

SUBMISSION TO THE PRODUCTIVITY COMMISSION REVIEW OF THE GST DISTRIBUTION SYSTEM & INTERIM REPORT

Submitter: John D. Purcell PSM

Location: Kambah, Australian Capital Territory

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1.0 EXECUTIVE SUMMARY

1.1 This submission responds directly to the Productivity Commission's interim report on the 2018 GST distribution reforms. The Commission is commended for its rigorous, empirically grounded evaluation of the Western Australia GST amendments. The interim findings accurately expose the substantial fiscal cost, structural distortions, and policy anomalies driven by those arrangements, directly addressing the core Terms of Reference regarding long-term federal fiscal sustainability and budgetary impact.

1.2 However, while the Commission has thoroughly examined the immediate WA mechanism, the interim report stops short of addressing the broader structural health of the federal financial relations architecture. The national reaction to the interim findings has exposed deep-seated, cross-jurisdictional dissatisfaction with how the horizontal fiscal equalisation (HFE) framework operates under modern economic pressures. There is a real and present danger that political compromises will lead to a watering down of true equalisation - such as arbitrary shifts toward crude population-share or equal-per-capita shortcuts.

1.3 To avoid this policy retreat, much can be gained if the Commission uses its final report to conduct a comprehensive systemic audit of HFE shortcomings across all jurisdictions. Rather than treating state submissions as isolated grievances, the Commission should collate and evaluate these pressure points, utilising a structured analytical matrix as an actionable implementation roadmap for the Commonwealth to direct the Commonwealth Grants Commission (CGC).

1.4 Crucially, the Commission must recognise that many of these structural pressures are fundamentally exogenous to state-level policy and do not belong inside an equalisation pool at all. Matters driven by federal ownership, national capital mandates, or intergovernmental spillovers demand direct, transparent Commonwealth funding outside the HFE architecture. This submission builds upon the empirical baseline established in my original submission - Submission 44, forwarded on 17 February 2025 - elevating those territory-specific findings into a broader national case study for structural reform.

2.0 EVALUATION OF THE INTERIM REPORT: UNPACKING THE FALLOUT AND POLICY OPTIONS

2.1 The interim report provides a vital public service by laying bare the mechanics and financial consequences of the 2018 changes. The Morrison-era interventions broke foundational GST harmony by carving out permanent, state-specific guarantees for mining-boom states, creating an open-ended contingent liability and an unsustainable structural pressure on the federal budget through ongoing top-up payments.

2.2 Western Australia's low GST share prior to 2018 was not evidence of a broken system; it was the predictable outcome of extraordinary revenue-raising capacity during the commodity boom. Equalisation measures fiscal capacity, not political sentiment. The legislated floor broke the essential link between a state's revenue capacity and its GST outcome by guaranteeing a minimum relativity regardless of underlying fiscal strength. By detailing how these political arrangements generated multi-billion-dollar pressures on the federal budget, the Commission has successfully completed the first component of its remit.

2.3 Yet, the policy options and scenarios floated in the interim report in response to these distortions risk triggering a secondary crisis. The public and intergovernmental debate following the release of the interim findings has revealed that states and territories are increasingly disillusioned with the predictive accuracy and fairness of CGC modelling. In an effort to escape this complexity, there is bureaucratic and political temptation to embrace simplified alternative models - such as population-share or equal-per-capita distributions.

2.4 Restoring integrity to the system requires rejecting these crude shortcuts. Treating the WA arrangement as a political exception rather than a permanent feature of HFE is essential, but the final report must go further. It must provide the institutional architecture required to fix the underlying methodologies rather than abandoning equalisation altogether.

3.0 THE WIDER MANDATE: EQUALISATION INTEGRITY, VERTICAL FISCAL IMBALANCE, AND EXTRA-HFE FUNDING

3.1 The inquiry's Terms of Reference required a broader examination of how federal financial relations arrangements promote long-term fiscal sustainability and equity across all states and territories. In reviewing the options tabled by the Commission, horizontal fiscal equalisation must be understood as a binary proposition: either the architecture maintains its integrity as a comprehensive mechanism to ensure every jurisdiction has the capacity to provide comparable services, or it degrades into arbitrary political redistribution.

3.2 Alternative proposals to shift toward a simplistic population-share model must be rejected outright. Such an approach ignores structural realities, severely penalising smaller jurisdictions and territories that carry unique cost burdens. If political compromises around floors or top-ups persist, they must not become a vehicle for dismantling equalisation. Any durable way forward must protect the baseline principle of equalisation while directly quarantining and funding unassessed structural cost pressures outside the main GST pool.

3.3 A central structural flaw across the current HFE framework - and a recurring grievance raised in submissions across multiple jurisdictions - is the persistent attempt to force idiosyncratic, nationally driven or asymmetric cost pressures through the rigid, state-equalisation machinery of the Commonwealth Grants Commission. Matters such as national-capital functions, federal planning constraints, major cross-border spillovers, and structural public-sector revenue distortions simply do not fit a national per-capita equalisation model. Trying to capture them via standard CGC formulas creates endless intergovernmental friction and distorts relativities for all other states.

3.4 As established in sound public finance theory, where structural burdens stem directly from national policy, federal ownership, or intergovernmental spillovers, they should be funded by the Commonwealth directly outside the equalisation process via dedicated, indexed special-purpose agreements. Quarantining these items preserves the analytical purity of HFE while providing clean, transparent compensation to the jurisdictions bearing the impost.

3.5 Running parallel to this structural debate is the widening vertical fiscal imbalance (VFI) between the Commonwealth and the States and Territories. State and territory governments carry the responsibility for delivering essential services - health, education, transport, policing, and community services - yet the Commonwealth controls the most efficient revenue instruments. The original growth promise of the GST has not been realised: the rate remains unchanged, the base has been eroded by exemptions, and consumption has shifted toward untaxed services. As documented across successive public finance reviews, GST revenue as a share of GDP has trended downwards since inception, forcing jurisdictions to rely increasingly on narrow, inefficient state taxes simply to maintain service standards. Genuine tax reform remains essential to the long-term viability of Australian federalism.

4.0 THE ACT AS A NATIONAL CASE STUDY: SYSTEMIC STRUCTURAL REALITIES AND QUANTIFIED IMPOSTS

4.1 To execute a comprehensive systematic review, the final report must address the operational realities and legacy burdens of smaller jurisdictions that standard equalisation models fail to capture. Rather than viewing the Australian Capital Territory's structural challenges as isolated local complaints, the Productivity Commission should treat the ACT as the primary diagnostic case study of how rigid federal equalisation models fail when applied to non-standard governance structures.

4.2 As established and quantified in Submission 44 (forwarded 17 February 2025), the ACT faces compounding systemic disadvantages and direct financial losses within the federal financial architecture:

- **Capital City-State Governance and Structural Imposts:** The ACT exercises combined territorial and municipal functions without a broader state-level resource or regional revenue base. Rigid federal design controls, the overreach of the National Capital Authority (NCA), and uncompensated aesthetic, security, and infrastructure mandates impose direct financial imposts. When measured against standard state-side equivalents, these uncompensated city-state burdens drain tens of millions annually from frontline territorial service delivery.
- **Infrastructure and Interface Friction:** Abstract HFE mechanics fail to capture material territorial cost pressures, such as transport, logistics, and infrastructure friction around major regional arterial corridors and federal-territory interface zones, representing significant unmeasured maintenance losses.
- **Balance-Sheet Constraints and Land Acquisition:** Unlike states that can easily expand borders or leverage extensive freehold land systems, the Territory faces unique land-tenure limitations stemming from federal ownership. Major structural outlays required to unlock urban growth and public housing - such as land acquisitions like the former CSIRO Ginninderra site - represent heavy upfront territorial balance-sheet constraints unrecognised by standard GST formulas, locking up capital valued in the tens of millions of dollars.
- **Cross-Border Service Delivery:** The ACT functions as the primary regional service hub for South-East New South Wales, absorbing continuous demand from cross-border residents for specialised healthcare, education,

transport, and emergency services. This uncompensated regional spillover creates an estimated net annual service delivery drain running into tens of millions of dollars that CGC models fail to offset.

- **Historic Housing Debt Legacies:** The ACT continues to bear an inequitable legacy debt—the 1989 foundational settlement forced onto the Territory at interest rates exceeding 12%. This exact impost drains an outstanding balance of \$80 million remaining, which extracts approximately \$11 million per annum in principal and interest servicing costs, directly clawing away vital funds from modern public housing and municipal maintenance, contrasting sharply with historical debt-forgiveness precedents applied to other states.
- **Population Data Distortions (ERP Undercounts):** Standard GST distribution formulas rely heavily on Estimated Resident Population (ERP) data, which has suffered from compounding undercounts in the ACT due to highly mobile demographics, defence personnel rotations, and university inflows, resulting in direct, ongoing annual GST revenue suppression.
- **Flawed Payroll Tax Capacity Assessments:** CGC revenue assessments regarding payroll tax capacity penalise the ACT by applying standard private-sector tax-raising assumptions to an economy structurally dominated by public-sector employment under strict national capital constraints, miscalculating actual fiscal capacity.

4.3 To provide a clear operational roadmap for reform, Attachment A sets out a comprehensive Analytical Matrix of HFE Assessed Disabilities and Structural Realities. By auditing these pressure points and their quantified fiscal losses across all jurisdictions where identified, the Productivity Commission can deliver an unassailable tool that provides an unmistakable implementation footpath for the Commonwealth to direct the CGC - while identifying where direct extra-HFE Commonwealth funding is the superior policy solution.

5.0 STRATEGIC RECOMMENDATIONS FOR THE FINAL REPORT

1. **Recognise Vertical Fiscal Imbalance as the Core Driver:** Acknowledge that the GST no longer provides a revenue base commensurate with state and territory service obligations, and recommend structural national tax reform to restore GST adequacy.
2. **Restore Pre-2018 GST Integrity & Reject Population-Share Shortcuts:** Treat the 2018 WA legislated floor as a political exception rather than a permanent feature of HFE, ensuring GST relativities once again reflect measured fiscal capacity without political overrides, and reject crude population-share alternatives that penalise growing smaller jurisdictions.
3. **Adopt Submission 44 as an Analytical Baseline:** Use Submission 44 (forwarded 17 February 2025) as the foundational framework for evaluating territory-specific fiscal disabilities, dual planning overreaches, interface infrastructure friction, cross-border service burdens, population data distortions, legacy debt traps, payroll tax assessment flaws, and structural revenue reform options in the final report.
4. **Conduct a Systemic HFE Audit, Quarantine Nationally Driven Costs & Direct Methodological Overhaul:** Recommend that the Commonwealth direct the Commonwealth Grants Commission (CGC) to adopt the structural reforms synthesised in Attachment A's analytical matrix, specifically:
 - Establishing dedicated, ring-fenced assessment factors for Indigenous Service Delivery and Natural Disasters & Climate Resilience to prevent formulaic lag and budget distortion.
 - Recognising that asymmetric national burdens (such as national-capital overheads, cross-border service loads, and federal planning constraints) do not fit standard equalisation formulas and should instead be funded directly by the Commonwealth via dedicated, indexed special-purpose agreements outside the main GST pool.
5. **Extinguish Inequitable Legacy Debt:** Recommend the formal extinguishment of the 1989 historic housing debt across all remaining jurisdictions thereby aligning federal treatment with historical debt-forgiveness precedents established for other states.

ATTACHMENT A: COMPREHENSIVE NATIONAL ANALYTICAL MATRIX OF HFE ASSESSED PRESSURES

Designed for Productivity Commission Final Report Recommendation and Commonwealth Direction to the Commonwealth Grants Commission (CGC).

Jurisdiction / Category	Core Submission Pressure Points Identified in Inquiry	Major Unassessed / Miscalculated Structural Pressures & Quantified Losses	Recommended Path for CGC Methodology Overhaul / Extra-HFE Funding
Indigenous Service Delivery <i>(Specialised Category)</i>	NT & QLD Submissions: Severe cost pressures regarding remote infrastructure, health backlogs, and multi-generational disadvantage that outstrip standard per-capita indexing.	Compounding socio-economic disadvantage and delivery costs in remote and regional communities.	Establish a Dedicated Indigenous Disadvantage Factor: Ring-fence and refine specific cost weights to reflect real-world service delivery parity, ensuring funding dynamically matches actual community need.
Natural Disasters & Climate Resilience <i>(Specialised Category)</i>	QLD, SA & TAS Submissions: Disproportionate exposure to extreme weather events, bushfires, and cyclones which severely disrupt state capital programs.	Unpredictable, highly concentrated climate shocks and reconstruction cost spikes that lag behind formulaic assessment cycles.	Quarantine Disaster-Recovery Outlays: Remove major emergency response and infrastructure reconstruction expenditures from baseline GST capacity calculations, funding them through indexed, separate Commonwealth-State risk mechanisms.

Resource & Economic Volatility (e.g., WA)	WA Government / CCIWA: Defence of the 2018 floor and relativity guarantees based on long-term mineral revenue cycles.	Revenue-smoothing moving averages that delay adjustment to multi-state mineral/coal cycles.	Refine moving-average smoothing to reflect contemporary multi-state commodity dynamics.
Large Pop. / Metropolitan Pressures (e.g., VIC, NSW)	VIC & NSW Submissions: Rapid population growth strains, high infrastructure congestion costs, and tax base vulnerability (heavy reliance on volatile property/stamp duty markets).	Interstate migration shifts and the compounding cost of urban transit/infrastructure scaling that outpaces standard per-capita models.	Refine Scale and Urban Cost Gradients: Explicitly account for high-density metropolitan infrastructure pressures and the fiscal impact of rapid interstate migration shifts.
Smaller & Transitioning States (e.g., SA, TAS)	SA & TAS Submissions: Ageing demographic profiles, lower private economic capacity, and escalating regional health and hospital delivery costs.	Structural economic transition costs and uncompensated regional service delivery burdens for ageing populations.	Protect Baseline Equalisation Streams: Safeguard baseline equalisation components from dilution while indexing regional demographic shifts accurately.

The Australian Capital Territory <i>(City-State Model)</i>	ACT Government & Submission 44: Combined municipal/territorial cost burdens, federal planning constraints, and unique structural overheads.	1. Dual municipal/territorial cost burdens. 2. Uncompensated cross-border service load (tens of millions in regional NSW spillovers). 3. Federal planning & NCA constraints. 4. Upfront balance-sheet land costs (tens of millions for CSIRO Ginninderra). 5. Compounding ERP population undercounts. 6. 1989 historic housing debt legacy (\$80M balance / \$11m annual drain). 7. Flawed payroll tax capacity assessments penalising a public-sector economy.	Direct Commonwealth Funding Outside HFE / Methodological Overhaul: Quarantine unassessed national-capital and cross-border burdens for direct Commonwealth extra-HFE funding, while directing the CGC to build an explicit sub-model measuring city-state overheads outside rigid per-capita caps.
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