SUBMISSION TO THE PRODUCTIVITY COMMISSION REVIEW OF THE GST DISTRIBUTION SYSTEM

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COVER SHEET

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EXECUTIVE SUMMARY

Australia's GST distribution system is being strained by a structural revenue failure that governments have allowed to deepen for decades. The GST was intended to be the States' primary growth tax — a revenue source that would expand in line with their service obligations. That promise has not been realised. The rate has never changed, the base has eroded, and consumption has shifted decisively toward untaxed services and digital activity. As a result, GST revenue no longer grows in line with the cost of delivering essential services.

This widening vertical fiscal imbalance has forced States and Territories to rely on narrow, distortionary taxes such as stamp duty, payroll tax and insurance levies. These taxes are volatile, inefficient and poorly aligned with modern economic activity. Disputes over GST distribution have obscured this deeper structural problem.

The 2018 Western Australia GST deal was a political settlement, not a principled reform. WA's low relativity reflected its extraordinary revenue-raising capacity during the mining boom — exactly what equalisation is designed to recognise. The GST floor severed the link between fiscal capacity and GST outcomes and required substantial Commonwealth subsidies to avoid disadvantaging other jurisdictions. It must not be treated as a precedent.

At the same time, the Commonwealth Grants Commission has repeatedly acknowledged that it cannot reliably measure several major categories of need — including natural disaster exposure, remote service delivery, Closing the Gap obligations and national-capital functions — even when these costs are real, material and unevenly distributed. The ACT sits squarely in this blind spot. Its national-capital responsibilities and planning constraints, city-state governance model, APS concentration and cross-border service role impose structural burdens that arise from national decisions, not local policy choices.

Horizontal Fiscal Equalisation is a national asset. It is one of the few institutions that ensures Australians, wherever they live, can expect broadly comparable public services. One of the great strengths of the current system is the quality of the underlying data. The CGC's assessed-against-actual service-provision datasets are, in my view, the most valuable public-sector datasets in the country. They link service demand, cost pressures and revenue capacity across every major function of government. This evidence base is the foundation of equalisation, and it should be protected, not diluted.

But improvements are necessary — and the most important is cultural, not technical. The CGC needs to step out from behind its website and re-establish the public presence it once had. In earlier decades, the Commission regularly appeared at public forums, parliamentary hearings and intergovernmental meetings across the country. That visibility built trust, understanding and legitimacy. Today, the system suffers from a lack of public comprehension, which has allowed simplistic and misleading narratives to take hold. A more open, outward-facing CGC would strengthen confidence in the system and help counter the myths that have distorted the debate.

The Productivity Commission now has an opportunity to address these structural issues directly. The solution is not to weaken equalisation, but to strengthen it by restoring GST adequacy, addressing vertical fiscal imbalance and quarantining nationally imposed costs that lie outside the conceptual boundaries of horizontal fiscal equalisation.

In the ACT's case, a dedicated national funding mechanism for national-capital, cross-border and payroll-tax disabilities — operating alongside the existing Municipal Services payment — would restore balance. Without such a mechanism, the ACT will continue to subsidise national functions at the expense of its own citizens, contrary to the principles of self-government conferred in 1989.

RECOMMENDATIONS

1. **Restore integrity to horizontal fiscal equalisation** Reverse the 2018 amendments and remove the legislated GST floor. Re-establish full equalisation based on measured fiscal capacity. Deliver any ongoing support for Western Australia outside the GST formula.
2. **Address vertical fiscal imbalance and GST adequacy** Acknowledge that VFI — not equalisation — is the core structural problem. Recommend national tax reform to restore GST adequacy (base, rate, or alternative instruments). Recognise that HFE cannot substitute for a structurally adequate revenue base.
3. **Quarantine nationally driven costs from HFE** State clearly that these costs lie outside HFE's conceptual boundaries. Recommend a whole-of-government process to identify nationally imposed obligations. Establish a dedicated, indexed national funding mechanism outside the GST pool.
4. **Provide a dedicated national-capital and ACT settlement** Acknowledge the ACT's national-capital, cross-border and payroll-tax

disabilities as nationally driven and structurally embedded. Recommend a specific national funding arrangement to recognise these obligations. Quarantine these costs from HFE and fund them transparently as national responsibilities.

5. **Strengthen and protect HFE as a national asset** Affirm HFE as essential to comparable services across Australia. Protect the CGC's world-class data system. Reject simplified "global indicator" models.
6. **Reform the CGC's public role and institutional culture** Recommend that the CGC emulate the Productivity Commission's public profile. Restore the CGC's participation in public forums, parliamentary hearings and intergovernmental processes. Require the CGC to communicate openly about its limits.
7. **Modernise technical elements of the system** Review the moving-average treatment of mining revenue. Ensure materiality thresholds do not obscure genuine disabilities. Support incremental methodological refinement once structural issues are addressed.

1. INTRODUCTION

The most significant change to the GST since its introduction has been the 2018 alteration to the distribution system — a politically driven intervention that increased Western Australia's share and reshaped the operation of horizontal fiscal equalisation. The Productivity Commission has now been asked to determine whether this arrangement is functioning efficiently, effectively and as intended.

In its November 2025 Issues Paper, the Commission signalled that its review would extend beyond the narrow circumstances that produced the 2018 reforms. It indicated it would examine the interaction between the GST and other Commonwealth transfers, consider broader issues in federal financial relations, and address the widening vertical fiscal imbalance and the division of roles and responsibilities across the federation.

This review therefore provides a rare opportunity to look past the symptoms — such as Western Australia's political campaign — and confront the structural issues that have been allowed to accumulate. The Commonwealth Grants Commission applies the rules of equalisation as determined by governments; it cannot change those rules, even when it identifies gaps or limitations. The Productivity Commission, by contrast, is uniquely placed to assess whether the rules themselves remain fair, sustainable and appropriate to today's federation.

The central structural issues are clear: the erosion of the GST base, the widening vertical fiscal imbalance, and the existence of nationally driven costs that the CGC cannot reliably assess. These issues sit at the heart of the federation's fiscal tensions and must be addressed if the GST system is to remain credible and sustainable.

2. BACKGROUND

The GST was introduced as a broad-based consumption tax meant to give States and Territories a reliable, expanding revenue stream. It was supposed to grow with the economy and keep pace with rising service demands. That promise has failed.

The GST rate has never changed. The base has narrowed through concessions and exemptions. Consumption has shifted decisively toward untaxed services and digital activity. As a result, GST revenue no longer grows in line with the cost of delivering essential services.

At the same time, the Commonwealth has increasingly relied on a patchwork of national funding agreements that are fragmented, inconsistent and often conditional. These agreements do not provide the stability or adequacy required for long-term service planning. Instead of a coherent revenue framework, the States are left with a shrinking GST base supplemented by short-term Commonwealth arrangements.

The CGC has repeatedly acknowledged that some of the most significant cost pressures faced by jurisdictions — natural disaster exposure, remote service delivery, Closing the Gap obligations and national-capital functions — are real, material and unevenly distributed. Yet it has also stated that it cannot reliably assess these costs within its methodology. This is not a failure of the CGC; it reflects the structural limits of equalisation.

3. THE REAL ISSUE — VERTICAL FISCAL IMBALANCE AND THE EROSION OF THE GST BASE

3.1 Narrative

The deeper structural issue underlying this inquiry is not Western Australia's political campaign nor the mechanics of equalisation, but the widening vertical fiscal imbalance between the Commonwealth and the States and Territories. The States carry the overwhelming responsibility for delivering essential services — health, education, transport, policing, and child protection — yet the Commonwealth controls the most efficient and broad-based revenue instruments.

When the GST was introduced, it was presented as a growth tax that would keep pace with the States' expanding service obligations. That promise has not been realised. The GST rate has remained unchanged, the base has been steadily eroded by concessions and exemptions, and consumption has shifted toward untaxed services and digital activity. As a result, GST revenue no longer grows in line with the cost of delivering essential services, particularly in the face of rapid population growth, rising complexity of need and escalating demand for health and human services.

This is not a new observation. The OECD has repeatedly warned that Australia's GST base is unusually narrow by international standards and increasingly unsuited to a modern service-dominated economy. The Henry Tax Review reached the same conclusion more than a decade ago, arguing that the GST base had eroded to the point where it could no longer perform its intended role as the States' primary growth tax.

More recently, the Parliamentary Budget Office has reported that GST revenue as a share of GDP has fallen from around 4 per cent in 2000–01 to approximately 3.5 per cent today, and is expected to remain at this diminished level over the medium term. The Productivity Commission's own work on corporate tax reform, included analysis by economist Chris Murphy, highlighted that broadening the GST would be one of the most growth-friendly ways to fund reductions in corporate tax while increasing the GST pool for the States.

More recently, the International Monetary Fund has also reiterated the need for tax reform, identifying the GST as a prime starting point.

This structural mismatch has forced the States and Territories to rely increasingly on narrow, distortionary taxes — stamp duty, payroll tax, insurance levies — that are volatile, inefficient and poorly aligned with modern economic activity. The Commonwealth's failure to maintain the GST as a genuine growth tax has therefore created the very pressures that now manifest as disputes over equalisation. The WA floor is a symptom of this deeper problem, not its cause.

The real solution lies in addressing the revenue side of the federation, not in carving out exceptions within HFE. Genuine tax reform — broadening the GST base, revisiting the rate, or replacing inefficient state taxes with more sustainable national revenue instruments — is the only durable way to offset vertical fiscal imbalance and provide the States and Territories with the certainty they need. A stable, adequate revenue base would allow HFE to operate as intended: distributing resources according to fiscal capacity, not compensating for a system in which the States are structurally underfunded.

Until the Commonwealth confronts the erosion of the GST and the imbalance it has created, disputes over distribution will continue to obscure the real problem: the States and Territories simply do not have the revenue tools required to meet the service demands placed upon them.

3.2 What the Productivity Commission is Asked to Do

1. Recognise that the core problem is vertical fiscal imbalance (VFI). The GST no longer provides the States and Territories with a revenue base commensurate with their service obligations. This structural mismatch is the primary driver of distributional disputes.
2. Recommend national tax reform to restore GST adequacy. The GST rate and base should be reconsidered, or alternative national revenue instruments explored, to ensure the States have a stable, adequate revenue base.

4. THE 2018 WESTERN AUSTRALIA GST DEAL

4.1 Narrative

Western Australia continues to argue that the pre-2018 GST system was unfair, that its exceptionally low GST share during the mining boom demonstrated a flaw in equalisation, and that the GST floor introduced in 2018 restored balance without harming other States because the Commonwealth provided top-up funding. It presents the floor as a structural improvement that should now be treated as a permanent feature of the system.

These claims do not withstand scrutiny.

WA's low GST share was not evidence of a broken system; it was the predictable outcome of a jurisdiction with extraordinary revenue-raising capacity. Equalisation measures fiscal capacity, not political sentiment, and WA's situation was unusual only in scale, not in principle. A system designed to recognise differences in fiscal capacity will, by definition, produce very low relativities when a State's revenue base becomes exceptionally strong. That is not a failure of HFE — it is the system working exactly as intended.

The GST floor introduced in 2018 fundamentally altered this logic. It severed the essential link between a State's revenue capacity and its GST outcome by guaranteeing WA a minimum relativity regardless of its underlying fiscal strength. This effectively insulated one jurisdiction from the consequences of its own economic capacity while all others remained fully exposed to the equalisation process.

The assertion that no State was harmed is true only because the Commonwealth injected billions in additional funding to hold other jurisdictions harmless. This was not a reform of HFE; it was an ongoing subsidy.

The result is a structural asymmetry: one State is guaranteed a minimum GST share irrespective of its fiscal capacity, while the rest of the federation continues to operate under the full discipline of equalisation. This asymmetry becomes more significant over time. If WA's revenue strength surges again, the floor will prevent the system from recognising that capacity, undermining the coherence, credibility and internal consistency of HFE.

For these reasons, the WA arrangement should be treated as an exception rather than a precedent. It was a political settlement designed to address a particular moment, not a principled reform of the equalisation framework. It should not be retained as a permanent feature of the GST system, nor should it guide future system design.

4.2 Other Commentators' Viewpoints

A substantial body of public commentary — from economists, journalists and policy analysts — has already demonstrated that Western Australia's account of the pre-2018 GST system does not withstand scrutiny. Their work has repeatedly shown that WA's low relativity during the mining boom was the predictable consequence of extraordinary revenue-raising capacity, and that the 2018 GST floor severed the essential link between fiscal capacity and GST outcomes. They have also documented that the Commonwealth's top-up payments constitute an ongoing subsidy that has weakened equalisation and imposed a far larger and longer-lasting cost on the federal budget than originally forecast.

These issues will be canvassed at length by other parties to this inquiry including a number of State Treasury submissions no doubt, and the Commission will receive extensive evidence on them. For that reason, I do not intend to rehearse, re-present or furnish new material that is already well established in the public domain. My purpose is simply to restate my own view — informed by long experience with HFE and by evidence readily available to the Commission — that the conclusions reached by these commentators are correct. In my view, the Commission should reach the same conclusion.

4.3 How the 2018 Adjustments Impact the Distribution System

From a practical viewpoint, the impact of the 2028 floor can best be illustrated from a methodological perspective.

Australia's GST distribution system now contains two different "standards," and understanding the difference between them is essential.

The first is the CGC's technical standard — a constructed benchmark reflecting the national average policy applied to the national average revenue base or cost. It shifts naturally as the economy changes. When WA dominated iron ore, WA's characteristics shaped the standard. As Queensland's coal

royalties have grown, the standard has shifted again. This is how equalisation is meant to work.

The second is the legislated standard State created by the 2018 reforms. This is not a conceptual benchmark but a real State — whichever of NSW or Victoria has the lower relativity. The law guarantees that no State can fall below that relativity. This is a political floor, not an equalisation principle. It overrides the CGC's assessment whenever a State would otherwise fall below NSW or Victoria.

In 2025–26, NSW is the standard State because it had the lower relativity in all three assessment years. Any State that would fall below NSW is lifted up, and all others are pushed down proportionally so the pool still adds up. Because the system is still in transition, the final relativities are a blend of the old system and the new floor.

This legislated floor interacts with other features of the system in ways that weaken equalisation. The CGC still uses a moving average for mining revenue — a mechanism designed when WA's iron ore royalties were uniquely large and volatile. Today, Queensland's coal royalties are substantial and cyclical, and the mining base is more diversified. Yet the smoothing mechanism continues to delay recognition of revenue strength, and the legislated floor then prevents the system from fully reflecting that strength even when it is eventually recognised.

The result is a system no longer driven solely by fiscal capacity. The CGC's technical standard continues to evolve with the economy, but the legislated standard State locks in a minimum relativity for all States, regardless of their revenue-raising strength. This reduces transparency, creates asymmetry and weakens the coherence of HFE.

To restore integrity, the legislated standard State should be treated as a political exception rather than a permanent feature. GST relativities should once again reflect measured fiscal capacity. The moving-average treatment of mining revenue should be reviewed to ensure it remains appropriate in a changed economic environment.

If the Commonwealth wishes to continue supporting WA, it should do so outside the GST formula.

4.4 What the Productivity Commission Is Asked to Do

1. State clearly that the 2018 Western Australia GST floor was a political settlement, not a principled reform, and advise governments that it should not be treated as a permanent feature of the GST system or a precedent for future system design.
2. Recommend that governments restore the integrity of horizontal fiscal equalisation by removing the legislated standard State, ensuring that GST relativities once again reflect measured fiscal capacity rather than politically determined minimum outcomes.
3. Advise that any ongoing financial support for Western Australia be delivered transparently and outside the GST formula, so that the equalisation system can operate consistently, coherently and without structural asymmetry between jurisdictions.

5. NATIONALLY DRIVEN COSTS - LIMITS OF EQUALISATION

5.1 Background

The CGC's 2025 Methodology Review is unusually candid about the limits of the equalisation framework. While the Commission reaffirms the principles of full equalisation, it also acknowledges that there are entire categories of state responsibility where the system simply cannot produce reliable, comparable or policy-neutral assessments. These are not marginal issues. They include some of the largest, fastest-growing and most nationally driven areas of state expenditure.

The CGC identifies several domains where it accepts that the costs are real, material and unevenly distributed, but where the methodology cannot accommodate them. These include:

- Climate change impacts, where escalating and asymmetric costs cannot be measured consistently across jurisdictions
- Closing the Gap and Indigenous service delivery, where national policy commitments impose significant obligations that cannot be separated cleanly from general service delivery
- Natural disasters, where costs are volatile, episodic and distorted by Commonwealth recovery arrangements
- National-capital and Commonwealth-driven responsibilities, which are unique, non-comparable and structurally embedded
- Cross-border service pressures, where data is incomplete and usage patterns are asymmetric
- Small-jurisdiction diseconomies of scale, which are real but routinely excluded by materiality thresholds
- Costs arising from national policy settings, which cannot be attributed cleanly to state choices
- Unique functions not performed by all states, which lack comparators and therefore cannot be assessed

Across all these areas, the CGC's message is consistent: the pressures exist, but the methodology cannot measure them reliably, and therefore cannot equalise them.

This is not a criticism of the CGC. It is an acknowledgement of the inherent limits of a system designed to compare state fiscal capacities, not to absorb the consequences of national policy decisions, global forces or unique constitutional arrangements.

The CGC's own language makes the point clearly: where needs cannot be measured with confidence, they cannot be assessed. And where costs arise from national decisions rather than state choices, they fall outside the conceptual boundaries of HFE.

This is the central structural issue facing the system today. The fundamentals of equalisation remain sound, and nothing in the 2025 Review suggests that a wholesale redesign is required. But the Review makes equally clear that HFE is now being asked to do too much — to carry responsibilities that are nationally determined, structurally embedded and unevenly distributed. These pressures cannot be equalised, and attempting to force them into the system risks distorting the very principles on which HFE is built.

This is the context for the chapter that follows. Nationally driven costs expose the practical limits of equalisation more sharply than any other category of expenditure. Understanding those limits — and recognising that they must be addressed outside the HFE framework — is essential to any credible discussion about the future of the system and essential for the Commission to address in its report.

5.2 Narrative

Natural-disaster exposure is the clearest example of the limits of the equalisation framework. The burden of cyclones, floods, bushfires and extreme weather events falls disproportionately on Queensland, New South Wales and increasingly Victoria. The CGC has repeatedly accepted that these costs are escalating, volatile and unevenly distributed, and that they arise from geography and climate rather than policy choice. Yet it has also stated, consistently, that it cannot construct a reliable assessment because disaster frequency and severity vary widely, data is inconsistent across jurisdictions, and Commonwealth disaster-recovery arrangements obscure the true net cost to States. The result is that jurisdictions with higher disaster exposure bear substantial, nationally driven costs that are only partially recognised — if at all — in equalisation.

A similar structural challenge exists in the Northern Territory. The fiscal demands associated with Closing the Gap, remote service delivery and the

unique demographic profile of Aboriginal communities are profound, nationally significant and unavoidable. The CGC fully assesses the demographic costs of Aboriginality — such as remoteness, socio-economic status and population shares — and this delivers large GST shares to the NT. But the CGC has been explicit that it cannot assess the far greater, policy-driven costs of actually meeting Closing the Gap targets. These include the higher service intensity required to lift outcomes, the expansion of Aboriginal community-controlled organisations, the additional burden of remote service delivery, and the extensive reporting and structural reforms mandated under the National Agreement. These obligations are real, substantial and nationally determined, yet they fall outside the CGC's methodology.

Climate change presents another area where the CGC openly concedes the limits of equalisation. The Commission acknowledges that climate-driven costs are growing rapidly and falling unevenly across jurisdictions — from coastal erosion and extreme heat to catastrophic bushfire risk and repeated flooding. These pressures are not hypothetical; they are already reshaping state budgets. Yet the CGC accepts that it cannot incorporate them into HFE because the impacts vary too widely, the expenditure is too volatile, and the underlying drivers are national and global rather than state-based. No consistent or comparable dataset exists that would allow the CGC to measure climate-related costs with the confidence required for assessment. In effect, climate change is producing real fiscal disabilities that the equalisation system cannot recognise.

The CGC also acknowledges the persistent difficulty of recognising diseconomies of scale in smaller jurisdictions. It accepts that small states face higher unit costs, thinner labour markets and limited capacity to spread fixed costs — structural realities that have nothing to do with policy choice. Yet many of these pressures fall below materiality thresholds or cannot be measured with sufficient precision to support an assessment. The result is a system that routinely overlooks genuine scale-related disabilities, not because they are unimportant, but because the methodology cannot accommodate them.

A further limitation arises from costs imposed by national policy settings. Many state obligations flow directly from Commonwealth legislation, national agreements or federally mandated service standards. These costs are real and often substantial, but the CGC notes that they cannot be attributed cleanly to state decisions, nor can they be measured in a way that preserves policy neutrality. The Commission's conclusion is that such costs lie outside the conceptual boundaries of HFE and must be dealt with through other mechanisms.

Finally, the CGC recognises that some jurisdictions perform functions that others do not, or perform them at a scale that is not comparable. These unique responsibilities may arise from geography, demography or constitutional arrangements, but they share a common feature: they lack comparators. Without a benchmark against which to measure need or cost, the CGC cannot construct an assessment that meets its own standards of reliability and neutrality. As the Review makes clear, if a function is unique, it cannot be equalised.

Taken together, these examples also demonstrate that the ACT is not an outlier in relation to its National Capital, cross border and payroll tax restrictions discussed in the next chapter. The CGC's own commentary confirms that equalisation cannot absorb the consequences of national policy decisions, unique constitutional arrangements or structural burdens that arise from the national interest rather than local choice.

5.3 What the Productivity Commission Is Asked to Do

The Productivity Commission is being asked to provide national leadership by stating clearly that a wide class of nationally driven, structurally embedded and unevenly distributed costs fall outside what the CGC can measure or equalise, and therefore require a coordinated whole-of-government response. These costs — including climate adaptation, disaster resilience, Closing the Gap commitments, small-jurisdiction scale pressures, unique functions and other obligations created by national decisions — cannot be reliably assessed within HFE without distorting the system. The Commission should recommend the establishment of a dedicated, indexed national funding mechanism outside the GST pool to recognise and fund these pressures, and make clear that quarantining them strengthens the integrity of equalisation rather than weakening it. It should also affirm the CGC's own position that governments must act outside HFE if they want these costs recognised, and call for an independent, engaged national process to identify, quantify and transparently assess them. Only such a mechanism can repair the structural gap in the federation's fiscal architecture.

1. Recognise that nationally driven costs lie outside HFE's conceptual boundaries.
2. Acknowledge that the CGC cannot reliably assess these pressures.

3. Recommend that governments establish a national mechanism to address them outside the GST distribution.

6. NON-RECOGNITION - ACT'S NATIONAL CAPITAL, CROSS BORDER, PAYROLL TAX ANOMALIES

6.1 Background

National-capital, cross-border and payroll-tax costs sit at the centre of the broader structural reality that some jurisdictions are required to carry responsibilities that exist for national reasons, not local ones, as outlined in Part 5. These ACT-specific obligations are not discretionary choices or optional service models; they are nationally imposed responsibilities that generate real, material and unavoidable costs for the Territory — **anywhere in the region of $200–$500 million per annum**. Across multiple reviews, the CGC has acknowledged that these pressures fall into areas where it cannot reliably measure needs or disabilities, even when the underlying costs are substantial and persistent. From a Territory perspective, this is not a minor methodological inconvenience — it is a systemic limitation of horizontal fiscal equalisation that imposes an extraordinary and ongoing financial impost on the ACT's budget. And that impost is not marginal: **a revenue loss of this scale is significant in the context of the ACT Budget**, materially reducing the Territory's capacity to fund core services. The limitation becomes more visible, and more consequential, precisely because these responsibilities arise directly from the national interest rather than from ACT policy decisions.

6.2 National Capital Legacies

Canberra's fiscal circumstances are shaped by a combination of national-capital obligations, planning constraints arising from the adoption of the 1912 Griffin Plan and the subsequent 'Griffin Legacy' policy framework, environmental realities and regional service pressures that no other jurisdiction in Australia faces. These pressures are structural, embedded in the very design and purpose of the National Capital, and they remain largely unrecognised within the current interpretation of the equalisation framework.

What makes this even more striking is that the Commonwealth itself still recognises these national-capital-related costs at the municipal level. It continues to provide general revenue assistance to the ACT to help meet the additional municipal costs that arise from Canberra's role as the National Capital—costs stemming from Canberra's distinctive design, the Territory's inability to levy rates on Commonwealth-owned land, and national-capital planning influences on water and sewerage services. This payment was developed prior to self-government as part of the establishment of an ACT fiscus, informed by two specific CGC inquiries into the Territory's financial responsibilities, and it has continued unchanged since self-government. In 2025–26, the Commonwealth will provide $62.6 million in general revenue assistance for these functions, indexed annually using a growth factor based on wages and inflation.

The irony is stark: the Commonwealth continues to acknowledge these national-capital disabilities at the municipal level, yet the CGC has progressively dismantled recognition of the very same disabilities at the state level. This represents a complete breakdown of the underlying principle of self-government—that the ACT would not incur additional costs from hosting the National Capital, and that the CGC would uphold this principle through its equalisation assessments.

In the post-self-government period, the Commonwealth commissioned two further ACT-specific CGC inquiries to determine how the Territory should transition into the equalisation system, including how its unique national-capital responsibilities should be recognised and protected. Those inquiries recommended a suite of special-purpose payments and transitional arrangements precisely because the ACT carried structural burdens that no other jurisdiction faced. These recommendations formed the basis of the ACT's entry into the equalisation process in 1994.

Yet over time, the CGC has overridden or absorbed these national-capital imposts into its general methodology, effectively erasing the very disabilities it once acknowledged explicitly. It now asserts that these costs cannot be assessed due to data gaps, restrictive national agreements and methodological limits—the same constraints that existed when the CGC originally recognised them. The result is a perverse outcome: the ACT continues to bear real, unavoidable costs arising from national decisions rather than local policy choices, while the equalisation system no longer reflects or compensates for them. The CGC has, in effect, invalidated its own earlier findings, leaving the ACT exposed to structural fiscal pressures that the Commission itself once accepted as legitimate and requiring dedicated treatment.

The 2020 CGC Methodology Review remains the most detailed and transparent examination of the ACT's national-capital and Commonwealth-driven cost burdens ever undertaken within the equalisation framework. It is also the clearest demonstration of the structural limits of HFE. The ACT entered that review with a comprehensive, evidence-based submission quantifying the full suite of national-capital and Commonwealth-imposed costs. Drawing on internal analysis, agency data and long-standing intergovernmental arrangements, the ACT estimated that these imposts exceeded $300 million per year. This figure encompassed the broad range of responsibilities the ACT carries because it hosts the nation's capital — responsibilities that no other jurisdiction shares, and which arise directly from Commonwealth decisions rather than state policy choices.

The CGC's response in the final 2020 Review was revealing. It accepted that the ACT faced real, nationally imposed costs. It accepted that these responsibilities were unique, structurally embedded and not comparable to those of other jurisdictions. It accepted that the ACT performed functions that other States and Territories did not, and that these functions were not discretionary. But it also stated, repeatedly and explicitly, that it could not assess the overwhelming majority of these costs because they were not comparable, not measurable, or not supported by data that met the Commission's evidentiary standards. The CGC's methodology requires reliable, consistent, cross-jurisdictional data. National-capital costs do not fit that requirement. They are unique, they lack comparators, and they arise from national policy settings rather than state choices.

The result was predictable. Against an ACT claim of more than $300 million in nationally imposed costs, the CGC was able to recognise only a narrow subset — $30 million — a small fraction of the total — and even that amount was absorbed into the ACT's relativity and diluted across the GST pool. The remaining vast majority of the ACT's demonstrated costs were excluded entirely, not because they were unimportant or unsubstantiated, but because the CGC's methodology could not accommodate them. The CGC was candid about this limitation. It stated that it could not assess costs that were unique to one jurisdiction, that lacked comparators, or that arose from national policy settings. It acknowledged that national-capital obligations were structurally embedded and not amenable to equalisation. And it emphasised that where needs cannot be measured with confidence, they cannot be assessed.

This is the context in which the Productivity Commission must now operate. The Commission is not being asked to revisit the 2020 Review or to calculate the precise quantum of the ACT's national-capital costs. But it is being asked to

recognise what the CGC itself has already acknowledged: that these costs are real, that they arise from national decisions, and that the CGC has no mechanism to deal with them. The structural gap exposed in the 2020 Review has only widened since then.

6.3 Narrative

The ACT operates under structural conditions that no other Australian jurisdiction faces. These conditions are not discretionary, temporary or the result of local policy. They are embedded in the institutional design of the National Capital and they impose enduring fiscal, regulatory and service-delivery burdens that the current equalisation framework is neither designed nor permitted to recognise.

In its 2020 submission, the ACT made clear that servicing the National Capital constitutes an additional stream of responsibilities that sits entirely apart from the Territory's planning, leasehold and land-management functions. The ACT emphasised that these national-capital obligations arise solely from Canberra's role as the seat of the Commonwealth Government and host to national institutions, diplomatic missions, major national events and nationally significant precincts. They generate substantial, unavoidable and ongoing service, regulatory, security and infrastructure costs that no other jurisdiction is required to carry. The ACT argued that these costs are nationally imposed obligations, not extensions of its ordinary governance functions, and that the failure to recognise this distinction has left the Territory absorbing fiscal burdens that properly belong to the Commonwealth.

A second and equally significant stream of national-capital imposts arises from the planning and land-use constraints imposed by the National Capital Plan. A substantial portion of the Territory is governed by this Commonwealth-determined framework rather than ACT planning laws. This arrangement constrains land supply, limits development pathways and imposes service obligations that arise directly from national-capital functions. No other state capital has height limits imposed on its CBD purely for aesthetic reasons to preserve the primacy of Parliament House. These restrictions suppress land values, constrain the Territory's revenue base and prevent the development of a high-rise commercial core that would otherwise support economic activity.

Canberra's urban form is the product of national planning decisions. Nationally protected ridgelines, hills and buffers remove large areas of developable land that would otherwise support housing and commercial activity, with consequential revenue implications. Environmental constraints intensify these

pressures: approximately 70 per cent of the ACT is national park or nature reserve. The proximity of suburbs to bushland means the entire city is bushfire-prone, requiring a level of emergency preparedness and infrastructure protection far beyond what would normally be expected for a jurisdiction of this size.

The ACT's settlement pattern entrenches diseconomies of scale. The straight-line distance from Taylor (North extremity—Gungahlin) to Banks (Southern extremity—Tuggeranong) is 33 kilometres, and the broader Canberra–Queanbeyan region spans 55 kilometres. Within this 33 km footprint live approximately 480,000 people. In every other mainland capital, the same spatial envelope contains vastly larger populations: more than 5 million in Sydney and Melbourne, nearly 3 million in Brisbane, over 2 million in Perth and around 1.4 million in Adelaide. Even Hobart and Darwin exhibit higher densities relative to their built-up areas. Canberra therefore supports one-tenth the population of Sydney or Melbourne, one-fifth that of Brisbane or Perth, and one-third that of Adelaide within an equivalent geographic span.

This density deficit has direct fiscal consequences. Linear infrastructure—roads, water, sewerage, stormwater, electricity, telecommunications—must be extended across long distances to service a small population. Emergency services, public transport and waste management must operate across a dispersed environment with limited opportunities for scale efficiencies. These are structural diseconomies, not inefficiencies.

The ACT's leasehold land-tenure system adds further complexity. It requires the government to regulate a wide range of lease conditions, generating administrative costs that have outpaced the Territory's capacity to enforce them. This is a system inherited, not chosen, and its inefficiencies fall squarely on the ACT budget.

The governance model compounds these pressures. A single 25-member Legislative Assembly must perform both state and municipal functions, with no local government tier. This forces municipal services to compete directly with state-level responsibilities for funding and attention, creating structural service-delivery constraints that no other jurisdiction faces. It might be said that this city-state model is at a crossroads, with a growing call for a structural review into the failure at the city-services level.

These different structural characteristics interact directly with the national-capital/seat of government responsibilities and explain why the **ACT Treasury's 2020 review identified well over $300 million per year** in national-capital-related costs, and why the **CGC could recognise only $30**

million within its constrained methodology. They demonstrate that the ACT's fiscal pressures are nationally created, structurally unavoidable and uniquely unrecognised within the equalisation system.

6.4 Cross Border Imposts

The ACT carries a regional service burden that no other jurisdiction in Australia faces given the fact it is surrounded one hundred per cent by another independent jurisdiction. Although the Territory has a population of around 480,000, it sits at the centre of a functional region of more than 700,000 people stretching across Queanbeyan, Googong, Jerrabomberra, Bungendore, Murrumbateman and Yass. Because Canberra is the only city in this region with tertiary hospitals, specialist health services, senior secondary colleges, courts, emergency-service capability and major transport infrastructure, large numbers of NSW residents rely on ACT-funded services every day.

6.5 Narrative

The scale of this reliance is well documented. ACT Health activity data shows that NSW residents account for roughly 20–25% of all ACT public hospital activity, and in some specialist areas — such as neonatal intensive care, trauma and oncology — the proportion is even higher. ACT Education reports thousands of NSW students enrolled in ACT public schools and training programs. ACT Policing, ACT Ambulance and ACT Fire & Rescue respond to cross-border incidents daily under mutual-aid arrangements. ACT roads and public transport carry large volumes of NSW commuters. These are not discretionary services; they are the predictable consequence of Canberra's role as the region's economic and institutional centre.

The fiscal impact of this cross-border reliance has been quantified repeatedly. Past ACT Treasury modelling, provided across multiple budget cycles and in submissions to the CGC, consistently estimates that NSW residents impose tens of millions of dollars in additional annual costs on the ACT Budget. When broken down, the components are clear:

- Hospital services: NSW patients consume activity equivalent to a small regional hospital, costing the ACT an estimated **$40–60 million per year**.
- Education: NSW enrolments in ACT schools impose **$10–15 million in additional costs**.

- Emergency services: Cross-border callouts cost **$5–10 million annually**.
- Transport and roads: NSW commuter use of ACT infrastructure imposes **$10–20 million** in maintenance and congestion costs.

These figures are supported by ACT Health and Education activity data and by independent regional analyses confirming that the ACT is the sole provider of tertiary services for a large NSW population. When combined, these pressures conservatively total **$70–100 million per year** — a burden equivalent to major service programs or entire agency budgets.

These estimates are net of any funding provided through national agreements, which recognise only patient and student numbers and apply national efficient prices rather than the ACT's actual service-delivery costs. As a result, the ACT receives only the national average funding for services it must provide at significantly higher cost, and receives no contribution whatsoever toward the capital infrastructure required to build, expand and replace the hospitals, schools and transport systems used extensively by NSW residents. This includes major assets such as tertiary hospitals, specialist clinical facilities, and high-demand public schools — all of which the ACT must finance alone.

The absence of any capital contribution has been a perennial point of dispute between the ACT and NSW Governments, since self-government without resolution. The consequence is clear: the ACT carries substantial cross-border operating and capital costs that are not recognised, not compensated, and significant in the context of the ACT Budget.

6.6 Payroll Tax Deficiency

The Australian Public Service presence imposes a further structural revenue loss that is both constitutionally entrenched and uniquely concentrated in the ACT. Under the Australian Constitution, Commonwealth entities are exempt from state taxes, including payroll tax. While this rule applies nationwide, its impact is not evenly distributed.

6.7 Narrative

In most States, only a very small share of the workforce is employed by the Commonwealth — on average around 2 per cent — so the revenue loss is modest. In the ACT, however, the effect is profound: approximately 42 per cent of the Territory's entire workforce is employed by the Commonwealth Government.

Because the ACT cannot levy payroll tax on these wages, a very large portion of its potential revenue base is simply unavailable — an impact no other jurisdiction experiences at anything like this scale.

The Commonwealth Grants Commission recognises this structural limitation in its payroll-tax assessment. Its method is straightforward: it estimates how much payroll tax each State would raise if all States applied the national average tax rate to their own taxable wages. Commonwealth wages are removed from every State's tax base because no State is allowed to tax them. This adjustment affects all jurisdictions, but it hits the ACT hardest because such a large share of its workforce is constitutionally untaxable.

In 2025–26, this resulted in the ACT receiving **an additional $63 million in GST funding** — equivalent to $129 per person — to compensate for its unusually limited capacity to raise payroll tax. This is the CGC's attempt to level the playing field.

However, this adjustment only partially offsets the Territory's true revenue loss. The ACT Government has consistently argued that the CGC's method significantly understates the scale of the disability. In its submission to the 2020 Methodology Review, the **ACT estimated that the real payroll-tax shortfall was around $120 million per year** — almost double the amount recognised in the GST distribution. This estimate was based on a detailed analysis of the Commonwealth wage bill in the Territory and the proportion of the ACT's labour market that is constitutionally untaxable.

Independent analysis suggests the gap may be even larger. As noted publicly by economist Matt Grudnoff in June 2025, the concentration of Commonwealth employment in the ACT implies a potential payroll-tax shortfall in the order of **$500 million to $850 million annually** — far beyond what the equalisation system is designed to address. While this upper-bound estimate reflects the full Commonwealth wage bill rather than the narrower CGC assessment base, it underscores the magnitude of the structural revenue constraint imposed on the ACT by national decisions.

Taken together, these figures demonstrate a consistent pattern:

- The CGC recognises only a fraction of the disability **($63 million)**
- The ACT Government's modelling places the shortfall at around **$120 million**
- Independent analysis suggests the true structural impact may be **several times larger**

The common conclusion is unavoidable: the ACT faces a unique, constitutionally entrenched payroll-tax disability that the equalisation system cannot fully capture, and which requires a dedicated national funding response outside the GST formula.

6.8 The CGC's Position on National-Capital, Cross-Border and Payroll Imposts

Since ACT self-government, the CGC has repeatedly acknowledged that the Territory faces real, structural and nationally driven disabilities arising from its role as the National Capital — yet for more than three decades it has failed to develop any credible method to measure or recognise them. The CGC's treatment of these issues has been inconsistent, piecemeal and ultimately evasive.

In the early years after self-government, the Commission accepted that the ACT bore additional costs linked to national-capital functions, symbolic land management, planning constraints and cross-border service pressures, but it quickly retreated from these findings, labelling them "immaterial," "judgement-based," or "not reliably measurable." By the mid-2000s, the CGC had abandoned both the national-capital and cross-border assessments entirely, not because the disabilities had disappeared, but because the Commission declared itself unable — or unwilling — to measure them within its increasingly rigid methodology.

National funding agreements were then used as a justification to withdraw cross-border recognition altogether, even though those agreements were never designed to compensate the ACT for its regional service role.

The CGC's 2025 Methodology Review simply repeats this long-standing pattern: it proposes discontinuing the national-capital assessment on the grounds that it is "immaterial," despite the ACT's clear evidence to the contrary, and again refuses to assess cross-border pressures because national agreements supposedly leave no measurable residual cost. In effect, the CGC has spent 35 years acknowledging that the ACT carries unique burdens on behalf of the nation, while simultaneously declaring itself institutionally incapable of recognising them. The result is a structural blind spot at the heart of equalisation: the ACT's national-capital and cross-border disabilities are real, material and nationally created — but the CGC has chosen to treat them as invisible.

In relation to payroll tax, the CGC has consistently acknowledged that the ACT faces a unique structural revenue loss because Commonwealth agencies — which dominate the ACT labour market — are exempt from payroll tax. However, the Commission has repeatedly stated that it cannot recognise this shortfall within equalisation because no other jurisdiction has a comparable concentration of Commonwealth employment, and compensating the ACT would require reducing the GST shares of other States for a disability that is national in origin. In its most recent 2025 Methodology Review, the CGC again confirmed that the payroll-tax exemption for Commonwealth entities is a real and material revenue constraint for the ACT, but concluded that it "cannot be reliably assessed" within the HFE framework and must therefore be treated as a non-assessable factor. The result is that the ACT continues to absorb a substantial structural revenue loss that arises entirely from its role as the National Capital, while the equalisation system treats this loss as if it were a normal variation in fiscal capacity rather than a federally imposed limitation.

6.9 What the Productivity Commission Is Asked to Do

The implications for this inquiry are unambiguous. Again, the Commission is not conducting a methodology review; the ACT is not asking the Productivity Commission to quantify its structural burdens or to reopen the CGC's methodology. It is asking the Commission to recognise that these burdens exist, that they arise from national decisions, and that the CGC has no mechanism to deal with them.

The Commission should state plainly its support for the following seven recommendations:

1. Formally recognise that the ACT's national-capital obligations, cross-border service pressures and constitutionally entrenched payroll-tax disability are nationally created, structurally unavoidable and unique in scale.
2. Acknowledge that the CGC's methodology cannot measure or assess these imposts, and that this limitation creates a structural gap in the federation's fiscal architecture.
3. Recommend that governments establish a dedicated, indexed national funding mechanism to recognise and fund these imposts outside the GST distribution.

4. Quarantine these costs entirely from HFE to ensure the ACT is neither advantaged nor penalised for structural circumstances it cannot influence.
5. Ensure that cross-border service use is funded appropriately through the national mechanism, rather than being absorbed by ACT taxpayers.
6. Endorse the CGC's own advice that governments must act outside the equalisation system if they wish to recognise these costs.
7. Emphasise that establishing a national funding mechanism is not a departure from equalisation but the only way to preserve its integrity.

In considering these recommendations, the Productivity Commission could also explore mechanisms through which the ACT's national-capital obligations, cross-border service pressures and payroll-tax disability can be examined by an independent, engaged team with a clear national mandate. This could take the form of a small, expert federal review unit reporting jointly to the Commonwealth and the ACT, with the authority to undertake detailed cost assessments and verify the scale of these nationally imposed burdens.

Alternatively, the Australian National Audit Office could be tasked with periodic audits; the Commonwealth Grants Commission could be issued with a fifth, ACT-specific term of reference from the Federal Minister for Territories via the Federal Treasurer; or the Productivity Commission itself could be given dedicated terms of reference to conduct a standing or periodic review. Other models — such as a joint Commonwealth–ACT advisory panel or a statutory national-capital oversight body — could also be designed, provided they offer independence, transparency and the capacity to engage directly with the evidence. The essential requirement is that these costs are examined somewhere within the federation's institutional architecture, because the ACT cannot be expected to carry nationally created burdens without a national process to recognise and address them.

7. OTHER SYSTEMIC FAILURES — ACT POPULATION AND HISTORIC HOUSING DEBT

7.1 Narrative

The ACT's population undercount and its historic housing debt are not abstract grievances. They go to the core of how horizontal fiscal equalisation works — and how it fails the ACT.

HFE only functions if the data feeding into it is accurate. When the population count is wrong, every part of the CGC's assessment is wrong. The CGC applies ABS population estimates directly into its relativities. It does not adjust them, question them or correct them, even when the ABS figures are clearly inaccurate. For the ACT, this is fatal. A population undercount means the CGC assumes the Territory has fewer people to educate, fewer patients to treat, fewer commuters to move, and a smaller tax base to draw from. The GST formula then locks in that error and multiplies it across every assessment category. A wrong population count becomes a wrong GST outcome — every year.

7.2 ABS Population Undercount

The ACT has long raised the persistent and systematic undercounting of its population by the ABS and the direct impact this has on the Territory's GST share. Between 2016–17 and 2022–23 alone, this undercount resulted in the ACT receiving **$550 million less in GST revenue** than it should have. This is not a marginal technical issue - it is a structural failure that has materially disadvantaged the Territory for decades.

The transient and highly mobile nature of the ACT's population is well documented, yet it has consistently proven elusive for the ABS to capture accurately in its official population estimates. These estimates feed directly into the CGC's equalisation process, meaning that every error is amplified through the GST distribution system. Despite repeated warnings from successive ACT Treasurers, the ABS has continued to rely on measurement methods that are plainly inadequate for the ACT's demographic profile.

Past attempts to resolve the issue - including joint officer working groups, seconded ABS staff, and even Medicare-based registration lotteries - have produced no meaningful improvement. Meanwhile, more accurate and contemporary administrative datasets now exist, such as interstate motor-vehicle registration

movements, which provide a far clearer picture of the ACT's population flows. The ABS has simply refused to adopt them.

Equally troubling is the CGC's unwillingness to exercise the broad-judgement adjustments it routinely applies in other areas of its methodology when data limitations are acknowledged. The CGC knows the ABS population estimates undercount the ACT. It knows the fiscal impact is large. It knows alternative data sources exist. Yet it has chosen not to act.

The PC's terms of reference explicitly invite comment on matters of significance to the operation of the equalisation system. The chronic undercounting of the ACT's population, and the resulting $550 million loss in GST revenue, is unquestionably such a matter.

7.3 ACT's Claim for Removal of Historic Public-Housing Debt

The ACT continues to press its case for the removal of its historic public-housing debt, a liability inherited at the time of self-government and now **exceeding $100 million**. This debt dates back to Commonwealth-funded public-housing construction undertaken prior to 1989 and has long been recognised as an anomaly within the federation. Unlike other jurisdictions, the ACT entered self-government carrying a legacy housing debt without the fiscal capacity or historical revenue base that states had developed over decades. The ACT Government has repeatedly argued that this debt constrains its ability to invest in new public housing and respond to acute housing-affordability pressures.

The Commonwealth has already acknowledged the inequity of these historical housing debts in at least one case. In 2019, the Federal Government agreed to waive Tasmania's $150 million public-housing debt as part of a negotiated arrangement with Senator Jacqui Lambie. That debt, like the ACT's, originated from Commonwealth loans used to build public housing between the 1950s and 1980s. The waiver was justified on the basis that ongoing repayments were undermining Tasmania's capacity to build new social housing and reduce waiting lists.

The ACT's position is that the same logic applies - indeed, applies more strongly - to the Territory. The ACT's historic housing debt was inherited at the moment of self-government, not accumulated through its own policy choices. It has been serviced for more than three decades, diverting funds that could otherwise have been invested in expanding and renewing the public-housing stock. The ACT Government has repeatedly raised this issue with the Commonwealth, including through formal reporting to the Legislative Assembly on the progress of negotiations.

Chief Minister Andrew Barr has described the selective waiver of Tasmania's debt but not the ACT's as "a perversion of Australian democracy", noting that the ACT faces the same structural constraints and the same need to reinvest freed-up funds into public housing. The ACT's claim is therefore straightforward:

- The Commonwealth has already established a clear precedent by waiving Tasmania's historic housing debt.
- The ACT's debt is of the same origin, inherited from Commonwealth housing programs prior to self-government.
- The ACT's fiscal capacity is more constrained, given its city-state structure and limited revenue base.
- Waiving the ACT's debt would immediately free funds for new public-housing construction at a time of acute housing need.

Given the PC's terms of reference - which explicitly invite comment on matters of significance affecting the operation of the federation - the Commission is well placed to highlight this inequity and call for consistent treatment across jurisdictions.

7.4 What the Productivity Commission Is Asked to Do

The ACT is not asking the Productivity Commission to quantify these disadvantages or to redesign the CGC's methodology. It is asking the Commission to acknowledge that these are structural failures embedded in Commonwealth-designed fiscal arrangements — failures the CGC has neither the mandate nor the willingness to correct. While the CGC could exercise broad judgement and apply reasonable adjustments where the evidence is clear, it has chosen not to do so, leaving the consequences to fall entirely on the Territory. And those consequences are substantial. These structural flaws impose a large, recurring and unavoidable **net fiscal loss on the ACT Budget exceeding +$100 million per annum,** hence, stripping resources from the Territory on a scale that materially constrains its capacity to fund core services. This is a Commonwealth-driven fiscal drain — created nationally, sustained nationally, and beyond the ACT's ability to fix.

1. State clearly that the ACT's population is being systematically undercounted, that the CGC applies those figures without correction, and that this has produced a long-running GST shortfall the Territory cannot remedy. It should also acknowledge that the ACT continues to carry a historic housing debt that the Commonwealth has already waived for another jurisdiction, and that the CGC's assessments cannot account for this inconsistency.
2. Recommend that governments take direct national action: require the ABS to modernise its population-estimation methods; direct the CGC apply broad-judgement adjustments until those methods improve; and

extinguish the ACT's historic housing debt in line with the Tasmanian precedent.

3. Identify these as nationally created problems. The ACT cannot fix them. The ABS has not fixed them. The CGC will not fix them. The Productivity Commission is the only body in this inquiry with the authority to say so — and to recommend that governments finally act.

8. FUTURE DIRECTIONS FOR REFORM

8.1 Narrative

Horizontal Fiscal Equalisation is a national asset — one of the few institutions that guarantees Australians, wherever they live, access to broadly comparable public services. The 2018 amendments weakened that principle and should be reversed, not because the system is broken, but because those changes compromised the integrity of a framework that has served the federation well for decades. Equally, Australia must resist calls to replace HFE with simplified "global indicator" models. These approaches have been examined repeatedly, including by the CGC, and every assessment has reached the same conclusion: they cannot deliver credible equalisation. Simplified indicators flatten structural differences, ignore genuine cost pressures, and systematically disadvantage smaller jurisdictions whose higher service-delivery costs disappear inside crude national averages. Far from modernising the system, they would entrench inequity by rewarding scale and penalising dispersion. The CGC has trialled multiple versions of these models over several reviews and ruled them out because they produce outcomes that are unstable, inaccurate and fundamentally incompatible with the purpose of equalisation.

One of the great strengths of the current system is the quality of its evidence base: the CGC compares actual service-delivery data — what States truly spend and deliver — with standardised assessments that reflect the national-average policy and cost benchmark, producing the most detailed and operationally meaningful dataset in the federation. This evidence base links service demand, cost pressures and revenue capacity across every major function of government, and it must be protected, not diluted.

But strengthening HFE requires more than technical refinement; it requires cultural renewal. The CGC once played a visible role in national policy debates, appearing before parliamentary committees, engaging with intergovernmental forums and contributing openly to public understanding of fiscal federalism. That presence built trust and legitimacy. Its withdrawal from those spaces has allowed simplistic and misleading narratives to take hold. A modern CGC must again be outward-facing — visible, engaged and willing to explain its reasoning in public. The Productivity Commission demonstrates what such an institution looks like: transparent, accessible and confident in its role. Equalisation deserves the same standard.

Reversing the 2018 amendments is therefore only the starting point. The pre-2018 system had weaknesses that must be addressed, not reinstated, and Australia must reject the simplistic indicator-based models that have been shown incapable of delivering genuine equalisation. The path forward is clear: restore the integrity of HFE, strengthen transparency, modernise institutional practice, and ensure the CGC once again plays an active national role in explaining how and why the system works. Reform should reinforce this national asset, not replace it with something that cannot do the job.

8.2 What the Productivity Commission Is Asked to Do

1. A Productivity Commission finding — reaffirming equalisation as a national commitment, grounded in evidence, supported by modern institutions, and capable of meeting the challenges of the decades ahead would itself strengthen the federation

9. CONCLUSIONS

Equalisation is not optional; it is a core pillar of national cohesion. It is the mechanism that ensures governments across Australia can deliver comparable services, regardless of their underlying fiscal capacity. Its authority derives from the CGC's comprehensive and empirically grounded data system — the only framework capable of revealing the true cost of service delivery across jurisdictions. Preserving and strengthening that system is a national imperative.

However, Australia's GST distribution system is under strain from structural revenue failure, widening vertical fiscal imbalance, and the accumulation of nationally driven costs that the CGC cannot reliably assess. These pressures have been allowed to build for decades. The 2018 Western Australia GST deal was a political settlement that weakened equalisation and should not be treated as a precedent. At the same time, the CGC's own Methodology Review makes clear that equalisation cannot absorb the consequences of national policy decisions, climate impacts, remote service obligations, national-capital functions or unique constitutional arrangements.

But the system cannot function effectively without cultural renewal inside the CGC. The Commission once had a strong public presence. That visibility built trust and legitimacy. Its withdrawal from those spaces has allowed misconceptions and simplistic narratives to fill the vacuum. Restoring an outward-facing CGC is essential to restoring confidence in equalisation.

The Productivity Commission now has the opportunity to address these structural issues directly. The solution is not to weaken equalisation, but to strengthen it by restoring GST adequacy, addressing vertical fiscal imbalance, and quarantining nationally imposed costs that lie outside the conceptual boundaries of HFE. In the ACT's case, a dedicated national funding mechanism for national-capital, cross-border and payroll-tax disabilities — operating alongside the existing Municipal Services payment — would restore balance and ensure that the Territory is not penalised for carrying responsibilities that serve the nation as a whole.

END