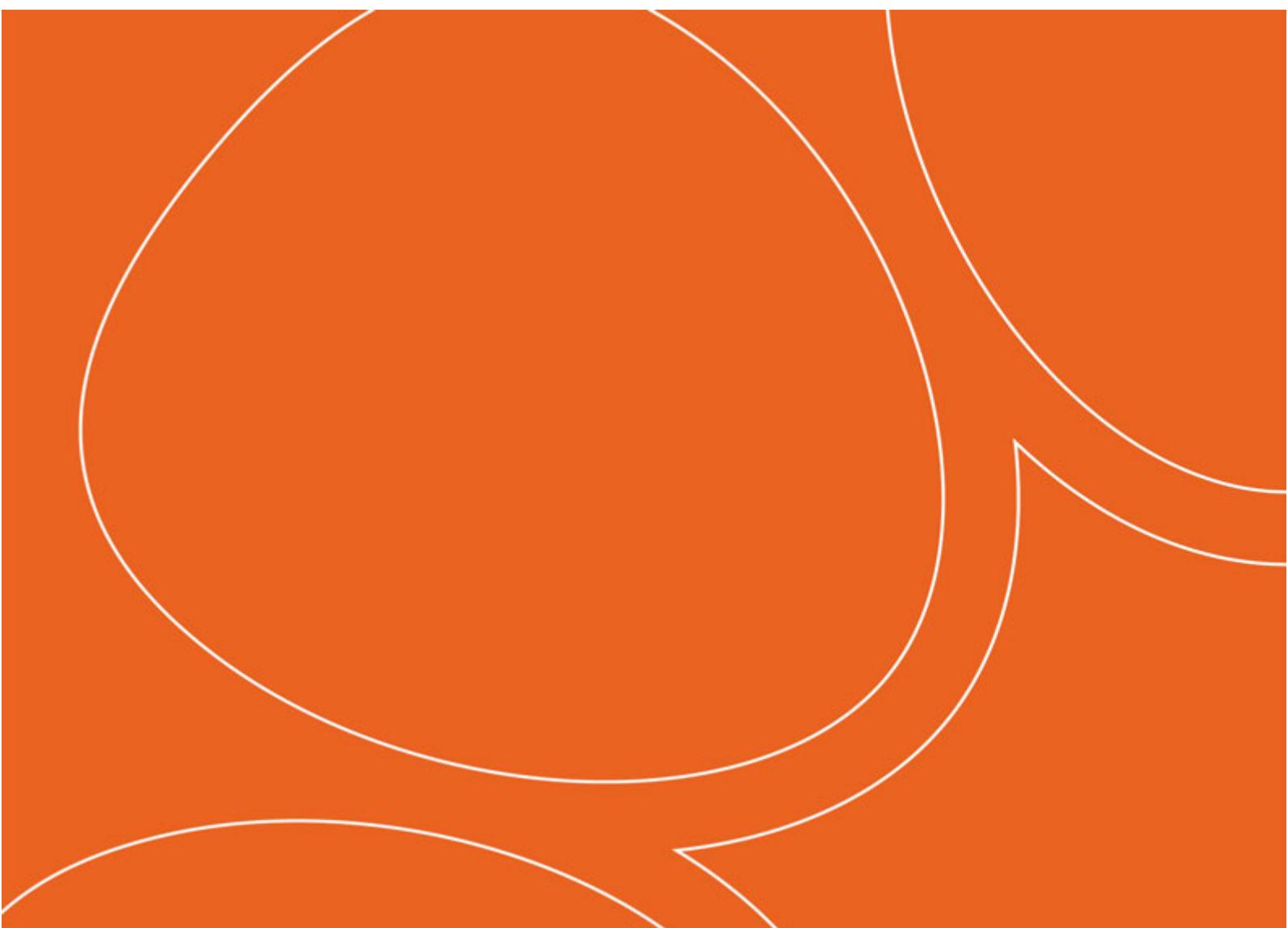


GST Distribution Reforms

Initial submission – Northern Territory Government



Acronyms	Full form
2017 inquiry	The Productivity Commission inquiry report on Horizontal Fiscal Equalisation, commenced in May 2017, with a final report in July 2018
2018 reforms	The package of reforms in the <i>Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018</i> , and supporting agreements including the <i>Extension of the GST No Worse Off Guarantee Funding Agreement</i>
GST	Goods and Services Tax
HFE	Horizontal Fiscal Equalisation
NoWO	No worse off (guarantee or payment)
PC	Productivity Commission
VFI	Vertical Fiscal Imbalance

Contents

1. Introduction.....	5
1.1. Summary of the Territory's position.....	5
2. The amendments in review: what has happened since 2018.....	6
2.1. Are the reforms operating as intended?.....	6
2.1.1. The reforms did not intend to depart from HFE.....	6
2.1.2. The reforms are not fiscally sustainable.....	6
2.1.2.1. Why does the Territory receive an above per capita share of GST?.....	10
2.2. Are the reforms operating efficiently and effectively?.....	12
2.2.1. The reforms are disproportionate to mining issues.....	12
2.2.1.1. The reforms distribute the cost inequitably between states.....	13
2.3. The reforms cause a large departure from HFE, with three states equal per capita in 2025-26.....	14
2.4. The reforms have not resolved policy neutrality in the mining assessment in states other than Western Australia.....	14
2.4.1. Unresolved issues in the mining assessment – dominant state.....	14
2.4.2. Unresolved issues in the mining assessment – new production.....	15
2.4.3. The GST distribution method should not be a reform incentive mechanism.....	16
2.5. Other unintended consequences of the 2018 reforms.....	16
3. What is sought: the Territory's submission for the GST system.....	17
3.1. A return to full HFE.....	17
3.2. Improvements to reduce volatility.....	17
3.2.1. GST volatility in the Northern Territory.....	17
3.2.2. Despite annual volatility, the Territory's long-run needs are stable.....	18
3.2.3. Impact of volatility in the Territory.....	19
3.2.4. Alternative option to address Territory GST volatility.....	21
3.3. Other changes – improvements to the mining assessment.....	22
3.4. Other changes – Commonwealth payments.....	22
3.4.1. Current exclusion frameworks.....	23
3.4.2. How do Commonwealth payments impact GST?.....	23
3.4.3. Closing the Gap and outcomes-funding: GST does not fund additional investment to achieve outcomes beyond average services.....	24
3.4.3.1. Example – Better and Fairer Schools Agreement (Northern Territory).....	26
3.4.3.2. GST, mainstream services and Aboriginal expenditure.....	26
4. What is opposed: alternative systems or proposals that the Territory does not support.....	27
4.1. Lower HFE benchmarks (including to equal per capita).....	27
4.2. Funding states outside the GST pool.....	27
4.2.1. Offsetting funding from within the GST pool.....	29
4.2.2. Offsetting funding from Commonwealth funding.....	29
4.2.2.1. The cost to the Commonwealth would exceed the 2018 reforms.....	29
4.2.2.2. There is no mechanism to distribute the payments.....	30

4.2.2.3. Democratic decision-making would be severely undermined.	30
4.3. Broader discounting of non-mining assessments.	30
4.4. No international benchmarking.	31
5. Responses to Productivity Commission issues paper questions.	31
5.1. Fiscal sustainability of the 2018 reforms for the Commonwealth and states and territories.	31
5.2. Are current GST distribution arrangements delivering a reasonable level of fiscal equalisation?.....	32
5.3. Balancing responsiveness to changing circumstances with reducing volatility and improving the certainty of GST revenue streams.	33
5.4. The impact of current GST distribution arrangements on the pursuit of state reforms, including efficient service delivery and revenue bases.....	34
5.5. Are there better alternative arrangements?	35

1. Introduction.

The *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (Cth) (reforms 2018) requires evaluation of:

- whether the 2018 reforms are operating effectively, efficiently and as intended
- the fiscal impact of the 2018 reforms on states and territories.

The 2018 reforms evaluation terms of reference, approved by the Commonwealth Treasurer, further ask the Productivity Commission (PC) to consider to what extent the current arrangements are:

- delivering a reasonable level of horizontal fiscal equalisation (HFE)
- appropriately balancing the objective of responsiveness to changing circumstances with the objectives of reducing volatility and improving the certainty of GST revenue streams to support state fiscal planning
- supporting states and territories to pursue reforms, including to the efficiency of service delivery and state and territory revenue bases
- fiscally sustainable for the Commonwealth and states and territories

as well as:

- whether alternative arrangements would better achieve some or all these outcomes
- the interaction between GST payments and other Commonwealth payments to states, including the principles for exempting payments from the Commonwealth Grants Commission's assessments.

The PC's November 2025 issues paper comprises five information requests and includes topics such as the Australian Federation and vertical fiscal imbalance (VFI).

As many of these issues are inter-related and evoke similar considerations, the Northern Territory provides a consolidated submission rather than responding to each question in isolation. This consolidated submission broadly covers the following:

- **The amendments in review:** what has happened since 2018.
- **What is sought by the Territory:** the Territory's submission for changes to the GST distribution system.
- **What is opposed by the Territory:** aspects of the 2018 reforms, or alternative systems or proposals, that the Territory does not support.
- **Responses to PC consultation questions.**

1.1. Summary of the Territory's position.

The Territory's key positions are:

- HFE arrangements that enable all states to deliver a national average service standard should be reintroduced and remain the benchmark against which GST is distributed.
- The 2018 reforms did not intend to embed a lower standard of HFE and the Territory does not support HFE to a lower standard, however effected.
- If the No-Worse-Off Guarantee (NoWO) lapses, states and territories, other than Western Australia, will face an unsustainable fiscal cliff that was not intended, resulting in a significant deterioration in services or state finances.
- If reforms are required to address concerns with GST distribution outcomes arising mainly due to the assessment of mining revenues, they should be specific to that assessment.

- The Territory does not support alternative funding arrangements that erode state and territory autonomy and increase dependence on the Commonwealth.
- There are other improvements consistent with the inquiry's terms of reference that could be made to enhance the GST system without departing from HFE principles, including:
 - providing the Territory with a fixed share of the GST pool based on long-term historical average outcomes to reduce unnecessary and counter-intuitive annual volatility. A fixed share would directly reduce annual GST volatility, provide significant scope to simplify the GST distribution methodology and reduce unintended consequences associated with the inclusion of certain Commonwealth funding in the GST assessment framework, while remaining consistent with the principle of full HFE over the medium to long term.
 - Commonwealth payments should continue to be generally included in the assessment of GST needs, however clearer exclusion frameworks are warranted for outcomes-based funding, particularly Closing the Gap type payments.

2. The amendments in review: what has happened since 2018.

2.1. Are the reforms operating as intended?

2.1.1. The reforms did not intend to depart from HFE.

The inquiry is asked to consider if the reforms are operating as intended and delivering a reasonable level of HFE. As such, it is important to consider what HFE is, and what "reasonable" HFE means.

The Territory describes HFE as distributing sufficient untied revenue to allow each state to deliver the same, average, standard of services, if each state applied the same effort in raising own-source revenues.

In Australia, HFE is generally delivered through distribution of Commonwealth Goods and Services Tax (GST) revenue in an untied manner. The distribution is based on an independent assessment of the per capita costs to deliver the average level of services (after taking into account relevant cost and demand drivers, and each states' ability to raise revenue from other sources) and distributes sufficient GST so each state can fund that cost.

Any alternative distribution of GST, or other untied revenue, would result in some states receiving insufficient total funding to deliver the average standard of services, while others receive more. Over time, such funding inequities would result in bifurcation of service levels or fiscal outcomes between jurisdictions. As such, consideration of lower HFE standards is a discussion on different levels of inequity.

It is submitted that "reasonable" HFE, is a misnomer. There is no "reasonable" level of inequity. It is not reasonable that some Australians should receive below-average services due to the state where they live.

It is also not sustainable that jurisdictions receiving inadequate funding to deliver the average level of services incur additional debt to bridge the gap and meet community expectations, creating intergenerational inequity.

Regardless of how HFE is described, the Territory submits the 2018 reforms never intended to entrench a lower standard of services or fiscal outcomes in any state compared to the former regime.

2.1.2. The reforms are not fiscally sustainable.

The inquiry is asked to consider the fiscal sustainability of the 2018 reforms.

The 2018 reforms were intended to be fully-funded within a modest ongoing Commonwealth pool top-up. This was expected to be shared among states and mean all would be able to deliver a higher level of services than would be possible from the GST pool alone.

The Commonwealth Treasurer’s second reading speech at the time described the reform as:

“... a plan that leaves all States and Territories better off.”¹

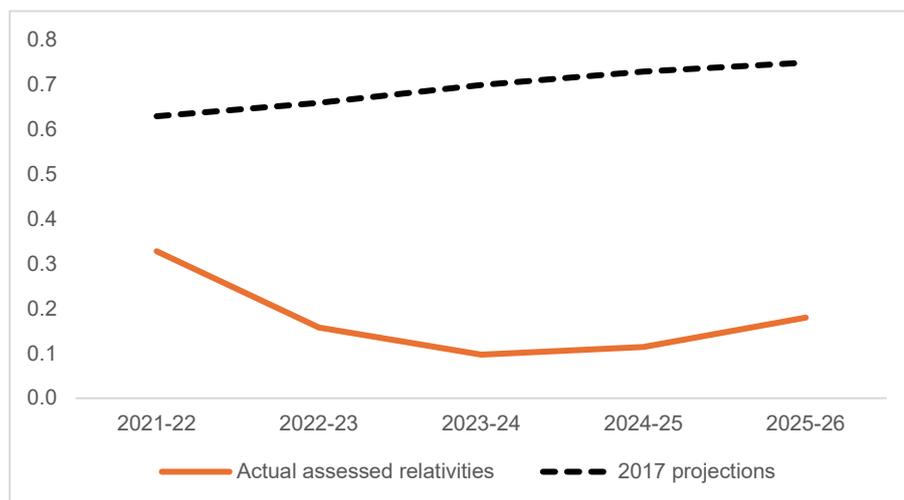
While it was intended that all states be fiscally better-off under the reforms, the NoWO was also introduced at the outset to ensure no state would receive less untied revenue than under the former arrangements.

Although the NoWO was time-limited, it was legislated to cover the entire implementation period to this inquiry, meaning no state would be worse off before this inquiry, and the inquiry could recommend changes if reform outcomes were contrary to the original intent.

The 2018 reforms clearly aimed to improve Western Australia’s overall funding. However, the impact was expected to be small, temporary and funded within the GST pool top up. This was based on forecasts at the time, which expected Western Australia’s mineral wealth boom to be short-lived. On original projections, no state, including Western Australia, was expected to have a GST share below 75% of their population share by 2025-26, constraining the cost of the reforms.

Western Australia’s mineral strength instead grew and persisted, leading to a significantly more costly reform than expected or intended (Chart 1).

Chart 1 – Western Australia relativity, actual to 2017 forecasts, 2021-22 to 2025-26.



Source: Commonwealth Grants Commission, 2017 PC inquiry

The additional amount required to fund Western Australia’s new GST share is now six times larger than the available GST pool top-up, requiring an additional \$5 billion in NoWO payments annually (Table 1 and Table 2) and completely eroding the potential benefit of the GST pool top-up to other states.

¹ Second reading speech to the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018*, and repeated in the Explanatory Statement and other publications at the time. However, the intention should not solely be gleaned from Commonwealth publications as the deal reflects the multilateral view of all states, territories and the Commonwealth. Nonetheless, better off overall was important to achieving multilateral agreement.

Table 1 – Cost of the 2018 reforms since 2021-22 (\$m)

	2021-22	2022-23	2023-24	2024-25	2025-26*
Pool top-up	600	662	686	981	1,044
NoWO payments	158	4,108	4,929	5,386	5,065
Total	758	4,770	5,615	6,367	6,108

*Commonwealth 2025-26 Mid-Year Economic and Fiscal Outlook estimate.

Table 2 – NoWO payments by state (\$m)

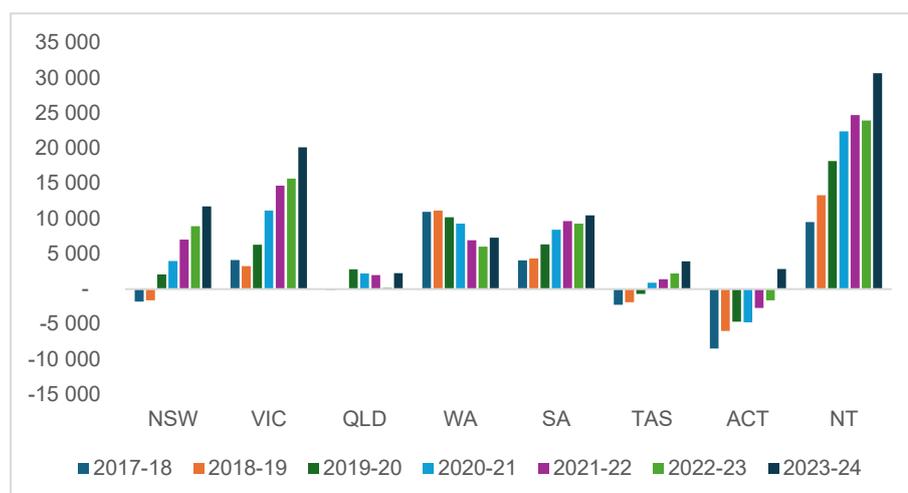
	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
2021-22	64	56	33	-	3	-	2	-	158
2022-23	1,464	1,204	947	-	314	87	81	12	4,108
2023-24	1,740	1,439	1,129	-	375	112	96	39	4,929
2024-25	1,899	1,562	1,239	-	412	122	106	46	5,386
2025-26*	2,285	1,876	59	-	501	150	128	66	5,065

*Commonwealth 2025-26 Mid-Year Economic and Fiscal Outlook estimate.

This excessive cost to the Commonwealth, with only a single state being better off and all others only protected from being materially worse-off due to the time-limited NoWO, was not expected or intended.

The main fiscal impact of the 2018 reforms is that Western Australia is now funded by the Commonwealth to provide services that are at least \$6 billion higher annually than in every other state. In practice, this has been reflected in improved fiscal outcomes in Western Australia in comparison to other states (Chart 2).

Chart 2 – Net debt, 2017-18 to 2023-24 (\$ per capita)

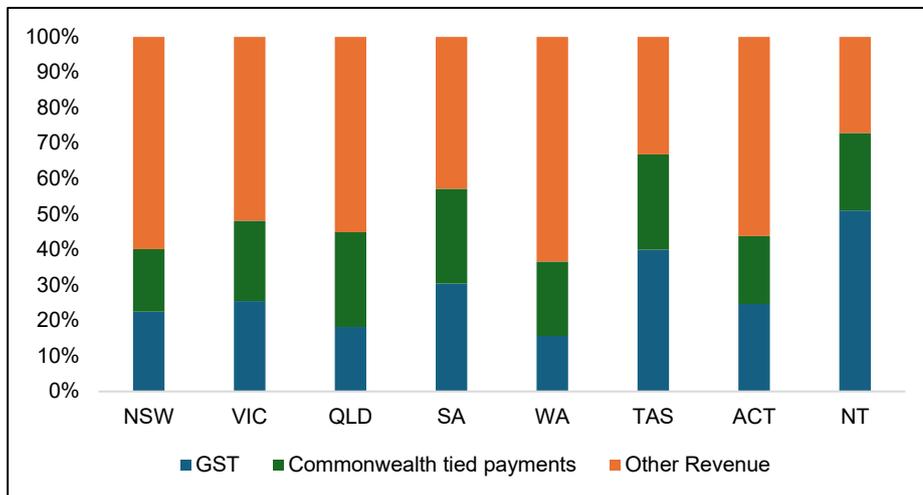


Source: Department of Treasury and Finance calculations on PC inquiry issues paper

To date, the NoWO has prevented negative fiscal and service delivery impacts. However, if the NoWO lapses, significant deterioration in fiscal outcomes or services would occur in all states except Western Australia. These outcomes would also be exacerbated by any reduction in the GST pool top-up.

To evaluate the sustainability of the 2018 reforms, it is useful to consider alternative revenue sources. The Territory has the highest dependence on GST revenue of any jurisdiction, at around 51% of revenue in 2025-26 compared to around 23% on average in other states and as low as 16% in Western Australia. Of the Territory’s remaining revenues, around 22% is tied Commonwealth revenue, which is also high in comparison to other states, and 27% is own-source revenue (Chart 3).

Chart 3 – Components of state revenue, general government 2025-26 (%)



Source: State and territory budgets and financial reports

As own-source revenues are the only revenues within state policy control, this is the most useful comparator to the NoWO. Table 3 shows the estimated increases in various own-source revenues that would be required to offset the fiscal impact of the NoWO lapsing. The information is provided for illustrative purposes only, with no suggestion this would be feasible, and ignores potential outcomes on GST relativities of increased revenues. Such changes would have major policy, economic, practical and political implications. Further, as state taxes are generally less economically efficient than the GST (as a broad-based consumption tax), any substitution would result in a net economic efficiency loss.

Table 3 – Territory own-source revenue to NoWO, 2025-26

Revenue Source	2025-26 Budget (\$m)	NoWO as share of own-source (\$60 million)
Taxes on employers	277	22%
Taxes on property (stamp duty)	139	43%
Taxes on property (land tax)	0	n.a.
Taxes on gambling	145	41%
Motor vehicle taxes	103	58%
Taxes on insurance	84	71%
Mining and petroleum royalties	346	17%

The PC’s issues paper also asks for submissions on the fiscal impact of the 2018 reforms on the Commonwealth. It is submitted that it is sufficient to note the Commonwealth has borne a total cost (as at the 2025-26 Mid-Year Economic and Fiscal outlook) to 2025-26 of \$23.6 billion, including \$6.1 billion in 2025-26, exclusively to the benefit of Western Australia.

The fiscal pressures on the Commonwealth arising from the 2018 reforms are likely to have had many consequences for states, including lower/forgone tied funding to states, increased tied funding conditions or co-contributions from the states, and opportunity costs from other forgone investments.

Commonwealth fiscal pressure can also impact states indirectly. For example, if it results in lower Commonwealth direct primary health and aged care investment this may increase state and territory hospital costs.

While it is difficult to draw direct links between the cost to the Commonwealth of the 2018 reforms and broader state funding outcomes, this does not mean the cost is sustainable or has no impact, merely that it is difficult to observe.

2.1.2.1. Why does the Territory receive an above per capita share of GST?

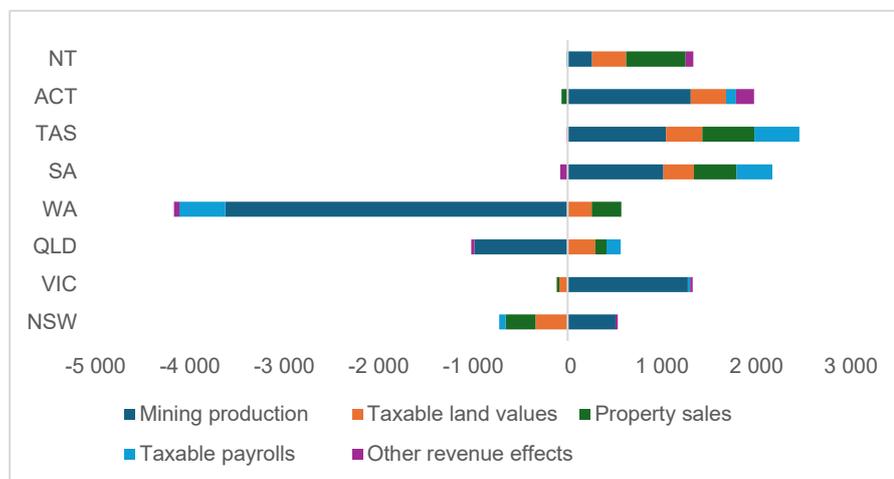
In considering the sustainability and “reasonableness” of the 2018 reforms, it is useful to understand how the GST calculation is made, and what a lower standard of HFE means.

The independent Commonwealth Grants Commission advises the Commonwealth Treasurer on how annual GST revenue should be distributed between states to ensure each can provide comparable services, if they all make a similar effort to raise revenue from their own taxes. This supports Australians receiving comparable levels of health, education, justice, welfare and other services, regardless of which state they live in.

Due to significant differences between states in revenue raising capacity and the cost of providing the average level of services, some states receive less than a per capita share of the GST pool, while others, including the Territory, receive more.

Nationally, the largest driver of GST distributions away from an equal per capita share is differences in revenue raising capacity between states, in particular differences in the ability to generate revenue from mining (Chart 4).

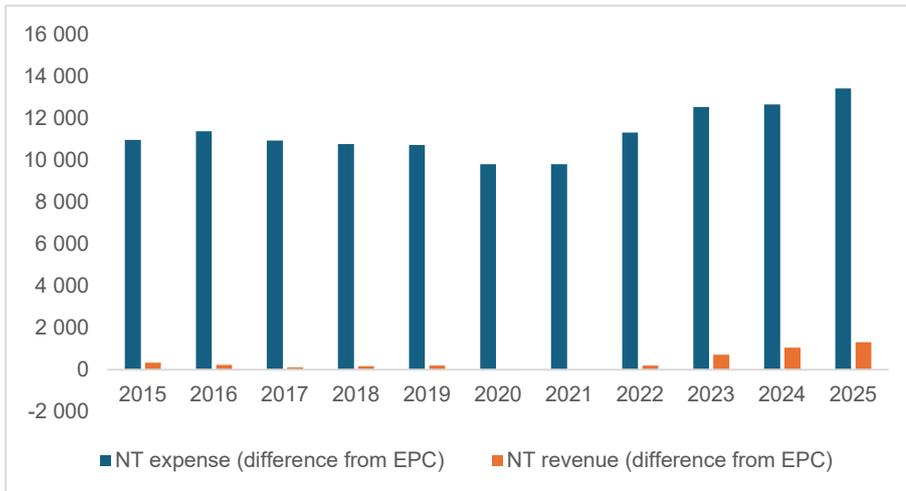
Chart 4 – Drivers of difference from equal per capita, revenue, 2025-26 (\$ per capita)



Source: Commonwealth Grants Commission

The Territory is atypical in that its high per capita share of GST instead overwhelmingly reflects differences in the cost of providing the average level of services, with revenue differences a much lower contributor (Chart 5).

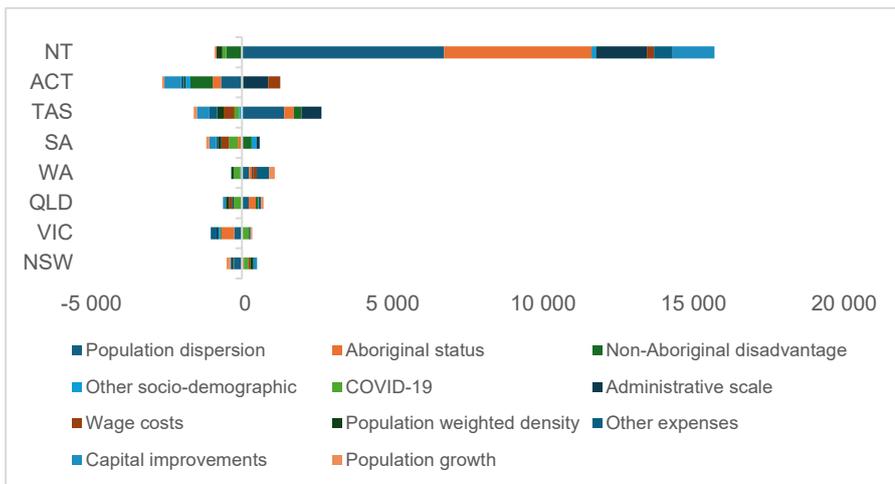
Chart 5 – Drivers of Territory GST revenue and expenses, 2015-16 to 2025-26 (\$ per capita)



Source: Commonwealth Grants Commission

The higher cost of providing the average level of services in the Territory reflects the dispersed population, including remoteness and diseconomies of scale in small communities, and the relatively high proportion of the Territory’s population who are Aboriginal², among other factors (Chart 6).

Chart 6 - Drivers of GST, difference from equal per capita, expense and investment, 2025-26 (\$ per capita)

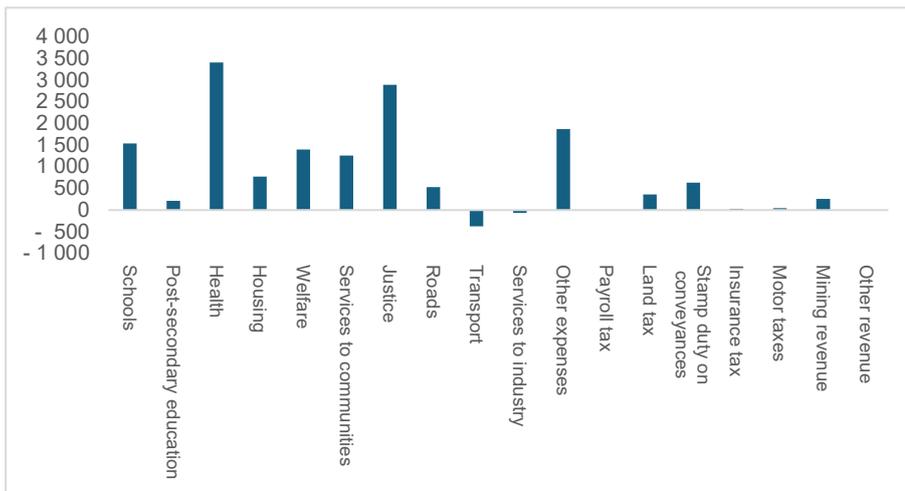


Source: Commonwealth Grants Commission

The estimated cost of providing the average level of services is the aggregate of a number of sectoral based assessments. At the sectoral level, the largest drivers of Territory GST distribution above a per capita share include health (higher Aboriginal use of health services), justice (remoteness costs and higher Aboriginal use of justice services), schools (remoteness costs and high proportion of Aboriginal students), welfare (remoteness costs and high proportion of Aboriginal use of child protection and homelessness services), services to communities (higher proportion of remote Aboriginal communities) and other expenses (reflecting the Territory’s relative isolation and general diseconomies of scale and other factors) (Chart 7).

² Aboriginal status is used in a number of Commonwealth Grants Commission assessments as a proxy for socio-economic disadvantage, noting people of lower socio-economic advantage, on average, are more intensive users of government services and therefore require more resources to service per capita.

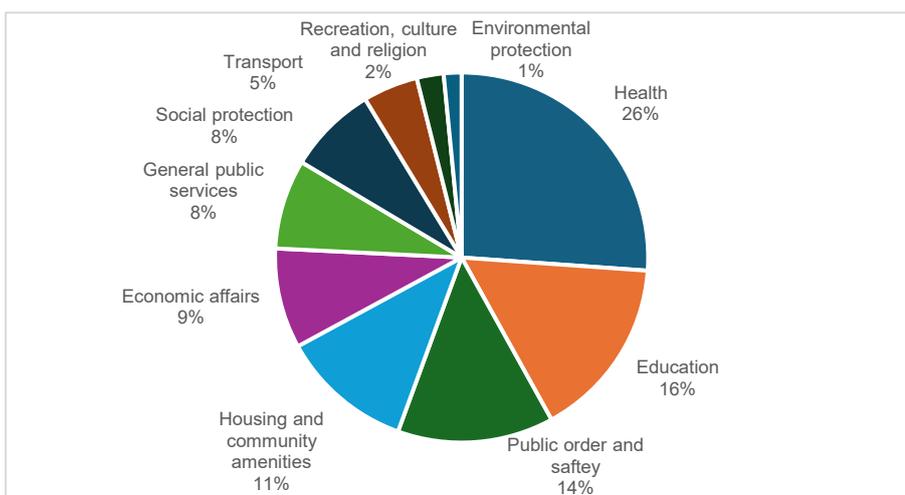
Chart 7 – Drivers of Territory GST, components, difference from equal per capita, 2025-26 (\$ per capita)



Source: Commonwealth Grants Commission

While GST funding is untied, a similar profile appears in the Territory’s actual expenses, noting the GST method measures national-average services, not the actual costs or policies in the Territory or any other state, and has various method limitations (Chart 8).

Chart 8 – Territory Budget components, 2025-26 (%)



Source: Territory Budget and financial statements

Both the Territory’s GST assessment and the Territory’s budget are dominated by frontline services, and predominantly those services used relatively intensively by Aboriginal Territorians, including health, education, public order and safety, housing and community services, social protection, and public transport. Of the remainder, the largest Territory expenses are interest and electricity generation costs.

2.2. Are the reforms operating efficiently and effectively?

2.2.1. The reforms are disproportionate to mining issues.

The inquiry asks if the reforms are operating efficiently and effectively.

One way to evaluate proportionality is to compare the reforms to the discount that would be applied to Western Australian mining GST measures to achieve a similar result. This would test the PC’s 2017 inquiry finding 7.4, that:

“Discounting mining (or other revenue categories) in the HFE process – or removing it entirely – is not justified and would come at a high cost to fiscal equality.”

The 2018 reforms are similar in magnitude to around a 50% discount of Western Australia’s mining capacity (Table 4). Under current Commonwealth Grants Commission discount guidelines, a 50% discount is the highest discount short of disregarding the entire assessment. The Territory’s position on discounting is at sections 3.3. and 4.3.

Table 4 – size of 2018 reforms compared to mining assessment, Western Australia, difference to per capita share, \$ million

	2021 Update	2022 Update	2023 Update	2024 Update	2025 Review
GST mining capacity	-6,417	-9,419	-11,553	-11,407	-11,075
Additional GST from 2018 reform	629	4,400	5,553	6,105	5,878
Proportion	10%	47%	48%	54%	53%

Source: Commonwealth Grants Commission

2.2.1.1. The reforms distribute the cost inequitably between states.

The 2018 reforms, including a relativity floor, are structured in a way that funds Western Australia by drawing from the states with the highest per capita GST shares first (i.e. takes most from the fiscally weakest). This means the Territory, which has the highest per capita share of GST, is drawn from first³.

The inequity in drawing from the Territory in these circumstances, in comparison to discounting the mining assessment, can be described in many ways, including:

- The Territory is effectively required to draw from its unrelated expense assessments to pay for issues that are unique to the mining assessment.
- The non-mining states are effectively cross-subsidised by the Territory, as those states are required to refund a smaller share of Western Australia’s GST for mining royalties, paid for by the Territory. This is a large cost to the Territory, but a negligible benefit to non-mining states due to the Territory’s small population share.
- The Territory is effectively losing GST in respect of mining twice, contributing GST for its own royalties to the non-mining states, but then also Western Australia.

Until 2024-25, the other state in a similar position to the Territory was Queensland. However, in 2025-26 Queensland became the second fiscally-strongest state overall due to a significant increase in coal production (prices and volumes) and effectively was no longer drawn from to fund Western Australia. This cannot occur in the Territory due to the Territory’s much higher expense assessments compared to Queensland or Western Australia.

Under the current arrangements, if the Territory had per capita mining revenue well above Western Australia or Queensland, it would still be worse-off under the reforms as the Territory’s expense assessments are so large that the mining assessment can effectively never be offset by the 2018 reforms.

The different outcomes based on unrelated expense assessments is unreasonable and inequitable.

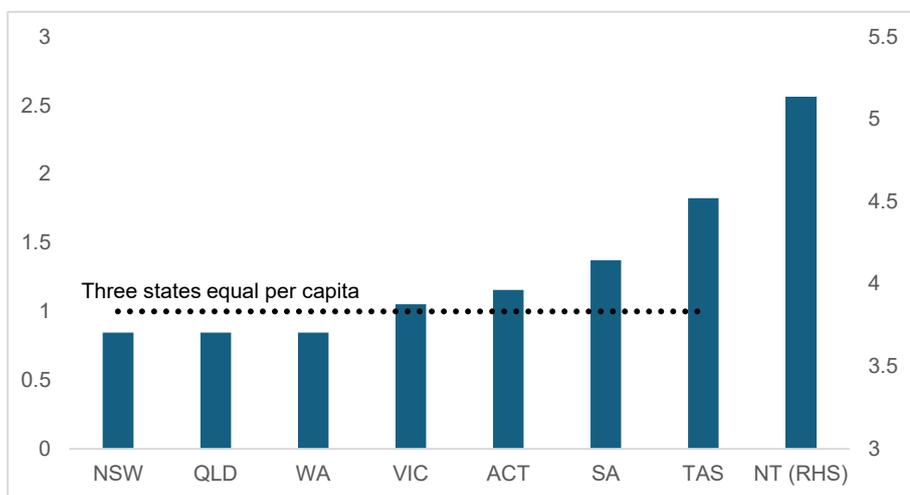
³ This is currently masked by the NoWO.

2.3. The reforms cause a large departure from HFE, with three states equal per capita in 2025-26.

As of 2025-26, there are three states which require less GST than their population share (Western Australia, Queensland and New South Wales). For the first time since the 2018 reforms commenced, there were two states that were fiscally stronger overall than New South Wales, with both Western Australia and Queensland having a lower GST share per capita. For the first time since the GST was introduced, Victoria required more than its population share of GST.

In 2025-26, but for the NoWO (and a small amount of transitional “blending”), Western Australia, Queensland and New South Wales would receive the same GST per capita (Chart 9). That is, there is no assessment of HFE between these three states. It is only through the NoWO that the different GST requirements of the three fiscally strongest states are recognised. This is an excessively large departure from HFE and shows the importance of the NoWO.

Chart 9 – Relativities (excluding blending), 2025-26



Source: Commonwealth Grants Commission

2.4. The reforms have not resolved policy neutrality in the mining assessment in states other than Western Australia.

Another objective in the 2017 PC inquiry, and in the current terms of reference, was that GST should not disincentivise states from pursuing reforms, i.e. should be policy-neutral.

As the reforms only benefit Western Australia, they do not resolve policy issues in other states.

There are two unresolved issues, both in the mining assessment:

- “dominant state”, where one state produces a sufficiently large share of production value to control state-average royalty policy used in GST calculations
- mining being assessed on actual production, creating a dis-incentive for states to develop their industries.

2.4.1. Unresolved issues in the mining assessment – dominant state.

The dominant state issue arises when one state has such a large share of national average revenue for an assessment category that it can effectively control GST outcomes by changing its own policies. The main

example is royalty rates, which are set by reference to national-averages, but can be controlled if a state is the only state with, or has a dominant portion of, mineral production.

There is no objective definition of a dominant state. Not all states which are large are dominant, and there is no “bright-line” test. Not every ability to influence the national average is a policy concern and whether a state is dominant is a matter of degree and judgment rather than objective ratio. For example, New South Wales as the largest state exerts a relatively high degree of influence on the national average policy in almost all GST assessments. However, influence does not equal dominance or necessarily a barrier to reform, and there is no evidence of reforms being made with the intent to gain a GST benefit.

The Territory submits that caution should be adopted for the dominant state issue, as most states are not sufficiently dominant to an extent that creates a real policy incentive or barrier to reform. Nonetheless, it is generally agreed that Western Australia would be a dominant state for iron ore. This has been addressed via the 2018 reforms, though in an unsustainable and inequitable way. It is however recognised that an unwinding of the 2018 reforms would re-enliven this issue.

The Territory does not support dominant state issues being resolved by trading-off HFE accuracy, such as by blending mining categories or using measures that are unrelated to state revenue raising capacity (such as gross state product or state final demand, noting states cannot tax various industries which contribute to such measures), as the choice of any trade-off is ultimately arbitrary and has a high risk of being unfit for purpose. Such options have been extensively and repeatedly considered and rejected by the Commonwealth Grants Commission.

The PC 2017 inquiry extensively considered the dominant state issue and recommended that HFE be reduced, based on judgement. The Commonwealth did not adopt the 2017 inquiry recommendations and made a different (but similar) judgement on the trade-off. The subsequent excessive cost and inequities show the danger of arbitrary judgements.

The Territory notes that dominant state issues are under consideration by the Commonwealth Grants Commission in their forward work program, though the Commonwealth Grants Commission should not be tasked to trade HFE against policy neutrality. Such decisions are more appropriately made by other processes, such as the present PC inquiry.

2.4.2. Unresolved issues in the mining assessment – new production.

States, other than Western Australia, are fiscally dis-incentivised from commencing new onshore mining, petroleum or gas production, as actual production causes a GST reduction.

Mining capacity for the purposes of GST distribution is assessed on per capita production rather than the availability of the underlying resource in each state. When new production occurs, that state’s GST is essentially reduced by the (average rate of) royalty on that production, only retaining their population share of royalties, with the remainder redistributed to other states via GST (all else equal).

While offsetting own-source revenue capacity against expenditure needs is entirely consistent with HFE principles, the current mining assessment creates a fiscal dis-incentive for any individual state to commence new production and rewards states with (regulatory) barriers to new production. That is, it reduces the fiscal benefits of new production and subsidises the cost of regulatory barriers to production in some states.

The Commonwealth Grants Commission recognised this issue in its 2025 GST distribution methodology review in respect of bans or restrictions on unconventional gas/petroleum production, and uranium. However, it concluded there was no reliable alternative basis to measure state mineral royalty capacities than actual production as the level of economically viable resources in each state is highly uncertain and difficult to objectively assess until production commences.

The Territory accepts the 2025 GST distribution methodology review outcome that the Commonwealth Grants Commission should not be tasked with determining a trade-off between HFE and policy neutrality, as this would compromise their role as HFE assessors and requires judgement outside the HFE regime, with no suitable alternative measurement basis. However, this inquiry is an appropriate avenue to further consider the interaction.

2.4.3. The GST distribution method should not be a reform incentive mechanism.

The inquiry's terms of reference asks if the GST distribution method is supporting states to make reforms. The Territory submits the GST distribution method should not be used as a vehicle to incentivise reform. It is sufficient that the GST distribution method does not create perverse incentives. GST should not be a reward payment or penalty system, and instead should continue to be distributed to achieve HFE.

There is a significant distinction between the current role of HFE, which is to fund the cost of delivering national average services, and a system which evaluates or promotes reform. The primary role of the GST distribution method is to provide a baseline revenue source for states to provide an average service standard. This ensures states are funded to deliver a national average service standard using an economically efficient, broad-based consumption tax that reduces the need for less-efficient state taxes to fund state policies.

Crucially, being untied, GST distributions enable state sovereignty, supporting democratic processes.

In contrast, reward, efficiency or tied payments are conditional on achieving some outcome or delivering specific outputs. This requires predefined policy targets and, given resource constraints, prioritisation of objectives. Who sets the targets and priorities, and how, would be controversial and require extensive judgements and trade-offs. Interfering in the GST distribution method for this purpose would erode the sovereignty of democratically elected state and territory governments.

Introducing a penalty into the GST distribution method for states which do not achieve reform(s) would also be dangerous and risks creating negative feedback loops. For example, it would be counterproductive to penalise states with high homelessness rates by reducing GST payments, as this would make it more challenging to address the issues and likely exacerbate the problem.

Reform incentives are better-placed within the Commonwealth's tied payment regime. The tied payment system is fit-for-purpose for political negotiations. It allows bespoke conditions specific to the circumstances in each participating jurisdiction, commensurate to an agreed funding envelope.

Section 3.4 of this submission discusses the interaction between GST and outcomes further.

2.5. Other unintended consequences of the 2018 reforms.

There are various other, more complex, implications from the 2018 reforms, which will persist if the reforms are not unwound.

For example, in its 2025 GST distribution methodology review, the Commonwealth Grants Commission made changes to how coal was assessed that shifted GST from Queensland to New South Wales to reflect Queensland's higher average coal values. This should not have materially impacted any other state as it was specifically designed to distribute royalty capacities between the coal mining jurisdictions.

However, in 2025-26 Queensland simultaneously became overall fiscally stronger than New South Wales, meaning its GST share could not further decrease. As a result, the method change unintentionally impacted other states. It is perverse that a method change intended to only impact coal mining states worsened GST outcomes in the other jurisdictions.

3. What is sought: the Territory’s submission for the GST system.

3.1. A return to full HFE.

The Territory submits that full HFE remains the most appropriate way to distribute GST revenue and the independent Commonwealth Grants Commission’s method is the appropriate mechanism to do so.

A return to full HFE is the “no change” outcome for seven of the eight states and territories and consistent with the intent of the reforms.

A return to full HFE would not preclude a bilateral arrangement between Western Australia (or any other jurisdiction) and the Commonwealth from outside the GST pool.

Notwithstanding the above, the Territory considers improvements could be made to HFE.

3.2. Improvements to reduce volatility.

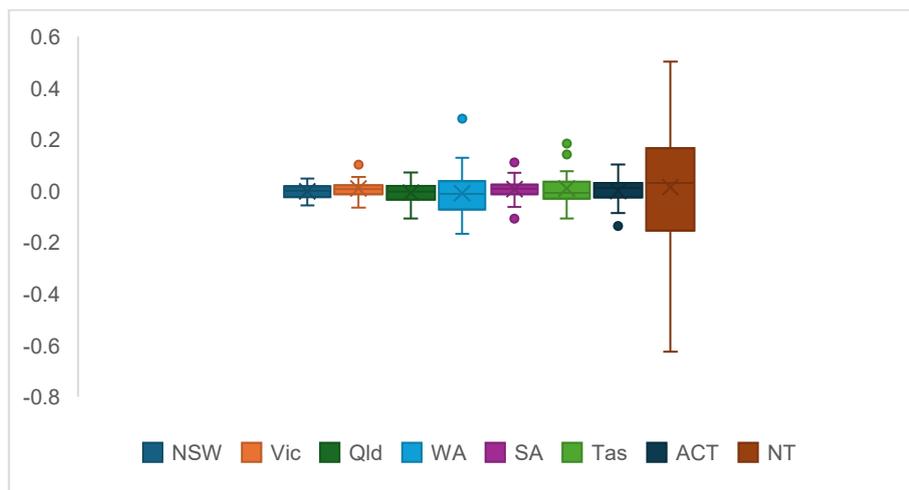
The Territory submits that its GST requirements would be better estimated by reference to a long-run average. That is, the Territory seeks a fixed-share of the HFE pool, rather than annual assessments.

This is not a change to HFE principles. Rather, it reflects a different way to measure the Territory’s fiscal circumstances, recognising that its long-run average GST need is broadly stable over time, and with 25 years of assessments to refer to, a fixed share with periodic reviews is a reasonable way to assess the Territory’s structural fiscal needs while reducing unnecessarily high annual GST volatility.

3.2.1. GST volatility in the Northern Territory.

The drivers of GST volatility are different between states and over time. On average, the Territory’s relativity is the most-volatile of any jurisdiction. While volatility can be measured in many ways, the simplest and most comparable method between states and over time is the nominal annual relativity movement (Chart 10).

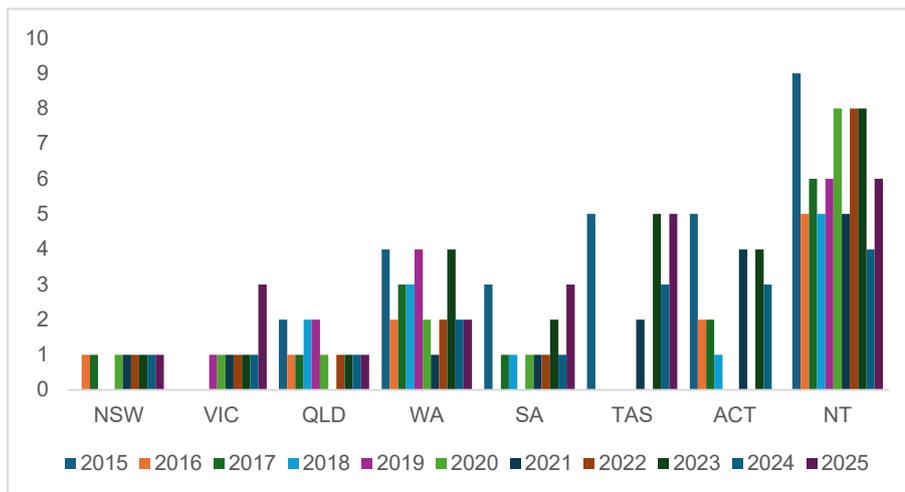
Chart 10 – Annual change in GST relativities since 2000-01 (on a consistent basis)



Source: Commonwealth Grants Commission

The Territory’s relativity volatility is spread over numerous categories, each with various sub-components and drivers. In the last 10 years, the Territory has had between 4 and 9 categories with more than +/- \$50 per capita change annually, around double the next-most volatile state (Chart 11).

Chart 11 – Number of expense and revenue categories with more than +/- \$50 per capita annual change, 2015-25



Source: Department of Treasury and Finance calculations on Commonwealth Grants Commission data

The Territory’s annual volatility is consistently larger than other states for most assessments, except for the mining assessment, with large positive and negative swings in each year. Unlike mining assessment variations that reflect a structural change in mining states’ revenue capacity, there is no general trend in the Territory’s volatility.

The annual volatility in the Territory’s relativity is counterintuitive given the stable underlying needs of its population. The annual revisions are largely an artifact of GST assessment methodologies which use a range of per person and remoteness loadings that compound to a much larger degree in the Territory than in other states⁴. This means modest changes in national average use and cost data can compound to generate unexpectedly large and artificial annual variations in the Territory’s relativity⁵.

While volatility could be reduced by not assessing HFE or restricting assessment methods, this would be an unacceptable trade-off from the Territory’s perspective.

It is noted that the Commonwealth Grants Commission recently released “*Occasional Paper #13 Is the GST distribution system too complex?*” on the trade-off between complexity and the HFE task.

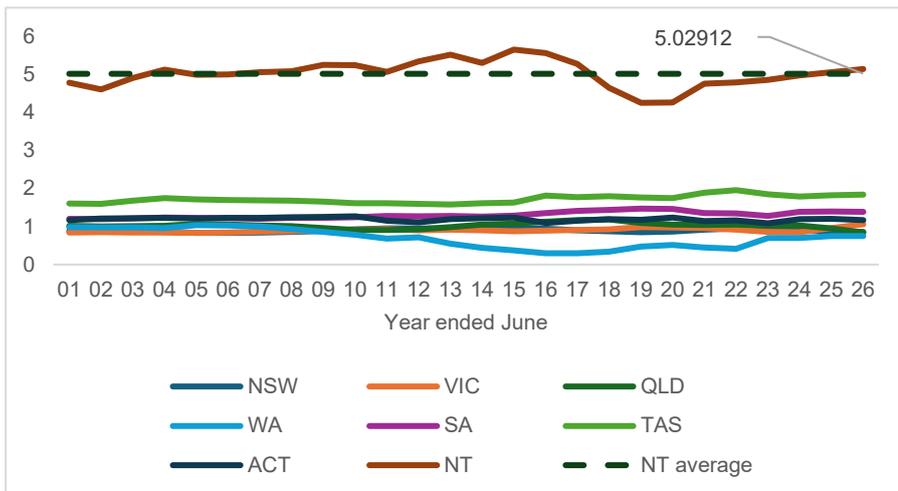
3.2.2. Despite annual volatility, the Territory’s long-run needs are stable.

Although the Territory has the largest annual relativity volatility, its long-run average GST requirement has not significantly changed since the GST was introduced, averaging slightly over 5% of the GST pool (Charts 12 and 13).

⁴ The Territory has the highest co-occurrence of loadings per person of any jurisdiction as approximately 30% of the Territory’s population is Aboriginal, with around three quarters living in remote or very remote areas and having very low socio-economic status.

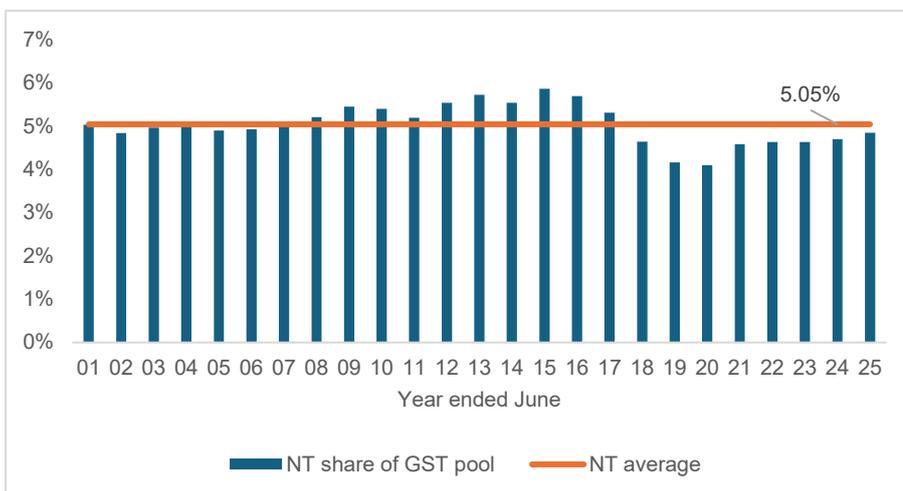
⁵ Another significant variable is total expenses (including total government expenses and the relative growth rate of expenses between assessment categories), as GST is an average cost formula. Most categories are driven predominantly by interstate spending patterns and data, with the Territory being only a small fraction of national data or expenses.

Chart 12 - Relativities over time (on a consistent basis)



Source: Commonwealth Grants Commission

Chart 13 - Territory share of the GST pool (%)



Source: Commonwealth Grants Commission, Commonwealth Final Budget Outcome

Conceptually, the Territory's consistently high GST requirement is expected. The Territory is geographically large but sparsely populated. The Territory's demographics have not materially changed over time and generally change more slowly than the national average.

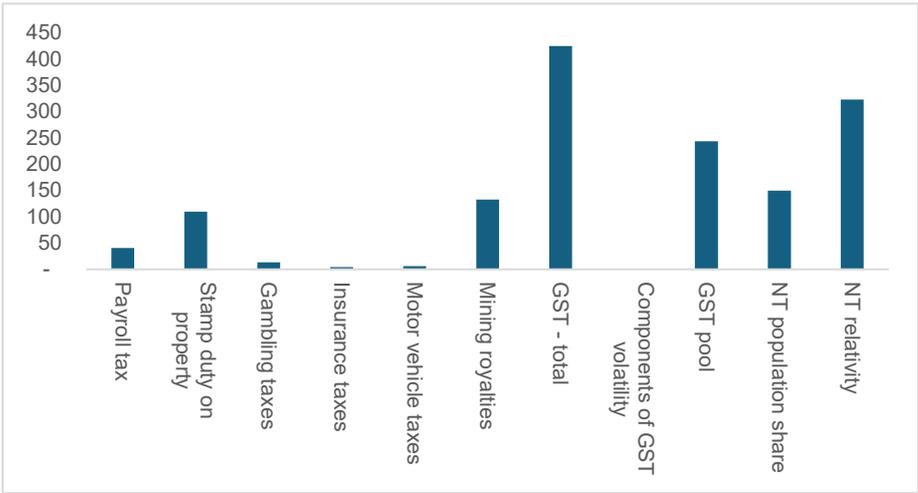
For example, nationally, there have been significant data revisions to the Aboriginal population over time, generally reflecting changes in self-identification norms in other states. In the 2021 Census, non-demographic change accounted for the majority (56.5%) of national inter-Censal growth in the Aboriginal population. The Territory is a notable exception to this trend, where Aboriginal population growth is 76.6% driven by demographic change.

In essence, there is a strong case that much of the Territory's GST requirement is stable, consistent and structural, which can be readily assessed by long-run average data rather than requiring annual measurement.

3.2.3. Impact of volatility in the Territory.

Relativity movements represent by far the largest source of annual budget volatility in the Territory. Chart 14 compares the Territory's revenue volatility from GST to other own-source revenues (average volatility applied to 2024-25 revenues).

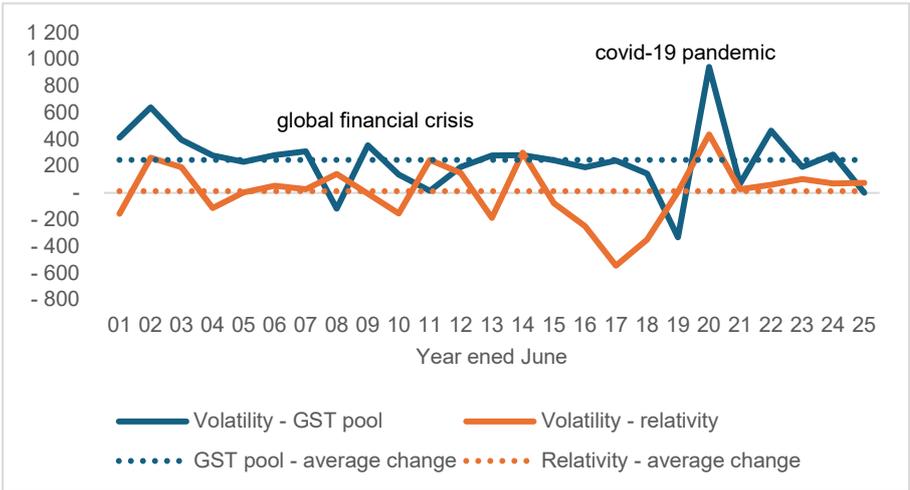
Chart 14 – Territory revenue volatility, 2024-25 levels (\$m)



Source: Department of Treasury and Finance calculations

The Territory’s largest source of revenue volatility is GST revenue, and the largest component of GST volatility is relativity movements. Relativity volatility also has a larger impact on fiscal planning than GST pool or population growth volatility, due to the higher difficulty in forecasting relativities. Own-source revenue lines and GST pool and population movements are generally able to be forecast using administrative data and established econometric and demographic tools. While some states maintain relativity forecasts, most seek to model revenue assessments only. This is less useful in the Territory where annual relativity variations are dominated by expense assessments. Chart 15 shows that GST pool volatility generally arises in response to broader economic conditions, while relativities are less predictable.

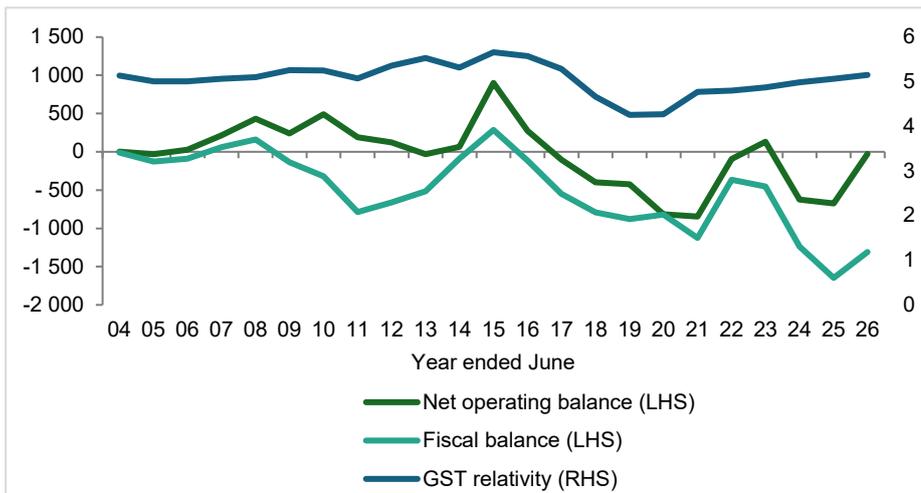
Chart 15 –Components of Territory volatility – GST pool and relativity, standardised to 2024-25 levels (\$m)



Source: Department of Treasury and Finance calculations

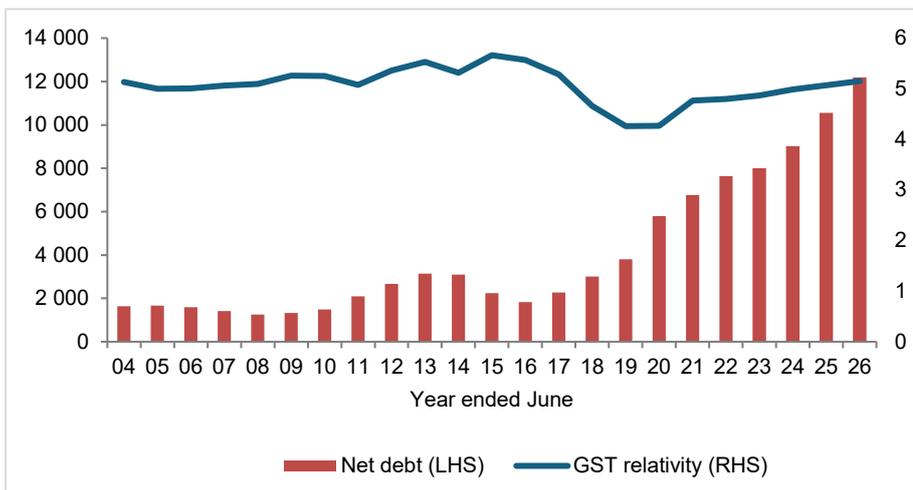
The impact of relativity volatility on fiscal outcomes is amplified because it is challenging to materially rescale services and workforces on an annual basis. Instead, downward volatility often results in additional debt. This was particularly the case for the Territory in 2016-17, when the Territory’s relativity declined by more than 1 over two years, that is, the Territory lost more than 100% of a population-share. While GST revenue is not the sole driver of Territory fiscal outcomes, this relativity decline caused a dramatic deterioration of the Territory’s fiscal position, despite no change in underlying need. Net debt approximately tripled between 2016-17 and 2019-20, leaving a legacy of elevated debt and interest costs despite a subsequent return to long-run average relativities (Charts 16 and 17).

Chart 16 – Territory net operating balance and fiscal balance (LHS, \$m) to GST relativity (RHS)



Source: Department of Treasury and Finance, Commonwealth Grants Commission

Chart 17 – Territory net debt (LHS \$m) to GST relativity (RHS)



Source: Department of Treasury and Finance, Commonwealth Grants Commission

Commonwealth tied payments can also change frequently year-on-year. However, most agreements are payments for a service, meaning there is a matched expense. The impact on state budgets is essentially the net difference between costs and revenues, with some complexities arising for co-contributions, additionality or substitution. As payment timing (including expiry) is generally known well in advance there is a greater ability to prepare and plan for change.

3.2.4. Alternative option to address Territory GST volatility.

The simplest and most direct option to reduce the Territory’s annual GST volatility is to provide the Territory with a fixed share of the GST pool, based on its long-run average. This option would remove annual volatility, while also not departing from HFE principles.

This approach recognises that an alternative method to estimating Territory GST is by reference to its long-run average, instead of an annual reassessment approach, recognising persistent structural costs.

Allocating the Territory a stable GST share should not, over time, come at a net cost to other states, as the Territory would be expected to fluctuate around its average, with movements offsetting over time. Further, any annual impact on other states would be minor, as while the Territory has the highest per

capita GST volatility, this is only a small fraction of a percent of the GST pool annually due to the Territory's relatively small population.

Fixing the Territory's GST share could simplify the GST assessment process as several expense categories and loadings are only material for the Territory and would no longer need to be assessed annually.

A fixed share of the GST pool is proposed, rather than a fixed relativity, to avoid issues in population data revisions where small revisions to Territory counts are multiplied by the Territory's relativity causing disproportionate revenue impacts. This is particularly problematic as Territory population sampling error is the highest, and method confidence is the lowest, due to small levels. This was the case in 2024 December quarter population results, which revised the Territory's estimated resident population by around 6000 persons, a proportionately much larger revision than any other state. This caused Territory GST to be disproportionately impacted, as reflected in the Commonwealth 2024-25 Final Budget Outcome balancing adjustment, with a Territory adjustment being an outsized 16% of the national adjustment (\$145 million of \$888 million). The Territory's adjustment was the second-largest overall, and by far the largest per capita, at \$552 compared to the second-largest at \$74.

It is recognised that this is a novel recommendation, and a range of technical issues would need to be worked through. It is envisaged that periodic reviews would be necessary, such as 5-yearly or 10-yearly. The Territory is open to a discussion with the PC, and any other relevant stakeholders, such as the Commonwealth Grants Commission or other state or Commonwealth Treasuries, on how this could be implemented, though noting the intent is a simple and predicable methodology that reduces volatility without eroding HFE.

3.3. Other changes – improvements to the mining assessment.

The Territory acknowledges the issues with the mining assessment, discussed in prior sections, under the pre-2018 HFE arrangements.

The Territory considers a 25% discount to the mining assessment would effect a smaller departure from HFE than the current reforms, and more directly and equitably resolve issues in that assessment. A discounting approach could also address the dominant state issue in the assessment of iron ore royalties.

This discounting is supported as an alternative to the 2018 reform arrangements.

3.4. Other changes – Commonwealth payments.

The Territory agrees that revenue from Commonwealth payments should be included when calculating state and territory GST requirements. This is consistent with HFE principles and recognises that states with an alternative revenue source do not require additional GST to deliver the average level of services.

Broadly, the current system works well. It minimises political intervention and allows independent assessment of HFE. However, the Territory considers that current administrative arrangements could be improved.

The Territory seeks additional administrative guidance to avoid GST interactions unwinding legitimate policy assessments of need. Specifically, the Territory considers that tied Commonwealth payments that intend to address outcomes beyond implementation of state-average policies should be generally excluded from the GST assessment process. This is particularly relevant for investments to support Closing the Gap outcomes but may also arise in other contexts, such as investment to address legacy issues associated with the infrastructure deficit inherited by the Territory upon self-government.

For clarity, the Territory submits the Commonwealth Grants Commission's decision-making framework on the treatment of Commonwealth payments is fit-for-purpose and is administered fairly, predictably, transparently and in a principled manner, and does not require change.

Importantly, the Commonwealth Grants Commission should not be tasked with making value judgements such as which social outcome Governments should prioritise.

The Commonwealth Grants Commission's terms of reference should continue to place objective measurement of HFE as the overriding assessment goal. However, there should be another (additional and not exclusive) mechanism to consider these issues. For example, the Commonwealth Treasury, as central administrators of the Intergovernmental Agreement on Federal Financial Relations, and particularly for federation funding agreements, could be given a formal role to determine which funding, or components of funding, are for outcomes that are not captured in, and should not be unwound through, GST methods, to assist decision-makers in determining exclusion requests. This could be supported by relevant portfolio agencies and other key stakeholders such as state and territory Treasuries.

3.4.1. Current exclusion frameworks.

There are currently two frameworks for the treatment of Commonwealth payments in the GST system:

- the Commonwealth Grants Commission's framework, which applies clear, but rigid, fetters on the treatment of Commonwealth payments
- the Commonwealth Treasurer's exclusions through the annual Terms of Reference, which are unfettered and not subject to any published guidance.

The Commonwealth Grants Commission's framework is longstanding, well-established and clear. Predominantly, it excludes payments to states where they are:

- not for a state service
- for a state service but where needs are not assessed.

Broadly, this works well. Most agreements are categorised into inclusion or exclusion by the Commonwealth Grants Commission, with states making specific submissions on individual complex cases should they arise in annual consultation. Almost all are agreed without comment, indicating broad consensus on, and understanding of, the rules and process.

In contrast, there are no guidelines or principles on the Commonwealth Treasurer's discretion, which is unfettered. While this is conceptually appropriate, as it allows the Treasurer to respond flexibly to specific issues, the reality is that intervention is rare. The general Commonwealth position is of non-intervention, and intervention typically only occurs for large and unusual agreements to avoid setting precedent for intervention, but this may change at any time for any reason.

3.4.2. How do Commonwealth payments impact GST?

The interaction between GST and Commonwealth payments is complex and not well understood.

While it is commonly appreciated that Commonwealth payments, like own-source revenues, offset states' GST revenue requirements, this is only part of the overall outcome. Importantly, there is also a less well-known offsetting expense interaction.

The GST methods assess Commonwealth payments as an "actual per capita" state revenue source. That is, Commonwealth payments reduce a state's GST share. This is known as the "revenue effect". However, as Commonwealth payments are then spent by states, and GST assessments are based on total state expenses, there is also an indirect and less well-known "expense effect".

The "expense effect" means that each state's expenses are higher than they would otherwise be if Commonwealth funding had not been provided. For example, state hospital expenses would be far lower without the National Health Reform Agreement.

In essence, the revenue effect directly reduces a state's GST requirements, while the expense effect indirectly inflates a state's GST requirements. It is the difference between the two results, which impacts net state GST outcomes.

These two effects fully offset where the expense assessment method is equal to the revenue effect. For example, if a state receives twice its per capita share in tied hospital funding and is also assessed as needing to spend double the national per capita average to deliver a national average level of hospital services then the state's net GST outcome is not impacted by the tied payment. However, where a state receives twice its per capita share in tied hospital funding and is assessed as only needing to spend the national per capita average to deliver a national average level of hospital services then the states' GST would be reduced, effectively redistributing a portion of the tied funding to other states through increased untied GST shares.

The expenditure effect means that the GST process overrides many tied funding allocations and states need to carefully consider signing tied agreements where funding shares exceed their assessed need in the relevant expenditure category.

Difficulties can arise where a specific element is captured in tied payments, but not in GST methods, such as investments to improve outcomes.

Where this occurs, additional guidance could assist, such as a formal process to allow the Commonwealth Treasury to determine where agreements, including parts of agreements, are for outcomes beyond standard state services that should not be unwound through GST distribution arrangements. Such a determination would provide valuable assistance for decision-makers in deciding GST exclusion requests.

3.4.3. Closing the Gap and outcomes-funding: GST does not fund additional investment to achieve outcomes beyond average services.

It is well-known that GST assessments take state demographic differences into account, providing additional funding to states with larger Aboriginal populations to support provision of the average level of services. This is particularly the case in the Territory, which has the highest Aboriginal population share of any state. However, this does not mean GST fully funds Aboriginal need.

The GST assessment process funds states to continue to deliver the same average historic services, at average historic intensity. This is because the GST assessment process is based on actual, average, historic service expenditure patterns. As a result, states are effectively funded to maintain the status quo, with incremental change over time as states implement new policies and investments that contribute to gradual shifts in national average policy.

The level of investment to support improved social outcomes and unmet need beyond national average policy is not assessed in the current GST assessment framework. This is appropriate as such assessment would require extensive value judgements that are more appropriately decided at the political level (for example, in a resource constrained environment, which outcomes should be targeted) and would be difficult to quantify in a robust manner (for example, how much does achieving each outcome cost). Outcomes based funding can also create perverse incentives.

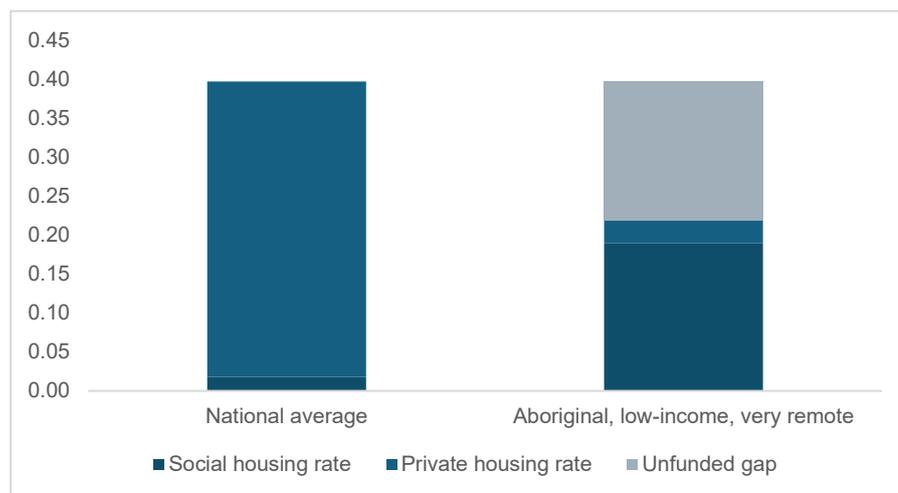
This issue has been considered extensively in previous HFE reviews, and the Territory strongly supports the continuation of the current arrangements, whereby HFE is used to distribute GST to enable provision of national average services, with tied payments used to deliver specific outcomes and, in certain cases, excluded from the GST assessment process to avoid unintended consequences. However, the Territory considers more specific guidance is required regarding the treatment of payments that seek to address Aboriginal disadvantage.

To explain this issue, it is useful to discuss the role of GST in funding services to Aboriginal persons.

As Closing the Gap national agreement indicators show, there is a significant gap between all states' average historic services, and the services needed to close the gap in Aboriginal socio-economic outcomes. As GST assessments are based on historic averages, it does not measure or fund this gap.

Social housing is a clear example of the gap between historic service levels and need, with Aboriginal persons in remote areas experiencing significantly higher rates of homelessness than any other cohort and requiring additional housing services. While all states provide significant additional social housing for this cohort, the investment remains insufficient to address all homelessness. For example, very remote, low-income Aboriginal persons on average receive around 3% of the national social housing stock but only represent around 0.3% of the population. Despite this, the total number of houses per remote Aboriginal person is around 0.2, well below the national rate of 0.4 due to low rates of private ownership (Chart 18).

Chart 18 – Houses per person, national average and Aboriginal, low-income, very remote, 2021-22 (ratio)



Source: Department of Treasury and Finance based on Commonwealth Grants Commission and 2021 Census data

As GST funds states at the average rate, states are funded to deliver 0.2 houses per person to this cohort, leaving a significant unfunded outcomes gap. This leaves a role for other payments to address the gap but requires exclusion from the GST assessment process to avoid unwinding the additional investment through lower GST shares for the relevant states.

In the housing example, to recognise the Territory's outsized remote Aboriginal homelessness outcomes gap, the Commonwealth and Territory invest through the co-funded Northern Territory Remote Housing program, the current iteration being a \$4 billion investment to provide up to 2700 houses over 10 years. Since 2018, the Northern Territory Remote Housing agreement has been excluded from GST assessment process to ensure this investment is not undermined by reductions in the Territory's GST.

The Commonwealth Grants Commission recognises this issue under current frameworks and agrees outcomes funding may warrant exclusion. However, significant administrative difficulties remain because:

- The Commonwealth Grants Commission is not, and should not be, an assessor of unmet need, as this is fundamentally outside the HFE calculation. This means that the Commonwealth Grants Commission is not always well-placed to determine if a payment is for average, or unmet, need. This could be more appropriately decided by the relevant funding entities.
- The Commonwealth Grants Commission relies on agreement descriptions to identify possible exclusions, which do not always provide the necessary level of clarity.
- Not all agreements delineate between funding for outcomes and other funding. This is particularly the case in the Territory where agreements are often uplifted beyond a population share to recognise a level of additional need, but the uplift is not specifically quarantined from other services. These are particularly challenging for the Commonwealth Grants Commission to exclude.

- The portion of funding for outcomes will vary between states. It is common for the Territory to enter into a multilateral agreement with a portion for Territory disadvantage, with no equivalent provision in another state (including due to less need). It is generally not possible for current frameworks to treat one state, or a subset of states, differently from others, even if there is a strong case to do so.
- Some agreements with these challenges are relatively small, with a localised policy issue. This makes them difficult to escalate to the Commonwealth Treasurer for resolution.

3.4.3.1. Example – Better and Fairer Schools Agreement (Northern Territory).

A recent example of the significant interaction between GST and tied funding is the Territory's Better and Fairer Schools Agreement bilateral agreement. The Territory's bespoke bilateral agreement embedded a higher rate of Commonwealth funding per student (as a proportion of the Schooling Resource Standard) than other states.

The bilateral agreement recognises the Territory has the largest schooling outcomes gaps for Aboriginal students in Australia and that the level of additional co-investment assumed to be required to close the outcomes gap under the national modelling underpinning the default agreement is beyond the Territory's fiscal capacity. However, the GST assessment method for schools funding until 2025-26 equalised all states to the same Commonwealth contribution rate. This explicitly conflicted with the Territory's bilateral agreement and would have entirely unwound the fiscal benefit of the deal to the Territory.

The Territory managed to negotiate a GST distribution term of reference change from the Commonwealth Treasurer for this agreement to avoid an unintended fiscal outcome, however express guidance on this topic would have streamlined this process and reduced uncertainty. Without the terms of reference change, it would not have been fiscally prudent for the Territory to participate in the agreement.

3.4.3.2. GST, mainstream services and Aboriginal expenditure.

For completeness, general observations are made on the role of GST in funding Aboriginal services and corresponding state expenditure. Commentary has been made over time, including in submissions to the PC 2017 inquiry, that as GST recognises Aboriginal costs, GST should be tied to, or quarantined for, Aboriginal persons or Aboriginal service providers.

There are significant difficulties in determining the level of expenditure from GST on Aboriginal persons (or, more accurately, services which Aboriginal persons engage with). There is no current or generally-agreed methodology for such an approach. While Governments are generally able to identify quarantined Aboriginal funding for specific groups, such as grants to the Aboriginal Community-Controlled sector, this is not the main component of Territory GST funding or expenses.

Most GST funding and spending on Aboriginal services in the Territory is through mainstream services such as hospitals and schools. For example, on average, Aboriginal persons present more frequently to Territory hospitals and with more complex health needs than non-Aboriginal persons. The GST assessment for health needs reflects this, providing the Territory with an above per capita share of GST funding to support the delivery of national average health services to Territorians. However, hospitals are a mainstream service, and it would not be appropriate to quarantine portions of hospital funding for specific population cohorts at the expense of others.

Notwithstanding the above, past reviews, such as the Northern Territory Indigenous Expenditure Review 2006-07, and the PC's Indigenous Expenditure Reports in 2010, 2012, 2014 and 2017, have found the Territory's actual expenses are broadly consistent with the implied share of funding for Aboriginal persons, particularly when considering funding for all sources, including own-source revenues.

4. What is opposed: alternative systems or proposals that the Territory does not support.

To assist the PC in considering alternate options to reform the GST regime, the Territory sets out various reforms that are not supported, including because the reforms would worsen the Federation, be fiscally unsustainable, too large a departure from HFE, not address barriers to reform, or otherwise be inequitable.

4.1. Lower HFE benchmarks (including to equal per capita).

The PC's 2017 inquiry considered various "alternative equalisation benchmarks" (at Part 8 of that inquiry). That inquiry's ultimate recommendation (8.1) was for "equalisation to the average", which meant an average size of GST distribution compared to a per capita share, not an average service standard. Other options included 90% equalisation, equalisation to the second-strongest state, and full equalisation for the small states only. The 2018 benchmark, of equalisation to the stronger of New South Wales or Victoria, is a similar approach.

Other than "equalisation for the small states" (discussed separately below), the options are not supported, as they:

- Are highly inconsistent with HFE and are inequitable. They do not provide states with the ability to fund an average service level and reduce services and/or worsen fiscal outcomes in the states with the greatest need the most. This was shown in the 2017 inquiry, where the Territory was estimated to be, per capita, the most-disadvantaged state in every option.
- Are uncapped and likely to cost far more than is necessary to achieve any policy goal. The cost of a lower HFE benchmark increases the more states' relativities differ from 1. As Western Australia's relativity is far below the other states, the cost of a lower benchmark is excessive.
- Are arbitrary. The 2017 inquiry essentially used judgement to select its equalisation to the average recommendation, with no ultimate policy basis for its preferred option. The Commonwealth response at the time disagreed and proposed a different model. There is no principled basis for either approach to be followed in the present inquiry.
- The impact is not linked to any of the specific drivers of fiscal strength or barriers to reform. As set out in earlier submissions, while the Territory is the fiscally weakest state overall, the Territory is relatively strong from a mining assessment perspective. The use of a lower HFE benchmark to address issues associated with the mining assessment has significant inequities for states in this situation with no policy basis.

The "equalisation for the small states" is a separate proposal. That option instead preserves full HFE in the four small states and assesses the large states in equal per capita shares. Such an approach is consistent with the Territory's primary submission on retaining full HFE (for the Territory) but would require consideration of the impact in the large states.

4.2. Funding states outside the GST pool.

In some previous reviews and public commentary, stakeholders have at times called for the fiscally weakest states to be funded outside the GST pool, i.e. directly by Commonwealth grants, either in full, or by reverting the Territory (and all states) to a per capita share, with an external top-up for small states, or the Territory alone, or other forms of Commonwealth tied funding in lieu of GST.

Substituting untied GST revenue with Commonwealth payments is not supported due to the significant sovereignty and fiscal risks associated with this approach.

An equal per capita GST distribution would cause such a significant revenue loss in the Territory that an offsetting arrangement must be considered from the outset. In 2025-26, the difference between a

per capita GST share and the current GST distribution is around \$10 billion, or 10% of the GST pool, in the following shares (Chart 19).

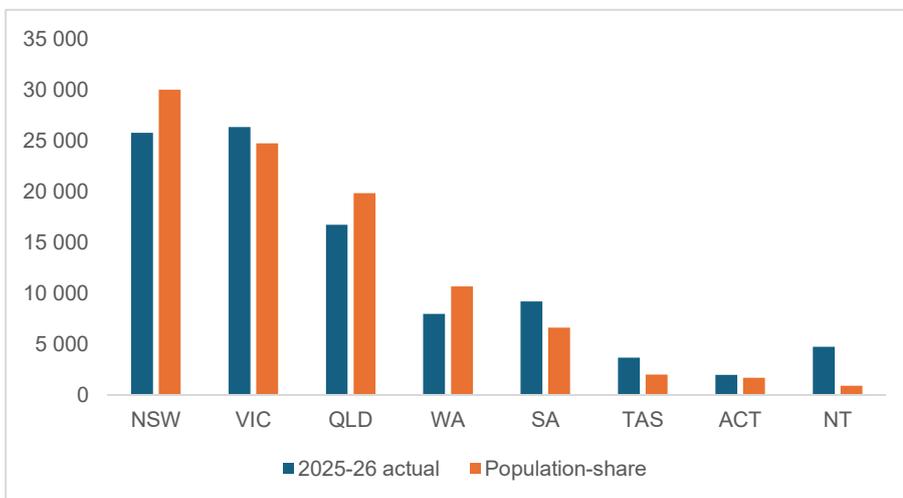
Chart 19 – GST gain/loss of moving to an equal per capita distribution 2025-26 (\$m)



Source: Commonwealth Grants Commission, Commonwealth 2025-26 Mid-Year Economic and Fiscal Outlook

While New South Wales has the largest nominal difference from a per capita share, around \$4.2 billion, this is only a small share of that state’s total GST, as that state has the largest population share, and the second-largest GST revenue overall (Chart 20).

Chart 20 – Actual GST compared to population-share, 2025-26 (\$m)



Source: Commonwealth Grants Commission, Commonwealth 2025-26 Mid-Year Economic and Fiscal Outlook

Proportionally, the increase to New South Wales from moving to a population share is around 16% additional GST. In contrast, the Territory would lose over 80% of its GST under a population-share (Chart 21).

Chart 21 – Gain/loss of moving to a population-share, portion of GST 2025-26 (%)

Source: Commonwealth Grants Commission, Commonwealth 2025-26 Mid-Year Economic and Fiscal Outlook

As the Territory is also more reliant on GST as a share of its total revenue than other states, the loss of moving to a population-share is also much larger, at around 38% of total revenue, compared to around a 3% gain in New South Wales. This would be untenable and require offsetting. There are essentially two options to offset this impact, fund certain states via a share of the GST pool, or fund separately via Commonwealth payments.

4.2.1. Offsetting funding from within the GST pool.

Funding the small states from within the GST pool is a subset of the current system. The main consideration would be which states would switch to a population-share and which would remain on the HFE method. As this is highly likely to preserve HFE for the Territory, it is consistent with the Territory's primary submission.

However, GST assessments may be compromised if the large states were removed, as most HFE data is from the large states. While this is not insurmountable, it would require careful consideration.

4.2.2. Offsetting funding from Commonwealth funding.

The other option is to fund the small states through separate Commonwealth payments. This is strongly opposed by the Territory.

4.2.2.1. The cost to the Commonwealth would exceed the 2018 reforms.

The 2018 reforms currently cost the Commonwealth at least \$6 billion annually, reducing to around \$1.3 billion when the NoWO expires. In contrast, the small states require around \$8 billion in 2025-26 relative to a per capita GST share. If the current reforms are fiscally unsustainable, this option would be even less so.

Under this approach, the future funding risks would ultimately be borne by the fiscally weakest states should the Commonwealth decide to vary payment terms, including indexation risks. Additionally, should indexation vary materially from GST pool growth, there is a risk of bifurcated service standards and fiscal outcomes across the Federation. The Territory considers this would be inconsistent with the principles of HFE and determinantal to the Federation.

4.2.2.2. There is no mechanism to distribute the payments.

Any new Commonwealth funding arrangement would require decisions on how to share that funding between states.

The current, and best-practice way to do this is the existing Commonwealth Grants Commission's assessment of HFE. The method is longstanding, highly principled, robust and fit-for-purpose. There are no other general funding models in Australia, much less any superior methods.

Retaining the Commonwealth Grants Commission method, but funded by the Commonwealth, would not have a rational policy advantage. It would simply replicate the current system at greater cost to the Commonwealth.

If the Commonwealth Grants Commission method was not followed, the question arises as to what new distribution model would be used and how and why it should differ from the current system, as well as what principles would apply in setting state shares. This was a key shortcoming of the pre-GST distribution of Commonwealth Financial Assistance Grants, which were characterised by a high degree of political influence and partisanship.

4.2.2.3. Democratic decision-making would be severely undermined.

Replacing Territory GST with Commonwealth funding would increase the Territory's dependence on Commonwealth revenue from around 26% of total budget revenue, to over 60%. At this level of vertical fiscal imbalance, even if an initial assurance were provided that any small-state GST-replacement revenue would be untied, it is inevitable that pressure could be placed on the Territory to justify receipt of revenue.

Such pressure would be particularly likely to arise in the event of policy conflict between the Commonwealth and small-state governments. This could come in many forms, from increased reporting and administrative burden for continued funding, to direct control over state Government policy, including the Commonwealth dictating which state policies to fund or how services are delivered and by whom.

The risks to small-state sovereign decision-making are significant and real, and at their most extreme could undermine democratic process.

4.3. Broader discounting of non-mining assessments.

In this submission, the Territory has canvassed the prospect of discounting the mining assessment. This was discussed because the mining assessment is the largest individual driver of HFE and can suffer from state dominance issues. Importantly, the Territory made this submission because discounting would be a smaller change to HFE than the actual 2018 reforms and is therefore more fiscally sustainable and more consistent with HFE.

Discounting in other contexts is a major departure from HFE and is not supported.

Discounting ignores state costs and revenue differences and moves the system towards per capita distributions. Discounting is generally favoured by states that are closer to a per capita distribution seeking additional revenue, rather than for legitimate policy reasons.

Discounts are currently used in some cases by the Commonwealth Grants Commission. This is subject to clear guidelines and is reviewed routinely with other methods. While many states disagree with discounting decisions, the Commonwealth Grants Commission's decisions are the best available choice of discount and there is no reason another decision-maker could form a superior view.

4.4. No international benchmarking.

The PC's initial issues paper asks whether international HFE approaches could be referred to in setting future reform options. The Territory does not consider this a useful approach.

HFE is intrinsically contextual to the circumstances in which it operates. This includes physical differences in service needs, costs, and revenue capacities, but also the broader federation architecture of each jurisdiction. Superficial international comparisons risk funding methods that are not fit-for-purpose in Australia.

Generally, the starting point should be that the Commonwealth Grants Commission's methodology is well-established, highly robust and fit-for-purpose. It is highly specific to the Australian context and is the best measure of HFE needs in each Australian jurisdiction. The Commonwealth Grants Commission has previously explored other methods and appropriately rejected them.

The most obvious differences between Australia and international circumstances are geographic size and population density. For example, no European countries, or counties, have similar size and dispersion differences as between Australian states and territories. The Territory's extreme population dispersion is a particular outlier.

Further, comparisons must consider the different fiscal structures in each country and the separation of roles between and across governments. The Australian constitution embeds a high level of vertical fiscal imbalance (VFI), by placing wide taxation powers with the Commonwealth, but service delivery is vested with states. GST serves not only a role in horizontal equity between states, but also a role in addressing VFI, as GST is ultimately a Commonwealth tax that is passed on to states and territories. Indeed, replacement of inefficient state taxes was a major reason for the introduction of the GST. This is also partly why GST includes Commonwealth grants in HFE calculations.

If HFE were reduced, VFI would worsen in the states that receive a lesser GST share. While this may be acceptable in other countries where states have greater taxation powers, in Australia states have well-defined functions and very limited alternative tax bases.

The non-applicability of international HFE approaches to the Australian context was considered in the PC's 2017 inquiry (at Appendix E), finding that learnings were limited. To the extent the 2017 inquiry referred to international standards, it largely related to the value of states having budget autonomy and the importance of a policy-neutral independent assessor, which is agreed, and already achieved in Australia through the Commonwealth Grants Commission.

5. Responses to Productivity Commission issues paper questions.

5.1. Fiscal sustainability of the 2018 reforms for the Commonwealth and states and territories.

How have the 2018 legislative changes impacted the fiscal positions of states and territories?

States have been protected by the NoWO to date. However, states face a fiscal cliff when the NoWO expires. Western Australia has been provided with a material fiscal advantage over other states, as evidenced by a comparison of net debt outcomes over the period.

- Have other Commonwealth payments to states and territories been affected?

The Commonwealth bears a cost of at least \$6 billion annually, which exclusively benefits Western Australia. It is likely this has resulted in foregone Commonwealth investment in other areas either over the period or into the future if funded by additional debt.

- Has Commonwealth, state, or territory revenue, service and infrastructure provision been supported or impeded by the changes?

As full HFE has been maintained, there has been no change in states to date other than in Western Australia, which is materially better off. The Commonwealth has faced significantly greater fiscal pressure from the reforms than intended.

- What would happen to Commonwealth, state and territory revenue, services and infrastructure if the no worse off guarantee ceased?

The outcome would be a dramatic reduction in services in all states except Western Australia or material and unsustainable deterioration in most states fiscal outcomes if service levels were maintained through additional borrowing.

Should other Commonwealth payments to the states, such as specific purpose payments and other general revenue assistance, be included in the Commonwealth Grants Commission's assessments?

Generally, yes. The current system is largely fit-for-purpose.

- Should some of these payments be excluded? If so, which payments should be excluded and why?

Yes, in specific circumstances. Additional exclusion frameworks are warranted for funding for outcomes that are not assessed, such as Closing the Gap reforms. This could include a formal process to allow the Commonwealth Treasury to determine where agreements, including parts of agreements, are for outcomes beyond standard state services that should not be unwound through GST distribution arrangements. Such a determination would provide valuable assistance for decision-makers in deciding GST exclusion requests.

- When the states ask for a payment to be excluded, what criteria do they use to determine if an exemption should be sought?

Commonwealth Grants Commission exclusion requests follow their framework. Commonwealth Treasurer exclusion requests are considered by exception.

Is additional guidance needed on which Commonwealth payments should be excluded?

- If additional guidance is required, what form should it take?

Yes, formal process and additional guidance would assist for outcomes-based funding, as set out above.

5.2. Are current GST distribution arrangements delivering a reasonable level of fiscal equalisation?

Have the GST distribution arrangements since the 2018 legislative changes delivered a reasonable level of horizontal fiscal equalisation?

The NoWO and GST pool top up have maintained full HFE in states other than Western Australia, which has received above HFE levels of resourcing. Should the NoWO expire, the impact will be unsustainable and unreasonable.

- How do you define a reasonable level of horizontal fiscal equalisation?

Full HFE is the only equitable system. Lesser HFE is a judgement on the level of inequity that would be embedded in the Federation.

- Should the PC look to international approaches to determine what reasonable fiscal equalisation is in Australia, and why?

No. HFE is intrinsically context-dependent. The Australian measure of HFE is robust, fit-for-purpose and more appropriate than international examples.

5.3. Balancing responsiveness to changing circumstances with reducing volatility and improving the certainty of GST revenue streams.

Do the 2018 GST distribution reforms strike the right balance between responding to changing circumstances and providing certainty around revenue?

No. The reforms have no effect on improving certainty other than in Western Australia, and shifts volatility to other jurisdictions.

- What changing economic and social circumstances are of most concern to states and territories?

The Territory considers its annual relative volatility continues to be a major concern. The volatility does not reflect changes in underlying need.

- Do the GST distribution reforms support states to manage the fiscal impact of shocks such as natural disasters or economic disruptions?

GST does not need to address all major economic shocks as alternative arrangements are possible. The Commonwealth Grants Commission now has ability to amend methods in response to major shocks. Commonwealth payments are a useful mechanism outside the GST system.

- Have changing economic and social circumstances affected revenues, and the provision of state services and infrastructure?

The Territory's largest revenue source is GST, which is primarily driven by expense requirements that are dominated by persistent long-term structural demographic and geographic features, rather than rapidly changing circumstances.

Some caution is warranted in broader comparisons of Territory economic activity to fiscal contexts, as the Territory has large (and compared to other states, oversized) facilities for the processing and export of offshore natural gas. This presents significant economic activity but is outside the Territory's jurisdiction for own-source royalty purposes, creating a mismatch between fiscal and economic impacts. While the Territory has significant established and prospective mining sectors, they remain proportionately smaller compared to Queensland or Western Australia.

- Has the impact of these changing economic and social circumstances been more or less significant than the changes in GST distribution on the states' finances?

The Territory's GST volatility is more significant to the Territory's fiscal position than other Territory economic or social changes.

- Have the GST distribution reforms decreased or increased the volatility of state finances?

The reforms redistributed GST volatility from Western Australia, and since 2025-26, Queensland, to the other states, though currently offset by the NoWO. If the current arrangements persist, Territory GST volatility will worsen after the NoWO expiry from 2029-30.

- Can volatility in the states' GST shares be reduced, and if so how?

The Territory has the highest volatility of any jurisdiction, however its long-run average, based on 25 years of GST assessments, indicates a stable and consistent pattern of need, in line with the Territory's persistent demographic and geographic characteristics.

There is merit in providing the Territory a fixed-share of the GST pool as a volatility-reduction measure. This would also provide opportunities to simplify the GST assessments for other states.

- How do the states manage volatility in their finances?

Relativity forecasting remains problematic, particularly in the Territory where relativities are driven by expense assessment changes and influenced by complex data and interstate spending patterns. Relativities are the largest, and least forecastable, source of Territory revenue volatility.

- Are there other sources of volatility in state finances?

Most Territory revenue lines are volatile as the Territory has a small tax base. However, GST relativities are the largest and least forecastable.

- Have the GST distribution reforms impacted the ability of the states to undertake fiscal planning?

To date, the reforms have not impacted Territory fiscal planning as the NoWO has ensured the same result as full HFE in all years within the forward estimates. The reforms materially worsen the Territory's projections after 2029-30.

5.4. The impact of current GST distribution arrangements on the pursuit of state reforms, including efficient service delivery and revenue bases.

- Do the current GST distribution arrangements impede states and territories pursuing service delivery or revenue raising reforms?

- What are the elements of the current arrangements that impede the pursuit of reforms?

GST policy issues remain in the mining assessment, except for Western Australia, but the 2018 reforms do not resolve this for other states or equitably.

GST can be a barrier to agreeing Commonwealth payments to support outcomes without additional exclusions.

- Should there be amendments to the current arrangements to remove impediments to reforms?

The 2018 reforms are inequitable, do not resolve policy neutrality issues in mining states other than Western Australia, and are excessively large compared to their policy goal.

- Should there be amendments to the current arrangements to provide support for reforms?

GST distribution arrangements support core service provision to enable Australians to have access to similar levels of government services regardless of the state in which they reside. GST distribution arrangements are not the optimal mechanism to drive reforms.

- Have states and territories pursued service delivery or revenue raising reforms since the 2018 GST distribution reforms?

GST should not be used to support reforms. It is sufficient GST is not a dis-incentive.

The Territory's experience is that GST has not been a barrier to reform. A notable example is the reforms enacted in response to the Scientific Inquiry into Hydraulic Fracturing from 2023. This included environmental, regulatory and royalty reforms in preparation for onshore gas exploration, and eventually production, despite possible GST impacts. Other Territory economic growth initiatives include land servicing and supply initiatives following a 2021 Brining Land to Market review, or at a smaller scale, first home owner support initiatives. The Territory maintains a Rebuilding the Economic 2025 Economic Strategy, and established a Territory Coordinator to champion investment and other economic initiatives. There are numerous such examples across all service and revenue areas, and in essence reforms are driven by their substantive merit instead of their GST consequences.

5.5. Are there better alternative arrangements?

Should alternative arrangements for GST distribution be adopted? What could alternative arrangements look like? Would alternative arrangements:

- result in a reasonable level of horizontal fiscal equalisation?
- provide stability and certainty to state and territory budgets?
- provide incentives to, or not impede, the pursuit of policy reforms that lead to higher prosperity and productivity?
- require additional funding from the Australian Government or other states? Could the proposal proceed without this additional funding?
- retain the independent basis for determining the fiscal needs of states?
- result in significant changes in Commonwealth transfers to states, in total and individually? If so, what are the likely transitional implications of the change?
- present any implementation challenges or risks?

The Territory prefers a return to full HFE, noting this is the same outcome as the current arrangements in each state and territory other than Western Australia. This does not preclude the Commonwealth from a bilateral arrangement with Western Australia or any other jurisdiction.

The Territory submits that providing the Territory with a fixed share of the GST pool would substantially reduce annual Territory GST volatility without impeding other principles, and at no net cost to other states if the Territory remains at its long-run average as has been the case since the introduction of the GST.

A discount to the mining assessment is preferable to the current arrangements if a response to policy non-neutrality is required, as it is a smaller departure from full HFE and more directly addresses the underlying policy concerns, while being more equitable to mining states other than Western Australia.