

SUBMISSION TO PRODUCTIVITY COMMISSION ON
GST DISTRIBUTION REFORM

This is a Submission by
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1. Introduction

The distribution of Goods and Services Tax (GST) revenue is often treated as a fiscal equity or federal balance issue. However, it also has significant implications for productivity. The way revenues are allocated affects States' capacities to invest in productivity-enhancing assets, manage economic volatility, and pursue reforms that support long-term growth.

Australia's system for distributing GST revenue has, over many decades, played a central role in maintaining national cohesion and supporting comparable standards of public services across the federation. The principle of Horizontal Fiscal Equalisation (HFE) remains widely accepted and continues to serve an important purpose.

However, confidence in the system has diminished where the strict application of equalisation has produced outcomes that are extreme, volatile, or difficult to reconcile with fiscal sustainability. This loss of confidence was most evident when the operation of the system produced the prospect of near-zero GST returns for Western Australia over successive years.

This submission does not seek to revisit historical disputes or to criticise the institutions responsible for administering the current framework. Instead, it identifies a structural limitation in the legislative settings that govern GST distribution and proposes a targeted reform to strengthen the system's durability, legitimacy, and long-term acceptance.

The issue is not the principle of HFE, but the absence of explicit statutory guidance requiring the Commonwealth Grants Commission (CGC) to consider proportionality, volatility, and sustainability in applying that principle.

2. Legislative framing and constraint

The CGC is required to apply HFE in making recommendations on the distribution of GST revenue. The governing legislation directs that comparability be achieved "*so far as practicable*".

That formulation obliges the CGC to equalise revenue capacity and cost differences wherever it is technically feasible to do so, regardless of the scale, volatility, or cumulative effect of the resulting outcomes. As presently framed, the legislation does not expressly require the Commission to have regard to:

- proportionality of outcomes across economic cycles.

- volatility arising from highly concentrated or fluctuating revenue bases.
- predictability and sustainability of state finances; or
- the effect of extreme outcomes on confidence in the GST system

As a result, once equalisation is assessed as practicable, it must be applied fully, even where outcomes are widely perceived as destabilising. This is not a matter of administrative judgement; it flows directly from the statutory mandate under which the CGC operates.

3. Horizontal Fiscal Equalisation

HFE is not defined in the underpinning legislation. The absence of statutory definition has allowed the principle to evolve administratively rather than legislatively. While the CGC is established by statute and directed to pursue comparability in state service provision “*so far as practicable*”, the detailed content of HFE has developed through the CGC’s reports, methodologies, and accepted practice over time.

The operational content of HFE has evolved through CGC practice rather than explicit Parliamentary articulation. This approach has provided stability and continuity, but it also means that fundamental questions are addressed through CGC methodology and precedent rather than through explicit legislative guidance.

Given the scale and fiscal significance of GST distribution, there is a case for Parliament to provide clearer statutory direction as to how the equalisation objective is to be applied and balanced against other public interest considerations such as sustainability and long-term confidence in Australia’s federal financial arrangements. Indeed, it should even require the CGC to consider the impact distributions have on a state’s efforts to promote investment in productivity-enhancing assets, and the pursuit of reforms that support long-term growth.

4. Status of CGC recommendations and implementation practice

The CGC’s assessments of GST relativities are, in formal terms, recommendations to the Commonwealth Government. Responsibility for the distribution of GST revenue rests with the Commonwealth, acting through executive and legislative processes.

In practice, however, those recommendations are adopted and implemented without variation as a matter of long-standing convention. Successive governments have treated the CGC’s advice as determinative, reflecting the value placed on independent assessment and the expectations established at the time the GST framework was introduced.

This convention reinforces the importance of ensuring that the legislative mandate guiding the CGC's work is sufficiently clear, complete, contemporary and explainable. Parliament should define the guardrails, not methodology precedent.

5. Consequences for system confidence

The effectiveness of GST distribution depends not only on technical correctness, but on sustained confidence among the states that the system operates within broadly acceptable bounds.

Where outcomes approach the effective exhaustion of a state's GST entitlement, or fluctuate sharply from year to year, several consequences follow:

- reduced fiscal certainty for states.
- increased difficulty in budget planning and service delivery.
- pressure for ad-hoc political intervention; and
- erosion of confidence in equalisation as a governing principle.

The subsequent need for legislative intervention to impose a minimum GST relativity demonstrates that the existing framework lacked sufficient internal capacity to manage extreme outcomes on its own. Addressing this limitation directly would strengthen the system and reduce reliance on future ad-hoc measures.

No equalisation system can endure if a participating state believes the framework permits outcomes that effectively extinguish its fiscal entitlement.

6. Proposed legislative refinement

Rather than altering the objective of HFE, consideration should be given to refining the legislative framework under which it is applied, to require explicit consideration of proportionality, sustainability, and confidence in the Federation.

In particular, the statutory requirement to pursue equalisation "*so far as practicable*" should be amended so that the CGC is expressly required to have regard to the reasonableness of outcomes in its application of HFE. This would preserve the CGC's independence and methodological integrity while ensuring that its assessments are guided by clear legislative direction on matters of systemic importance.

In Australian administrative law, "*practicable*" denotes technical feasibility. By contrast "*reasonably practicable*" requires a balancing of competing considerations including risk, cost and proportionality. For example, the standard applied under occupational health and safety legislation is that of "*reasonable practicably*" requiring a balance between the

degree of risk and the cost and feasibility of its elimination. This typically involves considerations of removal of risk, controlling exposure to the risk, use of protective equipment and other means to minimise the risk.

It is suggested that this Productivity Commission report should recommend a legislative amendment to the CGC Act that provides that the distribution of GST revenue should require HFE between the states “*so far as is reasonably practicable*”, and in doing so the CGC must have regard to:

- the proportionality of outcomes,
- revenue volatility,
- fiscal sustainability,
- the long-term stability and maintenance of confidence in Australia’s federal financial arrangements, and
- the economic prosperity and welfare of the people in every state.

This formulation would preserve HFE as the guiding objective, while imposing a clear statutory obligation on the CGC to consider the reasonableness and sustainability of its application.

7. Conclusion

The GST distribution framework has served Australia well, but its long-term durability depends on its capacity to adapt to modern economic conditions, including increased revenue concentration and volatility. Extreme outcomes undermine confidence not because equalisation is flawed, but because the current legislative framing provides insufficient guidance on how that principle is to be applied in circumstances of significant economic change.

Clarifying the statutory mandate to require consideration of proportionality, sustainability, and confidence would strengthen the GST system, support institutional independence, and reinforce confidence in Australia’s federal financial arrangements.

A reformed framework should aim to make explicit any minimum return tolerance that the federation is prepared to accept, apply that tolerance uniformly to all states, and leave the task of equalisation above that threshold to the Commission. In doing so, Parliament would reclaim ownership of the value judgments inherent in the system, while preserving the benefits of independent assessment and administration.

Reform of this kind would not weaken HFE ; it would secure its legitimacy for future generations.