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Productivity Commission Inquiry into 2018 GST distribution reforms

Victorian Government Response

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1. Executive Summary

This submission responds to the Issues paper – GST distribution reforms released by the Commonwealth Productivity Commission (PC) on 21 November 2025 as part of its inquiry into the GST distribution reforms (the inquiry). The GST distribution reforms refer to the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (the Act).

Victoria's position in response to the issues paper is that the 2018 changes are inherently inequitable and must be repealed in favour of the former system of equalisation. The reforms do not achieve their stated aims and will leave states and their residents materially worse off after 2029-30, if the extension of the no-worse-off guarantee (NWOOG) is allowed to expire.

Victoria supports the principle of horizontal fiscal equalisation (HFE), whereby all Australians should be able to access the same standard of basic services regardless of their home state. The 2018 changes distort HFE, providing additional funding to Western Australia (WA) above the level the Commonwealth Grants Commission (CGC) as the independent arbiter recommends it requires, at the expense of all other states.

The result is that residents of WA can enjoy a higher standard of public services and contribute less to state revenues, while other states must contemplate how to manage a looming fiscal cliff through increasing their own revenue collections or reducing services and infrastructure investment. States have so far been shielded from these fiscal impacts by the NWOOG, set to expire after 2029-30.

It is clear the current system is not financially sustainable for states without the guarantee. Victoria has already received \$4.3 billion in NWOOG payments from 2021-22 to 2024-25, and the Commonwealth has paid \$14.6 billion in total to all states through the guarantee. Victoria's 2025-26 guarantee payment of \$1.9 billion is equivalent to funding the salaries of around 17,000 additional nurses, teachers or police officers.

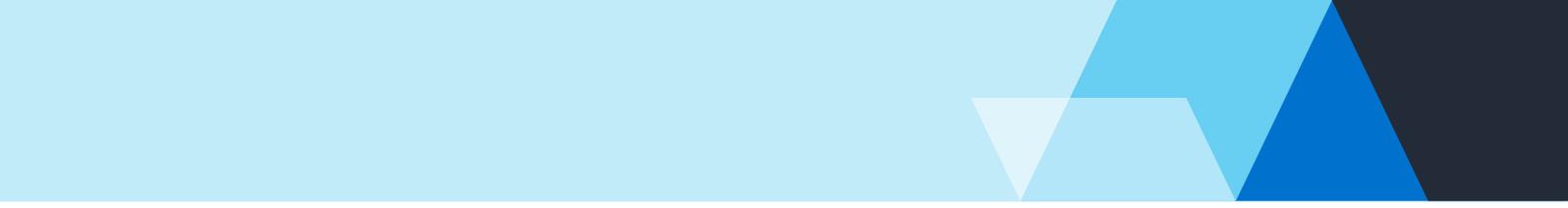
The 2018 changes were originally motivated by concerns that the former system of GST distribution was too volatile or disincentivised states from pursuing reforms. Victoria's submission shows these concerns were unfounded: there is minimal evidence that equalisation impedes states' budget management or policy effort.

Responding to the questions posed by the PC in its issues paper, Victoria's submission shows that the 2018 changes:

- Are fiscally unsustainable for states other than WA if the NWOOG is allowed to expire, risking leaving Australians in need short of essential services (Section 3).
- Do not deliver a reasonable level of equalisation, as they take away from states that need support to provide the wealthiest state, WA, funding it does not require (Section 4).
- Over-emphasised any issues with volatility in GST distributions and largely leave volatility unchanged for all states other than WA (Section 5).
- Have not encouraged any state efficiency or productivity reforms, and there is no practical or theoretical evidence that they will in future (Section 6).

At best, the reforms have not changed revenue predictability or reform incentives for all states except WA. At worst, they have introduced significant additional fiscal risks for all but the fiscally strongest state (WA) and have promoted no additional reform or economic development. And this comes at the cost of \$14.6 billion so far to the Commonwealth through the NWOOG.

In the absence of evidence of improved budget predictability for states or incentives for reform, the result of the 2018 changes so far has been to provide WA around \$6 billion in additional revenue each



year. This transfer represents a significant opportunity cost with demonstrable impacts to the Commonwealth's financial sustainability (or the states without the NWOG), with little to no demonstrated reward. Victoria considers there are alternative arrangements that would better achieve the desired outcomes of fairness, predictability and fiscal sustainability, the clearest of which is the former system, without the 2018 changes.

In evaluating potential alternatives, Victoria's primary concerns are that Commonwealth funding is distributed fairly between the states, in a way that is reasonably predictable. Victorians should receive Commonwealth funding sufficient to deliver a similar standard of services to the residents of other states, making similar contributions to their states' revenues. Commonwealth funding is a key revenue source for Victoria, noting that it has the lowest access to resources royalties of all states per capita and already makes significant effort to raise revenues from its other available sources.

Ultimately the Commonwealth can decide if it wishes to provide WA additional GST-related revenues, notwithstanding the opportunity costs and limited benefits. However, the other states should not bear that fiscal risk through the GST system or any other mechanism.

If the Commonwealth is committed to providing WA additional revenues, it should do so separately and outside the GST system. This would be more transparent than implementation through the GST system and would underpin the fiscal sustainability of the other states.

If the Commonwealth remains committed to the current system, then it must extend the NWOG in perpetuity. The loss of the guarantee would be a significant fiscal impact to states, potentially disrupting essential services and infrastructure.

2. Introduction

On 21 November 2025 the PC released an issues paper as part of its inquiry into the GST distribution reforms. The 2018 changes refer to the Commonwealth's 2018 legislation *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*. This submission is Victoria's initial submission to the inquiry and provides Victoria's response to the issues paper, and the Terms of Reference (ToR) issued by the Commonwealth Treasurer to the PC. Victoria thanks the PC for the opportunity to provide its views on this important issue.

The inquiry is a legislative requirement of the Act, which stipulates that the PC examine whether the Act is "operating effectively and as intended" and "the fiscal implications for each State, the Australian Capital Territory and the Northern Territory."

Following the Act, on 24 September 2025 the PC was issued ToR from the Commonwealth Treasurer to conduct the inquiry. The ToR direct the PC to investigate the operation of the 2018 changes, including:

- The extent to which they:
 - Deliver a reasonable level of equalisation.
 - Appropriately balance responsiveness, reducing volatility and providing certainty for states' fiscal planning.
 - Support states to pursue reforms, including to the efficiency of service delivery or revenue bases.
 - Are fiscally sustainable for the Commonwealth and states and territories.
- Whether alternative arrangements would better achieve some or all of these outcomes.
- The interaction between GST and other Commonwealth payments, and the principles for exempting payments from the CGC's assessments.

The ToR also state that the PC should include an assessment of implementation feasibility and risks, as well as being mindful of the Commonwealth's policy commitments in relation to the GST.

The issues paper from the PC poses five information requests for submissions, which correspond to the questions asked of the PC by the ToR.

In response to the issues paper and the ToR, Victoria's position is that the 2018 changes should be reversed. As demonstrated in this submission, the changes were unnecessary, failed to achieve their stated aims and leave states other than WA in an untenable fiscal position (if not for the NWOG).

This submission responds to the questions posed in the issues paper in turn. The submission commences by demonstrating that the 2018 changes would have an untenable fiscal impact on the states and would not be fiscally sustainable without the NWOG, see Section 3.

Section 4 shows the 2018 changes do not achieve a reasonable level of equalisation, as they leave the fiscally strongest state, WA, with more revenue than it requires to provide the same standard of services and infrastructure, while leaving the other states shortchanged.

Section 5 shows there was not a significant volatility issue from GST revenues for states, and that if the 2018 changes do improve predictability, it is only to benefit one state, WA.

Section 6 then demonstrates that the stated aim of promoting reform has not been achieved, and that equalisation does not have a material impact on states' incentives to undertake reform.

Responding to the question on whether alternative arrangements are preferable, and following an evaluation of possible alternatives, Victoria recommends the 2018 changes are repealed, and the former system reinstated (see Section 7). Victoria's view from its evaluation of possible alternatives is

that the former system provided the fairest level of equalisation, appropriately balanced volatility, did not practically limit states' reforms and was sustainable for all governments.

Finally, Section 8 responds to questions in the issues paper on how other Commonwealth payments should interact with the equalisation system. Victoria recommends the CGC continue to implement its existing approach to assessing Commonwealth payments, and that more information is provided when the Commonwealth Treasurer quarantines payments from that system.

2.1 Summary of the 2018 changes in practice

The inquiry is to review the changes made by the Commonwealth to the GST distribution and horizontal fiscal equalisation (HFE) systems in 2018 through the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* which amends the *Commonwealth Grants Commission Act 1973* and the *Federal Financial Relations Act 2009*.

Before the 2018 changes, the GST was distributed to achieve HFE. HFE aims to equalise the 'fiscal capacities' of the states, to ensure they have similar ability to provide services and infrastructure, given similar effort to raise revenues. Before the 2018 changes, and since being codified by the Commonwealth Fraser government in 1978, HFE aimed to provide each state the same capacity to provide services and infrastructure.¹

The CGC is annually tasked by the Commonwealth Treasurer to determine states' relative fiscal capacities and recommend a distribution of GST revenues. It does this by recommending 'GST relativities', which represent the proportion of a states' population share it should receive of the total pool of GST revenue.²

The 2018 legislation changed the distribution of GST revenues, essentially to limit HFE, leading to an end result where the strongest state, WA, retains a higher fiscal capacity than the others, which would have otherwise been shared under the former system. Specifically, the legislation changed the GST distribution system to:

- change the 'standard' of equalisation from lifting all states' capacities to a benchmark of the strongest state, to a lower standard of the higher of either Victoria or New South Wales (NSW)
- setting a minimum GST relativity of 0.75, such that any state with a lower calculated relativity (stronger fiscal capacity) would receive revenue as though its relativity were 0.75
- additional Commonwealth funding into the GST pool to be distributed between the states according to the relativities (the 'pool boost'), of \$600 million from 2021-22 and an additional \$250 million from 2024-25, indexed to growth in the GST pool
- a NWOG where the Commonwealth pays states separately if they are worse off under the 2018 changes compared to the previous approach, initially implemented from 2021-22 to 2026-27, but extended separately via an agreement to 2029-30.^{3, 4}

¹ Commonwealth Grants Commission (2023) Occasional paper 10, 90 years of the Commonwealth Grants Commission

² Commonwealth Grants Commission, *GST Relativities 2025–26*. Note, in practice the relativities are first multiplied by a states' population and then the share of this 'weighted population' is used to determine each states' share of the GST pool. This calculation differs slightly from directly multiplying a states' relativity to its population share as described.

³ Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018 - Federal Register of Legislation.

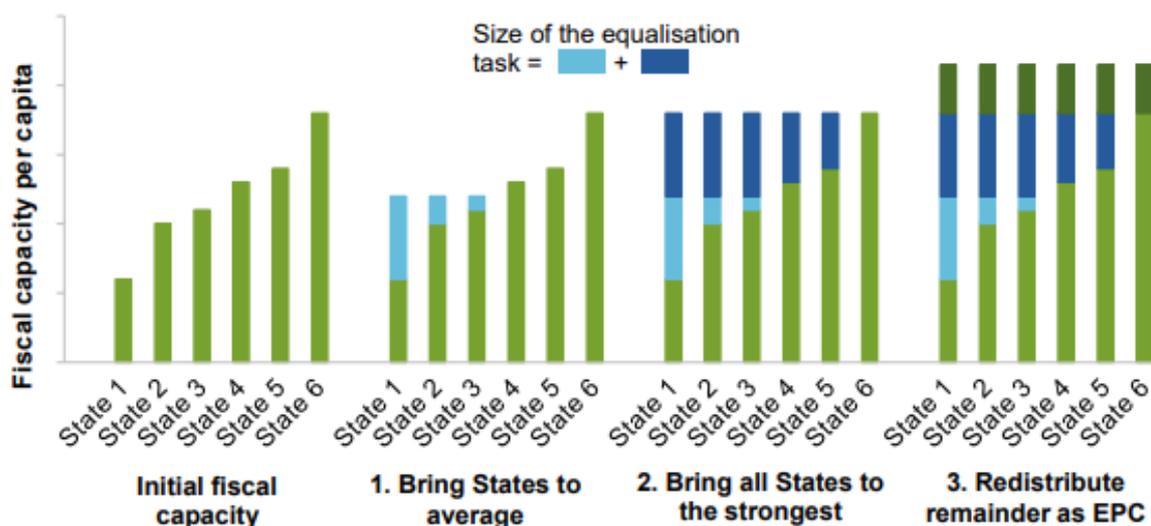
⁴ Commonwealth of Australia (2024) Extension of the GST No Worse Off Guarantee: Funding Agreement

The 2018 changes were implemented with a transition period from 2021-22 to 2026-27, where the new equalisation standard, relativity floor and pool boosts were gradually phased in.

The most significant change from the 2018 changes is the new equalisation standard, which effectively limits the contribution to HFE from any state stronger than Victoria or NSW. This has had a significant effect on the GST distribution since the 2018 changes were introduced (buffered in practice by the NWOOG), as – due largely to high commodity prices – WA has had a much stronger fiscal capacity than either Victoria or NSW.

In its previous inquiry into HFE completed in 2018, the PC provided a stylised example of how the former system operated, raising each state to the per capita fiscal capacity of the strongest state, before distributing the remainder of the GST pool equal per capita (EPC) (see Figure 1).

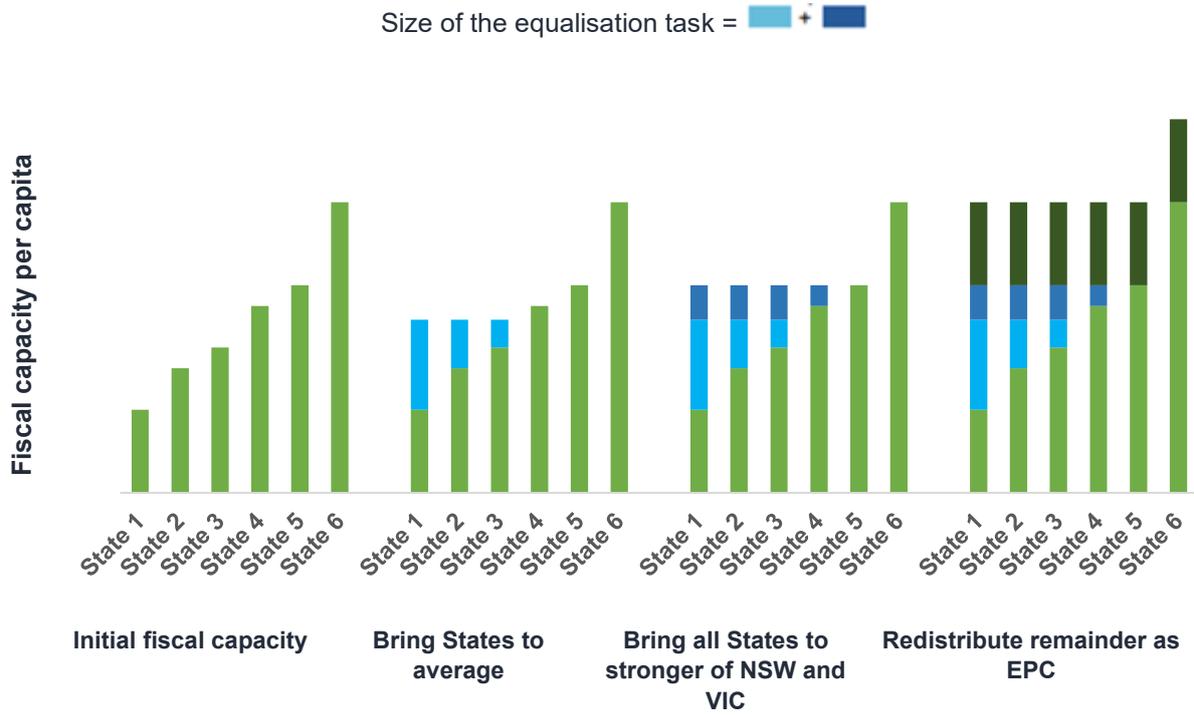
Figure 1: The stages of the former HFE process



Source: PC 2018, *Horizontal Fiscal Equalisation, Report no. 88, Canberra*

However, under the new system states have only been raised to the second strongest state's fiscal capacity. This means WA as the strongest state retains its fiscal advantage at the expense of all other states (see Figure 2). This has been compensated for by the Commonwealth's NWOOG, however this will currently expire after 2029-30. Section 4 of this submission demonstrates in more detail how the new system fails to achieve a reasonable level of equalisation by providing WA with more revenue than it requires.

Figure 2: The stages of the new HFE process



Source: Victorian Department of Treasury and Finance (DTF)

3. The 2018 changes are not fiscally sustainable

The 2018 changes would have had very large negative fiscal impacts for all states other than WA, if not for the NWOG. The Commonwealth and PC's original forecasts that all states would be better off have proven to be significantly inaccurate.

States rely on GST as a predictable, growing source of revenue to fund essential services and infrastructure. The 2018 changes will significantly reduce this funding for all states other than WA, putting the services Australians rely on at risk, as demonstrated in Sections 3.1 and 3.2.

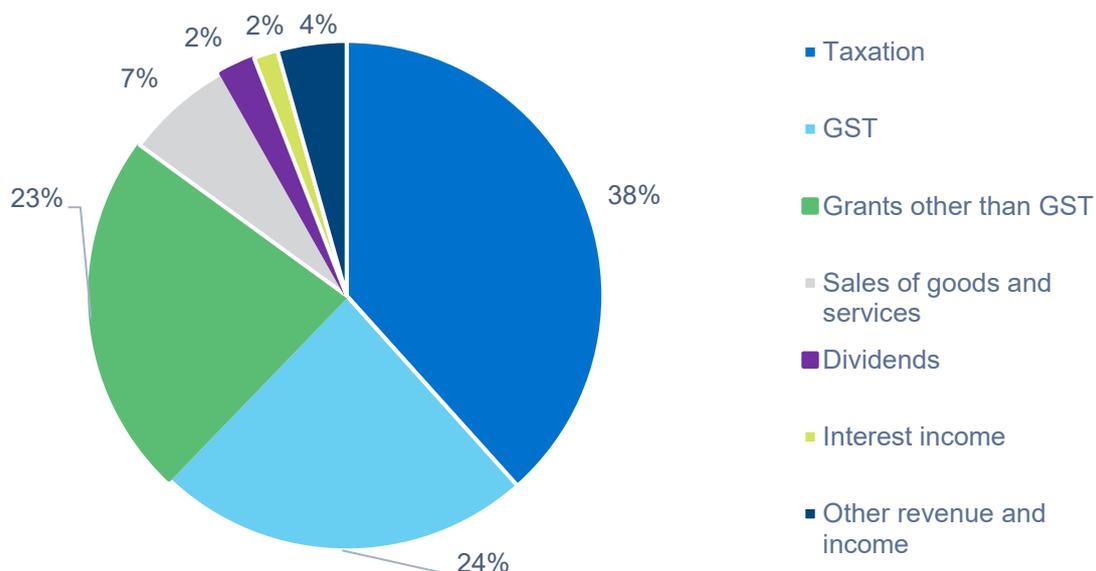
Victoria strongly urges the PC to recommend that the Commonwealth reverses the 2018 changes due to their untenable fiscal impacts - to states and the Commonwealth. Noting the significant costs of the guarantee to the Commonwealth, the sensible solution is to reverse or replace the 2018 changes and the need for a guarantee, as described further in Section 7. However, if the Commonwealth is committed to providing WA GST related additional revenues, it should do this outside the GST system and not compromise public services and infrastructure in the rest of the country.

3.1 Victoria relies on a fair share of GST revenue

GST makes up a significant proportion of each state's revenue. As shown in Figure 3, in 2024-25, GST comprised 24 per cent of total general government sector revenue for Victoria. GST is also untied which provides important budgetary flexibility for states, unlike other Commonwealth grants which are typically tied to specific service delivery responsibilities.

GST is essential to Victoria continuing to provide services and infrastructure to meet the needs of its growing population. Victoria requires a fair and certain share of GST revenue to deliver on its fiscal strategy, including delivering surpluses in 2025-26 and beyond, and reducing net debt as share of gross state product (GSP).

Figure 3: Victorian Government revenue sources, 2024-25



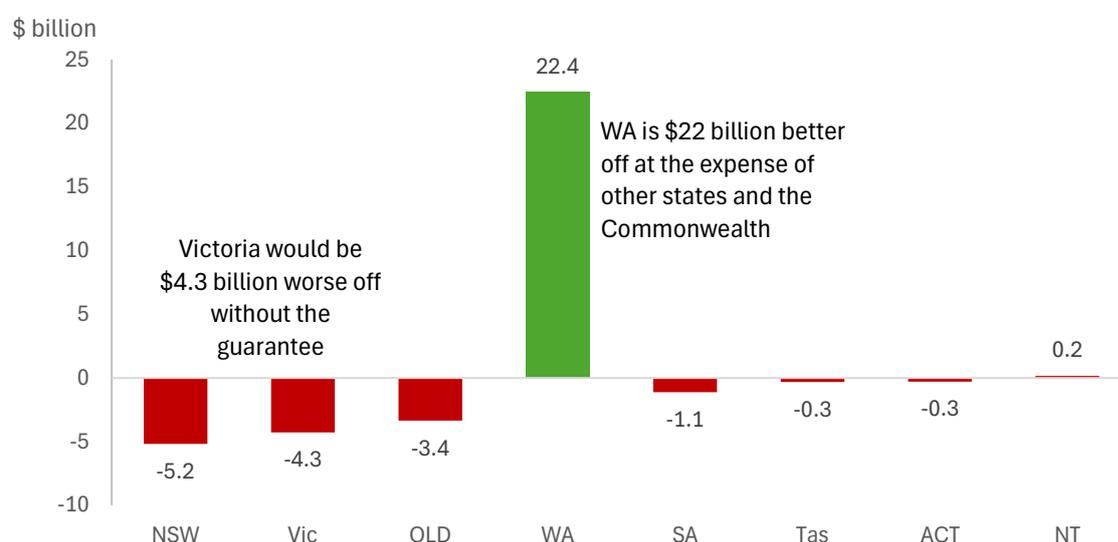
Source: Victorian 2024-25 Annual Financial Report

3.2 The loss of the NWOG would impact Victoria’s ability to deliver services and infrastructure

The 2018 changes would have left Victoria worse off every year they have been in place, if not for the NWOG. From 2021-22 to 2024-25, all jurisdictions except WA received NWOG payments, meaning that all except WA would have been worse off under the full implementation of the new system.⁵ This is due to the 2018 changes limiting WA’s contribution to equalisation, allowing it to retain its fiscal advantage at the expense of all other states (see Section 4.1).

Victoria has already received \$4.3 billion in NWOG payments from 2021-22 to 2024-25, and the Commonwealth has paid \$14.6 billion in total to all states.⁶ Since 2018-19, WA has benefitted from the 2018 changes by \$22.4 billion, including additional GST distributions and separate top-ups from the Commonwealth from 2018-19 to 2021-22.⁷ The NWOG payments indicate how much states would be worse off without the guarantee in place, shown in Figure 4.

Figure 4: Total Impact of GST reforms to states without the NWOG, 2018-19 to 2024-25



Source: Commonwealth FBOs

Note: The sum of the impacts to the other states and WA are not equal as the Commonwealth’s boost to the GST pool has partially offset the negative fiscal impacts on states from the 2018 changes, and WA and the NT also received additional separate Commonwealth payments from 2019-20 to 2021-22.

The Commonwealth’s most recent 2025-26 MYEFO indicates this will increase to a total of \$12.6 billion in NWOG payments to Victoria over the eight-year period from 2021-22 to 2028-29, and \$37.0 billion to all states over the 8-year period from 2021-22 to 2028-29 (see Figure 5).⁸ The 2025-26 NWOG payment of \$1.9 billion to Victoria is equivalent to the salaries of around 17,000 additional nurses, teachers or police officers.

⁵ Commonwealth Final Budget Outcomes (FBOs), 2021-22 to 2024-25

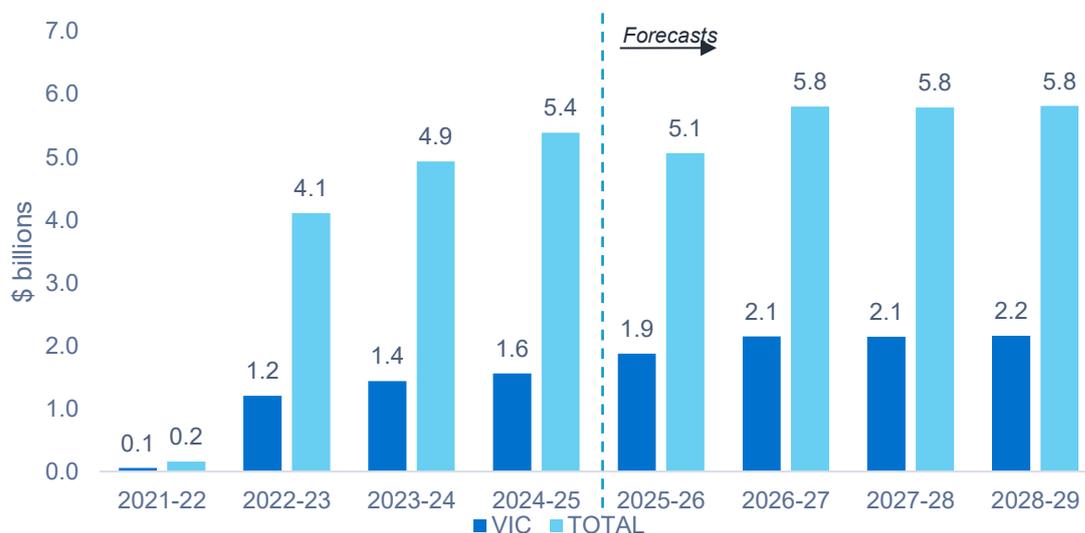
⁶ Ibid

⁷ Commonwealth FBOs 2019-20 to 2024-25, CGC annual update and methodology review reports.

⁸ Mid-Year Economic and Fiscal Outlook | Budget 2025–26

It should be noted the eight-year period considered (from Victoria's first NWOG payments in 2021-22 to the end of the forward estimates in 2028-29) includes years in the transition to the full 2018 system, under which Victoria was not fully exposed to the effects of the 2018 system as described in the Act. NWOG payments would have been higher in these years under the full new system.

Figure 5: Commonwealth reported NWOG payments to Victoria and all states, actuals and forecast

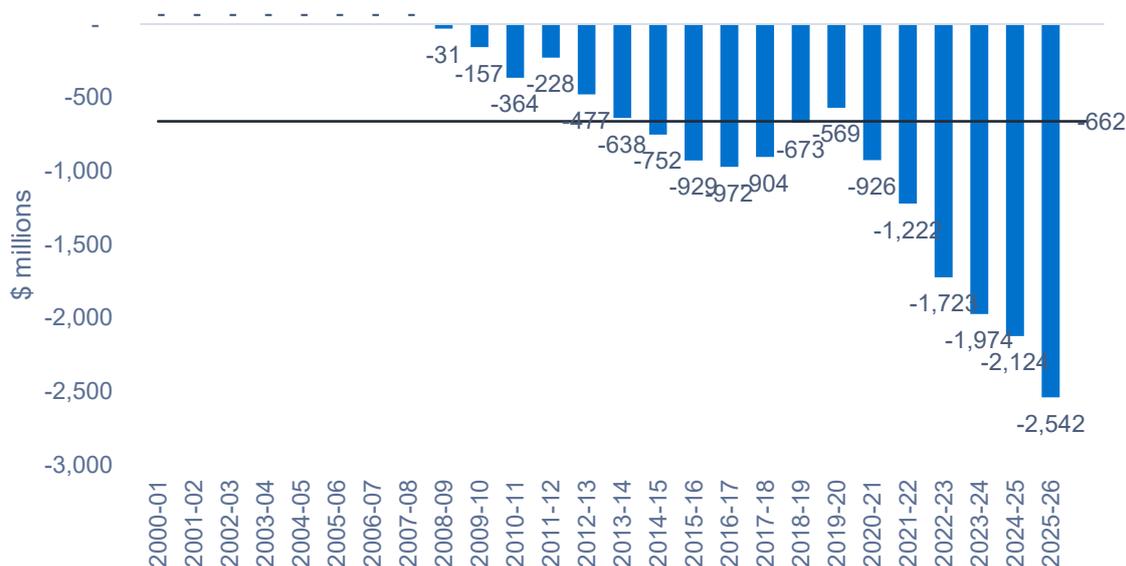


Source: Commonwealth 2025-26 MYEFO, FBOs 2021-22, 2022-23, 2023-24 and 2024-25

Figure 6 shows what would have been the impact to Victoria if the current system was fully in place every year since the introduction of the GST in 2000-01. The current system would have had no impact until WA became the strongest state in 2008-09. Every year since, Victoria would have been worse off under the new system – 18 of the 26 years of the GST's operation.

Including the years where there would have been no impact, Victoria would have lost on average \$662 million per year from the new system (in nominal terms, not adjusted for inflation). The average total impact of the new system on states other than WA would have been a loss of \$2.2 billion a year over that period. Figure 6 displays a strong increase in the negative impacts of the system to Victoria over time, driven largely by growth in WA's iron ore royalties.

Figure 6: Difference between current and former systems for Victoria, if fully applied in all past years



Source: CGC annual update reports, DTF calculations

If the new system is to continue unchanged, without the guarantee, Victoria is at significant risk of losing GST revenue compared to what the CGC recommends it needs.

Box 1: Stakeholder views on the fiscal impacts to Victoria from the 2021 Victorian Parliamentary Inquiry into Commonwealth support for Victoria

Victoria’s Parliamentary Economy and Infrastructure Committee held an inquiry into Commonwealth support for Victoria in 2021, which considered the 2018 GST changes extensively. The inquiry heard from independent experts and representatives of interest groups who warned of the adverse fiscal impacts to Victoria from the Commonwealth’s changes. These included:

- Saul Eslake: “Inevitably that will mean, unless something changes between now and then, that Victorians will experience a reduction in the amount of spending on public services or have to pay higher state taxes and charges or some combination of those two and possibly incur bigger state budget deficits.”⁹
- Chris Murphy: “it would put Victoria in a worse fiscal position than would be efficient ... Victoria would not be able to offer the same kinds of services. It would have to raise more taxes than would optimally be the case ... in the longer run the effects are more to do with people moving. So if services are not as good or taxes are higher, some people are likely to move to other states where they can get a better fiscal deal. So while in the short term ... there are inequity issues—in the longer term there are also economic efficiency issues in that people will no longer be in the states in which they can make the most economic contribution, because their state government’s

⁹ Mr Saul Eslake, Economist and Principal, Corinna Economic Advisory, public hearing for the Victorian Parliamentary Economics and Infrastructure Committee Inquiry into Commonwealth Support for Victoria, Melbourne, 10 December 2021, Transcript of evidence, p. 9.

budget has been artificially penalised, so the state is not [in] a position to offer the services that it should be able to offer.”¹⁰

- Emma King, CEO of Victorian Council of Social Service (VCOSS): “I note that based on the current forecasts DTF estimates that Victoria will be \$4.5 billion worse off under the new system over the budget and forward estimates period without the no-worse-off guarantee. So I think it is pretty hard to categorise that in any other way than catastrophic, really—the notion that we could get by with such a significant reduction in income and think that that will not have an impact across the whole of our society wherever you look. At the end of the day when there are cuts or when there are disasters like we have just seen, we know that people who are on low incomes and who are poor and who are disadvantaged are impacted the first, the hardest and the longest. And if that much money is going to come out of our system, it is hard to see how we will not have more Victorians that are actually going to be reliant on welfare and on social assistance and who are living in poverty. And it is hard to see how frontline organisations are actually going to receive the funding and the support et cetera that they need to be able to deliver for the most vulnerable in our communities. The only way I can describe it is it would be genuinely catastrophic.”¹¹
- Win Scott, Chair of Mallee Regional Partnership, with statements summarised in the Committee’s final report as follows: “Regional Victorians will also be affected by a reduction in GST revenue, according to Ms Win Scott, Chair of the Mallee Regional Partnership, which is one of nine partnerships in Victoria that act as a voice for their regions and advise the Victorian Government on regional priorities. Less funding for the regions would result in pressure to rationalise or withdraw services. If services are withdrawn, particularly in smaller regional centres, there would be a negative impact on employment, population growth and town viability, which would result in fewer visitors, investors and new residents in these areas.”¹²
- Mr Dylan Broomfield, General Manager of Policy and Advocacy at the Victorian Chamber of Commerce and Industry, which represents and supports Victorian businesses, the loss of GST revenue: “has significant implications which in turn impact business, either through the State Government having to increase taxes, such as we saw with the mental health levy, or the level of spending on infrastructure not being as high as it could be, which in turn presents significant challenges for businesses not being able to get as great access as they otherwise would be able to.”¹³

3.3 Limits on Victoria’s fiscal capacity

Victoria’s fiscal capacity is already constrained due to its natural inability to raise mining royalties, and managing the fiscal cliff from the expiry of the NWOG would require decisions that undermine Victorians’ wellbeing. Without a fair share of GST revenue, states have three possible courses of action:

¹⁰ Mr Chris Murphy, Economist and Visiting Fellow, Australian National University, public hearing for the Victorian Parliamentary Economics and Infrastructure Committee Inquiry into Commonwealth Support for Victoria, Melbourne, 10 December 2021, Transcript of evidence, p. 22.

¹¹ Ms Emma King, Chief Executive Officer, Victorian Council of Social Service, public hearing for the Victorian Parliamentary Economics and Infrastructure Committee Inquiry into Commonwealth Support for Victoria, Melbourne, 15 December 2021, Transcript of evidence, p. 32

¹² Committee Final Report, Inquiry into Commonwealth Support for Victoria, Legislative Assembly Economic and Infrastructure Committee, Parliament of Victoria, 10 March 2022, p. 18 .

¹³ Mr Dylan Broomfield, General Manager, Policy and Advocacy, Victorian Chamber of Commerce and Industry, public hearing for the Victorian Parliamentary Economics and Infrastructure Committee Inquiry into Commonwealth Support for Victoria, Melbourne, 15 December 2021, Transcript of evidence, p. 24.

- Increase state taxes – many of which have a higher marginal excess burden than Commonwealth taxes. The higher marginal excess burden would mean that every dollar of state taxes raised to make up for the loss of the NWOG would impose an additional deadweight loss on the Australian economy (see Figure 8).
- Lower expenditure – which reduces the wellbeing of people relying on services such as health, education, policing and emergency management, and causes economic harm by limiting development and maintenance of infrastructure to support a growing population, such as by enabling movement of people and goods.
- Increase debt – which increases borrowing costs and reduces the ability of states to provide services in the future.

States raised the risk of needing to increase their own revenues or reduce spending with the Commonwealth Treasurer during negotiations to extend the NWOG in 2023. In a communique following a meeting of the Council on Federal Financial Relations from 1 December 2023, the Board of Treasurers noted “Without the Guarantee, the Commonwealth will be fully responsible if states and territories are forced to consider a new tax or levy to ensure essential services are not compromised or reduced.”¹⁴

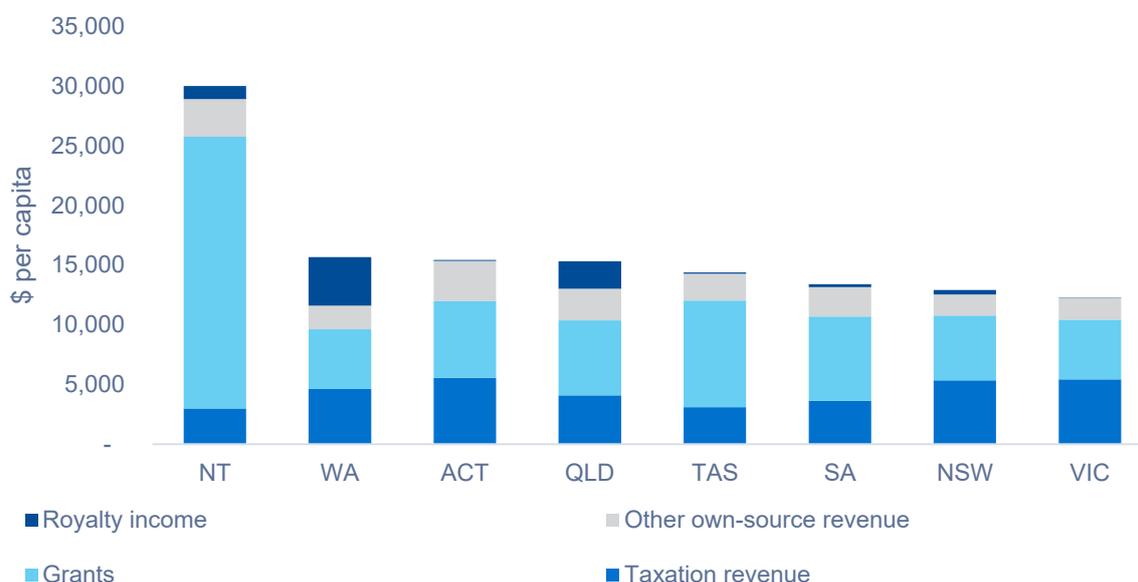
In the 2018 Inquiry, the Minerals Council of Australia (MCA) noted on the potential revenue losses to other states: “Such large fiscal impacts are likely to result in states raising taxes to address the deterioration in their fiscal position. The MCA submits that further analysis of the effects on the proposed reform on state economies, and any subsequent tax increases, is required.”¹⁵

If the NWOG expires, and Victoria does not receive its fair share of GST revenue, it is more constrained than other states due to its lack of mineral resources and other Commonwealth grants. According to the Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS), Victoria has had the lowest total revenue per capita of all states over the 10 years to 2023-24, shown by Figure 7. Considering only the states, WA has had the highest total revenue per capita. Victoria’s low total revenue is driven in part by receiving the lowest royalties per capita, but also the second lowest Commonwealth grants of all states.

¹⁴ https://www.treasury.sa.gov.au/__data/assets/pdf_file/0009/965511/Communique-BOT-Post-CFFR-1-Dec-2023.pdf

¹⁵ [Submission DR82 - Minerals Council of Australia \(MCA\) - Horizontal Fiscal Equalisation - Public inquiry](#)

Figure 7: Average state revenue per capita by source, 2014-15 to 2023-24



Source: ABS GFS

Victoria has historically been a net contributor to the federation in terms of Commonwealth support, receiving less than its population share of Commonwealth payments. This includes Victoria’s contribution to HFE through the GST, as Victoria has received around \$31 billion less than its population share of GST revenue since the GST was introduced, subsidising other states that receive more. In the recent Independent Review of the Victorian Public Service, Helen Silver AO noted

“Commonwealth funding in key areas has been below Victoria’s population share over a number of years, and uncertainty around future funding arrangements, such as hospital funding and the no-worse-off GST guarantee, represent key fiscal risks to the state. Uncertainty directly impacts the state budget and the delivery of core services.”¹⁶

Victoria has also not received its fair share of Commonwealth infrastructure funding, with the amount of federal funding received falling far short of the state’s share of the national population.

Victoria’s share of total infrastructure funding outlined in the 2025-26 MYEFO was 22.3 per cent over five years, compared with a population share of 25.7 per cent, after accounting for the estimated Commonwealth equity contributions to the Western Sydney Airport and the Melbourne Intermodal Terminal Package.

Over the past 10 years, from 2015-16 to 2024-25, Victoria has received around \$11.0 billion less than its population share of infrastructure funding – \$12.7 billion instead of \$23.7 billion. Over the same period, NSW has received about \$2.8 billion more than its population share of infrastructure funding – \$32.0 billion instead of \$29.3 billion.¹⁷

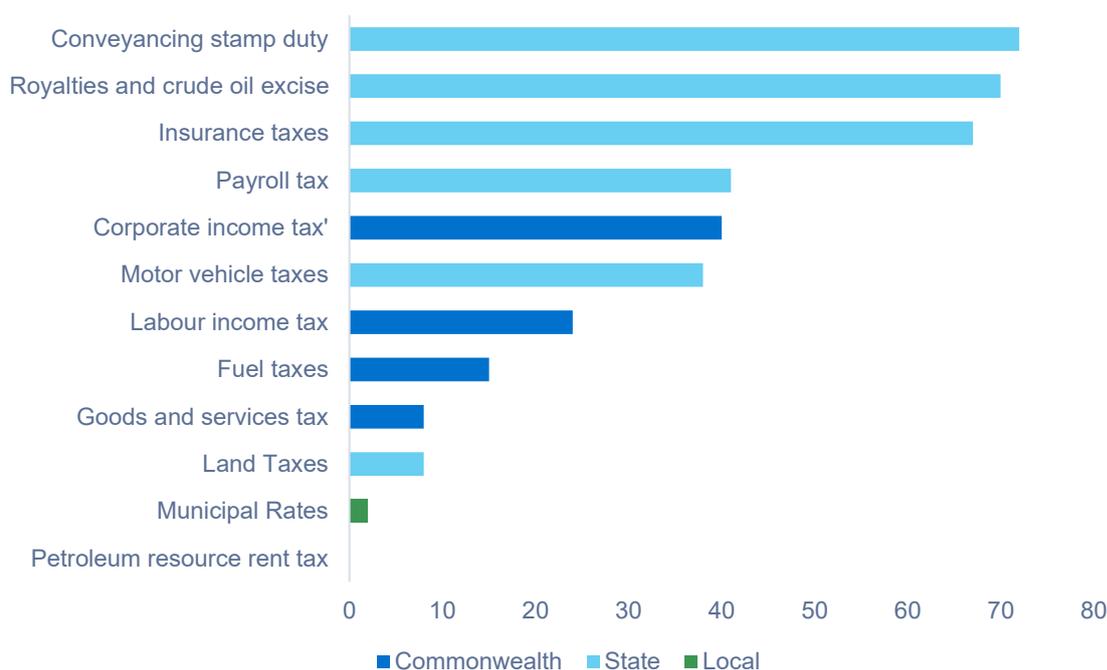
¹⁶ Government of Victoria (2025). Independent Review of the Victorian Public Service, Final Report.

¹⁷ Commonwealth FBOs, 2015-16 to 2024-25, ABS Demographic Statistics

Victoria has undergone significant policy effort to raise revenue from more efficient sources, however, it is severely limited by the vertical fiscal imbalance (VFI) in Australia. The constitutional challenges to raising additional state revenue were demonstrated in the recent decision by the High Court of Australia in *Vanderstock v. The State of Victoria (2021)*¹⁸ to overturn Victoria's electric vehicles charge, which further limits its scope for new revenue sources.

GST is a relatively efficient tax, compared to other sources available to states. The Commonwealth Parliamentary Budget Office (PBO) compared the marginal excess burden (the number of cents per each dollar of revenue lost to administration costs and distortions in economic activity) of Australian taxes (Figure 8) and found the GST was among the most efficient, ahead of states' other main revenue sources including conveyance duties, insurance, payroll and motor vehicle taxes.¹⁹

Figure 8: Marginal excess burden (cents per additional dollar) for selected taxes



Source: Commonwealth Parliamentary Budget Office (2024). *Australia's Tax Mix*, page 25

The GST has not kept pace with growth in the national economy as originally intended, further exacerbating the impacts of the 2018 changes on Victoria's fiscal capacity. In outlining the proposed tax changes to introduce the GST in 1998, the Howard Government contended that the GST would provide states with access to "a *secure and growing* source of revenue and the capacity in the medium to long term to allocate additional funding for services, such as health and education"²⁰ (emphasis added). However, in its Structural Trends in GST report (2020), the Commonwealth Parliamentary Budget Office (PBO) documented a decline in the GST to GDP ratio since 2000, from nearly 4 per cent of GDP in 2003-04 to 3.3 per cent in 2018-19.²¹

¹⁸ *Vanderstock & Anor v. The State of Victoria (2021)* High Court of Australia, Case M61/2021

¹⁹ Commonwealth Parliamentary Budget Office (2024). *Australia's Tax Mix*, page 25

²⁰ The Commonwealth of Australia (1998). *Tax reform; not a new tax, a new tax system 1998*, White Paper.

²¹ Commonwealth Parliamentary Budget Office 2020, *Structural Changes in GST*, Report no. 02/2020, Canberra. p.2

The PBO identified several trends which are likely to see it decline further, including higher growth in spending on GST-exempt items such as healthcare and basic food, compared to included items. The PBO found that from the introduction of the GST to 2018-19 spending on exempt items doubled, while spending on included items increased by only 50 per cent. When the size of the total pool is not keeping pace with growth in the economy, let alone state expenditure, it is unreasonable to expect states to also absorb the impact of receiving less than their fair share of the GST.

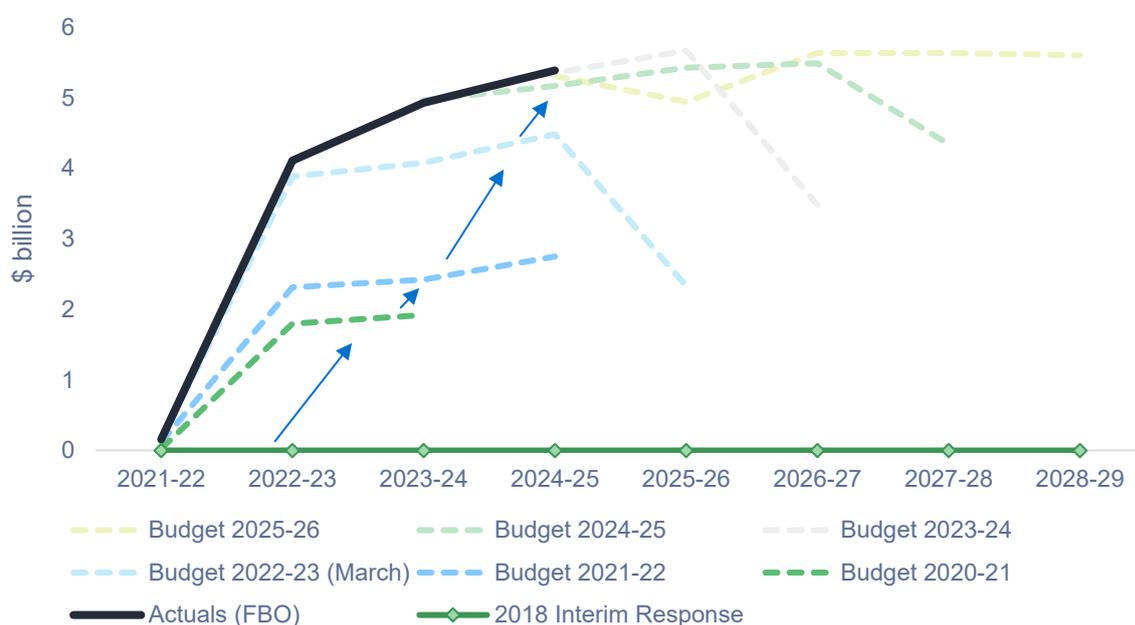
3.4 Current arrangements have fallen well short of HFE and are likely to continue, despite the Commonwealth's previous forecasts

The current GST allocation for each state except WA is less than what the CGC assesses it would need to be able to deliver the same standard of services, while WA receives significantly more than it needs (see Section 4). This falls well short of the principle of HFE, and if this continues, the Commonwealth risks breaking its commitment in 2018 that all states would be better off under the 2018 changes.²²

Point estimates of the impacts of the 2018 changes have proven inaccurate. Commonwealth budget publications have consistently underestimated the fiscal impacts of the NWO (see Figure 9). Based on initial forecasts in its interim response to the previous PC inquiry, the Commonwealth originally suggested states other than WA would be better off from the 2018 changes, yet it has paid \$15 billion in NWO payments to date. Forecasts in the Commonwealth's subsequent budget publications were likely to be inaccurate by design as they are based on a technical assumption that the relativities for the budget year will be constant through the forward estimates. The impacts of the 2018 changes are difficult to forecast out as far as the end of the NWO in 2029-30 and are subject to a low degree of confidence.

²² The Commonwealth of Australia (2018) Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response, page 2

Figure 9: Commonwealth annual NWOG payment forecasts (total of states)



Source: Commonwealth Budgets 2020-21 through 2025-26 and FBOs 2020-21 through 2024-25 and the Government interim response to the PC inquiry into HFE from 5 July 2018.

Since the 2018 changes were introduced, there have been several attempts to forecast or model their impacts using different approaches (see Table 1). All except the Commonwealth's interim response forecast the need for NWOG payments.

Table 1: Past estimates of total NWOG Payments

PUBLICATION	YEAR	APPROACH	TOTAL NWOG PAYMENTS (\$ MILLION)				
			Time period	Years	Low	Average	High
1 Commonwealth Interim Response to the PC Inquiry into HFE ²³	2018	Point estimate	2021-22 to 2024-25	4		0 ^a	
2 Victorian Submission to Commonwealth Senate Inquiry ²⁴	2018	6 scenarios, assumed relativities	2026-27	1	267	1 723	4 391
3 Commonwealth Budget 2021-22	2021	Point estimate	2021-22 to 2024-25	4		7 607 ^a	
4 Tasmania, Occasional Paper ²⁵	2021	Point estimate	2021-22 to 2031-32	10		755 ^b	
5 Victorian Submission to Victorian Parliamentary Inquiry ²⁶	2021	6 scenarios, assumed relativities	2027-28	1	189	1 631	3 864

²³ The Commonwealth of Australia (2018) Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response, page 21

²⁴ Victorian Government (2018) Submission to Senate Economics Legislation Committee Inquiry on the provisions of the Treasury Laws Amendment

²⁵ DTF, Tasmanian Government (2021) Occasional Paper: New GST distribution arrangements.

²⁶ Victorian DTF (2021) Inquiry into Commonwealth Support for Victoria.

PUBLICATION	YEAR	APPROACH	TOTAL NWOOG PAYMENTS (\$ MILLION)				
6 Australian Capital Territory (ACT) Submission to Victorian Parliamentary Inquiry ²⁷	2021	3 scenarios, assumed relativities	2021-22	1	2 629	3 108	3 463
7 South Australia (SA) Submission to Victorian Parliamentary Inquiry ²⁸	2021	Point estimate	2027-28	1		300 ^{a, c}	
8 Commonwealth MYEFO 2021-22	2021	Point estimate	2021-22 to 2024-25	4		7 848 ^a	
9 Commonwealth Budget 2022-23	2022	Point estimate	2022-23 to 2025-26	4		14 771 ^a	
10 Commonwealth Budget 2023-24	2023	Point estimate	2023-24 to 2026-27	4		19 413 ^a	
11 Commonwealth MYEFO 2023-24	2023	Point estimate	2023-24 to 2026-27	4		19 399 ^a	
12 Commonwealth Budget 2024-25	2024	Point estimate	2024-25 to 2027-28	4		20 420 ^a	
13 Commonwealth MYEFO 2024-25	2024	Point estimate	2024-25 to 2027-28	4		21 126 ^a	
14 Commonwealth Budget 2025-26	2025	Point estimate	2025-26 to 2028-29	4		21 811 ^a	
14 Commonwealth MYEFO 2025-26	2025	Point estimate	2025-26 to 2028-29	4		22,468	
15 Saul Eslake ²⁹	2024	Point estimate	2018-19 to 2028-29	11		39 800 ^a	
16 Chris Richardson ³⁰	2024	Point estimate	2018-19 to 2028-29	11		50 000 ^{a, d}	

Notes:

- Figure is a single published estimate, not an average
- Payment is to Tasmania only
- Payments to South Australia only
- Approximate figure only.

3.5 Even with the NWOOG, additional payments to WA can hurt the other states

The changes were initially only able to be legislated once the guarantee was added. A permanent guarantee is the minimum Victoria can accept if the 2018 system is to continue. The initial time limitation on the guarantee had been revealed to be a mistake, as evidenced by the decision to extend it further by National Cabinet in 2023.

The time limit was also at odds with the Commonwealth's statements at the time of the reform's introduction, which implied an enduring improvement to the system and equalisation. For example, the Prime Minister at the time Malcolm Turnbull stated that the 2018 changes would "ensure that all

²⁷ ACT Government (2021) Victorian Parliamentary Inquiry into Commonwealth Support for Victoria.

²⁸ Government of South Australia (2021) Victorian Legislative Assembly Economic and Infrastructure Committee, Inquiry into Commonwealth Support for Victoria

²⁹ <https://www.sauleslake.info/the-wa-gst-deal-the-worst-public-policy-decision-of-the-21st-century-thus-far-address-to-the-national-press-club/>

³⁰ https://www.linkedin.com/posts/chris-richardson-0086441b6_beyond-comprehension-was-gst-deal-to-activity-7162900137948696578-1saF

states are treated fairly and that no state is worse off.”³¹ Similarly, the Commonwealth Finance Minister at the time, Matthias Cormann, described the 2018 changes as “fairer for WA in a way that is good for the country... because it leaves every state and territory better off.”³²

The NWOG has been essential to ensure states other than WA haven’t faced a significant fiscal cliff since the introduction of the 2018 changes. However, even if extended in perpetuity to protect the other states, it maintains a significant cost for the Commonwealth and transfer to WA.

Victoria notes the Commonwealth ultimately has discretion over the extent of its funding support for WA. However, it should not disadvantage the other states and add unnecessary complexity and distortions to the longstanding system of HFE. It would be preferable if the Commonwealth provided this additional funding directly to WA, outside the GST system, if it is committed to providing this extra support. Victoria’s full analysis of alternative systems is provided at Section 7 and Appendix A.

In the context of this inquiry, the PC should also consider the overall impacts of the 2018 changes in the best interests of Australia overall. Additional transfers to WA relating to its GST share, either directly from the Commonwealth or from the other states may lead to worse economic, productivity and fiscal outcomes for Australia overall.

Any GST related transfer to WA, through the NWOG or otherwise, is a significant cost to the federal budget. The Commonwealth currently incurs a significant opportunity cost through the NWOG, effectively spending \$6 billion a year of Australian taxpayers’ funds on the transfer to WA. To the extent these additional fiscal resources translate into new government spending in WA, they also risk adding inflationary pressure to the WA and national economies. The same resources could be directed to other high-priority Commonwealth programs with demonstrated need and impact, or to improve the Commonwealth’s fiscal position.

This puts pressure on the Commonwealth’s ability to provide other grants to states, and engage in negotiations around agreements. Even with the Commonwealth’s initial commitment that the NWOG would not impact other grants to states, it is not possible for the Commonwealth to bear the significant unexpected cost of the NWOG without other fiscal ramifications and opportunity cost.³³

This additional cost must be funded through:

- Higher Commonwealth taxes – which has economic and welfare impacts on Victorians
- Lower Commonwealth expenditure – which reduces the wellbeing of Victorians relying on Commonwealth-funded services, infrastructure, and transfer payments
- Increased Commonwealth debt – which increases borrowing costs, and puts pressure on Victorians to contributing to Commonwealth revenues, including Commonwealth taxes.

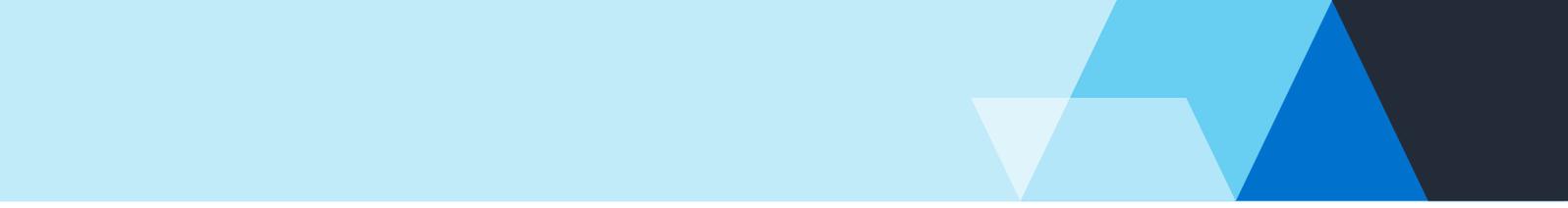
At a time when ratings agency S&P has advised that Australia’s AAA credit rating may be at risk from increasing debt levels and structural deficits,³⁴ there is limited fiscal capacity to justify measures that

³¹ <https://www.theguardian.com/australia-news/2018/jul/02/malcolm-turnbull-makes-gst-pledge-no-state-will-be-worse-off>

³² <https://www.abc.net.au/news/2018-11-14/gst-explainer-how-will-wa-spend-its-windfall/10493500>

³³ The Commonwealth Treasurer sent letters to state Treasurers noting “Any additional financial assistance referred to in the bill will not be offset or partially offset by a decrease in other grant funding to the states”, as tabled in the Australian Parliament and noted through the Commonwealth Senate Inquiry. See: https://www.aph.gov.au/-/media/Committees/economics_ctte/TLABFairShareofGST/d01.pdf; and https://www.aph.gov.au/Parliamentary_Business/Hansard/Hansard_Display?bid=chamber/hansards/8a611160-5451-4f48-bcda-57b8b94c6bee/&sid=0021#:~:text=That%20the%20letter%20from%20the,%E2%80%A6%20%E2%80%A6%20%E2%80%A6

³⁴ Australia’s AAA rating not at risk right now, but deepening debt a problem, says S&P, ABC News, 29 April 2025



further enhance the financial position of WA, the strongest state. Any downgrading of Australia's credit rating would make it less affordable to fund government programs and infrastructure projects.

4. The 2018 changes do not deliver a reasonable level of HFE

The 2018 changes effectively provide WA with a significantly higher fiscal capacity per person than the other states, and more than the independent arbiter the CGC calculates it needs to deliver the same level of services as the other states (see Section 4.1).

In Victoria's view, the 2018 changes therefore do not deliver a reasonable level of HFE, providing more resources to WA than it requires, subsidised by all the other states.

Any defence of the 2018 changes must demonstrate the policy rationale for why WA should receive an extra \$6 billion a year, funded by the Commonwealth taxpayer or the other states. To justify the new system, this must also be above and beyond what the CGC already accounts for, including the costs of developing and regulating the mining industry and supporting remote communities.

Victoria's view is that such a case cannot be made, and there is limited to no justification for this transfer. The potential for theoretical efficiency gains canvassed by the PC in 2018 would not be sufficient grounds for a \$6 billion annual expense in any other portfolio.

4.1 States no longer receive enough revenue to provide the same standard of services

The result of the new system for the foreseeable future is to advantage WA at the expense of the other states. This is because WA has been, and is expected to continue to be, the fiscally strongest state. The two key features of the new system, the relativity floor and new standard of equalisation, raise WA's relativity far above what it would be under the former system, at the expense of other states. As the GST pool is fixed, any increase in WA's entitlement comes at the expense of the other states.

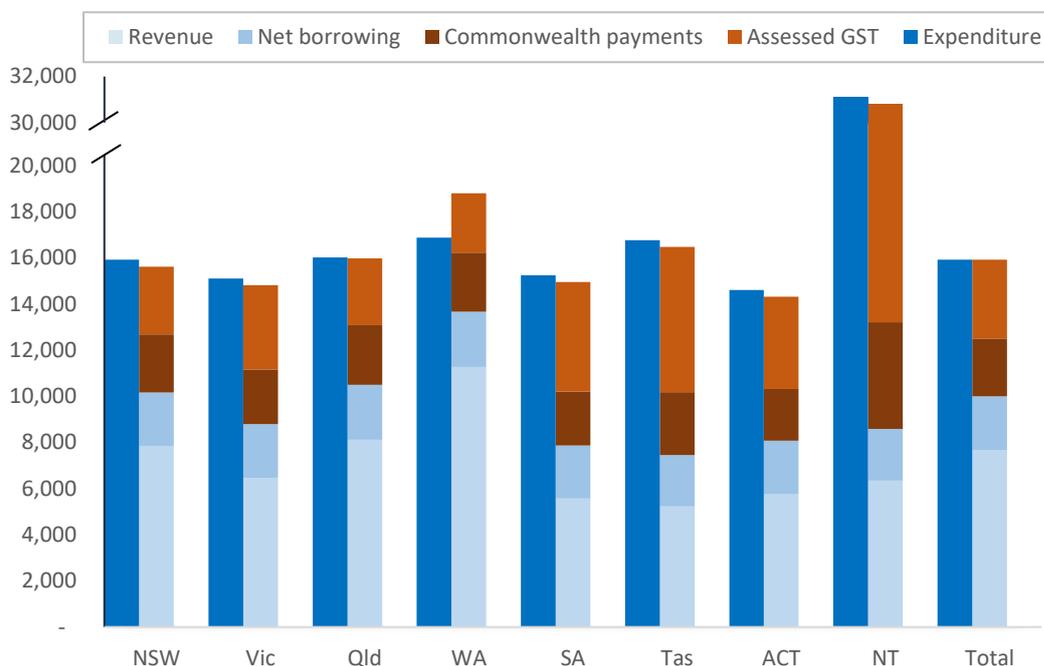
This means that under the new system, all states other than WA receive less revenue than the CGC determines is required to provide the same standard of services and infrastructure. In its GST Relativities 2025-26 report, the GCC noted: "Under the GST distribution legislation, Western Australia's relativity was increased to the floor of 0.75, lowering the GST shares of the other states. Western Australia is estimated to receive \$6 billion in additional GST payments in 2025–26 than under the previous GST distribution arrangements."³⁵

Figure 10 shows WA receives higher revenues than its required expenses, under the CGC's assessments, whereas all other states do not have sufficient revenues to meet their expenses.

The new system therefore allows for material differences in states' fiscal capacities to persist, disadvantaging the residents of certain states over others through inadequate funds to deliver services and infrastructure at a nationally consistent level.

³⁵ Commonwealth Grants Commission (2025). GST sharing relativities, 2025-26, page 11

Figure 10: CGC assessed fiscal capacities and GST requirements of states and territories, 2025-26 (dollars per capita)



Source: CGC, *GST Sharing Relativities 2025-26*, p64

The 2018 changes fundamentally do not provide a reasonable level of equalisation as they take significant revenues from all other states to provide more to the fiscally strongest state, which has the least need for this additional funding. Since 2018, WA has had the highest operating surpluses of all the states and its surpluses are projected to be greater than the surpluses of all other states over the budget and forward estimates. Since 2018, WA has received \$22.4 billion in redistributions or Commonwealth top-ups under the new system, and in the same period it has amassed cumulative operating surpluses of \$28.1 billion.

In contrast, the budget results of the other states across this period were a cumulative operating deficit, further revealing WA's relative fiscal strength and the negative impact of the 2018 changes on equalisation.

The significance of the 2018 changes to state finances has been recognised by the credit ratings agencies. WA is the only state with the top rating from ratings agencies Moody's and S&P³⁶, linked to its favourable GST treatment. When WA regained its AAA ratings from S&P and Moody's in 2022 and 2023 respectively, the agencies explicitly noted its GST distributions were a contributing factor:

- In 2022 it was reported that S&P noted that WA was "benefiting from elevated royalty revenues – without the previous downside of lower federal grants, thanks to the 2018 reforms to Australia's horizontal fiscal equalisation system – and growth in tax receipts".³⁷
- In 2023 it was reported that Moody's noted "Nevertheless, Moody's expects the broader Australian economy to represent the largest single source of budgetary revenue (39 per cent

³⁶ States are 'spending like they're in lockdown', S&P warns, *Australian Financial Review*, 15 January 2026 and *Moody's reaffirms Western Australia's AAA credit rating | Western Australian Government*

³⁷ AAA rating restored to 'powerhouse' WA. *Australian Financial Review*, 28 January 2022

in 2023-24 financial) for Western Australia, through goods and services tax (GST) distributions and other Commonwealth grants and transfers."

More recently, S&P was reported stating that "The GST reforms in 2018 were hugely beneficial to Western Australia, so it's getting a lot more grant revenue than it would have under the pre-2018 regime".³⁸

4.2 The former system worked to deliver HFE

The former system was the result of over a century of evolution, from the first ad hoc 'special grants' to the weaker states in 1910, and the establishment of the CGC and a systematic approach to equalisation in 1933. The system initially directly compensated only weaker states (such as WA at the time) and later distributed a dedicated pool of funding to all states and territories.³⁹ The end result was a successful, transparent, rules-based system under the custodianship of the CGC.

Australia should be proud of its robust HFE system, which has provided equality of opportunity across the Federation. Research has found that Australia has among the lowest levels of fiscal inequality across jurisdictions, in no small part due to its world-leading system of HFE.⁴⁰

The CGC was introduced to facilitate a fairer and more efficient method for the Commonwealth to determine funding to states to achieve equalisation. The CGC has a high degree of expertise and a long history of managing equalisation.

The CGC's approach is independent, rules-based and transparent, with regular reviews and open consultation with states. This provides states with certainty that they will receive the revenue required for essential services, and that this funding will not be subject to unilateral decisions of the Commonwealth or prolonged negotiations. Section 7.2 describes the advantages of this rules-based, independent system of distributing Commonwealth funding.

The introduction of a funding pool, and later the GST, allowed for this equalisation funding to be untied to any specific purpose, providing states with the necessary policy flexibility to respond to their citizens' needs. The size of the GST pool has been sufficient to enable equalisation, with a substantial proportion of the pool being distributed on an EPC basis, once equalisation had been achieved.

This is relevant context for consideration of proposals to make the GST distribution EPC, which often do not recognise the significant pre-existing extent to which GST is distributed on an EPC basis (see Appendix A). Since the GST was introduced, on average around half of the GST pool has been distributed EPC each year to 2024-25.⁴¹

The system of full equalisation in place prior to 2018 worked well to deliver the revenue states needed for essential services. It was bound by clear supporting principles (what states do, policy neutrality, practicality and contemporaneity) which were consulted with and agreed upon by all states.⁴²

³⁸ States are 'spending like they're in lockdown', S&P warns, Australian Financial Review, 15 January 2026

³⁹ Commonwealth Grants Commission (2023) Occasional paper No. 10: 90 years of the Commonwealth Grants Commission.

⁴⁰ Acil Allen Consulting (2017), Aspects of Australia's system of HFE, submission bn to PC Inquiry into HFE

⁴¹ Commonwealth Grants Commission (2025). GST sharing relativities, 2025-26, DTF calculations

⁴² The CGC's 2025 Review Outcomes report articulates its approach to equalisation and the supporting principles (see: Commonwealth Grants Commission, (2025) Review Outcomes - Fiscal equalisation, supporting principles and assessment guidelines, p.4) which has remained largely unchanged since before 2018, see for example the CGC's 2015 Review Report which includes the same principles (Commonwealth Grants Commission (2015) Assessment of State Fiscal Capacities, p.6).

The policy neutrality principle ensures that the system strives to avoid perverse incentives for states, encouraging policy reform, while ‘what states do’ complements this by reflecting states’ actual policy efforts without determining what states should or shouldn’t do. Practicality aims to ensure that equalisation is limited to what can actually be measured by robust data, while contemporaneity aims to ensure that equalisation outcomes accurately reflect changes in state circumstances.

Criticisms of this system, primarily that it disincentivised reform or was too volatile, are not founded on evidence. As shown in Sections 5 and 6, new evidence provided by the experience of the reform shows that moving away from this equalisation system actually worsened or had no impact on policy incentives or volatility.

Through these principles, the CGC methodology already accounts for many of the issues under consideration by this inquiry, such as volatility and policy neutrality. This, combined with regular consultation and method reviews, provides procedural fairness that ensures states can make their voices heard if the equalisation system is not meeting their needs.

Victoria is not in favour of proposals that would drastically reduce the granularity of assessing states’ fiscal capacities (for example an EPC assessment, or moving to focus on ‘broader’ measures like GSP) as they would lose accuracy in assessing states’ relative fiscal capacities for limited benefit. See Appendix A.2 for further detail.

The 2018 changes distorted the outputs of the system, but the underlying fundamentals remain sound.

4.3 The previous system was valued across Australia

HFE has been a long-standing feature of the Australian Federation, that has served Australia well, underpinning geographic equity. The CGC was established in 1933 to manage and recommend a fair distribution of Commonwealth grants. At the outset, the CGC established a definition of equalisation that largely reflects the modern approach, with some developments over time.

Equality of opportunity is a core principle of Australia’s egalitarian society. Public health, welfare and education systems exist to ensure that the circumstances of an individual’s birth do not limit their opportunities to improve their living standards. HFE exists to ensure that this is the case for people in each state. HFE provides an essential safety net that allows states to deliver a similar standard of services to all Australians, while also giving them the same opportunities to take the policy risks necessary to improve their fiscal capacity and their citizens’ lives.

However, this long-standing principle, at the heart of Australian values of equality, was broken by the 2018 changes.

Independent commentators have noted the detrimental loss of HFE from the new system, including the following examples:

- The Conversation polled 38 economists in early 2024 on the new system. Of those, 28 polled considered the changes should be ‘scrapped’, 6 were unsure and only 4 were in favour of retaining it. For example, Percy Allan, former Secretary of NSW Treasury said *“the reality is that the WA government is awash with revenue yet has been given an inordinate advantage in GST grant distributions”*.⁴³

⁴³ Saul Eslake’s one-man mission to undo the GST deal – and make WA pay. Australian Financial Review, 24 July 2024.

- The Grattan Institute, in a report on the Commonwealth Budget, wrote on the 2018 changes that *“In effect, the federal government spends more \$6 billion a year to support superior government services in the only state that is running a strong surplus, undermining the principles of equalisation on which GST is distributed.”*⁴⁴
- Centre for Independent Studies economist and former Treasury official Robert Carling said the 2018 system was “perverse” and that *“Western Australia is raking in vast amounts of royalties and they have by far the healthiest budget position among all the states.”*⁴⁵
- Independent economist Chris Richardson is quoted by the AFR as saying *“the policy had violated the GST in that the tax was now skewed towards helping the wealthiest state leaving federal taxpayers to compensate the others.”*⁴⁶
- Independent economist Saul Eslake wrote in a paper with his estimates of the future cost of the guarantee: *“It represents a transfer of almost \$40 billion over 12 years to the government of the richest state in Australia, which (as measured by per capita gross product) is richer than the rest of Australia by a vastly larger margin than any other state has ever been, at least since Federation, so that the citizens of that state can enjoy better public services and lower levels of state taxation than the citizens of the rest of Australia. How that can be reconciled with any sensible concept of equity, let alone fiscal prudence, is surely beyond comprehension.”*⁴⁷

Through the passage of the 2018 changes through the Commonwealth parliament, in response to an Australia Senate inquiry, all states other than WA noted they did not support the reduction in HFE from the 2018 changes (see Table 2).

Table 2: Quotes from states’ submissions to the Senate Inquiry

State	Position
NSW	“New South Wales has always played a key role in supporting the smaller states; however it is not responsible for funding states that receive revenue windfalls from its resources and then fail to plan for the future.”
Vic.	“Victoria considers the Commonwealth’s proposal to be inequitable, as it moves away from the principle of giving each State the potential to fund government services to the same standard.”
Qld.	“The Palaszczuk Government is a strong supporter of the current system of horizontal fiscal equalisation.”
SA	“The Government of South Australia has been a long-standing supporter of the current objective of horizontal fiscal equalisation (HFE), which is to provide states and territories with the capacity to provide services and the associated infrastructure at the same standard... In line with these views the South Australian Government’s preferred position is that the current GST distribution arrangements are retained.”

⁴⁴ Grattan Institute (2025). Orange Book 2025, page 31

⁴⁵ WA wins \$4b, Victoria loses on GST carve up. Australian Financial Review, 25 March 2022

⁴⁶ ‘Beyond comprehension’: WA’s GST deal to blow out to \$50b. Australian Financial Review, 12 February 2024

⁴⁷ <https://www.sauleslake.info/distribution-of-gst-revenue-the-worst-public-policy-decision-of-the-21st-century-to-date/>

Tas	“The Tasmanian Government remains of the view that the current system of HFE is not 'broken' and that the PC did not make a convincing case that it needs changing.”
ACT	“The claim that the current equalisation system is broken has been made by a variety of commentators and political leaders. This view is not shared by the ACT Government.”
NT	“The Northern Territory Government is a strong supporter of the current definition of Horizontal Fiscal Equalisation (HFE) and strongly rejects the view that the current system is broken.”

Source: Commonwealth Senate Standing Committee on Economics, Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018, submissions, available at: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABFairShareofGST/Submissions

Through the PC's previous inquiry, many non-government organisations, across social services and business groups, made submissions noting their support for HFE and criticising the 2018 changes:

- Victorian Trades Hall Council (VTHC): “HFE has achieved its objectives without impeding productivity and economic growth... The proposal to change this to the second strongest state essentially creates a two-tier system in which one state will always be better off than the rest”.⁴⁸
- Victorian Chamber of Commerce and Industry (VCCI): “there is no evidence that the current [sic: former] system is detrimental to productivity or provides a disincentive for states to exploit their natural resources”.⁴⁹
- Australian Chamber of Commerce and Industry (ACCI): “The Australian Chamber notes that there is no evidence that the current system of HFE is not in the best interests of national productivity. Nor does it produce a disincentive for a state to develop its resources or a potential industry.”⁵⁰
- Tasmanian Council of Social Service (TasCOSS): “endorses the existing [former] CGC definition of HFE and its objective” and “rejects the proposal of equalisation between states for the provision of services and associated infrastructure to a ‘reasonable standard’ contained in the Draft Report. This proposed standard is nebulous, inadequate to ensure equality of opportunity of residents between states, and would be highly liable to political erosion.” “Any speculative increases in efficiency must be weighed against the very evident adverse outcomes for equity.”⁵¹
- South Australian Council of Social Service (SACOSS): “pegging of equalisation to a set standard like the second strongest state by definition undermines equalisation. It allows one state to have a much greater capacity to provide services.”⁵²
- Community and Public Sector Union (CPSU) Northern Territory: “The CPSU opposes changing the current HFE system to partial equalisation which will permanently result in a permanent and ongoing reduction in the [Northern] Territory’s share of GST revenue, reduce service standards and increase economic and social disadvantage.”⁵³

⁴⁸ Submission DR93 - Victorian Trades Hall Council - Horizontal Fiscal Equalisation - Public inquiry

⁴⁹ Submission DR92 - Victorian Chamber of Commerce and Industry - Horizontal Fiscal Equalisation - Public inquiry

⁵⁰ Submission DR40 -Australian Chamber of Commerce and Industry - Horizontal Fiscal Equalisation - Public inquiry

⁵¹ Submission DR66 - Tasmanian Council of Social Service (TasCOSS) - Horizontal Fiscal Equalisation - Public inquiry

⁵² Submission DR75 - South Australian Council of Social Service (SACOSS) - Horizontal Fiscal Equalisation - Public inquiry

⁵³ Submission DR98 - Community and Public Sector Union (CPSU) NT - Horizontal Fiscal Equalisation - Public inquiry

- Queensland Teachers' Union (QTU): "HFE has achieved its objectives without having a net negative effect on productivity and economic growth".⁵⁴
- Queensland Nurses and Midwives' Union (QNMU): "Equalising to the second strongest State, currently NSW, would direct additional revenue to Western Australia, but it would reduce Queensland's payment by \$729 million ... [which] would inevitably come at a cost to the community."⁵⁵
- Chamber of Commerce and Industry Queensland (CCIQ): "Per the Productivity Commission's own findings, there is little evidence to suggest that HFE in its current form has negatively impacted and/or constrained economic growth in Queensland or Australia."⁵⁶
- Business SA: "There is no underlying fundamental rationale to touch Australia's HFE system which has served us well for over 100 years because one State jurisdiction, which has managed to turn the country's longest mining boom into a \$40 billion net debt balloon, has for only the last three years recorded budget deficits."⁵⁷

⁵⁴ Submission DR119 - Queensland Teachers' Union of Employees - Horizontal Fiscal Equalisation - Public inquiry

⁵⁵ Submission DR110 - Queensland Nurses and Midwives' Union - Horizontal Fiscal Equalisation - Public inquiry

⁵⁶ Submission DR120 -Chamber of Commerce and Industry Queensland - Horizontal Fiscal Equalisation - Public inquiry

⁵⁷ Submission DR026 -Chamber of Commerce and Industry South Australia - Horizontal Fiscal Equalisation - Public inquiry

5. Current arrangements have not improved GST volatility for states and territories other than WA

The PC has been asked to consider the extent to which the 2018 changes appropriately balance responsiveness to changing circumstances with reducing volatility and improving the certainty of GST revenue to support state fiscal planning.

The Commonwealth's interim response to the 2018 inquiry also highlighted a claimed inability of the former system to handle significant economic shocks and points to the mining boom as an example where volatility was introduced into the system.

The interim response suggested that by equalising to the "broad-based, stable economies" of NSW and Victoria⁵⁸ this volatility would be minimised and the new system "would remove the effects of extreme circumstances, like the mining boom, from Australia's GST distribution system". Additionally, the Commonwealth proposed a relativity floor of 0.75 to ensure that no state receives less than three-quarters of their population share of GST, limiting potential downwards volatility of state revenue.

Victoria considers that there were minimal issues with volatility or state fiscal planning from the previous GST system, and that the 2018 changes don't markedly improve state fiscal planning. The 2018 changes may reduce volatility for WA, but do not materially positively impact the ability of other states to plan.

5.1 The 2018 changes have not supported responsiveness to changing circumstances

The issues paper asks about how the 2018 changes affect states' ability to manage the fiscal impacts of shocks, such as natural disasters or economic disruptions. Victoria considers the 2018 changes have not improved the equalisation system's ability to respond to change, whereas the CGC has provided a mechanism for this through its 2025 methodology review.

The CGC's 2025 changes were prompted in large part by the failure of the HFE system to adjust to the challenges presented by the COVID-19 pandemic.

Between 2020-21 and 2022-23, Victoria and NSW had significant expenses for health and business support through their response to the COVID-19 pandemic. The CGC noted in 2021 that "the incidence of COVID-19 may be influenced by factors outside the health assessment, such as population density, or the effectively random location of COVID-19 outbreaks."⁵⁹ However, the CGC was unable to apply this approach to the GST methodology, as it constituted a method change which could only occur during a five-yearly review, unless requested by the Commonwealth Treasurer.

⁵⁸ Noting the setting of Victoria and NSW as benchmarks due to their 'stability' has been shown to be arbitrary given recent changes in relativities. In 2024-25 Victoria's former system relativity rose to over 1.0 for the first time since the CGC has calculated relativities, and remained over 1.0 in 2025-26. In 2025-26 Queensland had a lower relativity than Victoria or NSW, benefitting from the reforms through the new equalisation standard (but losing from the reforms overall due to WA's significant gains).

⁵⁹ *Commonwealth Grants Commission (2020): New issues for the 2021 Update Page 7-8,*

In 2023, the CGC estimated that the impact of this method change would have increased Victoria's GST revenue by \$879 million in 2023-24,⁶⁰ and that the impact of the change in the 2025 Review was \$870 million.⁶¹ It can be assumed that the impact in the CGC's 2024 annual relativities update would have been similar. Therefore, Victoria missed out on over \$1.7 billion in GST revenue from 2023-24 and 2024-25 because the GST distribution methodology was not flexible enough to deal with rapid changes in state circumstances, despite the 2018 changes. This is not simply a timing issue like the lagged impact of iron ore royalties. The CGC decided in its 2025 methodology review to not retrospectively apply these changes, so Victoria will never receive the GST revenue it needed in 2023-24 and 2024-25.

Rather than attempting to compromise HFE at the expense of all other states, Victoria instead sought to improve the CGC's flexibility and authority to address this lack of contemporaneity. At the outset of the 2025 Review, Victoria advocated to the Commonwealth to include in the ToR clauses for the CGC to examine increased flexibility to respond to unexpected developments between its reviews.

Through its 2025 review, the CGC developed a framework to make method changes between its five-yearly reviews, so that in future, states with rapid and unprecedented changes in their fiscal capacity will not have the same issues that Victoria and NSW faced. This mechanism, and not the compromised equalisation standard, is a fair and impartial way to respond to rapid changes in state economic conditions and new policies. This process also allows for changes to accommodate significant state reforms and unintended impacts from HFE, which as described in Section 6.5 are a more appropriate way to deal with perceived policy influences of HFE on reform.

5.2 There was never a real-world volatility problem to solve

In its 2018 inquiry, the PC already concluded that there was not a significant issue with the volatility of GST revenues for states. The PC noted the following in relation to the impact of GST on state budget management:

- “Even with limited contemporaneity, States should be able to manage the budgetary implications of lagged GST payments. Given the retrospective nature of the CGC's assessment processes, States are generally able to forecast the direction of changes in their GST relativities. Although volatile revenue streams — and fluctuations in the growth rate of the GST pool — can create difficulties in accurately forecasting specific relativities, GST payments are relatively stable compared to other revenue streams, and for several States they comprise the least volatile source of revenue.”
- “The most effective response to a lack of contemporaneity lies with the States themselves, and with the necessity for State Treasuries to factor the assessment period and GST lag into their budget management processes (which most do).”⁶²

Victoria agrees with the PC's findings in 2018, that issues with variance in GST revenues should be managed by states' fiscal planning processes, and that the 2018 changes were not necessary to improve budget certainty. Consistent with the PC's findings, WA was able to anticipate the fiscal implications of the mining boom, including its reduction in GST revenues, as demonstrated in Section 5.3.

⁶⁰ Commonwealth Grants Commission (2022) *New issues for the 2023 Update*, page 13-16

⁶¹ Commonwealth Grants Commission (2025). *2025-26 GST sharing relativities* page 26 Table 2-4

⁶² Productivity Commission (2018), *Horizontal Fiscal Equalisation*, Report no. 88, Canberra, Page 131, 138, 144.

The contemporaneity of the CGC's assessments has also been consistently reviewed and discussed by all states through the CGC's 5-yearly methodology review processes. For the last three reviews (2015, 2020 and 2025 reviews) states have generally supported the current approach to managing contemporaneity and there have been no changes to the approach. These discussions have focussed on elements within the CGC's methods, including the use of lagged data and three-year averaging to improve predictability for states, trading off some contemporaneity.

In its position paper on outcomes from the 2025 review, the CGC noted "All states broadly supported the current method of contemporaneity, noting that the 3-year lagged average approach will achieve equalisation over time."^{63,64}

The last change for contemporaneity was a shortening of the averaging period from five to three years made in 2010 to improve contemporaneity, in response to complaints from WA that the previous 5-year period did not adjust quickly enough to respond to the mining boom in the early 2000s.⁶⁵

5.3 GST volatility was not a problem for WA

WA predicted the changes in its royalty revenues and the subsequent impacts on its GST revenue through the first mining boom from around 2003 to 2013. Therefore, in practice, the claimed volatility should not have been a significant issue, as WA had the information to be able to plan and manage the fiscal impacts without requiring changes to the GST system impacting every other state.

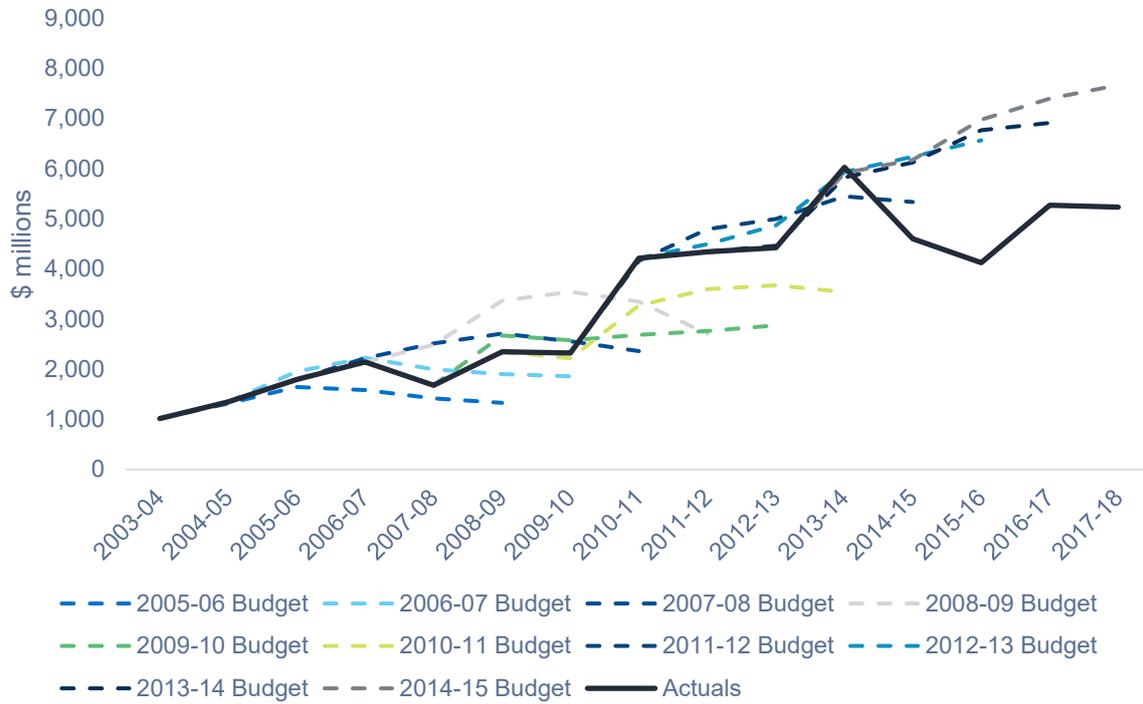
From 2000-01 to 2013-14, WA's fiscal capacity increased substantially through growth in resources royalties. At this time, WA's budget papers regularly forecast sustained growth in royalty revenue. Forecasts published in WA's Budget Paper No. 3 (BP3) through the 2000s and early 2010s anticipated continued strength in prices and volumes. Figure 11 shows WA's budgets generally forecast its royalty revenues to increase over this period.

⁶³ Commonwealth Grants Commission (2023). Commission's position on fiscal equalisation, supporting principles and assessment guidelines - 2025 Methodology Review, page 14

⁶⁴The 2020 methodology review noted "All States that commented on this issue, except Western Australia, said they supported the Commission's current approach to contemporaneity. Available at https://www.cgc.gov.au/sites/default/files/2021-11/r2020_report_-_volume_2_-_part_a_ch1-4.pdf

⁶⁵ Commonwealth Grants Commission (2010)- Report on GST Revenue Sharing Relativities - 2010 Review, page 4

Figure 11: WA budget forecasts of royalty revenue, 2005-06 Budget to 2014-15 Budget



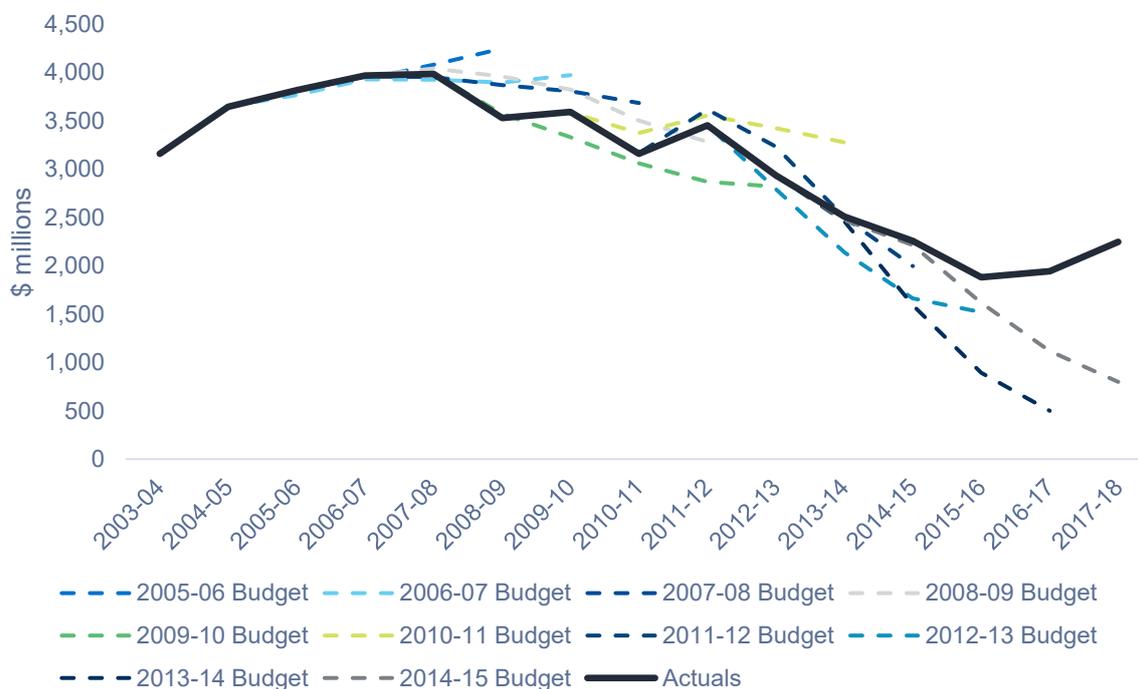
Source: WA budget papers

Due to the lagged nature of the CGC’s assessments, a corresponding decline in WA’s GST relativity was predicted. In its 2011-12 Budget, WA projected a fall in its relativity from 0.72 to 0.33 by 2014-15.⁶⁶ This proved accurate as its relativity fell to 0.38 by 2014-15.⁶⁷ Figure 12 shows WA’s budget papers broadly predicted a decline in its GST revenues as the mining boom entered the CGC’s assessments.

⁶⁶ Government of Western Australia (2011) - Budget 2011-12, page 84 table 6

⁶⁷ Commonwealth Grants Commission (2025). 2025-26 GST sharing relativity – supporting table no. 8: Relativity over time.

Figure 12: WA budget forecasts of GST revenues, 2005-06 Budget to 2014-15 Budget



Source: WA budget papers

WA budget publications anticipated the revenue decline but stated, without clear supporting evidence, that the GST system would be changed such that WA would receive more revenue than it would otherwise be entitled to:

- In its 2011-12 Budget, WA noted the 2012 Commonwealth GST Distribution Review, known as the Brumby, Carter, Greiner Review, was “likely to significantly alter WA’s GST grant share from 2013-14 onwards” and that “those arrangements are almost certain to change”.⁶⁸
- In its 2011-12 Budget speech the then WA Treasurer stated: “What we reasonably anticipate is that in 2013-14 the CGC will have brought in a new GST system. We expect it will produce a floor of around 75 per cent of our population share of the GST.”⁶⁹

When these changes did not eventuate as expected, the resulting revenue shortfall combined with low iron ore royalties to contribute to a deterioration in WA’s budget position, to an operating deficit of \$2.1 billion by 2015-16.⁷⁰

The Grattan Institute’s 2013 report *How Western Australia frittered away its mining bonanza*⁷¹ noted that:

- If mining royalties decline, WA budgets could face pressure, emphasizing the need for savings to manage future downturns

⁶⁸ Government of Western Australia (2011). 2011-12 Budget, Budget paper No:3 Economic and Fiscal Outlook, p64

⁶⁹ Productivity Commission (2018), *Horizontal Fiscal Equalisation, Report no. 88, Canberra, Page 12*

⁷⁰ ABS Government finance statistics, Annual, (Reference period: 2017-18 financial year)

⁷¹ Grattan Institute, *How Western Australia frittered away its mining bonanza*, Grattan Institute, 3 August 2013, <https://grattan.edu.au/news/how-western-australia-frittered-away-its-mining-bonanza/>.

- Rather than using mining windfalls to reduce other taxes or build savings, spending increased, with taxes and charges per resident remaining similar to other populous states such as Victoria, NSW, and Queensland
- Compared with these states, WA would need to reduce spending per capita by up to 15 per cent if its revenue base were similar
- The Institute recommended that WA begin saving to support budget stability over the coming decade.

5.4 Current arrangements have undermined certainty, harming fiscal planning

In response to the issues paper information request 3, it is evident the 2018 changes:

- do not support any state other than WA to manage fiscal shocks
- have not changed the volatility in state finances for any state other than WA
- may negatively impact the ability of states to undertake fiscal planning, with the logic that all states other than WA have a looming fiscal cliff from the expiry of the NWOOG which can make it harder to commit to long term investments.

As described in Section 2.1, the substantial changes to the GST system from the 2018 legislation are the new equalisation standard (to the stronger of NSW or Victoria, rather than the strongest state) and the relativity floor (of 0.75). These both set a lower limit on the relativity of any state with a fiscal capacity stronger than NSW and Victoria or the relativity floor. The 2018 changes negatively impact on the GST relativities of the other states by reducing them to accommodate the increase in the strongest state's (WA's) relativity.

Since the 2018 changes only effectively cap the relativities of states stronger than NSW or Victoria, they do not materially affect the volatility of GST revenues for other states. As such, even if Victoria were fully exposed to the fiscal impacts of the 2018 changes without the NWOOG, it would not improve the predictability of GST revenues for Victoria, or any state other than WA.

It is difficult to demonstrate the real budget and decision-making impacts from the 2018 changes currently, as states other than WA have received effectively the same total funding through the NWOOG. However, the potential loss of the guarantee from 2030-31 once it expires is a significant concern for states' future budget planning. It is also relevant for ratings agencies assessments of the states' long-term fiscal sustainability (as noted in Section 4.1). If similar conditions persist from 2030-31, Victoria stands to lose approximately \$1.9 billion each year, its NWOOG payment in 2025-26.

Victoria has consistently noted the expiry of the NWOOG as a specific fiscal risk in its budget papers since the 2018 changes.⁷² The other states have also noted in their budget publications the risks and uncertainty created by the 2018 changes, for example:

- Queensland's 2025-26 Budget notes as an 'emerging fiscal pressure', "uncertainty around Queensland's future GST entitlement, including potential impacts of the forthcoming Productivity Commission inquiry on horizontal fiscal equalisation, and the status of the GST no worse off guarantee beyond 2029–30."

⁷² See Victoria's 2025-26 Budget for example (available at: <https://s3.ap-southeast-2.amazonaws.com/vicbudgetfiles2025.26budgetvic/2025-26+State+Budget+-+Strategy+and+Outlook.pdf>)

- South Australia's 2025-26 Budget states, on the 2023 extension of the NWOOG "While the extension will provide funding certainty for the remainder of the decade, a permanent extension is required for the long-term fiscal sustainability of states and territories."
- Tasmania's 2025-26 Budget notes: "Tasmania is likely to receive significantly less GST revenue each year if the guarantee is not extended beyond 2029-30. This is a genuine risk that lies solely in the hands of the Australian Government."⁷³

In 2023 when negotiating the extension of the NWOOG, Treasurers noted its importance to states' budget certainty. In making the case to extend the guarantee, the previous Victorian Treasurer, Tim Pallas, noted: "State and territory budgets are planned and projected years ahead because we know the decisions needed to safeguard service provision and infrastructure must be made well in advance. All good budgets – whether personal, business or government – rely on solid, forward planning."⁷⁴ Likewise, Commonwealth Treasurer Jim Chalmers acknowledged that budget stability was at the heart of the 2023 negotiations, stating that the outcome would serve "to provide the states and territories with certainty in their coming budgets".⁷⁵

The 2023 extension of the NWOOG was a welcome reprieve for the states. However, it fell short of providing the required budget certainty and has delayed conclusive resolution of the issue, with the current extension of the NWOOG to expire at the end of 2029-30. A new fiscal cliff will enter states' budgets with the expiry of the extension to the NWOOG from next year's 2027-28 budgets. This short-term view is a long way removed from the budget certainty that the GST was touted as providing to the states upon its introduction (see Section 3.3), and the Commonwealth's statements around the 2023 extension to the guarantee.

This indicates that while potentially not directly influencing specific budgeting decisions currently, due to the NWOOG, the 2018 changes add to longer-term uncertainty and decrease confidence in committing to long-term investments. The expiry of the NWOOG will significantly impact states' decisions from their 2027-28 budgets, once its expiry enters the forward estimates period.

5.5 The 2018 changes damaged trust in the Commonwealth's commitment to fair funding for all states

The 2018 changes also created additional uncertainty for states by damaging trust in the Commonwealth's willingness to follow through on its funding and other commitments to states. The 2018 changes reduced states' confidence and certainty in the support they receive from Federal Financial Relations (FFR) generally, which inhibits progress on other long-term agreements. This ultimately can result in poorer outcomes for Australians who rely on government services through delays to necessary funding.

⁷³ Queensland's 2025-26 Budget is accessible at: <https://budget.qld.gov.au/files/Budget-2025-26-BP2-Budget-Strategy-Outlook.pdf>. SA's 2025-26 Budget is accessible at: https://treasury.sa.gov.au/__data/assets/pdf_file/0010/1159381/2025-26-Budget-Overview.pdf. Tasmania's 2025-26 Budget is accessible at: <https://www.treasury.tas.gov.au/Documents/2025-26%20The%20Budget%2c%20Budget%20Paper%20No.%201.PDF>.

⁷⁴ Tim Pallas, 'An end to the GST guarantee would be disastrous', AFR 2023, <https://www.afr.com/politics/an-end-to-the-gst-guarantee-would-be-disastrous-20231129-p5enol>

⁷⁵ Jim Chalmers, 'Extension of 'No Worse Off' deal to help fund essential services', Ministerial Statement, <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/extension-no-worse-deal-help-fund-essential-services>

The proof of the increasingly uncertain financial environment for states was when the Commonwealth effectively linked health and disability negotiations to the extension of the NWOOG at National Cabinet in December 2023.⁷⁶

This occurred despite the Commonwealth's 2018 commitments that states would be better off from the 2018 GST changes⁷⁷ and that the NWOOG would not impact other Commonwealth payments to states.⁷⁸ The Commonwealth Treasurer noted following the December 2023 National Cabinet meeting: "As part of the broader health and NDIS deal brokered by the Prime Minister with First Ministers at National Cabinet today, we have agreed to extend the No Worse Off Guarantee by three years to provide the states and territories with certainty in their coming budgets."⁷⁹

The uncertainty and looming fiscal cliff states faced from the expiry in the NWOOG in 2023 also impeded progress on national disability reform. Ahead of the National Cabinet meeting in December 2023, states were clear that progress could not be made on health and disability negotiations given the fiscal uncertainty around the expiry of the NWOOG. In a communique following a Council on Federal Financial Relations meeting from 1 December 2023, the Board of Treasurers noted:

"State and Territory Treasurers note ongoing discussions regarding the NDIS to support a sustainable model that supports Australians with a disability for future generations. State and Territory Treasurers believe the GST No-worse-off Guarantee needs to be resolved before any states and territories can consider any proposals for change."⁸⁰

States will be in a similar position again when preparing their 2027-28 budgets, when the expiry of the guarantee in 2030-31 enters budget forward estimates for the first time. At that time states may again find it challenging to engage in any other major agreements or areas of Commonwealth-state cooperation with the uncertainty of the loss of the NWOOG.

⁷⁶ <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/extension-no-worse-deal-help-fund-essential-services>

⁷⁷ The Commonwealth of Australia (2018) Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response, page 2 (<https://treasury.gov.au/sites/default/files/2019-03/HFE-Government-Response.pdf>)

⁷⁸ As noted in Section (a)(i)3.5, the Commonwealth Treasurer sent letters to state Treasurers noting "Any additional financial assistance referred to in the bill will not be offset or partially offset by a decrease in other grant funding to the states", as tabled in the Australian Parliament and noted through the Commonwealth Senate Inquiry. See: https://www.aph.gov.au/-/media/Committees/economics_ctte/TLABFairShareofGST/d01.pdf; and https://www.aph.gov.au/Parliamentary_Business/Hansard/Hansard_Display?bid=chamber/hansards/8a611160-5451-4f48-bcda-57b8b94c6bee/&sid=0021#:~:text=That%20the%20letter%20from%20the,%E2%80%A6%20%E2%80%A6%20%E2%80%A6

⁷⁹ Extension of 'No Worse Off' deal to help fund essential services | Treasury Ministers

⁸⁰ https://www.treasury.sa.gov.au/__data/assets/pdf_file/0009/965511/Communique-BOT-Post-CFFR-1-Dec-2023.pdf

6. The 2018 changes have not incentivised state-based reforms, and have undermined cooperation on national reform

The issues paper asks whether the GST system impedes states' reforms, citing concern around whether HFE impeded reform in the past, and how the 2018 changes impact this.

HFE is not an impediment to reform, and the CGC's policy neutrality approach largely removes any direct effects of the GST system on states policies. Where there are issues at the margins that may in theory influence state decision making, the CGC has committed to mitigating these effects and has established a process to do so in its 2025 Review (see Section 6.5).

The available evidence in favour of reform was not sufficient for such significant changes in 2018, and the case has only become weaker in the time since. The practical and theoretical evidence is that there is minimal if any influence from the HFE system on states reforms:

- The theoretical evidence for any incentives the 2018 inquiry relied on for its conclusions remain unclear (as they were in 2018), with academics not providing conclusive proof of incentives both in theory and examining historical and international experience (see Section 6.1).
- The experience of the 2018 changes since 2018-19 shows the only state insulated from supposed policy influences (WA) made little reform compared to the other states – a natural experiment (as described in Sections 6.2 and 6.3).
- Victoria's direct experience of implementing reform in practice is that GST system impacts are a minor concern in policy development – rather, improvements to Victoria's economic conditions and the wellbeing of Victorians, practicality and implementation are much more significant considerations in developing good policy (see Section 6.4).

6.1 There is no substantial evidence equalisation hinders states' reforms

There is no substantial international or academic evidence that equalisation hinders sub-national governments' reform incentives, as the PC acknowledged in its previous inquiry on this issue.

There is an extensive academic literature examining the efficiency and policy neutrality impacts of HFE, complemented by international experience of HFE systems in Canada, Germany, Switzerland and Sweden. The literature broadly supports equalisation and does not provide any conclusive evidence of efficiency impacts or disincentives. While the literature identifies theoretical efficiency costs, there is no conclusive evidence that these impacts occur in practice or are significant.

For example, some studies in the literature have shown the benefits of HFE – more equal societies with lower inefficient internal migration, including:

- Murphy (2017) builds on the analysis by Albouy (2012) and Buchanan (1952) to highlight the inefficient interstate migration that may arise from interjurisdictional fiscal inequality in Australia. They estimate that the HFE system in place before 2018 delivered around \$1 billion per year in net welfare benefits (compared to an EPC distribution) by limiting inefficient migration to WA. Murphy also evaluated the impact of a 0.75 floor in 2017, which would be

similar to the current system after the expiry of the NWO, and concluded that this would have resulted in a \$71 million net welfare loss.⁸¹

- Buettner (2001) found that equalisation transfers in Germany were also effective at reducing the variance of state income over time. They found equalisation acted as a risk pooling mechanism and supported sub-national government's long term budget stability.⁸²

Other analyses have found there is insubstantial evidence to be conclusive on the impacts of HFE on policy making. For example, in the previous inquiry, despite acknowledging the inconclusive academic and international evidence, the PC concluded that:

“Overall, while there is limited direct evidence, absence of evidence is not equivalent to evidence of absence... The potential for large impacts on GST — combined with VFI and an arguably limited range of efficient State revenue sources — means that States may not even consider major reforms, even where the benefits to the community would be considerable.”⁸³

Other reviews have made similar conclusions, for example:

- The Australian Government's GST distribution review in 2012 concluded “the current system creates perverse theoretical incentives in some instances, but there is little evidence that they have any effect in the real world. In particular, there is no evidence that HFE acts as a material disincentive to State tax reform”.⁸⁴
- The Swedish national Audit Office (2019), in reviewing the Swedish equalisation system found no evidence of increased redistribution having a negative impact on growth or tax effort.⁸⁵

This is not sufficient justification for a change that has transferred over \$22 billion from all other states to the fiscally strongest state in Australia. A lack of evidence is a lack of evidence: if the conclusions that the PC, the Commonwealth or WA would like to make cannot be proven, they cannot be proven and should not be the primary basis for a policy that has cost \$22 billion to date. There remains no conclusive evidence that HFE disincentivises states from pursuing reform.

This disregard for the burden of proof to justify a rationale for change is inherently inequitable and can just as easily be used to rationalise returning to the former system, as there is no evidence that the change has resulted in efficiency improvements as shown in Section 6.2 and 6.3.

6.2 The 2018 changes have not incentivised WA to undertake policy changes

The experience of state reform since the changes to the GST system from 2018-19 has shown HFE was not a major impediment to reform. WA has been under conditions where most theoretical

⁸¹ Murphy, Chris (2017) - Optimal fiscal equalisation and its application to Australia. Australian National University Working papers in Trade and Development. Working Paper No. 2017/12; and Albouy, David (2012), 'Evaluating the efficiency and equity of federal fiscal equalisation', Journal of Public Economics, Vol. 96, pp 824-839; and Buchanan, James M. (1952), 'Federal Grants and Resource Allocation', Journal of Political Economy, Vol. 60, No. 3, (June 1952), pp. 208-217

⁸² Buettner, T (2001) Fiscal Federalism and Interstate Risk Sharing: Empirical Evidence from Germany, Economics Letters Volume 74, Issue 2, January 2002, Pages 195-202

⁸³ Productivity Commission (2018), Horizontal Fiscal Equalisation, Report no. 88, Canberra, Page 15

⁸⁴ The Commonwealth of Australia (2012), GST Distribution Review

⁸⁵ Swedish National Audit Office (2020) : Growth-inhibiting incentives in municipal income equalization? Isbn 978-91-7086-560-2

disincentives from HFE have been removed, and it has made no substantial policy reforms, while the other states have (see Sections 6.2 and 6.4).

The 2018 changes created the conditions for a natural experiment to determine whether policy disincentives exist, and whether they were hampering the development of the strongest state, WA. WA's GST relativity has effectively been fixed at the floor since 2018,⁸⁶ which means it was in theory freed from the GST impacts of its policies.

Theoretically, WA should have been able to pursue productivity enhancing or fiscal-capacity-strengthening reforms which it claimed it was unable to do under full equalisation, such as invest in growing its mining industry or increase royalties.⁸⁷ On the other hand, other states still facing the full theoretical disincentives from equalisation should be discouraged from reform, as their GST revenue would in theory fall if they improve their fiscal capacities.

If the former system was repressing policy innovation and economic development in WA, then the past seven years of the 2018 changes should be replete with examples of productivity enhancing, fiscal-capacity-strengthening reforms in WA. Conversely, the enduring presence of these disincentives should have seen minimal reform across the rest of the country.

The practical evidence of states' reforms since the new GST system was introduced in 2018-19 shows these hypotheses have not eventuated. WA has not enacted efficiency enhancing policy reforms despite the supposed disincentives from HFE being removed.

The 2018 inquiry focussed on tax reform and mining royalties as key areas where HFE may hinder reform. WA has not changed its royalty rates since 2018 for any mineral, even though the WA government would be able to retain almost all of the additional revenue from doing so without flow on impacts from HFE. Similarly, it has not undergone any significant reforms to its other major tax lines.⁸⁸

For example, WA has still not abolished the inefficient duties on non-real business assets it committed to abolish as a part of the inception of the GST.⁸⁹ Under Schedule B to the 2009 IGA on Federal Financial Relations, states committed to abolish and not re-introduce a number of inefficient taxes.⁹⁰

- Four taxes had already been abolished by states: bed taxes on 1 July 2000, financial institutions duty (FID) on 1 July 2001, stamp duty on quoted/listed marketable securities on 1 July 2001 and debits tax on cheque accounts on 1 July 2005.⁹¹
- Six stamp duties were initially retained but were to be abolished by 1 July 2013: unquoted marketable securities; leases; mortgages, bonds, debentures and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; stamp duty on cheques, bills of exchange and promissory notes; and non-real non-residential conveyances.

While most states have implemented these reforms, WA and Queensland are yet to abolish non-real business conveyancing duty. WA had initially planned to abolish it in 2013, but deferred it due to

⁸⁶ WA has only had a GST relativity at the floor since it was implemented within the CGC's recommended relativity from 2022-23, however it effectively received total revenue as though the 0.7 floor was in place since 2018-19 due to separate payments from the Commonwealth topping its GST revenues up to that level.

⁸⁷ For example, WA's initial submission to the previous PC inquiry noted that the former HFE system "creates a major disincentive to Western Australia setting its royalty rates...": [Submission 15 - WA Government - Horizontal Fiscal Equalisation - Public Inquiry](#)

⁸⁸ [Government of Western Australia \(2024\), Overview of State Taxes and Royalties 2024-25, Appendix 3](#)

⁸⁹ [Government of Western Australia \(2024\), Overview of State Taxes and Royalties 2024-25, Appendix 2](#)

⁹⁰ [Intergovernmental Agreement on Federal Financial Relations, Schedule B: Tax Reform. Page B-1](#)

⁹¹ [Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations \(1998\). Section 5 \(vi\)](#)

budgetary constraints, announcing that: “The abolition will be revisited when its cost can be better accommodated in the State’s Budget.”⁹²

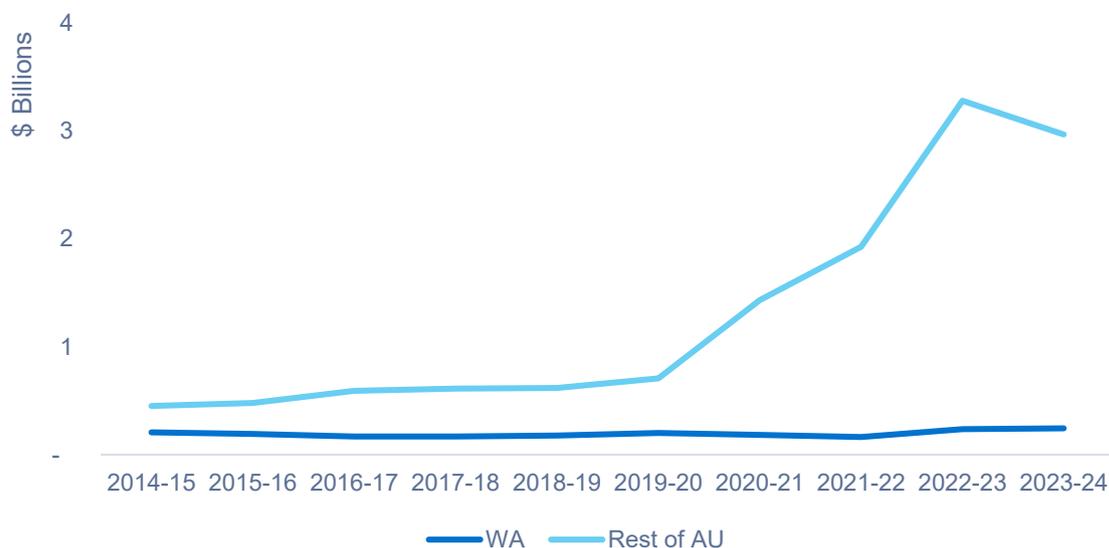
The 2018 changes have provided WA with an additional \$22.4 billion in GST revenue, and as such have eliminated both the budgetary constraints as well as the GST implications of this productivity enhancing reform. However, after seven years of the current system, and over 15 years after states committed to these reforms in 2009, this inefficient tax on business transactions remains in place in WA.

6.3 The 2018 changes have not affected incentives on WA to develop its economy

The 2018 changes theoretically provide WA the ability to further expand its resources revenue bases without the potential negative GST consequences. However, this has not eventuated since the 2018 changes were introduced as WA already had strong incentives to develop its economy and revenue bases, and there is no evidence that the 2018 changes had any effect on WA’s policy effort or outcomes.

The CGC’s assessment of services to industry expenses separately identifies government support for the mining sector. By this measure, since 2014-15 WA’s expenses in this area have remained stable, and declined as a share of the national total (Figure 13). While the investment data does not exist at the industry level, WA has had the second lowest levels of government investment as a share of GSP since 2018, at only 1.8 per cent of GSP while Victoria is running at almost double, at 3.5 per cent of GSP (Figure 14).⁹³

Figure 13: CGC services to industry actual expenditure in the mining sub-component

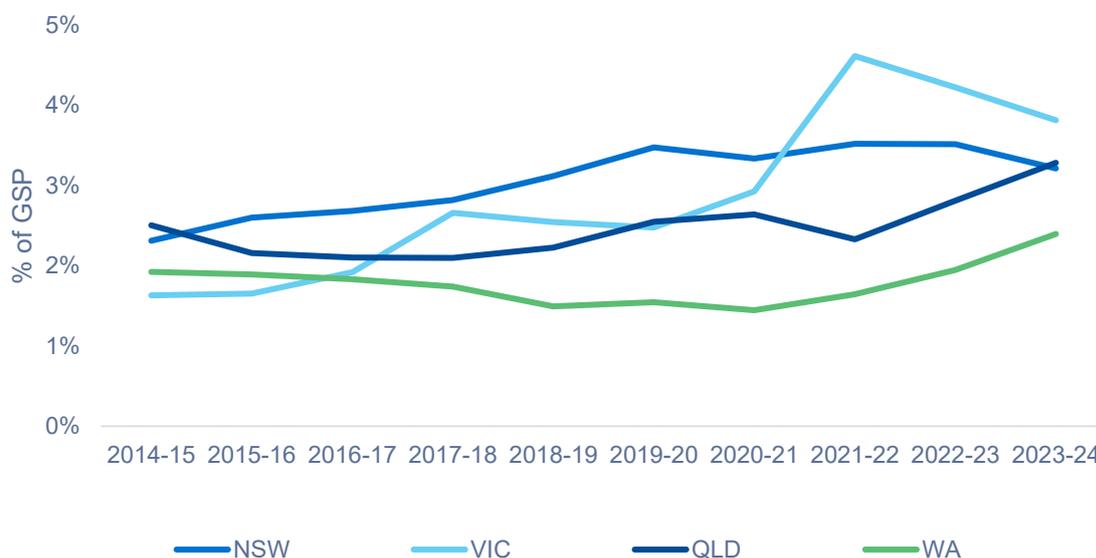


Source: CGC assessments

⁹² Duties Legislation Amendment Bill 2013 (WA), Explanatory Memorandum

⁹³ ABS Government Financial Statistics, ABS State accounts

Figure 14: Non-financial public sector acquisition of non-financial assets as a share of GSP



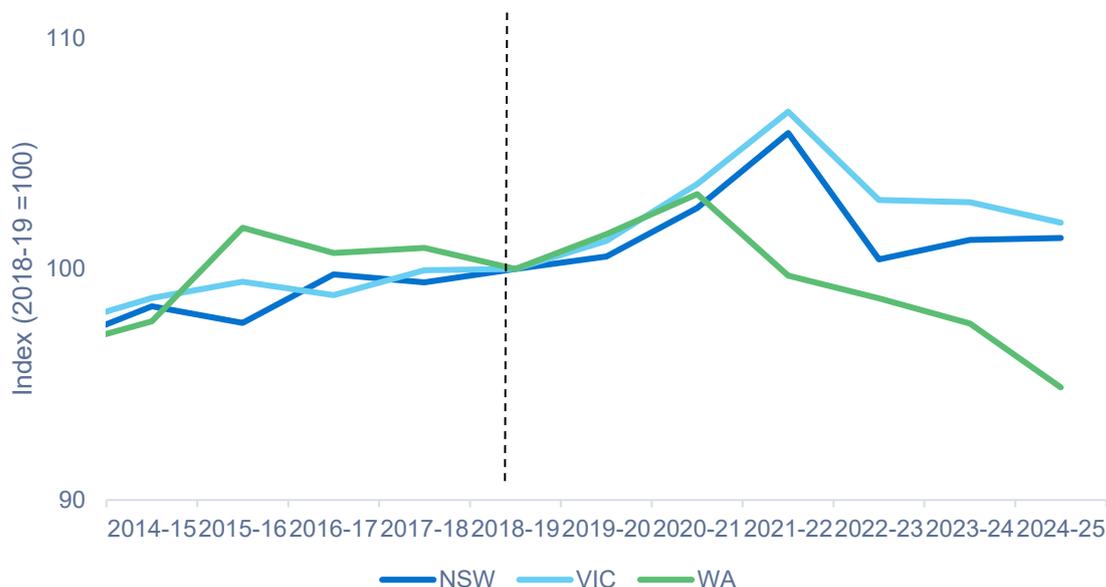
Source: ABS GFS

WA's mining sector did not record a lift in productivity after the 2018 changes, with WA mining industry gross value added per hour worked falling by 21 per cent between 2018-19 and 2023-24.⁹⁴ This was despite the WA government's strong fiscal position and capacity to influence productivity. Since 2018-19 WA has had the lowest productivity growth in the country, declining by five per cent, shown in Figure 15. In the same time, real per capita GSP in WA has only grown by 0.1 per cent, the lowest in the country (Figure 16). In terms of investment attractiveness, WA has fallen from first in 2021 to 17th in 2024 in the Fraser Institute Index of mining investment attractiveness.⁹⁵

⁹⁴ DTF calculations of gross value added per hour actually worked in WA mining industry using ABS State accounts and ABS estimates of state and territory hours worked by industry.

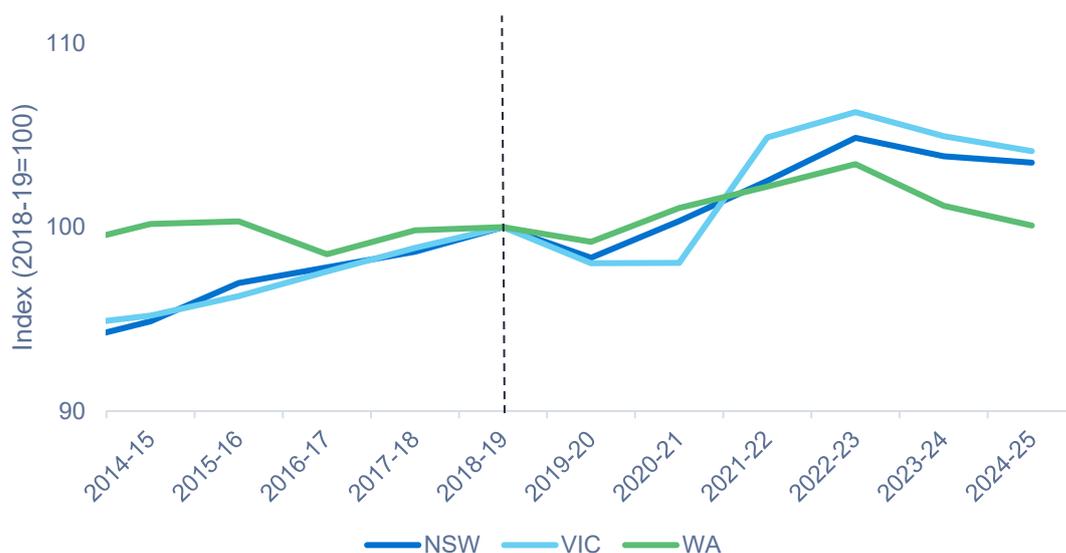
⁹⁵ Annual Survey of Mining Companies, 2024, Fraser Institute.

Figure 15: State productivity (GSP per hour worked)- change since 2018-19



Source: ABS State Accounts, ABS Labour Force

Figure 16: Real GSP per capita, change since 2018-19



Source: ABS State Accounts

This is not to say that WA has not made an effort to support its industries. However, mining investment and productivity are driven more by cyclical and global factors than theoretical GST impacts, and the 2018 changes have had no impact on WA’s policy effort or outcomes.

In contrast, former WA governments undertook significant policy effort through the 1980s and 1990s when WA was under the full effects of HFE. WA developed its North West Shelf offshore gas resources, and prior to that invested significantly in exploration and development of its mining

industry.⁹⁶ At that time, WA was a beneficiary of the HFE system, receiving more than its population share of Financial Assistance Grants.⁹⁷ Improving its revenue raising capacity would still have reduced its share of grants under equalisation (accounting for the CGC's policy neutrality controls), however it undertook this industry development regardless.

This raises an important point that states undertake reform and develop their industries for a range of reasons, not only a zero-sum fiscal calculus involving GST revenues. Reforms to improve revenue sources and develop industries are worthy goals of governments in and of themselves, regardless of the fiscal reward. In developing their mining industries and revenue bases, the mining states provide greater opportunities for employment and higher incomes for their populations, which are linked to wider benefits to society and individuals' wellbeing. Retaining additional GST revenue for these improvements is a windfall gain and does not promote any additionality to reform or development.

6.4 Other states have pursued reform despite theoretical disincentives

WA's record of reform since 2018 sits in contrast to the activity of other states during the same period.

While WA made no changes to its royalty regime, in 2023 Queensland introduced a progressive royalty rate system which allowed it to capture a greater return from its coal resources during the spike in prices caused by the Russian invasion of Ukraine.⁹⁸ Furthermore, NSW also increased its coal royalty rates in 2024-25.⁹⁹ Queensland and NSW went ahead with these changes despite the GST implications, and their policies did have an impact on the CGC's coal royalty revenue assessment.

While WA failed to abolish duties on business transactions, as noted in Section 6.2, Victoria, SA and the NT forged ahead with difficult stamp duty reforms to support commercial and industrial activity. In 2018 SA completed its abolition of stamp duty on commercial and industrial property.¹⁰⁰ In 2024 Victoria launched its commercial and industrial property tax, progressively transitioning from land transfer duty to a more efficient annual land tax on the unimproved value of the property.¹⁰¹

Victorian business insurance duty is also being reduced over a 10-year period from 1 July 2024. This will save businesses up to \$800 million over the first five years. Insurance taxes can distort business decision-making and can lead to under- or non-insurance, costing the Victorian economy more than \$100 million a year.¹⁰²

In 2024, the NT announced it would abolish duties on non-real business assets,¹⁰³ leaving WA and Queensland as the only states not to complete this reform (see Section 6.2).

Victoria, SA and the NT went ahead with these reforms to achieve significant benefits for their economies and budgets, which are far more relevant than the theoretical impacts to their GST revenues. For example, Victoria's reforms could prompt an increase in business insurance or property

⁹⁶ Submission 15 – WA Government - Horizontal Fiscal Equalisation - Public inquiry, 2017

⁹⁷ Commonwealth Grants Commission (2025). 2025-26 GST sharing relativities – supporting table no. 8: Relativities over time.

⁹⁸ Queensland Parliament united on new progressive coal royalties. Queensland Government media release, 26 June 2022

⁹⁹ Coal Royalty Changes from 1 July 2024, Revenue NSW

¹⁰⁰ Government of South Australia (2016). 2016-17 State Budget, Budget Paper No.3: Budget Statement, page 33

¹⁰¹ State Revenue Office (Victoria), 'Commercial and industrial property tax effective from 1 July 2024'

¹⁰² Government of Victoria (2024) Budget 2024-25, Budget paper No. 2: Strategy and Outlook, page 12

¹⁰³ Government of Northern Territory (2023) 2023-24 Budget, Budget Paper No. 2: Budget Strategy and outlook, page 15

transactions in Victoria, which would increase Victoria's revenue raising ability and decrease Victoria's GST share in the CGC's assessment. It is important to note that while these impacts may occur in theory, the CGC has stated its intention that its assessments do not deter states from enacting reforms.¹⁰⁴

Since the 2018 changes were introduced, the "controls" in the experiment (states other than WA) have undertaken reforms despite potential GST impacts, while the "treatment" (WA) has not, even though the 2018 changes guaranteed that any reform would not impact their GST. Linking to the PC's statement from the previous inquiry, that "an absence of evidence is not evidence of absence", Victoria considers there this is now significant evidence of absence.

This supports the reasoning that:

- HFE was not a significant factor inhibiting productivity enhancing reform
- the absence of HFE does not induce productivity enhancing reforms.

WA has effectively been rewarded for making no additional policy effort to increase its fiscal capacity, while other states have been made effectively worse off by the 2018 changes despite undertaking reform. This is diametrically opposed to the stated intentions of the 2018 changes being "fiscal reward for effort and policy reform".¹⁰⁵

6.5 The CGC's assessments already account for the majority of perceived issues with policy influence

The CGC's existing policy neutrality approach is largely successful and already accounts for the vast majority of potential policy influences on states from the GST system. The CGC's assessments are based on 'policy neutral drivers' which are broad, underlying characteristics that states do not have influence over directly. For example, most of the CGC's assessments of expenditure needs include the remoteness of resident populations and First Nations populations as key drivers. The CGC's revenue assessments are based on national average tax rates and underlying revenue bases that states do not directly control.

Assertions that the CGC's assessments deter states from developing their economies, revenue sources or improving efficiency of service delivery do not reflect how the CGC's assessments work in practice. The development of a states' economy (for example increases in GSP, employment, productivity or reductions to unemployment) does not directly influence the CGC's assessments – these macroeconomic factors are not included in the calculations. In a recent Occasional Paper "GST Distribution: Addressing Some Misconceptions" the CGC addressed this directly stating:

*The GST distribution arrangements do not compensate a state for poor fiscal management. A state is not rewarded with an increased share of GST revenue if it runs larger budget deficits than other states because of its policy choices. GST is based on states' relative, policy neutral fiscal capacities, not their fiscal policies.*¹⁰⁶

¹⁰⁴ Commonwealth Grants Commission (2021) Occasional paper No. 2: GST distribution and state tax reform, page 7

¹⁰⁵ Productivity Commission (2018), Horizontal Fiscal Equalisation, Report no. 88, Canberra, Page 5

¹⁰⁶ Commonwealth Grants Commission (2023) Occasional paper No. 12: GST distribution - Addressing Some Misconceptions, page 1

Individual state changes in policy around service delivery, including improvements to efficiency, have little impact on their GST distributions due to the CGC's policy neutrality controls in its assessments. How much GST each state receives from expenditure needs is not related to a states' actual service delivery costs. Instead, national average costs are attributed to state usage statistics associated with underlying drivers.

For example, in the assessment of hospital funding needs, the national rate of hospital activity and cost associated with different sociodemographic groups (for example First Nations status, age, remoteness and socioeconomic status) are applied to each states' population of those different groups for a total assessed need. If a state improves the efficiency of its service delivery, this does not directly impact its GST share. It would only have an impact through a change to the national use or cost of hospital services by different sociodemographic groups.

This impact is likely to be minor, given it is diffused across national populations and the impact on efficiency of service delivery likely apply to groups relatively evenly (e.g. efficiency improvements are unlikely to disproportionately make care for First Nations people more or less costly compared to non-First Nations people). The actual benefits from improved services (lower costs and better outcomes) greatly outweigh any minor potential GST impact, given the circuitous and likely negligible impacts.

For example, if Victoria were able to achieve the same outcomes across its health service delivery, including hospitals and community health, with 5 per cent lower expenditure, this would be equivalent to a \$1.4 billion reduction in Victorian spending based on the CGC's 2023-24 data. Applying this within the CGC's methods across the assessment years in its latest 2025-26 relativities, DTF estimates the resulting reduction in national assessed health spending needs would have only resulted in around \$30 million more GST for Victoria in 2025-26. This represents less than 2 per cent of the change in actual spending, hardly a significant incentive compared to the benefits in actual health spending and outcomes.

Where there are potential issues with the CGC's approach to policy influence, for example in a hypothetical state land transfer duty to land tax swap, the CGC has committed to changing its methods to remove these issues. In 2021, the CGC flagged its intention to support policy reform where possible through an Occasional Paper stating "Should the impact of the reform on GST distribution be material, the Commission could seek to identify and remove the impact" (noting deference given to directions from the Commonwealth Treasurer and its restrictions from method changes between methodology reviews).¹⁰⁷ In its recent 2025 review, the CGC concluded that it would be able to adjust its methods between the typical 5-yearly windows in the case of a "significant unanticipated shock (such as a pandemic) or where major state policy reforms are enacted between reviews".¹⁰⁸

Any marginal policy neutrality issues should be dealt with through the CGC's preexisting processes, rather than top-down overhaul of the system like the 2018 changes which don't directly address the issues. For example, a hypothetical land tax to land transfer duty swap still has the same potential GST impacts for all states other than WA under the 2018 changes.

¹⁰⁷ Commonwealth Grants Commission (2021) Occasional paper No. 2: GST distribution and state tax reform, page 7

¹⁰⁸ Commonwealth Grants Commission (2025). 2025 Review Outcomes - Flexibility to consider method changes between reviews

7. Australia should revert to the former system, or make the NWOG permanent

Through the inquiry the PC and other contributors will consider a range of potential alternative equalisation systems with an evaluation of which are best for Australia. Victoria has undertaken an analysis of potential systems, and concludes that the 2018 changes should be repealed, as they have not achieved the stated policy aims of improving volatility or incentives for reform, and come at a significant cost to most states. Instead, Victoria recommends that the former HFE system is reinstated as it best balances equality across jurisdictions, certainty, states' fiscal capacities and policy incentives – see Section 7.1.

Victoria's framework for assessing the options, including a detailed evaluation of potential alternatives is provided in Appendix A. Victoria's framework is to assess the options on the following criteria, as established as aims for the changes in 2018:

- Achievement of HFE
- Ensuring stability and supporting state's fiscal planning
- Minimising the fiscal impacts to states
- The potential for policy incentive influences.

Victoria's conclusion from this assessment remains that the former system is the most appropriate.

A high-level case for likely possible alternative systems is provided in this section, including expanding on the benefits of the former system (Sections 7.1 and 7.2). Further analysis of other potential options is provided at Appendix A.

Ultimately the Commonwealth will decide its policy for supporting WA. If it decides to continue to provide WA additional GST-related support, doing this outside the GST system would be simpler and more transparent, see Section 7.3.

If the Commonwealth continues with the 2018 changes, then the NWOG must be legislated permanently – see Section 7.4. Without the NWOG, the 2018 changes would have significant impacts to service delivery and infrastructure that would be negative for communities and the national economy.

7.1 The former system worked well, and the fundamentals remain sound

As described in Section 4.2, the longstanding former system of HFE, based on recommendations from the CGC, achieved a desirable level of interstate equalisation that made Australia a fairer and more prosperous place to live. The former system largely did not have significant issues with predictability for states (as shown in Section 5.2) and has not been a disincentive to useful policy change (as shown in Section 6.4).

Table 3 provides an evaluation of the former system against the principles identified. In terms of achieving these objectives, Victoria finds the former system of full HFE was superior to the 2018 changes.

It has been established in previous sections that the current system has failed to meaningfully achieve its stated objectives and is in many cases a step backwards. Simply reversing those changes would result in substantial improvements in fairness, equity and simplicity, while having minimal impact on efficiency or volatility and would leave states other than WA no worse off.

Note the evaluations in the following sections and Appendix A are relative to the current system as the default arrangements if no changes are made through this inquiry. These include the changes to the equalisation standard and a relativity floor, and the NWOG would end after its current extension to 2029-30.

Table 3: Evaluation of the former system

Aim	Impact compared to current system	Explanation
Achieving HFE	Much Better	Full HFE represents the highest practical standard of equalisation. This ensures states have the fiscal capacity to deliver the same standard of services.
Ensuring stability and supporting state's fiscal planning	Better	While the strongest state would be exposed to more volatility in their relativities, this volatility is entirely predictable, and other states would no longer have to deal with the complexity of the current system, and the uncertainty around the expiry of the NWOG.
Fiscal impacts to states	Better	<p>Relative to the former system, all states would be no better or worse off. Relative to the current system, WA would be worse off while other states would be better off.</p> <p>The balance of risks under the reforms for most states is currently negative, with a high chance of being significantly worse off and a low chance of being slightly better off due to the pool boosts (without the NWOG) or benefitting from the new standard of equalisation. Returning to the former system, even without the pool boost, would restore this balance of risks to neutral.</p> <p>Commonwealth funding currently absorbed by the NWOG could also be spent more effectively to benefit all states.</p>
Potential for policy incentive impacts	Much Better	<p>The former system:</p> <ul style="list-style-type: none"> • Doesn't reward or punish jurisdictions for undertaking productivity enhancing reform • Fairly shares Australia's mineral wealth • Is aligned with the opinion of experts and the views of most states.

7.2 An arms-length rules-based system for equalisation benefits citizens, the Commonwealth and states

As noted in Section 4.2, the CGC's approach has the benefit of being independent, rules-based and transparent, with regular reviews and open consultation with states. This provides states with certainty that they will receive the revenue required for essential services, and that this funding will not be subject to unilateral decisions of the Commonwealth or prolonged negotiations.

This arms-length and rules-based system is preferred to alternative arrangements that would place greater emphasis on ad hoc negotiated outcomes to achieve equalisation (see Appendix A.5 for an evaluation of equalisation achieved through tied grants).

The CGC itself notes that “HFE seeks to retain the benefits of decentralised governance and administration provided by sub-national jurisdictions, without requiring the transfer of functions to the Commonwealth. The combination of fiscal equalisation with decentralised governance is a longstanding feature of the Australian federation. The payment of HFE grants (that is, GST revenue) as general revenue assistance allows State governments to deliver services according to their State’s specific needs and circumstances.”¹⁰⁹

In addition to general revenue assistance (mainly GST), the Commonwealth government provides funding to states in the form of ‘tied grants’ or ‘specific purpose payments’ (SPP).

However, there are a number of potential drawbacks with tied grants determined via negotiation, compared to the rules-based approach for distributing the GST through the CGC.

Firstly, the current level of tied grants to each state is not based on any equalisation requirement, although the payments are considered in the CGC’s methodology (see Section 8). Victoria has consistently received less than its population share of tied grants and less than its population share of infrastructure funding (see Section 3.3). As equalisation is not considered, an over-reliance on tied grants could mean some states don’t receive the funding they require to provide a similar standard of services and infrastructure, leading to poorer outcomes for their residents.

Secondly, SPPs are typically based on negotiated bilateral or multilateral agreements. These agreements often involve significant control from the Commonwealth over the program implementation and reporting, even when the payment is for an area of service delivery or infrastructure under state responsibility. This reduces the capacity of states to respond to their unique needs and circumstances and of their elected government to implement appropriate policies, potentially resulting in poorer outcomes for citizens.

Thirdly, Australians benefit when grant funding is allocated through transparent, merit-based processes aligned with established policy objectives.¹¹⁰

The extension of the NWO should have remained separate from any other policy decisions or negotiations. The guarantee was necessary because of the Commonwealth’s unilateral decision to implement the 2018 changes to benefit WA. Addressing the impacts of the 2018 changes is the responsibility of the Commonwealth, without being tied to additional concessions from states that already abolished a range of state taxes at the introduction of the GST.

Under the former system, equalisation was achieved through a mostly objective, independent, evidence-based process. However, there were some exceptions. Despite the independence of the CGC, the current and former system require the Commonwealth Treasurer to provide ToRs for CGC assessments. These ToRs can be used to override the independent recommendations of the CGC. For example, the Commonwealth Treasurer did not allow the CGC to adapt its methodology to appropriately account for COVID-19 expenditure needs until 2025-26, long after the majority of the expenditure had been assessed (see Section 5.1).

¹⁰⁹ https://www.cgc.gov.au/sites/default/files/2021-11/fs04_horizontal_fiscal_equalisation.pdf

¹¹⁰ See, e.g., Wood, D., Griffiths, K., and Stobart, A. (2022). *New politics: Preventing pork-barrelling*. Grattan Institute.

Victoria has since led efforts to improve the governance of the GST distribution system through the Board of Treasurers and continues to recommend further standardisation, increased transparency and de-politicisation of the GST distribution system.

The more that equalisation can be determined by a politically independent and transparent process, the better off Australians will be. As described further in Section 8 and Appendix A.5, attempting to achieve HFE through tied grants would be inefficient and unlikely to succeed. An independent, rules-based system, with appropriate consultation and review, such as the system prior to the 2018 changes, is a superior method.

7.3 If necessary, the Commonwealth could directly support WA

Victoria maintains that any Commonwealth support for WA should be delivered in a way that preserves the integrity of the national HFE system. Offsetting the changes with the NWOOG results in unnecessary layers of complexity.

Providing targeted general revenue assistance to states is within the Commonwealth's role and discretion if it determines this is in the nation's best interests, however it is simpler and more transparent to do so outside the HFE system.

An alternative solution is to restore the former system, and implement external payments from the Commonwealth to WA. The 2018 changes would be repealed, and a separate agreement made between WA and the Commonwealth for payments as they agree appropriate. The CGC could be involved in this process to calculate what WA would have received under the current reforms to provide the basis for that payment, or other arrangements could be agreed for funding at another quantum. The other states and the general calculation of GST relativities would not be impacted by this process, except for the treatment of the payment within the CGC's methods which would need to be determined in future through the CGC's usual processes.

This could reflect the arrangements that were put in place for WA and the NT in 2019-20, 2020-21 and 2021-22, which provided separate payments to ensure they received total GST-related revenue (GST plus this additional payment) as though relativity floors were in place.

Regardless of the final payments to WA, the risk of any changes to this agreement would no longer be borne by the other states through redistributions of GST, but instead by the Commonwealth and WA (that is, the risk is borne by two parties rather than eight). This would also remove the additional complexity added to the calculation and interpretation of GST revenues by the 2018 changes.

While this is not the most efficient outcome due to the opportunity cost of Commonwealth transfers to the strongest state, this option allows the Commonwealth to maintain the fiscal outcomes of the 2018 changes. At the same time, it would improve simplicity and transparency in the GST system and greatly improve certainty by eliminating the fiscal cliff currently faced by other states (Table 4). This outcome would also foster intergovernmental trust and cooperation more than the current system, as it does not directly interfere with the GST system that states all bought into in 2000.

Table 4: Evaluation of Commonwealth direct support for WA

Aim	Impact compared to current system	Explanation
Achieving HFE	Better	Restoring the former equalisation standard would bring the system closer to full equalisation and improve transparency and simplicity, however the separate payments to WA would continue to result in uneven fiscal capacities.

Ensuring stability and supporting state's fiscal planning	Better	Restoring the former system would remove the uncertainty associated with the expiry of the NWOG. Uncertainty around negotiations for the external payments would only affect one state, WA, reducing overall impacts on fiscal predictability.
Fiscal impacts to states	Much better	Other states would be better off with their former system relativities, and the external payments would provide additional funding for the strongest state WA which could maintain its revenues under the 2018 changes or support it otherwise.
Potential for policy incentive impacts	Better	Largely unchanged from the current reforms, with additional payments to WA having minimal impact on the incentives to pursue reform. However, the 2018 changes result in an inequitable distribution of Australia's mineral wealth, and are at odds with the majority of expert recommendations.

7.4 If the 2018 changes are retained, the NWOG must be legislated permanently

Victoria's preferred outcome is that the 2018 changes are repealed and there is no additional GST-related transfer to WA. In the case that the Commonwealth maintains the 2018 changes, the NWOG must be extended permanently so that states are not adversely impacted.

Most direct fiscal impacts of the current system have been mitigated by the NWOG, resulting in outcomes similar to the former system outlined in Table 5. Without this guarantee, states other than WA face significant uncertainty and fiscal risks.

If the Commonwealth is committed to maintaining the current system which delivers additional revenue for WA, at a minimum, the NWOG must be maintained indefinitely to ensure no state is worse off. Similar to the repeal of the 2018 changes described in Section 7.1, extending the NWOG permanently would significantly reduce risk and improve fiscal sustainability for the other states, by eliminating the fiscal cliff of the NWOG expiry.

Far from acting as an impediment to reform, maintaining state GST allocations through the NWOG has allowed states other than WA to continue to pursue productivity enhancing reforms, showing that the GST allocation did not affect state decisions (as shown with the examples in Section 6.4). However, if the NWOG were to expire, states may face a more constrained fiscal environment, severely limiting the scope for further reform.

Table 5: Evaluation of extending the NWOG in perpetuity

Aim	Impact compared to current system	Explanation
Achieving HFE	Better	The NWOG brings states closer to full equalisation, but there is still a disparity between the strongest state and other states through the distribution of GST revenues.
Ensuring stability and supporting state's fiscal planning	Much better	Making the NWOG permanent would remove the uncertainty associated with the expiry of the NWOG.

Fiscal impacts to states	Better	The NWOG would remove the downside fiscal risk associated with the current system for most states, however the Commonwealth funds used to effectively subsidise this transfer to WA have an opportunity cost.
Potential for policy incentive impacts	Better	As with direct Commonwealth support described in the previous Section 7.3, largely unchanged from the current reforms, with additional payments to WA having minimal impact on the incentives to pursue reform. However, the 2018 changes result in an inequitable distribution of Australia's mineral wealth, and are at odds with the majority of expert recommendations.

The Commonwealth has the capacity to continue funding the guarantee with increased company tax windfalls from resources companies.

The cost of providing the NWOG is positively correlated with periods of high growth in its other tax revenues, for example, company tax driven by strong profits from mining activity (assuming there are no other changes in factors that influence the Commonwealth's tax revenues) The Commonwealth receives more from company tax receipts when iron ore prices are high, which is when guarantee payments are higher due to WA's strong fiscal capacity. Conversely, if iron ore prices drop, lower guarantee payments are required as the 2018 changes provide less of a windfall to WA.

As a result, the guarantee has a negligible impact on the Commonwealth's budget position and is manageable with the flows of its other revenues. The guarantee payments are far more critical to state budgets with real impact should they be withdrawn.

The 2025-26 Commonwealth Budget Sensitivity analysis chapter states: "A (permanent) US\$10 per tonne increase in the assumed price for iron ore exports is expected to result in an increase in tax receipts of around \$0.4 billion in 2025–26 and \$0.5 billion in both 2026–27 and 2027-28, before increasing to \$2.1 billion in 2028–29. An increase in iron ore prices increases mining company profits and therefore company tax receipts."¹¹¹

At the same time, Victoria estimates that the same increase in iron ore prices between 2024-25 and 2026-27 would result in a gradual increase in total NWOG payments to all states of \$0.3 billion in 2026-27, \$0.5 billion in 2027-28 and \$0.8 billion in 2028-29 due to higher iron ore royalties and a lower WA relativity before applying the new system.

¹¹¹ The Commonwealth of Australia (2025) Budget 2025-26, Budget paper No.1, Budget Strategy and outlook, page 185 page 185

8. The current arrangements appropriately manage the interaction between GST and other Commonwealth payments to States

Separately to the question of the performance of the 2018 changes, the ToR ask the PC to consider the interaction between other Commonwealth payments, GST and HFE. In its issues paper the PC additionally asked for views on specifics of the mechanics of this system, including when and how the CGC should exclude payments from its calculations, and the role of the Commonwealth Treasurer in these decisions.

Victoria considers in this respect the current system works well, where the CGC accounts for the effect of Commonwealth payments on states' fiscal capacities in its holistic calculations (see Section 8.1). Victoria supports the CGC's approach for how to assess Commonwealth payments, as did all other states in the CGC's recent reviews of this issue.¹¹²

There has already been work by the PC, Commonwealth, states and the CGC on clarifying the Commonwealth Treasurer's role in 'quarantining' or directing the exclusion of payments from the CGC's calculations. Victoria provides some suggestions on this issue in this submission (Section 8.2), however considers further work by Treasury forums should continue before changes are made to this process.

Overall, Victoria considers the issues of the interaction between Commonwealth payments, and the GST are already appropriately addressed by existing forums and processes (such as the CGC, and the Council on Federal Financial Relations) and are not a substitute for fulsome consideration of the 2018 changes by this inquiry.

These issues touch on broader considerations around Australia's fiscal structure and VFI (see Section 8.3). The ToR's direction to recommend other preferred alternative HFE systems could be interpreted as an opportunity to propose potential changes to broader FFR or other Commonwealth tied payments.

Victoria would not support changes to other Commonwealth payments or broader FFR issues as part of this inquiry. The focus of this inquiry should be assessing the effectiveness of the 2018 changes, with the major decision points being to repeal or retain the 2018 changes, and other approaches to distributing the GST to achieve HFE.

From a practical perspective, the timeframe and capacity of contributors to this inquiry, including the PC, Commonwealth and states, is already limited to address the complex current GST system and the 2018 changes. Expanding the scope to broader FFR issues risks decisions being made on poorer evidence and understanding, given there is not a significant, conclusive pre-existing evidence base or set of recommendations on tangible issues and preferred solutions to evaluate. As described in Appendix A.5, options to resolve issues with the GST system through changes to tied grants are impractical and unlikely to achieve the desired outcomes.

Victoria agrees there are issues with the broader FFR arrangements that should be reviewed and addressed. As noted in Section 7.2, the GST system has benefits from being removed from the broader FFR negotiating framework, with a predictable, arms-length approach to determining states'

¹¹² https://www.cgc.gov.au/sites/default/files/2025-03/2025R%20-%20Review%20outcomes%20-%20Commonwealth%20payments_FINAL.pdf

distributions. Section 8.3 below details some of Victoria's concerns with the broader FFR arrangements for completeness, but recommends the PC not make any recommendations for change as part of this inquiry outside the scope of the GST.

8.1 The CGC's approach for assessing Commonwealth payments is appropriate and widely supported

The current treatment of Commonwealth payments within the GST distribution system reflects the best approach to delivering HFE, while preserving the Commonwealth's funding discretion.

The CGC has long established principles for how to assess Commonwealth payments in the GST distribution methodology. Commonwealth payments are included in the assessments where they support states to deliver services in areas of states' primary responsibility, effectively supporting their own source revenues. In a recent Occasional Paper the CGC describes the rationale for its approach:

*"The Commission considers Commonwealth payments, like other revenue sources, are available to states to fund services and invest in infrastructure. Given the importance of these payments to state budgets, they need to be taken into account by the Commission when determining each state's fiscal capacity and GST share. If they were excluded, state fiscal capacities would not be similar and states that receive less revenue in the form of Commonwealth payments would be disadvantaged."*¹¹³

The CGC's principles cover the exclusion of some Commonwealth payments from the calculations which are for areas of Commonwealth responsibility, or for state expenditures which are not otherwise assessed in the CGC's methodology. Other exclusions include for facilitation or incentive payments, so that the behavioural impact of those payments is not diluted.

This approach has been widely accepted as an appropriate practice to fully capture states' fiscal capacities for HFE. The PC concluded as much in the 2018 inquiry report noting: "Existing principles for the treatment of Commonwealth payments in the HFE process largely provide a clear framework on whether a payment will be discounted, included or excluded from the HFE process by the CGC".¹¹⁴

Through the Intergovernmental Agreement on Federal Financial Relations 2009 (IGA FFR 2009), all states and the Commonwealth agreed that grants affect states' fiscal capacities and should be included in the CGC's assessments. It notes:

"National SPPs, NHR funding, Quality Schools funding (for government schools), National Housing and Homelessness Agreement and National Partnership project payments should affect the relativities, recognising that these payments provide the States and Territories with budget support for providing standard State and Territory services".¹¹⁵

¹¹³ Commonwealth Grants Commission (2022) Occasional paper No. 6: Why are some commonwealth payments to states included in calculations of GST needs?

¹¹⁴ Productivity Commission (2018), Horizontal Fiscal Equalisation, Report no. 88, Canberra, Page 185ss

¹¹⁵ Note the IGA FFR 2009 also describes the treatment for general revenue assistance, facilitation and reward payments and the discretion the Commonwealth Treasurer and CGC have to decide on treatment of specific payments as they arise. <https://federalfinancialrelations.gov.au/sites/federalfinancialrelations.gov.au/files/2022-11/schedule-d-payment-arrangements-november-2022.pdf>

The inclusion of Commonwealth payments in the CGC's calculation of states' fiscal capacities pre-dates the GST, and was included in the calculation of the first relativities for the GST distribution in 2000-01.¹¹⁶

The CGC's approach to assessing other Commonwealth payments to states is also regularly reviewed in consultation with all states through its annual GST relativities updates and more extensive five-yearly methodology reviews. Through the CGC's annual updates, states can comment on the CGC's proposed treatment of individual new payments. Typically, there is little commentary on the treatment of new payments from states, except where they are directed towards one state. For example, of the 46 new payments in 2023-24 discussed as part of CGC's consultation on the 2025-26 relativities, states only commented on four, three of which were only for individual states.¹¹⁷

In its methodology reviews since that time, states have broadly supported the CGC's approach. In the most recent 2025 methodology review there were relatively few changes to the assessment of Commonwealth payments, reflecting the CGC and states' comfort with the pre-existing methods. In the 2025 review, the CGC noted there was unanimous support from states for its overall approach: "All states supported retaining the 2020 Review guidelines" (the guidelines outline how the CGC assesses Commonwealth payments, including whether they impact states' fiscal capacities).¹¹⁸

There was discussion on specific issues in the 2025 review on the CGC's methods for assessing Commonwealth payments, however these were relatively minor (for example, the treatment of Commonwealth own-purpose payments) and had little discussion compared to more significant assessment areas. For example, the discussion on Commonwealth payments was seven pages long in the CGC's 2025 review outcomes documents (describing the CGC and states' views on the CGC's questions and state raised issues), whereas transport was 22 pages long and health was 32 pages long.^{119,120}

8.2 There should be greater transparency when payments are quarantined by the Commonwealth Treasurer

The Commonwealth has the discretion to direct the CGC to exclude a payment from the assessment through its ToR. This is an important tool which provides the Commonwealth with more flexibility to negotiate with states and achieve policy objectives.

Despite supporting the CGC's approach to assessing Commonwealth payments, Victoria agrees there are cases where it is beneficial for the Commonwealth Treasurer to be able to direct the treatment of some payments in its annual ToR. Noting this, Victoria considers there should be more transparency around this process, to ensure it is not overly used.

Victoria generally supports the practice of quarantining payments in limited cases. Over the past 20 years, some common characteristics of excluded payments are that they tend to be:

- bilateral payments, often the result of a bilateral negotiation
- related to state commitments beyond the subject of the payments

¹¹⁶ Commonwealth Grants Commission (Australia). (2001). Report on state revenue sharing relativities ... update working papers Retrieved January 23, 2026, from <http://nla.gov.au/nla.obj-851394946>

¹¹⁷ Commonwealth Grants Commission (2025) New issues for the 2025-26 GST relativities

¹¹⁸ Commonwealth Grants Commission (2025) 2025 Review Outcomes- Commonwealth Payments

¹¹⁹ Commonwealth Grants Commission (2025) 2025 Review Outcomes- Health

¹²⁰ Commonwealth Grants Commission (2025) 2025 Review Outcomes- Transport

- payments related to national policy objectives, of an area of Commonwealth or joint Commonwealth-state responsibility
- for a non-standard payment mechanism, such as an equity contribution, or asset recycling.

The rationale for excluding payments has not always been transparent or consistent. As a result, the 2018 inquiry recommended developing guidelines to govern quarantining payments from the CGC's methodology.

Under the current legislative arrangements, the Commonwealth has near complete discretion over the distribution of the GST and functioning of the CGC (noting it has always followed the CGC's independent recommendations).

Given the current legislative structures, rather than prescribing specific requirements for payments that can or cannot be excluded, and to retain the intention of flexibility, it is preferable to make the Commonwealth's decision making more transparent. The Commonwealth should provide reasoning for its decisions in the terms of reference to limit the risk of political interference with the CGC's independent process.

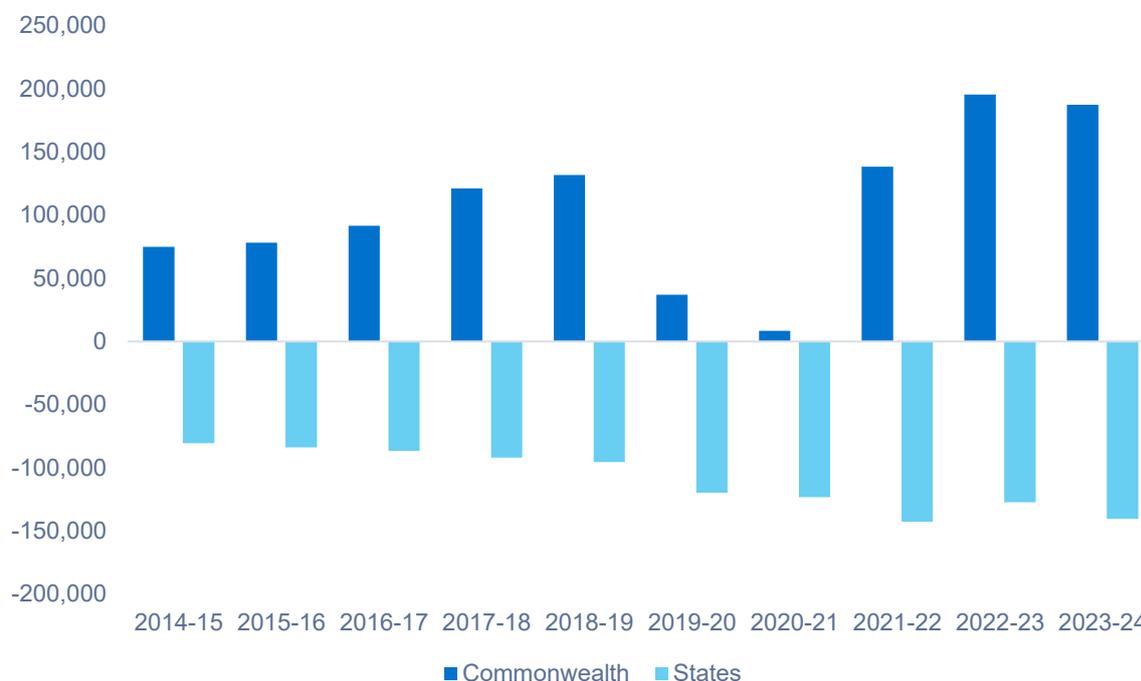
The past 25 years of GST distributions have created a long history of grants which have been quarantined. Victoria considers that these exclusions could serve as a precedent to justify future Commonwealth exclusions, in that payments with similar circumstances to previously excluded payments could receive similar quarantining and be noted in the relevant terms of reference. If a quarantined payment does not align with any previously excluded payment, the Commonwealth should be required to describe the policy rationale for excluding this payment in the terms of reference, adding to the body of precedents.

8.3 Vertical Fiscal Imbalance creates additional pressure on GST revenues for states, however, is outside the scope of this inquiry to resolve

Noting Victoria's preference that this inquiry does not make recommendations to address broader FFR issues, Victoria does agree there are challenges that deserve more considered review through other processes.

Australia has a relatively high degree of VFI, where the Commonwealth raises more revenue than it requires for its spending, and states have less than required, as shown in Figure 17. This means Commonwealth grants to the states like the GST are a critical part of funding services and infrastructure.

Figure 17: Differences between own-source revenues and expenses for the states and Commonwealth, 10 years to 2023-24



Source: ABS GFS

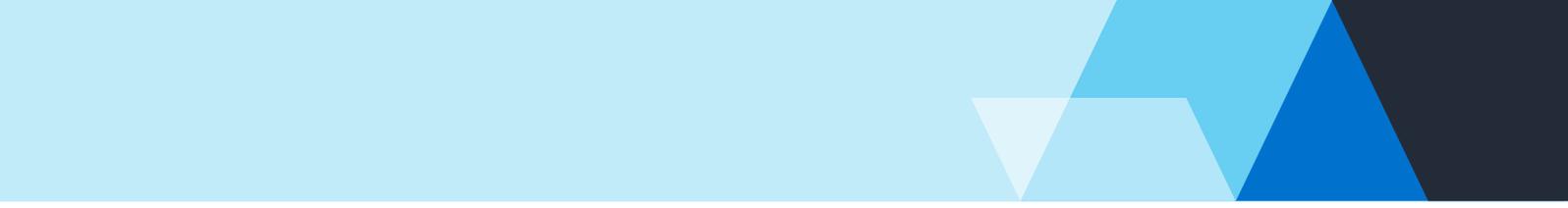
Note: 'Own source' refers to revenues and expenses excluding all grants as reported by the GFS operating statement.

According to the Organisation for Economic Cooperation and Development (OECD) 81.6 per cent of tax revenue in 2022 accrued to the Commonwealth government, as compared with 15.5 per cent to the states.¹²¹ This contrasts with some other OECD federations such as Canada, where 42.9 per cent of income accrued to the central government, compared with 38.9 per cent to the sub-national governments.

VFI in Australia stems from the Constitution and its judicial interpretation. Sections 51 and 52 of the Constitution create the presumption of state responsibility for matters not otherwise specified. Section 96 gives the Commonwealth wide discretion in providing money to the states, while Section 90 precludes the states from levying excises (with the original interpretation of an excise subsequently broadened by successive High Court interpretations). Meanwhile, judicial interpretation has made it impracticable for the states to levy income taxes, leaving this source of revenue the exclusive preserve of the Commonwealth.

High levels of VFI can create inefficiencies, including pressure on states to avoid committing to longer term or ongoing spending which may be more efficient in the long term, either due to high upfront costs and long-term benefits in the case of infrastructure, or if the funding is subject to the changing priorities of the Commonwealth. Untied funding through the GST helps insure against this, by providing an ongoing, predictable source of funding.

¹²¹ Organisation for Economic Cooperation and Development 2024, *Revenue Statistics, Health Taxes in OECD Countries*, p.26



Appropriate funding through the GST can also improve Government accountability and responsibility. Following the 'subsidiarity principle', services should be provided by the level of government closest to the population. As untied funding, GST revenue allows states flexibility to provide services responding to local needs.

Conversely, departures from this principle may lead to inefficiencies where higher levels of government may lack the knowledge of local conditions needed to provide service effectively. Unlike SPPs, the untied nature of GST revenue enhances accountability by providing clarity on roles and responsibilities, and states with discretion for their funding allocation decisions.

Appendix A: Analysis of potential options for reforming the HFE system

A.1 Evaluation of potential options finds the former system is preferred

As noted in Section 7, Victoria considered a range of potential options for reform, including those raised in the previous inquiry and that have been proposed by other states or groups. A fulsome description and analysis of the options is presented below, and a summary of the options is in Table 6.

Table 6: Summary of potential options evaluated to reform the HFE system

Option	Summary description
Former system: Full HFE	The 2018 changes are repealed, and GST allocations reflect the CGCs assessment of GST required to deliver an equal standard of services.
Extend NWOOG permanently	The 2018 changes are retained, and the Commonwealth maintains support for states permanently under a legislated NWOOG
External support for WA	The 2018 changes are repealed, and the Commonwealth develops an intergovernmental agreement to provide top-up payments to WA, providing additional revenues at an amount to be agreed between WA and the Commonwealth.
Full EPC funded by Commonwealth	States with a relativity greater than 1 would receive their full GST requirement from the GST pool. States with a relativity below 1 would receive their GST allocation from the GST pool, plus top-ups from the Commonwealth such that all states' GST plus top ups are at least equivalent to a relativity of 1.0 (their population share).
Partial EPC funded by Commonwealth	A portion of the GST pool is allocated EPC, and the remainder is allocated according the CGC's assessed relativities. Any state that receives less than what it would have under the former system would receive top-ups from the Commonwealth.
EPC	All states receive their population share of the GST pool.
EPC with HFE achieved through tied grants	All states receive their population share of the GST pool. Intergovernmental agreements on federal financial relations would be modified to consider differences in expenditure needs on a case-by-case basis.
Equalise to average	All states are equalised so that states are at least able to deliver the average level of services (pre-equalisation). The remainder of the GST pool is distributed EPC.

Of all the options considered, Victoria maintains that returning to the former system of full equalisation best achieves the government's stated objectives. Table 7 ranks each of the options according to their performance against each of the criteria.

Table 7: Victoria's assessment of alternative HFE systems

Option	Impact on criteria (compared to 2018 changes)				
	Improve HFE	Stability	Fiscal impact to states	Incentive impacts	Overall
Former system: Full HFE	Much Better	Better	Better ^(a)	Much better	Much better
Extend NWOG permanently	Better	Better	Much Better	Better	Much better
External support for WA	Better	Better	Much Better	Better	Much better
Partial/full EPC funded by Commonwealth	Better	Better	Much better	Better	Better
EPC	Much worse	Better	Worse	Better	Worse
EPC with HFE achieved through tied grants	Much Worse	Much Worse	Unclear	Much Worse	Much Worse
Equalise to average	Worse	Same	Worse	Same	Worse

Note: (a) the fiscal impact of the former system compared to the 2018 changes for states is rated only as 'better' accounting for the fiscal loss WA would face, despite the significant benefits to all other states.

The following presents an evaluation of each proposed option against the criteria established in Section 7.

Note that evaluations of some options are included in Section 7 of this submission:

- The former system (Section 7.1)
- External funding for WA (Section 7.3)
- Extend NWOG permanently (Section 7.4).

A.2 Option: EPC distribution

An EPC distribution would provide each state a share of GST revenue equal to its population share, or the same amount of GST per person across the country. The CGC often use an EPC distribution as a starting point or benchmark for its assessments. In the absence of any other information on fiscal capacity, or in areas of uncertainty, EPC is a fair way to distribute revenue.

However, it is clear that jurisdictions have different fiscal capacities, and applying an EPC distribution in spite of this evidence would undermine the equitable outcomes of the former HFE system. Under a completely EPC system, recipient states (with current GST relativities above 1.0) would be much worse off, and the standard of public services would vary significantly between states. The PC recognised this in its 2018 inquiry, finding that:

“An equal per capita approach to the distribution of GST revenue is incapable of providing States with the fiscal capacities to deliver a reasonable standard of services. It is thus inimical to the fiscal equality rationale underpinning HFE.”¹²²

Victoria is not in favour of an EPC approach, or other proposals¹²³ that would drastically reduce the granularity of assessing states’ fiscal capacities, with the only benefit of increasing simplicity by doing away with the need for the relativities and the majority of the CGC’s calculations.

However, this simplicity would also mean that the system loses any ability to cushion volatility in a state’s fiscal capacity by increasing its GST share. In this way, the volatility in state fiscal capacities that was pooled and diversified in the former system becomes concentrated in each state. Some states may experience minimal volatility and benefit from a consistent flow of GST revenue, but others which experience a decline in fiscal capacity will no longer receive an offsetting (albeit delayed) increase in GST revenue.

Victoria supports simplification generally, and has commented on the complexity of the CGC’s assessments through previous processes, including the CGC’s recent 2025 methodology review. Victoria considers simplification is best achieved through the CGC’s existing processes, primarily its periodic methodology reviews. Victoria supports the CGC’s approach to equalisation and accepts that it requires a degree of complexity to accurately capture states’ fiscal capacities, noting there can be a trade-off between complexity and accurately capturing policy neutral fiscal capacities. Victoria agrees with the CGC’s statement in a recent Occasional Paper that “There is inherent complexity in a system that assesses the factors that influence each state’s main areas of expenditure ... and revenue ... Adding to complexity is the need to quantify the extent to which these factors are beyond each state’s control, rather than driven by policy.”¹²⁴

It is also important to note that the difference in outcomes between an EPC distribution and the former system is not as significant as may be assumed, as a substantial proportion of the GST pool is distributed EPC under the former system. As noted in Section 4.2, around half of the GST pool was distributed EPC each year since the GST was introduced to 2024-25. Therefore, any assumed policy incentive impacts from an EPC distribution are only relevant to the half that was not distributed EPC under the former system.

Victoria’s evaluation of the option for an EPC distribution against the principles is provided in Table 8 below.

Table 8: Evaluation of EPC distribution

Aim	Impact compared to the 2018 changes	Explanation
Achieving HFE	Much Worse	EPC is a complete abandonment of the principle of HFE, leading to different fiscal capacities and standards of services and infrastructure between states.

¹²² Productivity Commission (2018), Horizontal Fiscal Equalisation, Report no. 88, Canberra. Finding 8.1

¹²³ Other examples including moving to focus on ‘broader’ measures, basing assessments of states’ fiscal capacities on GSP, budget surpluses and so on.

¹²⁴ Commonwealth Grants Commission (2025). Occasional Paper No. 13: Is the GST Distribution System too complex? Page 1.

Ensuring stability and supporting state's fiscal planning	Better	Volatility in GST revenue for each state could be reduced, however there would no longer be a mechanism to pool or offset volatility in individual state fiscal capacities.
Fiscal impacts to states	Worse	Current recipient states would be much worse off, and current donor states would be better off.
Potential for policy incentive impacts	Better	Theoretical disincentives for reform are removed under EPC. While it can be argued that EPC is "fair", and the same treatment applies to all states, an EPC system would leave smaller states behind.

A.3 Option: EPC with top ups from the Commonwealth to reach full HFE

The previous analysis under Section A.2 of an EPC distribution assumed that recipient states' shares of GST would decline to an EPC share. If the system continued to recognise the fiscal needs of recipient states by allocating them additional non-GST revenues to meet their needs then it could still achieve the core aims of HFE. This system of EPC with a NWOOG would be functionally similar to full equalisation for small states with an injection of cash from the Commonwealth, while the larger states would receive more from the GST than otherwise.

The PC also investigated this option in its previous inquiry, noting support from several submissions, and its similarity to HFE arrangements before 1981. It concluded that while this would guarantee each state could provide a reasonable level of services, the top-ups would have to be funded by the Commonwealth budget through higher taxes, lower spending, increased debt or a restructure of other payments to states. This makes the winners and losers of such a system less transparent.

The "equalisation task" or the amount of GST which is redistributed from donor states to recipient states would currently be \$12.8 billion under the former system.¹²⁵ Given the current fiscal environment, it is unlikely to be funded through the Commonwealth budget. Even if it were funded, the PC notes that its future would not be guaranteed: "If top-up funding is forthcoming, it would always be subject to the vagaries of Commonwealth budget pressures, with commensurate uncertainty for State budgets and planning."¹²⁶

Therefore, while this option performs well against the criteria, assuming states are topped up separately to full HFE, the cost to the Commonwealth and the uncertainty around how these top ups would be funded means it is unlikely to be a suitable alternative – see Table 9 for Victoria's evaluation of this option.

¹²⁵ GST Relativities 2025-26, Table 2-11, p. 39, Commonwealth Grants Commission, March 2025: [GST Sharing Relativities 2025-26_Final.pdf](#)

¹²⁶ Productivity Commission 2018, [Horizontal Fiscal Equalisation, Report no. 88, Canberra, page 227](#)

Table 9: Evaluation of EPC with top ups from the Commonwealth to reach full HFE

Aim	Impact compared to the 2018 changes	Explanation
Achieving HFE	Better	While all states needs are met or exceeded, the ongoing cost of the top-ups to the Commonwealth and taxpayers reduces the transparency and sustainability of the system.
Ensuring stability and supporting state's fiscal planning	Better	Volatility in GST revenue is reduced for donor states through and EPC distribution, whereas volatility for recipient states remains (and is able to offset volatility in fiscal capacity). Uncertainty around the future of additional Commonwealth top ups for the smaller states to achieve HFE increases uncertainty.
Fiscal impacts to states	Much better*	<p>Recipient states would be no worse off, donor states would be better off.</p> <p>*Noting that the opportunity cost for the Commonwealth will be significant and likely impact states indirectly through other areas.</p>
Potential for policy incentive impacts	Better	State fiscal needs are met, and all states have a minimum EPC-equivalent share of the GST pool. Policy incentives are theoretically reduced for the larger states as their GST revenues are an EPC share.

A.4 Option: Partial EPC subsidised by Commonwealth

The main drawback for an EPC distribution with top-ups as described under Section A.3 is the unviability of implementation due to the cost to the Commonwealth. However, one of the benefits of the EPC concept is that can be applied in degrees. The CGC regularly employs the practice of “discounting” in its assessments to address data limitations or uncertainty, blending the outcomes of an assessment with an EPC distribution of varying weights depending on the degree of uncertainty. The level of discounting to be applied is a scalable parameter, which can be debated, but ultimately set at a level that balances competing considerations.

Therefore, one potential option to balance fairness, efficiency and budgetary concerns is a partial EPC approach, where the entire assessment is discounted by a certain weight towards an EPC distribution. There is then an option for the Commonwealth to fund the resulting deficit in recipient state GST revenue. This option was suggested by the CGC and considered by the PC in the previous inquiry in the form of a 90 per cent equalisation, 10 per cent EPC option.

Under this benchmark, 90 per cent of the GST pool would be distributed according to the CGC’s recommendations under full HFE, with the remainder of the GST distributed on an EPC basis. This benchmark can therefore be thought of as ‘diluting’ equalisation outcomes under the current approach by 10 per cent of the GST pool. Noting as shown in Section 4.2, in practice a significant proportion of the GST pool is already distributed on an EPC basis, due to the size of the equalisation task being smaller than the full GST pool.

This option offers improvements on the 2018 changes across most of the identified criteria and has the flexibility for additional top ups to smaller states to work within Commonwealth budgetary constraints.

While it does not achieve full HFE, GST outcomes would continue to loosely reflect state fiscal capacities. If additional top ups were funded by the Commonwealth to meet HFE, a similar standard of services would be achieved across states, as no state would be worse off.

Discounting the GST relativities also reduces the potential volatility in GST revenue, by tying a consistent portion of the pool to a more stable EPC distribution.

Finally, in terms of fairness, this option applies a similar treatment to all states, and in the PC's own analysis, results in the most equal distribution of theoretical incentives for reform.

This system would maintain relative differences in fiscal capacity, but would narrow them considerably. Stronger states would continue to have an advantage, but it would be curtailed to ensure all states can provide a reasonable standard of service.

Using the 2025-26 GST relativities, a 10 per cent EPC distribution would increase donor state (states with relativities below 1.0) revenues by \$1.3 billion, at the expense of an equal reduction in recipient states' (states with relatives above 1.0) revenues.

These losses could potentially be compensated for by the Commonwealth, for example repurposing the GST pool boost payments to ensure recipient states are no worse off. This is therefore likely to be a more sustainable top-up and less subject to Commonwealth budget constraints than the larger top ups described under the option in Section B3. If the Commonwealth is willing to commit to funding a greater proportion of equalisation, the EPC share can also easily be increased without any additional complexity.

Overall, a partial EPC option with Commonwealth top-ups, while compromising on full HFE, largely achieves the criteria identified, as shown in Table 10.

Table 10: Evaluation of partial EPC subsidised by Commonwealth

Aim	Impact compared to the 2018 changes	Explanation
Achieving HFE	Better	While there is a slight disparity between donor and recipient states, all states assessed fiscal needs are met or exceeded if subsidised by the Commonwealth.
Ensuring stability and supporting state's fiscal planning	Better	The introduction of an EPC portion of the GST pool would dilute the effect of relativities and reduce volatility in GST revenues.
Fiscal impacts to states	Much better	Recipient states would be no worse off if subsidised by the Commonwealth, donor states would be better off compared to the former system.
Potential for policy incentive impacts	Better	State fiscal needs are met, all states have a minimum EPC-equivalent share of the GST pool, if subsidised by the Commonwealth. Potential improvement in policy incentives as donor states' GST shares are buffered by the set EPC share.

A.5 Option: EPC with HFE achieved through other tied grants

Another mechanism that has been proposed to implement an EPC system and retain some HFE is to distribute the GST EPC and use the existing tied grants to achieve HFE. GST would be distributed EPC to exclusively address VFI, while SPPs, some of which already have been negotiated to incorporate state characteristics and expenditure drivers into funding allocations, would be refocused to achieve HFE objectives.

Some tied payments already have HFE elements, where more revenue per capita is directed towards states on the basis of need, which is implicitly or explicitly tied to states' fiscal capacity. For example, the Better and Fairer Schools Funding agreement provides funding based on the Student Resource Standard, which includes similar weightings as the CGC's assessments for higher cost cohorts like First Nations or remote students.

Victoria does not consider this option is viable. The current arrangement of using GST as an untied grant to achieve HFE, and SPPs as tied grants to achieve specific policy objectives works effectively, and protects the fairness and certainty of GST revenue for states. The design of these payment streams makes them suitable for their current tasks.

SPPs allow the Commonwealth to execute its policy objectives by providing funding to states. Importantly, SPPs contain reporting and performance requirements to give the Commonwealth confidence the desired outcomes for the funding are achieved. Furthermore, the quantum of funding is controlled by the Commonwealth and regularly lapses so that the Commonwealth has the flexibility to wind down funding if policy objectives have been met, or reallocate funding if policy priorities shift, noting the frictions these negotiations cause.

GST on the other hand was designed to be a reliable source of revenue for states, growing in line with the economy. Importantly, GST grants are untied, and the transfer of GST from the Commonwealth to the states is enshrined in the *Federal Financial Relations Act (2009)* as its enduring policy aims are to reduce vertical and horizontal fiscal inequality.

Changing SPPs to more explicitly achieve HFE has pros and cons. On the one hand, if fiscal needs are driven by disparities in expenses, tied payments would more directly go towards areas where a state has an identified need, increasing accountability. This would address the criticism sometimes levelled at the HFE system, that while significant funding is directed to areas of need, there is little to no accountability for making improvements in these areas. For example, GST funding allocated due to the higher use and cost of services from First Nations people or people living in remote areas, is not directly tied to services for those groups as it is provided as untied funding.

However, this also undermines state autonomy for recipient states by reducing untied GST funding and increasing tied payments. Furthermore, disparities in revenue raising ability are unlikely to be addressed through tied payment programs which are generally tied to state expenditure responsibilities.

SPPs, while incorporating some elements of state expenditure drivers, would be an inadequate instrument to achieve HFE because they conduct a piecemeal analysis of state fiscal capacity, which is inferior to the CGC's holistic assessment. Most importantly, SPPs negotiated for state service portfolios are exclusively focussed on expenditure, and have no mechanism to assess differences in revenue raising ability, a core driver of differences in fiscal disparities between states.

A more prospective approach would be to refocus the GST distribution to only address the disparities in revenue raising capacities between states, and leave expenditure equalisation to the tied payments system, which directly address expenses. A number of other developed federations like Switzerland, Germany and Canada place a greater emphasis on revenue in their equalisation systems.

This option could also exacerbate the policy incentive concerns it would be notionally attempting to address. Tied agreements have a much closer nexus to the policy areas they are funding, and are generally not ‘policy neutral’ in the sense that they directly fund states for their policies. For example, under the NHRA states are paid an efficient price for the activity they undertake. States’ policies around what hospital services they provide directly impact their funding levels. These systems are designed to incentivise efficient spending or reform and avoid ‘gaming’ – for example, NHRA funding is distributed according to a standardised efficient price and national weighted activity units. However, this is fundamentally different to the CGC’s approach where the allocation of funding to achieve HFE aims to avoid policy impacts, rather than incentivising or rewarding certain outcomes.

Additionally, there are significant downsides to moving HFE from an independent large data driven process to one involving significant negotiation and behind-the-scenes discretion, as outlined in Section 7.2. While the CGC’s methodology is continuously being refined, debated and improved, it is by far the most transparent, fair and certain approach to distributing Commonwealth funds. This predictable, rules-based approach provides states with some certainty that their measurable funding needs will be met, and if the existing methodology is inadequate, it can be improved through regular reviews.

SPPs and the associated web of intergovernmental agreements are highly complex and revising them wholesale to address HFE would be a significant negotiation task. The process to enact this revision would be challenging, given the ad hoc, discretionary nature of agreement negotiations, and the complex, interrelated legislative arrangements. Section 7.3 describes the challenges with ad hoc, politically negotiated agreements.

It is unclear how this greater focus on HFE would be implemented practically and then agreed by all jurisdictions. It is entirely possible that changes to the GST system could be legislated relatively quickly, but negotiations on changes to agreements could take years, if ever completed, meaning this proposal is unlikely to balance the HFE element in practice.

This is a simplistic proposal that is likely to worsen fiscal inequality unless accompanied by broader reforms to federal financial relations, which would be complex and difficult to reach interjurisdictional agreement on. Victoria’s assessment of this option compared the principles identified is that it is overall much worse than the 2018 changes, as shown in Table 11.

Table 11: Evaluation of EPC with HFE achieved through other tied grants

Aim	Impact compared to the 2018 changes	Explanation
Achieving HFE	Much Worse	At best, if holistically targeted towards HFE, the SPPs would still only capture expenditure side of equalisation and not capture differences in revenues. Although deeply flawed, the 2018 changes at least equalise some of the disparities in revenue raising capacities.
Ensuring stability and supporting state’s fiscal planning	Much worse	While they don’t markedly improve on predictability compared to the former system, the 2018 changes at least maintain a rules-based, lagged, formulaic approach to providing grants. Negotiated agreements are near impossible to forecast given the discretion negotiators have to change terms or even walk away from funding.

Fiscal impacts to states	Unclear	The net quantum of funding each state would receive from this proposal is highly unclear, as the changes to tied agreements are subject to significant uncertainty and would require extensive policy work and negotiation to resolve.
Potential for policy incentive impacts	Much Worse	Given the GST is distributed EPC, policy incentives from GST would be removed, however potentially greater policy incentives would be introduced from the more direct nexus to funding in tied grants.

A.6 Option: Equalising to the average fiscal capacity of all states

Of the options considered by the PC in its 2018 inquiry, equalisation to the average of all states was its recommended option, noting that “Amongst a number of options designed to equalise to a reasonable standard, equalisation to the average of all States (rather than to the strongest State) is judged to provide a better balance between fiscal equality, fairness and efficiency.”¹²⁷

The PC explained that this benchmark works by allocating GST such that those states with a below-average fiscal capacity prior to the distribution of GST are brought up to the average (pre-GST) fiscal capacity of all the states, with all remaining GST revenue allocated on an EPC basis to all states. This contrasts with the former system, which allocates GST such that each state’s fiscal capacity is topped up to that of the strongest state, before allocating the remainder EPC.

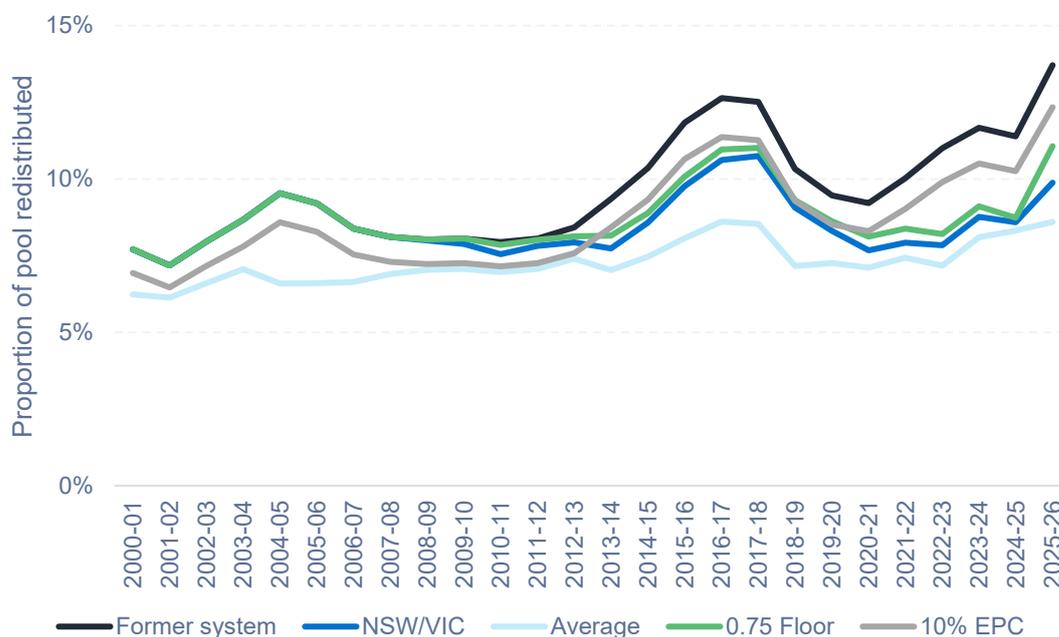
Unfortunately, the average fiscal capacity pre-equalisation is purely theoretical, and not an observable standard of services. In practice, states operate using their post equalisation revenue, and the average pre-equalisation fiscal capacity (i.e. without any GST revenue) would represent an unacceptably low standard of services, given the significance of the GST to states’ budgets – around a quarter of all revenue for Victoria. Therefore, the notion of any average standard of services arising from this equalisation standard is misleading. It simply results in a disparity in service levels between states with fiscal capacities above the estimated “pre-equalisation average”, and those below.

In practice, based on current and historical relativities, equalising to the average sets the equalisation standard below that of the second strongest state. Therefore, it represents a step further away from full equalisation, and greater disparities between states. Of the options considered by the PC in its previous inquiry, this option results in the lowest level of equalisation, as illustrated in Figure 18.

Without any safeguards such as the NWOG this represents an unequivocally worse outcome than the 2018 changes, and would leave states with an even greater fiscal challenge. This would result in negative outcomes for residents of states made worse off, to a greater extent than as noted in Section 3 under the 2018 changes. Victoria’s assessment of this option is summarised in Table 12.

¹²⁷ Productivity Commission 2018, Horizontal Fiscal Equalisation, Report no. 88, Canberra, page 2

Figure 18: Total difference to an EPC distribution as a share of the GST pool under different equalisation standards



Source: DTF estimates based on data from Commonwealth FBOs and CGC annual updates

Note: Figure adapted from figure in previous 2018 PC inquiry final report: PC 2018, Horizontal Fiscal Equalisation, Report no. 88, Canberra, page 237. The GST pool is not inclusive of the pool boost introduced in the 2018 changes.

Table 12: Evaluation of Equalising to the average fiscal capacity of all states

Aim	Impact compared to the 2018 changes	Explanation
Achieving HFE	Worse	The average fiscal capacity will generally be lower than the stronger of NSW or Victoria, and therefore will result in a lower equalisation standard, moving further away from full HFE.
Ensuring stability and supporting state's fiscal planning	Unchanged	Equalising to the average will result in outcomes similar to the 2018 changes, which have not resulted in a more stable or predictable GST outcome for most states.
Fiscal impacts to states	Much Worse	Without the NWO, a lower equalisation standard will result in states with below average fiscal capacity receiving less GST revenue than they do under the current system, meaning they will be even more worse off.
Potential for policy incentive impacts	Unchanged	The system would largely not change policy incentives, and would continue to create theoretical rewards for above average states and punish below average states.

