Submission Cover Sheet

Inquiry into the Fiscal Sustainability of the ACT

Submission number: 021

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Date authorised for publication: 20 March 2026

Submission to the Select Committee on the Fiscal Sustainability of the ACT

Inquiry into the Fiscal Sustainability of the ACT

Recognising the ACT-Southern NSW Functional Service Catchment

in Fiscal Equalisation

The ACT Government should request that the Commonwealth Grants Commission examine whether its methodology should recognise the ACT-Southern NSW region as a functional service catchment when assessing expenditure needs and fiscal capacity.

This could be implemented through the incorporation of a discounted functional population adjustment in relevant assessment categories where ACT institutions provide significant services to residents of surrounding NSW regions.

Such an approach would remain consistent with the principles of horizontal fiscal equalisation while improving the accuracy of fiscal comparisons for jurisdictions that function as regional metropolitan service centres.

1. Executive Summary

The Australian Capital Territory provides metropolitan-level public services to a regional population that extends well beyond its jurisdictional boundary. ACT public hospitals operate as the tertiary referral centre for large parts of Southern New South Wales. As a result, the ACT health system serves a functional regional population significantly larger than the Territory's resident population.

However, fiscal equalisation and most public expenditure comparisons use ACT estimated resident population as the denominator. This creates a structural mismatch between the population served by ACT institutions and the tax base available to fund them.

Factor	Current fiscal treatment	Functional reality
Service population	ACT residents (460,000)	ACT + discounted Southern NSW (590,000)
Tax base	ACT residents	Surrounding tax base largely in NSW
Service delivery	ACT funded	Regional catchment

This structural mismatch contributes to the perception that ACT public service expenditure per resident is unusually high, particularly in health.

A more evidence-based planning estimate suggests that as much as 22 per cent of ACT Health system capacity is effectively supporting surrounding NSW residents, accounting for programs where patient flow data are not readily available and for the full range of services normally provided by an integrated health system to support the wider population. This is equivalent to around $640-780 million per year, substantially exceeding current cross-border funding flow payments which are largely for hospital clinical costs and do not cover costs of non-ABF components such as block grants for teaching, research, public health and corporate costs.

This submission therefore proposes that the Commonwealth Grants Commission consider recognising the ACT-Southern NSW region as a functional service catchment when assessing fiscal capacity and expenditure needs.

2. Evidence of regional integration

The ACT and surrounding Southern New South Wales operate as a highly integrated economic and service region.

Labour market integration

Census data from the Australian Bureau of Statistics show substantial commuting flows between the ACT and surrounding New South Wales local government areas including:

- Queanbeyan-Palerang
- Yass Valley
- Snowy Monaro.

These commuting patterns demonstrate that Canberra functions as the dominant employment centre for a much wider regional labour market.

Service utilisation

ACT public hospitals provide tertiary and specialist care to residents of Southern New South Wales, including:

- Trauma services
- Cancer treatment
- Neonatal intensive care
- Complex surgery.

3. Fiscal asymmetry

Despite this functional integration, the tax base associated with the surrounding population sits largely outside the ACT. Examples include:

Revenue source	**Jurisdiction collecting**
Payroll tax from NSW-based employers	NSW
Motor vehicle registration	NSW
Land tax	NSW
Stamp duty	NSW
NSW GST share allocation	NSW

At the same time, tertiary public services for the region are delivered primarily by ACT institutions. This creates a structural imbalance in which regional service costs are supported by a relatively small resident tax base.

4. Current Commonwealth Grants Commission treatment

The Commonwealth Grants Commission already recognises some cross-border service effects in specific categories, including homelessness services, post-secondary education and some cross-border health activity. The CGC methodology also recognises functional service populations in certain areas. For example, in the transport category the Commission uses urban centres and localities (UCLs) as service populations, rather than strict jurisdictional populations to estimate service needs.

However, these adjustments do not fully capture the broader regional service role played by the ACT, particularly in tertiary health services. Building on these existing methodological approaches, the Commission could consider whether a similar functional population concept is appropriate for jurisdictions that act as regional service hubs beyond their formal boundaries.

5. Review of current submissions to this Inquiry

A review of current submissions to the Committee indicates that a number of contributors recognise that ACT institutions provide services to residents of Southern New South Wales.

Several submissions also refer to economic integration between the ACT and surrounding NSW regions, and historical ACT committee work has noted issues associated with cross-border reimbursement for services. However, no current submission appears to explicitly propose that the ACT and surrounding NSW be recognised as a functional economic or service region for fiscal equalisation purposes.

Most submissions instead focus on improving bilateral reimbursement arrangements between NSW and the ACT. While cross-border reimbursement arrangements are important, they do not fully address the broader fiscal imbalance created by the ACT's role as a regional metropolitan service centre (see section 7).

The interim report prepared for the Committee by the specialist advisor highlights that the ACT's per capita public spending, particularly in health, appears high compared with other jurisdictions. That analysis is based on comparisons using the ACT estimated resident population as the denominator. If the ACT health system is understood as serving a broader regional population extending into Southern New South Wales, the interpretation of these comparisons may change significantly. Recognising the ACT's regional service role would therefore complement the report's fiscal analysis by ensuring that expenditure comparisons reflect the effective population served by ACT institutions.

6. Functional Economic Region (FER) concept

The ACT-Southern NSW region can reasonably be considered a functional economic region.

Functional regions are typically defined by:

- Commuting patterns
- Labour market integration
- Shared service catchments.

In most Australian states, tertiary hospitals serve large regional populations within a single state fiscal system.

Examples include Westmead Hospital in Western Sydney, John Hunter Hospital in the Hunter region and Royal Brisbane Hospital in Queensland. The Specialist Children's Hospitals in each State also treat statewide and sometimes national catchments. These institutions serve

populations far larger than their immediate local government areas but are funded within integrated state systems.

The ACT differs in that the regional service centre and much of the surrounding population sit in different jurisdictions.

7. Estimated fiscal impact

The ACT health system currently costs approximately $3.5 billion per year when expressed on a normalised system basis. The published ACT health budget of around $2.9 billion largely reflects recurrent health expenditure. For comparison with larger state health systems, it is also appropriate to recognise the broader cost of maintaining the Territory's health infrastructure and service capacity.

This includes services that in other jurisdictions are funded within health portfolios but may sit in different budget categories, as well as an annualised share of hospital capital infrastructure, central administration/policy costs and asset replacement required to sustain the tertiary hospital system serving the needs of the broader ACT and surrounding regional population. Some services under ACT Community Care are often provided by State health systems elsewhere.

Illustrating the fiscal mismatch

The ACT health system currently costs approximately $3.5 billion per year when expressed on a normalised system basis, including hospital, community and public health services that in other jurisdictions are often funded within health portfolios. Available activity data indicate that approximately 27 per cent of ACT hospital activity relates to patients from surrounding New South Wales communities. However, this reflects observed demand, not the capacity required to sustain a full tertiary system for a regional population.

A more appropriate approach is to estimate a functional catchment population based on Southern NSW Local Health District (219,353 people) with a dependency discount reflecting NSW policy to shift activity locally. Applying a 50-70 per cent dependency range (central estimate 60 per cent) yields an effective NSW catchment of approximately 110,000 to 154,000 people (central 132,000). This implies a total ACT functional service population of approximately 570,000 to 615,000 people (central 592,000).

On this basis, the NSW-attributable share of ACT Health and Community Care capacity is approximately 22 per cent, with a plausible range of around 19 to 25 per cent. This estimate is consistent with a functional catchment approach based on Southern NSW Local Health District population and a dependency-adjusted utilisation share.

Notably, the implied NSW share of approximately 22 per cent can be derived using two complementary approaches. A population-based method estimates the share of the discounted functional catchment attributable to NSW residents (approximately 130,000 of 590,000), while a cross-border flow and capacity-based method estimates the proportion of total system resources required to support that population within a tertiary health system. The close alignment between these approaches provides a useful internal consistency check, noting that actual cost shares may vary with casemix and service intensity.

Under national hospital funding arrangements, NSW reimburses the ACT for actual reported cross-border hospital activity through activity-based funding payments linked to National Weighted Activity Units (NWAUs). These payments reflect the actual volume of clinical services delivered, rather than the broader cost of maintaining a regional health system.

Importantly, cross-border payments apply primarily to hospital activity streams and do not extend to the full range of health system costs.

Recent reconciled data indicate that the ACT receives approximately $122 million per year from NSW for cross-border hospital services, or around $97 million net of ACT outflows to NSW.

On a capacity basis, the NSW-attributable share of the ACT health system corresponds to approximately:

- $560 million to $725 million when applied to the published $2.9 billion recurrent ACT health budget; or

- $675 million to $875 million when applied to the $3.5 billion normalised system cost (central estimate approximately $640 million to $780 million per year).

On either basis, the ACT faces a direct residual funding burden of approximately $650-700 million per year, representing the gap between the notional NSW-attributable share of system capacity and the actual cross-border payments received.

This gap arises because activity-based funding is designed to reflect the efficient cost of clinical activity, based on a National Efficient Price derived from national averages, rather than the full cost of operating a hospital system. In a smaller jurisdiction such as the ACT, the absence of economies of scale and the need to maintain a full range of tertiary services for a regional population mean that average costs are likely to exceed the efficient price. In addition, cross-border payments do not include broader system costs funded through block grants, such as teaching, research, training, corporate costs and major infrastructure, further contributing to the residual funding burden

However, the broader fiscal issue arises from the difference between activity-based service payments and population-based fiscal capacity. Fiscal equalisation frameworks assess revenue-raising capacity primarily based on resident population. The ACT therefore receives fiscal capacity recognition based on its resident population of around 460,000 people, while in practice Canberra's public institutions operate as the metropolitan service centre for a broader functional regional catchment of approximately 570,000 to 615,000 people.

This gap reflects the difference between activity-based reimbursement and the capacity required to operate a regional tertiary health system, rather than inefficiency in service delivery.

This estimate is deliberately conservative, as it excludes broader outer-regional referral patterns and focuses only on the core Southern NSW service catchment with an explicit dependency adjustment.

8. Conceptual difference between fiscal capacity and hospital activity payments

Some further clarification of this fiscal mismatch is possibly warranted here to help reinforce the understanding of the conceptual differences, as the above analysis gives rise to the distinction between the way fiscal equalisation frameworks measure revenue-raising capacity and the way hospital funding is calculated under activity-based funding arrangements. Fiscal capacity is typically assessed on a population basis, reflecting the tax base associated with residents in a jurisdiction. By contrast, cross-border hospital payments are calculated based on actual service utilisation, usually measured through activity such as National Weighted Activity Units (NWAUs). These two approaches measure fundamentally different things.

In practice, only a relatively small proportion of any population uses hospital services each year. Prior analyses of Australian hospital utilisation suggest that roughly 10-15 per cent of a population receives admitted hospital care in a typical year, although this varies by age and region. Activity-based payments between jurisdictions therefore reflect observed clinical demand rather than the broader service capacity required to support a health system for the entire population.

The ACT health system must maintain infrastructure, specialist services and workforce capacity to serve a functional regional catchment of approximately 590,000 people, including both ACT residents and surrounding communities in Southern New South Wales. This service population is substantially larger than the ACT's resident population. While cross-border activity-based payments compensate for a portion of hospital demand, they do not necessarily reflect the cost of sustaining the full range of tertiary services, capital infrastructure and system capacity required for a regional metropolitan health system of that scale. Smaller jurisdictions may also face higher average costs due to limited economies of scale and higher unit costs for specialised services.

In addition to permanent residents in the regional catchment, ACT health services also experience fluctuating demand from tourists, seasonal workers and transient populations associated with activities such as snow-field tourism and agricultural work in surrounding NSW regions. These temporary populations can increase demand on emergency departments and other hospital services during peak periods but are not captured in standard resident-population measures used in fiscal comparisons.

Taken together, these factors highlight that activity-based cross-border payments and population-based fiscal capacity measures operate on different conceptual bases. Cross-border payments compensate for observed hospital activity, whereas fiscal equalisation frameworks seek to measure the revenue base associated with the population served by public institutions. Where a jurisdiction functions as a regional service hub for a broader catchment population, these two approaches may diverge, potentially understating the fiscal capacity required to sustain the full health system infrastructure supporting the region.

On a personal observation from long experience: if Australia's public and private health financing arrangements across multiple funders, providers, and jurisdictional boundaries, were calibrated precisely on an actuarial basis top down across the entire health system, these types of residual funding mismatches might be expected to be small or not arise at all. In practice, however, the health system has evolved through a series of institutional arrangements that cannot perfectly align service catchments, funding streams and fiscal capacity. Modest adjustments within existing Commonwealth Grants Commission methodology could therefore help reduce these structural uncertainties where jurisdictions operate as regional service hubs beyond their borders.

9. Illustration of the population denominator effect

A simple comparison illustrates how the choice of population denominator affects the interpretation of ACT health spending (on a consistent normalised system basis).

Measure	Population used	Approximate spending per person
ACT resident population	460,000	$7,600
Regional service population (dependency-adjusted)	590,000	$5,900

When health system spending is assessed using a functional regional population rather than the ACT resident population alone, ACT expenditure per person appears broadly consistent with other metropolitan and regional health systems. This suggests that much of the apparent difference in ACT spending arises from the population denominator used in fiscal comparisons rather than unusually high service costs.

This analysis already incorporates a dependency-adjusted functional catchment for surrounding NSW populations. More broadly, applying a discounted functional population approach is consistent with methods used in other public funding models to account for partial reliance on alternative service providers.

On this basis, the ACT health system is more appropriately understood as a mid-sized regional system serving a population closer to 600,000 rather than a small standalone jurisdiction of 460,000.

10. International and NSW precedents

International economic analysis often recognises functional metropolitan regions that extend beyond administrative boundaries. The OECD Functional Urban Area (FUA) framework defines metropolitan regions based on commuting patterns and labour market integration.

The NSW Government itself has adopted the concept of Functional Economic Regions (FERs) as a framework for regional economic policy. Under the Regional Economic Development Strategies program, the NSW Government developed economic strategies for regional areas based on functional regions rather than strictly administrative boundaries. These FERs are defined as one or more local government areas that together form a coherent economic area with strong labour market, infrastructure and industry linkages.

This framework explicitly recognises that economic activity, labour markets and service utilisation often extend beyond administrative borders. For example, the Southern Tablelands and Queanbeyan-Palerang strategies both note the strong economic integration between surrounding NSW regions and the ACT, including significant commuting flows, shared labour markets and cross-border infrastructure connections. These NSW Government strategies therefore implicitly recognise that the Canberra metropolitan area functions as a regional economic hub for surrounding NSW communities. Applying a similar functional regional perspective in fiscal equalisation analysis would therefore be consistent with existing NSW policy approaches to regional planning and economic development.

The same logic that underpins the Functional Economic Region approach in regional economic policy also applies to major public service systems such as health. Large tertiary hospitals typically serve populations well beyond their immediate administrative boundaries, particularly in regional settings where specialist services are concentrated in a single metropolitan centre. In the ACT-Southern NSW region, Canberra’s hospitals function as the primary tertiary referral hub for a large surrounding population in southern New South Wales. Recognising functional service catchments in fiscal analysis would therefore align the treatment of public service provision with the regional economic and labour market integration already recognised in NSW Government regional development strategies.

These provide international and local precedents for recognising functional service populations in fiscal analysis.

11. Possible implementation pathway

The proposed adjustment could be examined as a “new issue” within the Commonwealth Grants Commission’s regular methodology review process rather than requiring immediate structural changes to the GST distribution framework. The Commission could initially undertake analytical work to assess the scale of cross-border service utilisation between the ACT and surrounding Southern New South Wales regions and consider whether a discounted functional service population should be incorporated into relevant expenditure assessments.

This approach would allow the issue to be evaluated using existing CGC review mechanisms and available data.

Proposed CGC Adjustment

A possible CGC methodology adjustment could involve recognising a discounted functional service population.

Step 1 - Identify regional catchment

- ABS commuting zones
- Hospital referral patterns
- Regional service utilisation.

Estimated catchment population	**Population**
ACT	460,000
Southern NSW catchment – dependency adjusted	130,000
Total functional region	590,000

Step 2 - Apply discount factor

- Not all surrounding residents rely exclusively on ACT services.
- A discount factor could therefore be applied. For example:
    - Assessed ACT population = ACT residents + (Southern NSW population × 50-70% dependency factor)

This mirrors techniques used in other public funding models where population needs-based activity is discounted to reflect substitution by other providers.

Step 3 - Apply to CGC assessments

- The adjusted population could be incorporated into relevant CGC categories:
    - Health and community services
    - Transport
    - Education.

Advantages of this Approach

- Consistent with CGC principles.
    - The CGC's objective is to equalise fiscal capacity so jurisdictions can provide comparable services.
    - Recognising regional service catchments improves the accuracy of this assessment.
- Avoids interstate tax transfers
    - The proposal does not require NSW to transfer state tax revenue directly to the ACT.
    - Instead, it operates within the existing GST equalisation framework.
- Builds on existing CGC practice. The CGC already uses:
    - Cross-border adjustments
    - Functional service populations
    - Activity-based measures.

This proposal extends those principles to a unique regional context.

12. Conclusion

The ACT functions as the metropolitan service centre for a broader regional population extending into Southern New South Wales, yet fiscal equalisation continues to rely primarily on jurisdictional population boundaries.

Recognising a discounted functional service population in fiscal equalisation assessments could help reconcile this difference between activity-based service funding and population-based fiscal capacity measures. Where a jurisdiction operates as a regional service hub for surrounding areas beyond its administrative boundary, the population effectively served by major public infrastructure may exceed the jurisdiction's resident population.

In such circumstances, incorporating a discounted share of the surrounding functional economic region into population-based assessments could provide a more accurate representation of the fiscal capacity required to sustain the full system of services supporting that regional population. This approach would be consistent with the Commonwealth Grants Commission's existing practice of recognising cross-border service flows and functional service populations in some assessment categories.

Doing so would also improve the accuracy of fiscal comparisons and ensure that the ACT's unique role as a regional service hub is properly recognised within Australia's system of horizontal fiscal equalisation.

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17 March 2026