Australian Government
Productivity Commission

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GST distribution reforms

Interim report

This is an interim report prepared for further public consultation and input. The PC will finalise its report after these processes have taken place.

August 2026

Acknowledgment of Country

The Productivity Commission acknowledges the Traditional Owners of Country throughout Australia and their continuing connection to land, waters and community. We pay our respects to their Cultures, Country and Elders past and present.

About us

The PC is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long-term interest of the Australian community.

The PC's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

For more information visit our website: www.pc.gov.au.

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Publication enquiries:
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Opportunity for comment

The PC thanks all participants for their contribution to this inquiry and now seeks additional input for the final report.

You are invited to examine this interim report and comment on it by written submission or brief comment to the PC, preferably in an electronic format, by 30 September 2026.

Feedback can also be provided by appearing at a public hearing. Proposed dates of public hearings are outlined below. You can register your interest to attend or present at a public hearing on the inquiry website (www.pc.gov.au/inquiries-and-research/gst-reforms/).

The PC will prepare its final report after considering the evidence provided in further submissions and public hearings and after undertaking further analysis. The final report is due to be delivered to the Australian Government by 31 December 2026.

Public hearing dates

Dates	Location
14, 15, 16 and 18 September 2026	Online

Further information on public hearings will be available on the PC website.

Commissioners

For the purposes of this inquiry and interim report, in accordance with section 40 of the *Productivity Commission Act 1998* the powers of the PC have been exercised by:

Alex Robson, Deputy Chair

Angela Jackson, Commissioner

Terms of reference

I, the Hon Jim Chalmers MP, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, and Section 4 of the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST)* Act 2018 (the 2018 legislation), request the Productivity Commission (the Commission) undertake an inquiry into the 2018 Goods and Services Tax (GST) distribution reforms. The inquiry will also examine ways in which the federal financial relations system can best promote fiscal sustainability across the states and territories (the states) and the Commonwealth, while delivering the best outcomes for all members of the Australian community.

Background

Australia's system of federal financial relations involves the transfer of revenue collected by the Commonwealth to the states. An important part of the system is the Goods and Services Tax (GST), collected by the Commonwealth and distributed to the states in accordance with the *Federal Financial Relations Act 2009* and the *Commonwealth Grants Commission Act 1973.*

Since the inception of the GST in 2000, the principle of Horizontal Fiscal Equalisation (HFE) has determined GST distribution to the states (a similar HFE principle was often used prior to 2000). It has been an accepted policy position across jurisdictions that Commonwealth GST grants should aim to compensate for or narrow the gap between fiscally stronger and weaker states and territories.

In recent times, the objective of HFE was to ensure each state had the fiscal capacity to provide services and infrastructure at the same standard, if each made the same effort to raise revenue from its own-sources and operated at the same level of efficiency. The model also accounted for material factors beyond the control of state governments that may affect state revenues or spending – the demographics or relative remoteness of its population, for example.

In 2018, the Commonwealth Parliament changed the way GST revenue is distributed among the states to address concerns about the volatility of this revenue source.

The main reforms legislated via amendments to the *Commonwealth Grants Commission Act 1973* in 2018 were:

- changing the equalisation benchmark so that each state's relativity is at least as high as the relativity of the fiscally stronger of New South Wales or Victoria
- ensuring an additional minimum GST revenue-sharing relativity (now 0.75)
- requiring the GST pool to be 'topped-up' by the Commonwealth into perpetuity, and for that 'top-up' to grow at an indexed rate
- during a transition period of six years from 2021–22 to 2026–27, any state that received less than it would have received under the previous GST distribution system would be entitled to additional 'no worse off' (NoWO) payments.

The 2018 legislation also provides for a review of the operation of the Act by the Productivity Commission by 31 December 2026.

In November 2024, the NoWO was extended to 2029–30 through a Funding Agreement with all states except Western Australia.

Scope of the inquiry

The Commission will inquire into the operation of the 2018 legislation, including whether the 2018 changes to the GST distribution system are operating efficiently, effectively and as intended and the fiscal implications for each state and territory, and for the Commonwealth, of the changes made by the 2018 legislation.

The Commission is to investigate:

- To what extent the current arrangements are:
  1. Delivering a reasonable level of horizontal fiscal equalisation
  2. Appropriately balancing the objective of responsiveness to changing circumstances with the objectives of reducing volatility and improving the certainty of GST revenue streams to support state fiscal planning
  3. Supporting states and territories to pursue reforms, including to the efficiency of service delivery and state and territory revenue bases, and
  4. 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 payments and other Commonwealth payments to states, including the principles for exempting payments from the Commonwealth Grants Commission's assessments.

Any recommendations made by the Commission should include an assessment of implementation feasibility and risks, and be cognisant of the Commonwealth's policy commitments in relation to GST distribution. In its recommendations, the Commission should provide a range of options including options with a funding relativity floor comparable to the current level, with and without top-up funding from the Commonwealth.

Process

The Commission should engage widely and undertake appropriate public consultation processes, including inviting public submissions and holding hearings. The Commission should engage actively with other Commonwealth entities (notably the Commonwealth Treasury and Commonwealth Grants Commission) and all state and territory governments (notably state and territory Treasuries).

In undertaking the review, the Commission should have regard to previous inquiries where relevant, including the 2018 Horizontal Fiscal Equalisation inquiry, along with any relevant Government reforms and reform directions.

Deliverables

The Commission should provide an interim report to Government by 28 August 2026 and a final report to Government ahead of the legislated deadline of 31 December 2026.

The Hon Dr Jim Chalmers MP
Treasurer

[Received 24 September 2025]

Disclosure of interests

The *Productivity Commission Act 1998* specifies that where Commissioners have or acquire interests, pecuniary or otherwise, that could conflict with the proper performance of their functions they must disclose those interests.

Commissioner Alex Robson discloses he was an adviser in the Office of the then Prime Minister, the Hon Malcolm Turnbull, from November 2015 to August 2018.

Commissioner Angela Jackson discloses she was a part-time Commissioner at the Commonwealth Grants Commission from August 2022 to April 2025.

Acknowledgments

The Commissioners express their gratitude to the many individuals and organisations who have taken the time to contribute to this inquiry, including those who participated in visits and provided public submissions.

In particular, the Commissioners wish to thank the staff of the Commonwealth Grants Commission, who have reviewed many of the PC's calculations included in this report, and provided data and responses to questions raised by the PC during the course of the inquiry.

The Commissioners also wish to thank the Commonwealth Treasury and state and territory Treasuries for providing their experiences and perspectives to the inquiry.

The Commissioners also wish to express their appreciation to the PC team who worked on the interim report.

The conclusions and views reached by the PC on the basis of the information and data provided to the inquiry are those of the PC. They should not be attributed to other organisations.

AI disclosure

This report was prepared using the assistance of AI tools for purposes of general research, summarising material from consultations and editing. PC staff reviewed all AI-generated outputs for accuracy and quality.

Contents

Appendices B to E and the supporting paper for chapter 1 are referenced in the report but are available only on the PC website (www.pc.gov.au/inquiries-and-research/gst-reforms/).

Executive summary

Since Federation, the Australian Government has aimed to limit the fiscal gap between the states and territories (hereafter 'states'). This has evolved into the principle known as horizontal fiscal equalisation (HFE), which holds that the Australian Government should 'equalise' the financial capacity of the states, such that they can provide services to a similar standard. The principle is supported by all states, but historically they have held different views about the level of equalisation the system should seek to achieve, and whether this level is reasonable.

Today, the Australian Government pursues HFE by collecting GST and distributing it to the states. Every year, the Commonwealth Grants Commission (CGC) compares the fiscal positions of the states and makes recommendations about how much GST revenue per person a state should receive – which is known as a state's 'GST relativity'. States with less fiscal capacity have a higher relativity, as they need more funding per person than the average state to provide a similar level of services, and states with greater fiscal capacity have a lower relativity. [1]

The onset of the mining boom in the early 2000s resulted in Western Australia becoming the fiscally strongest state, sending its relativity, and its GST share, to unprecedented lows. In response to Western Australian concerns and other longstanding criticisms of the HFE system, the Australian Government passed a series of reforms in 2018.

The Australian Government has asked the Productivity Commission (PC) to review the 2018 reforms to the GST distribution system and whether alternative arrangements would better deliver on the objectives of equity, efficiency, fiscal sustainability and certainty.

Understanding the 2018 reforms

The 2018 reforms to HFE consisted of 3 measures.

1. A new fiscal equalisation standard, set at the relativity of whichever of New South Wales or Victoria has the greater fiscal capacity (the 'standard state'). This standard was phased-in over 6 years.
2. A GST relativity floor, set at 0.70 in 2022–23, then increased to 0.75 from 2024–25.
3. A boost to the GST pool through a perpetual yearly increase from the Australian Government.

[1] This is a very simple description of the CGC process, which incorporates an assessment of the unavoidable costs states face when determining how much of the GST pool the Australian Government should allocate to each state. More detail on the CGC and its processes are in the PC's supporting paper on *Understanding Australia's system of fiscal transfers*.

These changes were intended to make the system more resilient to economic shocks and improve stability and predictability of state revenue, while simultaneously making all states better off from the reforms. Every state other than Western Australia opposed the changes, but their approval was not required for the changes to become law.

At the time the reforms were introduced, the mining boom was projected to moderate. The boom – and especially strong iron ore prices and production – was the main driver of Western Australia's high assessed fiscal capacity and record low GST relativity. A moderation of the boom would have seen Western Australia's relativity revert towards its historical average. It would also have meant the GST pool boost – which was $600 million from 2021–22, then $850 million from 2024–25 (indexed to GST pool growth) – would have left all states better off.

However, not all states shared the expectation that the mining boom would ease and that all states would benefit from the reforms. Many argued that the 2018 reforms should be accompanied by a (Australian Government funded) No Worse Off (NoWO) guarantee to ensure that no state was left financially worse off because of the changes. A temporary NoWO guarantee was therefore introduced, although the Australian Government did not expect it to be required. However, it quickly became clear that the NoWO guarantee would be called upon, and in the lead-up to its original expiry in 2026–27, the Australian Government and states agreed for it to be extended until 2029–30.

The 2018 reforms are costing more than expected

The 2018 reforms were expected to cost the Australian Government about $5 billion by 2024–25, but have ended up costing almost $23 billion, largely due to payments made under the NoWO guarantee (figure 1). While Western Australia was expected to benefit by a cumulative amount of about $3.9 billion by 2024–25, it has received the majority of the benefit from the $23 billion spent by the Australian Government. Other states were expected to be better off by about $1.1 billion by 2024–25, but have not ended up benefiting from the reforms. Instead, they only remained no worse off due to the NoWO guarantee.

The 2018 reforms have largely not achieved their intent

After reviewing the evidence, consulting with all state governments and reviewing over 60 submissions from the public, the PC has determined that the 2018 reforms have largely not met their intent and have introduced a range of undesirable features into Australia's HFE system.

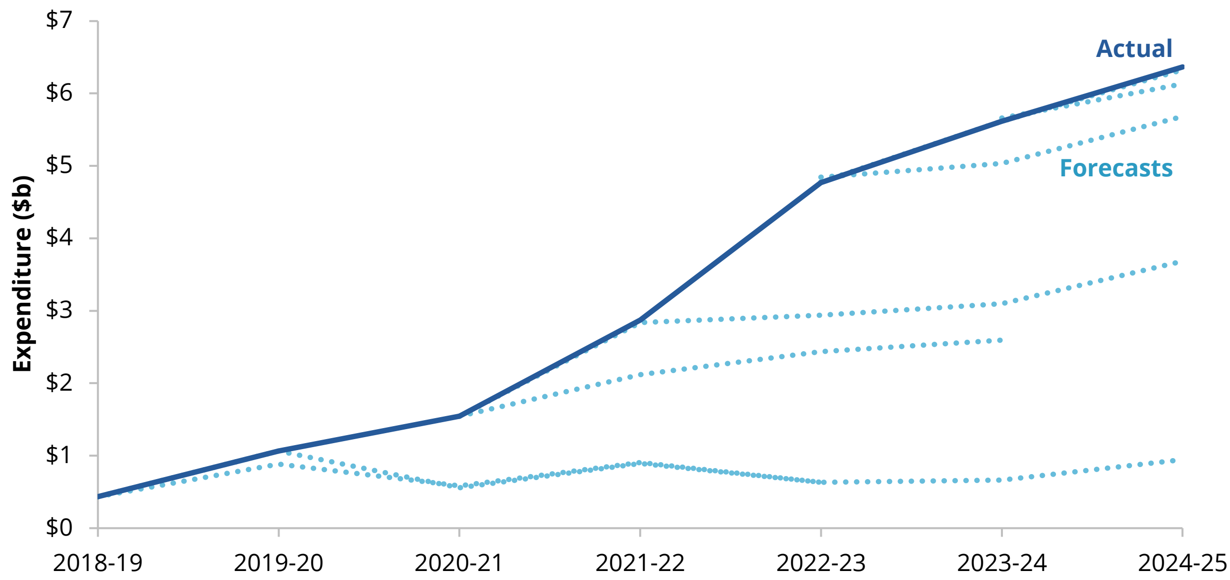
The standard state equalisation benchmark is not working as intended

The standard state benchmark has introduced the possibility of the system producing **perverse outcomes that invert the logic of HFE**. For example, the benchmark means that Western Australia could gain additional GST revenue when New South Wales or Victoria experiences a natural disaster. If New South Wales incurs net fiscal costs associated with a bushfire for example, its relative fiscal capacity decreases, leading to a higher GST relativity and share of GST revenue. While all other states would experience a reduction in their share of the GST pool, Western Australia would have its GST share increased to match the now higher standard state benchmark.[2] In some circumstances, the operation of the standard state benchmark can also mean that increases in Western Australia's own-source revenue can lead to an *increase* in its share of GST revenue.

[2] Section 2.2 in chapter 2 provides more detail on how this can occur.

Figure 1 – The cost of the 2018 reforms has been higher than anticipated

Annual actual and forecast costs (nominal), 2018–19 to 2024–25



'Forecasts' includes data from both Budget documents and longer-term estimates from the Australian Government's interim response to the PC's 2018 inquiry into *Horizontal Fiscal Equalisation*. 'Actual' data is from Final Budget Outcomes, with 2024–25 being the most recent year of published data.

Source: Australian Government (2018, p. 21) (various years); Commonwealth of Australia (2024a, 2025) (various years).

The standard state benchmark has created a **two-tiered GST distribution system** where a state like South Australia that has a lower fiscal capacity than New South Wales or Victoria does not benefit from the equalisation benchmark. This means that if South Australia improves their financial position, they receive less GST revenue.

On the other hand, a state with greater fiscal capacity, like Western Australia, now has its relativity automatically increased to the same as Victoria or New South Wales. This means that if Western Australia improves its financial position, it can receive the same or even more GST revenue than it otherwise would.

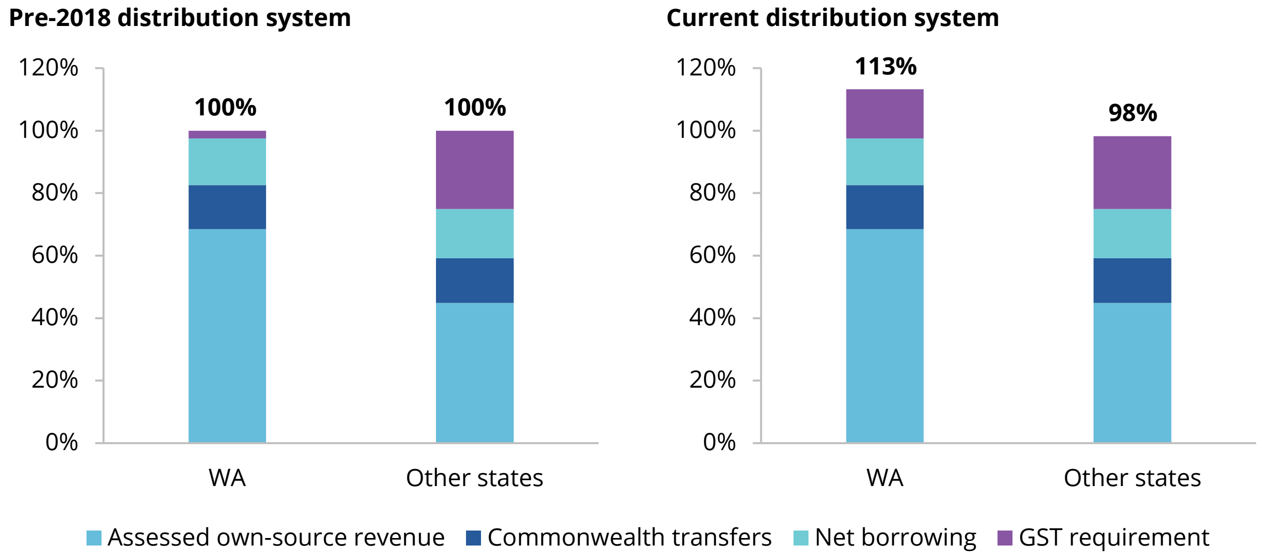
Only Western Australia has benefited from the reforms

The GST pool boost that was introduced as part of the 2018 reforms was intended to make all states 'better off' by increasing the amount of GST revenue available for distribution. But the reforms have only materially benefited Western Australia, improving its fiscal position relative to other states.

Prior to 2018, all states received enough GST revenue to meet 100% of their assessed fiscal needs, consistent with the principle of HFE. However, as a result of the reforms, Western Australia received enough GST revenue to meet 113% of its assessed fiscal needs in 2024–25 – compared with 98% for all other states (figure 2). The Australian Government's $5.4 billion of NoWO payments in 2024–25 ensured all states received 100% of their assessed fiscal needs, but the PC estimates that an additional $47 billion would be required to provide all states with the same fiscal capacity as Western Australia. This calculation illustrates the extent to which the current system has departed from the pre-2018 version of HFE.

Figure 2 – GST payments no longer equalise states' assessed budgets

Assessed 2024–25 fiscal need met, by distribution system and revenue source



NoWO payments are not incorporated in assessed budgets. States' GST requirements under the pre-2018 distribution system were calculated as a residual to balance assessed revenue and assessed expenditure.

Source: PC estimates using CGC (2024); Commonwealth of Australia (2025, p. 67).

A key criticism of the pre-2018 system was that it was too volatile – with GST distributions to the states varying widely and unpredictably between years. The 2018 reforms have only decreased this volatility for Western Australia, and they have done this at the expense of the Australian Government. Consequently, the cost of revenue volatility has not been eliminated; it has merely been shifted and spread between governments.

The reforms have imposed a significant ongoing cost on the Australian Government

The need for ongoing NoWO payments has created an open-ended fiscal liability for the Australian Government that moves in line with commodity prices. These payments are forecast to cost $6 billion in 2025–26, but if iron ore prices or production increase, the payments could reach $12 billion per year.

On the other hand, if the NoWO guarantee is allowed to expire, the $6 billion cost of servicing the current arrangement – which largely goes towards Western Australia - will shift from the Australian Government to the other states.

There have been minimal efficiency gains from the reforms

The greater the extent to which a HFE system influences state government policy choices, the lower its efficiency. For this reason, the CGC seeks to prevent a state government's policy choices from unduly affecting its share of GST revenue. In the past, and during this review, concerns have been raised that the system of HFE creates disincentives for states to reform and grow their economies, because they could lose GST revenue.

New PC modelling for this review has found that the incentives for reform have only been marginally improved as a result of the 2018 reforms, as they reduced dominant-state effects in the mining assessment in an untargeted way through an across-the-board GST relativity floor, but have a minimal impact outside those effects.[3]

To the extent disincentives for reform exist, there is limited evidence they have played a role in state policy decisions. Other fiscal tools are available outside the HFE system to mitigate any disincentives.

Overall, the 2018 reforms have made the GST distribution system more complex and less consistent with its core purpose. In doing so, the changes have created ongoing challenges for harmonious and productive federal financial relations and imposed a large and ongoing cost on the Australian Government.

The system needs to change

Taken together, these shortcomings point to a system that needs reform. As requested by the Australian Government, the PC has considered a number of alternatives. The PC has developed an analytical framework to consider alternative arrangements identified through submissions and a review of the literature. Developing such a framework requires clarity on what the HFE system should actually be seeking to achieve.[4]

Consistent with the broad views provided by states and other participants in this inquiry, the PC regards the reasonable level of fiscal equalisation to be that which can be achieved without creating costly challenges to efficiency (policy neutrality), fiscal sustainability and certainty that cannot be managed by other policy tools.

This recognises that the primary goal of the HFE system should be to drive equity – or more precisely, drive equality of fiscal opportunity – between jurisdictions. The other objectives – efficiency, sustainability and certainty – are constraints on the extent to which HFE is pursued and achieved.

The PC applied this framework to consider the strength of a range of reform directions and different policy parameters. This analysis has led the PC to recommend 3 preliminary options for reform (presented in decreasing order of their assessed benefits).

- The **first-best option** is for the Australian Government to transition back to the pre-2018 GST distribution system, but with a direction from the Australian Treasurer to the CGC to address costly dominant-state effects where they arise. The PC envisages that dominant-state effects in the mining assessment would be one area where a direction from the Treasurer would occur.
- The **second-best option**, which is less desirable but would still overcome the major shortcomings of the current system set out above, is to return to the pre-2018 system, but with a commitment from the Australian Government to make direct and transparent payments to states it considers to be materially impacted by dominant-state effects (instead of the Treasurer directing the CGC to account for these impacts 'in-system').

[3] The CGC has not formally defined the 'dominant-state effect'. In practical terms, it arises where a state's share of an assessed revenue base is much larger than its population share, so its policy choices can strongly influence the average policy used in the assessment and produce large changes to GST payments.

[4] In the 2018 PC review, a change to the HFE system was recommended on the basis of disincentives to tax reform and the pursuit of efficient service delivery. Since the 2018 reforms, the PC's view has changed due to changing circumstances, including the pursuit of tax reforms which are discussed in chapter 3.

- The **final option**, which should be considered if the Australian Government is only minded to make minimal and critical changes to the current system, is to remove the standard state benchmark (which would result in the relativity floor of 0.75 being reactivated). This option would have an enduring detrimental impact on the fiscal position of states other than Western Australia relative to the pre-2018 system. Therefore, if this option is adopted – and only if this option is adopted – the NoWO guarantee should be made permanent. The GST pool boost, which has failed to make all states better off, should also be removed. This would ensure that the Australian Government – rather than the states other than Western Australia – continues to bear the ongoing cost of its policy choice to change the system in 2018.

Regardless of whether they pursue any of these reforms, the Australian Government should also take steps to address a number of governance issues to strengthen the stability and productivity of the broader federal financial relations system. These include:

- ensuring that there is cross-jurisdictional consultation on any changes to the GST distribution system
- more regular engagement (through the Council on Federal Financial Relations) between the Australian Government Treasurer and their state counterparts, with a focus on future economic and fiscal challenges and how these may be addressed
- more transparency in the treatment of non-GST Commonwealth payments in the HFE system.

The PC recognises that recommendations in this report, if adopted, would substantially change the GST distribution and the broader federal financial relation system. Stakeholders will have the opportunity to share views on the merits of the PC's interim recommendations and transitional issues through public hearings in September 2026, and we welcome further submissions to the inquiry on the PC's proposals. This input will inform the PC's final report, due to be provided to the Australian Government by 31 December 2026.

1. Horizontal Fiscal Equalisation in Australia

Fiscal transfers from the Australian Government to state and territory governments (hereafter 'states') are critical to states' ability to deliver the public services for which they are responsible. GST payments comprise around half of these transfers and totalled to $91.1 billion in 2024–25 (Commonwealth of Australia 2025, p. 64). The GST pool is distributed based on the principle of horizontal fiscal equalisation (HFE), which recognises and seeks to account for differences in states' capacities to provide and fund public services.

The principle of HFE is a key and longstanding feature of Australia's Federation. It is widely supported for its objective of enabling states to provide a similar standard of public services. However, the outcomes HFE creates when applied are often contested. Following the 2000s mining boom, the fiscal capacity of Western Australia – Australia's most resource-rich jurisdiction – increased and diverged significantly from other states. GST payments to Western Australia decreased in recognition of its greater fiscal capacity, which strained community acceptance of the HFE system in the state. Political pressure from the Western Australian Government and public, alongside broader concerns that the HFE system could act as a barrier to state policy reform ultimately led the Australian Government to introduce reforms to the system in 2018. The context for these reforms is explored later in this chapter. The impact of these reforms on the HFE system is explored in chapter 2.

The supporting paper *Understanding Australia's system of fiscal transfers* (hereafter 'supporting paper') provides a more detailed explanation of Australia's HFE system.

1.1 Australia's system of fiscal transfers

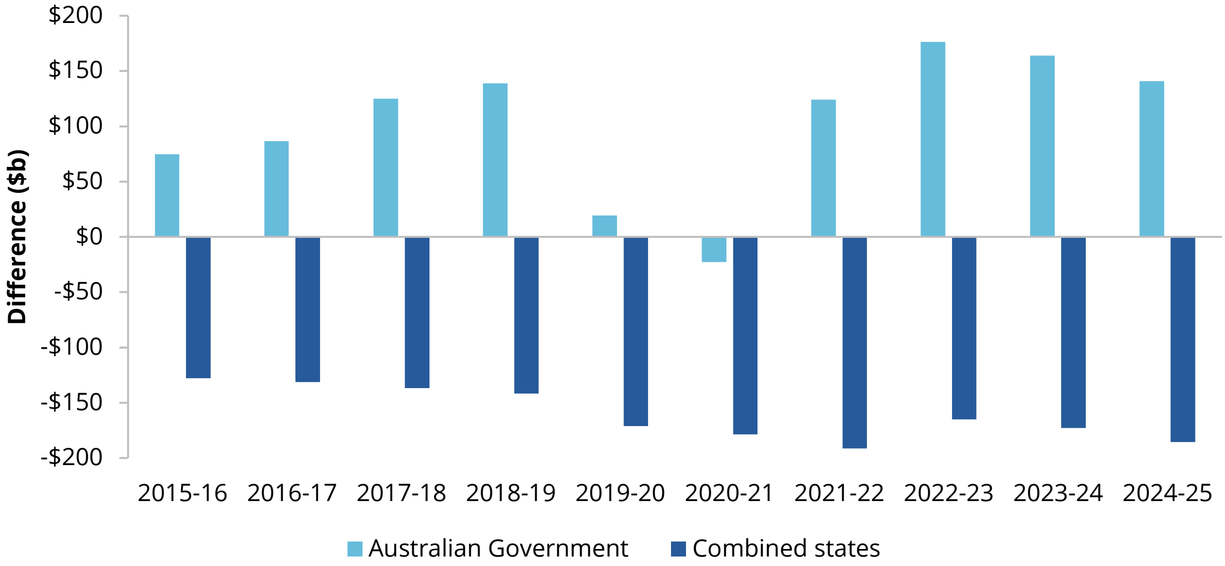
States collect insufficient revenue to fund their policy responsibilities …

Australia experiences vertical fiscal imbalance (VFI): the Australian Government raises more revenue than required to provide the services it is responsible for, while states raise less revenue than required to fund their spending responsibilities (figure 1.1). For various constitutional and historical reasons, Australia experiences a high degree of VFI compared to similar federations like Canada and Germany (CGC 2022c, p. 1). This imbalance has persisted over time due to factors including policy decisions which consolidated revenue-raising at the national level, state policy choices about tax rates and bases, and High Court decisions which have constrained states' ability to raise revenue.[1]

[1] For example, *Ha v New South Wales* (1997) and *Vanderstock v Victoria* (2023).

Figure 1.1 – The states raise insufficient revenue to meet their policy responsibilities

Difference between Australian Government own-source revenue and expenses, and combined state own-source revenue and expenses, 2014–15 to 2024–25, constant prices 2024–25 basis



Australian Government expenses exclude grant expenses to states.

Source: PC estimates using ABS (2026a and various other years).

States also differ in their ability to fund policy responsibilities. This is known as horizontal fiscal imbalance (HFI): some states can raise revenue more easily or provide services more efficiently than others because of structural factors, such as resource endowments and the demographic composition of their populations. The supporting paper contains further discussion of VFI and HFI in Australia.

… so the Australian Government provides states with fiscal transfers

The Australian Government provides grants to states each year to assist them in undertaking their policy responsibilities. In 2024–25, the total value of grants was $195 billion, equivalent to approximately 27% of total Australian Government revenue and 49% of total state revenue (PC estimates using ABS 2026a; Commonwealth of Australia 2025). Australia has the largest transfers as a share of government revenue among OECD federations, reflecting Australia's high degree of VFI (Dougherty and Forman 2021, p. 13). These grants supplement revenue raised by states from their own sources to better align states' revenues with their service delivery responsibilities. They also ensure the benefits of decentralised governance are retained (CGC 2020a, p. 2).

Tied grants are used to fund service delivery in specific policy areas

In 2024–25, the Australian Government provided about $97.4 billion in tied grants to states, accounting for approximately half of total grants (PC estimates using Commonwealth of Australia 2025). Tied grants are payments to states that must be used for pre-agreed purposes and are usually made in policy areas where the states are primarily responsible for service delivery (such as health, education or infrastructure) (Commonwealth of Australia 2025, p. 60).

These tied grants are negotiated between the Australian Government and states to support, incentivise or reward the delivery of a particular service, project, or reform by the states (chapter 5).

While other factors play a role in negotiations, the quantum of tied grants is primarily driven by the cost (or value) of achieving the agreed outcomes, and not the broader fiscal circumstances of states. This means that a state's fiscal capacity, or its capacity to raise revenue to deliver public services, is not necessarily indicative of how much it receives in tied grants (supporting paper, section 3).

The GST pool – the primary source of untied grants – is distributed with the intent of delivering HFE

The Australian Government also provides untied grants, which states have greater autonomy to spend according to their own budget priorities (Commonwealth of Australia 2025, p. 64). Most untied funding is delivered through the distribution of the GST pool,[2] which is an Australian Government tax that is passed on to the states. In 2024–25, states received $97.3 billion in untied funding, of which $91.2 billion, or 94%, was GST payments (PC estimates using Commonwealth of Australia 2025, p. 64).

The GST pool is distributed to the states with the explicit intent of delivering HFE. HFE involves the transfer of financial resources to and between subnational governments with the aim of mitigating regional differences in fiscal capacity and expenditure needs (Dougherty and Forman 2021, p. 5). States have different fiscal capacities because of differences in their ability to raise revenue from their own sources and differences in the expenditure needs of their populations. Australia's HFE system seeks to address HFI by providing states with the fiscal capacity to deliver public services of a similar standard (CGC 2025f, p. 231).[3] Without HFE, the capacity of states to provide a similar standard of services would depend on structural factors, such as the demographic makeup of the population or resource endowments.

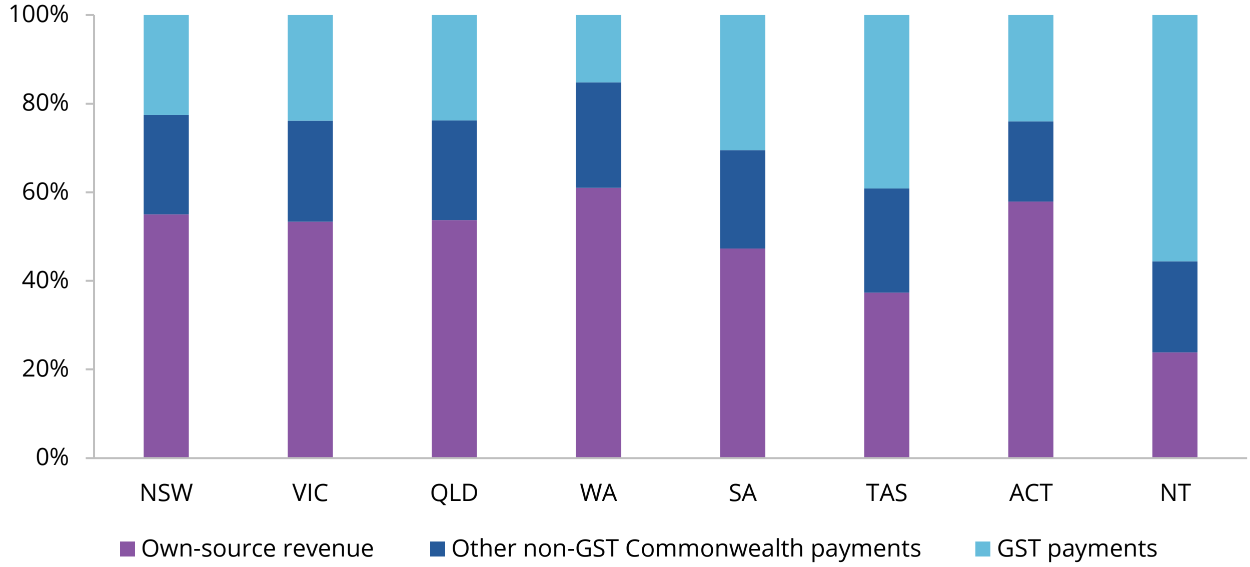
In practice, HFE means that states with a relatively lower fiscal capacity – because of higher costs of delivering services and/or a lower capacity to raise revenue (including from other non-GST Commonwealth payments) – receive a greater share of the GST pool to supplement their other revenue than states with a relatively higher fiscal capacity (figure 1.2).

[2] Other sources of untied funding include payments to Western Australia for mining activities in the North West Shelf and to the Australian Capital Territory for the provision of municipal services (Commonwealth of Australia 2024a, pp. 126–127).

[3] Assuming states make the same effort to raise own-source revenue and operate at the average level of efficiency.

Figure 1.2 – The importance of GST payments varies between states

Average contribution of own-source revenue, non-GST payments and GST payments to total state revenue, 2000–01 to 2024–25



All non-GST general revenue assistance (including payments under the No Worse Off guarantee and GST transitional top-up payments) are included in non-GST payments.

Source: PC estimates using ABS (2026a) and Commonwealth of Australia (2025 and various other years).

Australia chooses to undertake HFE for several reasons

HFE supports **equality of fiscal opportunity** by supporting the ability of states to provide a similar level and quality of public services to citizens, regardless of the state in which they reside (chapter 3). This objective was widely supported by inquiry participants.[4] To the extent that HFE *actually* reduces geographical differences (as opposed to providing states with the capacity to do so), it may also have broad positive implications for **social cohesion** as access to high-quality public services can reduce the negative consequences of income and wealth inequality and foster upward mobility (OECD 2015, p. 80, 2025, pp. 1, 7–12; Verbist et al. 2012, p. 62). This finding was also supported by several participants in this inquiry, who noted the role HFE plays in promoting **national cohesion**.[5]

By recognising changes in states' relative fiscal capacities, HFE can help to cushion state budgets from localised economic downturns and therefore can act as a **fiscal stabiliser** in a federation where states do not have their own exchange rate or monetary policy (Asdrubali et al. 1996, p. 1082,1092; PC 2018, p. 132; Smart 2004, pp. 197–198).

HFE may also enhance the **efficient distribution of productive resources** across Australia by neutralising some of the distortionary incentives for people to migrate based on the fiscal benefits a

[4] Saul Eslake, sub. 3, p. 2; Tasmanian Government, sub. 48, p. 2; City of Melbourne, sub. 47, p. 2; Northern Territory Department of Treasury and Finance, sub. 39, p. 34; Victorian Government, sub. 59, pp. 1, 22; NSW Government, sub. 61, p. 8; Queensland Government, sub. 62, p. 3; Rob Fairs MP, sub. 15, p. 1.

[5] Rob Fairs MP 2026, sub. 15, p. 2; Brendan McCarthy, sub. 29, p. 2; John Purcell, sub. 44, p. 38; Queensland Government, sub. 62, pp. 21, 26.

state can offer (such as lower taxes or better funded services) rather than genuine economic opportunities (Chris Murphy, sub. 45, p. 24; Buchanan 1950, p. 589; Murphy 2018, p. 9). However, it is important to note that this justification is contested, with an alternative view holding that through dissuading migration to locations where public services can be provided at a relatively lower cost, HFE detracts from the efficient distribution of labour (NSW Government, sub. 61, p. 8; Garnaut and Fitzgerald 2002, p. 134; OECD 2013, p. 111). There is limited empirical evidence in the Australian context demonstrating the impact of HFE on the efficient distribution of resources, either positive or negative. The supporting paper discusses these justifications for undertaking HFE in more detail.

The introduction of the GST linked the HFE system to a single revenue source

HFE has taken various forms throughout the history of Australia's Federation (supporting paper, section 5). From the 1970s, the HFE system was effectively a constant-sum game, whereby additional funding given to one state meant the same amount was foregone by the other states. States negotiated the size of the pool of funds used for HFE with the Australian Government each year.

The HFE system remained a constant-sum game when it was linked to GST receipts in 2000, but the size of the pool could no longer be negotiated with the Australian Government. It was legislated that the GST pool would be shared with the states based on the principle of HFE, on the condition that states abolished several other inefficient taxes (Commonwealth of Australia 1999; Costello 1998, p. 83). The introduction of a fixed pool shifted the focus from the size of the pool to how the pool was allocated between states. The supporting paper discusses the context of the GST's introduction and its impact on the HFE system in more detail.

The GST is an Australian Government tax, collected and administered centrally. It is not possible to calculate with any level of confidence the amount of GST 'paid' by residents of each state (CGC 2025g, p. 3). However, it is often perceived to be the 'states' tax' as GST revenue collected by the Australian Government is passed on to states. This perception has created a sense of geographic entitlement to GST revenue, which has been exacerbated by the misconception that equal per capita GST allocations are identical to GST paid by residents within a state.

The Commonwealth Grants Commission provides recommendations on the distribution of the GST pool based on the principle of HFE

The Commonwealth Grants Commission (CGC) – an independent agency established in 1933 – provides recommendations to the Treasurer on the distribution of the GST pool based on the objective of achieving HFE. The distribution is governed by legislation and an annual terms of reference issued by the Treasurer (CGC, sub. 34, p. 2). Although the Treasurer can decide not to accept the CGC's recommendations, historically they have always been accepted (Commonwealth of Australia 2024c, pp. 121–122).

Australia implements HFE in a more comprehensive way than similar federations by assessing revenue, expenditure and investment capacities, compared to the revenue-only assessment conducted by Canada, for example (CGC, sub. 34, p. 2; CGC 2022c, p. 20; chapter 3). The supporting paper provides more detail on the CGC's assessments.

The CGC's goal is to reduce fiscal disparities between states, meaning each state has a similar fiscal capacity to provide services and associated infrastructure (CGC 2026f). To do this, the CGC determines the national average policy – this is the benchmark. If each state operated at the national average policy, the GST pool would simply be distributed on an equal per capita basis. In other words, each state would receive the same amount in GST payments per capita.

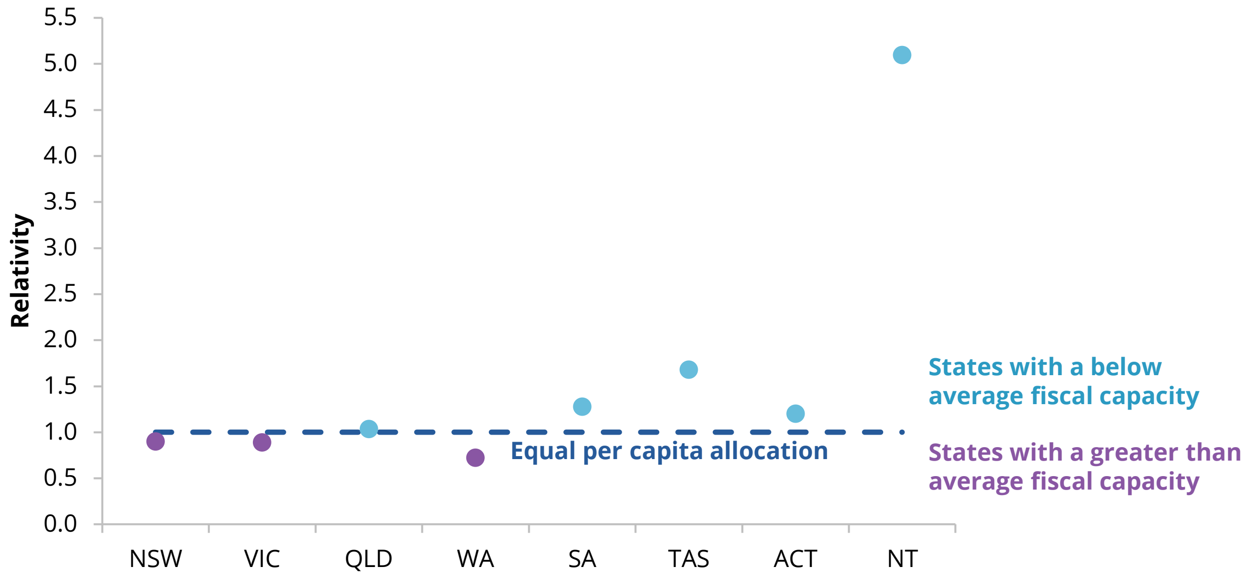
However, not all states have the fiscal capacity to meet the benchmark. The CGC therefore determines each state's relative fiscal capacity and the level of support each state requires to be able to provide the benchmark standard of services and infrastructure. States' relative fiscal capacities are determined by examining differences between states' capacities to raise revenue and their costs of providing services (supporting paper, section 6). Each state's GST requirement therefore equals their equal per capita allocation plus or minus the level of support they are assessed to need.

Each state's relativity is based on their assessed relative fiscal capacity. Relativities reflect a state's share of the GST pool relative to its share of the national population. For example, a state with a relativity of 1.05 would receive 105% of its population share of the GST pool. This is not equivalent to the percentage of GST returned to the state relative to the amount collected.

If all states were assessed to be equal in fiscal capacity, each would have a relativity of 1. States with a greater-than-average fiscal capacity have a relativity of less than 1 and states with a below-average fiscal capacity have a relativity of greater than 1 (figure 1.3).

Following the 2018 reforms, the CGC's approach has additional steps which are discussed in chapter 2.

Figure 1.3 – The CGC determines relativities based on the relative fiscal capacity of states
Average state relativities, 2000–01 to 2018–19



Average state relativities are shown for 2000–01 to 2018–19 only as 2018–19 was the last financial year before the 2018 reforms came into effect.

Source: PC estimates using CGC (2026b).

The CGC's assessments are informed by a number of supporting principles, however these are secondary to the primary objective of pursuing HFE (box 1.1).

Box 1.1 – The CGC's assessments are guided by 4 supporting principles

- **What states do –** the Commonwealth Grants Commission's (CGC's) methods should, as far as possible, reflect what states collectively do, and not make judgements about what they could or should do.
- **Policy neutrality –** a state's policy choices (for the revenue it raises or the services it provides) should not directly influence its GST payments. The CGC's assessments should not create incentives or disincentives to choose one policy over another.
- **Practicality –** assessments should be based on sound and reliable data and methods. Methods should be as simple as possible, while capturing the major influences on state revenues and expenses.
- **Contemporaneity –** to the extent reliable data will allow, the GST distribution in a year should reflect state circumstances in that year.

Source: CGC (sub. 34, pp. 3–4).

Correcting the record about the HFE system

Several inquiry participants noted how the complex nature of the HFE system and the CGC's methodology has led to a lack of public understanding about how the GST pool is distributed and how HFE is pursued in Australia (Australian Centre for Federalism, sub. 23, p. 7; Andrew Gibbs, sub. 25, p. 3; NSW Government, sub. 61, p. 9). One inquiry participant suggested that the complex nature of the system has allowed *'simplistic and misleading narratives to take hold'* (John Purcell, sub. 44, p. 6), while another suggested that the depiction of HFE as overly complex has '*allowed the emergence of inaccurate narratives in the public domain'* (Government of South Australia, sub. 13, p. 17). The prominence of inaccurate narratives has undermined the quality of public debate surrounding the HFE system.

The complexity of the HFE system is partly a by-product of the CGC's comprehensive approach to capturing state circumstances – measuring what the benchmark is for various government services is not straightforward and requires judgements from the CGC about the methods and data it uses. The CGC has itself identified the trade-off: while simpler methods could be adopted, they would likely overlook certain differences between the fiscal capacities of states and ultimately result in a lower level of equalisation (CGC, sub. 34, p. 19).

While Australia's system of HFE involves trade-offs between equity, efficiency and certainty, it is important that public debate is based on a factual characterisation of the system, rather than on misconceptions.

Dispelling some misconceptions about the HFE system

Relativities do not represent 'cents in the dollar' of GST raised in a state

A common misconception about the HFE system is that relativities represent the percentage or 'cents in the dollar' of GST raised in a state which is being 'returned' to it through GST payments. For example, a state with a relativity of 0.85 might say they are only receiving 85%, or 85 cents in the dollar, of the GST raised in that state.

This characterisation is untrue. GST is collected by the Australian Government and distributed to the states based on the principle of HFE. It is not possible to calculate the amount of GST paid in each state with any level of confidence (CGC 2025g, p. 3). Even if data was collected, it would likely be inaccurate as it would need to be consistently classified for every purchase involving GST. For example, if a Canberran purchases a bus ticket to Sydney from a company whose headquarters are based in Victoria, there would be difficulties in determining whether the GST paid on the ticket should be classified as GST raised in the Australian Capital Territory, New South Wales or Victoria.

The argument that states are only 'getting back' a certain percentage of the GST paid by their population also relies on the assertion that a state pays its exact population share of GST (Saul Eslake, sub. 3, pp. 7–8). There is no way of verifying this assertion given the lack of data.

Further, the argument that states are not 'getting back' their population share of the GST does not align with attitudes towards other key federal taxes in Australia. For example, there is no public expectation that income tax paid by an individual is returned to the state or postcode in which they live.

This misconception may have played a role in shaping the public discourse which ultimately led to pressure to change Australia's HFE system. For example, media reporting ahead of the 2018 reforms erroneously suggested that the reforms involved modifying the GST distribution system so states would '*keep more of the GST they collect*', as well as that Western Australia was receiving *'47 cents for every dollar it [sent] to federal coffers'* in 2017–18 (Elton-Pym 2018; Perpitch and Laschon 2018).

States are not entitled to receive their population share of the GST pool

The GST pool is distributed on the basis of HFE with the intention of equalising states' fiscal capacities to a defined benchmark. If all states had the same fiscal capacity, the GST pool would be distributed on an equal per capita, or population share, basis. However, because state fiscal capacities differ, an equal per capita distribution of the pool would not equalise states' fiscal capacities. Rather, it would ensure that some states consistently have a greater fiscal capacity than others, and in the absence of some other mechanism, this would lead to a divergence in the capacity of states to provide services and ultimately actual divergence in the level and quality of services that states are able to provide.

The GST distribution does not reward states with poor fiscal management

The GST pool is distributed based on the principle of HFE, which aims to equalise states' fiscal capacities. Just as the HFE system is not designed to reward, or punish, a state's fiscal management, it is also not designed to influence the state's policy choices. In undertaking its assessments, the CGC applies principles of 'what states do' and policy neutrality to minimise any influence their actions may have on state policy making (box 1.1, above). As important as the task of productivity-enhancing reform is, the HFE system is not intended to incentivise or disincentivise states from undertaking such reforms. This issue is explored further in chapter 3.

A larger share of the GST pool is not, on its own, a fiscal win – it means more support is needed

The HFE system is not intended to reward strong economic performance or punish weak performance. Rather, under HFE, the GST pool is distributed to support states' capacity to provide a similar standard of public services and associated infrastructure, assuming states make a similar effort to raise revenue and deliver services.

For this reason, where a state receives a smaller share of the GST pool, it reflects a need for less support to deliver this level of services, relative to other states. In other words, a lower share indicates that a state has a relatively greater fiscal capacity and is less reliant on GST payments to provide a similar standard of services to other states. In that sense, receiving a smaller share of the GST pool should not automatically be described as a 'loss' in terms of the state's overall fiscal position – rather, it indicates the state has relatively more scope to provide a similar standard of services to other states with its own fiscal capacity.

Similarly, receiving a larger share of the GST pool should not be characterised as a fiscal 'win'. Rather, a larger share reflects that a state has a need for relatively more support to be able to deliver a similar standard of services to other states.

It is also important to recognise that year-on-year increases or decreases in a state's GST payments are also influenced by a number of factors, including their share of the population, data revisions or methodological changes.

GST payments are not intended to influence state policy decisions

The CGC seeks to account for structural factors – not policy choices – that impact a state's revenue-raising capacity or expenditure requirements. To do this, the CGC's assessment of individual state fiscal capacities assumes national average policy, which is based on the average of actual state policies. States' needs are assessed on the basis of this national average policy, meaning that if they make a policy choice to spend above national average policy, they do not receive compensation for this through GST payments (chapter 3).

Additionally, the CGC does not assess differences in state debt levels, as these are considered to be the result of policy decisions. While the CGC includes net borrowing costs, this is assessed using the average level of borrowing and interest costs across states and does not reflect the actual debt level of any state.

GST payments are not intended to address structural disadvantage

The HFE system assesses differences in states' fiscal capacities arising from structural factors beyond their control. However, the system is not intended to address and overcome the underlying causes of these structural differences. For example, a state may be assessed as requiring a greater share of the GST pool to reflect high service delivery costs due to a greater share of their population living in remote areas. This allocation is intended to give the state the capacity to provide a similar standard of services to other states, despite their higher costs of service delivery. It is not required – or even expected – that the additional funds be used in a way that would induce more of the population to move to lower-cost urban areas. GST payments are only intended to provide states with the capacity to address the impact their structural disadvantages have on service delivery, rather than providing states with the capacity to overcome their structural disadvantages.

Additionally, states who receive a greater share of the GST pool to reflect their structural disadvantage are not required to spend the additional revenue on addressing the areas of disadvantage. Indeed, GST payments are unlikely to be sufficient to fix structural disadvantage, and where the Australian Government seeks to address such disadvantage, it often does so through tied funding agreements.

Interim finding 1.1
A lack of understanding of the HFE system has undermined the quality of public debate on the topic

The complex nature of the horizontal fiscal equalisation (HFE) system has contributed to a lack of public understanding of the system and caused several misconceptions to become prominent in public debate. The prominence of these misconceptions has undermined the quality of public discourse surrounding the HFE system and resulted in debate which is often based on mischaracterisations of the system.

1.2 The HFE system was under pressure prior to the 2018 reforms

The GST pool has not grown in line with the Australian economy or state expenditures

When the GST was introduced in 2000, the then Treasurer described it as *'a revenue base that [would grow] in line with the economy'* and claimed it would *'provide a secure base [for states] to fund their services.'* (Costello 2000, p. 3). However, GST pool growth has not kept pace with GDP growth over time. Had the GST pool grown at the same annual nominal rate as GDP since its introduction in 2000–01, states would have received about $39 billion more in GST payments (cumulatively, in nominal terms), including about $4 billion more in 2024–25 alone (PC estimates using ABS 2026a; and Commonwealth of Australia 2025 and various other years).

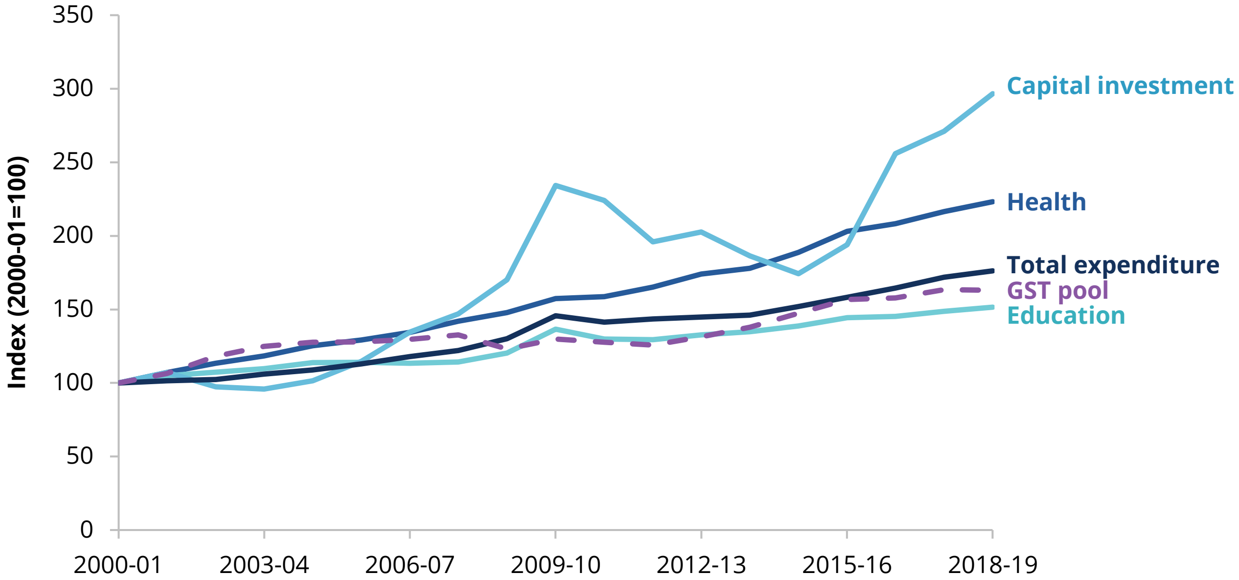
This divergence is due to several interdependent factors.

- First, household spending as a share of GDP has fallen since the GST was first introduced due to the increasing contribution of largely GST-free mining exports – particularly iron ore exports – to economic activity and greater propensities among households to save (PBO 2020, pp. 24–26).
- Second, the relative prices of GST-exempt items like healthcare and rent have risen faster than items that are subject to GST (PBO 2020, pp. 7–8). Consequently, a smaller proportion of household spending is on items that are subject to GST, decreasing the share of taxable expenditure (PBO 2020, pp. 5, 26).

Growth in the current largest state expenditure categories has outpaced growth in the GST pool (figure 1.4). This means that the scope for GST payments to support state service delivery has declined over time.

Figure 1.4 – State expenditure has grown faster than the GST pool

Growth of the GST pool and state expenditure categories, constant prices 2024–25 basis



Total expenditure refers to the sum of total expenses and net acquisition of non-financial assets (ABS 2015). Capital investment refers to gross fixed capital formation. The GST pool refers to total GST payments to states.

Source: PC estimates using ABS (2026a) and Commonwealth of Australia (2025 and various other years).

The mining boom had an unprecedented impact on the HFE system

Australia has experienced a mining boom driven by a significant increase in the demand for, and consequently, the value of, a range of mineral commodities, particularly iron ore (box 1.2). The global iron ore price went from being AUD$30 per tonne in 2002–03 (a price that had been relatively stable for many years beforehand) to AUD$72 per tonne in 2017–18, with a peak at AUD$144 per tonne in 2010–11 (PC estimates using DISR 2025 and various other years).

The mining boom had a significant effect on the outcomes produced by the HFE system because mineral resources, and consequently mining royalty revenues, are concentrated in a small number of states. About 83% of Australia's iron ore deposits and 99% of Australia's iron ore production is concentrated in Western Australia (Geoscience Australia 2026, p. 10; Government of Western Australia, sub. 37, p. 16).

The growth in iron ore prices and production volumes led to Western Australia's overall royalty revenue increasing from around $1.3 billion in 2001–02 to $8.2 billion in 2013–14 (PC estimates using ABS 2026a), which demonstrated an unprecedented increase in Western Australia's ability to generate own-source revenue (figure 1.5).

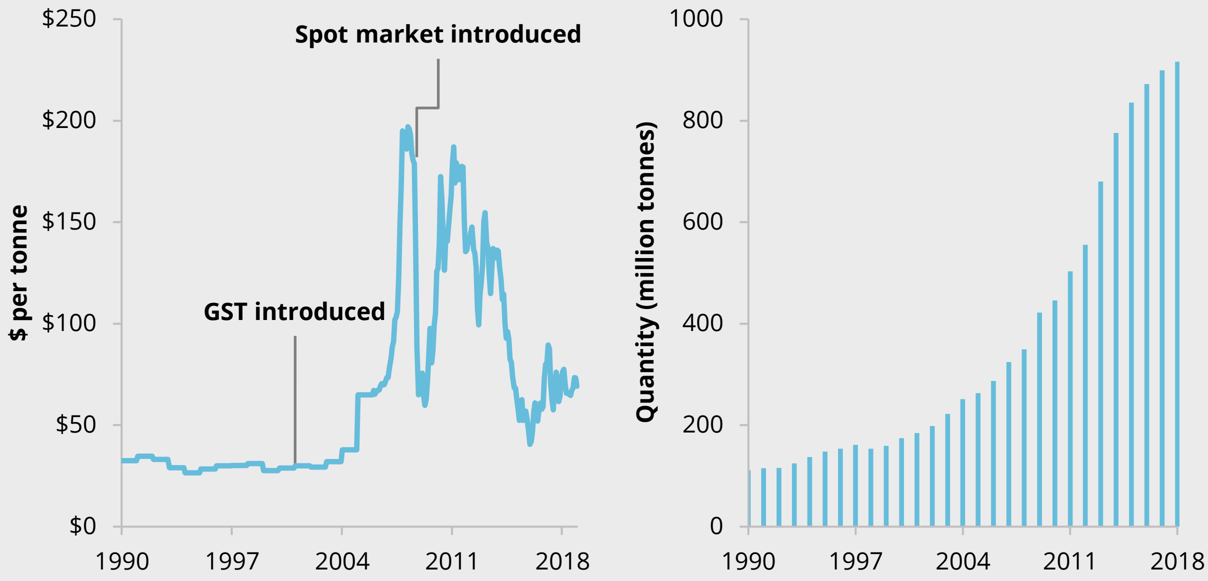
Box 1.2 – The iron ore market changed after the introduction of the GST

The GST was introduced in 2000, before the modern iron ore market emerged. Iron ore was previously sold mostly under long-term benchmark contracts, China had not yet joined the World Trade Organisation, and the boom in Chinese steel production had not begun (Caputo et al. 2013; World Trade Organisation 2026).

From the mid-2000s, stronger Chinese demand for iron ore lifted structural iron ore prices and volumes. The shift to shorter-term pricing tied to current market prices – known as spot-linked pricing – also made royalty revenue more responsive to global market conditions, leading to increased volatility (RBA 2012).

Together, these changes increased the scale and volatility of mining-related differences in state revenue-raising capacities, likely beyond what the HFE system's original designers anticipated. Chapter 3 discusses commodity-driven volatility in the HFE system in more depth.

Iron ore prices and Australian iron ore production increased following the mining boom

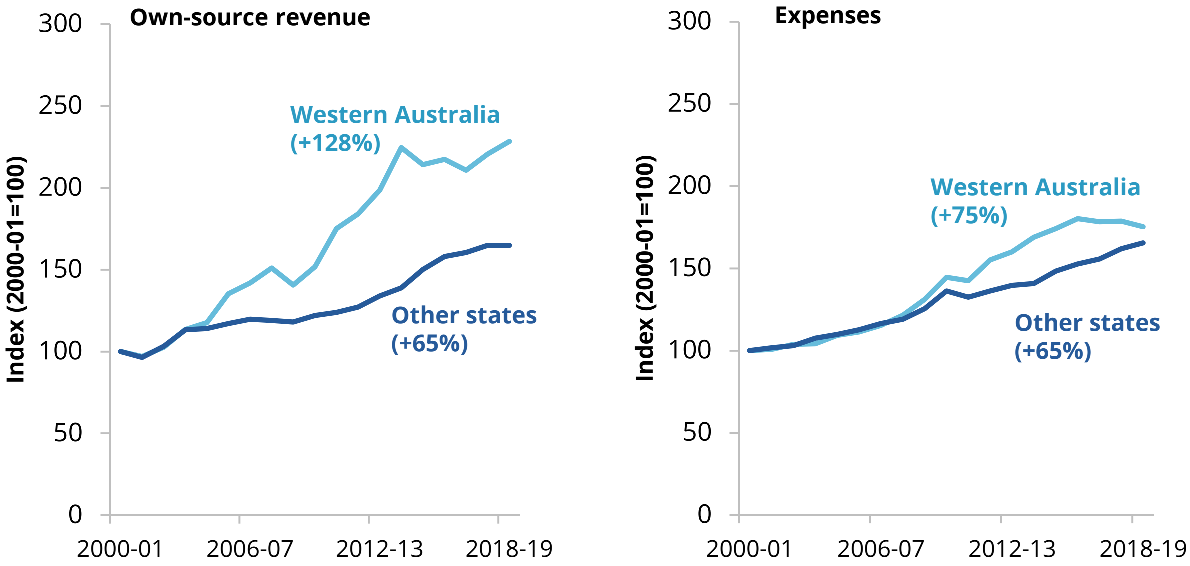


Iron ore prices are expressed in US dollars per dry metric tonne unit and reflect the current spot market price, including the cost of shipping to the destination port (or US $/dmtu, CFR spot). Iron ore price data has been converted from financial years to calendar years, where 1990 data is from the 1990–91 financial year.

Source: PC estimates using DISR (2025 and various other years).

Figure 1.5 – Western Australia's fiscal capacity increased following the mining boom

Growth of own-source revenue and expenses, 2000–01 to 2018–19



'Other states' is the sum of total state own-source revenue and expenses, excluding Western Australia.

Source: PC estimates using ABS (2026a).

In the 2011–12 Western Australian Budget, the then Western Australian Treasurer announced that the royalty rate on iron ore fines would be gradually increased to 7.5%, despite the Australian Government warning that this would reduce Western Australia's GST payments (Gillard 2011; Porter 2011, p. 12).[6] As a result of these changes to prices, volumes and policy decisions on royalty rates, Western Australia's iron ore royalty revenue increased from around $280 million in 2001–02 to $5.5 billion in 2013–14 (Government of Western Australia 2003, p. 120, 2015, p. 115). Following the 2018 reforms, the state's royalty revenue from iron ore reached a peak of over $11 billion in 2020–21 (Government of Western Australia 2022, p. 78).

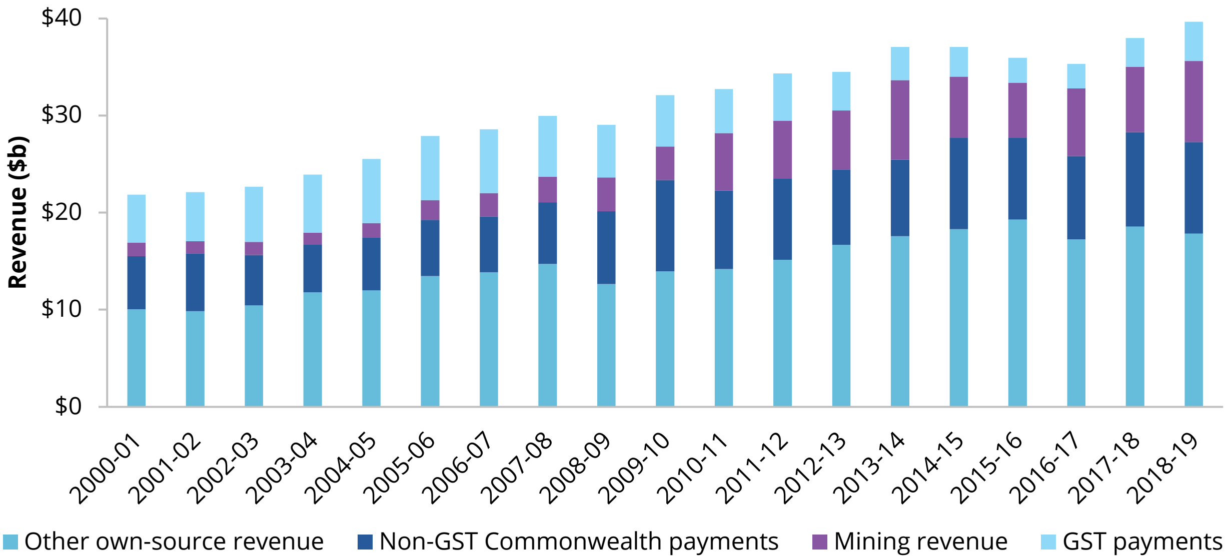
Western Australia's lower need for GST payments strained community acceptance of the HFE system in the state

As discussed earlier in this chapter, all else being equal, lower GST payments reflect a relatively greater fiscal capacity. From 2008–09 onwards, Western Australia had the greatest fiscal capacity among the states and was therefore assessed as requiring an increasingly lower share of the GST pool. By 2015–16, Western Australia's relativity had fallen to 0.3 – the lowest of any state ever (CGC 2025e, p. 68; Kate Chaney MP, sub. 31, p. 1). This reflected Western Australia's unprecedented capacity to raise own-source revenue, particularly through royalties on mining production (figure 1.6).

[6] These warnings were made during the broader policy debate surrounding the introduction of an Australian Government Mineral Resources Rent Tax (MRRT). Subsequently, Western Australia successfully made a case that the CGC's treatment of iron ore fines (small particles of iron ore) in its mining assessment would result in a reduction in GST payments greater than the additional revenue raised from the increase in iron ore fines (Senate Economics Legislation Committee 2011, p. 2). The then Australian Treasurer directed the CGC to prevent this from occurring in the terms of reference for the CGC's 2011 Update (Senate Standing Committee on Economics 2011). The issue was addressed with a change to the mining assessment in the CGC's 2015 methodology review (CGC 2015a, pp. 106–109).

Figure 1.6 – Western Australia's GST payments decreased as royalty revenue increased

Western Australia's revenue sources by revenue category, 2000–01 to 2018–19



Other own-source revenue excludes mining revenue. Non-GST payments include all Commonwealth payments except for GST payments.

Source: PC estimates using ABS (2026a) and Commonwealth of Australia (2025 and various other years).

However, the prospect of receiving near zero GST payments caused public confidence in the system to erode in Western Australia (Brendan McCarthy, sub. 29, p. 2; Government of Western Australia, sub. 37, p. 23), and led to suggestions that the exceptionally low GST payments demonstrated the pre-2018 HFE system was unsustainable and unfair (Government of Western Australia, sub. 37, p. 92; the Hon Mathias Cormann, sub. 56, p. 1–2). The impact of the mining boom on Western Australia's GST payments was also exacerbated by changes to the CGC's mining revenue assessment in the 2015 Methodology Review, including the adoption of a mineral-by-mineral approach to assessing states' mining revenue capacity (chapter 3, box 3.1).

Additionally, during the mining boom, divergences from an equal per capita allocation of the GST pool were increasingly caused by states' relative revenue-raising capacities, rather than differences in the costs of providing services (PC estimates using CGC 2026b and various other years). Mining revenue in particular became an increasingly significant determinant of states' GST payments (CGC 2021b, p. 3). This produced a sentiment among many Western Australians that the state was 'losing' its revenue (Wright 2017). As the Hon. Colin Barnett (sub. 30, p. 4) noted *'the [West Australian] public saw it as Western Australia being penalised for its economic success'*.

The loss of public confidence was compounded in 2013–14, when Western Australia's GST payments began to decrease at the same time as its mining royalties because of falling international demand for iron ore. This arose because of the CGC's longstanding approach of using lagged moving averages in their assessments to reduce volatility in GST payments. The lag meant GST payments in that period were calculated based on data from when iron ore prices were higher (Government of Western Australia, sub. 29, p. 49; CCIWA, sub. 49, p. 6). However, it is important to note that this lag effect worked in the opposite direction whenever royalties increase to Western Australia's benefit.

The HFE system also faced criticisms beyond mining

Alongside criticisms of Western Australia's decreasing GST payments, there were also concerns that the HFE system was disincentivising states from pursuing efficiency-enhancing reform.[7] This criticism reflects the Garnaut and Fitzgerald report (2002, p. 2) which argued that Australia's HFE system disincentivises states from undertaking reform by distributing the revenue benefits across states, without similarly sharing the costs borne by the state which undertakes the reform.[8] However, there is limited evidence of these disincentives existing in practice (Saul Eslake, sub. 3, pp. 17–18; Government of South Australia, sub. 13, p. 16; Tasmanian Government, sub. 48, p. 40; Commonwealth of Australia 2012, p. 135). Inquiry participants noted that states choose to undertake reforms for a range of reasons, and there are several examples of states undertaking reforms despite an expected decrease in GST payments (Tasmanian Government, sub. 48, p. 41; Government of South Australia, sub. 13, p. 16). In other words, even though impacts on GST payments may exist, they may be inframarginal with respect to policy decisions. The incentive effects of the HFE system are explored further in chapter 3.

Additionally, there were broader concerns raised by Western Australia that where a revenue base is concentrated in one state, the CGC's assessments were not policy neutral, as the dominant state's policy would determine the national average policy.[9] The dominant-state issue is discussed further in chapter 3.

In response to these concerns, the Productivity Commission was asked to undertake an inquiry into the HFE system

In light of these criticisms, the then Treasurer directed the PC to undertake an inquiry into Australia's HFE system in 2017. The PC was tasked with considering the impact the system had on productivity, efficiency and economic growth (PC 2018, pp. iv–v). The PC's final report was published in 2018, finding parts of the then system were functioning well, but that there were also deficiencies.

The inquiry made several recommendations, including that the objective of the HFE system should be changed to 'reasonable' (rather than 'full') equalisation (PC 2018, p. 39). It also recommended steps be taken to simplify the CGC's approach and improve the policy neutrality of its assessments (PC 2018, p. 42).

Against the backdrop of the PC's inquiry, longstanding criticisms of the incentive effects and volatility of the HFE system, and political pressure from the Western Australian Government and public, the Australian Government introduced reforms to the HFE system in 2018 (Fenwick and Stewart 2025, p. 99; Wright 2018). Every state other than Western Australia opposed the changes, but their unanimous approval was not required (Senate Economics Legislation Committee 2018, pp. 8–9).

[7] Government of Western Australia, sub. 37, p. 62; Amanda Haley, sub. 8, p. 11; CME, sub. 50, p. 2; CCIWA, sub. 49, p. 5; Sandra Brewer MLA, sub. 52, pp. 2–4.

[8] The HFE system does not redistribute revenue between states. Instead, a state which undertakes reform may be assessed as having a greater fiscal capacity due to an increased ability to raise revenue. This results in that state being assessed by the CGC as requiring relatively less support to provide a similar standard of services to other states, and therefore the state may receive relatively less in GST payments from the Australian Government.

[9] Following the 2018 reforms, the dominant state issue has been raised by several other states and considered by the CGC.

Interim finding 1.2

An unprecedentedly low relativity – arising from the impacts of the mining boom – strained community acceptance of the HFE system in Western Australia and was a catalyst for the 2018 reforms

Strong and sustained demand for key mining commodities has resulted in a significant and prolonged increase in Western Australia's own-source revenue-raising capacity. This caused Western Australia's relativity to reach unprecedented lows, straining community acceptance of the horizontal fiscal equalisation (HFE) system in the state.

Dissatisfaction with the HFE system in Western Australia further intensified when GST payments began to fall at the same time as royalty revenues due to the Commonwealth Grants Commission's use of lagged data. Political pressure from the Western Australian Government and public, alongside longstanding criticisms of the incentive effects and volatility of the HFE system, led the Australian Government to introduce the 2018 reforms.

2. Impacts of the 2018 reforms

In 2018, the Australian Parliament passed the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (Cth) (the Act). Schedule 1 of the Act made 4 substantial changes to how horizontal fiscal equalisation (HFE) is implemented in Australia by introducing:

- a new **fiscal equalisation standard** (with transitional arrangements) – set at the relativity of whichever of New South Wales or Victoria has the greater fiscal capacity (figure 2.1; s. 1)
- a GST **relativity floor** – set at 0.70 in 2022–23, then increased to 0.75 from 2024–25 (s. 4)
- a GST **pool boost** – perpetual yearly top-ups of the GST pool by the Australian Government ($600 million from 2021–22, then $850 million from 2024–25, indexed to GST pool growth), which was introduced with the intent of making all states and territories (hereafter 'states') better off following the reforms (explanatory memorandum (EM) 1.28; s. 5)
- a **No Worse Off (NoWO) guarantee** – ensuring that no state receives less under the current GST distribution system than it would have received under the pre-2018 system (s. 3).

NoWO payments were set to end in 2026–27. However, the NoWO guarantee was subsequently extended by 3 years to the end of 2029–30 *'as part of [a] broader health and [National Disability Insurance Scheme] deal … to provide [states] with certainty in their coming budgets'* (Chalmers 2023). The Act was not amended to give effect to the extension. Separately from the legislation, until 2021–22, the Australian Government provided **transitional top-up payments** to any state with a GST relativity below 0.7 and to the Northern Territory if its GST relativity fell below its 2017–18 level.

Together, these changes (hereafter 'the 2018 reforms') represent a significant change to how HFE is undertaken in Australia. And while not directly related to the 2018 reforms, the Commonwealth Grants Commission (CGC) has made several changes to their operations since 2018 (box 2.1).

Box 2.1 – The CGC has taken several actions following the 2018 reforms

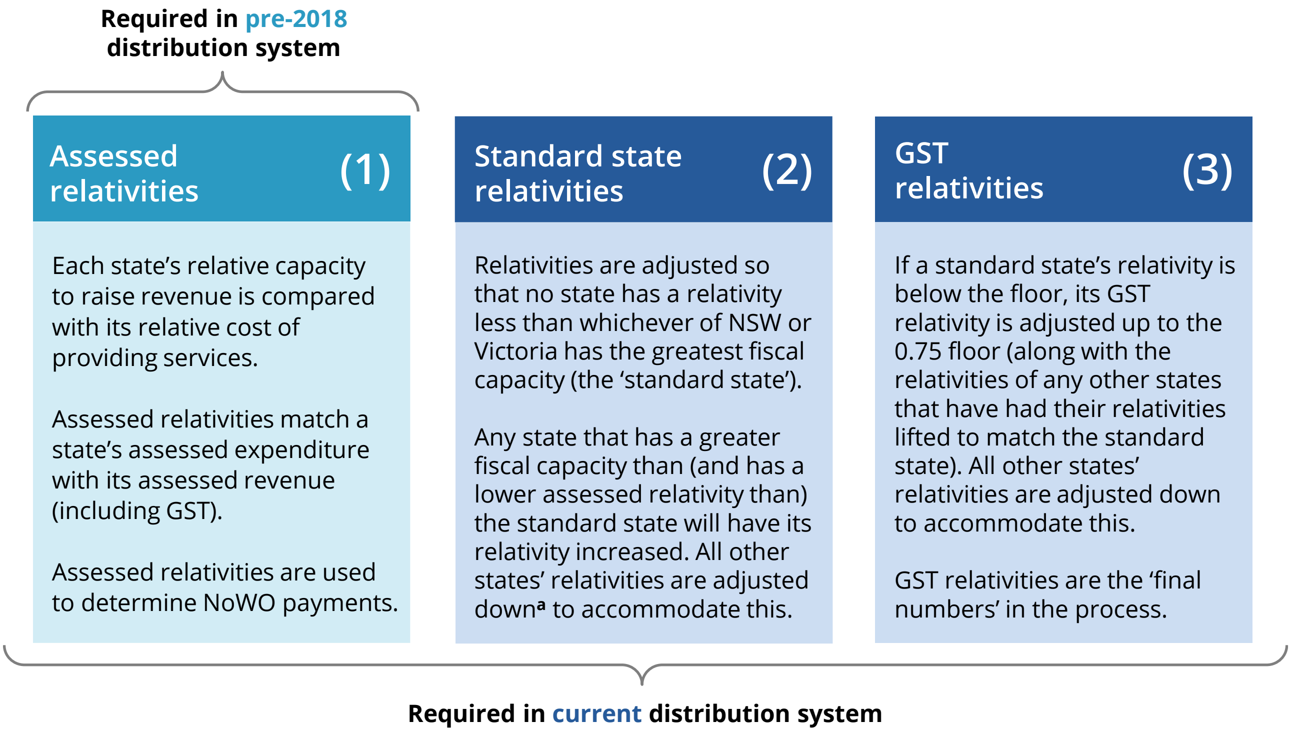
Since 2018, the CGC has established an Occasional Paper and Research Paper series that provide non-technical discussions of the CGC's work. Additionally, recent CGC publications – including the release of the 2025–26 GST relativities and 2025 Methodology Review – were accompanied by a media release and plain-English supporting documentation. The CGC has also introduced a forward work program of research topics (giving states the opportunity to provide inputs to the CGC's research work) and a Data Working Group (enabling the CGC and states to look for ways to improve data quality, processes and procedures, such as exploring opportunities to reduce data confidentiality restrictions).

Source: CGC (sub. 34, pp. 20–21).

As part of this inquiry, the Productivity Commission has been asked to examine whether the 2018 reforms are 'operating efficiently, effectively and as intended'. As such, this chapter:

- explores the intent of the 2018 reforms (section 2.1)
- analyses the impact of the reforms (section 2.2)
- evaluates, to the extent possible, whether the reforms are operating 'efficiently, effectively and as intended' (section 2.3).

Figure 2.1 – The 2018 reforms have introduced more steps to the GST distribution process, making the system more complex



Chapter 1 includes a more comprehensive explanation of relativities and their role in the GST distribution system. This figure relates to the GST distribution system after the conclusion of transitional arrangements. **a.** States' relativities are adjusted down on a population share basis.

Source: adapted from CGC (sub. 34, p. 22).

2.1 The intent of the 2018 reforms was not explicitly defined

The then Australian Government's broad rationale for the 2018 reforms was that the mining boom revealed that Australia's GST distribution system *'[did] not function well when faced with economic shocks'*, resulting in a need to reform the system amid *'declining community confidence'* (EM 1.11–1.13).[1]

However, the ultimate 'intent' of the 2018 reforms – or in other words, the specific outcomes the Australian Government was seeking to achieve – was not explicitly defined in the Act. Instead, the EM contained several statements about the aims of the reforms that can be interpreted as 'intent'. These statements covered concepts such as predictability, fairness and sustainability, and referenced states

[1] The context of the reforms is explored more deeply in chapter 1.

being both *'better off'* and *'no worse off'* as a result of the reforms (figure 2.2).[2] The EM also referred to recommendations from the PC's 2018 inquiry into *Horizontal Fiscal Equalisation* around better balancing equity and efficiency in the GST distribution system (EM 1.20).[3]

The Australian Government's interim response to the PC's 2018 inquiry, along with Government members' second reading speeches on the Bill introducing the 2018 reforms, expressed similar themes (Australian Government 2018, p. 11; House of Representatives 2018, pp. 10799–10800; Senate 2018, p. 7804).

Figure 2.2 – The intent of the 2018 reforms had several elements

Guard against the negative effects of economic shocks (on states' GST revenue)
by moving to an updated HFE system

Maintain and improve the HFE system
with minimal disruption, now and into the future

Provide a long-term solution with more stable and predictable revenue
for all states, while preserving equity in the HFE system and leaving all states better off

Transition Australia's HFE system
in a fair, reasonable and sustainable way that leaves no state worse off

Source: adapted from EM (1.14, 1.16, 1.17, 1.23).

2.2 The 2018 reforms have so far had several (primarily negative) impacts on Australia's GST distribution system

As arrangements to transition to the new fiscal equalisation standard were only completed in 2025–26 and the NoWO guarantee has been extended to 2029–30, the complete effects of the 2018 reforms have not yet fully emerged. However, it is clear the 2018 reforms have already affected Australia's GST distribution system in several ways. Specifically, the reforms have:

- reduced the level of HFE achieved in Australia
- introduced perverse outcomes to the GST distribution system
- come at a significantly higher cost to the Australian Government than expected
- had mixed impacts on states' fiscal positions – with Western Australia being better off, and other states no worse off – while creating additional fiscal uncertainty for governments
- increased the complexity of the GST distribution system, making it less transparent.

The 2018 reforms deliver a lower degree of HFE

HFE *'is not an exact science'* and involves *'estimates, trade-offs and judgements'* (CGC, sub. 34, p. 3). As a result, it is not possible for the CGC to achieve 'perfect' equalisation between states. However, while

[2] These parts of the EM were identified as representing the core 'intent' of the reforms because of their consistent sentence structure. Each statement started with the words '*The plan …*'.

[3] The interaction of the GST distribution system with incentives for state tax reform is discussed in chapter 3.

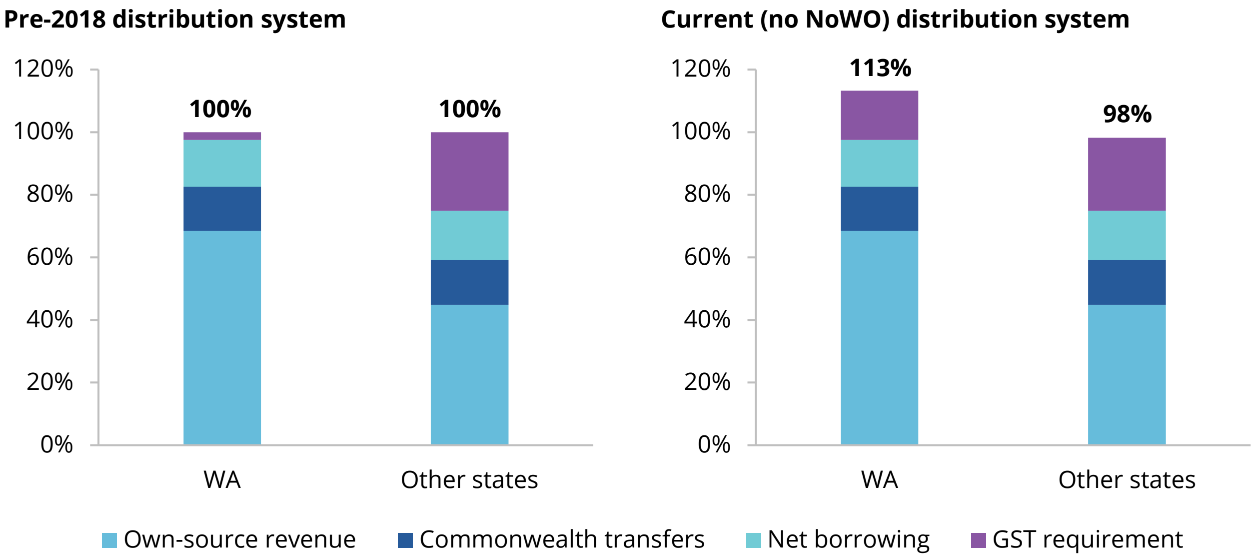
departures from perfect equalisation are inevitable, different GST distribution systems vary in the extent to which they stray from the best available estimate of perfect equalisation.

Under the pre-2018 distribution system, the CGC's recommended distribution of the GST pool balanced these estimates, trade-offs and judgements as best as it could. Consequently, if each state made the same effort to raise own-source revenue and operated at the average level of efficiency, it could provide a *similar* standard of services and infrastructure as other states (CGC 2025f, p. 230). In other words, each state's assessed revenues (including GST revenue) met their assessed expenditures (figure 2.3, left panel). The current distribution system now delivers a lower degree of equalisation, with Western Australia receiving a higher amount of GST revenue than required to meet their assessed expenditure, with all other states' total assessed revenues (excluding NoWO payments) failing to cover their assessed expenditure (figure 2.3, right panel). As summarised by the CGC:

> the [reforms] have put limits on equalisation … Most states receive less GST revenue than would be needed to provide the average level of services … Western Australia receives more GST revenue than would be needed to provide the average level of services. (sub. 34, p. 9)

Figure 2.3 – GST revenues no longer equalise states' assessed budgets

Assessed 2024–25 fiscal need met, by distribution system and revenue source



NoWO payments are not incorporated in assessed budgets. States' GST requirements under the pre-2018 distribution system were calculated as a residual to balance assessed revenue and assessed expenditure.

Source: PC estimates using CGC (2024, figure 1–1); Commonwealth of Australia (2025, p. 67).

While NoWO payments (worth $5.4 billion in 2024–25) have so far ensured that other states' assessed revenues have continued to meet their assessed expenditures, the Australian Government would have needed to provide these states with about $47 billion in additional assessed revenue to ensure they had the same relative fiscal capacity as Western Australia in 2024–25 (PC estimates using CGC 2024; Commonwealth of Australia 2025, pp. 64, 67).

The new fiscal equalisation standard can create perverse outcomes

HFE is intended to respond to structural differences in states' fiscal capacities, including because of resource endowments, and to do so consistently between states. As such, prior to the 2018 reforms, if a state's relative fiscal capacity weakened, it would receive a larger share of the GST pool, and the shares of other states would fall to accommodate this. Likewise, if a state's relative fiscal capacity rose, it would receive a smaller share of the GST pool, with other states receiving a larger share.

The new equalisation standard introduced as part of the 2018 reforms requires that no state has a relativity lower than whichever of New South Wales or Victoria has the greatest fiscal capacity (the 'standard state') (figure 2.1, panel 2). This standard state benchmark can create perverse outcomes in the GST distribution system, as state policy choices and external shocks now impact different states in different ways. As a result of the 2018 reforms:

- **States that have a lower fiscal capacity than the standard state** do not need to have their relativity adjusted upwards to meet the standard state benchmark. For these states, a relative improvement (weakening) in their fiscal capacity would reduce (increase) their GST share. This is consistent with the logic of HFE.
- **States that have a greater fiscal capacity than the standard state** (currently only Western Australia) have their relativities adjusted upwards to meet the standard state benchmark. In response to a state policy change or external shock, states in this position can now experience a relative improvement in their fiscal capacity and see their GST share increase, rather than fall. This runs counter to the logic of HFE: a state with a greater revenue-raising capacity should need less GST revenue as its relative fiscal capacity increases, not more.

The PC has explored a non-exhaustive number of perverse outcomes arising from the introduction of the new fiscal equalisation standard. These cases involve natural disaster payments, as well as mining revenue rising because of either state policy choices or increases in commodity prices or volumes. These perverse outcomes create equity concerns that could undermine community confidence in the GST distribution system.

The 2018 reforms mean a natural disaster impacting New South Wales could result in Western Australia receiving more GST revenue

As natural disaster damage is largely outside of state control and not influenced by state policy, it is consistent with the logic of HFE that related expenses are incorporated in assessed relativities.[4] A natural disaster, such as a bushfire, in New South Wales (the current standard state) would negatively impact its relative fiscal capacity, increasing its assessed relativity. However, a state with an assessed relativity below that of New South Wales[5] – as Western Australia's currently is – would also need to be adjusted upwards to the (now higher) standard state benchmark. Consequently, Western Australia would receive more GST revenue. The policy case for increased GST revenue for Western Australia in response to a natural disaster in New South Wales is unclear and this could create community concerns about the fairness of the GST distribution system.

[4] The CGC's treatment of natural disaster expenditure only considers state spending net of reimbursements from insurance payments and Australian Government contributions (CGC 2022b, p. 2). This ensures the assessment only includes expenditure that affects state fiscal capacity. For clarity, this stylised example does not include the lags that exist in the GST distribution system or disasters in other states. Further detail is available in appendix C.

[5] This example assumes that the fiscal capacity of New South Wales remains greater than that of Victoria.

Table 2.1 and figure 2.4 illustrate this using the example of a bushfire that imposes $100 million in costs (outside Australian Government support and insurance) on New South Wales. Prior to the 2018 reforms, the disaster would have resulted in $69 million additional GST revenue for New South Wales, with other states' GST revenues adjusted downwards on a population share basis in response. In essence, the fiscal burden of the bushfire would have been shared between *all states*.

By contrast, following the 2018 reforms, Western Australia would *receive* $21 million GST revenue following the bushfire in New South Wales, while other states, including the disaster-affected New South Wales, would receive less GST revenue. As such, the cost of this natural disaster would no longer be fully shared between all states. Until the end of 2029–30, states other than Western Australia are compensated for this reduction in GST revenue through $32 million in additional NoWO payments.

Table 2.1 – The fiscal burden of natural disasters is no longer shared between all states

GST impacts of a $100 million increase in New South Wales natural disaster expenses ($m)

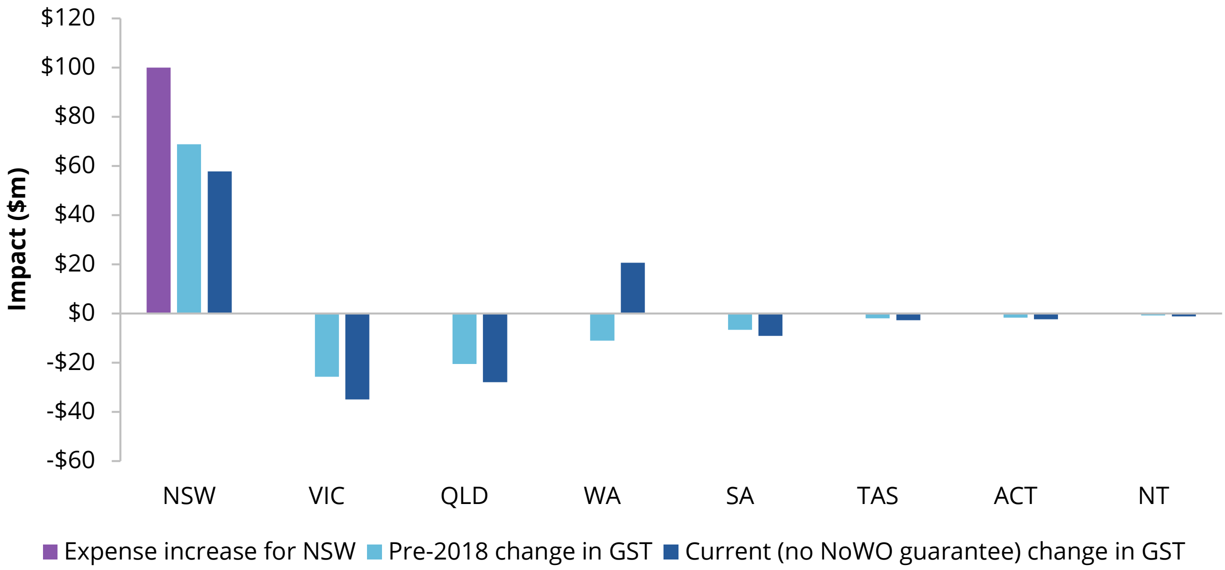
	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Expense increase for NSW	100	0	0	0	0	0	0	0
Pre-2018 system change in GST outcome	68.7	-25.8	-20.6	-11.1	-6.7	-2.0	-1.7	-0.9
Current (no NoWO guarantee) system change in GST outcome	57.7	-35.0	-27.9	20.6	-9.1	-2.7	-2.4	-1.2
Change in GST revenue between pre-2018 and current (no NoWO guarantee) systems	**-11.0**	**-9.2**	**-7.3**	**31.7**	**-2.4**	**-0.7**	**-0.7**	**-0.3**

Calculated as a static shock to 2024–25 assessment data. The final row does not sum to zero due to rounding.

Source: PC estimates using CGC (unpublished) data.

Figure 2.4 – A bushfire in New South Wales can increase Western Australia's GST revenue

GST impacts of a $100 million increase in New South Wales's natural disaster expenses



Calculated as a static shock to 2024–25 assessment data (further detail is available in appendix C).

Source: PC estimates using CGC (unpublished) data.

The 2018 reforms mean that Western Australia could receive additional GST revenue when its mining revenue increases

Prior to the 2018 reforms, when a state's assessed mining revenue increased, all else equal, its relative fiscal capacity would increase, and its GST share would decline. At the same time, the relative fiscal capacity of other states would weaken, raising their assessed relativity and GST share. This was in line with the logic of HFE – as the relative fiscal strength of a state increases, the GST revenue it requires falls, and the GST revenue required by other states rises.

However, under the new fiscal equalisation standard, any state with an assessed relativity below the standard state benchmark retains *all additional mining revenue* it generates – even if it is already the state with the greatest relative fiscal capacity – regardless of whether this revenue increase occurs because of higher iron ore prices, higher production volumes or the imposition of a higher royalty rate. This is because its relativity cannot fall below that of the standard state's (figure 2.1, panel 2).

In fact, Western Australia could receive additional GST revenue on top of the increase in mining revenue. This could arise because an increase in Western Australia's mining revenue would weaken the relative fiscal capacity and increase the assessed relativity of New South Wales, which currently serves as the standard state benchmark that Western Australia is brought up to. This increase in the standard state benchmark could result in Western Australia keeping the additional mining revenue while also receiving an increase in GST revenue. The extent to which this happens can vary based on what the increase in mining revenue is used for – for example, Western Australia's share of GST revenue would grow if the additional mining revenue was used to fund reductions in payroll tax.

The PC has not found any evidence that Western Australia has been the beneficiary of such perverse outcomes, and the magnitude of these outcomes is likely to be small. Nevertheless, their existence inverts the logic of HFE and risks undermining community confidence in the GST distribution system.

Interim finding 2.1
The new fiscal equalisation standard creates perverse outcomes that invert the logic of HFE – it should not be an ongoing feature of the GST distribution system

The new fiscal equalisation standard has introduced perverse outcomes to the GST distribution system. One example is the ability for states that have a greater fiscal capacity than the standard state (currently only Western Australia) to receive additional GST revenue following a natural disaster in New South Wales (currently the standard state). This outcome runs counter to the logic of horizontal fiscal equalisation (HFE) and could undermine community support for the current GST distribution system.

The 2018 reforms have cost the Australian Government considerably more than expected

The direct financial cost of the 2018 reforms for the Australian Government comprises 3 parts: transitional top-up payments (paid between 2018–19[6] and 2021–22); NoWO payments (paid

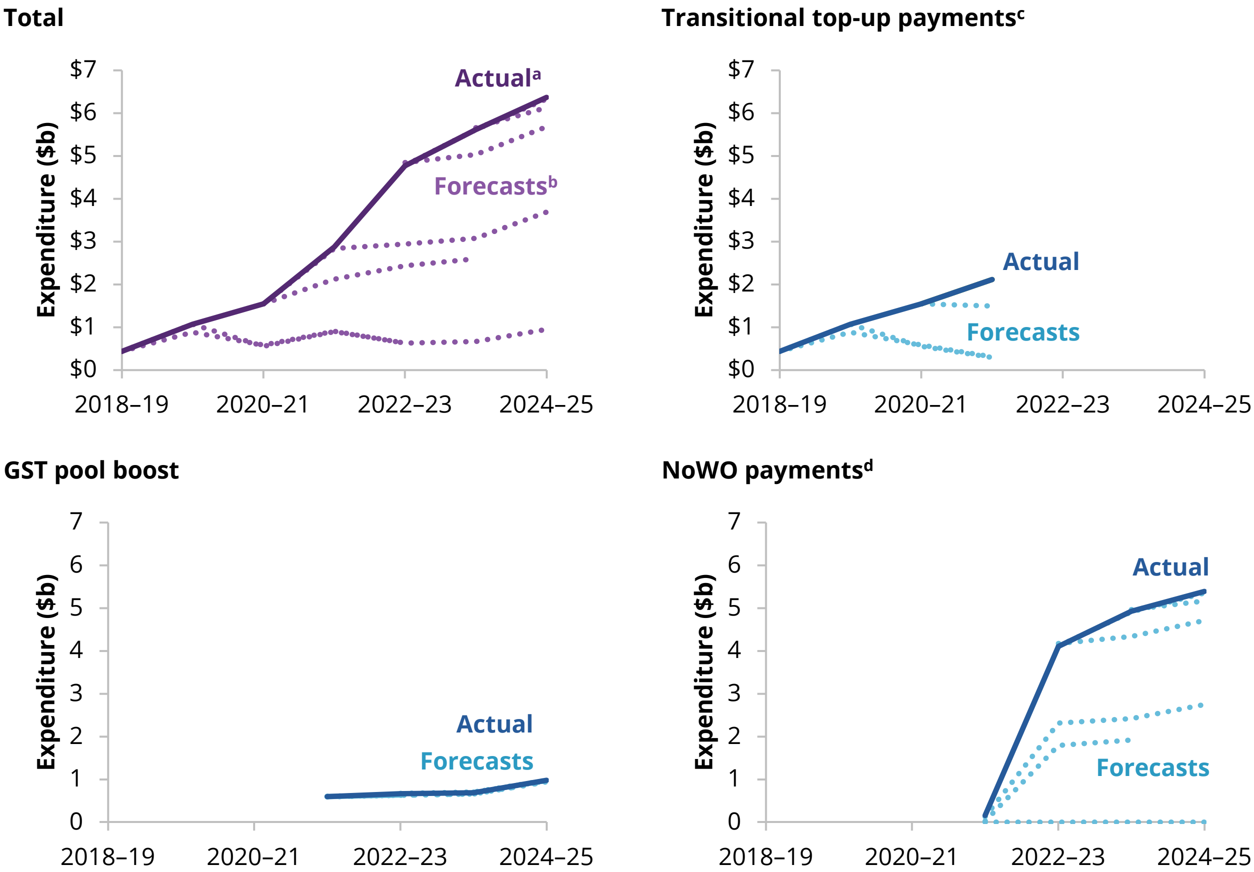
[6] Arrangements for transitional top-up payments were in place between 2019–20 and 2021–22 but appear in Budget documents from 2018–19 as Western Australia received an advance on a 2019–20 payment in 2018–19.

since 2021–22); and the GST pool boost (paid since 2021–22). The reforms severed the longstanding nexus between the GST pool and HFE payments, as the Australian Government funds these payments from other revenue sources.

The reforms were initially expected to cost the Australian Government a cumulative total of about $5 billion by 2024–25 (PC estimates using Australian Government 2018, p. 21). This included the cost of transitional top-up payments and the GST pool boost, but not the cost of NoWO payments (which were not anticipated to be needed).[7] However, the actual cost of the reforms so far has been significantly higher than expected (figure 2.5).

Figure 2.5 – The cost of the 2018 reforms has been higher than anticipated

Annual actual and forecast costs (nominal), 2018–19 to 2024–25



a. 'Actual' data is from final budget outcomes, with 2024–25 being the most recent year of published data. **b.** 'Forecasts' measures include data from both Budget documents and longer-term estimates from the Australian Government's interim response to the PC's 2018 inquiry into *Horizontal Fiscal Equalisation*. **c.** Transitional top-up payments appear in Budget documents from 2018–19 as Western Australia received an advance on a 2019–20 payment in 2018–19. **d.** NoWO payments are labelled as 'HFE transition payments' in documents.

Source: Commonwealth of Australia (2018, p. 21, 2024a (various years), 2025 (various years)).

[7] This was because the combined effect of an anticipated weakening of the iron ore market (narrowing the gap between Western Australia's GST revenue under the pre-2018 and current distribution systems) and the GST pool boost (which increases the size of the GST pool) was anticipated to leave all states better off.

The reforms have cumulatively cost the Australian Government almost $23 billion to 2024–25 (the latest year of published final budget outcome data), more than 4 times the initial estimated cost. This additional spending has been largely driven by iron ore prices and volumes being stronger than forecast, leading to transitional top-up payments and NoWO payments being significantly more costly than expected (box 2.2).

Box 2.2 – Transitional top-up and NoWO payments have cost more than anticipated

The Australian Government's original cost estimates for the 2018 reforms were based in part on forecasts of relativities from the PC's 2018 inquiry into *Horizontal Fiscal Equalisation* (Tasmanian Government 2018, p. 3; Victorian Government 2018, p. 2). The PC's estimates were in turn derived by averaging forecast relativities provided by selected state treasuries (PC 2018, p. 363). These estimates assumed that Western Australia's assessed relativity would rise over the following years (that is, that the iron ore market would weaken and Western Australia would be assessed as requiring a larger share of GST revenue).

However, since the introduction of the 2018 reforms, iron ore prices have remained elevated and Western Australia's assessed relativity (or in other words, the state's relativity if the reforms had not been put in place) has remained lower than expected (CGC, sub. 34, p. 7). Consequently, although the GST pool boost has increased the amount of GST revenue available for distribution to all states, the amount of GST revenue needed to bridge the gap between Western Australia's GST revenue under the pre-2018 and current distribution systems has been larger than expected. This has left other states worse off, requiring the Australian Government to make NoWO payments.

Even once the need for NoWO payments was recognised in the Australian Government Budget, the continued strength of the iron ore market has meant that the magnitude of NoWO payments has been consistently underestimated. Likewise, transitional top-up payments were more costly than expected largely because conditions in the iron ore market remained stronger than anticipated until 2021–22.

Although the Australian Government's spending on the 2018 reforms is relatively small in the context of the wider Australian Government Budget (the cost of the reforms represented 0.8% of Australian Government expenses in 2024–25) (PC estimates using Commonwealth of Australia 2025, pp. 4, 64, 66), all spending must be considered against its opportunity cost. By way of context, the $6.4 billion spent on the 2018 reforms in 2024–25 could deliver a more than $450 tax cut for each Australian taxpayer,[8] or fund an increase in JobSeeker payments to 90% of the Age Pension including supplements (PC estimates using Commonwealth of Australia 2024b, p. 1; Phillips 2026).

The 2018 reforms have also introduced a new source of fiscal uncertainty for the Australian Government, as the magnitude of NoWO payments is largely determined by external factors that are difficult to forecast and beyond the Australian Government's direct control, such as iron ore prices. This is discussed more in chapter 3.

[8] Based on there being 13.6 million Australian taxpayers from 1 July 2024 (Commonwealth of Australia 2024b, p. 1).

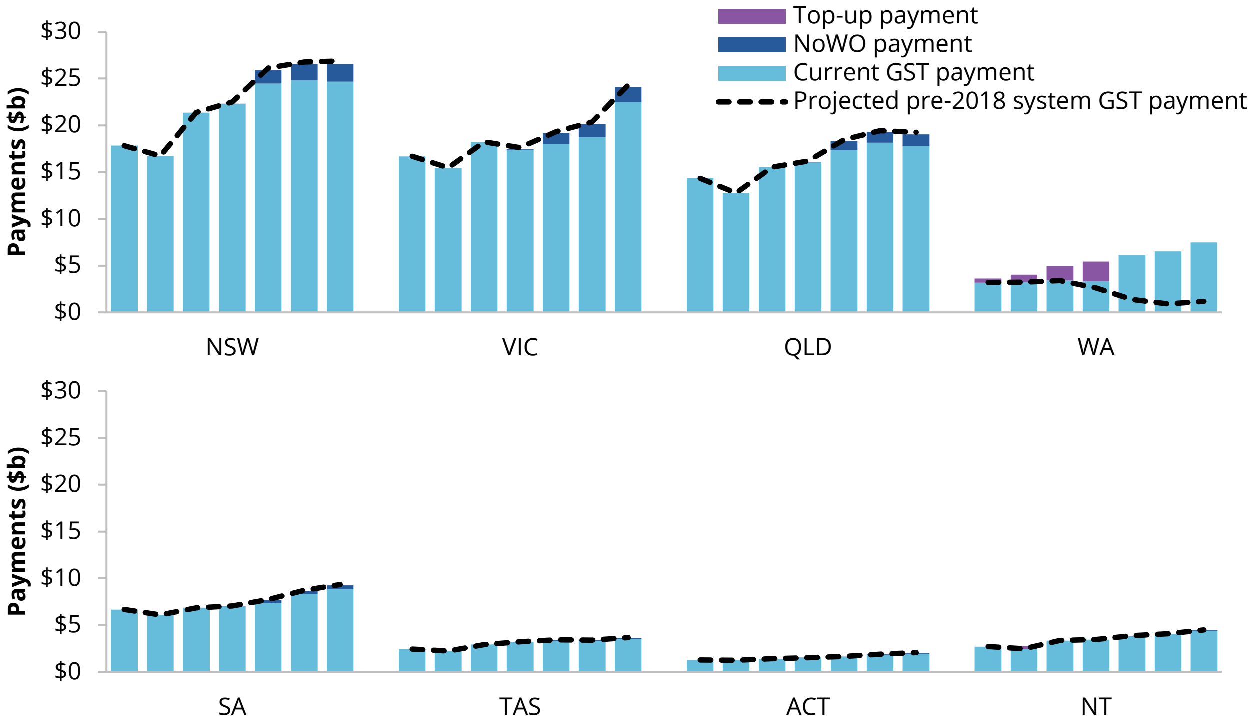
The 2018 reforms have had mixed impacts on states' fiscal positions so far, while introducing significant fiscal uncertainty

The NoWO guarantee has ensured that no state is fiscally worse off because of the reforms …

The GST pool boost that was introduced as part of the 2018 reforms was intended to make all states *'better off'* by increasing the size of the GST pool available for distribution to all states (EM 1.28). However, this intent has not been realised: no state other than Western Australia is better off. As the pool boost has not covered the additional GST payments made to Western Australia, other states have relied on the NoWO guarantee to ensure that their GST payments have remained cumulatively equivalent to what they would have received under the pre-2018 distribution system (figure 2.6).[9]

Figure 2.6 – The 2018 reforms have only improved Western Australia's fiscal position

GST and related payments (nominal), 2018–19 to 2024–25



GST payments under the pre-2018 distribution system were calculated using the CGC's assessed relativities and applied to the GST pool as per final budget outcomes. GST and NoWO payments reflect allocations, not actual advances paid or year-on-year corrections using balancing items.

Source: PC estimates using CGC (2024, p. 19) (assessed relativities) (various years); Commonwealth of Australia (2025, pp. 67–68) (current GST and NoWO payments, population, GST pool) (various years).

[9] Although NoWO payments are made to states each year, the NoWO guarantee is ultimately cumulative over the transition period. States are guaranteed to receive at least as much GST revenue under the current distribution system as they would have under the pre-2018 system not in each year, but across the transition period (CGC 2021c, p. 3).

… while Western Australia is substantially better off

For Western Australia, the 2018 reforms have increased its GST payments relative to the pre-2018 distribution system (figure 2.6). The state received just under $5 billion in transitional top-up payments between 2018–19 and 2021–22. In addition, changes to Western Australia's GST relativities as a result of the 2018 reforms have increased its GST revenue by approximately $17.4 billion between 2021–22 and 2024–25, compared with what it would have received under the pre-2018 distribution system.

Part of this $17.4 billion has been funded through the GST pool boost. In practice, the pool boost only benefits states not receiving NoWO payments – to date, only Western Australia has benefited from the additional revenue. Because the 2018 reforms have increased Western Australia's GST payments relative to the pre-2018 system, the pool boost forms part of the Australian Government's cost of funding Western Australia's improved fiscal position. The distribution of the pool boost between states is discussed in detail in chapter 3. The remainder of the additional GST payments have been funded out of the GST payments of other states – with these reductions in states' payments offset by NoWO payments. Without the NoWO guarantee, other states' GST payments would have fallen to offset the additional payments to Western Australia.

Every state other than Western Australia agreed that the reforms have improved Western Australia's relative fiscal capacity.[10] These states submitted that the current system provides Western Australia with greater relative capacity to fund services, reduce taxes or debt, and support stronger growth, and that this will create an economic gap between Western Australia and other states over time (Government of South Australia, sub. 13, p. 9; Northern Territory Department of Treasury and Finance, sub. 39, p. 8; Tasmanian Government, sub. 48, pp. 7, 10).

By contrast, the Government of Western Australia stated that the additional GST revenue from the 2018 reforms has supported investment that benefits the national economy through flow-on effects on interstate supply chains and higher Australian Government tax receipts (sub. 37, p. 73). The PC also notes that between 2018–19 and 2024–25, the combined real net debt of all states other than Western Australia rose by more than 200% ($129 billion to $425 billion), while Western Australia's net debt levels fell by 32% ($50 billion to $34 billion) (PC estimates using ABS 2026a).

The fundamental purpose of HFE is supporting states to deliver a similar standard of services and infrastructure (assuming states make the same effort to raise own-source revenue and operate at the average level of efficiency), not promoting economic investment or superior fiscal conditions in a single state. If the Australian Government sees merit in providing additional funds to a state beyond what is needed for HFE, this can be delivered more transparently through payments made outside of the GST distribution system.

In particular, if state activity generates material, uncompensated, policy relevant fiscal spillovers to the Australian Government and there is evidence that in the absence of payments, the state's activity would be inefficiently low, there is a straightforward policy solution available: the Australian Government can subsidise these activities directly, in a way that reflects the economic characteristics and magnitude of the spillover. There is ample precedent for this, including National Competition Policy payments.

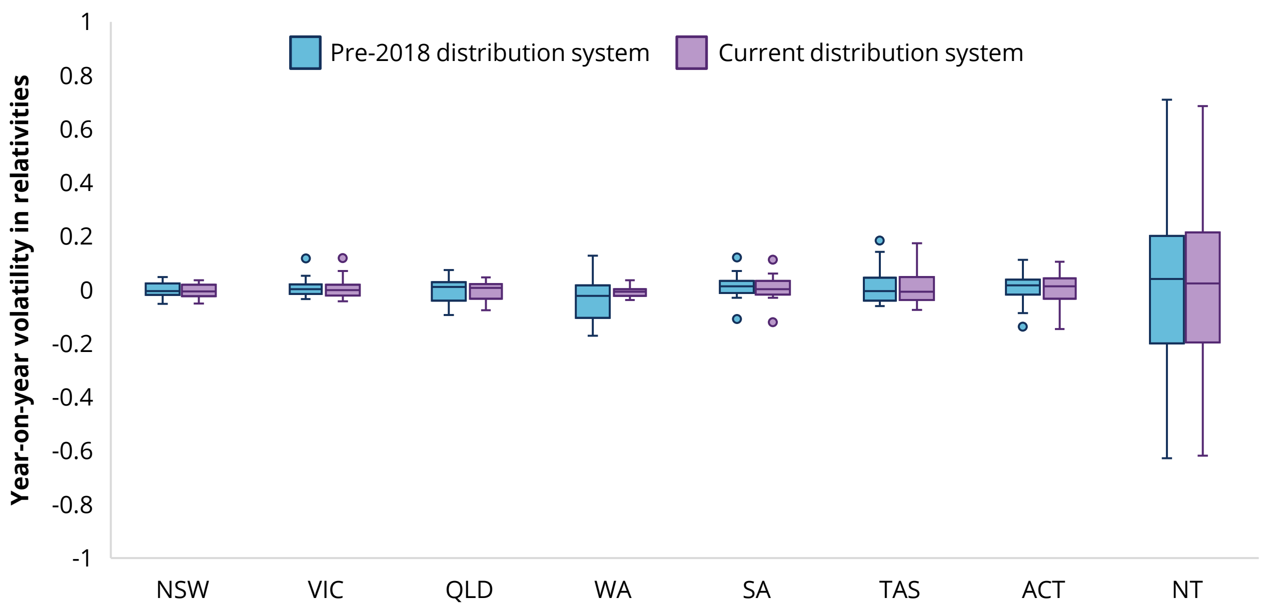
[10] ACT Government, sub. 38, p. 4; Government of South Australia, sub. 13, p. 9; Northern Territory Department of Treasury and Finance, sub. 39, p. 31; NSW Government, sub. 61, p. 15; Queensland Government, sub. 62, p. 11; Tasmanian Government, sub. 48, p. 7; Victorian Government, sub. 59, p. 20.

The reforms have had a mixed impact on volatility for states …

The 2018 reforms changed the way relativities are calculated and therefore have the potential to impact the volatility of GST payments to individual states. Comparing states' (theoretical) relativities under the pre-2018 and current distribution systems between 2001–02 to 2024–25 highlights that the 2018 reforms have had little effect on year-on-year volatility, except in Western Australia, where volatility is noticeably reduced (box 2.3; figure 2.7).[11] For the other states, changes are minimal.

Figure 2.7 – The 2018 reforms have had a mixed impact on volatility

Pre-2018 and current system year-on-year volatility in relativities, 2001–02 to 2024–25



'Pre-2018' refers to assessed relativities. 'Current' refers to standard state (not blended) relativities. Year-on-year volatility in relativities is the change in relativities each year (for example, relativities of 0.8 in 2023–24 and 0.9 in 2024–25 would create year-on-year volatility of 0.1). This analysis does not account for NoWO payments.

Source: PC estimates using CGC (unpublished) data.

However, it is important to note that the reduction in revenue volatility for Western Australia has come at the direct expense of the Australian Government, and therefore at the expense of citizens from all states. Consequently, the cost of revenue volatility has not been eliminated; it has merely been shifted and spread between governments.[12]

Chapter 3 includes a broader assessment of volatility in the GST distribution system – including using other measures to assess the volatility of GST distribution systems that incorporate the NoWO guarantee.

[11] Trends in volatility are similar if the analysis is restricted to the years following the 2018 reforms.

[12] Ultimately this does not mean that this change was not desirable, as the Australian Government may be better placed to bear volatility-related risks.

Box 2.3 – Assessing the volatility-related impacts of the 2018 reforms

Inquiry participants held diverse views on how to best assess the volatility-related impacts of the 2018 reforms. It is difficult to isolate these impacts using *actual GST relativities*, as throughout the transition period, relativities have been calculated using a blend of the pre-2018 and current methodologies. It is also difficult to identify volatility impacts using *GST payments*, as payments are affected by factors external to the impact of the 2018 reforms, such as the size of the GST pool and population changes. Consequently, the PC has chosen to assess the volatility impacts of the 2018 reforms using *theoretical relativities*: comparing states' pre-2018 (assessed) relativities to current (standard state) relativities from 2001-02 to 2024-25. Current relativities are calculated as if the current methodology had been implemented in full since 2001–02 (with no transition period or associated NoWO payments). The PC has used other measures to assess volatility in the GST distribution system more broadly (including a NoWO guarantee) in chapter 3.

… while introducing substantial fiscal uncertainty

Many inquiry participants noted that the lack of a permanent NoWO guarantee has created significant fiscal uncertainty for states, with some likening the end of the guarantee to a 'fiscal cliff'.[13]

As noted earlier, the 2018 reforms severed the nexus between the GST pool and HFE payments by committing the Australian Government to provide funding for the ongoing GST pool boost and temporary NoWO payments. All else being equal, this creates budgetary pressure and reduces the ability of the Australian Government to spend in other areas, including non-GST Commonwealth payments. Accordingly, several states raised concerns that the fiscal burden of the 2018 reforms has created uncertainty about the Australian Government's capacity or willingness to provide funding to states outside the GST distribution system.[14] The Victorian Government suggested that these concerns have already been realised to some extent, with the Australian Government '*effectively link[ing] health and disability negotiations to the extension of the [NoWO guarantee] at National Cabinet in December 2023*' (sub. 59, p. 34).

The PC recognises that the fiscal uncertainty stemming from the planned expiration of the NoWO guarantee is problematic for many states and may negatively affect budgetary processes – for example, by reducing states' confidence in making long-term investments or in entering long-term funding contracts with service delivery providers. As noted above, the PC also recognises that the NoWO guarantee represents a significant source of fiscal uncertainty for the Australian Government.

[13] Dean Winter MP, sub. 14, p. 2; Government of South Australia, sub. 13, p. 15; Huon Valley Council, sub. 19, p. 2; Northern Territory Department of Treasury and Finance, sub. 39, p. 31; Rob Fairs MP, sub. 15, p. 2; Rosalie Woodruff MP, sub. 26, p. 2; Tasmanian Government, sub. 48, p. 39; Victorian Government, sub. 59, p. 33.
[14] ACT Government, sub. 38, p. 5; Dean Winter MP, sub. 14, p. 2; Government of South Australia, sub. 13, p. 11; Northern Territory Department of Treasury and Finance, sub. 39, pp. 9–10; NSW Government, sub. 61, p. 33; Tasmanian Government, sub. 48, p. 14; Victorian Government, sub. 59, pp. 33–34.

The 2018 reforms have increased complexity in the GST distribution system

Several inquiry participants noted that the 2018 reforms have increased complexity in the GST distribution system (Government of South Australia, sub. 13, p. 4; NSW Government, sub. 61, p. 10; Victorian Government, sub. 59, p. 47). As outlined above, the calculation of relativities has become significantly more involved, with the CGC now required to keep 'multiple books' of relativities: assessed relativities, standard state relativities *and* GST relativities (figure 2.1).

2.3 The 2018 reforms are not operating efficiently, effectively or as intended

While some aspects of the reforms are operating 'as intended' …

From 2018–19 to 2024–25, Western Australia received about $22 billion in additional revenue through transitional top-up payments and GST relativity adjustments as a result of the reforms. This revenue has, as intended, largely shielded Western Australia from reductions in GST relativities and payments that the state would have otherwise faced due to the continued strength in the iron ore market.

As discussed above, beyond Western Australia, the new relativity floor and fiscal equalisation standard would provide similar protection to any other state experiencing a state-specific, large, positive economic shock that results in their assessed relativity falling below whichever of New South Wales or Victoria has the greater fiscal capacity.[15]

However, a trade-off of this absolute revenue protection is a loss of responsiveness of GST revenue to broader macroeconomic conditions. For example, consider Western Australia – a state with a greater fiscal capacity than the standard state – experiencing a $3 billion fall in iron ore royalties (all else equal). Under the pre-2018 system, this reduction in own-source revenue would have resulted in a substantial *increase* in GST revenue for Western Australia (albeit with a lag). By contrast, under the current system, Western Australia's GST revenue would slightly *decrease* in response. This is because the relative fiscal strength of New South Wales (the standard state) would increase following the fall in Western Australia's own-source revenue, and Western Australia's relativity would continue to be pegged to the (now lower) standard state relativity of New South Wales. Essentially, while Western Australia's absolute revenue position would remain stronger than under the pre-2018 system, the current system undermines the ability of the GST distribution system to operate as a macroeconomic stabiliser.

The NoWO guarantee has also ensured that, to date, the 2018 reforms have met their intended aim of '*leav[ing] no state … worse off*', albeit at a high cost to the Australian Government (EM 1.23; figures 2.5 and 2.6).

[15] For New South Wales and Victoria, the shock would need to see their assessed and standard state relativities fall below 0.75 to be afforded protection.

… other aspects are not …

However, the 2018 reforms have failed to make all states *'better off'* as intended: Western Australia is better off compared to the pre-2018 distribution system, while all other states are only no worse off (EM 1.17, figure 2.6).

The reforms were passed without agreement from all states. All states except Western Australia expressed significant dissatisfaction with the changes, labelling them as *'inherently inequitable'*, *'increasingly unfair'* and *'neither fair nor sustainable'*.[16] Insofar as the GST distribution system is intended to promote national cohesion (chapter 1), the 2018 reforms have done little to encourage this. It is far from clear that the reforms are (or will be) the desired *'long-term solution'* to the pressures and challenges facing Australia's GST distribution system (EM 1.17), particularly if the NoWO guarantee is not extended beyond 2029–30. And even if the NoWO guarantee is extended, the existing and emerging fiscal pressures facing many states (outlined in chapter 3) will likely produce ongoing tension in Australia's federal financial relations system.

The 2018 reforms have had a mixed impact on volatility for states, with a clear reduction in volatility seen only for Western Australia (figure 2.7). Therefore, the 2018 reforms have not fully delivered on their aim of providing *'more stable and predictable [GST revenues] for all [states]'* (EM 1.17). The scheduled expiry of the NoWO guarantee has also generated fiscal uncertainty for states and reduced the longer-term predictability of GST revenues.

… and other features of the 2018 reforms detract from their overall efficiency and effectiveness

The 2018 reforms have introduced perverse outcomes to the GST distribution system (interim finding 2.1), have not coincided with greater state tax reform activity (chapter 3), and have reduced the extent of HFE achieved in Australia (figure 2.3). The reforms have also increased complexity in the GST distribution system and cost the Australian Government considerably more than expected (figure 2.5), with a significant associated opportunity cost. And so long as it is in place, the NoWO guarantee is a source of fiscal uncertainty for the Australian Government (chapter 3).

Taken together – and notwithstanding that some aspects of the reforms' intent have been met – this evidence has led the PC to conclude that the 2018 reforms are – on the whole – not working efficiently, effectively or as intended.

[16] Government of South Australia, sub. 13, p. 5; Northern Territory Department of Treasury and Finance, sub. 39, pp. 5–6; NSW Government, sub. 61, p. 4; Queensland Government, sub. 62, pp. 3–7; Tasmanian Government, sub. 48, pp. 2–3; Victorian Government, sub. 59, p. 1.

Interim finding 2.2
The 2018 reforms are not operating efficiently, effectively or as intended

In some respects, the 2018 reforms are operating as intended.

- The new fiscal equalisation standard and relativity floor limit the extent to which a state's share of the GST pool can fall in response to a positive economic shock.
- The No Worse Off (NoWO) guarantee has ensured that, to date, no state has been fiscally worse off following the reforms.

However, the 2018 reforms are not operating as intended in other ways.

- Only one state is fiscally better off following the reforms: Western Australia.
- The 2018 reforms have not provided more stable and predictable GST revenues for all states, with the scheduled expiration of the NoWO guarantee reducing the longer-term predictability of GST revenues and creating fiscal uncertainty for most states.
- There is widespread and deeply felt dissatisfaction with the 2018 reforms among most states, limiting the likelihood that the reforms will be a long-term solution to the pressures facing the GST distribution system.

Other impacts of the 2018 reforms – including the introduction of perverse outcomes into the GST distribution system (interim finding 2.1), increased complexity, and costs to the Australian Government being significantly higher than expected – detract from their efficiency and effectiveness.

3. The PC's assessment of the current system

3.1 The framework for assessing GST distribution systems

The inquiry's terms of reference identified 4 objectives for the GST distribution system (equity, efficiency, sustainability and certainty). Within these competing objectives, the Productivity Commission views the primary role of the GST distribution system to be driving horizontal fiscal equalisation (HFE) between states (equity). The primacy of the fiscal equalisation task for the GST distribution system was generally supported by state and territory (hereafter 'states') submissions to the inquiry,[1] and is consistent with both the governing legislation of the Commonwealth Grants Commission (CGC, sub. 34, p. 2), and the Intergovernmental Agreement on Federal Financial Relations agreed between all jurisdictions when the GST was introduced (Commonwealth of Australia 1999, p. 3).

The goals of efficiency, sustainability and certainty are important, but mainly as constraints on the extent to which HFE is pursued and achieved. Moreover, relying on the GST distribution system to achieve too many goals risks none of these goals being achieved particularly well. The question for this inquiry is the degree of any trade-offs between these objectives, and what degree of equalisation can be sustained before the system begins to create costly challenges to efficiency, sustainability or certainty that cannot be addressed by other tools. Costs might include discouraging worthwhile state reforms, creating fiscal sustainability pressures for the states that undermines community support for the system, or making future revenues unpredictable to the point where prudent fiscal planning is impeded. Where those problems arise, they may justify some departure from full HFE but only if the costs are material, and only if they cannot be addressed by other policy tools.

Taking this approach, the PC defines the reasonable level of HFE to be the highest level of equalisation that can be maintained without creating material costs to efficiency, sustainability or certainty that cannot be addressed by other parts of the federation's policy toolkit (figure 3.1).

This chapter assesses the extent to which the current system under the 2018 reforms delivers a reasonable level of equalisation, using the 4 goals in the PC's framework (appendix B).

[1] Northern Territory Department of Treasury and Finance, sub. 39, p. 16; Tasmanian Government, sub. 48, p. 2; ACT Government, sub. 38, p. 3-4; Government of South Australia, sub. 13, p. 12-13; Victorian Government, sub. 59, p. 1; Queensland Government, sub. 62, p. 21.

Two versions of the current system are considered in this chapter:

- **Current system without No Worse off (NoWO) payments:** the new equalisation standard,[2] the 0.75 relativity floor and permanent GST pool boost, but without NoWO payments.
- **Current system with permanent NoWO payments:** the system as above, but with NoWO payments as a permanent feature of the system. In the case where the Australian Government retains the 2018 reforms, several state governments indicated to the inquiry that a permanent NoWO guarantee was essential (Victorian Government, sub. 59, p. 44; Tasmanian Government, sub. 48, p. 54; Government of South Australia, sub. 13, p. 17; Queensland Government, sub. 62, p. 7).

Figure 3.1 – Understanding the PC's framework for assessing the GST distribution system

PRIMARY GOAL: Equity

Equity is principally about the extent to which the system equalises fiscal capacity between the states, supporting equality of fiscal opportunity, while recognising that broader ideas of fairness remain contested and cannot be settled technically.

What this means

- How much equalisation each model delivers.
- How much of the GST pool must be redistributed under each model.
- Judgements about 'fairness' are a social choice the PC can help inform but not adjudicate.

Secondary constraints on equalisation

Efficiency

Efficiency means GST distribution should avoid materially distorting state tax, spending or reform choices unless material distortions can be targeted by other policy tools.

What this means

- Seek evidence on GST system distortions to state policy choices.
- Assess the overall magnitude of state policy impacts on GST outcomes.

Sustainability

Sustainability means the GST distribution does not force major state or Australian Government policy changes or pose a threat to their solvency in the longer term, while remaining affordable for the Australian Government.

What this means

- Will the system add or alleviate pressure on states' fiscal sustainability, given existing state fiscal positions and service delivery expectations?
- What will the additional cost to the Commonwealth be?

Certainty

Certainty means states have reliable expectations about their overall revenues to better support budget planning.

What this means

- What matters most is reliable expectations about overall revenues in the future (inclusive of GST).
- Lower volatility is helpful, but not always – volatility in GST may offset volatility in other revenue sources.

Chapter 4 then compares the current system without NoWO payments to a number of alternative GST distribution systems that might allow greater equalisation outcomes while improving or maintaining the efficiency, sustainability, or certainty properties of the system. The PC used a mixture of qualitative and quantitative methods to assess different GST distribution systems against its framework and allow comparison. The measures chosen for each aspect of the framework are introduced in this chapter.

[2] Each state's relativity must be at least as high as the standard state benchmark (that is, the relativity of whichever of New South Wales or Victoria has the greater fiscal capacity).

Further detail on the application of these methods and the framework that supports them is in appendix B. To assess the impacts of different GST distributions arrangements the PC estimated what GST relativities would have been had the alternative arrangement been in place in the past, assuming that all other state budget settings were unchanged. This approach was preferred to forecasting because forecasting GST relativities would be highly uncertain and are unlikely to reflect a range of relevant economic circumstances.

3.2 HFE can support equality of opportunity in Australia, but this is reduced by the current system

HFE is broadly consistent with the equality of opportunity view of equity, as well as vertical and horizontal equity principles commonly used in public policy. Equity arguments that relate to rewards for policy effort are captured in the inquiry's efficiency assessments of the alternative arrangements, which assess the degree to which GST distribution outcomes are impacted by the policy choices of the states (further discussion in appendix B).

HFE supports equality of fiscal opportunity by reducing differences in states' fiscal capacities that result from structural factors outside of a state's control. Equality of opportunity and the principle of a 'fair go' are widely recognised and accepted as cultural and political values in Australia (Braun 2006, p. 12; Fenwick and Silva 2026, p. 5). HFE aligns with these values by providing support to state governments so the quality of public services which citizens receive are less dependent on which state they live in.[3] Many of these services are important for equality of opportunity. Education, for example, can act as an equaliser between individuals by improving lifetime earnings (Leigh 2025, p. 1).

The inquiry uses the degree of equalisation as the primary measure of equity, recognising that the primary goal of the GST distribution system is to drive fiscal equalisation between the Australian states. An equalisation rate of 100% means all states have the same fiscal capacity.[4]

The current system with temporary NoWO payments delivers an equalisation rate of 77%, which reduces to 73% without NoWO payments. The equalisation rate decreases only marginally without NoWO payments because other states continue to have a much lower fiscal capacity than Western Australia. In order for the current system to have delivered a 100% equalisation rate in 2024–25, states other than Western Australia would need to have received about $47b extra funding (in addition to the $5.4b in NoWO payments that were made) (PC estimates using CGC 2024; Commonwealth of Australia 2025, pp. 64, 67).

The equalisation rate for the current system, with or without NoWO payments, compares favourably to international comparators (figure 3.2). Nevertheless, the inquiry's issues paper noted *'differences in country-specific settings and contexts may limit the extent to which the experience of other federations can be taken as a guide for Australia'* (PC 2025, p. 14). These differences may include varied policy contexts that constrain higher levels of fiscal equalisation, as well as different social choices about the desirable

[3] Saul Eslake, sub. 3, p. 2; Tasmanian Government, sub. 48, p. 2; City of Melbourne, sub. 47, p. 2; Northern Territory Government, sub. 39, p. 6; Victorian Government, sub. 59, p. 1; Queensland Government, sub. 62, p. 3; Rob Fairs MP, sub. 15, p. 1.

[4] The PC notes that the degree of fiscal equalisation can be measured in several ways, including with Gini coefficients. The PC will consult on the most relevant measure before the Final Report.

degree of equalisation in other countries. The framework chosen by the inquiry enables to PC to make policy recommendations that reflect the Australian context.

Figure 3.2 – Australia pursued a high rate of equalisation compared to international comparators

Equalisation rate is defined as the extent to which equalisation fills the gap for sub-central governments below mean fiscal capacity. Only countries which undertake gap-filling or revenue/cost equalisation, and reported an equalisation rate are included. Australia's post-2018 reforms equalisation rate is based on PC analysis.

Source: Adapted from OECD (2021, p. 9).

HFE did not address structural disadvantage or ensure equal outcomes, the current system (without NoWO) makes both worse

While HFE is designed to support additional costs faced by states delivering services to groups with higher needs, including those in regional and remote areas and lower socio-economic groups, it does not attempt to address structural disadvantages or ensure that communities receive equal services (Yothu Yindi Foundation, sub. 43, p. 2). Specific purpose payments, as well as Australia's tax and transfer system (which operates at the level of individuals and households), are key mechanisms in this regard. HFE, under the pre-2018 system, aimed to provide state governments with the fiscal capacity to provide public services at a broadly comparable level and quality (CGC, sub. 34, p. 2–3; Saul Eslake, sub. 3, p. 2; Tasmanian Government, sub. 48, p. 2). Through this mechanism it supported equality of opportunity by supporting public services such as health, education, police services, child protection services, and social services more generally.

The extent to which equal capacity translates into comparable service delivery and outcomes is largely a matter for the state governments themselves; it is these governments that are ultimately accountable to their constituents for the way in which GST revenue is spent, and the nature and size of the benefits that this spending secures. Transparency mechanisms like the annual *Report on Government Services* can help governments and the public monitor the extent to which the volume and quality of public services are comparable between different Australian states. They can also be used to communicate any divergences between states in terms of service quality and provision.

Due to the standard state benchmark, the current system without NoWO payments does not provide states with the same fiscal capacity, meaning some states receive less than the CGC assesses is required to provide services at the Australian average level. The current system with NoWO payments better supports equity by providing most states with virtually equivalent payments to what they would have received under the pre-2018 system (CGC 2025a). However, by allowing some states to retain greater fiscal capacity than other states, it does not support equity as much as full HFE.

The current system's new fiscal equalisation standard reduces equity

As detailed in chapter 2, the current system's use of the standard state benchmark as a new fiscal equalisation standard weakens the link between GST payments and relative fiscal need – undermining a key equity principle.

The process of HFE should result in states that have *relative improvements* in their fiscal capacity *receiving less* relative fiscal support from GST payments, and vice versa for states whose relative fiscal capacity worsens. However, under the current system, there are cases where a state with greater fiscal capacity than the standard state (currently only Western Australia) could *improve* its fiscal capacity relative to the standard state (currently New South Wales) and receive *more GST revenue*. There are also cases where the standard state's fiscal capacity weakens (for example, due to a natural disaster) resulting in states with a greater fiscal capacity than the standard state receiving more GST revenue.

The pool boost has, so far, worsened the divergence of fiscal capacities

To date, only the state with the highest fiscal capacity, Western Australia, has received higher GST revenues (compared to the pre-2018 system) because of the GST pool boost. As a result, the pool boost has effectively increased the divergence in states' fiscal capacities – counter to the objective of HFE.

The NoWO guarantee ensures that a state cannot receive less GST revenue than it would have had none of the 2018 reforms been introduced – including the pool boost. While the pool boost gives all states access to a larger GST pool, the new equalisation standard can require states with a fiscal capacity at or below the standard state to forego GST revenue. The increased revenue from the pool boost has been insufficient to offset the GST revenue foregone to increase Western Australia's GST relativity for every state in every year since the introduction of the reforms. Because Western Australia has continued to have the greatest fiscal capacity by a substantial margin, it has been the only net beneficiary of the pool boost in total GST revenue terms.

For states that require a NoWO payment, removal of the pool boost would leave their GST revenue unchanged, as it would be fully offset by an increase in NoWO payments. States that do not require a NoWO payment receive less GST revenue which would be a fiscal saving for the Australian Government.

If the NoWO guarantee does not continue and the pool boost was discontinued, all states would receive lower GST revenues, including Western Australia.

As explored in chapter 2, the intent of the pool boost – to make all states better off – has not been realised (interim finding 3.1).

Interim finding 3.1
The GST pool boost has, so far, contributed to a divergence in fiscal capacities between the states and failed to meet its intent

Because all states except Western Australia have received No Worse Off (NoWO) payments since the introduction of the pool boost, it has only increased Western Australia's GST revenue. This is both contrary to the intent of the reform (to make every state better off) and to the objective of horizontal fiscal equalisation (by increasing fiscal divergence between the states).

3.3 HFE is broadly policy neutral

The greater the extent to which a HFE system influences state government policy choices the lower its efficiency (appendix B). Any potential effects are likely to be at the margin, given that state governments are influenced by a number of factors when making policy choices, including improving overall social and economic outcomes for their populations and managing community concerns.

The CGC aims to be policy neutral in its application of HFE (CGC 2021a, p. 1). GST shares are intended to reflect differences in states' underlying fiscal capacity, not differences in their policy choices. In practice, policy choices can still affect GST shares if they change the average policy used in CGC assessments. These effects are usually modest but can be larger where the assessed base is highly concentrated in one state, such as mining royalties or if a policy tax change occurs (appendix C). It is important to note that the CGC does not 'take away' GST revenue from a state that makes a reform, rather the distribution of GST revenue change depending on the change to each state's relative fiscal capacity.

HFE does not reward higher spending states

The CGC assesses what each state would need to spend to provide services at the average standard, assuming average policy and average efficiency. A state that chooses to spend more on a service still bears the direct budget cost of that decision. Its GST share can only change indirectly, by changing the average expense per capita used in the assessment or a measured driver of spending need.

The impacts of changes in service delivery spending on GST payments are small on average. Under the current system without NoWO payments, the PC estimates the weighted average effect for expense assessments is about 1%.[5] Put differently, a $100 change in spending by a state would change that state's GST payments by about $1 (increase or decrease) over the course of 3 years, all else equal.

This conclusion is consistent with both the 2012 *GST Distribution Review* (2012) and the PC's 2018 inquiry into *Horizontal Fiscal Equalisation* (2018). The 2012 Review considered expenditure-side incentives directly and rejected expenditure efficiency discounts, noting that higher assessed expenditure needs can reflect factors beyond a state's control rather than inefficiency (Commonwealth of Australia 2012, pp. 47–50). The PC similarly found that service delivery policy changes can affect GST payments, but that the impacts are mostly trivial and unlikely to materially affect service delivery efficiency (PC 2018, pp. 16–17, 37).

Some expense categories can have larger state-specific effects, particularly where spending is concentrated or where one state has a large influence on the national average. These include First Nations community development, electricity subsidies for remote communities and water services for small communities. But these are not typical of the expenditure assessment overall. The largest service delivery categories such as schools, health, justice, roads and transport generally involve large direct costs and service obligations that will dominate any changes to GST payments.

Broader community benefits are likely to outweigh these small changes to GST payments. A state that improves health, education, justice or transport services receives the benefits of better outcomes, reduced long-run costs or higher productivity. A state that delivers a service more efficiently keeps the direct fiscal saving. Any impact to GST payments is lagged, uncertain and generally small relative to those direct benefits. These effects are likely to be of similar magnitude whether or not the no worse off guarantee was made permanent.

[5] Note this is the average weighted by assessed expenses of the absolute value of the rate effect, meaning it is measuring distance from no GST effect or pure neutrality.

Revenue choices can result in larger changes to GST payments than spending choices, but effects are usually modest outside mining

The effect of revenue choices on GST payments are usually modest outside mining, but they are more visible than on the expenditure side in some cases (table 3.1). For non-mining taxes, the average effect under the current system without NoWO payments is around $1.10 for every $100 of additional revenue raised by increasing tax rates. With NoWO payments the average effect for non-mining changes is similar, but the average effect for mining-related changes is larger. In both cases this represents a marginal improvement compared to equalisation under the pre-2018 system, although incentives have mostly only improved for Western Australia, which causes bigger redistributions in GST revenue or NoWO payments due to being dominant in the mining assessment. This is larger than the average effect for expense assessments, but still small relative to the direct fiscal and political costs of changing tax policy.

These averages should not be read as the effect faced by every state. For example, some states have higher GST rate effects in land tax (New South Wales) and mining revenue (Queensland, Western Australia and South Australia). For broad-based taxes, state effects are generally clustered closer to zero, reinforcing the conclusion that impacts on GST payments are usually marginal.

These results suggest that given impacts on GST payments are generally small, they could influence tax reform incentives, but potentially only at the margin. A state that raises a broad-based tax only sees a relatively small reduction in its GST share. A state that cuts an inefficient tax still faces the main fiscal constraint directly: it must replace the revenue or reduce spending. Outside mining, the impacts on GST payments are generally too small to be the main driver of reform choices.

This is consistent with PC analysis of tax reform activity across the states, both before and after the 2018 reforms. The average number of tax changes recorded in New South Wales's *Interstate comparison of taxes* publications does not show a clear break after 2018 (figure 3.3). Where more frequent reform activity occurred after 2018, it is more readily explained by state circumstances such as COVID-related pressures or a need for budget repair rather than by the 2018 reforms themselves.

Table 3.1 – The impact on GST payments are small for tax-rate changes, but mining stands out

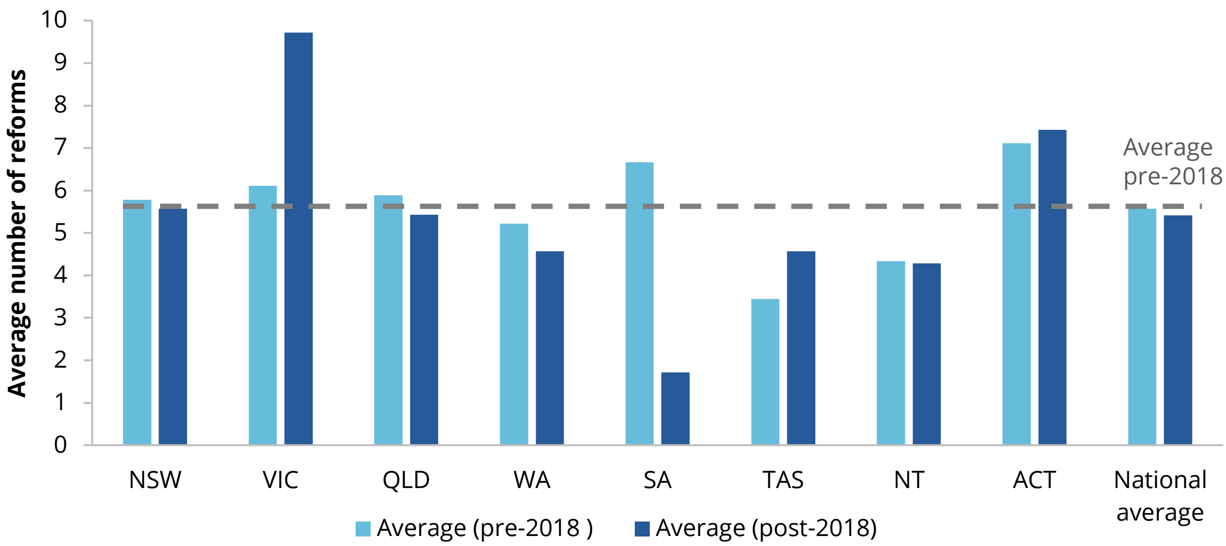
Average size of GST change from $100 increase (tax rate), 2024–25 assessment data

Revenue item	Current system without NoWO payments	Current system with NoWO payments	Pre-2018 system
Payroll tax	$0.5	$0.6	$1.1
Insurance tax	$0.7	$0.7	$0.8
Light vehicles	$0.8	$0.7	$0.7
Motor stamp duty	$1.0	$1.0	$1.3
Heavy vehicles	$1.2	$1.3	$1.8
Stamp duty on conveyances	$1.7	$1.7	$1.5
Land tax	$4.7	$4.6	$4.7
Average non-mining tax	$1.1	$1.1	$1.2
Average mining revenue	$9.1	$10.6	$19.3

Figures are the average absolute change in GST from a $100 increase in revenue, across states with material assessed revenue in that category (≥$1). This measures the magnitude (positive and negative) of the GST distribution effect that would be experienced over 3 years based on 2024–25 assessment year data from the 2026 inquiry. Effects for average non-mining and mining revenue, are weighted based on their share of assessed revenue.

Figure 3.3 – The 2018 reforms have not coincided with greater state tax changes

Average number of major tax changes per year, 2008–09 to 2025–26



Excludes 2009–10 and 2017-18 as data is not available for these years. Pre-2018 is 2008-09 to 2018–19 (inclusive), post is 2019–20 to 2025–26.

Source: Data set compiled from available New South Wales interstate comparison of taxes reports 2008–2026 and other sources (Government of Western Australia 2025; NSW Treasury 2026).

Large reforms can generate material changes to GST payments; but their exact impact is uncertain

Large reforms which impact the tax base of states can produce larger and more uncertain impacts to GST payments because they can affect both the assessed tax rate and the assessed tax base. Two reform cameos illustrate this: abolishing insurance taxes and fully replacing stamp duty with a revenue neutral broad land tax (appendix C). Figure 3.4 shows the results under the current system (without the NoWO guarantee), the full results are in appendix C. Only the effects for New South Wales and Western Australia are specifically shown here as New South Wales is a representative large state and Western Australia represents the state most effected by the 2018 GST distribution reforms to date. Note that these elasticity effects are highly uncertain and difficult to measure.

The impact on the GST distribution of abolishing insurance taxes is small relative to the own-source revenue at stake. The main fiscal challenge is replacing the revenue no longer collected or reducing spending, not the GST assessment.

The impact on the GST distribution of replacing stamp duty with a broad-based land tax would potentially have larger impacts on reform (PC 2018, pp. 37, 108–109). Replacing stamp duty with a broad land tax affects a large and volatile tax base and could increase property turnover, with flow-on effects for GST shares. Depending on the elasticity assumptions the modelled impacts on the GST distribution can be material, but they should not be read as forecasts. Real reforms would likely be phased in over decades, results are sensitive to behavioural assumptions, and the CGC may be able to address material and measurable base effects through elasticity adjustments to the extent it is practicable and material (CGC 2017b, p. 26, 2025d, pp. 32–33).

Figure 3.4 – Summary of 2 modelled large unilateral tax reform cameos

	Insurance tax cut	Stamp duty → land tax[a]
NSW	**\$12–43m lower GST** GST reduction is small compared to \$2.7b lower insurance tax revenue.	**\$58m–\$1.6b lower GST** Large reduction depending on assumed elasticity base effect.
WA	**~\$3m GST increase** Small GST increase, but minor beside ~\$1b in lower insurance tax revenue.	**\$1m lower GST – \$23m higher GST** The standard state benchmark protects WA.
Other states	**Modest effect** Small GST reduction relative to large reduction in insurance tax revenue.	**Generally lower GST** Large potential GST reduction depending on behavioral response.

These reforms show the fully realised impact on GST revenue, under the current system (without the NoWO guarantee) based on 2024–25 assessment data (assuming all factors except the modelled change are held constant over the 3 assessment years). These reforms are unilateral, capturing the effect if only one state makes the change. The range of GST revenue changes depends on the assumed elasticity of property/insurance transaction volumes to tax changes. Additional detail on assumptions is available in appendix C. **a.** The broad land tax base uses ABS Australian System of National Accounts Table 61 total land values (ABS 2025).

Source: PC estimates using CGC (unpublished data).

For all states that have equal or lower fiscal capacity than the standard state (currently, all states apart from Western Australia) GST revenue impacts of the modelled tax changes are the same under the current system with NoWO payments and the pre-2018 system. Any GST-related revenue impacts (which may affect incentives) remain unchanged. For these states, the difference in revenue impact between pre-2018 and current system (without NoWO payments) in the modelled scenarios, depends on their share of the revenue base. There are limited differences between these systems for states with a smaller share of the relevant revenue bases, whereas states with a larger share of the revenue base have greater GST revenue effects under the different systems.

For states that have a greater fiscal capacity than the standard state (currently only Western Australia), GST revenue changes are significantly smaller under the current system (both with and without NoWO payments), although, depending on the assumed elasticity of transactions to the tax change, there is not always an increase to GST revenue.

Despite the impact on GST revenue some states have pursued tax reform

Recent Australian Capital Territory and New South Wales experiences show how these issues play out in practice. The Australian Capital Territory has gradually reduced conveyance duty and raised more revenue through general rates since 2012 (ACT Revenue Office 2025). GST issues have been manageable, so far the CGC has not identified a significant elasticity effect from the Australian Capital Territory reform, and considers any adjustment unlikely to materially affect its assessed revenue capacity (CGC 2025d, p. 31). In 2022, New South Wales advanced an opt-in property tax for first home buyers despite identifying potentially material long-run reductions in GST payments and an even larger revenue gap from replacing upfront stamp duty with annual payments (NSW Treasury 2021, p. 53). In this instance, the CGC indicated it could make an adjustment for identifiable elasticity effects, however, the reform was later withdrawn after a change of government (CGC 2021a, p. 1; NSW Department of Premier and Cabinet 2023).

The experience of New South Wales and the Australian Capital Territory suggest the GST distribution can add complications to stamp duty reform but is unlikely to be the main reason reform succeeds or fails. The larger barriers are funding the transition, managing distributional impacts and sustaining public acceptance over decades. 'Base effects', the driver of these large, modelled impacts to GST payments, can be addressed through CGC elasticity adjustments if found to be material enough to warrant them.[6] Where the problem is the revenue transition, direct and transparent Australian Government reform payments would be a better vehicle than relying on the HFE system.

Mining was and remains the biggest challenge for policy neutrality

Mining royalties create a challenge for the policy neutrality of the GST distribution because mining revenue is highly concentrated in a small number of states, creating dominant-state effects. Dominant-state effect arises when one state accounts for most of the assessed base for a mineral, meaning its royalty policy can heavily influence the national average rate used by the CGC.[7] In extreme cases, such as iron ore, one state's policy effectively sets the benchmark royalty rate.

This matters because the more dominant a state is in a single a revenue line, the more of its actual revenue from that category enters the CGC's assessment. The more revenue the CGC assesses a state has, the less GST revenue it receives, all else equal. If a state were to raise tax rates on a non-dominant tax category, say payroll taxes, the additional revenue would be assessed by the CGC at the national average (which only marginally changed).

In practice, this means that when a dominant state makes policy changes to increase its revenue (for example, increasing its royalty rate or mining related infrastructure) this will result in a significant reduction in its future GST payments, above and beyond what would occur if it were not a dominant state. This creates policy neutrality challenges, where dominant states have less incentives to take actions such as developing new resource deposits or imposing optimal levels of royalties.

These effects are removed by the current system for any state that has a greater fiscal capacity than the standard state (currently only Western Australia). In the current system without NoWO payments, the 'cost' of reducing this effect is borne by the other states in forgone GST revenue, relative to the pre-2018 system. With the NoWO guarantee, this 'cost' is borne by the Australian Government. For states that have a lower fiscal capacity than the standard state, the impacts of additional revenue on GST payments are broadly the same.

Figure 3.5 shows that the mining assessment can have large impacts on GST payments and how this has changed under the current system. For example, in a scenario where Western Australia raised an additional $100 in revenue from lithium, this would result in a $91 decrease in GST revenue under the pre-2018 system.[8] Under the current system, the same scenario would result in Western Australia's GST

[6] The CGC has committed to further investigating elasticity adjustments in its 2026 forward work plan (CGC 2026e, pp. 3–4).

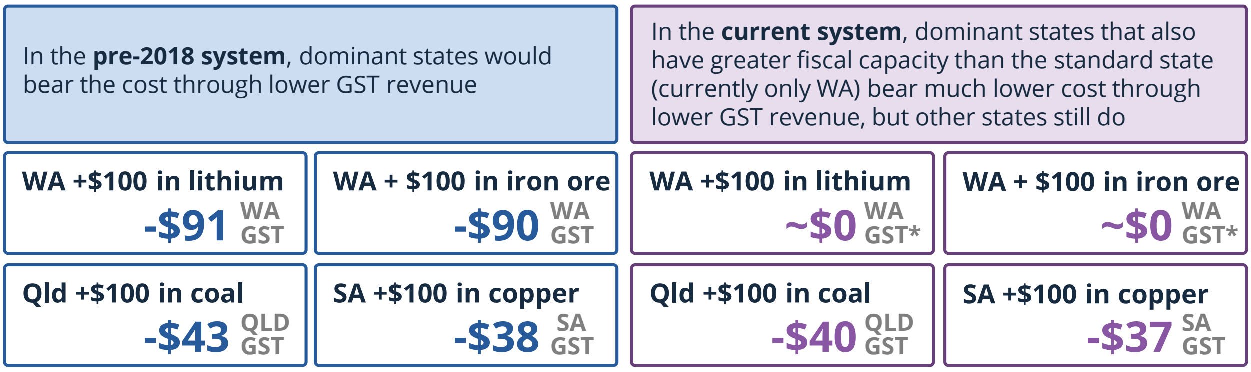
[7] The CGC has not formally defined the 'dominant-state effect'. In practical terms, it arises where a state's share of an assessed revenue base is much larger than its population share, so its policy can strongly influence the average policy used in the assessment and produce large changes to GST payments.

[8] Given CGC assessments average over 3 years, this stylised scenario reflects the cumulative effect over 3 years.

revenue being largely unaffected as their GST share is determined by the standard state benchmark (currently New South Wales). Where NoWO payments are in place the Australian Government faces an increased cost. Without NoWO payments, the other states have a lower share of GST revenue compared with the pre-2018 share.

Figure 3.5 – Concentrated mining revenue can lead to large changes in GST payments; in the current system, this varies based on a state's fiscal strength relative to the standard state

Cumulative effect over 3 years in response to a $100 increase in revenue in the assessment area using 2024–25 assessment data



**The cost of the differences in GST revenue is effectively transferred from WA to Australian Government through higher No Worse Off payments.*

Source: PC estimates using CGC (unpublished data).

The design of the mining assessment affects how strongly dominant-state effects flow through to GST payments and shares. As the CGC's assessment of mining has become more granular, changes aimed at improving the measurement of mining revenue capacity have also increased policy-neutrality risks where production is concentrated (box 3.1).

The dominant-state effect explains why mining remains the clearest policy-neutrality test in the GST assessment. But it does not mean changes to GST payments determine royalty policy. For example, Queensland introduced new progressive coal royalty tiers in 2022–23, despite expecting to see its GST share decline materially over time. Queensland has retained the reform despite CGC methodology changes (box 3.1) impacting Queensland's GST share even further.

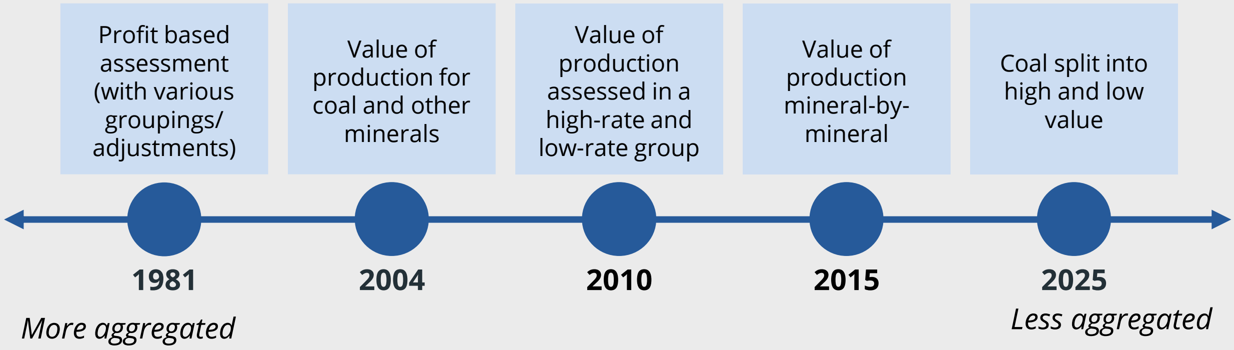
Western Australia's gold royalty experience points the other way. The 2018 reforms removed the large GST revenue reduction that would previously have accompanied a Western Australia gold royalty increase. Earlier attempts to lift Western Australia's gold royalty rate had failed partly because the states GST share would have been reduced by more than half of the additional revenue over the long run, alongside concerns about investment and jobs (Parliament of Western Australia 2017, p. 11).

Yet even with these impacts to GST payments removed Western Australia has not increased its gold, or any other of its royalty rates. This suggests that while removing the impacts to GST payments from a tax increase may improve the payoff from reform, broader economic and community concerns can continue to constrain reform activity. As the Government of Western Australia noted, '*even with the protection of the reforms, it is difficult to prosecute [an increase in the gold royalty rate] when it has already received such negative attention*' (sub. 37, p. 68). Indeed, the 2018 reforms may have even weakened the case for reform in Western Australia by easing the budget pressure that motivated the earlier proposal.

Box 3.1 – More granular mining assessments can increase dominant-state effects

The mining assessment has become more granular over time to better measure differences in revenue-raising capacity across minerals (figure below). However, this has exposed an important trade-off: greater granularity can exacerbate dominant-state problems, making the assessment more sensitive to the royalty policy of states that dominate production of a particular mineral.

The CGC's mining assessment has become more granular over time



Source: (CGC 2025d, p. 58; PC 2018, p. 122)

From 2010 to 2015, the CGC assessed mining royalties using 2 broad groups: high-rate and low-rate minerals. This dampened the influence of any one state's policy but created a category-switching risk. A royalty change that shifted a mineral between groups could produce very large changes to GST payments, as occurred when Western Australia moved to lift the concession on iron ore fines in 2011. The potential GST revenue reduction exceeded the additional royalty revenue, leading the Australian Government Treasurer to direct the CGC to not make changes to its assessment to prevent such an outcome between 2011 and 2014 (the PC understands the CGC recognised this issue and was examining ways to address it prior to the direction by the Australian Treasurer).

The mineral-by-mineral method adopted in 2015 removed this category-switching problem, but increased sensitivity to dominant-state effects. For example, when iron ore was 'bundled' (assessed with) with coal, Western Australia's policy had less influence on the assessed average rate than it does under a separate iron ore assessment.

The 2025 coal changes show how this issue can evolve. The CGC now assesses high-value and low-value coal separately. Higher-value metallurgical coal is more concentrated in Queensland, so Queensland's royalty policy now has more influence in that part of the mining assessment.

Source: PC (2018, p. 122); CGC (2017a, pp. 1–2, 2023, p. 16, 2025d, pp. 49–61).

Notwithstanding the lack of reform to Western Australia's royalty rates since 2018, dominant-state effects can still reduce the fiscal return to state policy effort and make the GST distribution consequences of mining decisions uneven and uncertain. These issues could be addressed through assessment changes or direct Australian Government payments for specific reforms.

Either approach involves trade-offs: reducing the impact of dominant-state effects on GST payments can improve policy neutrality, but shifts costs to other states in the absence of NoWO payments or the Australian Government (in the current system with NoWO payments).

Interim finding 3.2
The GST distribution system was and is broadly policy neutral, with some exceptions that are best managed through targeted responses

The GST distribution system was and is broadly policy neutral for most expenditure decisions and incremental non-mining tax changes. There are impacts to GST payments, but these are small compared to the larger constraints to reform such as transition funding, distributional impacts and public acceptance.

The effect on GST payments can add to the fiscal cost and uncertainty of large state tax reforms, particularly stamp duty to land tax reform and mining royalty changes. However, the evidence since 2018 suggests these effects are not decisive. States have proceeded with reforms despite material changes to their GST payments, and reducing this effect has not necessarily led to reform.

The PC therefore places less weight than the 2018 PC review on the effect of policy changes on GST payments as a rationale for system-wide horizontal fiscal equalisation reform. Where effects to GST payments are material and measurable, they are better managed through targeted Commonwealth Grants Commission assessment changes or, especially where the main barrier is the revenue transition, direct Australian Government support.

3.4 Considering fiscal sustainability is necessary, given how much the GST distribution impacts government budgets

A government's fiscal sustainability can be defined as its ability to maintain its current spending, tax and other related policies into the long term, without a threat to its solvency or the need for large and sudden adjustments to policy settings (Commonwealth of Australia 2023, p. 224; European Commission 2017, p. 1).

Given that GST revenue accounts for a significant proportion of state revenue, 23% in 2024–25, changes to how it is distributed have material impacts on state governments' fiscal positions (PC estimates using ABS 2025a, unpublished data). As the Australian Government now bears responsibility for 2 direct costs of the system – the pool boost and NoWO payments – sustainability for the Commonwealth also needs to be considered.

There is no single measure that captures whether a government is fiscally sustainable. Quantitative indicators such as debt-to-revenue (or debt-to-GDP), interest-to-revenue and fiscal balance-to-revenue capture different aspects of a governments fiscal position at a point in time (further discussion in appendix D). Over the longer term, the trajectory of debt to GDP is often used as a measure of fiscal sustainability. A government's fiscal position is generally considered more sustainable if, on average, this ratio is expected to remain stable or trend downwards over the medium and long term (PBO 2025a, p. 11). For state governments, total revenue is used instead of GDP or GSP because state revenue streams are not as directly linked to states' economic outcomes as they are for the Australian Government (Government of Tasmania 2021, p. 40). Given this, this chapter primarily draws in the debt to revenue trajectory to illustrate the trends facing government budgets (with a range of other indicators presented in appendix D).

Growing expenditure has put pressure on most states' fiscal positions

Overall, states' fiscal positions have been deteriorating, as indicated by states' growing net debt to revenue ratios, with the clear exception of Western Australia (figure 3.6) (Western Australia's divergence is discussed in chapter 2).[9,10] This is also reflected in declining state credit quality. During and post the COVID-19 pandemic, negative rating actions outnumbered positive actions almost 5-to-1, with Tasmania, the Australian Capital Territory, New South Wales and Victoria all receiving credit downgrades (S&P Global 2026).

Only a handful of jurisdictions have published medium- or long-term fiscal sustainability assessments: New South Wales through an intergenerational report, Tasmania through a fiscal sustainability report, and the Australian Capital Territory through a recent parliamentary inquiry into fiscal sustainability. These assessments frame sustainability more in terms of flexibility and resilience than short-term solvency, but all indicate that states' fiscal positions are weakening in this respect. They highlight that spending pressures, higher debt-servicing costs and growing interest payments will reduce governments' capacity to absorb fiscal shocks, respond to future priorities and maintain service delivery over the long term (Eslake 2026, p. 5; Government of Tasmania 2026, pp. 12–13; NSW Government 2021a, p. 7).

However, the general deterioration in state fiscal positions is not a result of lower equalisation under the current system. To date, NoWO payments have ensured that each states' GST payments have remained virtually equivalent to what they would have received previously under the pre-2018 system (except Western Australia, which has received more).

Rather, states' growing debt burden reflects that states' net operating balances have on average deteriorated since the early 2000s, compounded by the added fiscal pressure states faced due to the COVID-19 pandemic (PBO 2025b, p. 4). Steady but sustained growth in state expenses has been a key driver of this deterioration – as a share of GDP, state expenses have grown from 13.6% in 2000–01 to 14.7% in 2024–25, this increases to 14.0% in 2000–01 to 16.1% in 2024–25 when total expenditure is considered (PC estimates using ABS 2025b, 2025a, unpublished data). By contrast, revenue growth has been significantly more limited, moving from 13.8% of GDP in 2000-01 to 14.4% in 2024–25 (PC estimates using ABS 2025b, 2025a, unpublished data). While population growth is one driver of increased state expenses, per capita expenses have also been increasing faster than revenue per capita. State expenditure per capita grew at an average of 1.8% each year (CAGR) between 2000-01 to 2024–25, compared with only 1.3% per annum for revenue per capita over the same period (constant prices, 2024–25 basis) (PC estimates using ABS 2025a, unpublished data).

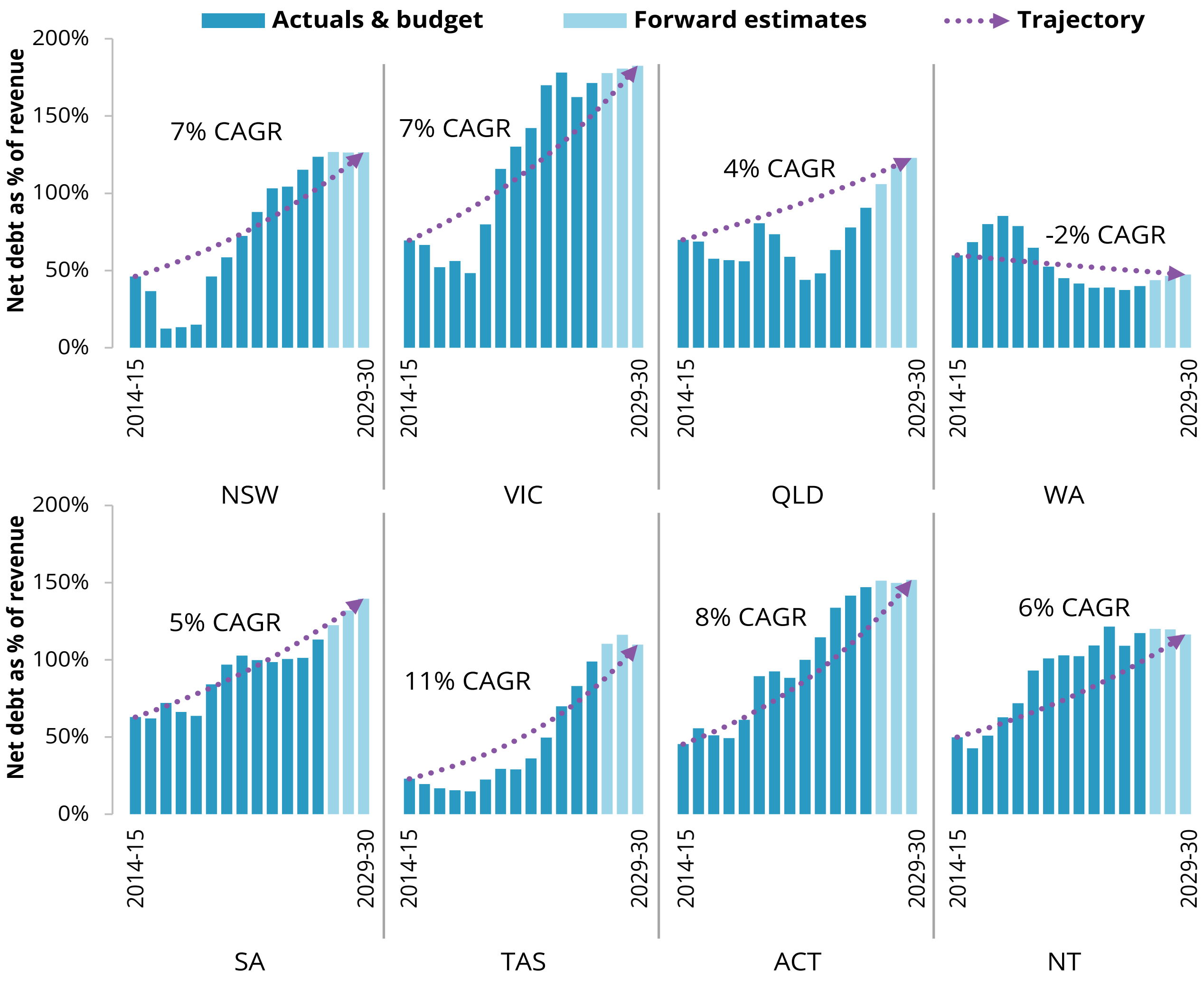
The fastest-growing areas of per capita state expenditure are capital investment, interest repayments and health (PC estimates using ABS 2025a, unpublished data).

[9] Figure 3.6 includes budget and forward estimates to illustrate the expected trajectory into the future, actuals data from the GFS is only available until 2024-25.

[10] Analysis of state governments' fiscal positions often focuses on the general government (GG); however, it can be valuable to consider a broader scope that incorporates both the general government and public non-financial corporations, known as the total non-financial public sector (TNFPS). It should be assumed that analysis refers to GG unless stated otherwise.

Figure 3.6 – Net debt to revenue ratios are increasing for all states except Western Australia

TNFPS net debt to revenue ratios, 2014-15 to 2029–30



The figure uses the most recent ten years of GFS observations (2014–15 to 2024–25, constant prices 2024–25 basis), state budget records for 2025–26 (revised) and 2026–27 (budget) and state budget forward estimates from 2027–28 to 2029–30. For the Australian Capital Territory, net debt as recorded in the GFS does not align with the net debt reported in Australian Capital Territory budget or financial statements. Therefore, data from the Australian Capital Territory's Consolidated Annual Financial Statements have been used for 2014–15 to 2024–25 (inclusive) instead of GFS data, the figure for the Australian Capital Territory should be interpreted with caution.

Source: PC estimates using: ABS (2025a, unpublished data), ACT Government (2016, 2017, 2019, 2021, 2023, 2025, 2026a), NSW Government (2026b, pp. 105–107), NT Government (2026a, pp. 96–97), Queensland Government (2026, pp. 105–106), SA Government (2026, p. 156,158), Tasmanian Government (2026, pp. 227, 230) Victorian Government (2026, pp. 67–69), WA Government (2026, pp. 253–254).

Health is the largest expense pressure on state budgets and has increased as a proportion of overall state expenditure from 22% in 2000-01 to 28% in 2024–25 (PC estimates using ABS 2025a, 2026a). Growth in health expenses is – in part – driven by population ageing, which increases demand for urgent, complex and costly health services. While this is one factor, state governments have also faced broader cost increases and higher community expectations about the standard of health care provided (Government of Western Australia, sub. 37, p. 110; NSW Government 2021a, pp. 74, 111; Queensland

Government, sub. 62, p. 28; Smith 2020, p. 32). Health costs are not felt equally across states, and are particularly significant in South Australia and Tasmania – the states most affected by population ageing – where they account for 32% and 35% of expenditure respectively (PC estimates using ABS 2025a, unpublished data; CGC 2026c). Population ageing is one of the key forces shaping the Australian economy, which will continue to drive health-related expenditure pressures for all Australian governments in the medium to long term (Commonwealth of Australia 2023, p. 9).

Increased capital investment is also a major and growing source of state government spending, but state spending profiles have differed over time. New South Wales and Victoria – which dominated infrastructure spending from the mid-2010s through the early 2020s – are expecting a plateau and a decline in spend over the forward estimates period (Government of Victoria 2026; NSW Government 2026a, p. 19). However, other states – such as Queensland and South Australia – are planning expansions in their capital investment programs (Crisafulli et al. 2027; Infrastructure Partnerships Australia 2025).

Interest expenses are growing rapidly, reflecting increased borrowing and higher interest rates. Most state debt is issued as fixed-rate semi-government bonds (semis) with maturities of 5 years or more, meaning higher interest rates flow through gradually as older bonds mature and are refinanced. States issued significantly more semis during the COVID-19 pandemic, when interest rates in general were historically low. Prevailing interest rates have since grown significantly in response to market conditions. States' interest rates are also influenced by their credit quality, which has fallen post-pandemic to its lowest point since 2000 (S&P Global 2026). Some states have already refinanced debt at higher interest rates and more will need to be refinanced in the future. Around one third of state government bonds (at face value) on issue will mature between 2026–27 and 2029–30 (PC estimates using ACT Government 2026b; NT Government 2026b; QTC 2026; SAFA 2026; TASCORP 2026; TCorp 2026; TCV 2026; WATC 2026). Given states' debt positions these will likely need to be refinanced at prevailing market rates, putting further pressure on state interest expenses.

Some states are more vulnerable to changing GST distributions

States' ability to generate own-source revenue (and consequently, their dependence on GST revenue) varies.[11] A greater ability to generate own-source revenue can increase states' fiscal flexibility and capacity to respond to shocks such as a reduction in GST revenue. Mining revenue can be a driver for states having an above-average capacity to raise own-source revenues, as is the case for Western Australia and to a lesser extent Queensland (CGC 2026a).

By contrast, the Northern Territory and Tasmania rely more heavily on Commonwealth payments, with 75% and 63% of total revenue respectively coming from this source in 2024–25 (PC estimates using ABS 2025a, unpublished data). Higher reliance on Australian Government transfers makes the Northern Territory and Tasmania's fiscal positions more vulnerable to increased spending pressures and decreases in Commonwealth payments, such as GST payments, as they have less capacity to increase own-source revenues to offset these in response.

The NoWO guarantee lapsing could worsen fiscal sustainability risks

NoWO payments are material for several states. In 2024–25, they were equivalent to 3% of own-source revenue on average, for states other than Western Australia. While a small proportion in an absolute

[11] Own-source revenue is total state revenue excluding Commonwealth payments.

sense, it is significant when contextualised against states' other own-source revenues. For example, in 2024–25, NoWO payments were equivalent to 70% of motor vehicle taxes on average, for states other than Western Australia (PC estimates using ABS 2025a, unpublished data). If the NoWO guarantee were to lapse, some states indicated that significant increases in own-source revenue would be necessary to offset the fiscal impacts (NT Department of Treasury and Finance, sub. 39, p. 9). The size of NoWO payments are also significant when measured in terms of the services they could fund (NSW Government, sub. 61, p. 35; Queensland Government, sub. 62, p. 14; Government of SA, sub. 13, p. 9). For example, the New South Wales Government indicated that the cessation of the NoWO guarantee is equivalent to a reduction in around 13,000 nurses in the public hospital system and a reduction of over 14,000 New South Wales public school teachers (NSW Government, sub. 61, p. 35). The cost of the termination of the NoWO guarantee could also compound over time through higher debt and interest expenses.

When assessing the fiscal sustainability implications of alternative GST distribution systems for states, the PC has used the **ratio of interest expenses to revenue** for the total non-financial public sector (TNFPS).[12] This measure illustrates how much of a government's revenue is absorbed by debt-servicing costs, and therefore how much fiscal pressure debt places on the overall balance sheet, competing with other spending priorities.

To facilitate comparison of GST distribution systems, the PC converts states' interest expense to revenue ratios into an aggregate 'fiscal pressure' score (table 3.2). The PC uses Moody's Baseline Credit Analysis interest-to-revenue thresholds to assess when debt-servicing costs may start to constrain fiscal sustainability. [13] This focus is consistent with Tasmania's Fiscal Sustainability Report, which states that '*a ratio above 10 per cent, while still incurring budget deficits, would indicate the State's finances are becoming unsustainable'* (Government of Tasmania 2026, p. 13). States with relatively low interest burdens receive a score of zero, while higher interest burdens receive progressively larger scores, reflecting growing fiscal pressure.

Table 3.2 – Interest to revenue thresholds and weightings

Moody's bands	aaa	aa	a	baa	ba	b	caa	ca
Interest-to-revenue threshold bands	<0.5%	0.5% – 1.5%	1.5% – 3%	3% – 5%	5% – 8%	8% – 12%	12% – 18%	>18%
PC score	*0 – unlikely to be a significant pressure on fiscal sustainability*			1	2	3	4	5

Source: Moody's Ratings (2026).

To provide a consistent basis for comparison of GST distribution systems, the PC used a historical simulation method to understand how each system would have affected states' debt and interest expenses had they operated historically since 2001-02, under a set of simplifying assumptions (appendix C).[14]

[12] Total non-financial public sector is considered for debt and interest because it captures the wider state balance sheet, including infrastructure-related borrowing outside the general government sector.

[13] The Moody's categories are used only as a benchmark for interpreting when interest costs become more material to fiscal sustainability; they do not imply a credit rating for any state or GST distribution system.

[14] The PC's modelling provides a consistent basis for comparing the relative fiscal sustainability impacts of alternative GST distribution systems, rather than an estimate of the fiscal outcomes that would have occurred in practice.

PC modelling of interest-to-revenue ratios indicates that the current system without the NoWO guarantee would have relatively higher interest-to-revenue ratios for every jurisdiction except Western Australia, than the current system with the NoWO guarantee (table 3.3). Most of these higher ratios do not alter the system's fiscal pressure score, because it is based on movements between threshold bands. However, without NoWO payments South Australia and Queensland's interest-to-revenue ratios move from the 3%–5% band into the 5%–8% band and the Northern Territory's interest to revenue ratio moves into the 12%–18% band (results not visible in table due to rounding). As a result, the aggregate fiscal pressure score for all jurisdictions increases from 12 under the current system with the NoWO guarantee to 15 without the NoWO guarantee.

The widespread nature of state fiscal sustainability issues highlights a broader sustainability issue within the federation. While the negative fiscal impacts of the current system have been muted by NoWO payments, the 2018 reforms severed the nexus between the GST pool and HFE, thereby introducing a new element of vertical fiscal equalisation into Australia's federal financial relations. Even with permanent NoWO payments, most states would be in deteriorating fiscal positions. In some ways, these changes could be seen as an early warning sign regarding whether the nexus between the GST pool and HFE is desirable and sustainable.

Table 3.3 – Relative fiscal sustainability impact of current system with and without the NoWO guarantee

Modelled interest expenses to revenue ratio in 2024–25, TNFPS

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total PC score
Current system without NoWO payments	6%	8%	5%	1%	5%	4%	8%	12%	**15**
Current system with NoWO payments	5%	7%	4%	1%	4%	4%	7%	12%	**12**

Source: PC estimates using ABS (2025a, unpublished data); CGC (unpublished data).

The NoWO guarantee has direct fiscal impacts on the Australian Government

The direct fiscal impacts of the GST distribution system vary between state governments and the Australian Government. While GST revenue is a large revenue source for state governments, it previously had no direct impact on the Australian Government's fiscal position – it appeared as both revenue and spending (via payments to states) in the Australian Government Budget, netting to zero.

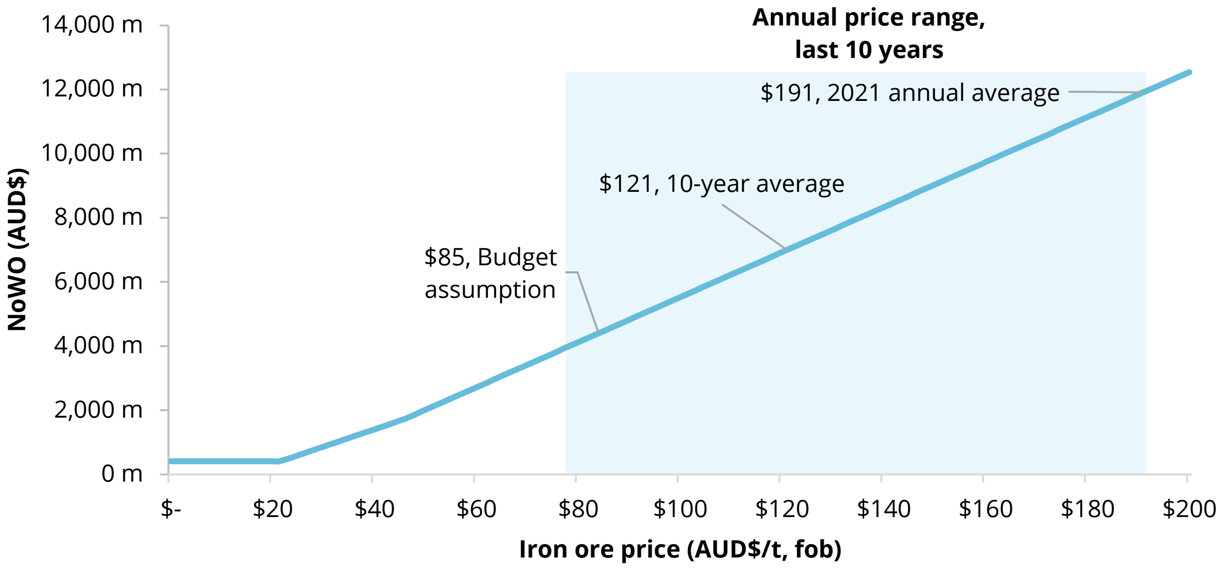
The 2018 reforms materially changed the Australian Government's fiscal exposure to the GST system. NoWO payments are now a growing budget cost, driven largely by commodity prices, especially iron ore. Figure 3.7 estimates the annual NoWO cost to the Australian Government across different iron ore price points. The price points in the chart are to illustrate the contingent liability linked to the commodity. Some price points reflect circumstances that may not repeated in the foreseeable future, such as the high prices during COVID-19. Similarly, a price point substantially below the Australian Government Budget assumption (Commonwealth of Australia 2026) is not necessarily expected to eventuate. Table 3.4 explores hypothetical commodity price scenarios and the associated NoWO implications.

Higher iron ore prices also generate additional Australian Government revenue through company and personal income taxes. While the PC has not estimated the net fiscal effect, the associated rise in NoWO payments diminishes at least part of that revenue gain.

Western Australia is currently the only state above the standard state benchmark, largely due to its exceptional capacity to raise iron ore royalties. As Western Australia accounts for 99% of Australia's iron ore production, higher iron ore prices increase its assessed revenue capacity. Under the pre-2018 system, higher prices would have reduced Western Australia's GST share and increased the shares of the other states. Under the current system, Western Australia's GST share does not decrease to reflect its increased fiscal capacity. Until 2029–30, the gap between other states' GST shares under the pre-2018 and current systems are covered by Australian Government NoWO payments. As iron ore prices increase, the new and old systems diverge and the cost of NoWO increases.

Figure 3.7 – NoWO is positively related with iron ore prices with no ceiling

Estimated NoWO guarantee costs by iron ore price, with key price points highlighted



In this model, Western Australia's assessed relativity becomes negative above an iron ore price of US$154 per tonne. Although prices exceeded this level in 2021, the CGC's 3-year averaging kept Western Australia's assessed relativity positive. As it is unclear how the CGC would treat a negative 3-year average relativity, the model allows negative values.

Source: PC estimates using CGC (2025) and DISR (2025) data.

NoWO payments are unlikely, on their own, to threaten the Australian Government's fiscal sustainability, accounting for less than 1% of annual Australian Government revenue. Even so, they represent a material, volatile and open-ended budget cost, with corresponding trade-offs for other spending and revenue priorities. For context, had the current system operated from 2001–02 to 2024–25, cumulative NoWO payments are estimated to have reached $65.4b in 2024–25 prices.

A range of commodity prices need to be considered when assessing the effects of different GST distribution systems

The assumptions made when the 2018 reforms were introduced suggested the future cost to the Australian Government would be constrained to the costs of the GST pool boost. Subsequent commodity price increases demonstrated that its exposure was much larger than initially assumed.

Mining royalties are among the largest and most volatile drivers of states' assessed fiscal capacity. As discussed above iron ore is particularly important. Metallurgical and thermal coal in Queensland and New South Wales also affect the GST distribution, but their broader fiscal effects are smaller because production is less concentrated, and revenues are lower, than for Western Australian and iron ore. Relative price movements across commodities nevertheless matter. For instance, Western Australia's GST share could rise even if iron ore prices were falling, depending on whether coal prices were declining by more.

The inquiry's terms of reference require an assessment of fiscal sustainability for both the Australian Government and the states. That cannot be done without considering the commodity price environments in which a future HFE system may operate. Commodity prices, however, are difficult to forecast with precision. They are shaped by global economic forces including, but not limited to Chinese steel production, unexpected supply disruptions, exchange rates, the energy transition, policy decisions and geopolitical shocks. While some of these drivers are observable and predictable; others are inherently unpredictable.

Reflecting these challenges, the PC has developed a set of hypothetical price scenarios for the major commodities that influence the GST distribution (table 3.4). Each scenario applies plausible demand and supply shocks to a base case to derive hypothetical commodity prices. These are then fed into the PC's NoWO payment simulation model to estimate the resulting payments. As a validation check, using 2025 prices for iron ore, metallurgical coal and thermal coal produces an estimated NoWO payment of $7.2b, about 10%more than the actual cost.

These prices are not forecasts. They illustrate prices that could arise under a range of plausible, but ultimately unforeseeable, changes in underlying supply and demand conditions. They are designed to stress test how developments in commodity markets could flow through to prices and production volumes, state royalty revenue, assessed fiscal capacity, GST relativities and, ultimately, NoWO payments. This matters because a GST distribution model that appears fiscally sustainable and fair at one assumed iron ore price can look very different under a sustained price boom or a sharp price correction. What these hypothetical prices show is that even small structural changes to relative commodity prices can affect the HFE system, as the relative distribution of revenue is an important driver of GST outcomes.

The states will pay for the 2018 reforms without the NoWO guarantee

Currently, the Australian Government bears the full fiscal cost of the 2018 reforms. However, if NoWO payments cease after 2029–30, the fiscal cost of the 2018 reforms will be transferred to states with assessed relativities at or above the standard state benchmark (currently all states other than Western Australia), further weakening HFE. This is because without NoWO payments, these other states would be worse off than in the pre-2018 system. States with relativities below the benchmark or floor (currently only Western Australia) will continue to receive beyond their assessed fiscal needs.

Figure 3.8 shows the difference in GST payments under the current against the old system, at different iron ore price points. It demonstrates that, as iron ore prices rise, Western Australia receives greater share of the GST revenue while other states bear a larger share of the reform's fiscal burden.

Table 3.4 – PC hypothetical commodity prices with estimated annual NoWO payments

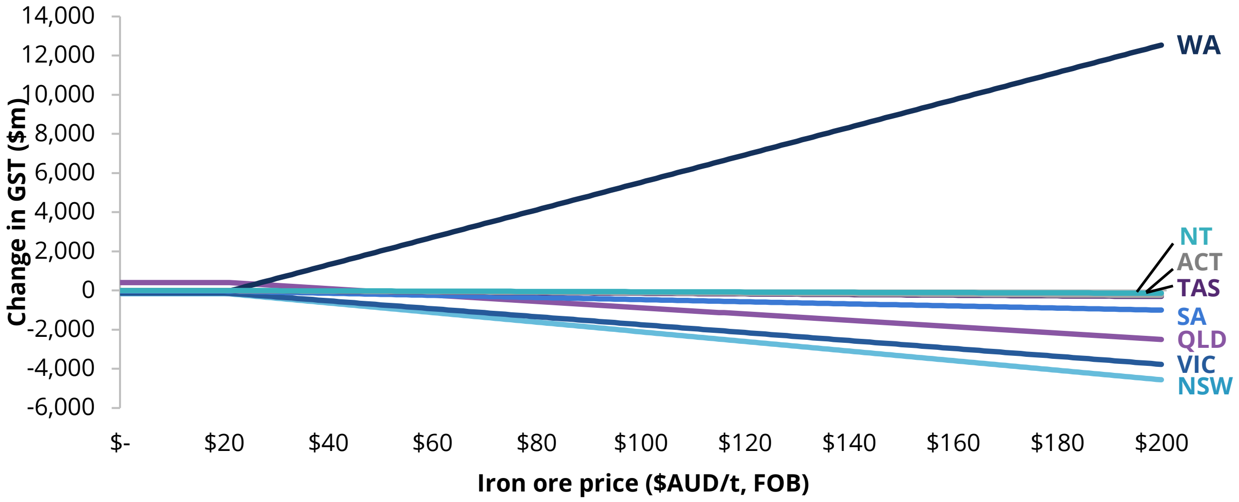
Hypothetical	Narrative and key assumptions	Commodity	Indicative price range, 2030–35	NoWO payments (per annum)
Base case	Describes a gradual transition in global steel and bulk commodity markets, with moderating Chinese demand partly offset by stronger growth in India and other emerging economies, increasing steel recycling, and evolving global supply.	Iron ore	$115 – $131	$5.7 – $7.0b
		Metallurgical coal	$340 – $394	
		Thermal coal	$200 – $211	
Scenario 1	This represents a slower than expected transition away from carbon-intensive steelmaking and coal use proceeds. Blast-furnace steelmaking remains more resilient, India contributes more strongly to demand growth, China's steel exports remain elevated, and some competing supply is delayed or constrained.	Iron ore	$109 – $137	$5.7 – $7.6b
		Metallurgical coal	$295 – $362	
		Thermal coal	$153 – $162	
Scenario 2	The represents an orderly but faster than expected decarbonisation transition. Chinese steel demand and blast-furnace intensity weaken faster, scrap and electric arc furnace production gain share, and competing supply places more pressure on Australian producers. Indian demand does not supplement diminish Chinese demand.	Iron ore	$79 – $115	$3.7 – $6.0b
		Metallurgical coal	$245 – $253	
		Thermal coal	$132 – $140	
Scenario 3	This represents transition occurring faster than expected, alongside with severe structural supply displacement. The shift away from blast-furnace steelmaking and coal use is stronger, China's contestable demand falls further, and marginal Australian production faces greater pressure. This affects metallurgical and thermal coal the most. For iron ore, the price path should be interpreted carefully because weaker demand is partly offset by assumed supply exit.	Iron ore	$82 – $127	$3.7 – $7.1b
		Metallurgical coal	$242 – $250	
		Thermal coal	$128 – $137	

Commodity prices are based on nominal FOB benchmark prices in US dollars per tonne, converted to Australian dollars using an exchange rate of US$0.65. NoWO payment estimates are in Australian dollars.

Source: PC estimates using Wood Mackenzie (2026) and DISR (2025) data.

Figure 3.8 – Without the NoWO guarantee, states above the benchmark will take on the fiscal cost of the 2018 reforms

Estimated difference in GST payments under the current system vs the pre-2018 system by iron ore price



Source: PC estimates using CGC (2025) and DISR (2025) data.

In addition to questions around the appropriate level of equalisation, this also raises the central question of who should bear the fiscal burden of the reforms. This is because, unless NoWO payments are continued, or the system was fully redesigned, the zero-sum nature of the GST distribution system will result in winners and losers. Reforms such as altering the CGC's mining assessment or discounting mining revenue will still result in some states paying for the reform through a lower GST-share.

This needs to be considered alongside the fiscal position of the states. As discussed above, many of the states with less fiscal capacity are facing with fiscal sustainability concerns. These concerns would be exacerbated if those states are required to support higher GST shares for states with greater fiscal capacity. Without NoWO payments, states with less capacity will bear the cost of a reform they did not support, when introduced, potentially through higher debt, reduction in services or tax increases. Under temporary NoWO guarantee arrangements, states face ongoing fiscal uncertainty as the Australian Government could withdraw support at any point. For these reasons, and its relatively stronger fiscal position, the Australian Government is better placed to bear the costs of reform by introducing a permanent NoWO guarantee.

3.5 The GST distribution has limited impact on states' already reasonable revenue certainty

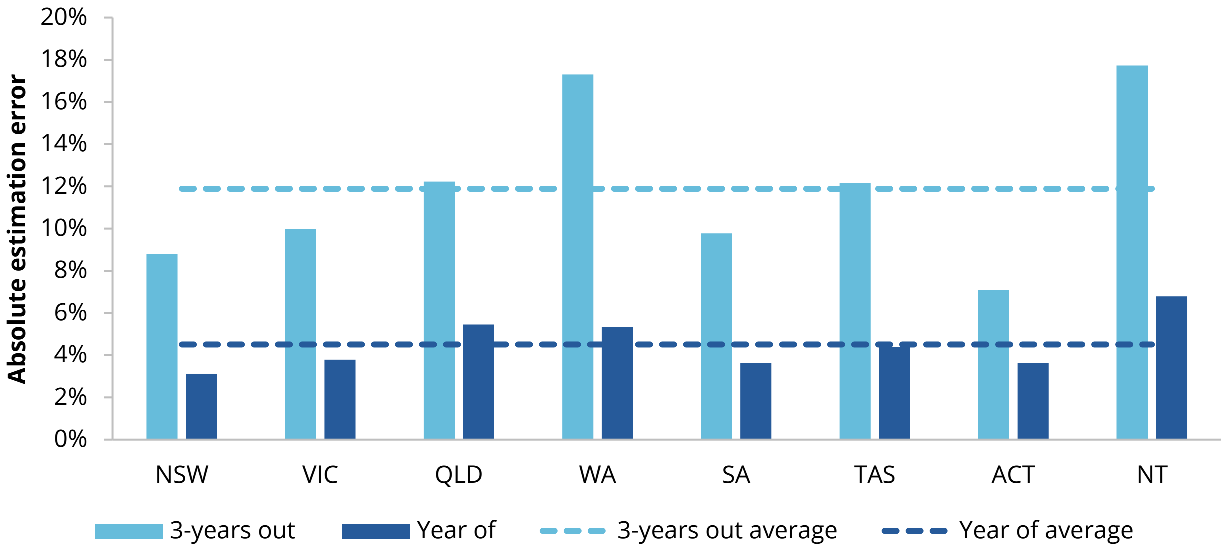
States have now, and have always had, reasonable revenue certainty

To support sound fiscal planning, states need to be able to form reliable expectations about their overall revenues in the future, inclusive of GST payments. GST revenue is fungible with other state government revenue, so state government fiscal planning is only constrained by GST revenue uncertainty insofar as it contributes to total revenue uncertainty.

Historically, states have been able to predict their total revenues with a reasonable degree of accuracy. Between 2006–07 and 2024–25, states estimated their total revenue within approximately 12% of the outcome 3 years in advance (the first year it enters the forward estimates), and within approximately 5% of the outcome in the year of the budget (figure 3.9).

Figure 3.9 – Historically, states have predicted total revenue with reasonable accuracy

Average absolute estimation error in total revenue, 2006–07 to 2024–25



This period has been selected as it is the longest available given the data published in historical state budgets.

Source: State budgets (2003–04 to 2026–27).

Due to the unpredictability of global commodity prices, the largest source of revenue uncertainty for the states is mining royalties. States with strong mining sectors – such as Western Australia, Queensland, and the Northern Territory – tend to have the greatest revenue estimation error both for longer- and near-term estimates. All state governments also experienced considerably higher revenue estimation error during unanticipated global shocks, such as the global financial crisis and the COVID-19 pandemic.

Broadly, states have also been successful in predicting future GST revenues. While not all states have produced forward estimates of GST revenue, New South Wales, South Australia, Tasmania and the Australian Capital Territory have, on average, estimated GST revenue within 10% of the true value 3 years in advance from 2011-12 to 2024–25.[15] All states except Western Australia and the Northern Territory have predicted GST revenue within 5% of the true value in the year of the budget (PC analysis using state budgets).[16]

For most states, GST revenue has been relatively stable: year-on-year changes in GST revenue have averaged around 1% of total revenue (table 3.5). However, GST revenue can be more volatile in states

[15] Western Australia's forecasts are confounded by the introduction of the 2018 reforms and preceding revenue support, which create a significant unanticipated increase in GST revenues unrelated to the mechanics of the distribution system.

[16] Western Australia (sub. 37, pp. 51, 58–59) suggested that large swings in GST revenues can challenge budget management and predictability, and the Northern Territory (sub. 39, pp. 18, 20) noted its GST relativity was subject to unpredictable volatility due to expenditure patterns in other states.

where demographic groups with more volatile assessed expenditure needs – such as Indigenous people and people living in regional areas – comprise a larger share of the population (Northern Territory, sub. 39, pp. 18, 20). For example, the average yearly swing in the Northern Territory's GST revenue (in dollar terms) is more than the total value of its 2024–25 gambling and motor vehicle taxes combined, and Tasmania's is more than its 2024–25 motor vehicle tax revenue.

Table 3.5 – Average absolute change in per capita GST payments, year-on-year

Average change from 2000–01 to 2024–25, constant prices 2024–25 basis

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Average absolute change in payments ($ per capita)	130	147	196	212	190	297	196	941
% of total per capita revenue (2024–25)	1%	1%	1%	1%	1%	2%	1%	3%

Source: PC analysis using (2025a, unpublished data).

Many state governments, including the disproportionately affected Tasmania, indicated that GST revenue specifically is adequately predictable and that any effects from GST revenue volatility can be managed through standard budget processes (ACT Government, sub. 38, p. 5; Government of South Australia, sub. 13, pp. 14–15; Tasmanian Government, sub. 48, p. 34; Victorian Government, sub. 59, pp. 28–29). Many states also suggested that using data over a rolling 3-year period to calculate relativities strikes the right balance between aiding predictability and ensuring the distribution is responsive to changing state needs (ACT Government, sub. 38, p. 5; Government of South Australia, sub. 13, p. 14; Queensland Government, sub. 62, p. 24; Tasmanian Government, sub. 48, p. 34; Victorian Government, sub. 59, p. 29).

More generally, state governments have access to debt markets that can smooth any intertemporal mismatches (anticipated or otherwise) between their expense needs and their revenue.

Given this combination of reasonable revenue predictability and the availability of tools outside the GST distribution system to manage revenue uncertainty, such as government debt markets, the PC has given certainty less influence in its framework to assess alternative GST distribution systems.

The 2018 reforms have had mostly minimal effects on GST revenue certainty

The system implemented through the 2018 reforms – with the no worse off guarantee expiring as scheduled – has different effects on certainty depending on the GST relativity of the state. In most cases the effect is marginal.

The reforms have introduced methodological complexity which has reduced certainty. States now need to estimate the national set of relativities as they would have been without the reforms, then adjust them to ensure no state is below the standard state benchmark. These forecasts reflect a mix of HFE as it was previously, adjustments to the new equalisation benchmark, and system-wide rescaling. If these adjustments are incorrectly applied to any state (for example, because a state does not need to be brought up to the standard state), all forecasts are likely to be incorrect by a greater margin. Nonetheless, a state with an assessed relativity below the standard state may benefit from greater certainty from this more complex process if the resultant GST relativity is still more predictable than its own relativity under the previous system.

The 0.75 relativity floor introduces a hard lower bound of GST revenue which, theoretically, provides additional certainty. However, the 0.75 floor will only reflect a state's final relativity if the standard state has a relativity below 0.75. All else equal, this would not have happened in any year if the GST distribution system had always operated in the ways stipulated by the 2018 reforms (PC analysis using CGC unpublished data).

While the no worse off guarantee operates, states are guaranteed to receive GST revenue at least equivalent to the relativities with no adjustments applied. This means revenue certainty has been unaffected for all states benefitting from the no worse off guarantee compared to the pre-2018 system.

The PC's preferred measure of the fiscal uncertainty created by the GST distribution system is the average year-on-year volatility of states' GST revenue driven by the GST distribution system.[17] The purpose of measuring volatility is to act as a proxy indicator for the level of uncertainty the GST distribution system creates for budget planning: more volatile GST revenues are more challenging to predict.

The PC has assessed the certainty of the current system and the current system with a permanent no worse off guarantee. Western Australia is the only state which would have had substantially less GST revenue volatility if the current system existed since 2000–01 (chapter 2).

If the current system operated with a permanent NoWO guarantee, Western Australia's decreased volatility would be retained. Other states would experience the same GST revenue volatility to the pre-2018 system, as the NoWO guarantee would have ensured the same revenue outcome (with the exception of Queensland, which would have received NoWO payments in some years) (PC estimates using ABS 2025a, unpublished data; CGC, unpublished data).

The PC assesses the volatility of a range of alternative GST distribution systems in chapter 4.

The PC's analysis does suggest that total state government revenue was, on average, less volatile than state revenue excluding GST and NoWO payments (PC estimates using ABS 2025a, unpublished data; CGC, unpublished data). This is not an unexpected result – GST revenues generally move in the opposite direction to a state's economic conditions relative to other states (albeit with a lag), while other state government revenue streams generally move in the same direction. For the most part, trends in revenue have persisted in the same direction for the duration of the CGC assessment lag, so GST revenues have offset total revenue volatility. However, in instances where shocks have materialised rapidly, the CGC assessment lag has resulted in GST payments exacerbating total revenue volatility. Given the time lag between a revenue change and the subsequent GST revenue change prevents the GST distribution from structurally affecting total revenue volatility, the PC has not used total revenue as its measure of volatility.

[17] The PC has examined the volatility of real GST revenue per capita, adjusted for growth in the GST pool. This makes the growth in national average GST per capita without the pool boost equal to 0. The PC's exact methodology is outlined in appendix C.

3.6 The current system reduces equalisation, with limited gains against other framework objectives

The PC has been asked to assess whether the current system, with and without NoWO payments, delivers a reasonable level of HFE while balancing the objectives of efficiency, fiscal sustainability and certainty. While the meaning of a ‘reasonable’ level of equalisation is contested, the PC defines it here as the highest level of equalisation that can be achieved without unacceptable costs to sustainability, efficiency or certainty that cannot be addressed by other elements of the federation’s policy toolkit.

The current system, with or without NoWO payments, reduces equity in the GST distribution compared with the pre-2018 system, which fully equalised assessed need and fiscal capacity. The current system achieves an equalisation rate of 77% with NoWO payments and 73% without them.

The inquiry has found that both versions of the current GST distribution system are broadly policy neutral, except for the dominant-state effect in the mining assessment. Changing the equalisation benchmark may have reduced the scale of the dominant-state effect, but it does so by weakening equalisation and introducing mechanisms that can produce perverse outcomes. A full HFE system that directly targets dominant-state effects in the mining assessment would better address legitimate issues in the previous system without producing these outcomes (interim finding 3.2).

State governments are facing growing fiscal sustainability pressures that cannot be addressed by the GST distribution system alone. Nonetheless, uncertainty about the future of NoWO payments means the current system could add to existing fiscal sustainability pressures on a range of states. If NoWO payments were made permanent, all states would receive at least the equivalent of what they would have received under the pre-2018 distribution system. While this would reduce the risk of worsening states’ fiscal positions, it would create an ongoing and open-ended budgetary risk for the Australian Government. If the Australian Government allowed the guarantee to expire, this risk would effectively be transferred to states (other than those with greater fiscal capacity than the standard state – currently only Western Australia).

The PC has found that states have generally been able to predict their overall future revenue with reasonable accuracy. Many states also indicated that GST revenue is adequately predictable and that any effects from GST revenue volatility can be managed through standard budget processes. As a result, certainty is included in the PC’s framework but receives relatively less weight than equity, efficiency and sustainability. The current system provides greater certainty to Western Australia because its GST relativity is pegged to the less volatile New South Wales GST relativity. However, the standard-state benchmark adds complexity and can create interactions that are difficult to explain or predict.

Overall, even if the NoWO guarantee were made permanent, the current system would not provide the strongest available balance between equalisation, efficiency, fiscal sustainability and certainty. Chapter 4 discusses several alternative arrangements that perform better than the current system, with or without NoWO payments, against the PC’s framework.

4. Assessing alternative GST distribution arrangements

This chapter assesses alternative arrangements for distributing GST revenue that have been proposed to the Productivity Commission (PC) by inquiry participants or explored in literature reviewed by the inquiry. Given the diversity of alternative arrangements, the PC has selected a subset to examine in more detail in this chapter, including the pre-2018 system, the pre-2018 system with mining discounts, the current system with permanent No Worse Off (NoWO) payments and a range of different GST relativity floors, and a number of equal per capita (EPC) variants. The assessment of these main alternatives provides an insight into the inherent trade-offs that exist between alternatives. A list of alternative arrangements proposed to the inquiry and summary of the framework used in our assessment are provided in appendix B.

In undertaking this assessment, the PC's central question has been whether equalisation can be pursued in a way that achieves a better balance between equity, efficiency, sustainability and certainty than the current distribution system.

The PC's analysis of alternatives suggests 3 broad conclusions. First, the system that preceded the 2018 reforms delivered a high degree of equalisation, though the treatment of mining revenue generated some concerns around policy neutrality and fairness. Second, the 2018 reforms addressed those concerns indirectly and at considerable cost, creating fresh concerns regarding complexity, fiscal cost and fairness. Third, there are viable alternatives that could improve on the current system, particularly if reform is directed more narrowly at the source of the most significant distortions: dominant-state effects, which can be particularly pronounced in the mining assessment.

Our analysis demonstrates that alternatives involve trade-offs between equity, efficiency, sustainability and certainty, though not all trade-offs are of the same magnitude. Different alternatives also involve different fiscal costs for the Australian and state and territory (hereafter 'states') governments, estimated for the 2024–25 financial year.

Some alternatives address the main policy neutrality concerns with the mining assessment while achieving a higher level of equalisation than the 2018 reforms, and at a lower cost to fiscal sustainability. Table 4.1 summarises how the main alternatives considered by the inquiry perform relative to the current system (without the NoWO guarantee), the details of which are further explored throughout this chapter. If NoWO payments were not made, the cost to states in table 4.1 represents the fiscal loss for states compared to the pre-2018 system.

Table 4.1 – Summary assessment of alternative GST distribution arrangements

Model	Equity[a]	Efficiency	State fiscal sustainability	Certainty	Cost to Aus Gov[b]	Cost to states relative to pre-2018	Comparison to current system (without NoWO guarantee)
Measure[c]	**1**	**2, 3**	**4**	**5**			
P = pool boost included, N = NoWO guarantee included							
Current system variants with standard state							
Current system P	73%	1.7%, 20%	15	2.9%	$1.0b	$6.0b	Baseline system, **perverse outcomes from standard state benchmark[d]**
Current system + NoWO P N	77%	1.8%, 19%	12	2.9%	$7.0b	$0b	Better equity, better sustainability, similar efficiency and certainty, **perverse outcomes from standard state benchmark[d]**
Current system variants with minimum changes							
Min change 0.75 floor N	84%	1.7%, 19%	12	2.9%	$6.2b	$0b	Better equity, better sustainability, similar efficiency and certainty
Min change 0.5 floor N	94%	1.7%, 19%	12	3.3%	$3.8b	$0b	Better equity and sustainability, similar efficiency and certainty
Min change 0.3 floor N	98%	1.7%, 19%	12	4.1%	$1.8b	$0b	Much better equity, better sustainability, similar efficiency and slightly worse certainty
Current system variants with fixed floors							
0.75 floor P	78%	1.5%, 19%	14	2.9%	$1.0b	$5.3b	Better equity and sustainability, similar efficiency and certainty
0.5 floor P	87%	1.5%, 19%	12	3.3%	$1.0b	$2.8b	Better equity and sustainability, similar efficiency and certainty
0.3 floor P	91%	1.5%, 19%	12	4.1%	$1.0b	$0.9b	Better equity and sustainability, similar efficiency and slightly worse certainty
Pre-2018 system and mining discounts							
Pre-2018	100%	2.5%, 30%	12	4.6%	$0b	$0b	Much better equity, better sustainability, slightly worse efficiency and certainty
10% mining discount	95%	2.4%, 27%	12	4.1%	$0b	$1.5b	Much better equity, better sustainability, slightly worse efficiency and certainty
25% mining discount	88%	2.2%, 22%	13	3.6%	$0b	$3.7b	Better equity and sustainability, similar certainty and slightly worse efficiency
50% mining discount	75%	1.8%, 15%	15	3.3%	$0b	$7.3b	Better equity, similar sustainability, efficiency and certainty. Large cost to states relative to pre-2018
Equal per capita models[e]							
EPC + NoWO N	63%	0.6%, 9%	10	2.1%	$10.2b	$0b	Much better sustainability, better efficiency, similar certainty and worse equity. Large cost to Australian Government
90% EPC, 10% HFE	20%	0.2%, 3%	19	0.6%	$0b	$9.2b	Much worse sustainability and equity, slightly better efficiency and better certainty. Large cost to states relative to pre-2018

a. The framework dimensions have not been weighted equally. The PC views the primary role of the GST distribution system to be driving horizontal fiscal equalisation between states (equity). **b.** The cost to the Australian Government includes the cost of the NoWO guarantee and pool boost payments where they are included in the GST distribution system, in 2024-25. **c.** The measures for each framework dimension are as follows: 1) equity – equalisation rate; 2) efficiency – weighted average departure from policy neutrality; 3) efficiency – average of maximum departure from policy neutrality; 4) state fiscal sustainability – fiscal pressure score, based on estimated interest to revenue ratios; 5) certainty – year on year volatility driven by the distribution system. **d.** The efficiency challenges produced by the standard state benchmark are not fully reflected in the efficiency metrics. Nevertheless, the standard state benchmark is judged by the PC to create additional policy distortions that can weigh on system efficiency. **e.** EPC was not included in this assessment as it is not consistent with the GST system's goal of fiscal equalisation.

The PC considers that the most-preferable system has 2 components: (i) the pre-2018 HFE system; and (ii) the Treasurer directing the Commonwealth Grants Commission (CGC) to address costly dominant-state effects, which can be particularly pronounced in the mining assessment, if and where they arise. If that approach is not accepted, the inquiry considers that the next-best option is to return to the pre-2018 system but with the Australian Government making direct payments to states it considers to be unfairly affected by dominant-state issues. Both options would be a simpler and more transparent approach than the changes introduced by the 2018 reforms.

The possibility of perverse outcomes created by the 2018 reform's adoption of a new equalisation standard (chapter 2) should be corrected. The PC's view is this could be achieved by removing the standard state benchmark. A fixed relativity floor would remain, although the PC has not yet reached a conclusion on what an appropriate relativity floor would be. The merits of a floor are discussed in more detail later in this chapter.

4.1 Assessing the current system, with and without the NoWO guarantee

The 2018 reforms changed the GST distribution system by replacing equalisation of all states with equalisation to the stronger of New South Wales or Victoria, subject to a legislated relativity floor. The reforms also introduced a permanent GST pool boost and temporary NoWO payments funded by the Australian Government, which are currently scheduled to end in 2029–30.

The PC has been asked to assess whether these arrangements deliver a reasonable level of horizontal fiscal equalisation, while balancing the objectives of efficiency, fiscal sustainability and certainty. While what constitutes a 'reasonable' level of equalisation is contested, it is defined here as the highest level of equalisation that can be achieved without unacceptable costs to efficiency, fiscal sustainability, or certainty, that cannot be addressed by other elements of the federation's policy toolkit.

The current system, with or without NoWO payments, reduces equity in GST distribution compared with the pre-2018 system (figure 4.1). While the pre-2018 system fully equalised fiscal capacity, the current system achieves an equalisation rate of 77% with NoWO payments and 73% without them (appendix B). This is because under the current arrangement, states below the standard-state benchmark (i.e. states with greater fiscal capacity) are overcompensated relative to their assessed needs. This creates a new fiscal gap relative to other states, even after NoWO payments are distributed.

The inquiry has found that – with the exception of the dominant-state effect in the mining assessment and the operation of the new equalisation standard – the current GST distribution system (with and without NoWO payments) are broadly policy neutral. The pre-2018 system was also broadly policy neutral, with the exception of the dominant-state effect in the mining assessment. The inquiry's preliminary analysis suggests that there have been limited efficiency gains from reducing the level of equalisation in the current system.

While changing the equalisation benchmark reduced the impact of the dominant-state effect in Western Australia, it did so at the expense of equalisation across the Federation and introducing a mechanism that can produce perverse outcomes that undermine the logic of HFE. For example, under the current system with and without NoWO payments, a state whose GST relativity is 'brought up' to the standard state can receive additional GST payments when a natural disaster occurs in New South Wales or Victoria (chapter 2). A similar system to pre-2018 equalisation that directly targets dominant-state effects in the mining assessment would better address legitimate issues found in the previous system, without the perverse outcomes that can be produced by the current system (interim finding 3.2).

In terms of sustainability, the PC has found that state governments are facing growing fiscal sustainability pressures which cannot be addressed by the GST distribution system alone. Due to the uncertainty around the future of NoWO payments, the current GST distribution system exacerbates fiscal sustainability concerns, given the degree of reliance of some states on GST revenue and the differing levels of own-source revenue flexibility across governments.

If NoWO payments were made permanent, all states would receive at least the equivalent of what they would have received under the pre-2018 distribution system. While this minimises the risk of exacerbating states' deteriorating fiscal positions, this would build in an ongoing and open-ended budgetary risk to the Australian Government. Preliminary PC estimates indicate that NoWO payments could exceed $5 billion per year, depending on the movement of volatile and unpredictable commodity prices. While the Australian Government can let the guarantee expire, doing so would essentially transfer this risk to states with less fiscal capacity. This would have material impacts on their fiscal positions, particularly given the deteriorating fiscal trajectory of some jurisdictions.

Any state with greater fiscal capacity than New South Wales and Victoria would continue to receive more GST payments than required to meet their assessed expenditure needs, allowing these states to maintain a higher level of fiscal capacity than other states. States with persistently higher fiscal capacities are structurally advantaged to provide higher quality public services to its residents, which could both produce inefficient labour mobility and undermine public support for the system.

In terms of certainty, the PC has found that states have broadly been good predictors of their overall future revenue. Many states have also indicated that GST revenue is adequately predictable and that any effects from GST revenue volatility can be managed through standard budget processes (ACT Government, sub. 38, p. 5; Government of South Australia, sub. 13, pp. 14–15; Tasmanian Government, sub. 48, p. 34; Victorian Government, sub.59, pp. 28–29). Government debt markets are another avenue states can use to smooth revenue volatility (ACT Government, sub. 38, p. 5). This means that while the PC does include certainty as part of its framework, its assessment is relatively less important than those for equity, efficiency and sustainability. The current system would have provided greater certainty to Western Australia as their relativity would have been pegged to the (less volatile) New South Wales relativity. However, the new equalisation standard adds complexity and can create interactions that are difficult to explain or predict. For example, under the current system with the NoWO guarantee expiring as planned, all states are required to estimate the full equalisation set of relativities for all states but then must also estimate how much their own relativity will fall if any state needs to be raised to the standard state benchmark (figure 2.1).

Overall, the current system, even if the NoWO guarantee is made permanent, does not represent a strong endpoint for Australia's GST distribution system. In either case, the PC considers that the level of equalisation achieved is not 'reasonable', given the current system has not, and is not expected to, deliver marked improvements to efficiency and fiscal sustainability (interim finding 4.1).

Figure 4.1 – Assessment of the current system with permanent NoWO payments

Current system + permanent NoWO guarantee (includes pool boost)

Model description

This model retains the current GST system and makes No Worse Off payments a permanent feature, paid for by the Australian Government through general revenue. The pool boost is retained, as is the **standard state benchmark with the associated perverse outcomes**.

Results and key takeaways

- Including the NoWO guarantee improves equity.
- Reduced pressure on state fiscal sustainability at the cost of the Australian Government.
- Similar efficiency and certainty to current system.

Costs outside the model in FY25

Cost to Australian Government	$7.0 billion
Cost to states relative to pre-2018 system	$0

Framework dimensions

Selected | Comparison | Other

Equity – equalisation rate, relative to CGC assessment
Higher = closer to pre-2018 equalisation rate

Pre-2018 system	100%
Current system with NoWO	**77%**
Current system without NoWO	**73%**
EPC + NoWO	63%
90% EPC, 10% HFE	20%

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality
Lower = more policy neutral

90% EPC, 10% HFE	0.2%
EPC + NoWO	0.6%
Current system without NoWO	**1.7%**
Current system with NoWO	**1.8%**
Pre-2018 system	2.5%

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score
Lower = less pressure on fiscal sustainability

EPC + NoWO	10
Pre-2018 system	12
Current system with NoWO	**12**
Current system without NoWO	**15**
90% EPC, 10% HFE	19

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system
Lower = less volatile

90% EPC, 10% HFE	0.6%
EPC + NoWO	2.1%
Current system without NoWO	**2.9%**
Current system with NoWO	**2.9%**
Pre-2018 system	4.6%

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	**77%**	Higher rate of equalisation than the current system.
Efficiency	Departure from policy neutrality: weighted average	**1.8%**	Similar efficiency, with similar average departures and average maximum departures from policy neutrality to the current system.
	Departure from policy neutrality: average maximum	**19%**	
Sustainability	Pressure on states' fiscal sustainability	**12**	Less pressure on state fiscal sustainability than the current system.
	Cost to Australian Government	**$7.0b**	Higher cost relative to current system because of the permanent NoWO guarantee.
Certainty	Volatility driven by the distribution system	**2.9%**	Similar system-driven volatility to the current system.

Interim finding 4.1
The reduction in equalisation under the current system, with or without a permanent NoWO guarantee, has not markedly improved efficiency, fiscal sustainability or certainty

Relative the pre-2018 system, the current system – even if No Worse Off (NoWO) payments were made permanent – reduces equity without making marked improvements to efficiency, fiscal sustainability or certainty.

The reforms have also created the possibility of perverse outcomes by introducing a mechanism whereby states with higher fiscal capacities can receive increased GST payments.

The reforms, with the NoWO guarantee expiring as scheduled, will add to existing fiscal sustainability pressures on a range of states. Even if the NoWO guarantee was made permanent, the reforms ensure any state with a greater fiscal capacity than New South Wales and Victoria can retain a fiscal advantage over the rest of the Federation. This could undermine public support for the system.

The reforms have marginally improved the predictability of GST revenue for some states and, if the NoWO guarantee is not made permanent, marginally reduced it for others. For all states, the reforms have introduced additional methodological complexity and created interactions which increase the risk of forecasting error.

4.2 Assessing the current system with minimum changes to address critical issues with the system

The PC's assessment of the current system, both with and without NoWO payments, against the analytical framework suggests 3 critical issues – potential perverse outcomes associated with the new equalisation standard, uncertainty around future NoWO payments, and the pool boost failing to meet its intent of making all states better off. If the Australian Government does not proceed with the PC's preferred recommendations (interim recommendations 4.1 and 4.2) and instead chooses to leave the current system broadly in place, there are some minimum changes that would address these critical issues. Addressing only these critical issues does not represent the PC's preferred position, rather it represents the minimum reforms that the Australian Government should implement to the current distribution system. The base case for comparison under the PC's framework is the current system, without a permanent NoWO guarantee (figure 4.2). The PC recognises that this does not reflect the policy reality in 2025–26 where NoWO payments of $6.6 billion are expected to be paid to states, but this ensures our analysis is based on the current stated Australian Government policy to end NoWO payments in 2029–30.

The **new equalisation standard** requires that no state has a relativity below the standard state benchmark, has introduced the possibility of perverse outcomes in the GST distribution system which runs counter to the logic of HFE (chapter 2). Removing the standard state benchmark would see the 0.75 floor become binding. The relative merits of different fixed floors are discussed later in this chapter.

Figure 4.2 – Assessment of the current system with PC's minimum changes

Minimum change: 0.75 floor + NoWO guarantee (excludes pool boost and removes standard state)

Model description

This option keeps the current GST assessment framework, removes the standard state benchmark (leaving the 0.75 floor) and removes pool boost.

A 0.75 floor is applied within the GST pool, as well as 0.5 and 0.3 floors as points of comparison. No Worse Off payments are provided outside the pool to preserve the guarantee

Results and key takeaways

- Better equity than the current system without NoWO.
- Similar efficiency and certainty to current system.

Costs outside the model in FY25

Cost to Australian Government	$6.2 billion
Cost to states relative to pre-2018 system	$0

Framework dimensions

Selected · Comparison · Other

Equity – equalisation rate, relative to CGC assessment
Higher = closer to pre-2018 equalisation rate

Pre-2018 system	100%
0.3 floor + NoWO	98%
0.5 floor + NoWO	94%
0.75 floor + NoWO	**84%**
Current system without NoWO	**73%**

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality
Lower = more policy neutral

Current system without NoWO	**1.7%**
0.3 floor + NoWO	1.7%
0.5 floor + NoWO	1.7%
0.75 floor + NoWO	**1.7%**
Pre-2018 system	2.5%

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score
Lower = less pressure on fiscal sustainability

Pre-2018 system	12
0.3 floor + NoWO	12
0.5 floor + NoWO	12
0.75 floor + NoWO	**12**
Current system without NoWO	**15**

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system
Lower = less volatile

Current system without NoWO	**2.9%**
0.75 floor + NoWO	**2.9%**
0.3 floor + NoWO	3.3%
0.5 floor + NoWO	4.1%
Pre-2018 system	4.6%

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	**84%**	Higher equalisation rate than the current system.
Efficiency	Departure from policy neutrality: weighted average	**1.7%**	Similar efficiency to current system, with similar average departures and average maximum departures from policy neutrality.
	Departure from policy neutrality: average maximum	**19%**	
Sustainability	Pressure on states' fiscal sustainability	**12**	Less pressure on state fiscal sustainability than the current system.
	Cost to Australian Government	**$6.2b**	Higher cost relative to current system, due to the inclusion of NoWO payments.
Certainty	Volatility driven by the distribution system	**2.9%**	Similar system-driven volatility to current system.

Removing the standard state benchmark and reverting to a fixed floor improves equity. It would also improve the efficiency of the system, by removing a perverse mechanism where a state that has greater fiscal capacity than the benchmark could receive greater GST payments when their fiscal capacity increases, or when that of New South Wales or Victoria reduces (chapter 2). It also removes potential policy neutrality concerns where a state below the standard state benchmark can influence its GST share through policy choices that impact the fiscal capacity of either New South Wales or Victoria.[1]

A higher floor limits how far changes in a state's assessed fiscal capacity flow through to GST shares. This is most relevant where the revenue base is highly concentrated, such as mining in Western Australia. If Western Australia's relativity remains below the floor, then the floor will continue to blunt the largest dominant-state effects on efficiency and certainty while removing the negative impacts of the standard-state benchmark.

The disadvantage of a floor is that it is a blunt policy instrument. It can also bind for states where there is no dominant-state problem, limiting equalisation for reasons unrelated to policy neutrality concerns (PC 2018, p. 231). A floor may therefore improve efficiency in some cases, but it can do so unevenly and at the cost of equity (equity improvements from lower floors are discussed later in this chapter).

Removing the new equalisation standard also has benefits in terms of increased certainty. The new equalisation standard introduced additional complexity into the system and can create counterintuitive interactions between states' fiscal capacities. Any event impacting the fiscal capacity of the standard state effectively impacts the relativity of all states with a greater fiscal capacity than the standard state, at the expense of all states with lower fiscal capacity.

The **potential that NoWO payments would not continue after 2029–30** generates the risk that the fiscal burden of the 2018 reforms will shift from the Australian Government to states with relatively lower fiscal capacity. While the 2018 reforms were intended to make all states better off, this has not occurred.

The cessation of NoWO payments would also mean that states with greater fiscal capacity than the standard state will have an even greater fiscal capacity than other states. Relative to the current system, introducing permanent NoWO payments improves the equity of the system given it restores states that are not affected by the new equalisation standard to payments that are cumulatively equivalent to what they would have received under the pre-2018 system (making NoWO payments permanent increases the equalisation rate from 73% to 77%).[2]

The potential cessation of NoWO payments is particularly problematic given the fiscal pressures facing states other than Western Australia. A permanent NoWO guarantee would provide states with greater fiscal certainty by preventing the Australian Government from leveraging these payments in other fiscal or policy negotiations. It would also represent sound fiscal management by the Australian Government in accordance with the Charter of Budget Honesty – ensuring that the budget reflects future expenditures.

The intention of the **GST pool boost** has not been realised, so it should be removed if the NoWO guarantee is made permanent. The intention of the pool boost was to make all states 'better off' by increasing the amount of GST available for distribution. However, this benefit is only realised if a state's

[1] The efficiency challenges produced by the standard state benchmark are not fully reflected in the efficiency metric. Nevertheless, the PC judge the standard benchmark creates additional policy distortions that can weigh on system efficiency.

[2] Note that full equalisation does not occur because while other states are brought up to their full HFE fiscal capacity, a new inequality is introduced because some states receive more than their assessed need.

final GST distribution is drawn from the boosted GST pool. All states other than Western Australia have required payments under the NoWO guarantee in every year since the transition to the new fiscal equalisation standard. As such, Western Australia has been the only state to benefit from the pool boost (interim finding 3.1).

Overall, while these minimum changes address the most critical issues with the current system, they do not reflect a first or second-best policy solution for the GST distribution. Permanent NoWO payments help to protect states with lower fiscal capacities, at the cost of a continuing an open-ended fiscal liability for the Australian Government. This cost is in small part reduced by the removal of the pool boost. While the removal of the new equalisation standard would prevent the associated perverse outcomes in the current system, retaining a floor of 0.75 would still involve equity trade-offs. The PC will explore whether alternative fixed floors better address these equity trade-offs in its final report, in the context of minimal changes to the existing system.

4.3 Alternative arrangements

The inquiry has considered several alternative arrangements (table 4.2). This list is not exhaustive and has been drawn from the available literature and submissions received by the inquiry to provide a sense of the trade-offs that might exist between the various alternatives.

The PC has not included equalisation approaches proposed by Saul Eslake (sub. 3, pp. 25–26), the Australian Centre for Federalism (sub. 23, pp. 6–7), and Chris Murphy (sub. 45, pp. 25-26) in this chapter, though they are explored in appendix B. The inquiry has focused to date on those alternative arrangements that can be readily made within the existing policy architecture of the federal financial relations system. The inquiry would welcome additional proposals in submission responses to this interim report.

Table 4.2 – GST distribution systems in inquiry submissions

	Submission
Pre-2018 system	Victorian Government; Australian Capital Territory Government; Government of South Australia; Tasmanian Government
Pre-2018 + mining adjustment	Northern Territory – Department of Treasury and Finance; Queensland Government
Current system	Government of Western Australia
Pre-2018 system but with fixed relativity floor	Modelled in Tasmanian Government submission
Split pools (90% EPC, 10% HFE)	The Hon Colin Barnett
EPC+	New South Wales Government
Broader indicators	Saul Eslake
Optimal equalisation	Chris Murphy

This list is not exhaustive. A full list of submissions received by the inquiry is provided in appendix A. Nor does it include all alternative arrangements in state submissions. For example, it does not include the NSW Government's secondary proposal for a Commonwealth funded 0.5 fixed relativity floor, or the Northern Territory – Department of Treasury and Finance's proposal for a fixed share of GST revenue, amongst others.

A return to the pre-2018 system was put to the inquiry by a range of participants, including many state government submissions (Victorian Government, sub. 59, p. 44; ACT Government, sub. 38, p. 8; Government of South Australia, sub.13, p. 4; Tasmanian Government, sub. 48, p. 3). It restores the strongest form of equalisation, removes the need for NoWO payments, and restores the nexus: it returns the system to a largely self-contained one in which Australia's HFE task is achieved from within the GST pool. The inquiry's preliminary assessment is that doing so would deliver a notable improvement in equity and fiscal sustainability for the states and the Australian Government. Given the pre-2018 system appears to have been broadly policy neutral, except for the pronounced dominant-state effects in the mining assessment, it would also have limited impacts on efficiency.

It is important to note that simply returning to the pre-2018 system would not address the concerns about institutional sustainability and fairness, due to dominant-state effects. The PC considers remaining efficiency concerns would be best addressed by targeted adjustments to the mining assessment rather than through wholesale changes to the broader GST distribution system.

Another option evaluated by the inquiry has been to retain the current system but replace the new equalisation standard with a lower fixed relativity floor. This would remove the new equalisation standard-related perverse outcome that allows Western Australia to indirectly *increase* its GST revenue when its own mining royalty base strengthens. The inquiry's preliminary analysis suggests that lower fixed floors may offer improvements relative to the current system (without NoWO payments) including better equity and fiscal sustainability outcomes. The higher the floor is set the lower the equalisation rate, and the higher the pressure on state fiscal sustainability (figure 4.5).

The 2018 reforms broke the nexus between the GST pool and untied grants. This is a significant departure from what was originally envisaged in 1999 and begs the question as to whether there may be other, more preferable ways of permanently breaking this nexus and whether it would depart from – or conform with – HFE principles.

For example, more significant departures from HFE are possible in models such as EPC+ and split pool approaches. An EPC+ model could distribute the GST pool on an EPC basis and then provide separate Australian Government NoWO-style payments to states that would have otherwise received a higher than EPC allocation under the pre-2018 system. This performs relatively well on efficiency and certainty grounds, because it reduces the feedback between state policy choices and subsequent GST distributions. It also performs strongly in terms of reducing pressures on state fiscal sustainability. But it does so by transferring the HFE task from the GST pool to the Commonwealth budget. In doing so, as with the current NoWO payments, it means that the Australian Government directly takes on the task of making discretionary HFE-like payments. It also creates a new gap, where some states receive more than their assessed needs (the states with greater fiscal capacity) while other states receive only their assessed needs. Other split pool approaches, such as 90% EPC/10% HFE, can improve efficiency but at the cost of a significant reduction in fiscal equalisation, relative to the current system (without NoWO payments).

Other alternatives, such as broad indicator models or partial equalisation approaches were proposed by participants in this inquiry. The appeal of the broader indicators model lies in the possibility of reducing direct links between state policy choices and subsequent GST distributions by using broader measures such as gross state product, demographic structure or other proxies for need and capacity. But this strength may present other challenges. The further the system moves away from direct measures of fiscal capacity, the greater the risk that it ceases to equalise with regard to the appropriate factors. While conceptually appealing, they may be less faithful to the core purpose of HFE and more vulnerable to dispute over the choice and weighting of indicators. A further discussion of these alternatives is provided in appendix B.

Assessing the pre-2018 GST distribution system

The pre-2018 GST distribution system delivered a high degree of equalisation and aligned with the long-standing logic of HFE (figure 4.3). For states with below-average revenue-raising capacity, or above-average service delivery costs, the system provided substantial support. For states with relatively strong revenue bases, including from natural resources, the system reflected this by assessing those states as having a lower need for GST revenue.

The pre-2018 system delivers the highest degree of equity, when using the equalisation rate metric. It most directly advances the core objective of the GST distribution system by addressing differences in fiscal capacity across Australia. An additional strength was that it did so without requiring separate discretionary side payments from the Australian Government. For states concerned about fairness across Australia, this remains an important strength. A system that equalises less fully can be proposed and defended, but it requires a clear explanation of why the reduction in HFE is justified and what offsetting gains it delivers.

On efficiency grounds, the pre-2018 system was broadly policy neutral, with the notable exception being specific dominant-state effects in the mining assessment. In a broad sense, the pre-2018 system was not an impediment at the margin to good policy. That distinction matters for policy design, which should target the specific issue that needs to be addressed, rather than using a blunt tool that creates other trade-offs.

The pre-2018 system did not fully address the fiscal sustainability challenges facing the states but did not add to these issues as the current system (without NoWO payments) does. It also did not impose additional fiscal costs on the Australian Government, which is a significant advantage relative to systems that rely on NoWO payments, a GST pool boost, or payments outside the system.

In terms of certainty, the pre-2018 system involved considerable system-driven GST revenue volatility for Western Australia, propelled by its dominant-state status and the vulnerability of its GST relativity to fluctuations in commodity prices. The 2018 reforms addressed this issue for Western Australia but did little to reduce system-driven volatility (commodity-based or otherwise) for other states (table 4.3).

The inquiry's assessment is that the pre-2018 system scores highly on equity, performs well on fiscal sustainability, albeit at some cost to certainty. It also performs better on efficiency than is often assumed, other than in the case of pronounced dominant-state effects in the mining assessment. Proposed alternatives need to do more than identify theoretical weaknesses associated with full equalisation; they need to answer the 'compared to what' question: they must demonstrate that they produce meaningful gains in practice that are large enough to justify the reduction in equalisation and any accompanying fiscal costs, institutional instability, and broader costs to the Federation.

A return to the pre-2018 system would continue to have a central role for the independent CGC in assessments, ensuring institutional trust. However, simply returning to the pre-2018 system would not address the concerns about fairness that led to the 2018 reforms. Submissions from the Western Australian Government and members of the public highlighted the strongly held view that the previous system was not fair and did not adequately reward effort. The inquiry considers these concerns would be best addressed by targeted, transparent adjustments to the mining assessment rather than through wholesale changes to the GST distribution system. Some options to adjust the mining assessment are identified in the next section.

Figure 4.3 – Assessment of the pre-2018 system

Pre-2018 system (NoWO guarantee and pool boost not included)

Model description

Pre-2018 GST distribution system. It removes the current standard state benchmark, fixed GST relativity floors, GST pool boost, and NoWO payments.

Results and key takeaways

- Much better equity and less pressure on state fiscal sustainability than the current system without NoWO.
- Slightly less efficient and slightly more uncertain than the current system without NoWO payments.

Costs outside the model in FY25

Cost to Australian Government	$0
Cost to states relative to pre-2018 system	$0

Framework dimensions

Selected / Comparison / Other

Equity – equalisation rate, relative to CGC assessment
Higher = closer to pre-2018 equalisation rate

Pre-2018 system	**100%**
Current system with NoWO	77%
Current system without NoWO	**73%**
EPC + NoWO	63%
90% EPC, 10% HFE	20%

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality
Lower = more policy neutral

90% EPC, 10% HFE	0.2%
EPC + NoWO	0.6%
Current system without NoWO	**1.7%**
Current system with NoWO	1.8%
Pre-2018 system	**2.5%**

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score
Lower = less pressure on fiscal sustainability

EPC + NoWO	10
Pre-2018 system	**12**
Current system with NoWO	12
Current system without NoWO	**15**
90% EPC, 10% HFE	19

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system
Lower = less volatile

90% EPC, 10% HFE	0.6%
EPC + NoWO	2.1%
Current system without NoWO	**2.9%**
Current system with NoWO	2.9%
Pre-2018 system	**4.6%**

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	**100%**	Much higher rater of equalisation than the current system.
Efficiency	Departure from policy neutrality: weighted average	**2.5%**	Slightly worse average and maximum policy neutrality departures than current system due to dominant state effects.
	Departure from policy neutrality: average maximum	**30%**	
Sustainability	Pressure on states' fiscal sustainability	**12**	Less pressure on state fiscal sustainability than the current system.
	Cost to Australian Government	**$0**	Lower cost than the current system because the pool boost is saved.
Certainty	Volatility driven by the distribution system	**4.6%**	Slightly higher system-driven volatility than the current system.

Table 4.3 – The 2018 reforms have minimal impacts on certainty for all states except Western Australia

Average annual absolute change in year-on-year adjusted real GST revenue per capita, 2001–02 to 2025–26

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Pre-2018 system	2.5%	2.3%	3.4%	14.8%	2.4%	3.0%	3.9%	4.5%
Current system	2.3%	2.7%	2.8%	1.8%	2.5%	3.0%	3.9%	4.4%
Current system + NoWO payments	2.5%	2.3%	3.1%	1.8%	2.4%	3.0%	3.9%	4.5%

These values do not represent actual expected volatilities in GST revenues under different distribution systems: they are only an indicator of the level of volatility induced by the particular GST distribution system. Other factors not captured in this indicator, including growth in the size of the GST pool and population changes, would also contribute to GST revenue volatility. Full details can be found in appendix B.

Source: PC analysis based on CGC (unpublished data).

The broad lesson from these alternatives is that while there is considerable theoretical appeal to the idea that HFE creates reform disincentives, distortions and efficiency costs, there is little evidence that significant departures from HFE result in notable efficiency gains. By contrast, targeted changes can improve some of the current system's weaknesses without abandoning the logic of HFE. This points to a reform approach that starts from the logic of HFE and focuses on the specific assessment features that create the strongest distortions, rather than bluntly reducing equalisation across the board.

Assessing the pre-2018 GST distribution system with an adjustment to the mining assessment

The inquiry has found that the main efficiency question for the pre-2018 system lay in the treatment of mining royalties, where dominant-state effects are particularly pronounced. The inquiry has considered several possible targeted adjustments to the mining assessment that could address the issue. These include applying a discount to the mining assessment, bundling commodities together rather than assessing them separately, or changing the base used to assess mining revenue capacity (box 4.1). Each of these options seeks, in different ways, to reduce the extent to which dominant-state effects distort policy incentives while continuing to support fiscal equalisation between the states.

Mining discounts would retain the pre-2018 HFE structure but count only part of each state's mining royalty revenue when calculating GST shares (figure 4.4). For example, a 25% mining discount would count only 75% of a state's mining revenues when assessing a state's fiscal capacity. This directly targets dominant-state effects in mining, especially where Western Australia and Queensland account for a large share of the assessed revenue base. Compared to the current system, it has the benefit of addressing these concerns for all states affected, not just states below the standard state benchmark or floor.

Relative to the current system (without NoWO payments) mining discounts generally improve equity (figure 4.4). All 3 mining discount alternatives modelled produce a higher equalisation rate, but the equity gains fall as the discount rises. A 10% discount delivers the largest equity improvement, while a 50% discount is only slightly more equalising than the current system (without NoWO payments).

Box 4.1 – Alternative approaches to the mining assessment

The Commonwealth Grants Commission (CGC) uses the mining assessment to compare states' mining revenue-raising capacity, so that large differences in mining income can be considered when the GST pool is divided. It is part of the process that the CGC uses to assess the fiscal capacity of states, and thereby the GST relativity of each state.

Mining royalties are payments made to state governments when minerals such as iron ore, coal and gold are extracted from their state. The current approach considers how much of each mineral is being produced, and the mineral royalties collected on that production. Different minerals are assessed separately because they are produced, priced and taxed in different ways. In practice, however, the current system does not fully equalise mining revenues, due to the application of the new fiscal equalisation standard in determining GST relativities.

Some ways the mining assessment could be adjusted to reduce dominant-state effects are:

- **Across-the-board mining discount** – A mining discount reduces the proportion of state mining revenue that is used to assess a state's fiscal capacity. For example, a 25% mining discount would mean that only 75% of a state's mining revenue is counted in the CGC assessment of its fiscal capacity.
- **Dominant-state mining discount** – A mining discount but only for commodities in which a state has a dominant-state effect in. That is, a commodity that the state has a disproportionately high share of.
- **Hotelling Rule-based discount** – a mining discount that recognises that mining income is generated from the run-down of a non-renewable resource. That is, mining revenue would be assessed as net revenue, net of the rundown in the state's natural capital stock (El Serafy 1997).
- **Sustainable income approaches** – Similar to the rationale for the Hotelling Rule-based discount, this approach would assume that a state's mining royalties were paid into a notional sovereign wealth fund, and only the 'sustainable income' (the income that allows the fund to maintain its value) would contribute to the state's fiscal capacity assessment (Pincus 2011, pp. 5–6).
- **Bundle of commodities approach** – Instead of separately assessing revenue from iron ore, coal, gold and other minerals separately, commodities would be assessed as a group. This could reduce the weight of any one mineral that a state is otherwise dominant in.
- **Endowment-based approach** – This would assess fiscal capacity based on states mineral endowments rather than production. Because resource endowments can be less concentrated than actual production, this may reduce dominant-state effects.
- **Profitability-based approach** – This would assess fiscal capacity not from the royalties paid on mining activity, but on mining profits or economic rents. In some cases, this could reduce extreme outcomes where very high production does not translate into equally high underlying returns.

On certainty, small discounts perform slightly worse relative to the current system (without NoWO payments) (figure 4.4). On state fiscal sustainability, smaller discounts perform better than the current system (without NoWO payments) while the largest discount (50%) performs similarly. While NoWO payments could partly address fiscal sustainability concerns for the states, this would come at a cost to the Australian Government. Larger discounts improve efficiency and certainty, at the cost of reduced equity.

A key challenge for mining discounts (figure 4.4) is their conceptual basis. While discounts are already used by the CGC where there is uncertainty about the data or methodology, they are not currently used as a response to policy neutrality concerns. One conceptual basis may be that the existing methodology does not fully account for differences in policy effort, which in principle could create efficiency costs. The PC has also heard mining discounts could better account for the idea that royalty revenues from the exploitation of natural resources are unlike other forms of income for the purposes of fiscal equalisation (Pincus 2011).

Bundling mining commodities offers another possible path. Instead of assessing iron ore, gold and other commodities separately, a bundled approach would assess revenue-raising capacity across the mining sector more broadly. This could reduce the extent to which dominant-state effects in a particular commodity drive the outcome. However, the design details matter. A simple average-rate approach may not be the best way to combine commodities, as market conditions for each resource differ substantially. More work is needed to determine whether a bundled assessment could be made conceptually robust and practically stable.

A further possibility is to retain the pre-2018 system and deal with specific adjustment pressures through direct Commonwealth payments rather than by redesigning the GST distribution system itself. This approach has the advantage of separating the equalisation task from compensation for concerns about outcomes. If the Australian Government considers that a state is unfairly affected by a feature of the assessment, it can address that concern directly and transparently. In this regard, it is important to note that the Treasurer already has a direct and transparent power to substitute the CGC's recommended relativities with their own (although no Treasurer has done so). Direct Commonwealth payments would be a simpler and more transparent approach than the changes introduced by the 2018 reforms. However, such an approach could reduce certainty for any state that receives these payments and reduce equity.

A lower floor would increase equity

A first set of broader alternatives would retain the HFE assessment but replace the current standard-state benchmark with an explicit relativity floor. Instead of equalising states to the stronger of New South Wales or Victoria, the floor would define the minimum GST share any state could receive, with the rest of the pool distributed through the HFE assessment. This would keep the GST distribution as the main equalisation instrument while making the limit on distribution more transparent.

The main design choice is the level of the floor. A lower floor delivers stronger equity outcomes because it allows the GST distribution to respond more fully to differences in fiscal capacity and expenditure needs. Lowering the floor to 0.5 or 0.3 would therefore be a more material shift away from the current system towards full equalisation (figure 4.5). A 0.3 floor would bind less often (4 times between 2000-01 and 2024-25) and produce outcomes closer to full equalisation than a 0.5 or 0.75 floor. Lower floors also perform better in terms of state fiscal sustainability, with all 3 floors performing better than the current system (without NoWO payments).

For states with relativities lower than the floor, relativity floors create greater certainty as they minimise GST revenue volatility. Higher floors are binding more frequently for more states and so produce systems with greater overall certainty. A 0.75 and 0.5 floor result in similar degrees of overall certainty relative to the current system (with and without NoWO payments). A 0.3 relativity floor would have marginally less certainty than the current system (with and without NoWO payments).

Figure 4.4 – Assessment of pre-2018 system with a mining discount

Pre-2018 system + mining discounts - 10%, 25% and 50% (excludes pool boost and NoWO)

Model description

Pre-2018 GST distribution system but with mining discounts of 10%, 25% and 50%. All options otherwise preserve the pre-2018 system assessment structure.

Results and key takeaways

- All discounts have better equity than the current system without NoWO payments. Lower discounts have higher equalisation rates.
- 10% and 25% discounts are slightly less efficient than the current system without NoWO payments but put less pressure on states' fiscal sustainability.

Costs outside the model in FY25	
Cost to Australian Government	$0
Cost to states relative to pre-2018 system	$1.5 - 7.3 billion

Framework dimensions

Selected · Comparison · Other

Equity – equalisation rate, relative to CGC assessment
Higher = closer to pre-2018 equalisation rate

Pre-2018 system	100%
10% mining discount	**95%**
25% mining discount	**88%**
50% mining discount	**75%**
Current system without NoWO	**73%**

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality
Lower = more policy neutral

Current system without NoWO	**1.7%**
50% mining discount	**1.8%**
25% mining discount	**2.2%**
10% mining discount	**2.4%**
Pre-2018 system	2.5%

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score
Lower = less pressure on fiscal sustainability

Pre-2018 system	12
10% mining discount	**12**
25% mining discount	**13**
50% mining discount	**15**
Current system without NoWO	15

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system
Lower = less volatile

Current system without NoWO	**2.9%**
50% mining discount	**3.3%**
25% mining discount	**3.6%**
10% mining discount	**4.1%**
Pre-2018 system	4.6%

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value 10/25/50	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	**95%, 88%, 75%**	Higher equalisation rate than the current system, the equalisation rate falls as the discount rises.
Efficiency	Departure from policy neutrality: weighted average	**2.4%, 2.2%,1.8%**	Slightly worse or similar efficiency to the current system. 10% and 25% mining discounts are slightly less policy neutral than the current system, both on average and at a maximum. 50% mining discount is similar to the current system.
	Departure from policy neutrality: average maximum	**27%, 22%, 15%**	
Sustainability	Pressure on states' fiscal sustainability	**12, 13, 15**	Pressure on fiscal sustainability increases as the discount increases.
	Cost to Australian Government	**$0, $0, $0**	Slightly lower cost relative to current system, as NoWO payments and the pool boost are saved.
Certainty	Volatility driven by the distribution system	**4.1%, 3.6%, 2.3%**	10% discount has slightly higher system-driven volatility than the current system.

Figure 4.5 – Assessment of the current system with different floors

Current system + floor levels 0.3, 0.5 and 0.75 (includes pool boost, removes standard state benchmark and NoWO guarantee)

Model description

These alternative arrangements retain much of the current system but remove the standard state benchmark and set a fixed GST relativity floor of either 0.3, 0.5 or 0.75.

Results and key takeaways

- All relativity floors (0.3, 0.5, 0.75) have better equity than the current system without NoWO payments, with higher floors having lower equity.
- All floors have similar efficiency to the current system.

Costs outside the model in FY25

Cost to Australian Government	$1 billion
Cost to states relative to pre-2018 system	$0.9 - 5.3 billion

Framework dimensions

Selected Comparison Other

Equity – equalisation rate, relative to CGC assessment
Higher = closer to pre-2018 equalisation rate

Pre-2018 system	100%
0.3 floor	91%
0.5 floor	87%
0.75 floor	78%
Current system without NoWO	73%

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality
Lower = more policy neutral

0.75 floor	1.5%
0.5 floor	1.5%
0.3 floor	1.5%
Current system without NoWO	1.7%
Pre-2018 system	2.5%

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score
Lower = less pressure on fiscal sustainability

Pre-2018 system	12
0.3 floor	12
0.5 floor	12
0.75 floor	14
Current system without NoWO	15

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system
Lower = less volatile

Current system without NoWO	2.9%
0.75 floor	2.9%
0.5 floor	3.3%
0.3 floor	4.1%
Pre-2018 system	4.6%

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value 0.3/0.5/0.75	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	91%, 87%, 78%	High equalisation rate than the current system, the equalisation rate rises as the floor falls.
Efficiency	Departure from policy neutrality: weighted average	1.5%, 1.5%, 1.5%	Similar efficiency for the size of the modelled policy change, with similar average departures and average maximum departures from policy neutrality to the current system for all floors.
	Departure from policy neutrality: average maximum	19%, 19%, 19%	
Sustainability	Pressure on states' fiscal sustainability	12, 12, 14	All floors put less pressure on state fiscal sustainability than the current system.
	Cost to Australian Government	$1.0b, $1.0b, $1.0b	Similar cost to current system as NoWO payments are saved but the pool boost payments are not.
Certainty	Volatility driven by the distribution system	4.1%, 3.3%, 2.9%	0.3 has slightly higher system-driven volatility than the current system.

Equal per capita alternatives would weaken equity

EPC+ would simplify the GST distribution, but at the cost of weakening equity and creating a system where some states are treated unequally.

Under EPC+, the GST pool would be distributed equally per person. States who the CGC assesses as having needs above an equal per capita share would receive a separate Australian Government NoWO-style payment (which would be the '+' element of this approach). This would make the GST pool itself simple and more policy neutral for those only receiving EPC payments, while keeping the complexity of the HFE system determining payments for others.

States below the EPC benchmark would keep their full population share of GST revenue, even if they have greater fiscal capacity. States above the benchmark would depend on a separate Australian Government payment. Equalisation would therefore apply asymmetrically. States with relatively lower fiscal capacity would rely more directly on Commonwealth discretion to manage structural service costs and revenue weakness.

EPC+ would materially reduce equalisation (figure 4.6). The model has an equalisation rate of 63%, compared with 73% under the current system (without NoWO payments). This means it would close less of the difference between states' assessed fiscal capacities.

EPC+ performs much better on state fiscal sustainability relative to the current system (without NoWO payments). This is a product of all states receiving the equivalent payments that they would have received under the pre-2018 system, as well as some states receiving a higher GST payment through their EPC share. But this result depends on a large permanent Australian Government payment. In 2024–25, EPC+ would have required around $10b in NoWO payments. This would create an ongoing fiscal exposure for the Australian Government and make support for states with relatively lower fiscal capacity more dependent on annual Commonwealth decisions.

On certainty, EPC+ has slightly more certainty to the current system (without NoWO payments). It would be simpler at the level of the GST pool, but less stable institutionally. A separate NoWO-style payment would be more visible, more contestable and more exposed to budget decisions than a rules-based GST distribution. Over time, that risks politicising the distribution of NoWO-style payments which could weaken confidence in the durability of the system among the smaller states reliant on these payments.

The 90% EPC, 10% HFE model shows the trade-offs with equity more starkly (figure 4.7). It has the best measured efficiency and the highest certainty, but this is achieved by sharply reducing equalisation. Its equalisation rate is only 20%, and performs the worst of the systems assessed in terms of state fiscal sustainability. This suggests very high EPC models can look efficient and certain in a narrow mechanical sense, but only because they leave more fiscal pressure with the states least able to absorb it.

Overall, EPC+ would be easier to explain and would improve some policy neutrality measures, but it would significantly reduce the degree of fiscal equalisation produced by the system.

Figure 4.6 – Assessment of EPC+

EPC + NoWO guarantee (excludes pool boost)

Model description

This model distributes the GST pool equally per person. States with greater fiscal need would receive additional Australian Government payments outside the GST pool (NoWO guarantee), shifting the HFE task onto Australian Government payments.

Results and key takeaways

- Lower equalisation rate than current system without NoWO payments, but much less fiscal pressure states.
- Slightly better efficiency relative to current system.

Costs outside the model in FY25

Cost to Australian Government	$10.2 billion
Cost to states relative to pre-2018 system	$0

Framework dimensions

Selected | Comparison | Other

Equity – equalisation rate, relative to CGC assessment

Higher = closer to pre-2018 equalisation rate

Pre-2018 system	100%
Current system with NoWO	77%
Current system without NoWO	**73%**
EPC + NoWO	**63%**
90% EPC, 10% HFE	20%

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality

Lower = more policy neutral

90% EPC, 10% HFE	0.2%
EPC + NoWO	**0.6%**
Current system without NoWO	**1.7%**
Current system with NoWO	1.8%
Pre-2018 system	2.5%

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score

Lower = less pressure on fiscal sustainability

EPC + NoWO	**10**
Pre-2018 system	12
Current system with NoWO	12
Current system without NoWO	**15**
90% EPC, 10% HFE	19

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system

Lower = less volatile

90% EPC, 10% HFE	0.6%
EPC + NoWO	**2.1%**
Current system without NoWO	**2.9%**
Current system with NoWO	2.9%
Pre-2018 system	4.6%

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	**63%**	Lower equalisation rate than the current system.
Efficiency	Departure from policy neutrality: weighted average	**0.6%**	Slightly better efficiency than the current system, with average and average maximum departures from policy neutrality smaller than the current system.
	Departure from policy neutrality: average maximum	**9%**	
Sustainability	Pressure on states' fiscal sustainability	**10**	Much less pressure on state fiscal sustainability than the current system.
	Cost to Australian Government	**$10.2b**	Much higher cost relative to current system, due to large NoWO payments required.
Certainty	Volatility driven by the distribution system	**2.1%**	Similar system-driven volatility to the current system.

Figure 4.7 – Assessment of 90% EPC, 10% HFE

90% EPC, 10% HFE (excludes NoWO guarantee and pool boost)

Model description

This model first distributes 90% of the GST pool between the States and Territories on an equal per capita (EPC) basis and then distributes the remaining 10% of the pool on a HFE basis.

Results and key takeaways

- Much worse equity and much greater pressure on state's fiscal sustainability than the current system without NoWO payments.
- Better certainty and slightly better efficiency.

Costs outside the model in FY25

Cost to Australian Government	$0
Cost to states relative to pre-2018 system	$9.2 billion

Framework dimensions

Selected | Comparison | Other

Equity – equalisation rate, relative to CGC assessment

Higher = closer to pre-2018 equalisation rate

Pre-2018 system	100%
Current system with NoWO	77%
Current system without NoWO	**73%**
EPC + NoWO	63%
90% EPC, 10% HFE	**20%**

equalisation rate average, if system was in place FY02 to FY25

Efficiency – degree of policy neutrality

Lower = more policy neutral

90% EPC, 10% HFE	**0.2%**
EPC + NoWO	0.6%
Current system without NoWO	**1.7%**
Current system with NoWO	1.8%
Pre-2018 system	2.5%

weighted average absolute GST revenue change from policy change (FY25)

Sustainability – fiscal pressure score

Lower = less pressure on fiscal sustainability

EPC + NoWO	10
Pre-2018 system	12
Current system with NoWO	12
Current system without NoWO	**15**
90% EPC, 10% HFE	**19**

sum of state scores based on interest-to-revenue bands in FY25, if system was in place FY02 to FY25

Certainty – GST revenue volatility driven by distribution system

Lower = less volatile

90% EPC, 10% HFE	**0.6%**
EPC + NoWO	2.1%
Current system without NoWO	**2.9%**
Current system with NoWO	2.9%
Pre-2018 system	4.6%

average year on year change in real, pool adjusted GST per capita if system was in place FY02 to FY25

Model summary

Dimension	Variable	Value	Comparison to current system (without NoWO guarantee)
Equity	Equalisation rate	**20%**	Much lower equalisation rate than the current system.
Efficiency	Departure from policy neutrality: weighted average	**0.2%**	Slightly better efficiency than the current system, with average and average maximum departures from policy neutrality smaller than the current system.
	Departure from policy neutrality: average maximum	**3%**	
Sustainability	Pressure on states' fiscal sustainability	**19**	Much more pressure on state fiscal sustainability than the current system.
	Cost to Australian Government	**$0**	Slightly lower cost relative to current system, due to no pool boost payments.
Certainty	Volatility driven by the distribution system	**0.6%**	Lower system-driven volatility than the current system.

4.4 Preliminary findings and recommendations

The analysis in this chapter has considered a non-exhaustive range of GST distribution systems put to the inquiry through submissions, existing literature and the inquiry's own preliminary modelling. They do not cover every design choice. Nor do they resolve all practical questions that would arise in implementing reform. But they do provide a sufficient basis for some preliminary judgments about the direction of reform and the relative merits of the main classes of alternative arrangements.

All alternatives assessed to date involve trade-offs between equity, efficiency, fiscal sustainability and certainty. Some alternatives appear to offer a better balance than the changes from the 2018 reforms. Alternatives that weaken the link between state mining revenue and GST shares tend to reduce equalisation, increase Commonwealth costs, or both. Alternatives that provide greater certainty for one jurisdiction can reduce fiscal flexibility or shift uncertainty to others. This is not a reason to avoid reform. It is a reason to be clear about what problem reform is intended to solve, and about whether the gains are large enough to justify the costs.

The PC's view is that the 2018 reforms are not the only way to address the concerns that led to reform, and that some alternatives would perform better across our assessment framework.

This points to a reform hierarchy. The first-best response would be to return to the pre-2018 system and address the underlying issues in the mining assessment directly and transparently. This could be undertaken by the Treasurer directing the CGC to consider and address dominant-state challenges where they arise (interim recommendation 4.1). The second-best response would be to return to the pre-2018 system but with the Australian Government making direct payments to states it considers to be unfairly affected by dominant-state issues (interim recommendation 4.2). If neither of these options are regarded as desirable, government should improve the operation of the current system by removing the new equalisation standard, adopting a clearer floor arrangement and improving the transparency and fiscal credibility of the system by making NoWO payments permanent and removing the GST pool boost (interim recommendation 4.3).

Interim finding 4.2
Some alternatives perform better at lower cost to HFE than the 2018 reforms

All alternatives considered by the inquiry to date involve trade-offs between equity, efficiency, fiscal sustainability and certainty. Nevertheless, some alternatives have better equity outcomes than the current system, without marked costs to efficiency, state fiscal sustainability, and certainty.

The inquiry's preliminary judgment is that the key challenge faced by the pre-2018 system was the interaction between the mining assessment and dominant-state effects. Where one state dominates a particular mining revenue base, changes in that state's policy choices can affect GST distribution outcomes in ways that are difficult to reconcile with policy neutrality. This can weaken policy neutrality and create perceptions of unfairness. But because the problem is concentrated, the policy response should be targeted and transparent, rather than blunt and opaque. The PC has identified a range of possible mining assessment adjustments to address potential dominant-state challenges (box 4.1). The final report will further explore which of these approaches might provide a principled and sustainable response to these challenges.

In recognition of the principal source of the challenges with the pre-2018 system, the inquiry has arrived at the following recommendations as a way of moving Australia's GST distribution system towards a system that delivers on its principal policy goal of HFE, at a lower cost to efficiency of the pre-2018 system, and at a lower cost to equity and fiscal sustainability than the current system.

Interim recommendation 4.1
Australia should return towards the pre-2018 system but the Australian Treasurer should direct the CGC to address dominant-state effects

Australia should move back towards the pre-2018 GST distribution system but the Australian Treasurer should direct the Commonwealth Grants Commission (CGC) to address costly dominant-state effects where they arise.

Interim recommendation 4.2
If the Australian Government is not minded to pursue interim recommendation 4.1, Australia should return to a pre-2018 system and the Australian Government should make direct payments to states it considers are affected by dominant-state issues

Australia should move back towards the pre-2018 GST distribution system and it is recommended that the Australian Government make direct payments, outside of the GST pool, to states it considers materially affected by dominant-state effects.

If the Australian Government were not to proceed with the PC’s preferred recommendations (interim recommendations 4.1 and 4.2) and instead chooses to leave the current system broadly in place, it should adopt the minimum changes outlined in interim recommendation 4.3. Addressing only these critical issues does not represent the PC’s preferred position, rather it represents the minimum reforms that the Australian Government should implement to the current distribution system. In making these recommendations, the PC acknowledges they do not represent first-best policy and come with significant costs. In particular, the current system remains fiscally expensive for the Australian Government and hard to explain.

The cost to the Australian Government is significant and volatile. Making the NoWO guarantee permanent requires payments of $5.7 billion ongoing at current commodity prices and creates a significant ongoing exposure to commodity prices. Removing the pool boost mitigates this but only marginally.

Interim recommendation 4.3
If the Australian Government does not pursue interim recommendation 4.1 or 4.2, it should make the minimum changes to address the critical issues in the current system

If the Australian Government does not pursue interim recommendation 4.1 or 4.2, the minimum changes to address critical issues with the current system are as follows:

- remove the standard state benchmark
- remove the pool boost
- make the No Worse Off guarantee, or broadly equivalent payments outside of the GST distribution system, to the states permanent.

4.5 Implementation considerations

Whatever GST distribution system is ultimately recommended in the PC's final report, the structure and path of implementation will matter. Changes to the GST distribution system can have large fiscal effects on individual states, and even well-designed reforms may be difficult to sustain if they are introduced abruptly or through unclear institutional pathways. The legal route to implementation will depend on the nature of the reform. Retaining the 2018 framework but changing the benchmark or floor would require legislative amendment. Returning to the pre-2018 system would require repeal of the current legislative settings. More targeted changes to the CGC's methodology can be achieved through a Treasurer's direction in the CGC's terms of reference.

Transitional arrangements may also be necessary. If reform produces large negative fiscal effects for a particular jurisdiction, it may be necessary to consider phasing-in the reform. Such measures are not costless. A temporary guarantee may soften incentives to adjust and can obscure the true effects of reform. A permanent guarantee can lock in an additional Commonwealth liability and undermine the internal logic of the system. These trade-offs suggest that transitional measures should be designed to support adjustment, not to avoid it indefinitely.

Implementation also requires clarity about the objectives of reform. If the purpose is to improve policy neutrality in the mining assessment, then the reform package should be judged by whether it achieves that, not by whether it reproduces a preferred distributional outcome. If the purpose is instead to reduce volatility or improve certainty, that should be stated plainly. There is no free lunch. Clear objectives matter because they shape both the design of reform and the way it is communicated. In an area as contested as GST distribution, transparency about purpose and method is essential to institutional durability.

For these reasons, implementation issues are not an afterthought. They are part of the policy judgment itself. A theoretically attractive model that depends on opaque compensation arrangements, open-ended guarantees or poorly explained discretion may perform badly in practice. By contrast, a slightly less ambitious reform that is transparent, well-targeted and institutionally workable may offer a more credible basis for long-term improvement.

More broadly, the GST distribution system does not operate in isolation. Equalisation interacts with tied funding, non-GST Commonwealth payments, Commonwealth policy choices and the broader institutions through which intergovernmental fiscal decisions are made. Such governance related issues, and the inquiry's interim recommendations on them, are detailed in chapter 5.

5. Governance arrangements for an effective FFR system

With the Australian Government transferring almost $200 billion[1] to the states and territories (hereafter 'states') each year, it is essential that the governance structures in place to manage these transfers are both administratively efficient and effectively deliver policy objectives. Sound governance arrangements can enhance accountability, public trust and assist governments to set and implement their strategic objectives.

This chapter examines some key governance aspects of Australia's horizontal fiscal equalisation (HFE) and broader federal financial relations (FFR) system, and whether there are opportunities to strengthen these going forward. It considers:

- how the CGC exercises its functions in the HFE system (section 5.1)
- the case for ongoing monitoring of outcomes if a HFE system that advantages one or more states is maintained (section 5.2)
- whether non-GST Commonwealth payments can be administered more efficiently (section 5.3)
- the operation of the Council on Federal Financial Relations (CFFR) (section 5.4)
- opportunities to improve governments' fiscal transparency (section 5.5).

5.1 The CGC's approach to exercising its key functions is broadly sound

While ultimate policy responsibility for the HFE system lies with the Australian Government, it is the CGC's independent assessments and recommendations that underpin the annual distribution of GST revenue and give practical effect to how equalisation is undertaken.

The Productivity Commission has examined the CGC's operations with respect to a number of considerations – namely whether the CGC is sufficiently independent; whether it is consultative in its work; and whether suitable transparency measures are in place.

The PC's overall assessment is that the CGC has the structure, procedures and capabilities to undertake its role well. This is a key prerequisite for a stable and broadly supported HFE system (noting that some tension is unavoidable when large amounts of funding is allocated across governments).

However, given the importance of the CGC's assessments to states' GST revenue allocations, and consequently for the broader community, it is important that the CGC strives to continuously improve how it undertakes its work. Accordingly, the PC has identified some areas where there may be opportunities for further improvement.

[1] Final Budget Outcome 2024–25, table 3.1.

The CGC's independence is central to its effectiveness

The CGC is an independent statutory authority, operating under its own Act and led by Commissioners who are appointed for fixed terms of up to 5 years. These features support the CGC to undertake its functions at arm's length from governments and reduces the risk – or any perception – that its recommendations are influenced by political considerations. This supports the legitimacy, credibility and perceived fairness of the system.

The CGC's independence also supports the long-term planning and capability-building it needs to perform its role effectively. This includes maintaining enduring relationships with state treasuries, investing in specialised data systems and progressing forward work programs, as well as supporting the CGC to preserve its 'institutional memory'.

The CGC is consultative and has good working relationships with states

The PC consistently heard from state governments that they generally have developed good working relationships with the CGC. States broadly indicated that the CGC has been comprehensive and helpful when responding to their requests for information and clarification. They also reported that the CGC consistently provides the data and methodological information they need to be able to simulate the likely impacts of policy changes on their GST distribution and to forecast future GST relativities (while noting that these activities are still subject to a degree of inherent uncertainty).

States have formal opportunities to contribute to the CGC's work. As part of each annual update, states are consulted for their views on new issues that could be considered by the CGC. States are also consulted throughout the CGC's 5-yearly methodological reviews, including on its proposed approach and work program, on its assessment methods and data sources, and in response to its draft report (CGC 2025c).

The CGC has undertaken further steps to deepen its engagement with state governments. This includes establishing a forward work program – which states will have input into and will receive updates on – that will advance research on significant topics ahead of the next methodological review (CGC, sub. 34, p. 20). The CGC has established a Data Working Group with states *'to discuss data issues and ways to improve the CGC's data processes and procedures'* (CGC, sub. 34, p. 21). These are positive initiatives.

Taken together, this evidence suggests that the CGC's engagement with states, and the processes that support this engagement, are broadly effective.

And while the CGC's work is reasonably transparent …

The CGC demonstrates a reasonable degree of transparency when undertaking its work.

The CGC publishes the methodology it uses for its annual updates on its website (CGC 2025f). It also publishes the new issues it considered as part of each annual update and sets out (after considering the views of states) its decisions on how it will respond to these issues as well as its underlying rationale (CGC 2026g).

The key outputs of the annual update are reported transparently. The CGC's recommended GST relativities and relevant supporting data are published on the CGC's website. The recommendations are also communicated through a media release (CGC 2026d).

Similarly, there is considerable transparency around the CGC's 5-yearly methodological reviews. The process through which these reviews are undertaken is clearly defined, state submissions are published, and the CGC's decisions and the reasons for these are documented (often with reference to how it has considered state feedback) (CGC 2025b).

In addition, the CGC has taken steps to improve transparency about how HFE is implemented in Australia by publishing short, accessible occasional and research papers focussing on different aspects of the system (CGC 2026h, 2026i).

… it should continue to explore opportunities to take transparency and consultation further

While the CGC exercises its key functions with a reasonable degree of transparency and consults well with states, neither transparency nor effective consultation are all-or-nothing propositions. In a process as complex and as consequential as recommending how GST revenue be distributed, there is almost always scope for improvement.

One potential opportunity for further transparency – which was raised by some inquiry participants and with which the PC agrees – relates to how the CGC manages potential trade-offs across its 'primary objective' of horizontal fiscal equalisation and its different 'supporting principles'.[2]

The CGC has recognised that applying these principles in its assessments can involve trade-offs and judgments on its part and indicated that when trade-offs are required, it would outline the reasons for its decisions (CGC 2025d, p. 313).

The PC examined the 2025 methodological review and found instances where the CGC– at least at a high level – documented how it considered different principles in its decisions (for example, with respect to considering the case for changing its 'mineral-by-mineral' approach as part of its mining assessment (CGC 2025d, pp. 50–51)). However, more comprehensive explanations (where possible) of how the CGC weighs up its objective of HFE and its different supporting principles would assist stakeholders to better understand why decisions have been made, maintain credibility and confidence in the CGC's assessments, and support consistency in CGC decision making.

Data is another area where inquiry participants identified opportunities to enhance transparency. For example, some participants noted that the CGC faces restrictions around sharing confidential data, which limits states' ability to fully replicate the CGC's calculations. While there may be legitimate confidentiality reasons that prevent data from being shared in full, it is important to recognise that this is not costless – it detracts from the system's transparency and limits states' capacity to effectively forecast – and should be minimised. The CGC has flagged that exploring opportunities to reduce data confidentiality restrictions could be in the remit of its newly formed Data Working Group (CGC, sub. 34, p. 21). The PC's view is that exploring these opportunities is worthwhile.

Further, some participants raised concerns that the CGC sometimes modifies data provided by primary sources (such as the Australian Bureau of Statistics (ABS)) if the data does not align with its requirements or methodology. This too should be undertaken only when necessary – maintaining consistency between publicly available data and the data used by the CGC helps to reduce uncertainty about how assessments are undertaken and supports transparency, replicability and confidence in the process.

[2] The CGC's supporting principles are: 'what states do'; policy neutrality; practicality; and contemporaneity. Box 1.1 contains more information about these principles.

There would be value in the Data Working Group exploring opportunities to make greater use of innovative, public data assets, including linked administrative data such as PLIDA and BLADE.[3] These assets may help improve assessments in areas where existing data is scarce, missing or imperfect, while increasing transparency by making greater use of data that is publicly available.

Where data limitations mean that the CGC has little choice but to adjust data for its purposes prior to use, more documentation that could be provided to stakeholders on the nature and basis of these changes would be beneficial.

The PC also encourages the CGC to consider the merits of trialling a broader consultation approach as part of its 5-yearly methodological reviews. At present, the CGC only seeks formal submissions from the states. Allowing other interested parties– such as service delivery organisations, academics, policy experts and members of the public – to make submissions would strengthen the evidence base for the CGC to draw on to inform decisions on any changes to its methodological approach.

Interim finding 5.1
The CGC has adopted an independent, consultative and transparent approach to its role, but should strive for continuous improvement

By recommending how GST revenue should be distributed, the Commonwealth Grants Commission (CGC) has a critical role in Australia's horizontal fiscal equalisation (HFE) system.

The CGC performs this role with a high degree of independence, maintains highly productive and consultative relationships with state treasuries, and undertakes its work with reasonable transparency. These characteristics strengthen the system.

However, HFE arrangements are complex, and efforts to continuously improve transparency are important. Given this, there would be value in the CGC exploring any opportunities to:

- more fully disclose how it weighs up its primary objective of HFE and its different supporting principles when considering changes to its methodological approach
- further address data confidentiality restrictions so that more data can be shared with key stakeholders
- make greater use of public data sources – including linked administrative data – to improve consistency between public-facing data and the data it uses
- better disclose the nature and basis of any adjustments it makes to public-facing data where those adjustments are necessary because of data limitations.

The CGC should also consider trialling a wider approach to consultation as part of its 5-yearly methodological review by accepting public submissions from interested parties beyond state governments.

[3] PLIDA and BLADE are integrated data assets managed by the ABS. PLIDA is the Person Level Integrated Data Asset. BLADE is the Business Longitudinal Analysis Data Environment.

5.2 The extent that the HFE system may be contributing to diverging outcomes should be monitored

Policy experimentation and diversity are a key source of benefits in a competitive federation. Heterogeneity of policy approaches is expected and should be welcomed. If a state discovers a productivity-enhancing reform (for example, a way of providing the same level of services at lower cost), then that is desirable from the point of view of that state's taxpayers as well as those in other states, whose governments can learn from the reform.

Fiscal equalisation should neither directly hinder nor help with such policy experimentation; that is why policy neutrality is such an important goal. However, so long as the HFE system's settings very directly allow one jurisdiction – or a small number of jurisdictions – to maintain a greater fiscal capacity than others, there is a material risk that the HFE system will drive some divergence in fiscal and service-delivery outcomes. This divergence may take many forms – it could include relatively lower taxes, more or higher-quality services, better infrastructure, or a stronger overall budget position. Any divergence can be expected to intensify with time, as the advantages associated with having a greater fiscal capacity compound. The consequences of significant and persistent differences in subnational governments' fiscal capacity– and consequently their ability to fund vital services – can be observed elsewhere, including in the United States (Schapiro 2020).

The PC's first-best reform direction significantly reduces differences in states' fiscal capacity arising through HFE by transitioning to a system that more closely resembles the one in place prior to the 2018 reforms (with a direction from the Australian Treasurer for the CGC to address costly dominant-state effects – interim recommendation 4.1). The point of this recommendation is not to eliminate all policy differences – rather it is that the HFE system should have no impact upon incentives to create policy differences. However, recognising that HFE can drive divergence in outcomes across states, if the current system is retained, or if another system is implemented that continues to enable some states to maintain a significantly greater fiscal capacity than others, the extent to which this contributes to a divergence should be monitored.

As such, the Australian Government should undertake regular analysis of the extent to which the settings of the HFE system are contributing to diverging state outcomes, drawing on data sets such as the Report on Government Services and Government Financial Statistics.[4] Such analysis would introduce a degree of transparency about the real-world impacts of maintaining a HFE system that allows some states to maintain a higher fiscal capacity than others – something that is currently lacking. It would provide policymakers – as well as the community more broadly – with evidence on the extent, nature and causes of any divergence in fiscal and service delivery outcomes, which would support a more informed debate about whether such divergence is socially or economically acceptable, sustainable over time, and consistent with the objectives sought through the HFE system.

[4] In the PC's view, using Report on Government Services data to help inform this analysis would be consistent with the recommendation of the *Review of the Report on Government Services and the Performance Reporting Dashboard* that there be additional quantitative, cross-sectional and qualitative analysis undertaken with that data (while noting that it was recommended in the review that the initial focus of additional analysis be on innovative or high-impact case studies) (Australian Government Department of the Treasury 2024, p. 4).

Interim recommendation 5.1
Monitoring the potential for the HFE system to contribute to diverging state outcomes

If the Australian Government's policy settings for the horizontal fiscal equalisation system allow one or more states to maintain a fiscal capacity that is significantly stronger than that of others – as current settings do – the Government should undertake regular analysis that examines the extent to which this is contributing to diverging state outcomes.

5.3 Non-GST Commonwealth payments can be administered more efficiently

The Australian Treasurer should publish reasons for their decisions to quarantine payments from GST distribution

Outside of the distribution of GST, the Australian Government also provides grants to states to support, incentivise or reward the delivery of particular services, projects, and reforms. These grants, including payments for specific purposes (SPPs) and other general revenue assistance, vary in their quantum, duration and subject matter, but are concentrated in policy areas where the constitution implies the states are primarily responsible for service delivery (Australian Government Department of the Treasury 2022e, p. 3). These areas include health, education, infrastructure, housing and the environment (Commonwealth of Australia 2025, p. 63).

In line with the instructions provided to it, the CGC considers '*payments which support state services, and for which expenditure needs are assessed*' when determining GST relativities (CGC 2025d, pp. 295–296). This means that assessable grants increase a state's assessed revenue and, to the extent the expenditure needs associated with the payment occur within other states, reduces the amount of GST revenue that state requires to achieve HFE.

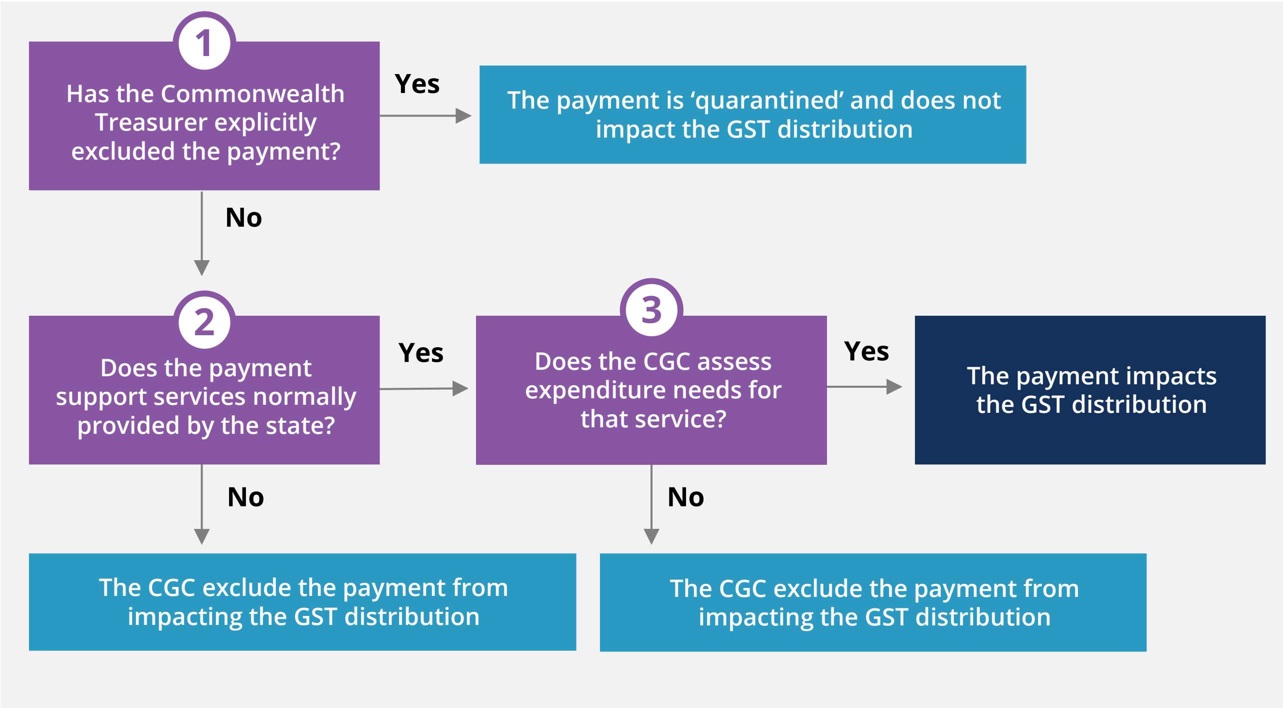
These grants are not distributed equally amongst the states.[5] If these payments were excluded from GST distribution assessments, states that receive relatively less would face a fiscal disadvantage not addressed by the GST distribution system (CGC 2022a, p. 4).

States have a direct financial incentive to have Commonwealth payments they have received excluded from GST distribution calculations. Where a state receives an excluded payment, any contribution this payment makes to their fiscal capacity – even indirect contributions, such as by covering an expenditure the state would otherwise incur – will not be equalised through the distribution of GST revenue.

Three types of non-GST Commonwealth payments are not considered in – and therefore do not affect – the GST distribution (figure 5.1).

[5] Differences in the distribution of these payments between states is discussed further in the supporting paper to this interim report: *Understanding Australia's system of fiscal transfers*.

Figure 5.1 – There are 3 reasons a Commonwealth payment would not affect the GST distribution



Source: Adapted from CGC (2025f, p. 210).

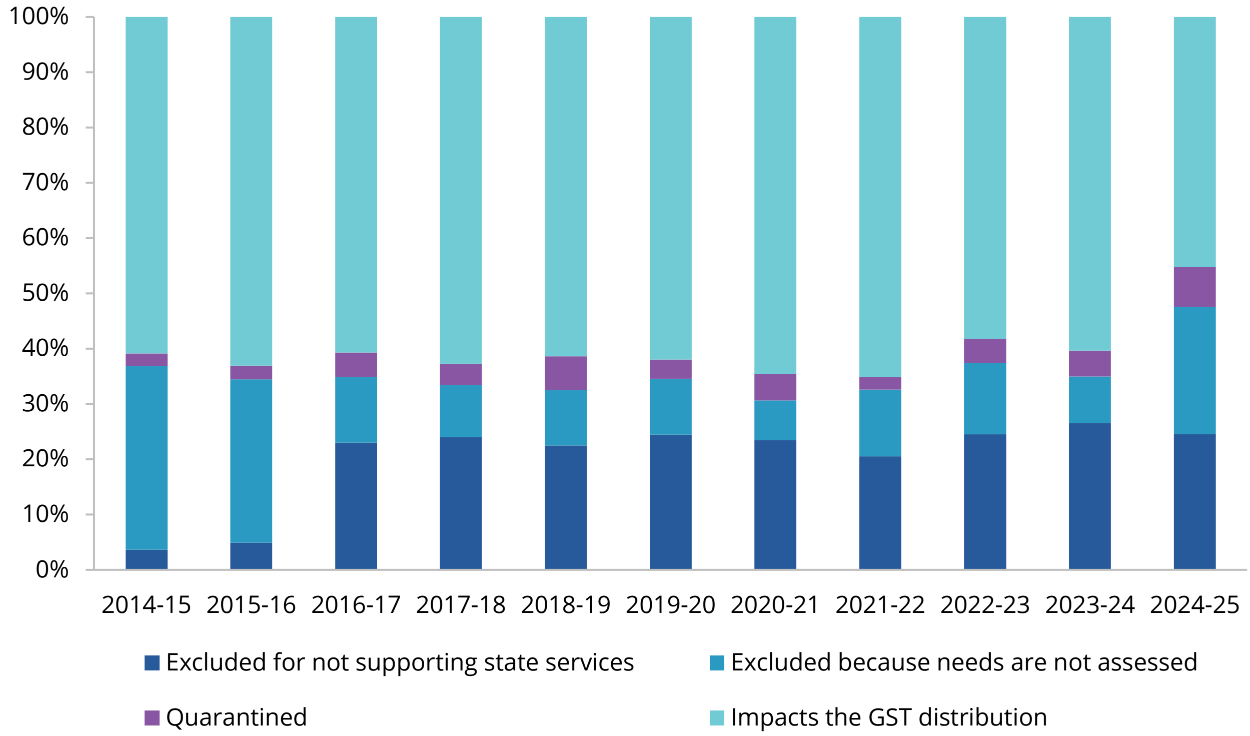
Two types of excluded payments do not meet the CGC's assessment criteria: payments which do not support state services (such as payments supporting non-government schools), and payments for which expenditure needs are not assessed by the CGC (either because of data constraints, or because the CGC cannot identify a measure of expenditure need that is not controlled by state policy choices (CGC 2022d, p. 4)). States can advocate to the CGC that a particular payment does not support a state-provided service or that needs are not assessed and the CGC publishes their decisions and associated reasons (CGC 2025f, p. 212, 2026j).

The other way a payment can be excluded from affecting the GST distribution is through an explicit instruction from the Australian Treasurer (Australian Government Department of the Treasury 2022b, p. 10). The Treasurer can use their discretion to exclude payments on a case-by-case basis, a practice known as 'quarantining' the payment.

In the 10 years to 2024–25, approximately 40% of all non-GST Commonwealth payments (by value) have not affected the GST distribution (figure 5.2). Most of these payments have been excluded on the basis that they do not support state-government services, such as payments to non-government schools and payments to local governments distributed through the states. The second most common reason a payment is excluded is because the CGC does not assess the expenditure needs associated with the payment. Payments excluded on this basis include some related to natural disaster recovery, state-specific infrastructure projects and environmental protection services. The share of payments quarantined by the Treasurer's discretion – the final way a payment can be excluded – is relatively low: usually between 2-7% of all payments, or just over $7 billion in 2024–25.

Figure 5.2 – Commonwealth payments are increasingly not affecting the GST distribution

Share of Commonwealth payment dollars by effect on GST distribution, 2014-15 to 2024–25



Data prior to 2014–15 is not considered, as prior to this time all payments to non-government schools were treated as impacting the GST distribution. The marked transition in payments supporting services where needs are not assessed from impact payments in 2024–25 is driven by the treatment of payments to public schools under the Better and Fairer Schools Agreement (the education sector NFFA). The Australian Government instructed the CGC not to unwind the different funding amounts provided to states under that agreement through the distribution of GST revenue, which left the CGC without a way to measure expenditure needs (CGC 2026, p. 31; Treasury 2025, p. 2).

Source: PC estimates using Commonwealth of Australia (2025 and various other years) and CGC (unpublished data).

Without the power to quarantine certain payments, the Australian Government would be limited in its ability to use payments to incentivise states to undertake nationally significant reforms (such as National Competition Policy payments, which minimise costs for businesses transacting across the country) or target specific structural disadvantages that are not addressed through the HFE process.

However, the current process for quarantining payments has contributed to inconsistent outcomes, with some payments for similar purposes being treated differently without a clear basis for distinguishing between them. For example, some payments which support state-specific infrastructure have been quarantined (such as payments in 2024–25 to support the Macquarie Point Urban Redevelopment in Tasmania (Australian Government Department of the Treasury 2025, p. 1), which includes construction of a new stadium (King and Abetz 2026)), while others have not (such as payments to support construction of a stadium in Townsville in 2020-21 (CGC 2020b), or to support the upgrade of a stadium in Parramatta in 2012–13) (CGC 2015b, p. 603). Similarly, some payments supporting national biosecurity have been quarantined (such as payments supporting pest and disease preparedness and response), while others have not (such as payments supporting Australia's protection from escalating exotic animal diseases) (CGC 2026j).

This lack of consistency strengthens the incentive of states to seek quarantining for every Commonwealth payment, rather than undertake a principle-based analysis of which payments should be included in the HFE system. Furthermore, given the different net fiscal benefits of payments with different treatments in GST distribution arrangements, inconsistency can erode public trust in the system due to perceptions of bias or favouritism.

To preserve the benefits of quarantining payments in exceptional circumstances, while also increasing transparency and mitigating the unintended consequences of the current approach, state governments should be required to publicly submit a formal written request to the Australian Treasurer when they are seeking a payment be quarantined. The Australian Treasurer should be required to publicly respond to each request with a decision and supporting reasons. Both the application and the decision should clearly outline why a payment should (or, where supporting decisions to not exclude a payment, should not) be permitted to increase a state's fiscal capacity outside of the HFE system. All applications and decisions should be published. This process is not intended to create fixed positions from which the states or Australian Treasurer cannot deviate but would impose greater accountability on governments to explain their positions.

The PC considers that guidelines which govern when payments should be quarantined would improve consistency. Guidelines would necessarily limit the Treasurer's flexibility to address changing state circumstances through the FFR system. Successive reviews have suggested the creation of guidelines (Commonwealth of Australia 2012, pp. 70–71; PC 2018, pp. 185–186), and although the Australian Government accepted this recommendation (Australian Government 2018, p. 25), guidelines still do not exist. This is, at least in part, because states have not reached agreement about how prescriptive guidelines should be and which types of payments should fall within them.[6] The PC's recommended approach would increase transparency and consistency in quarantining without incurring these costs.

Interim recommendation 5.2
There should be a more transparent approach for quarantining Commonwealth payments

Where a state government seeks a payment to be quarantined from GST distribution calculations, it should be required to publicly write to the Australian Treasurer to formally request this. Requests should articulate why the state believes that the payment should be permitted to increase their fiscal capacity outside the horizontal fiscal equalisation system.

The Australian Treasurer should be required to publicly respond to all requests with a decision and their supporting reasons. In their response, the Treasurer should address the substantive elements of the application, including outlining any factors that distinguish the payment from previous similar payments.

To support transparency, all applications and their associated decisions should be tabled in Parliament at the time they are made and published in an appendix to the annual GST relativity update terms of reference provided to the Commonwealth Grants Commission.

[6] For example, the NSW Government (sub. 61, p. 20) submitted that quarantining should be limited to cases where the state is supported to undertake an action on behalf of Australia or the Australian Government, while the Northern Territory Department of Treasury and Finance (sub. 39, p. 22) and the Queensland Government (sub. 62, p. 20) suggested payments intended to address outcomes beyond delivering average service quality should fall within any quarantine guidelines.

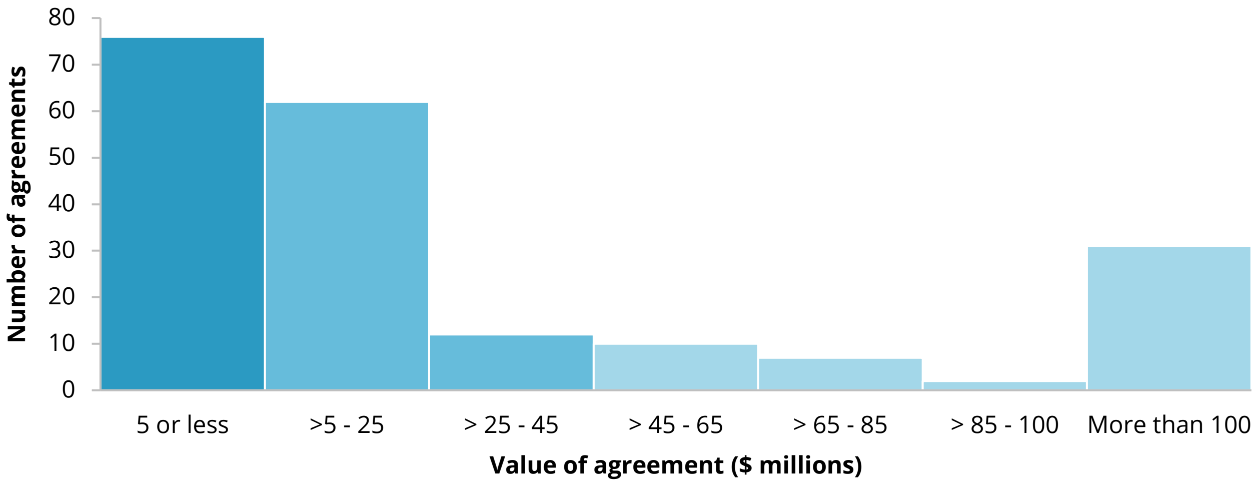
Federation Funding Agreement schedules that are high cost, geographically concentrated and low value should be removed

The FFR system is underpinned by principles intended to support the system's efficiency, transparency and outcomes that benefit all Australians. In August 2020, National Cabinet endorsed 8 overarching principles to guide the construction and negotiation of agreements, complementing the existing agreement design principles outlined in the Intergovernmental Agreement on Federal Financial Relations (IGAFFR) (Australian Government Department of the Treasury 2022d, p. 1, 2022c, p. 4). These principles include – among others – limiting the number of low value agreements to minimise administrative costs; providing states with autonomy to deliver services and infrastructure; and ensuring support from the Australian Government is closely linked to national objectives or where the benefits are likely to exist beyond the boundaries of a single state (Australian Government Department of the Treasury 2022d, pp. 1–2, 2022c, p. 4).

Despite these principles, many agreements do not appear to fully accord with them. For example, in 2024–25, 76 agreements – or just under 40% – were for less than $5 million (figure 5.3). The median agreement is for just under $10 million, indicating that a large share of agreements involve relatively small amounts of funding and may impose administrative costs disproportionate to their value (PC estimates, based on Commonwealth of Australia 2025).

Figure 5.3 – Many Commonwealth payments are relatively low value

Number of funding agreements by value in 2024–25, $ millions



Source: PC estimates using Commonwealth of Australia (2025).

Some of these agreements also have highly localised benefits. For example, the purpose of one agreement was to enable one Western Australia community group to purchase a bus, desktop computer, and 6 fabric covered dining chairs (Butler and Punch 2024). Another agreement focused on the construction of a mountain bike trail in the hills surrounding one Victorian town (King and Shing 2025).

There is a legitimate case to be put that the specific projects captured by these types of agreements should not receive Australian Government funding. However, even if that case is rejected, funding these projects through this mechanism can create high administrative costs per dollar spent. For example, with respect to the example outlined above, the Victorian Government must produce 4 progress reports and a completion report to demonstrate that the funding has been used to construct the mountain biking track, and the Australian Government will need to review these reports to ensure compliance. These administrative costs, combined with the cost of negotiating the agreement, compound the initial fiscal cost of subsidising the project. When the benefits of these projects are highly geographically concentrated, or the funding received is relatively small, the net benefits of these agreements for the broader community is reduced.

Inquiry participants also suggested that some agreements had deliverables or implementation plans which were primarily controlled by the Australian Government, rather than being jointly developed with the states (ACT Government, sub. 38, p. 9; Victorian Government, sub. 59, p. 46). For example, the National Agreement for Foundational Supports stipulates that children aged 8 and under with autism and/or developmental delay with low to moderate support needs must be the first priority cohort (Albanese et al. 2026, p. 10), irrespective of whether other cohorts require support more urgently in particular states. While the Australian Government needs to ensure that funds are spent for the agreed purpose, the subsidiarity principle suggests that overly prescriptive agreements are undesirable, as state governments are often better placed to determine the best allocation of funding to achieve a specific outcome, given their closer proximity to the issues facing their residents (chapter 2).

Interim recommendation 5.3
Ensure Federation Funding Agreement schedules provide net benefits for the community

To maximise the benefits of intergovernmental funding agreements, the Australian Government and state governments should abide by the federal financial relations principles to which they have already agreed, including minimising the number of low value agreements with highly localised benefits.

This would ensure that the benefits resulting from agreements outweigh the costs associated with them, including the administrative costs of negotiation, compliance and monitoring.

The IGAFFR and its schedules are outdated and should be modernised

The IGAFFR and the associated legislation lay the groundwork for an already complex part of Australia's policy and intergovernmental landscape. But in its current outdated form, they make it difficult to discern how the system operates in practice without a substantial investment of time and resources. A clear legislative grounding, expressed in simple, contemporary and consistent language, would support public accountability and transparency. The IGAFFR, and its accompanying legislation and schedules, should be updated to provide this clarity.

In some instances, the lack of timely updating has left key responsibilities within the intergovernmental landscape unclear. For example, Schedule C assigns the responsibility of assessing eligibility for reward payments to the COAG reform council, a body which has not existed since 2014 (Cormann 2014).[7] This creates uncertainty about how reward payments would be assessed in practice. Without a clear assessment process, the Australian Government's ability to use financial incentives to encourage state policy reform

[7] Though the Australian Government at the time suggested the PC would take over the residual responsibilities of the abolished council, the current schedule suggests that no replacement body has been established (Australian Government Department of the Treasury 2022a, p. 1; Cormann 2014). The PC has never been instructed to undertake this function.

may be weakened, and states may face uncertainty about whether eligible reforms will be rewarded. Previous inquiries have also identified this as an issue which should be resolved (ANAO 2018, p. 9).

Another consequence has been reduced clarity around which payment terms and schedules remain active. For example, Schedule D contains payment schedules for national specific purpose payments – a funding mechanism which is now inactive (Australian Government Department of the Treasury 2022b, pp. 13–14). While maintaining a historical record of previous payments is useful, an active schedule of the IGAFFR – which contains many terms relevant to the financial relationship between governments today – is not an appropriate place for this. Similar issues exist within the *Federal Financial Relations Act 2009* (Cth). The legislation includes references to national specific purpose payments for disability services (s 13) and temporary energy bill relief (s 15E), both of which are inactive. On the other hand, NFFAs that are active, such as for foundational supports and justice, do not appear at all.

The language of the IGAFFR itself is also outdated. For example, there is a combination of references to 'National Partnership payments' and 'FFA schedules', despite the latter replacing the former in 2020 (Australian Government Department of the Treasury 2022e, pp. 4, 5).

Interim recommendation 5.4
Update the IGAFFR, its schedules, and the enabling legislation

The Intergovernmental Agreement on Federal Financial Relations (IGAFFR) and its schedules, and the *Federal Financial Relations Act 2009* (Cth) should be updated to reflect the current federal financial relations architecture. This should include:

- replacing references to National Partnerships with Federation Funding Agreement schedules in the IGAFFR, or where references to national partnerships are essential, amending the reference to the past tense
- removing references to the COAG Reform Council in Schedule C of the IGAFFR and clarifying which body has taken over as the independent assessor of eligibility for reward funding
- removing references to historical payment schedules in Schedule D of the IGAFFR or at least consolidating the active elements of the schedule to the front of the document
- amending the *Federal Financial Relations Act 2009* (Cth) to remove provisions for now ceased payments, and to add provisions for active payments that are not referenced in the Act.

5.4 CFFR's role in the FFR system is diminishing

The Council on Federal Financial Relations (CFFR) – which comprises the Australian Treasurer and the Treasurer of each of the states – is the key intergovernmental forum for managing Australia's federal fiscal relations. Among other things, CFFR oversees Commonwealth-state funding agreements and cross-jurisdictional actions to improve regulation and productivity. CFFR also provides a forum for Treasurers to collaborate and respond to shared economic and fiscal policy issues that can affect the economic performance of all jurisdictions (CFFR 2023; Commonwealth of Australia nd).

Given this role, a well-functioning CFFR is central to the effective operation of the broader FFR system. The PC has examined how CFFR has operated since 2023 – when intergovernmental collaboration across the Federation began returning to more business-as-usual arrangements following the disruption of the

COVID-19 pandemic. This examination suggests that CFFR's prominence in administering the FFR system has diminished, and some changes are needed to restore its value and improve its transparency.

CFFR should meet more regularly

CFFR only met 3 times in 2023, 2 times in 2024 and 3 times in 2025. And there were often long gaps between meetings – for example, in 2024, there was an 8-month gap between the 2 meetings held that year, while CFFR's first meeting in 2025 did not occur until mid-August. As of the start of August – when this report was finalised – CFFR had met once in 2026. [8]

CFFR's agenda is too important for it to be meeting so sporadically. A more consistent meeting cadence – such as once every 3 months, which would be in line with its terms of reference – would give CFFR more opportunity to consider longer-term economic and fiscal issues that could affect the Federation. This would support more effective implementation of CFFR's forward work program by giving Treasurers more regular opportunities to monitor progress, resolve emerging issues and provide direction on how work should proceed. A more regular schedule would also be conducive to maintaining goodwill across Treasurers – something that is harder to sustain when there are fewer opportunities to meet.

More regular meetings would also ensure that there are more opportunities for consultation on any changes to the GST distribution system or other significant funding instruments between the Australian Government and the states.

States' ongoing engagement through the Board of Treasurers[9] suggests that state Treasurers continue to have a strong appetite for collaboration. More regular CFFR meetings – where the Australian Treasurer is an active participant – would help ensure this collaborative spirit is not wasted.

Moving to more regular meetings provides CFFR with an opportunity to review how items proposed by states are placed on meeting agendas. The PC heard from representatives from several states that it was difficult to ensure items that states wished to discuss were on CFFR's agenda and given sufficient discussion time at meetings. This suggests that the existing process for agreeing agendas may not be working as effectively as it can be. Given the purpose of CFFR is progressing economic and fiscal reforms of national significance, all members should have a clear opportunity to raise matters that they consider require collective attention.

CFFR's meeting outcomes should be more transparently reported

CFFR's current practice is to report meeting outcomes as a media release from the Australian Treasurer. The PC has reviewed the outcomes for CFFR meetings held since the beginning of 2023, where these have been published,[10] and is of the view that there are opportunities to more clearly and transparently document the decisions made at CFFR.

First, CFFR should summarise meeting outcomes in the form of an official communiqué. This would provide a clearer public record that the outcomes reached by CFFR are agreed and owned by all

[8] These findings are based on a list of CFFR meeting dates provided to the PC by the Australian Treasury.

[9] The Board of Treasurers comprises the Treasurers of each of the states with its role being to *'collaborate on issues of common interest, advance national reform priorities from a state and territory perspective, and foster more constructive and effective engagement with the Commonwealth government'* (Government of South Australia 2026).

[10] The PC found a record for 6 of the 9 CFFR meetings held since 2023.

governments, which in turn, can improve accountability and collective ownership to see these decisions through. The current practice of publishing meeting outcomes as media releases from the Australian Treasurer risks implying that it is the Australian Government driving and owning the decisions made at CFFR, even where there has been agreement by all parties.

Second, meeting outcomes should be published on a single, enduring public repository that is separate from the Treasurer's ministerial media website – akin to how National Cabinet meeting outcomes are published (PM&C 2026). Like National Cabinet, CFFR makes consequential decisions that can have significant and lasting implications across the Federation. For accountability, continuity and posterity, these decisions should be published in the one place – such as on the Australian Treasury or the Federal Financial Relations websites.

There should be clearer guidance on CFFR's referral pathways

Intergovernmental forums work best when there are clear pathways for escalating issues that require the attention of higher decision makers. However, at present, the criteria for referring matters to CFFR are somewhat opaque. CFFR's terms of reference do not specify the circumstances in which referrals from other intergovernmental forums should occur, and the formal guidelines for intergovernmental meetings only suggest that Ministerial Councils '*engage with CFFR with respect to National Partnerships and other funding agreements'* or *'when needed* ' (PM&C 2023, pp. 2–3).

There would be value in greater clarity about when Ministerial Councils should refer matters to CFFR for consideration, especially given CFFR's remit extends beyond just intergovernmental funding agreements to broader matters such as productivity and regulatory reform. In particular, there should be a clearer articulation of when CFFR expects to have matters referred to them, including criteria for when referral should occur. This would remove some of the ambiguity associated with the existing referral process, and provide a clearer basis for Ministerial Councils to refer matters to CFFR where these expectations are met.

Additionally, there should be clearer guidance about when CFFR should escalate matters to National Cabinet for consideration. While there is some guidance on the process by which matters can be referred to National Cabinet[11], there is limited direction on the circumstances where it should occur. The PC heard this has contributed to the boundary between National Cabinet and CFFR becoming somewhat unclear – and has led to some key decisions concerning the fiscal relationship between the Australian Government and states 'defaulting' to National Cabinet without first being given due attention at CFFR.

[11] The *Guidance for Intergovernmental Meetings* indicates if a Ministerial Council (such as CFFR) wishes to escalate a matter to National Cabinet, its Chair should write to the Prime Minister seeking escalation and that clear options on courses of action should be presented for National Cabinet's consideration (PM&C 2023, p. 3).

Interim recommendation 5.5
Improving the functioning of CFFR

The Council on Federal Financial Relations (CFFR) should:

- commit to a more regular meeting cadence and review the agenda-setting process to ensure that state-led items are given sufficient time for discussion
- publish its outcomes as a communiqué rather than as a media release by the Australian Treasurer, and publish these outcomes on an enduring central repository, such as the Australian Treasury or Federal Financial Relations websites
- provide clearer guidance on when Ministerial Councils are expected to refer matters to CFFR for consideration.

Additionally, CFFR should work with National Cabinet to clarify the circumstances when CFFR should escalate matters to National Cabinet for First-Ministers' consideration.

5.5 Governments should take steps to improve their fiscal transparency

As a building block for understanding government finances, more attention should be given to the Government Finance Statistics

The Government Finance Statistics (GFS) – published by the ABS – provides a framework for measuring and reporting the financial activities and positions of Australian governments, covering measures such as revenue, expenses, net operating balance, assets and liabilities in a way that can support comparisons across governments and across time (ABS 2026b). The GFS is an important data source for a range of analysis and reporting and is one of the key data sources informing the CGC's assessment of states' fiscal capacity. This inquiry has drawn extensively on the GFS too – particularly when examining the fiscal positions of state governments (chapter 3).

The range of uses of the GFS underscores its value and the importance of its accuracy, completeness and accessibility. While the PC was not presented with any evidence suggesting there are fundamental problems with the GFS framework or the way it is used, it did hear – and its own use of the data suggests – there are opportunities to enhance its usefulness, namely by:

- state governments strengthening their processes for validating GFS data before it is submitted to the ABS. The PC heard that the quality assurance of GFS data is sometimes limited, increasing the risk of avoidable inaccuracies. This is particularly important in instances where the GFS data is highly disaggregated, when errors or inconsistencies can materially impact individual data items.
- the ABS exploring opportunities to improve its documentation explaining the structure, classifications and relationships within the GFS. At present, these can be difficult to understand without direct guidance from the ABS. Clearer documentation would improve transparency and support users to draw on and interpret the data more consistently.

Interim recommendation 5.6
Enhancing the GFS

To further enhance the accuracy and utility of the Government Financial Statistics (GFS):

- state governments should strengthen their processes for validating GFS data before it is submitted to the Australian Bureau of Statistics (ABS)
- the ABS should explore opportunities to improve its public-facing documentation explaining the structure, classifications and relationships within the GFS.

All governments should publicly report on their long-term fiscal sustainability

Long-term, publicly facing fiscal modelling has a range of benefits. It supports informed judgements about the fiscal outlook and sustainability of government decisions, enables frank conversations about emerging fiscal pressures and policy trade-offs, and strengthens accountability for managing public finances in a way that supports intergenerational equity.

But despite these benefits, public long-term fiscal updates are produced by relatively few Australian governments. The PC understands that only the Australian Government and the Governments of New South Wales (in the form of an intergenerational report) and Tasmania (in the form of a long-term fiscal sustainability report) regularly publish dedicated, whole-of-government reports containing long-term fiscal projections (Commonwealth of Australia 2023; Government of Tasmania 2026; NSW Government 2021a).[12]

Long-term planning is central to effective budget stewardship and, as such, the absence of public modelling on governments' long-term fiscal sustainability in some jurisdictions is a gap that should be addressed. Filling this gap is all the more critical given the fiscal pressures that many states are facing (appendix D).

The Australian and all state governments should commit to undertaking regular, public reporting on their long-term fiscal sustainability. At a minimum, this reporting should demonstrate the impact of maintaining existing government policies over the longer term and ideally would also assess how key demographic or economic trends can be expected to impact on the long-term budget position. But such reporting could also go further – it is also a way to take stock of the broader economic opportunities and challenges facing economies and how these can be responded to in a way that unlocks the greatest benefits (or imposes the least costs) for citizens.[13]

[12] Some jurisdictions have completed ad-hoc reporting on their fiscal sustainability – such as the 2026 inquiry into the fiscal sustainability of the Australian Capital Territory (Eslake 2026) – but do not undertake reporting on a regular basis, or do not extend past the forward estimates.

[13] An example where reporting has looked at broader opportunities is the 2021–22 New South Wales Intergenerational Report, which explored the potential economic and fiscal benefits from increasing women's labour force participation in New South Wales (NSW Government 2021b, p. 45).

In jurisdictions with regular long-term fiscal reporting, the requirement to produce and publish this analysis is set out in legislation. [14] This is likely no coincidence and suggests that a legislative basis is an important enabler – without a requirement to report regularly on financial sustainability, governments may simply have little incentive to do so. This is especially so given that such reporting can initiate important – but potentially politically challenging – debate on governments' policy priorities and their approach to fiscal management.

Interim recommendation 5.7
Improving governments' long-term fiscal sustainability reporting

Governments should ensure that they produce regular, long-term fiscal sustainability reporting – such as a 5-yearly intergenerational report – that demonstrates the fiscal impacts of maintaining existing government policies over the long term. A legislative requirement to produce this reporting should be introduced in jurisdictions that do not already have this.

[14] The relevant legislative provisions are: the *Charter of Budget Honesty Act 1998* (Cth), ss. 20–21; the *Fiscal Responsibility Act 2012* (NSW), s. 8(e); and the *Charter of Budget Responsibility Act 2007* (Tas), schedule 1; part 6A.

A. Public engagement

This appendix outlines the engagement process undertaken for this inquiry and lists the organisations and individuals who participated.

The Productivity Commission received the terms of reference for this inquiry on 24 September 2025.

An issues paper was released on 21 November 2025 inviting public submissions and brief comments.

In total, 64 public submissions (table A.1) and 50 brief comments were received. The submissions and brief comments are available online at: www.pc.gov.au/inquiries-and-research/gst-reforms/submissions/.

During the inquiry, the PC held consultations (table A.2) and convened an academic roundtable (table A.3).

The PC would like to thank all those who participated in this inquiry.

Table A.1 – Submissions

Participants	Submission no.
ACT Government	38
Amanda Haley	8
Andrew Gibbs	25
Andrew Wilkie MP	12
Anglicare Tasmania	17
Association of Mining and Exploration Companies (AMEC)	16
Australian Centre for Federalism	23
Australian Services Union (ASU) Victorian and Tasmanian Authorities and Services Branch	64
Break O'Day Council	20
Brendan McCarthy	29
Canberra Region Joint Organisation	42
Centre for Independent Studies (CIS)	63
Chamber of Commerce and Industry WA (CCIWA)	49
Chamber of Minerals and Energy of Western Australia (CME)	50
Chris Murphy	45
Circular Head Council, Tasmania	7
City of Launceston	60
City of Melbourne	47

Participants	Submission no.
Clive Brooks	6
Commonwealth Grants Commission (CGC)	34
Councils of Social Service (COSS)	28
Country Mayors Association of NSW (CMA)	58
Dean Winter MP	14
Faith Housing Australia (FHA)	41
Glenorchy City Council	53
Government of South Australia	13
Government of Western Australia	37
Government of Western Australia – WA people's submission	33
Greater Hobart Strategic Partnership (GHSP)	55
Howard Ong	21
Huon Valley Council	19
Institute of Public Affairs (IPA)	35
John Purcell	44
John Tremayne	5
Kate Chaney MP	31
Ken Clarke	32
Municipal Association of Victoria (MAV)	10
Northern Territory – Department of Treasury and Finance	39
NSW Government	61
Paul Lindwall	1
Peter Raffles	24
Queensland Government	62
Real Estate Institute of Australia (REIA)	36
Rob Fairs MP	15
Robert Paturzo-Elliott	9
Rod Glover	46
Rosalie Woodruff MP	26
Russell Morse	2
Sam Gow	4
Sandra Brewer MLA	52
Saul Eslake	3
Selena Uibo MLA	40
Senator Jacqui Lambie	11

Participants	Submission no.
Senator the Hon Michaelia Cash	22
Stuart Hocking	27
Tasmanian Forest Products Association (TFPA)	18
Tasmanian Government	48
The Australia Institute	54
The Hon Colin Barnett	30
The Hon Mathias Cormann	56
Victorian Chamber of Commerce and Industry	57
Victorian Government	59
Western Tiger Corporate Advisors	51
Yothu Yindi Foundation (YYF)	43

Table A.2– Consultations

Participants
ACT Chief Minister, Treasury and Economic Development Directorate
ACT Treasurer – the Hon Chris Steel
ALGA and member associations
Australia Institute
Australian Bureau of Statistics
Australian Government Department of the Prime Minister and Cabinet
Australian Government Treasury
Australian Government Parliamentary Budget Office
Australian Taxation Office
Business Council of Australia
Centre for Independent Studies
Chris Murphy
Committee for Economic Development of Australia
Commonwealth Grants Commission
e61 Institute
Grattan Institute
Huw McKay
Institute of Public Affairs
New South Wales Treasurer – the Hon Daniel Mookhey
New South Wales Treasury
Northern Territory Department of Treasury and Finance

Participants
Northern Territory Opposition Leader – Selena Uibo MLA
Northern Territory Treasurer – the Hon Bill Yan
Organisation for Economic Co-operation and Development (OECD)
Professor Bob Breunig and Dr Peter Varela
Queensland Productivity Commission
Queensland Treasurer – the Hon David Janetzki
Queensland Treasury
S&P Global
Saul Eslake
South Australian Department of Treasury and Finance
South Australian Treasurer – the Hon Tom Koutsantonis
Tasmanian Department of Treasury and Finance
Tasmanian Shadow Treasurer – Dean Winter MP
Tasmanian Treasurer – the Hon Eric Abetz
Victorian Department of Treasury and Finance
Victorian Treasurer – the Hon Jaclyn Symes
Western Australian Department of Treasury and Finance
Western Australian Shadow Treasurer – Sandra Brewer MLA
Western Australian Treasurer – the Hon Rita Saffioti
Yothu Yindi Foundation

Table A.3 – Academic roundtable

Horizontal Fiscal Equalisation and the 2018 GST Distribution Reforms – 15 April 2026 Participants
Alan Fenna – Curtin University
Tracy Fenwick – Australian National University
Thiago da Silva – Australian National University
Chris Murphy – Australian National University
Yan Xu – University of New South Wales
Neil Warren – University of New South Wales
Jonathan Pincus – Adelaide University

Abbreviations

Abbreviation	Definition
ABS	Australian Bureau of Statistics
CAGR	compound annual growth rate
CFFR	Council on Federal Financial Relations
CGC	Commonwealth Grants Commission
COAG	Council of Australian Governments
EPC	equal per capita
FBO	Final Budget Outcome
FFA	Federation Funding Agreement
FFR	federal financial relations
GDP	gross domestic product
GFS	Government Finance Statistics
GSP	gross state product
GST	Goods and Services Tax
HFE	horizontal fiscal equalisation
HFI	horizontal fiscal imbalance
IGA	intergovernmental agreement
NFFA	National Federation Funding Agreement
NoWO	No Worse Off (guarantee)
OECD	Organisation for Economic Co-operation and Development
PC	Productivity Commission
VFI	vertical fiscal imbalance

Glossary

Term	Description
Assessed relativities	Relativities that compare each state's relative capacity to raise revenue with its relative cost of providing services. Assessed relativities match a state's assessed expenditure with its assessed revenue (including GST). Without the 2018 reforms, GST relativities would equal assessed relativities.
Current distribution system	The Commonwealth Grants Commission's assessment of equalisation following the 2018 reforms, after the conclusion of transitional arrangements for the new equalisation standard.
GST relativities	Relativities that have been adjusted so that if a standard state's relativity is below the GST relativity floor, its relativity is adjusted up to the 0.75 floor (along with the relativities of any other states that have had their relativities lifted to match the standard state). All other states' relativities are adjusted down on a population share basis to accommodate this. GST relativities are the 'final numbers' in the relativity calculation process. The Commonwealth Grants Commission recommends these relativities to the Australian Treasurer for the distribution of the GST pool.
New fiscal equalisation standard	The fiscal equalisation standard introduced as part of the 2018 reforms – requiring that no state has a GST relativity lower than whichever of New South Wales or Victoria has the greatest fiscal capacity.
Non-GST Commonwealth payments	Grants provided by the Australian Government to states outside of GST payments. These payments – including payments for specific purposes and other general revenue assistance – support, incentivise or reward the delivery of particular services, projects, and reforms.
Pre-2018 distribution system	The Commonwealth Grants Commission's assessment of full equalisation: comprising the GST distribution methodology used prior to the 2018 reforms, plus changes from 2021 and 2025 methodology reviews.
Standard state benchmark	The relativity of whichever of New South Wales or Victoria has the greatest fiscal capacity. Any state that has a greater fiscal capacity than (and a lower assessed relativity than) this benchmark will have its relativity increased to the benchmark as part of calculating standard state relativities.
Standard state relativities	Relativities that have been adjusted so that no state has a relativity less than whichever of New South Wales or Victoria has the greatest fiscal capacity (the 'standard state'). Any state that has a greater fiscal capacity than (and has a lower assessed relativity than) the standard state will have its relativity increased. All other states' relativities are adjusted down on a population share basis to accommodate this.
Tied grants	Payments to states that must be used for pre-agreed purposes and are usually made in policy areas where the states are primarily responsible for service delivery (such as health, education or infrastructure). Tied grants are a subset of non-GST Commonwealth payments.

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