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.