Commission will endeavour to use the best available data if a fully compliant source was not available.

43 Several states supported increasing materiality thresholds, preferring the State and Local Government Final Consumption Expenditure chain price index to the Commission's proposal. Others did not support indexation or felt it would raise the threshold too high. Western Australia noted that the thresholds proposed by the Commission were rounded to the nearest $5 per capita, which was appropriate for simplicity, but suggested the Commission continue to apply its indexation to the same base year so that rounding errors did not accumulate over time.

44 The ACT and the Northern Territory did not support materiality thresholds. The ACT suggested an additional, less onerous, test. The Northern Territory preferred the State and Local Government Final Consumption Expenditure chain price index if indexation of the materiality threshold were to occur.

Commission response

45 The Commission considers the 2020 Review assessment guidelines remain appropriate, although it will increase the materiality threshold levels.

46 The Commission's view is that there is no need to amend the definition of fitness for purpose to incorporate the timeliness of data because the contemporaneity principle provides sufficient guidance on the use of timely data. Similarly, the guidelines provide the Commission with the flexibility to use the best available data, with adjustments, if necessary, when data that fully comply with the guidelines are unavailable. Timeliness of data is also a consistent requirement of terms of reference issued by the Commonwealth Treasurer which direct the Commission to

'have assessments that are simple and consistent with the quality and fitness for purpose of the available data' and to 'use the latest available data consistent with this.'

47 The Commission acknowledges the Northern Territory's concerns that the use of materiality thresholds can contribute to inaccuracies over time. However, they are an important aspect of simplifying assessments and they are the means by which the Commission determines the material factors to comply with the horizontal fiscal equalisation objective. The Commission recognises that materiality thresholds cannot be applied mechanistically and that judgement is required.

48 The Commission was persuaded by state arguments in relation to the appropriate basis for increasing materiality threshold levels. The Commission will increase the materiality thresholds to $40 per capita for the assessment of a driver and $12 per capita for a data adjustment. These increases are broadly in line with the State and Local Government Final Consumption Expenditure chain price index. This was the approach used in the 2020 Review and it is consistent with most state views that materiality thresholds should be increased to maintain their value in real terms over time.

49 In response to Western Australia's concern that rounding errors can accumulate over time, the Commission recalculated the thresholds using the same base year and they did not change. In addition, the Commission rounded down the data threshold.

50 The Commission considered the test proposed by the ACT involving a 2-part materiality threshold that included an aggregate redistribution materiality threshold. However, it is satisfied that the state-based approach to thresholds is appropriate and the number of cases where an assessment is material overall but not for any state are likely to be small and do not warrant the additional complexity of a 2-part materiality test.

51 The Commission agrees that the materiality of all factors and assessments should be reconsidered in a review. It retested the materiality of all drivers of need and assessments as part of the 2025 Review.

Commission decision

52 The Commission will retain the 2020 Review assessment guidelines, although it will increase the level of materiality thresholds.

53 The Commission will increase its materiality thresholds to $40 per capita (for the assessment of a driver) and $12 per capita (for a data adjustment).

Discounting assessments

54 As part of the 2025 Review, the Commission reviewed its use of discounting to ensure consistency across assessments.

55 The Commission proposed to retain the 2020 Review discounting framework and the discount levels. That is:

> Where a case for assessing a driver in a category is established, but the Commission has concerns with the underlying data or assessment method, a uniform set of discounts will be used — low (12.5%), medium (25%), high (50%) or no assessment (100%). The Commission will use higher discounts when the Commission has greater concerns with the underlying data or assessment method.

56 Under the discounting framework, discounts are used where there are concerns with data or methods and not applied in cases of general uncertainty or to address policy neutrality.

57 The Commission invited state views on whether the 2020 Review discounting framework remained appropriate and the case for discounting particular assessments was considered as part of consultation on those assessments.

58 The Commission considered the consistency of its use of discounting across assessments towards the end of the review and published the outcomes in *Significant changes since the Draft Report*.

State views

59 Queensland, South Australia, Tasmania and the ACT supported the 2020 Review approach to discounting. Queensland and South Australia said there was a need for regular reviews of discounts, so they reflect the degree of uncertainty and unreliability of the data and methods. They identified assessments where they considered a higher level of discount should be applied.

60 New South Wales was concerned that discounting was arbitrary. It said the Commission applies a discount where it considers data to be unreliable, but discounting was only ever in one direction, towards an equal per capita distribution. Discounting could be moving the outcomes further away from true horizontal fiscal equalisation. New South Wales supported greater consistency in the use of discounts. It suggested that assessments with a discount be given greater attention in order to improve them. It also suggested the Commission increase its efforts to collect more reliable data from states with the aim of removing discounts over time.

61 Victoria sought greater clarity over the definition and application of discounts. It said that where a high discount is applied, there were concerns with the appropriateness of the data or method and as such, it raised the question whether an assessment should be made. Victoria noted that discounts were not applied to judgement-based estimates, whereas Victoria considered there was a greater case for using discounts in these situations.

62 Western Australia said the Commission should be using discounting more often. It supported the use of discounts in cases of general uncertainty and policy neutrality.

It also suggested that an alternative to discounts to individual assessments would be a discount to the assessed relativities or a floor on relativities.

63 The Northern Territory was opposed in principle to extensive discounting. It said that general uncertainty and methodological difficulties did not always warrant a discounting approach.

Commission response

64 The Commission acknowledges that discounting involves judgement. However, discounting allows the Commission to capture states' fiscal capacities while recognising the limitations of data and methods in some circumstances. The Commission will continue to consider discounts on a case-by-case basis, explain the reason for any discount and ensure consistency of approach across assessments.

65 The Commission agrees with New South Wales' suggestion that it should increase efforts to collect more reliable data from states with the aim of removing the need for discounting.

66 As New South Wales noted, discounting moves assessments closer to equal per capita. The Commission considers this to be the only practical way to deal with situations where there is evidence that material differences exist between states in the level of use or unit costs, or both, in providing services or in their capacities to raise revenue, but there is uncertainty over the reliability of the data or the method. In such situations, discounting the assessment method for this uncertainty will be more consistent in moving towards horizontal fiscal equalisation than not undertaking an assessment. However, if the level of uncertainty is too large, it agrees with Victoria that an assessment should not be made.

67 The Commission does not apply discounts to judgement-based estimates because, in determining those estimates, it has already considered the degree of uncertainty involved.

68 The Commission does not consider that discounting assessed relativities is an alternative to discounting individual assessments. When deciding on whether to apply a discount, the Commission takes into account the circumstances of the individual assessment.

69 The Commission has not changed its view that discounts should only be used for concerns with data or methods. Discounts will not be applied in cases of general uncertainty or to address policy neutrality.

Commission decision

70 The Commission will retain the 2020 Review discounting framework.

71 In the 2025 Review methods there will be 6 discounts. It will retain the 4 discounts from the 2020 Review at the same levels and add 2 new discounts: applied to the

entirety of the roads assessment and the non-state sector adjustments in the health assessment.

72 Table 1 indicates the assessments where the Commission has applied a discount to an assessment, including the rationale for the discount and its level. More detail on individual discounts, and consideration of state proposals regarding discounts, is provided in the relevant assessment chapters.

Table 1 Discounts in the 2025 Review

Assessment	Component	Rationale for discount	Level of discount
Land tax	Whole assessment	Uncertainty about the reliability and comparability of taxable land value data.	12.5%
Health	Community health socio-demographic	Reliance on a proxy measure of activity for a significant share of community and public health expenses.	12.5%
Health	Non-state sector adjustments	Uncertainty about the reliability of data and the robustness of the methods for determining the adjustments.	12.5%
Roads	Whole assessment	Uncertainty about the reliability of data included in several aspects of the assessment, including the reliability of the rural road synthetic network as a proxy measure of what states do.	12.5%
Wage costs	A range of category assessments	Uncertainty about the reliability of private sector wages as a proxy for public sector wage pressures, and the capacity of the model to control for all differences in employee productivity.	12.5%
Geography	Regional costs general gradient, applied to a range of category assessments	Uncertainty about the reliability of the gradient, given it is applied where a gradient cannot be directly measured.	25.0%

31. Flexibility to consider method changes between reviews

Review outcomes

- The terms of reference for the 2025 Review asked the Commission to consider if there is a case for the Commission to be given the flexibility to consider alternative assessment methods in cases where there is a significant unanticipated shock (such as a pandemic) or where major state policy reforms are enacted between reviews.
- The Commission considers it would be beneficial to have additional flexibility to change methods between reviews in very limited circumstances, and in full consultation with states.
- Those limited circumstances would include major unexpected developments or major state policy changes where all of the following conditions apply:
  - there is a significant impact on the fiscal positions of one or more states
  - the impact is not captured in existing assessment methods
  - a change in assessment methods before the next review would better achieve the objective of fiscal equalisation.
- The Commission would consult closely with the states on whether an event falls within the circumstances that may warrant consideration of alternative methods and, if it does, all aspects of possible changes to assessment methods.
- The Commission supports operationalising flexibility to change methods between reviews in a standing clause in terms of reference for updates.
- The Commission does not support retrospectively adjusting GST shares in cases where an assessment method is changed between reviews.

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 position on each issue.

Issues considered

5 Clause 6 of the terms of reference for the 2025 Review asks the Commission to:

> ...consider if there is a case for the Commission to be given the flexibility to consider alternative methods in cases where there is a significant unanticipated shock (such as a pandemic) or where major policy reforms are enacted in between reviews.[1]

6 The Commission engaged with states on issues relevant to increasing the flexibility to change assessment methods between reviews through bilateral meetings, as well as through a consultation paper and the Draft Report. In particular, the Commission sought states' views on whether there is a case for greater flexibility to change methods between reviews, the circumstances in which methods could be changed and how such flexibility could be operationalised.

The case for greater flexibility to change assessment methods between reviews

7 The terms of reference for the Commission's annual updates traditionally asked it to use 'the same principles, categories and methods of assessment' as the most recent methodology review. However, they have allowed method changes between reviews, in consultation with states, to overcome data problems or in response to major changes in Commonwealth-state relations.[2] Method changes in updates for those 2 reasons have not been common.[3]

8 The Commission proposed circumstances where it considered there was a case for extending the flexibility to change assessment methods between reviews, beyond data problems and major changes in Commonwealth-state relations. These circumstances were outlined in the Draft Report, namely:

- there is a significant impact on the fiscal positions of one or more states
- the impact is not captured in existing assessment methods
- a change in assessment methods before the next review would better achieve the objective of fiscal equalisation.

State views

9 Most states said they supported the Commission having additional flexibility to change methods in very limited circumstances and in full consultation with states. New South Wales said the existing arrangements, while allowing for flexibility through annual terms of reference, had not functioned effectively. Victoria said

[1] J Chalmers, *Terms of Reference for the 2025 Methodology Review: Commonwealth Grants Commission Act 1973*, 9 February 2023.

[2] For example, see clauses 8(b) and 10 of the 2024 Update Terms of Reference.

[3] In a few cases, update terms of reference have also asked the Commission to consider a change to (or not to change) a particular method. For example, the 2011 Update Terms of Reference directed the Commission not to move iron ore fines between its mineral groups in the mining revenue assessment. Terms of reference for the 2005 Update asked the Commission to review its assessment of the Northern Territory's debt charges and depreciation needs.

additional flexibility would ensure that fiscal equalisation could be achieved in light of significant uncertain events and that it would not impede efficiency-enhancing policy reforms.

10 Victoria said it had presented extensive arguments that the treatment of COVID-19 related spending under the 2020 Review methods was inappropriate. It said steps to prevent a future diminution of fiscal equalisation in such circumstances, as well as ensuring the fairness of the system, were critical.

11 Western Australia said it was encouraged by the Commission's statement in the Draft Report that a method change may not be introduced in the first update following the change in circumstances. It said that reliable data may not be available immediately and there is a need for adequate time for consultation. South Australia said it did 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.

12 South Australia and Tasmania said, while methodology reviews should be the primary process for determining method changes, unforeseen circumstances could arise that may not be accommodated by existing flexibility to change methods in updates.

13 Queensland and the Northern Territory said they did not support the Commission having greater flexibility to consider alternative methods between reviews. Queensland said additional flexibility would require a rigorous framework, agreed by states, to guide any proposed changes. It said the Draft Report did not consider a higher materiality threshold, a higher degree of consultation than usual and an annual review of any changes. It said, in the absence of such safeguards, there was a risk of arbitrary changes and continuous method reviews. Queensland said the heavy reliance on Commission judgement, particularly on trade-offs between supporting principles, could result in increased volatility in methods and potentially large changes to GST distributions. The Northern Territory said existing terms of reference provided sufficient and appropriate flexibility to respond to major shocks.

Commission response

14 The Commission considers that, in almost all circumstances, the approach of 5-yearly reviews and annual updates appropriately balances stability in methods with the need to capture changes in state circumstances over time. However, in rare circumstances, developments can significantly affect states' relative fiscal capacities in ways that are not adequately captured by the existing assessment methods. In those very limited circumstances, it would be beneficial for the Commission to have flexibility to change methods, in consultation with states, such that they better reflect changed state circumstances and the objective of fiscal equalisation.

15 While the Commission aims to develop methods that capture states' fiscal circumstances as they evolve, not all changes in circumstances can be anticipated when the Commission is finalising a methodology review. The Commission agrees

with New South Wales that the existing approach, where specific terms of reference are needed to address significant unanticipated events, has not worked well. This is illustrated by 2 major developments since the 2020 Review – the COVID-19 pandemic and a major property tax reform proposal by New South Wales – where the requirement to use the 2020 Review methods resulted (or could have resulted) in measures of state fiscal capacities that were inconsistent with fiscal equalisation. In both cases, the ability to consider, consult on, or implement adjustments to assessment methods in response to unanticipated developments prior to the 2025 Review could have improved the assessment of state fiscal capacities, including in the context of major state reforms.

16 The Commission notes that it is required to exercise a degree of judgement, including in balancing supporting principles, when developing all its methods. In making judgements on method changes between reviews, the Commission would continue to follow the processes outlined in its assessment guidelines and seek to make its judgements as consistent, transparent and understandable as possible. Further, consideration of changes to methods would involve extensive consultation with states. Queensland's proposal for a higher materiality threshold is addressed in the next section.

17 The Commission acknowledges the concerns about continuous method changes. The next section deals with circumstances in which method changes could be considered. While it is difficult to predict how often such events may occur, the Commission expects a change in assessment methods between reviews would only be made in very limited circumstances.

Commission position

18 The Commission considers that it would be beneficial for it to have additional flexibility to change methods between reviews in very limited circumstances, and in full consultation with states.

Circumstances that would justify a change in assessment methods between reviews

19 The terms of reference ask the Commission to consider the case for flexibility to change methods between reviews 'where there is a significant unanticipated shock (such as a pandemic) or where major policy changes are enacted between reviews'.[4] These examples reflect the experience since the 2020 Review. But the case for greater flexibility to change methods is not limited to the specific events of the past few years.

[4] Chalmers, *Terms of Reference for the 2025 Methodology Review.*

20 The Commission proposed that the limited circumstances in which it should have flexibility to consider method changes include major unexpected developments or major policy changes where all of the following conditions apply:

- there is a significant impact on the fiscal positions of one or more states
- the impact is not captured in existing assessment methods
- a change in methods before the next review would better achieve the objective of fiscal equalisation.

State views

21 Most states said they supported the Commission's proposed circumstances in which changes to methods could be considered. Victoria said specific wording or quantitative triggers would be difficult to define. Victoria accepted the Commission's view that its proposal to conduct scenario planning may be difficult to implement. South Australia said the Commission must also consider the availability of reliable and policy neutral data on which to base an alternative assessment. It said COVID-19, while a major unanticipated shock, was a clear example of where it was not possible to construct an alternative assessment based on reliable, policy neutral data.

22 South Australia and Tasmania said the case for allowing flexibility for major policy changes, including taxation reform, was less strong. South Australia said major policy changes were not unexpected events and usually had a relatively long development timeline. It said they were best addressed as part of methodology reviews. South Australia said a state seeking assurances on a particular assessment approach in advance of committing to a policy reform was a separate issue. It said alternative assessment decisions should not be based on proposed legislation or on estimated future impacts involving untested assumptions.

23 Queensland said it did not support the proposed circumstances in which changes to methods could be considered. It said the proposed approach would afford the Commission too much discretion. It said method changes between reviews should be subject to a materiality threshold at double the current level. It said the method change should exceed the materiality threshold in the states directly impacted by the shock or reform.

Commission response

24 Most states supported the Commission's view that greater flexibility to change methods between reviews should only be considered in very limited circumstances. As emphasised in the Draft Report, it is difficult to specify in advance the precise nature or characteristics of what would constitute a significant unanticipated event.

25 Instead, the Commission considers the more pragmatic approach is to define what constitutes such an event based on its consequences, as outlined in paragraph 20.

26 In considering a change in methods in consultation with states, the Commission would apply its assessment guidelines. The availability of fit-for-purpose data, as well as a reliable method, is a key feature of those guidelines. (The next section discusses the process the Commission would follow).

27 The Commission does not consider introducing a specific higher materiality threshold is an appropriate trigger for considering a change in assessment methods. A specific higher materiality threshold may prove too restrictive, for example, if an alternative method clearly improves fiscal equalisation but falls just below this higher threshold.

Commission position

28 The Commission considers that the limited circumstances in which the Commission could change an assessment method would include major unexpected developments or major policy changes where all of the following conditions apply:

- there is a significant impact on the fiscal positions of one or more states
- the impact is not captured in existing assessment methods
- a change in methods before the next review would better achieve the objective of fiscal equalisation.

How would the Commission implement a change in method?

29 In the Draft Report, the Commission proposed a process for considering whether method changes were warranted. The first step in that process would be to consult with states on whether an event falls within the circumstances in which method changes may be warranted (outlined in paragraph 28). The Commission would issue a consultation paper to the states on these issues.

30 Having considered state views, if the Commission judged that a change in method may be warranted, it would undertake research and analysis to identify alternative methods and consult with states on all aspects of possible changes to assessment methods. The Commission proposed that it would consider changes in assessment methods in the same way as it does in a methodology review, involving extensive consultation with states.

State views

31 All states said they agreed that consideration of whether method changes were warranted should be undertaken in consultation with states. New South Wales noted the proposed process for considering method changes between reviews would be via a consultation paper to states on the relevant issues, before a wider consultation with states on all aspects of possible changes to assessment methods.

32 Western Australia was concerned that any change could be rushed without adequate consideration and consultation or allowing the implications of the shock to be gauged. It said it was important that the Commission was prepared to take time for extensive consultation, which may take more than one annual update.

33 South Australia said the Commission and states would have to agree on a case-by-case basis whether existing methods captured the impact of the shock or whether exploration of alternative methods was warranted. It said it supported the Commission having the ability to change methods between reviews after detailed consultation with states where there was a sound conceptual case for the change supported by sufficient empirical evidence, an alternative method based on reliable and fit-for-purpose data, and the change was material. It said those circumstances were likely to be very rare.

Commission response

34 The Commission proposes a structured process of consulting with the states on whether method changes in response to unanticipated shocks or major state policy reforms are warranted in the very limited circumstances outlined above. As a first step, the Commission would consult with states on whether an event falls within those circumstances in which changes to methods may be warranted before the next review.

35 Having considered state views, if the Commission judged that a change in method may be warranted, it would undertake research and analysis to identify alternative methods and consult with states on all aspects of possible changes to assessment methods.

36 The Commission would consider changes to methods in the same way as it does in a methodology review, involving extensive consultation with states. The Commission would apply its supporting principles and assessment guidelines.[5] That is, there would need to be a sound conceptual case for the change supported by sufficient empirical evidence, the Commission would need to identify a reliable and implementable method and fit-for-purpose data, and any change would need to be material.[6] The Commission would exercise its judgement to balance any trade-offs between its supporting principles. After consulting states on the development of an alternative method, the Commission would issue a consultation paper to states on any proposed change.

37 If, after considering state views, the Commission decided to change an assessment method, it would aim to make the change in the earliest practicable update following consultation. This may not be the first update following the change in circumstances. Any change in assessment method would require the identification of reliable data and adequate time for consultation with the states. It could also be possible that, notwithstanding the circumstances that initiated the process, a reliable alternative method cannot be identified, and no change would be made, but could continue to be considered in the next review. In the case of policy reforms, some states said that

[5] See Commission position paper on fiscal equalisation, supporting principles and assessment guidelines.

[6] In the 2025 Review, a revenue or expense driver is material if it redistributes more than $40 per capita for any state compared to an equal per capita assessment.

a long implementation period would preclude the need to consider method changes between reviews. However, a state may seek an indication of how a proposed major policy reform would be assessed, prior to proceeding with the reform. This was the case with the property tax changes being considered by New South Wales. It was concerned that the existing assessment methods would be a significant constraint in proceeding with the reform.

38 The Commission is cognisant of the extra workload for states in considering potential method changes. Given it expects consideration of changes in methods in very limited circumstances, concerns relating to resourcing should be minimal.

Commission position

39 The Commission proposes a process for considering, in close consultation with states, whether an event falls within the circumstances that warrant a change in methods and, if it does, all aspects of possible changes to assessment methods.

How greater flexibility could be operationalised

40 In the Draft Report, the Commission proposed that additional flexibility could be provided in a standing clause in terms of reference for updates. Such an approach would be consistent with the Commission's role as the independent agency responsible for advising the Commonwealth Treasurer on states' relative fiscal capacities for the purposes of GST distribution. It would build upon the existing flexibility in terms of reference to overcome data problems or in response to major changes in Commonwealth-state relations.

State views

41 Victoria said it broadly supported the mechanism to implement flexibility through a standing clause in terms of reference. However, its preference was for flexibility to be actioned as a condition of the 2025 Review methods. It said the Commission's proposed approach implies the Commission will direct the Commonwealth Treasurer to amend its terms of reference, which it cannot do. South Australia said it was open to terms of reference allowing method changes between reviews, subject to appropriate processes for the review of any changes. The ACT said standing terms of reference should be accompanied by written guidelines elaborating on the circumstances that would trigger the exercise of such flexibility.

42 Victoria said it did not support the proposal from another state for the Commission to make separate recommendations to the Treasurer to alter the terms of reference while providing recommendations on the distribution of GST based on existing methods. It said there would not be enough time to respond to the late direction from the Treasurer and it would re-create the current issue where the Treasurer is the arbiter of method changes.

43 Queensland said it did not support operationalising flexibility in standing terms of reference.

Commission response

44 The Commonwealth Treasurer has asked the Commission to provide advice on whether it should be given additional flexibility to change methods between reviews.

45 Under existing arrangements, the Commonwealth Treasurer can ask the Commission, through terms of reference, to consider particular method changes in an update. However, this places the Commonwealth Treasurer in the position of 'umpire' on changes where there will always be winners and losers. In the absence of a specific terms of reference direction on a method change, the Commission is required to use the 'same principles, categories and methods of assessment' as the most recent methodology review.

46 Providing for additional flexibility in a standing clause in terms of reference for updates would be consistent with the Commission's role as the independent agency responsible for advising the Commonwealth Treasurer on states' relative fiscal capacities for the purposes of GST distribution. Contrary to Victoria's view, the Commission is not proposing to 'direct' the Treasurer to amend the standing terms of reference for an update to provide the Commission with greater flexibility to change methods between reviews. This is the Commission's recommendation to the Commonwealth Treasurer. It is always open to the Commonwealth Treasurer not to accept the Commission's recommendations.

47 Including additional flexibility in a standing clause in terms of reference for updates would complement the existing flexibility to change methods where there are data problems or in response to significant changes in Commonwealth-state relations. A standing clause in terms of reference could require that the Commission send a separate report and recommendation to the Commonwealth Treasurer on the alternative method adopted in the update.

Commission position

48 The Commission supports operationalising flexibility to change methods between reviews in a standing clause in terms of reference for updates.

Retrospectively adjusting GST shares for method changes

49 Victoria said, in cases where the Commission is unable to implement new methods in an update, it could consider 'backwards adjustments' in future years.

State views

50 Queensland and South Australia said that, if the Commission were given flexibility to make changes, they did not support any retrospective adjustments to GST relativities for method changes between reviews.

Commission response

51 The Commission does not consider it appropriate to make retrospective adjustments to GST relativities for method changes between reviews. The Commission has not made retrospective adjustments to GST shares for previous method changes (either in reviews or in updates). It considers retrospective adjustments may move away from fiscal equalisation in the years in which they are made and increase budget uncertainty for states.

Commission position

52 The Commission does not support retrospectively adjusting GST shares in cases where an assessment method is changed between reviews.

32. Forward work program

Review outcomes

- The Commission will establish a forward work program comprising the following topics:
  - health
  - urban transport
  - cultural and linguistic diversity
  - administrative scale
  - transition to net zero emissions
  - elasticity adjustments
  - First Nations socio-economic status
  - a dominant state adjustment in mining.
- The forward work program will provide an opportunity for the Commission and states to undertake analysis on a selection of more complex issues in preparation for the next methodology review.
- The Commission recognises that there will be resourcing constraints and competing priorities that may impact a state's level of involvement in the forward work program.
- While the forward work program will inform the next review, it will not replace the usual detailed consultation on potential method changes that would occur in a review. As part of the forward work program, the Commission will not make decisions on assessment methods prior to the next review.
- The Commission will establish a Data Working Group with the states ahead of the next review to consider the availability of reliable, fit-for-purpose data across a range of assessments.
- The Commission has separately identified some specific issues it will continue to monitor ahead of the next review.

Introduction

1 On 6 July 2024, the Commission published the 2025 Methodology Review Draft Report.

2 In the Draft Report the Commission proposed to undertake a forward work program, involving detailed research to inform the next methodology review.

3 State submissions on the Draft Report, including on the Commission's proposed forward work program, can be viewed here.

4 This chapter includes:

- state views on the establishment of the Commission’s forward work program
- state views on the forward work program topics proposed in the Draft Report
- other topics suggested by states
- the Commission’s response and decision.

Establishing a forward work program

5 The Commission identified several topics where it considered further detailed research should be undertaken in preparation for the next review. Some involve emerging topics, while others require detailed additional analysis building on issues identified during the 2025 Review. These topics would constitute the Commission’s forward work program.

State views

6 All states supported the Commission’s proposal to establish a forward work program. New South Wales, Victoria, Queensland, Western Australia and the ACT provided general feedback on the Commission’s approach to the forward work program.

7 New South Wales noted a concern that the forward work program could be used as a tool to defer difficult decisions.

8 Victoria said that, given the consistency in terms of reference for methodology reviews over time, the Commission should not wait for terms of reference before beginning work on the next review. Queensland said that reviews should be treated as a continuous and ongoing process.

9 Victoria said the forward work program proposed by the Commission contained too many significant topics to meaningfully examine ahead of the next review. Victoria noted that states ‘resource up’ for reviews and may have limited capacity to engage with the Commission. Western Australia suggested that the forward work program would encourage states to maintain dedicated resources for horizontal fiscal equalisation between method reviews.

10 Victoria asked the Commission to provide states with a work program including timelines, milestones and the use of external consultants. Victoria and Queensland recommended that the Commission use more external consultants during reviews and that these consultants be engaged in advance of the next methodology review.

11 Victoria and Western Australia noted that states’ priorities following the 2025 Review will be influenced by the Productivity Commission's forthcoming review of GST distribution reforms and associated deadlines. Victoria also said that work on the justice assessment will likely require states’ post-review resources and may affect the forward work program.

12 The ACT said that the forward work program will support horizontal fiscal equalisation outcomes and is consistent with the latest developments around federal financial relations and climate change policies.

Topics proposed in the Draft Report.

Health

13 Noting the number of judgements used in the health assessment, along with its complexity, the Commission proposed a review of the health assessment framework to identify any potential improvements and simplification. The Commission proposed to specifically examine the non-state sector adjustments and potential differences in the health service needs of people in similar socio-economic groups.

State views

14 New South Wales, Queensland, Victoria, Western Australia and South Australia said the Commission should explore state and non-state sector interactions in the non-state sector adjustment. They also suggested further consideration of different methods to recognise substitutability between state and non-state sectors.

15 New South Wales, Queensland and the Northern Territory agreed the Commission should explore the evidence on health service needs of people in similar socio-economic groups across states.

16 Queensland and the Northern Territory asked the Commission to engage with states on potential improvements to the broader health assessment framework. The Northern Territory wanted the Commission to review admitted patients and the community health services assessment as a priority.

17 New South Wales suggested that the Commission continue to monitor uncertainty about the extent to which patient transport costs are captured by National Weighted Activity Units in the non-hospital patient transport assessment.

18 Western Australia asked that the Commission specifically examine emergency department non-state sector substitutability by remoteness areas. Western Australia also asked the Commission to look into variation in private health insurance benefit payments per separation for admitted patients.

19 South Australia said the Commission should investigate the appropriateness of using national weighted activity units and continue engaging with the Independent Health and Aged Care Pricing Authority to test the appropriateness of the non-hospital patient transport assessment.

Urban transport

20 The Commission acknowledged the complexity of the urban transport assessment and the significant degree of unease among some states with the assessment

method. Given this, the Commission proposed to seek external advice on the assessment prior to the next methodology review. This will include retesting the urban centre characteristics regression model. 2026 Census data, available progressively in 2027 and 2028, will inform this work.

State views

21 New South Wales and Victoria did not support the Commission seeking further external advice on the urban transport assessment. New South Wales considered the model to be robust and only implemented in the 2020 Review. Victoria said re-examining the urban transport assessment before the next review would be impractical due to relevant data not being available.

22 Following the proposed changes to the measure of population-weighted density outlined in the Draft Report, New South Wales asked the Commission to investigate the optimal measure of population-weighted density as part of the forward work program.

23 Queensland and Western Australia thought the Commission should seek further external advice on the urban transport assessment.

24 Queensland said that the external advisor should have a broad scope to scrutinise and recommend changes to the urban transport assessment as a whole. It asked that the consultant be able to investigate the historical and economic factors underpinning the value and volume of urban transport capital in Australian cities and the extent to which Commission transport assessments have incentivised and disincentivised urban transport expenditure and capital investment. Queensland proposed that the external advisor be a respected transport economist, preferably working as an academic at an Australian university.

25 Western Australia proposed that the external advice on the urban transport assessment should have a broader scope than retesting the urban centre characteristics model and suggested the inclusion of a separate assessment of student transport costs. In particular, Western Australia sought an investigation into how best to capture the increased costs from the use of dedicated student buses in remote areas.

26 South Australia and Tasmania thought the Commission should conduct further work on the urban transport assessment. South Australia said that this would be an appropriate opportunity to consider conceptual concerns with the model. South Australia raised concerns that ongoing changes to the transport assessment between reviews have the potential to introduce a high level of volatility in the GST distribution. South Australia and Tasmania supported seeking external advice on the model prior to the next review.

27 South Australia noted that the impact of urban density on the cost and demand for transport provision could be explored further as part of the forward work program. It also asked the Commission to consider whether population squared or population

is more appropriate for blending the investment assessment in the urban transport model.

Cultural and linguistic diversity (CALD)

28 The Commission proposed to work with states and relevant data providers to consider the potential to use cultural and linguistic diversity as a driver of expense assessments, as well as appropriate definitions and data.

State views

29 New South Wales and Victoria saw value in the Commission's proposal. New South Wales acknowledged there may be difficulty in establishing nationally consistent definitions and measurements, and that not all cultural and linguistic diversity individuals require the same level of assistance or individual support. Victoria said this is a key issue in the health and welfare assessments.

30 South Australia queried the overall case for cultural and linguistic diversity as a cost driver but supported examining it as a cost driver in the health assessment.

31 Queensland said it did not oppose the proposal, noting that there are significant limitations around available data.

Administrative scale

32 In the 2020 Review, the Commission developed the underlying basis for the assessment by constructing a hypothetical organisational chart reflecting the minimum staffing structure for each state function. This was a time-consuming task and given that it was not practical to perform as part of the 2025 Review, the Commission proposed to undertake a similar comprehensive analysis ahead of the next review to ensure the assessment remains contemporary.

State views

33 Victoria and Queensland suggested reconsidering the conceptual basis of the assessment method.

34 New South Wales and the ACT noted the Commission's proposal.

35 New South Wales and Victoria said the Commission should also consider potential diseconomies of scale for more populous states.

Transition to net zero emissions

36 Noting that this is an emerging issue, the Commission proposed to monitor net zero policies, identify relevant expenses, and examine whether reliable policy neutral drivers of spending can be identified.

State views

37 New South Wales noted the potential difficulties of tracking expenses related to the net zero transition. South Australia suggested the Commission develop a definition for in-scope expenses and investigate an appropriate policy neutral measure of needs.

38 Victoria and Queensland agreed this area should be considered, noting the need for policies to settle and data to be available.

39 Western Australia agreed with the Commission's proposal.

40 The ACT also agreed with the proposal, and recommended investigating electric vehicles as a differential assessment within the motor taxes assessment.

Elasticity adjustments

41 The Commission proposed to continue to consider how the complexities and uncertainties of incorporating elasticity adjustments in revenue assessments can be addressed.

State views

42 Victoria, Western Australia and the ACT agreed the Commission should consider elasticity adjustments in the lead-up to the next review. Western Australia said the Commission's investigation should include identifying policy inconsistencies and influences in observed revenue bases more broadly.

43 New South Wales said elasticity adjustments should be implemented in the 2025 Review, and did not support the inclusion of this work in the forward work program.

44 Queensland and South Australia did not support the introduction of elasticity adjustments. Queensland said the adjustments would add a further level of complexity to assessments and would likely be of questionable reliability. South Australia said it was not aware of any robust way of estimating appropriate adjustments to assessments or differentiating the impact of behavioural changes from the impact of state circumstances and general market conditions.

Other data issues

45 The Commission acknowledged that data challenges remain a significant issue for many assessments and proposed to work with the states and data providers to obtain improved data.

State views

46 Three states supported a review into First Nations socio-economic status and disadvantage being included as a separate item in the forward work program.

- Queensland suggested the Commission investigate whether First Nations population data remain accurate, noting the impact of non-demographic population changes on measures of First Nations disadvantage. Queensland also sought further reviews of Person Level Integrated Data Asset based measures, compounding factors of socio-demographic disadvantage and Commonwealth payments related to socio-demographic disadvantage.
- Tasmania supported the Commission's continued investigation into the appropriate measurement of First Nations and non-Indigenous socio-economic status.
- The Northern Territory said it supported the Commission's proposal, as outlined in the socio-economic status chapter of the Draft Report, to work with states to review the Indigenous Relative Socioeconomic Outcomes index (IRSEO).

47 Queensland supported continued development of the Commission's data sources, noting it did not support changing data sources between reviews.

48 Queensland asked the Commission to consider the following: a way to capture the increased costs associated with certain geographies; explore how to improve the consistency of state Government Financial Statistics data; review the appropriateness of the Rawlinson's index in the investment assessment along with value ranges in the land tax assessment; and examine the consistency of Australian Institute of Health and Welfare data across states in the housing assessment.

49 Queensland and Western Australia asked the Commission to consider adding a review of Accessibility/Remoteness Index of Australia Plus (ARIA+) to the forward work program. Queensland specifically asked the Commission to engage with the ABS to develop an alternative to the current ARIA+ measure. Western Australia also asked the Commission to explore alternative options to ARIA+.

50 Western Australia asked for an investigation into the additional costs associated with Western Australia's isolation. Western Australia also asked for a review of reductions in First Nations cost weights due to increased self-identification.

51 The ACT recommended that the Commission consider outcomes from the Life Course Data Initiative, which will be released by the ABS in 2026–27, to review the use of socio-economic status as the driver across expense assessments.

Other topics suggested by states

52 Most states asked for more topics to be added to the forward work program.

Mining revenue – a dominant state adjustment

53 While not proposed as a specific topic in the forward work program in the Draft Report, the Commission proposed to continue to examine a dominant state adjustment and consult with states on how it could be addressed in preparation for the next review.

54 Queensland said the Commission had not proposed any suitable method for mitigating the extreme policy influence that some states have on parts of the mining assessment. It said the Commission should work with states to develop effective methods for dealing with the policy contamination in the next methodology review. Western Australia said this was a longstanding issue and should remain a priority. It supported further consultation with states on the issue before the next review and proposed adding it to the forward work program.

Other topics raised by states

55 Four states requested the proposed individual-based housing assessment be included in the forward work program. This was in response to an individual-based assessment proposed in the Draft Report.

56 Victoria identified several priority topics for the next methodology review. These included a re-examination of the administrative scale assessment, consideration of a congestion driver, a review of spending under treaties with First Nations people, an investigation of a housing stress or private market affordability driver for the housing and homelessness assessments, and an examination of additional infrastructure costs in dense areas or brownfields and the impact of higher land prices in major cities. However, Victoria accepted that while it considered these issues were priorities for the next review, there was not capacity to add them to the forward work program.

57 Queensland asked the Commission to add several additional topics to the forward work program. This included reviews of regional costs for socio-demographic use rates, the impact of physical factors in the roads assessment, the Commission's application of policy neutrality in mining, a disaggregation of the services to communities assessment, the development of a regional cost gradient in housing, and distinguishing between service accessibility issues and changes in need by use populations. Queensland asked that the mining assessment be considered as a priority area of the next review.

58 Western Australia proposed several additional topics, including investigations into water quality and availability, and observed revenue bases.

59 Tasmania encouraged the Commission to revisit its approach to the wages assessment.

Commission response

60 The Commission notes the general support from states for the proposed topics in the forward work program.

61 Some states raised concerns about including urban transport, cultural and linguistic diversity and elasticity adjustments in the forward work program. The Commission considers it appropriate for these topics to be included for the following reasons.

- Urban Transport — The 2020 Review introduced significant changes to the urban transport assessment based on an external consultant's report. The changes to the assessment method had a sizeable impact on the distribution of GST revenue. While 2 states considered the urban transport assessment was robust and did not require further review, a number of states expressed significant concerns with the results of the implementation of the assessment model and questioned its conceptual basis. The Commission considers the urban transport assessment model, incorporating the changes identified in the 2025 Review remains appropriate. However, given the complexity of the method and the concerns raised by several states, the Commission considers it will be beneficial to obtain external advice on the urban transport assessment method in preparation for the next review.
- Cultural and linguistic diversity — The Commission accepts there is a conceptual case that some culturally and linguistically diverse population groups can drive higher costs in providing some state services. The Commission also notes the significant challenges with reliably defining, identifying and assessing how such groups affect costs across the range of state services. Given these challenges, the Commission considers it would be beneficial to work with the states and relevant data providers to consider the potential to use culturally and linguistically diverse drivers, as well as appropriate definitions and data. The complexity of this exercise and its potential application across multiple assessments makes it an appropriate addition to the forward work program.
- Elasticity adjustments — The Commission acknowledges that, if differences in state tax rates have material effects on their observed revenue bases, incorporating elasticity adjustments (provided they can be reliably measured) would improve the policy neutrality of assessments. Several states opposed introducing elasticity adjustments on the basis of additional complexity and the questionable reliability of any adjustment. Given the potential importance of elasticity adjustments, the Commission considers it appropriate to consult states on how the concerns, complexities and uncertainties could be addressed in preparation for the next review.

62 In considering state suggestions for additional topics to be added to the forward work program, the Commission was mindful of targeting the program to priority topics that could be meaningfully progressed in preparation for the next review. In identifying the topics for the forward work program, the Commission recognises that there will be resourcing constraints and competing priorities that may impact a state's level of involvement - for example, the Productivity Commission's forthcoming review of the GST distribution reforms, which is scheduled to be completed by the end of 2026.

63 Given the importance of First Nations socio-economic status in assessing state spending needs, the Commission agrees with states that this is a priority issue and has added it as a separate item in the forward work program. The Commission will seek to initiate a review of measures of socio-economic status for the First Nations population, including the Indigenous Relative Socioeconomic Outcomes index.

64 Given the importance of the dominant state issue in the mining assessment, the Commission will continue to seek to identify a practical dominant state adjustment in consultation with the states in preparation for the next review. The Commission has added it as an item in the forward work program.

65 The Commission has decided not to proceed with an individual-based housing assessment so this will not be included in the forward work program. Opportunities to improve the housing assessment through the identification and use of better data may be considered by the Data Working Group.

66 While the research and analysis undertaken through the forward work program will inform the next review, it will not replace the usual comprehensive and detailed consultation on potential method changes that occur in a methodology review. As part of the forward work program, the Commission will not make decisions related to assessment methods prior to the next review, nor will it indicate views as to how a method should change. All assessments will still be examined as part of the next methodology review.

67 States will be consulted on the scope of each of the forward work program topics and the timing of the work. The Commission will look to leverage its Research Paper series to discuss relevant issues where appropriate. States will have the opportunity to provide input to the Commission's research. Recognising that some states may be constrained in their ability to provide input, the Commission notes that this research will feed into the next review, when all states will be fully consulted on possible method changes.

68 Several issues raised by states as priority topics have not been included in the forward work program. They may still be considered as part of the next methodology review.

69 The Commission has separately identified issues it will monitor following the 2025 Review. Attachment A provides a consolidated list of these issues.[1]

Commission decision

70 The Commission will establish a forward work program comprising the following topics:

- health
- urban transport
- cultural and linguistic diversity
- administrative scale

[1] Following the completion of the 2025 Review, the Commission will seek state feedback to inform an evaluation of the 2025 Review process.

- transition to net zero emissions
- elasticity adjustments
- First Nations socio-economic status
- a dominant state adjustment in mining.

71 In the first half of 2025, the Commission will provide states with an outline of how it proposes to progress the forward work program. The Commission will also meet bilaterally with states to discuss its approach.

72 The Commission will establish a Data Working Group, including Commission staff and state officials, to identify data issues across assessments. The Data Working Group will examine where new or improved data may become available and existing datasets can be improved. The findings from the Data Working Group may inform other topics in the forward work program and sub-groups may be formed to examine individual data issues or datasets. The Commission will consult with states on the structure and governance of the Data Working Group from July 2025.

73 Given the time needed to analyse and consult on the latest state data, the review of the justice assessment will be completed after the 2025 Review, and any changes will be incorporated in the 2026 Update.

Attachment A: Issues the Commission will monitor following the 2025 Review

Assessment	Issue
Payroll tax	Developments in the Australian Bureau of Statistics use of Single Touch Payroll data from the Australian Taxation Office
Payroll tax	Development of Business Longitudinal Analysis Data Environment and Person Level Integrated Data Asset datasets
Stamp duty on conveyances	Developments in elasticity effects from Victorian reforms
Motor taxes	Concessions provided by states regarding electric vehicles (where they are classified in Government Financial Statistics data)
Mining	State bans and restrictions on minerals
Schools	Comparability of data on school children with a disability
Schools	State spending on early childhood education
Schools	Measures associated with First Nations students
Health	Differences between the 2 data sources (Australian Prudential Regulation Authority and Australian Institute of Health and Welfare) for the non-state sector activity indicator for the admitted patients component
Housing	Developments in affordable housing support and exploration of a differential assessment of spending on housing support for people in private accommodation
Welfare	Improvements in the measurement of drivers including mental health conditions, family and domestic violence, disability and housing affordability
Welfare	Developments in the future Commonwealth-state framework for providing non-National Disability Insurance Scheme foundational supports
Welfare	Availability of evidence regarding service delivery scale for child protection and family services
Services to communities/ natural disaster relief	Developments in natural disaster mitigation and national disaster resilience policy. Specifically, outcomes of the Independent Review of Commonwealth Disaster Funding
Services to communities	Developments in Commonwealth-state commitments on water pricing
Roads	Development of the National Service Level Standards in roads
Transport	Non-urban transport assessment, including remote school transport.
Services to industry	A consistent definition of net-zero spending and identification of net-zero business development (and non-business development) spending
Native Title and land rights	Approaches to Native Title compensation and associated expenditure patterns. The impact of Treaty negotiations on Native Title and land rights expenditure in updates.
Investment	Appropriateness of Rawlinsons cost indices
Adjusted budget	The use of preliminary Australian Bureau of Statistics data to ensure it remains appropriate to use in assessment year 3