The Hon Mathias Cormann AC

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By email: gst.reforms@pc.gov.au

Dear Commissioners,

Re: Supplementary Submission – Response to the Interim Report of the Inquiry into the 2018 GST Distribution Reforms

Thank you for the opportunity to respond to the Commission's interim report, published this month. This supplementary submission builds on my submission of 9 March 2026 (sub. 56) and responds directly to the interim report's findings and preliminary recommendations, in support of a substantially revised final report.

I want to be candid with the Commission, as I was in my first submission. I was genuinely surprised and concerned by the interim report. It is a report which confirms that the pre-2018 system drove Western Australia's Goods and Services Tax (GST) relativity to 0.30 – the lowest of any state in the history of the Australian Federation – and which acknowledges that this outcome strained community acceptance of horizontal fiscal equalisation (HFE) itself. It is a report which concedes that the floor and the new equalisation benchmark have shielded Western Australia from a repeat of those extremes, exactly as they were designed to do, and that the no-worse-off guarantee has ensured that no state or territory has been left worse off. And yet its central preliminary recommendation is to return to the very system that produced the crisis the 2018 reforms resolved. In my respectful view, that conclusion does not follow from the report's own analysis, and I urge the Commission to reconsider it before finalising its report.

1. What the interim report gets right

The interim report correctly confirms the scale and singularity of the problem the 2018 reforms addressed. No state in the history of the Federation had ever experienced anything approaching Western Australia's position. On the Commonwealth Grants Commission's (CGC) own historical data, no other state's relativity has ever fallen materially below approximately 0.85. Western Australia's fell to 0.30, with no floor beneath it and no mechanism for timely correction. The interim report's acknowledgement that this outcome was straining public support for equalisation itself (interim finding 1.2) is important, because it confirms that the 2018 reforms responded to a genuine structural crisis, not a political convenience.

I also welcome the interim report's governance recommendations. Genuine cross-jurisdictional consultation before any future change to distribution arrangements, more regular engagement through the Council on Federal Financial Relations, and greater transparency around Commonwealth payments to states are all sensible improvements which I support.

2. The cost of the reforms: a legitimate concern, but the wrong conclusion

The interim report's central empirical finding is that the reforms have cost approximately $23 billion to 2024–25 against an original estimate of around $5 billion. That is a legitimate matter for scrutiny.

It is important to be precise about where that money actually went. The overwhelming majority of the cost is the no-worse-off guarantee: additional Commonwealth payments made not to Western Australia, but to every other state and territory, to ensure they lose nothing from the decision that no more than 25 per cent of Western Australia's per capita GST share should be redistributed away from Western Australia. On the Commonwealth Grants Commission's own annual updates, every jurisdiction except Western Australia receives no-worse-off payments. Western Australia's improved position was delivered predominantly through the operation of the floor and the benchmark within the existing GST pool. The $23 billion so often cited was therefore not a payment to Western Australia. It was the price of capping Western Australia's contribution to equalisation at a level still higher than any other state has ever been asked to make – while leaving every other state whole. Characterising this expenditure as a transfer to Western Australia, as much of the public commentary does, inverts its actual destination.

The Commission must also be clear-eyed about why the costs ended up so much higher: iron ore prices remained strong for far longer than anyone – including the Commonwealth Treasury – anticipated in 2018 (generating significantly higher revenues for the Commonwealth than previously anticipated). That fact has a direct and unavoidable implication for the counterfactual. Had the reforms not been made, Western Australia would have remained trapped at extreme, unprecedented and unfair lows for at least another decade, and most probably longer. The higher-than-forecast cost is therefore not evidence that the reforms failed. It is the measure of the continued unfairness the pre-2018 system would have kept inflicting on one state, year after year.

The scale of that continuing unfairness can be stated precisely. On assessed relativities published by the Commonwealth Grants Commission, Western Australia's counterfactual relativity in 2023–24 – the share it would have received had the reforms not been made – fell below 0.10: less than one tenth of an equal per capita share. No federation could regard such an outcome as sustainable or fair, and any assessment of the reforms' cost must be made against that counterfactual.

That figure must also be understood against the fiscal architecture within which the GST sits. Australia has one of the highest levels of vertical fiscal imbalance of any comparable federation: the Commonwealth raises around four-fifths of total tax revenue, while the states carry primary responsibility for delivering hospitals, schools, police and public transport. The GST was created, under A New Tax System and the Intergovernmental Agreement on Federal Financial Relations, precisely to address that imbalance – with every dollar of GST revenue paid to the states as untied general revenue, intended to give them access to a reliable, stable and growing revenue base to fund those services. Any system of horizontal fiscal equalisation which redistributes away more than 90 per cent of one state's share of the very revenue designed to be its reliable growth revenue base is unbalanced in the extreme. For the state concerned, that is not equalisation – it is effective exclusion from the intended benefit of the GST settlement, unfair and unsustainable in a federation characterised by such deep vertical fiscal imbalance.

Nor is the pre-2018 counterfactual cost-free. The interim report compares the reforms against a status quo which the Commission itself acknowledges was politically unsustainable. An unreformed system would have required repeated ad hoc Commonwealth interventions – as occurred from 2015, when top-up payments of approximately $1.4 billion were required simply to prevent Western Australia's effective share falling below 30 cents in the dollar – and would have carried a mounting risk of a corrosive collapse in public support for equalisation itself. The fiscal cost of the reforms should be weighed against the fiscal, economic and institutional costs of that alternative, which the interim report does not attempt to quantify.

There is a further dimension the interim report does not confront: the cost of the reforms and the Commonwealth's own revenue windfall over the same period share the same cause. The sustained strength of iron ore prices that drove the no-worse-off payments above forecast also delivered the Commonwealth far more in company and personal income tax receipts than was assumed when the reforms were costed against a long-run iron ore price assumption of US$55 per tonne. Successive Commonwealth budget sensitivity analyses have estimated the effect of a sustained US$10 per tonne movement in the iron ore price at between $1 billion and $3 billion a year in tax receipts – and prices averaged roughly double the costing assumption across the reform period, at times exceeding US$200 per tonne. On any reasonable estimate, the additional revenue this delivered to the Commonwealth substantially exceeded the full cost of the reforms. It is not analytically sound to cite the cost of the reforms while ignoring the cause of that cost – and ignoring that the same cause delivered the Commonwealth a far larger fiscal gain. The reforms were not a zero-sum transaction. The fiscal pie was much larger than forecast; the Commonwealth gained most; every other state was held harmless; and Western Australia – whose resources sector generated the bulk of the windfall and carried the development risk – retained a fairer share of its own success.

The final report should also distinguish clearly between the cost of the reform as legislated in 2018 – the six-year transition concluding in 2026–27 – and the cost of the separate decision, taken in 2024 and formalised through a funding agreement rather than legislation, to extend the no-worse-off guarantee by three years to 2029–30. Attributing the cost of that later extension to the design of the 2018 reforms conflates the fiscal impact of two distinct decisions taken six years apart.

3. “Only Western Australia is better off” applies the wrong test

The interim report finds that Western Australia has been the principal beneficiary of the reforms and that other states have been kept whole rather than made better off. With respect, this analysis applies the wrong test.

Of course the principal beneficiary was the one state being substantially and unfairly disadvantaged by the pre-2018 arrangements. That was the point of the reform. The test the Government set itself in 2018 was never whether every other state would be made better off by correcting an unfairness those states did not suffer. The test was whether that unfairness could be corrected without leaving any other state worse off. On the interim report’s own findings, that test has demonstrably been met: every other state and territory has received at least every dollar the pre-2018 system would have delivered. That the GST pool boost has not, on current projections, delivered an additional margin above that guarantee reflects commodity price outcomes, not a design failure – and it does not alter the fact that the reform’s actual objective, correction of the unfairness with no state worse off, has been achieved in full.

It is also worth stating plainly what the reformed system continues to ask of Western Australia. Even at the 0.75 floor, Western Australia forgoes a quarter of its per capita GST share in support of other states – a larger contribution to equalisation than has ever been asked of any other state in the history of the Federation. The suggestion that the reforms ended Western Australia’s solidarity with the rest of the country is not sustainable on the data.

Nor are the reformed arrangements the single-state carve-out they are sometimes portrayed as. In 2026–27, the first year of full operation, the floor was not triggered at all: the standard state benchmark, not the floor, determined Western Australia’s relativity, lifting it to New South Wales’ level of 0.82. The benchmark also lifted Queensland’s position in two of the three assessment years used for that year’s calculation. The architecture protects any state that develops strong fiscal capacity, precisely as it was designed to do.

4. The efficiency finding is premature

The interim report concludes that the reforms have delivered minimal efficiency gains. That finding is, frankly, highly premature.

The transition to the new equalisation benchmark only completes in 2026–27 – this financial year. The system has not yet operated in its fully implemented form for a single year. No credible economist would expect a reform still moving towards full implementation to have already transformed state behaviour and national productivity. Incentive effects of this kind – on state decisions about resource development, infrastructure investment and tax reform – are subtle, cumulative and play out over decades in the political economy of a federation, not over a handful of mostly transitional years. It is genuinely surprising that the Productivity Commission, of all institutions, would reach a conclusive judgement on efficiency before the arrangements it is assessing have even commenced full operation.

If anything, the incentive problem the reforms addressed matters more today than it did in 2018. The development of Australia's critical minerals and rare earths – much of it in Western Australia – and the liquefied natural gas (LNG) industry that anchors Australia's economic relationships with Japan and Korea are no longer matters of state economic development alone; they are now central to Australia's national security and its alliance relationships. A fiscal system that told a state it would forfeit most of the improvement in its fiscal position from developing the very industries essential to the national interest would be self-defeating. The final report's assessment of efficiency effects should weigh this strategic dimension.

The appropriate course for the final report is to defer any conclusive efficiency assessment and to recommend a proper evaluation after the reformed system has operated in full for a meaningful period – for example, five years from 2026–27.

5. The complexity critique is inverted

The interim report criticises the reformed system as complex and less transparent, while recommending as its preferred alternatives a return to the pre-2018 arrangements supplemented either by case-by-case directions from the Treasurer to the CGC (Option 1) or by discretionary Commonwealth side-payments to affected states (Option 2).

I cannot reconcile these two positions. A transparent, legislated formula with a known, permanent floor is the opposite of complexity: every state knows, in advance and as a matter of law, the minimum share it will receive and the benchmark to which it will be equalised. By contrast, both Options 1 and 2 would make distribution outcomes contingent on the political judgement of the Treasurer of the day. That would reintroduce precisely the ad hocery, unpredictability and political contestation – and, ultimately, the risk of unfairness – that the 2018 reforms were designed to end, and it would draw the CGC, an institution whose authority rests on its independence, back into political controversy. Whatever the theoretical appeal of a return to full equalisation, Options 1 and 2 would leave Australia with a less rules-based, less predictable and less institutionally robust system than the one now in place.

6. The "perverse outcomes" identified are theoretical and fixable within the framework

The interim report identifies scenarios in which the standard state benchmark could produce counterintuitive results. I note, however, the report's own concessions: the Commission has found no evidence that any such outcome has actually occurred, and assesses that the magnitude of any such effect would likely be small.

Hypothetical edge cases of small likely magnitude are not a basis for dismantling an architecture that has demonstrably delivered fairness and stability in practice. To the extent the Commission considers these scenarios warrant attention, they can and should be addressed through targeted technical refinements to the CGC's assessment methods within the existing legislated framework – a proportionate response to a theoretical problem.

7. The Commission's changed equalisation standard requires justification

I note that the interim report assesses the 2018 reforms against a standard of the fullest achievable equalisation, and acknowledges that the Commission's view has evolved since its 2017–18 inquiry, which recommended equalisation to a "reasonable" rather than maximal standard. The 2018 reforms were designed in good faith against the analytical framework the Commission itself provided at the time. If the Commission now proposes to apply a materially different standard, the final report should explain, transparently and in detail, why its position has changed – and should acknowledge that the reforms cannot fairly be judged a failure against a benchmark that did not exist when they were designed and legislated. I would also recall that the Commission's 2017–18 inquiry, while judging the broader efficiency effects of equalisation to be small and difficult to quantify, identified resource development as the significant exception – the very defect the 2018 reforms were designed to remedy.

8. Where the interim report's concerns are legitimate, there are better answers

Several of the concerns identified in the interim report are real, and each has a better answer than a return to the pre-2018 system.

The "fiscal cliff"

The uncertainty created by the scheduled expiry of the no-worse-off guarantee in 2029–30 is a genuine problem for other states, and I acknowledge it. It should be resolved by making the guarantee permanent, funded by the Commonwealth from its own resources, consistent with the principle that no state should be left worse off by reform. I note this is a feature of the interim report's Option 3, and I support it.

Theoretical perverse outcomes

As set out above, these should be closed through targeted technical refinements by the CGC within the existing framework, not by abolishing the benchmark.

Governance and transparency

The interim report's recommendations on cross-jurisdictional consultation, engagement through the Council on Federal Financial Relations and transparency of Commonwealth payments deserve support and should be carried into the final report.

9. Assessment of the three preliminary options

Against that background, my assessment of the interim report's three options is as follows.

Options 1 and 2 – a return to the pre-2018 system, supplemented by Treasurer directions or discretionary side-payments – should not be pursued. They would restore the arrangements that produced the most extreme and unfair distribution outcome in the Federation's history, replace legislated rules with ministerial discretion, politicise the CGC, and reignite the interstate conflict the 2018 settlement resolved. They are also, as the Commission will appreciate, inconsistent with the standing commitments both major parties of government have given, and with the terms of reference's direction that recommendations be cognisant of the Commonwealth's policy commitments on GST distribution.

Option 3 contains elements worth building on – in particular, a permanent, Commonwealth-funded no-worse-off guarantee. However, the standard state benchmark should be retained alongside the floor. The floor and the benchmark perform different functions: the benchmark provides a stable, representative equalisation standard anchored to the two largest and most diversified state economies, while the floor provides a legislated backstop against extremes. Removing the benchmark and relying on the floor alone would reintroduce volatility into relativities and weaken the predictability that has been one of the reforms' clearest achievements.

10. Recommendations for the final report

I respectfully urge the Commission, in its final report, to:

First, preserve the core architecture of the 2018 settlement – the 0.75 floor, the standard state benchmark, and the no-state-worse-off principle – which operate together as an integrated system.

Second, recommend that the no-worse-off guarantee be made permanent and funded by the Commonwealth, resolving the 2029–30 fiscal cliff and providing all states with lasting certainty.

Third, recommend targeted technical refinements to CGC assessment methods to address the theoretical benchmark scenarios identified in the interim report, within the existing legislated framework.

Fourth, defer any conclusive assessment of the reforms' efficiency and productivity effects until the system has operated in its fully implemented form for a meaningful period, and recommend a dedicated evaluation at that point.

Fifth, carry forward the interim report's governance and transparency recommendations.

Sixth, set out transparently why the Commission's equalisation standard has changed since its 2017–18 inquiry, and assess the 2018 reforms fairly against the framework that applied when they were designed.

Conclusion

The 2018 reforms resolved the most serious crisis in the history of Australia's federal financial relations while preserving one of the strongest systems of fiscal equalisation in the world. They replaced ad hoc discretion with permanent, transparent, legislated rules. They corrected a manifest unfairness while leaving no state worse off. And they have not yet even completed their transition to full operation.

An interim report is exactly that – interim. The Commission has the opportunity, and in my respectful view the obligation, to revisit its preliminary findings and recommendations in its final report.

Yours sincerely,

The Hon Mathias Cormann AC
Former Australian Minister for Finance (2013–2020)

18 August 2026