



Australian Government
Commonwealth Grants Commission

Submission

Productivity Commission Inquiry into the 2018 GST Distribution Reforms

February 2026

Introduction

This submission to the Productivity Commission's Inquiry into the GST Distribution Reforms provides the Commonwealth Grants Commission's (CGC) analysis of the impact of the 2018 legislated reforms. The discussion is based on the information requests and questions posed in the Productivity Commission's Issues Paper, noting not all questions are relevant to the CGC's role.

The 2018 Productivity Commission Inquiry into Horizontal Fiscal Equalisation, which preceded the legislated changes, made a number of recommendations relevant to the operations of the CGC. Information on the CGC's actions in response to the recommendations accepted by the then government is at Appendix A.

Role and approach of the Commonwealth Grants Commission

The CGC provides independent advice to the Australian Government on how GST revenue should be distributed among the states and territories (states). The distribution of GST revenue is governed by legislation and annual terms of reference issued by the Commonwealth Treasurer, which require the CGC's advice to be based on the objective of horizontal fiscal equalisation.¹

Horizontal fiscal equalisation in Australia

States have diverse economic, social and geographic circumstances. This leads to different capacities to raise revenue and different costs of providing services to residents. Historically, Australia has sought to address these disparities through horizontal fiscal equalisation.

Many countries have arrangements to allocate funds to regional governments. In June 2025, the Organisation for Economic Co-operation and Development (OECD) observed the common use of fiscal transfers 'to ensure that decentralised policy responsibilities are matched with sufficient funding for subnational governments.' It also noted that 'fiscal equalisation mechanisms play a central role in promoting equitable and efficient public service provision across regions... helping to level the playing field in access to public services.'²

In the Australian context, Fenna and Phillimore have commented, 'Australia has long had one of the most thorough-going equalisation systems of any federation, characterised by a fiscal egalitarianism whereby systematic effort is made to ensure comparable resourcing of each jurisdiction.'³

Australia's approach differs from comparable countries.⁴ For constitutional and historical reasons, Australia's degree of vertical fiscal imbalance is relatively high.⁵ The longstanding 'systematic effort' to address this through fiscal equalisation arrangements includes full consideration of both the revenue and expenditure needs of each state by an independent body (the CGC) that makes evidence-based recommendations to the Treasurer.

¹ [Commonwealth Grants Commission Act 1973](#), [Federal Financial Relations Act 2009](#) and [Treasury Laws Amendment \(Making Sure Every State and Territory Gets Their Fair Share of GST\) Act 2018](#).

² OECD, [Intergovernmental fiscal transfers and fiscal equalisation in a time of consolidation](#), June 2025, p 3.

³ Fenna and Phillimore, [Fiscal Equalisation in Australian Federalism: Share and Share Alike?](#), *Australian Journal of Politics & History*, 2025, p 1.

⁴ See Commonwealth Grants Commission, [Research Paper 3 – Some international themes in fiscal equalisation: an Australian perspective](#), 2022.

⁵ In Australia, 'vertical fiscal imbalance' refers to the Commonwealth raising more revenue than it spends, while state governments spend more than they raise.

The form of, and specific outcomes sought from, Australia's horizontal fiscal equalisation arrangements have changed over time. The goal of 'full' equalisation commenced with the *States (Personal Income Tax Sharing) Amendment Act 1978*. With the introduction of the GST in 2000, the Commonwealth and all states signed the 1999 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations. This stated that GST revenue would be distributed according to horizontal fiscal equalisation principles. These principles, outlined in the 1978 legislation, remain a central feature of the current 2009 Intergovernmental Agreement on Federal Financial Relations.

In 2018, the Commonwealth Parliament legislated a new way to distribute GST revenue to the states. The legislation changed the GST distribution arrangements from a 'full' equalisation standard to a 'reasonable' equalisation standard.⁶

Further information on the CGC's role in supporting the various arrangements for providing Commonwealth financial assistance to states since 1933 can be found here: [Occasional Paper No.10 – 90 Years of the Commonwealth Grants Commission](#).

Approach to calculating GST relativities

Estimating relative fiscal capacities and assessed relativities

The GST distribution is a zero-sum game. Each year the size of the pool is fixed and in order for a state to gain an additional share of the pool, one or more states must receive less.

The starting point for calculating GST relativities is to estimate each state's relative fiscal capacity.

The CGC assesses each state's revenue raising capacity in comparison to the average revenue collected by all states. The CGC also assesses each state's expenses and accounts for circumstances outside their control that affect the cost of providing services, relative to other states. In each revenue and expense assessment,⁷ the CGC considers a range of economic, demographic and geographic characteristics (for example, property sales, age, socio-economic status and levels of remoteness).

The CGC estimates the revenue needed to give each state the fiscal capacity to provide services and infrastructure at the average standard if it makes the average effort to raise revenue and operates at the average level of efficiency. It translates this estimate into a per person 'relativity' to facilitate GST distribution. For example, a state with high expense needs and low revenue capacity will require an above-average amount of GST revenue per person, which translates into an 'assessed relativity' above one. A state with low expense needs and high revenue capacity will require a below-average amount of GST revenue per person, which translates into an 'assessed' relativity below one.

The CGC's assessed relativities seek to put states on an equal footing and minimise differences in fiscal capacities as much as possible, after allowing for circumstances that are beyond their control.

Supporting principles

Pursuing horizontal fiscal equalisation is not an exact science. It depends on the availability of appropriate data and requires the CGC to apply estimates, trade-offs and judgements. Recognising the practical aspects of assessing state revenue capacities and expenditure needs, the CGC's approach is to recommend a distribution of the GST that would minimise, as far as possible, differences in the fiscal capacities of the states to provide services.

The CGC's deliberations are guided by 4 supporting principles.

- **What states do** — the CGC's methods should, as far as possible, reflect what states collectively do, and not make judgements about what they could or should do.

⁶ [Explanatory Memorandum – Treasury Laws Amendment \(Making sure every state and territory gets their fair share of GST\) Bill 2018](#); Information on the calculation of GST relativities under the 2018 legislated arrangements is at Appendix B.

⁷ 'Assessment' refers to the CGC's use of calculations and data to determine each state's assessed expenditure needs and revenue-raising capacity as inputs to assessing relative fiscal capacities.

- **Policy neutrality** — a state's policy choices (for the revenue it raises or the services it provides) should not directly influence its GST share. The CGC's assessments should not create incentives or disincentives to choose one policy over another.
- **Practicality** — assessments should be based on sound and reliable data and methods. Methods should be as simple as possible, while capturing the major influences on state revenues and expenses.
- **Contemporaneity** — to the extent reliable data will allow, the distribution of GST in a year should reflect state circumstances in that year.

The supporting principles are guiding considerations in designing and evaluating assessment methods and are secondary to the primary objective of facilitating horizontal fiscal equalisation.

Operational challenges

At the operational level, the CGC faces challenges including:

- finding fit-for-purpose data for all states at a suitable level of disaggregation
- making sound decisions transparently, including navigating trade-offs and limiting complexity
- explaining states' GST shares effectively, given the complexity of shifts in state circumstances and the fact that each state's relativity is affected by every other state's relativity.

The CGC takes a range of actions to address these challenges.

The CGC works closely with state treasuries and data agencies (such as the Australian Bureau of Statistics and the Australian Institute of Health and Welfare) to source fit-for-purpose data. Following the 2025 Methodology Review, the CGC established the Data Working Group with the states to help resolve data challenges and refine its use of data.

The CGC has developed a coherent and comprehensive methodology to assess states' relative GST needs. This methodology is publicly available and includes supporting principles and assessment guidelines to ensure consistency.⁸ Around every 5 years, the Australian Government asks the CGC to undertake a methodology review. The review assesses the appropriateness of all methods and data and identifies changes to support a continuing fit-for-purpose approach. State treasuries are key stakeholders in this exercise and are closely consulted throughout the review.

The CGC's methodology is complex. This reflects the wide range of state revenues and expenditures that are considered and the legislative framework. It also results from efforts to make methods 'policy neutral'. The CGC adopts a materiality threshold whereby it will only include an assessment if it results in a change in the distribution above a specified per capita threshold. This is a guardrail against undue complexity and states have generally supported this approach. The level of the materiality threshold is reviewed in each methodology review.

The CGC seeks to thoroughly explain its decisions in a consistent, transparent and clear way. All the CGC's calculations are made available to the states, except where states or other data custodians have imposed confidentiality restrictions on underlying data. This open approach strengthens accountability and provides for peer review from state experts. To support public understanding, the CGC has introduced an Occasional and Research Paper series (refer to Appendix C). These papers explain the CGC's work in non-technical terms.

The CGC is always open to feedback and to further assisting states and stakeholders to improve their understanding of its methodology and the implications for the distribution of GST revenue. The CGC seeks feedback from states on the processes for undertaking 5-yearly methodology reviews and annual updates of GST relativities. Staff from the CGC and state treasuries work together to build expertise through training and ongoing discussions.

⁸ Commonwealth Grants Commission, [Commission's Assessment Methodology](#), 2025.

Information request 1: Fiscal sustainability of the 2018 reforms for the Commonwealth and states and territories

Key points

- Over the first 5 years of the transition period (2021–22 to 2025–26), the fiscal impacts for states were:
 - Western Australia receiving around \$23 billion more GST revenue than it would have under the previous arrangements
 - other states receiving the same amount as under the previous arrangements, after including Commonwealth no worse off payments.
- Over the first 5 years of the transition period, the fiscal impacts for the Commonwealth were:
 - top-up payments to the GST pool of around \$4 billion
 - no worse off payments to the states (other than Western Australia) totalling around \$20 billion.
- Between 2018–19 and 2021–22, the Commonwealth also made GST top-up payments to Western Australia and the Northern Territory of nearly \$5.2 billion.
- Since 2022–23, the Commonwealth's additional funding (GST pool top-ups plus no worse off payments) has equalled the additional funding to Western Australia.
- The CGC has a longstanding and broadly supported approach to incorporating Commonwealth payments that impact state fiscal capacities in its assessments. Through the annual terms of reference, the government can direct the CGC to exclude, or treat in a different manner, certain Commonwealth payments.

Fiscal impacts for states

A key feature of the 2018 legislated changes is that if any state is fiscally stronger than the standard state,⁹ its GST relativity is raised to that of the standard state. As a consequence, the GST relativities of the other states must fall to accommodate this. The then government also introduced a no worse off guarantee for the transition period from 2021–22 to 2026–27. The no worse off guarantee has since been extended to 2029–30.¹⁰

As a result of the changes, the fiscal capacity of Western Australia has improved relative to other states. This means that Western Australia has the capacity to provide a higher level of state services and infrastructure, and/or to impose a lower tax burden, compared with other states.¹¹

For 2025–26, Table 1 compares the estimated distribution from the GST pool (including pool top-ups but excluding no worse off payments) with the CGC's estimate of what each state would have received if the 2018 GST distribution legislation had not been enacted (that is, full equalisation with no GST pool top-ups).

⁹ The 'standard state' is the fiscally stronger of New South Wales or Victoria.

¹⁰ A GST relativity floor of 0.75 also exists, and was used during the transition, while standard state relativities were being phased in. The full implementation of standard state relativities will, all else being equal, result in larger no worse off payments.

¹¹ The no worse off guarantee reduces, but does not remove, Western Australia's fiscal advantage over other states.

Table 1 Impact of 2018 legislation on the distribution of the GST pool, 2025–26 (excludes no worse off payments)

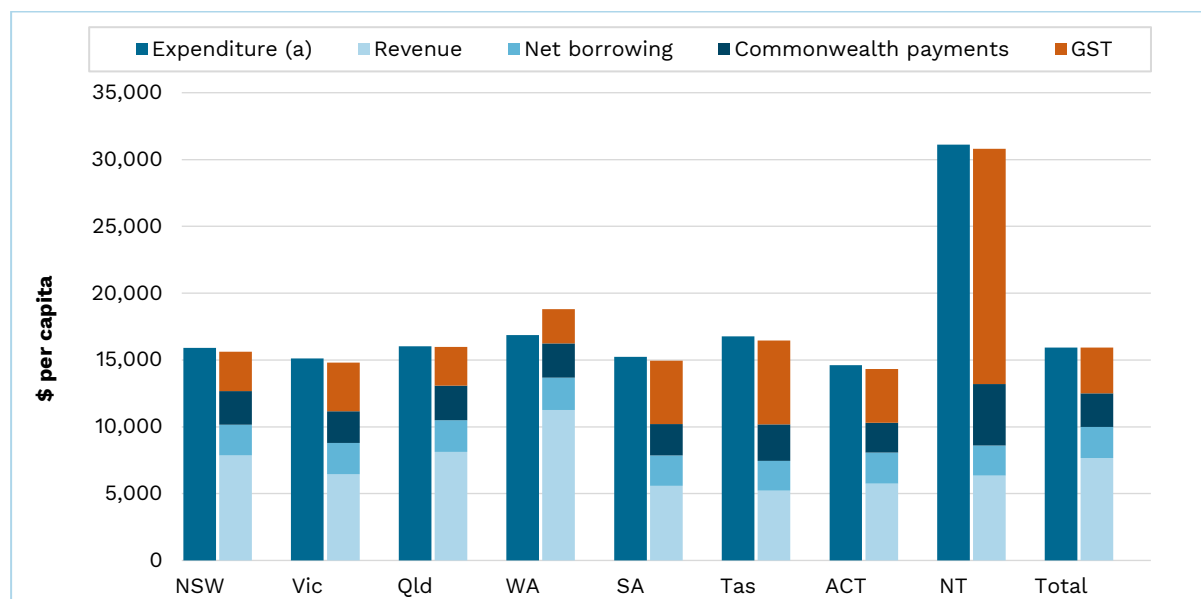
	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Estimated GST pool distribution	25,482	26,147	16,562	7,830	9,032	3,635	1,934	4,527	95,150
Distribution under previous arrangements	27,716	27,988	16,608	1,863	9,518	3,781	2,058	4,588	94,120
Difference	-2,234	-1,841	-47	5,968	-486	-146	-124	-61	1,030

Source: Commonwealth Grants Commission, GST Relativities 2025–26, 2025, p 21.

In 2025–26, Western Australia is estimated to have received almost \$6 billion in additional GST payments, with all other states receiving less than under the previous arrangements (excluding no worse off payments). The difference between the estimated distribution in 2025–26 and the estimated distribution under the previous arrangements (\$1 billion) reflects the Commonwealth’s estimated top-up to the GST pool in 2025–26.

Another way of understanding the fiscal consequences of the 2018 legislated changes is to compare the CGC’s estimate of each state’s assessed expenditure with its estimate of assessed revenue, including revenue from the GST distribution. For 2025–26, this is shown in Figure 1. The blue bar on the left shows the total assessed expenditure for each state. The bar on the right shows the sum of assessed revenue, assessed net borrowing, Commonwealth payments and revenue from the GST pool.

Figure 1 Assessed budgets per capita 2025–26



Note: (a) Expenditure includes expenses and investment.

Source: Commonwealth Grants Commission, GST Relativities 2025–26, 2025, p 64.

Under the previous GST distribution arrangements, each state’s GST share was calculated so that its assessed revenue (including its recommended GST distribution) equalled its assessed expenditure. This meant that each state had the fiscal capacity to provide the average level of services to its population.

After applying the 2018 GST distribution legislation, Western Australia’s GST distribution, combined with its assessed revenues, will exceed its assessed expenditure. For other states, no worse off payments will largely offset the difference between their assessed expenditure and the combination of their GST distribution and assessed revenues.

Fiscal impacts for the Commonwealth

The fiscal impacts for the Commonwealth have been much greater than expected when the 2018 changes were legislated.

Between 2018–19 and 2021–22, the Commonwealth provided \$5.16 billion to Western Australia and the Northern Territory as GST top-up payments.¹² This additional funding supported Western Australia for having a relativity below 0.7 and the Northern Territory when its relativity fell below its 2017–18 level.

From 2021–22 to 2025–26, the Commonwealth provided \$3.96 billion in top-ups to the GST pool.¹³ During the same period, the Commonwealth also made no worse off payments totalling \$19.52 billion.¹⁴ These payments have been significantly higher than anticipated by the Commonwealth at the time of the reforms, primarily because the expected decline in iron ore prices and resulting convergence of Western Australia's relativity with the standard state did not eventuate. The size of the Commonwealth's future no worse off payments to the states will largely depend on the extent to which any state's assessed relativity is below that of the standard state.

Since 2022–23, Western Australia has been the only state to be better off from the legislated changes. This means that the additional funding from the Commonwealth each year (GST top-ups plus no worse off payments) has equalled the additional amount of GST revenue received by Western Australia.

Commonwealth payments to the states other than from the GST pool

In 2024–25, the Commonwealth provided states with \$194.7 billion in financial assistance.¹⁵ Around half of this was general revenue assistance (mostly GST revenue). The other half was Commonwealth payments that must be used for the purpose agreed with the Commonwealth (specific purpose payments).

Through the Commonwealth Treasurer's annual terms of reference, the CGC is asked to consider Commonwealth payments when calculating GST relativities. This recognises these payments are available to fund services and invest in infrastructure. If they were excluded, states that receive less revenue from Commonwealth payments would be disadvantaged in the GST distribution.

Not all Commonwealth payments to states are included in the GST distribution calculations. Payments can be 'quarantined' by the Commonwealth in the terms of reference. Alternatively, the CGC may determine that a payment is for a purpose for which needs are not assessed. In 2024–25, about 55% of non-GST Commonwealth payments, equivalent to 13% of all state revenue, were excluded from the GST calculations.¹⁶

Framework for determining Commonwealth payments included in GST calculations

CGC decisions on Commonwealth payments are guided by its principles-based framework for assessing such payments. This supports a consistent and transparent decision-making process. Payments that support state-type services for which needs are assessed are included in the calculation of the distribution of the GST pool. Figure 2 outlines the CGC's decision-making framework for assessing Commonwealth payments to states. The states have been consulted on this framework and broadly support it.

Before making a final decision on the treatment of Commonwealth payments, the CGC consults with states. States have the opportunity to advocate for a 'no impact' treatment of a payment when they consider this to be warranted. States can also advocate to the Commonwealth to have a payment quarantined through the terms of reference.

¹² 2018–19, 2019–20, 2020–21 and 2021–22 Final Budget Outcomes.

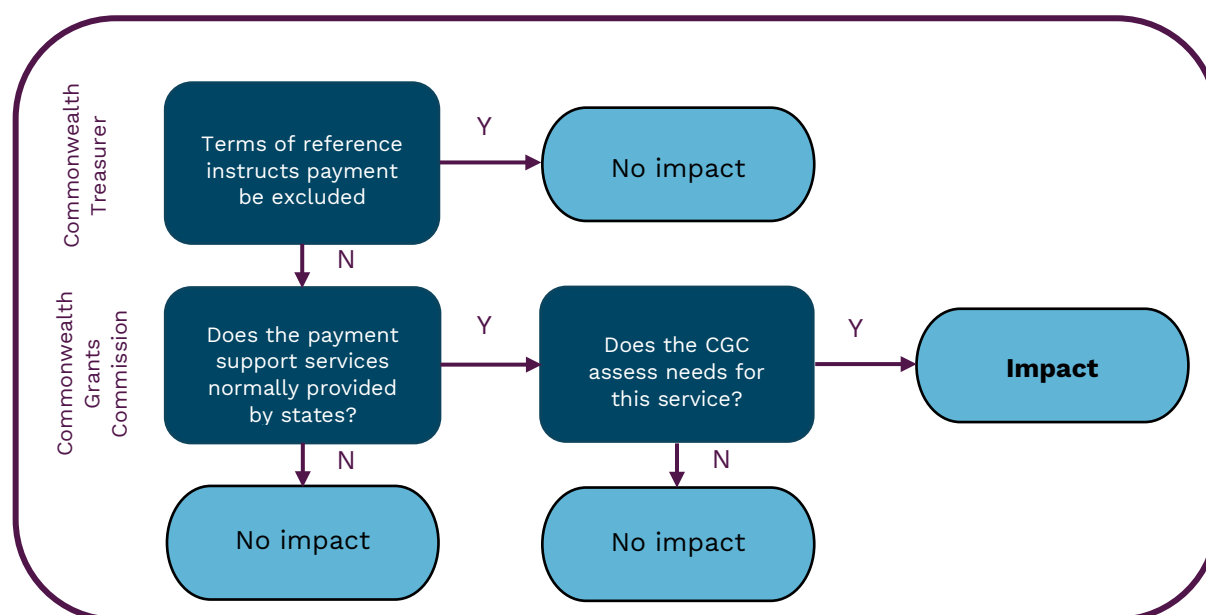
¹³ Final Budget Outcome (various); CGC, [GST Sharing Relativities 2025–26](#), 2025.

¹⁴ Ibid.

¹⁵ 2024–25 Final Budget Outcome, Table 3.1.

¹⁶ 2024–25 Final Budget Outcome, CGC calculations.

Figure 2 CGC decision framework for the treatment of Commonwealth payments



Impact of Commonwealth payments on GST distribution

A state will receive more GST if its share of Commonwealth payments is below its share of associated assessed expense needs. Equally, a state will receive less GST if its share of Commonwealth payments is above its share of associated assessed expense needs. For example, if a state's assessed needs were 10% of expenses nationally and it received a share of payments that was 7%, it would receive more GST. If it received a share of payments that was 14%, it would receive less GST.

This approach is important to support the CGC's mandate to make state fiscal capacities broadly comparable.

Fiscal impact on the Commonwealth of specific purpose payments

The 2018 changes have increased the fiscal impact on the Commonwealth when it provides specific purpose payments to a state that is fiscally stronger than the standard state.

In certain circumstances, a Commonwealth payment to a state that is fiscally stronger than the standard state can ultimately cost the Commonwealth up to double the initial cost. Payments have the initial direct cost. Subsequently, they strengthen that state's fiscal capacity, reducing its assessed relativity. This then increases the cost to the Commonwealth of no worse off payments to other states by a similar amount.¹⁷

Further information on the interaction between GST payments and other Commonwealth payments to states can be found in [Research Paper No 5 – The framework for the treatment of Commonwealth payments in GST distribution](#).

¹⁷ This analysis only applies to specific purpose payments that are treated as impact payments and while no worse off payments apply. 'No impact' payments do not affect states' assessed relativities.

Information request 2: Are current GST distribution arrangements delivering a reasonable level of fiscal equalisation?

Key points

- Defining reasonable equalisation is a matter for government. A clear definition of the objective for GST distribution supports effective implementation.
- Under the 2018 changes, the reasonable equalisation objective means less than full equalisation. The resulting disparities in states' fiscal capacities has led to pressure from the states on the Commonwealth to narrow these gaps, as evidenced by the Commonwealth's no worse off payments.

Clarity of the objective

The CGC's role is to recommend the GST distribution in a way that is consistent with its legislation and annual terms of reference. The objective of GST distribution arrangements and the extent to which it is 'reasonable' is a matter for government. It is not the role of the CGC to make subjective judgements about the level of equalisation being targeted. This makes it important that the Commonwealth clearly defines the equalisation objective.

Prior to the 2018 changes, 'full' equalisation was the objective with all other considerations subordinate. Following the 2018 legislated changes, the standard became 'reasonable' equalisation, and this involved no state having a relativity below that of the standard state or the GST floor. Both approaches could be effectively implemented because they defined the level of equalisation required and the CGC could put in place supporting methodologies to calculate the corresponding GST distribution outcomes. Any future changes should include clear guidance defining the objective.

System trade-offs

Setting the objective of the GST distribution requires being clear on the consequences and trade-offs involved.

The 2018 changes departed from the sole pursuit of full equalisation. The changes have put limits on equalisation through the GST pool. It is no longer possible for any of the 6 smaller states to have a GST relativity lower than the relativity of the strongest of New South Wales or Victoria. Further, no state's GST relativity can fall below 0.75.

The changes have led to trade-offs with simplicity and with full equalisation of states' relative fiscal capacities. They have also resulted in additional costs to the Commonwealth.

- The new approach has increased the complexity of GST distribution (for example, the introduction of standard state relativities and no worse off payment calculations).
- In the current economic circumstances, most states receive less GST revenue than would be needed to provide the average level of services. At the same time, Western Australia receives more GST revenue than would be needed to provide the average level of services.
- To mitigate the impact of the new arrangements on states, the introduction and subsequent extension of no worse off payments has come at a fiscal cost to the Commonwealth. No worse off payments have meant that the capacity of states to provide average services has largely been restored, noting Western Australia retains a fiscal advantage.

Information request 3: Balancing responsiveness to changing circumstances with reducing volatility and improving the certainty of GST revenue streams

Key points

- Under the current model:
 - volatility in GST shares results from volatility in states' relative circumstances
 - the 3-year lagged, moving average of data mitigates some of this volatility
 - historically, volatility in GST revenue has affected some states more than others.
- The 2018 changes have meant that:
 - During the transition period, the operation of the GST relativity floor eliminated volatility in Western Australia's GST relativity. Volatility for other states was unaffected, after taking account of no worse off payments.
 - From 2026–27, a state that is fiscally stronger than the standard state will have the same relativity (and the same volatility) as the standard state. Volatility for other states will be unaffected, after taking account of no worse off payments.
- Forecasting state relativities is challenging. The CGC does not support taking responsibility for forecasting relativities. It would not provide greater certainty to states and would potentially undermine confidence in the system when forecast relativities differed markedly from subsequent actual relativities.

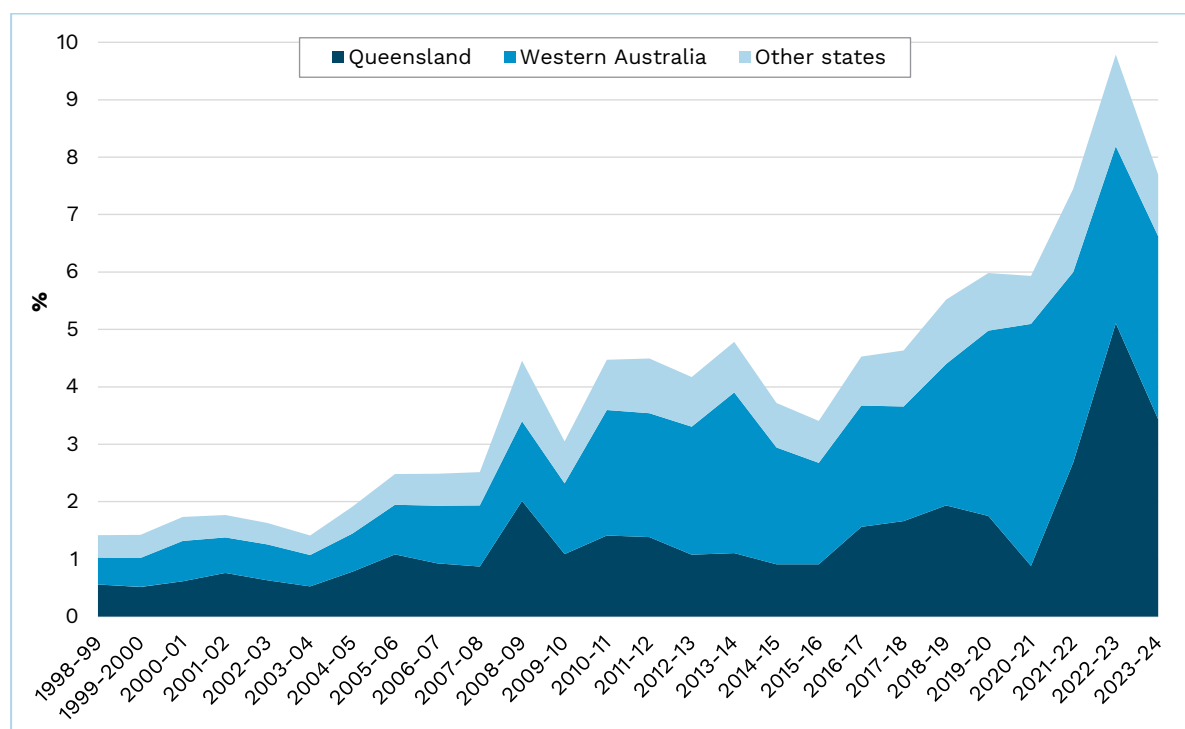
GST volatility

Volatility in state circumstances can lead to volatility in assessed needs

Volatility is both a necessary feature and challenge for the GST distribution system. Some state own-source revenues (e.g. mining royalties) and expenses (e.g. natural disasters) are particularly volatile. Given the zero-sum nature of the system, this volatility in state circumstances impacts all states' relative fiscal capacities. GST distribution based on horizontal fiscal equalisation acts as a stabiliser for volatility in states' relative fiscal capacities, albeit with a delay. GST payments will vary year-to-year in response to changing state circumstances.

The mining assessment is the largest revenue impact on states' relative fiscal capacities. The value of mining production can vary sharply from year-to-year and is a key reason why states' GST shares shift between updates. The increasing importance of mining royalties as a source of revenue for states (Figure 3) heightens volatility in mining states' own-source revenues and their assessed GST needs. This volatility also flows through to other states' assessed needs because of the impact of mining revenues on relative fiscal capacities.

Figure 3 Share of mining royalties in total state revenue



Source: ABS 2025, Government Finance Statistics, unpublished.

On the expenditure side, natural disasters and investment are common sources of volatility in relative fiscal capacities and therefore of volatility in assessed needs. Further, one-off unexpected events, such as the COVID-19 pandemic, can have a significant impact on expenditures.

The 3-year lagged, moving average of data helps mitigate volatility

Since the 2010 Methodology Review, following consultation with the states, the CGC has used a 3-year lagged, moving average for data. Before this, it was 5 years. This approach seeks to balance contemporaneity with smoothing year-to-year variations in GST receipts.

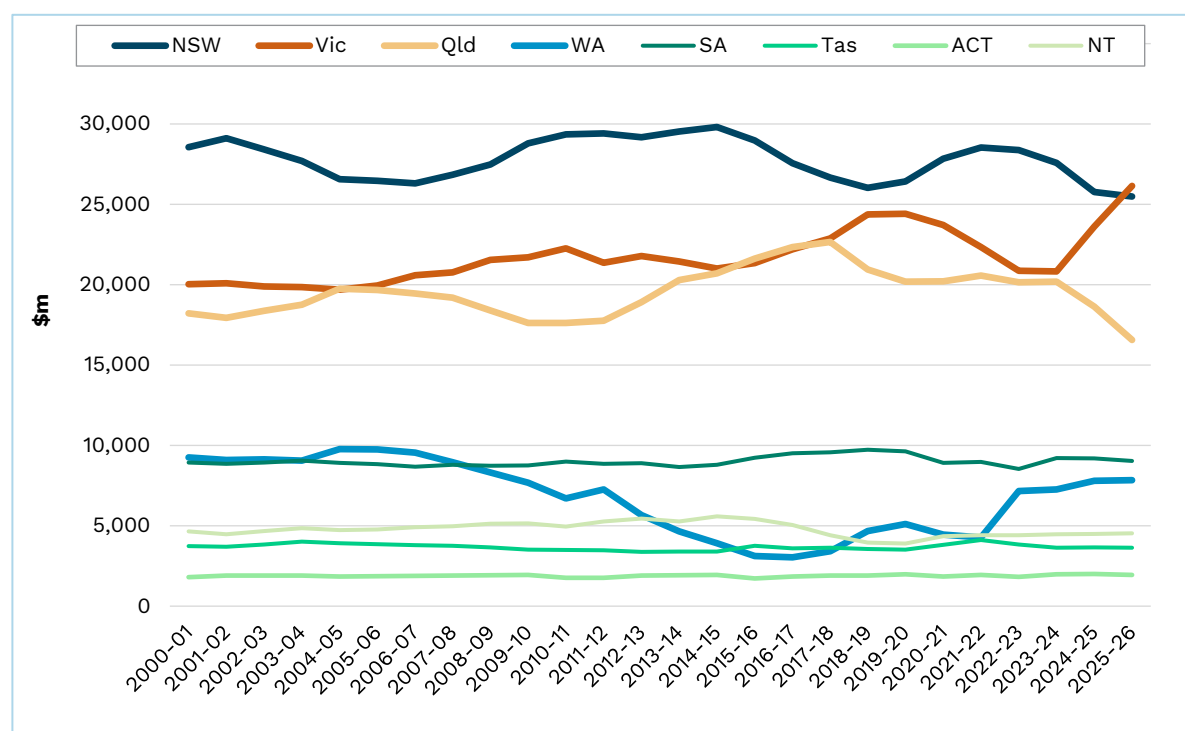
The CGC's contemporaneity supporting principle aims to support, to the extent reliable data will allow, the distribution of GST provided to states in a year reflecting state circumstances in that year. A fully contemporaneous approach would equalise state fiscal capacities in the application year. However, robust data on state circumstances are unavailable until the application year has passed. In the absence of such data, the CGC bases its recommendations on historical data. The 3-year lagged, moving average provides a balance between contemporaneity, predictability and smoothing the impact of fiscal shocks.

Volatility has affected some states more than others

Figure 4 shows how the real value of GST payments to each state has changed over the past 25 years.

Since 2021-22, for states with relativities above the GST relativity floor (all states except Western Australia), the 2018 legislation has not impacted the volatility of GST revenue. The most notable volatility has occurred in the distributions to Victoria and Queensland, driven by a combination of changes in relative revenue raising capacity from mining and relative transport expenditure needs, as well as method changes from the 2025 Methodology Review.

Figure 4 GST distribution to states since 2000–01 (real value in 2025–26 dollars)



Source: CGC calculations.

Impact of 2018 changes on volatility

Volatility was identified as the primary reason for reforming the GST distribution in 2018. At the time, the then government said, ‘The effects of the mining boom, particularly on Western Australia, created extraordinary volatility in the GST distribution... The economic shocks of the last decade have shown that the GST distribution system needs to be refined.’¹⁸

The government also noted that the intent of the changes was to leave ‘Australia with a more stable and predictable source of revenue for all States and Territories, while preserving the best features of the horizontal fiscal equalisation system in terms of equity, leaving all States and Territories better off.’¹⁹

The greatest impact of the 2018 changes on reducing volatility is for fiscally stronger states with a relative below either the floor or the standard state. The following outlines the impact during and post the transition period.

Volatility: transition period

During the first 5 years of the transition period from 2021–22 to 2025–26, the GST floor gave Western Australia certainty about its GST relative. It was guaranteed 70% and then 75% of its equal per capita share of the GST pool through the relative floor.²⁰ No worse off payments for the other states during this period meant that volatility was effectively the same when compared with pre-2018 arrangements.

Volatility: 2026–27 onwards

All states are assured that their GST relative cannot fall below the standard state or the floor (0.75).

With no worse off payments, New South Wales, Victoria and states that are fiscally weaker than the standard state will experience the same levels of volatility as prior to the 2018

¹⁸ [Explanatory Memorandum – Treasury Laws Amendment \(Making sure every state and territory gets their fair share of GST\) Bill 2018.](#)

¹⁹ Ibid.

²⁰ In 2025–26, Queensland benefited from the 2018 GST distribution legislation as its assessed relative was lifted to the standard state. However, this benefit was more than offset by the reduction in its relative (along with other states) as a consequence of lifting Western Australia’s relative to the GST relative floor of 0.75.

changes. For a state that is fiscally stronger than the standard state, they will experience the same volatility as the standard state as their GST is lifted to match that of the standard state.

Volatility in Commonwealth no worse off payments

The 2018 changes have introduced volatility in the cost to the Commonwealth of making no worse off payments to the states. The size of these payments varies depending on the extent to which a fiscally stronger state's relativity has been raised to the standard state. This in turn influences the magnitude of the reduction in the relativities of the other states and the associated no worse off payments.

Forecasting states' GST relativities is challenging

There is uncertainty with any economic forecast. This uncertainty is magnified with any attempt to forecast a state's GST relativity because it requires forecasting changes in the future relative fiscal capacities of all states.

The difficulty in forecasting GST relativities is most evident in revenue, where states' relative circumstances can change from year-to-year, particularly with mining or property booms or downturns. While many expenditures are more stable there are still areas, such as investment and natural disasters, which can be volatile.

Some stakeholders have suggested the CGC provide forecasts of its relativities to improve the predictability of future GST distributions. The CGC does not support this view. States are best placed to forecast their fiscal circumstances and the CGC is not in a better position than states to forecast their overall relative fiscal capacities. Forecasting relativities would not deliver greater certainty for states but would potentially undermine confidence in the system when a forecast relativity differed markedly from an actual GST relativity.

Instead, the CGC seeks to help stakeholders better understand the model and likely impacts of changes. For example, the 3-year lagged, moving average approach means in each update the oldest year drops out and is replaced by a new year. Given the model uses historical data, stakeholders can identify where the change of period is likely to have a significant impact on their relativity because of different circumstances, such as mining booms/downturns or exogenous events such as the COVID-19 pandemic.

As part of the 2025 Methodology Review, the CGC publicly released a document summarising its assessment methodology. This document is intended to serve as a manual for understanding the CGC's assessment methods. The CGC also provides states with access to source data (unless they are confidential) and the more detailed calculations used to derive relativities.

Information request 4: The impact of GST distribution arrangements on the pursuit of state reforms, including efficient service delivery and revenue bases

Key points

- The CGC's policy neutrality supporting principle assists the CGC to develop assessments that neither incentivise nor disincentivise policy reform.
- The design of expenditure assessments means there is generally no identified reason why fiscal equalisation would impede policy reforms in service delivery.
- In some situations, there is a conceptual case (but limited empirical evidence) that revenue assessments may inhibit policy reforms in revenue raising.

Policy neutrality supporting principle

When designing methods for calculating GST relativities, one of the CGC's supporting principles is policy neutrality. This means that a state's policy choices (in relation to the revenue it raises or the services it provides) should not directly influence its GST share. Similarly, the CGC's assessments should not create incentives or disincentives for states to choose a particular policy approach. For example, a state that runs a larger budget deficit than other states through its policy choices will not be rewarded with an increase in its GST share.

In most cases, the CGC broadly achieves policy-neutral assessments through its weighted average policy approach. Under this approach, a state's policy choice will only affect the assessment to the extent it affects the average revenue or expenditure (that is, it cannot directly influence its GST share).

This approach is consistent with the CGC's 'what states do' principle, which bases an assessment on national average policy across states, rather than on subjective views of what state policy should be.

Expenditure assessments

When a state saves money through innovative or efficient service delivery, its GST distribution is largely unaffected. In other words, it retains any gains. Similarly, if a state spends more than its assessed need to spend, it is not compensated for this through the GST distribution. For example, if a state invests in an infrastructure program that exceeds the national average effort, its GST share does not rise accordingly.

The Productivity Commission's 2018 Inquiry into Horizontal Fiscal Equalisation concluded, 'On the expenditure side, changes in State policy can affect GST shares, though the potential to do so is much lower than on the revenue side. There is no compelling case that Australia's HFE system systematically biases State expenditure policy. HFE is unlikely to directly discourage (nor encourage) States from improving the efficiency of service delivery or addressing their structural disadvantages given the broader benefits of doing so to the community. A greater driver of expenditure effort is accountability, which is lacking due to vertical fiscal imbalance and blurred funding responsibilities.'²¹

Revenue assessments

Policy reform in revenue raising is, in most cases, unlikely to be discouraged by fiscal equalisation. This is because of the use of national average policy. However, there are some scenarios where this is not the case, notably where:

²¹ Productivity Commission, [Horizontal Fiscal Equalisation, Report no. 88](#), 2018, p 99.

- a state's share of a revenue source far exceeds its population share, meaning much of the benefit of a reform would flow to other states
- a revenue raising reform could result in the state's assessed revenue base increasing, overstating that state's (policy neutral) revenue raising capacity
- one state extracts a mineral while another does not, and the CGC is unable to quantify the fiscal impact of policy choice.

Dominant state

Policy neutrality concerns can arise where a revenue base is concentrated in one state, for example onshore gas in Queensland, or iron ore production in Western Australia. In 2023–24, Queensland and Western Australia accounted for more than 90% of onshore gas and iron ore production, respectively. As a result, Queensland's and Western Australia's policies determine average policy for those activities, challenging the primary mechanism for achieving policy neutrality. In addition, the large share of the revenue base in each state will result in large GST effects when royalty rates change. This could lead to a case where states are potentially disincentivised from raising royalty rates because most of the additional revenue would be offset by a decrease in assessed GST. In both cases, the policy choices of Queensland and Western Australia may influence their GST shares.

Despite the conceptual risk, there is limited evidence that states' decisions on royalty rates are driven by potential GST effects. The 2018 legislation insulated Western Australia from the GST impacts of increasing its mineral royalties. However, its royalty rates remain unchanged, noting other factors influence such policy decisions. Conversely, Queensland faced a significant reduction in GST from raising coal royalties in 2022 (a \$0.41 reduction in GST for every additional dollar raised) yet it proceeded with these reforms. Further, New South Wales increased its coal royalties in 2024, despite the likelihood of a reduction in its GST share.

The CGC has, and continues to, consider changes to the mining assessment to deal with this policy neutrality issue where there is a dominant state. In the 2025 Methodology Review, the CGC raised the possibility of making an adjustment to allow for a dominant state to retain more than its population share of a royalty increase. This option received a mixed response from states, largely because it introduces a tension between the overarching objective of horizontal fiscal equalisation and the supporting principle of policy neutrality. This topic is on the CGC's forward work program in preparation for the next methodology review.

Elasticities

There is also a potential impediment to reducing or abolishing other taxes. For example, if a state was to abolish stamp duties on conveyances in favour of a property tax and experience a resulting increase in property turnover, the CGC's assessment of the state's revenue raising capacity could be increased if it applied the average state duty rate to the higher level of property turnover. This would result in a reduction in the state's assessed GST needs and could be an impediment to tax reform and compromise policy neutrality. At the request of New South Wales, the CGC considered this matter in 2021 and concluded, 'In keeping with the Commission's principle that individual state policy choices should not unduly influence that state's GST share (the policy neutrality principle), the Commission could seek to identify and mitigate any material observed impact of state tax reform on the GST distribution. This would likely involve an element of judgement'.²²

The Commonwealth Treasurer could ask the CGC, through the terms of reference, to consider any method changes consistent with facilitating a major state tax reform initiative. Alternatively, the Treasurer could include a standing clause in the terms of reference for updates giving the CGC flexibility to change methods between reviews in very limited circumstances, such as state tax reform. This latter option was proposed by the CGC in the 2025 Methodology Review.

²² Commonwealth Grants Commission, [Occasional Paper 2 – GST distribution and state tax reform](#), 2021, p 1.

As part of its forward work program, the CGC is investigating the feasibility of incorporating elasticity adjustments into revenue assessments.

Banned minerals

Queensland, New South Wales and Victoria have different policies on the exploration and extraction of coal seam gas. In the 2025 Methodology Review, the CGC considered whether it was appropriate to continue assessing royalties from coal seam gas on an actual production basis.

The CGC considered an alternate, equal per capita assessment, on the basis that policy choice was in play. However, such an approach would effectively assume that policy choice is the only difference between states, which is not the case. Some states have no coal seam gas. Others have the resource, but it is unclear how much exists, or whether extraction is viable under average policy settings. An equal per capita assessment would fail to capture the different revenue raising capacities of the states. The CGC decided to continue the actual production assessment, reflecting the priority of its fiscal equalisation objective over the policy neutrality supporting principle.

Information request 5: Are there better alternative arrangements?

Key points

- The GST distribution operates within the broader federal financial relations system.
- The objective of the GST distribution is a matter for government. The long-standing priority for the GST distribution has been the pursuit of horizontal fiscal equalisation.
- If an alternative objective is determined, it is important for government to give adequate guidance on the level of equalisation being pursued.
- The objective informs the design of the approach, and all approaches inevitably involve trade-offs.
- In the past decade the following approaches have been used:
 - distributing the GST pool in pursuit of full equalisation
 - distributing the GST pool in pursuit of full equalisation, supplemented by Commonwealth grants to Western Australia and the Northern Territory to address particular circumstances
 - distributing the GST pool on the basis of less than full equalisation, supplemented by top-ups to the GST pool and Commonwealth no worse off payments to states.

GST payments occur within the context of the broader federal financial relations system

The GST distribution is one part of the federal financial relations system. Under the system, the Commonwealth provides financial transfers to the states, including:

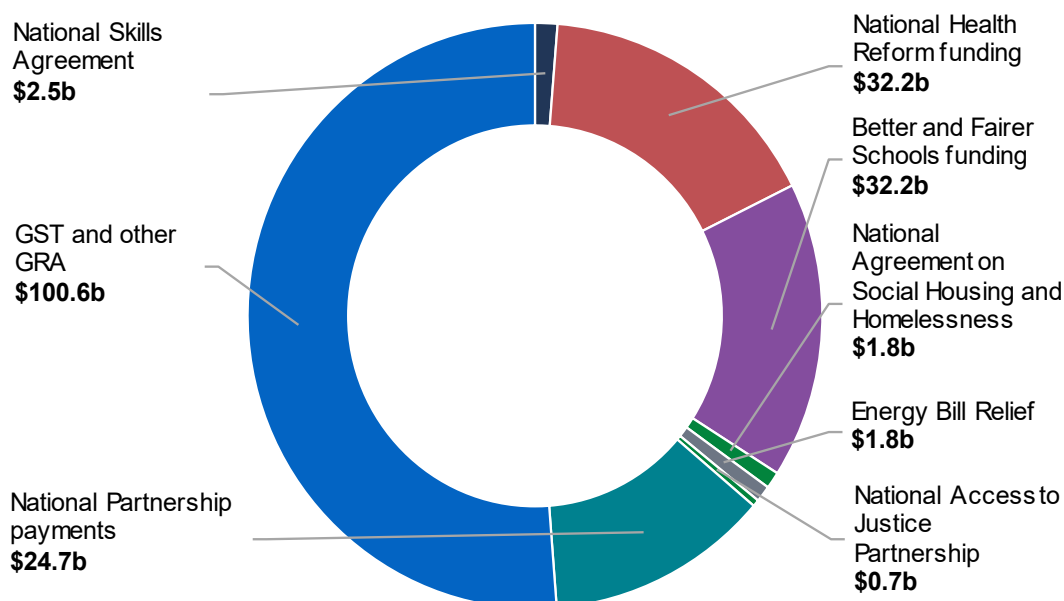
- GST distribution, along with pool top-ups and no worse off payments
- specific purpose payments, some of which are assessed as part of the GST distribution system
- local government grants.

Australia has relatively large fiscal imbalances between the Commonwealth and states (vertical) and between the states (horizontal).²³ While the federal financial relations system can be viewed as a series of agreements designed to fund and/or reform key sectors, it also operates in concert to address these imbalances.

GST payments to the states are untied and are the primary tool for addressing horizontal fiscal equalisation. However, as shown in Figure 5, they only account for about half of the Commonwealth payments to the states each year. Specific purpose payments, while tied to specific uses, also play an important role in addressing vertical and, in some cases, horizontal fiscal imbalances.

²³ OECD, [Federal-State Relations in Australia](#), *OECD Economics Department Working Papers*, No. 1198, 2015, p 9–10.

Figure 5 Estimated total Australian Government payments to the states, 2025–26



Note: National Partnership payments made under the National Skills Agreement, Energy Bill Relief and National Access to Justice Partnership are shown separately.

Source: Commonwealth of Australia, Budget Paper No.3, Budget 2025–26, p 7.

Recent approaches to GST distribution

The objective of the GST distribution system is a matter for government. Historically, the system has been targeted at horizontal fiscal equalisation, whether that be ‘full’ equalisation (pre-2018 reforms) or ‘reasonable’ equalisation (post-2018 reforms). The objective of the GST distribution system will determine the design and implementation approach. The objective needs to be consistent with the GST’s role within the broader federal financial relations system.

Since the introduction of the GST, 3 approaches have been adopted.

- The pursuit of full equalisation operated from 2000 until the 2018 changes, with the objective of the GST distribution being to provide all states with the same fiscal capacity to provide a comparable level of services.
- Prior to the 2018 legislation coming into effect, and still under full equalisation, Western Australia and the Northern Territory received financial assistance from the Commonwealth, in addition to the GST distribution. This was based on the Commonwealth’s view at the time that the amount of GST distributed to those states was unreasonable in the circumstances.²⁴
- With the implementation of the 2018 legislated reforms, the objective changed to reasonable equalisation, which is less than full equalisation. Key elements of the approach are the GST floor and standard state relativity, and Commonwealth funded GST pool top-ups and no worse off payments.

Under each approach, other Commonwealth objectives (such as reducing First Nations disadvantage) have been pursued through specific purpose payments.

All approaches involve implementation trade-offs

The objective of the GST distribution arrangements and the extent to which equalisation is a goal will determine the implementation approach. To support achieving the CGC’s mandate, it uses a systematic approach to assess each state’s major sources of revenue and areas of expenditure. This necessarily involves complexity, trade-offs and judgements.

²⁴ Commonwealth of Australia, [Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response](#), p 10–11.

Quantifying relative fiscal capacities is a contested task. There is no perfect system and there will be challenges involved with implementing any objective. Within the public debate a number of issues about the current approach are often raised. Some of these issues could be addressed but will inevitably come with trade-offs. Examples include:

- Improving contemporaneity – a closer match between the GST payments and current state circumstances could be achieved by using only the most recent year of data. However, this would likely increase volatility as the benefit of smoothing GST revenues through the 3-year lagged, moving average data approach would be lost. It would also remove the ability to incorporate data revisions, reducing robustness.
- Enhancing policy neutrality – changes could be made to enhance policy neutrality through reflecting elasticity effects or further removing potential disincentives (e.g. mining royalties – refer to Information request 4). These would likely add complexity and, depending on the adjustment, may detract from equalisation.
- Increasing stability of GST revenues – states could be provided with greater certainty about GST revenues through different approaches including maintaining relativities for more than one year, averaging data over more than 3 years, or limiting year-to-year changes. These approaches, however, would reduce contemporaneity, leaving states more exposed to managing their own short-term budget volatility, and likely reduce fiscal equalisation.

While some issues could be addressed, other criticisms are based on misconceptions. For example, horizontal fiscal equalisation as the primary objective does not align with distributing GST on an equal per capita basis, notwithstanding its simplicity. Criticism that a state that receives less than its population share of the GST pool is being ‘short-changed’ is inconsistent with the objective of fiscal equalisation.²⁵

Further to these examples, the overall complexity of the current system is raised as an issue.²⁶ Complexity often originates from a state’s request for its circumstances to be more fully captured. Simpler methods could be adopted, however they would likely overlook differences in states’ fiscal capacities and result in a lower standard of equalisation.

Alternative approaches to assessing fiscal capacity that would simplify assessment methods and improve policy neutrality have been explored by various reviews, including the Productivity Commission’s 2018 Inquiry into Horizontal Fiscal and the 2012 GST Distribution Review. Both reviews concluded that with horizontal fiscal equalisation as the objective, it was not possible to achieve fundamental simplification that produced comparable results to the best estimates of states’ relative fiscal capacities.

The CGC explored options for significant simplification in the 2020 Methodology Review. It considered a variety of options for broader assessment methods for expenditure requirements and revenue capacity. These included reducing the number of expenditure assessments and using a global measure, such as Gross State Product, to approximate states’ revenue raising capacity.

Under each option considered, the CGC found the method did not sufficiently account for the specific circumstances affecting each state’s expenditure needs or revenue raising capacity. Distributing GST on the basis of these alternative approaches would be inconsistent with seeking to equalise state fiscal capacities. Other than a further increase in the materiality threshold, the CGC concluded it was difficult to find alternatives that were simpler, placed a greater weight on policy neutrality, and were still consistent with the full equalisation objective.

²⁵ For further information see [Occasional Paper No.12 – GST distribution – addressing some misconceptions](#).

²⁶ For further information see [Occasional Paper No. 13 – Is the GST distribution system too complex?](#)

CGC actions following 2018 Productivity Commission Inquiry

On 1 October 2018, the then government issued a media release responding to the Productivity Commission's *Horizontal Fiscal Equalisation: Inquiry Report*. This attachment outlines the actions the CGC has taken to give effect to the government's response, in addition to implementing the 2018 legislated changes discussed in the body of this submission.

Rec 6.2: The CGC should provide a strong neutral voice, to facilitate a better-informed public discourse on the HFE system.

Over the past 5 years the CGC has sought to contribute to public understanding of the GST process and horizontal fiscal equalisation through the introduction of an Occasional Paper and Research Paper series. These papers provide non-technical information on the CGC's work and aspects of the distribution of GST.

The release of GST relativities for 2025–26 and the reports for the 2025 Review were accompanied by a media release and a plain English overview explaining the recommended GST distribution.

With the release of the annual updates and method reviews, the Chairperson and Secretary make themselves available to respond to media requests. More broadly, the CGC responds to media and other stakeholder enquiries for explanations and background information.

The CGC engages in forums covering the GST distribution arrangements. This includes seminars, briefing parliamentarians and other agencies and appearing before parliamentary inquiries and committees.

The CGC continues to look at options to further improve its communication with the public.

Rec 6.3: The CGC should strengthen its formal interactions with the state and Commonwealth governments. In particular, when requested by a state Government, it should provide provisional 'draft rulings' on the HFE implications of a policy change.

The CGC is always open to assisting states with the potential GST implications of possible policy changes. For example, the CGC worked closely with New South Wales several years ago on possible stamp duty/land tax reforms. Advice is dependent on states providing sufficient detail on the proposed policy and its timing.²⁷

The CGC has strengthened its collaboration with state treasuries. As part of the 2025 Methodology Review, the CGC introduced a detailed forward work program (commencing in 2025) to advance research on significant topics in preparation for the next review. States will have the opportunity to provide input to this research, including the scope, timing and conduct of the research. States will be kept informed of progress.

The CGC seeks to provide states with reasonable timeframes to respond to consultation and information requests, calibrated to external considerations such as the time provided by the terms of reference, release of relevant data and state budgets.

The CGC seeks to provide the context and background for consultation requests, including the relevance and importance to the distribution of GST. To help guide the states with their submissions for the 2025 Review, the CGC posed specific consultation questions and provided the CGC's preliminary position on issues.

For annual updates, the CGC gives states advance notice of the timeline for data returns and consultation on new issues. For methodology reviews, the CGC seeks state input before

²⁷ Further information on how the CGC might respond to state tax reform initiatives can be found in [Occasional Paper 2 – GST distribution and state tax reform](#).

releasing a detailed outline of the approach and timeline, including the timing for consultation with the states.

In 2025, the CGC and the Board of Treasurers collaborated to improve the CGC's interactions with state treasuries.

Rec 6.6: The CGC should immediately and systematically make the data provided by the states publicly available on its website, along with the CGC's calculations on these data.

Accompanying each update of GST relativities is a substantial amount of supporting data and analysis. Data are provided on state populations, disaggregated by socio-demographic status; state budgets, including both actual and assessed expenses and revenue; Commonwealth payments to states; and GST relativities over time. Analysis is provided on the drivers of change in GST distribution from the previous update.

The CGC has established a Data Working Group with the states to discuss data issues and ways to improve the CGC's data processes and procedures. This could include exploring opportunities to reduce data confidentiality restrictions, to support the publication of additional data.

Calculation of GST relativities

The CGC's recommendations on GST relativities are consistent with the *Commonwealth Grants Commission Act 1973*, the *Federal Financial Relations Act 2009*, the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* and the terms of reference issued by the Commonwealth Treasurer. The CGC undertakes several steps to produce GST relativities.

Assessed relativities

Assessed relativities are calculated for each assessment year by comparing each state's relative capacity to raise revenue with its relative cost of providing services.

Drivers of differences in revenue capacity include mineral endowments, land values, property transactions, and taxable payrolls. States also receive different levels of funding through Commonwealth payments.

Service costs can vary by state for a range of reasons, including socio-demographic characteristics of the population, wage pressures, population dispersion, population density and rates of population growth.

Assessed relativities match a state's assessed expenditure with its assessed revenue including GST. Without the 2018 GST distribution legislation, GST relativities would equal assessed relativities.

Standard state relativities

Standard state relativities are calculated for each assessment year by adjusting assessed relativities so that no state has a relativity less than the lower of New South Wales or Victoria (referred to as the 'standard state'). Therefore, any state that is fiscally stronger (and therefore has a lower assessed relativity) than the standard state, will have its relativity increased to the assessed relativity of the standard state. Given the GST is distributed from a fixed funding pool, relativities for all states are adjusted down on a population share basis to accommodate this increase.

GST relativity floor

The GST relativity floor sets a minimum relativity (0.75), below which any state's per capita share of the GST pool cannot fall. If a standard state's relativity is below the floor, its GST relativity is adjusted up to the floor, along with any other states that may also have a GST relativity below this floor after being lifted to the standard state. To accommodate this, the relativities of the remaining states are adjusted down on a population share basis. In 2026–27, the standard state relativities were above 0.75, so no adjustments related to the GST relativity floor were required.

GST relativities

The final numbers are called GST relativities. The CGC recommends these to the Commonwealth Treasurer for the distribution of the GST pool.

CGC publications

Occasional papers

[Occasional Paper #1 Impact of the COVID-19 pandemic on GST distribution](#)

[Occasional Paper #2 GST distribution and state tax reform](#)

[Occasional Paper #3 Mining revenue and GST distribution](#)

[Occasional Paper #4 New arrangements for distributing GST](#)

[Occasional Paper #5 GST distribution to states and territories in 2022–23](#)

[Occasional Paper #6 Why are some Commonwealth payments to states included in calculations of GST needs](#)

[Occasional Paper #7 Natural disaster relief and the GST distribution](#)

[Occasional Paper #8 Commonwealth Grants Commission Commencement of 2025 methodology review](#)

[Occasional Paper #9 GST Distribution to states and territories in 2023–24](#)

[Occasional Paper #10 – 90 Years of the Commonwealth Grants Commission](#)

[Occasional Paper #11 GST distribution to states and territories in 2024–25](#)

[Occasional Paper #12 GST Distribution: Addressing Some Misconceptions](#)

[Occasional Paper #13 Is the GST distribution system too complex?](#)

Research papers

[Research Paper #1 Fiscal equalisation and mining booms](#)

[Research Paper #2 Why states get different shares of GST](#)

[Research Paper #3 International themes in fiscal equalisation: an Australian perspective](#)

[Research Paper #4 States' GST needs over a decade](#)

[Research Paper #5 The framework for the treatment of Commonwealth payments in GST distribution](#)

[Research Paper #6 GST distribution and state investment needs](#)