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Submission to the Productivity Commission on the Interim Report: *GST Distribution Reforms* (August 2026)

Support

We support the Productivity Commission's preferred recommendation that Australia return to the pre-2018 GST revenue distribution system, while addressing costly dominant-state effects directly and transparently. The Interim Report finds that the current arrangements reduce equalisation without creating marked improvements in efficiency, fiscal sustainability, or certainty, and have introduced greater complexity and potentially perverse outcomes.

The pre-2018 system more closely meets the central objective of HFE by enabling States to provide services and infrastructure to comparable standards, assuming comparable revenue effort and operational efficiency. It also relies on the independent and transparent advice of the Commonwealth Grants Commission (CGC) and distributes funding as untied grants, preserving State discretion over expenditure.

Any direction by the Australian Treasurer in respect of dominant-state effects should, however, be tightly framed. The final report should define such effects using objective and materiality-based criteria, require publication and intergovernmental consultation, prescribe principles for distribution, and provide for periodic review. If the Commonwealth wishes to provide additional assistance to a particular State for reasons extending beyond HFE, it should do so through direct and transparent payments outside the GST pool, consistently with interim recommendation.

Comparative experience reinforces the case for this distinction. Canada and Switzerland demonstrate the value of predictable, institutionally mediated transfers that preserve subnational autonomy, whereas Germany illustrates the risks of layering centralised control and complex equalisation arrangements.

Transition

A return to the pre-2018 system may produce substantial changes in individual State revenues and should thus be accompanied by a transparent transition plan. Transitional assistance should be separate from the HFE formula, temporary, declining, and subject to a fixed sunset provision. This would support budgetary adjustment without embedding the current relativity floor or creating an ongoing No Worse Off (NoWO) liability for the Commonwealth.

The Productivity Commission should model alternative transition paths by reference to State fiscal sustainability, cost to the Commonwealth, and the period reasonably needed for budgetary adjustment, rather than recommending a fixed transition period without supporting analysis.

One transition option for the Commission to model would involve a rule-based ten-year phase out of the current arrangements. Under this option, the current minimum level (or relativity floor) of 0.75 would be reduced by 0.05 each year and abolished at the end of year ten. NoWO payments would be reduced each year by 10 percent of their initial amount and cease in year ten. The Commission should compare this option with a transition that restores the pre-2018 system earlier and provides declining transitional assistance outside the GST pool.

Longer Term Adequacy of Untied Funding

A separate, longer-term issue is the adequacy of the aggregate untied transfer pool available to support State government expenditure responsibilities. State expenditure has grown faster than the GST pool, which has not kept pace with GDP. The design of the HFE distribution formula should thus be distinguished from the question of how the aggregate untied transfer pool is determined. The pool's size should respond to aggregate State expenditure responsibilities and Commonwealth fiscal capacity. Its distribution should continue to reflect relative fiscal capacity and expenditure needs under HFE. Conceptually, Commonwealth revenues are fungible and the amount transferred need not be permanently tied to the yield of one tax.

Key reasons discussed in the Interim Report for the declining GST revenue share and HFE aggregate fund include the fall in household spending as a share of GDP and the faster growth in the prices of GST-exempt items such as healthcare and rent. The Report also notes that expenditure on major State responsibilities, including health and education, has grown faster than the GST pool. Health and education services are supplied by both the private sector and the government. Extending GST to private health and education services currently not subject to GST could raise their relative price and induce consumers to reallocate outlays from private sector supplied services to government-provided services with a lower relative cost to users. This substitution could have adverse efficiency effects and affect the net fiscal position of governments, although the effects would require careful modelling.

Options for increasing the aggregate untied transfer pool available for HFE include raising the GST rate (for example to 15 percent comparable to New Zealand's GST rate, subject to distributional analysis and compensatory measures) as part of a wider tax mix reform package, and incorporating a share of income tax revenue into the revenue pool. These options should be assessed separately from the immediate reform of the GST distribution formula.

The final report should recommend that the longer-term adequacy of the aggregate untied transfer pool be considered as part of a broader review of federal financial relations and tax reform. That review could examine whether GST revenue should continue to be the exclusive benchmark or should be supplemented by a specified share of another broad Commonwealth revenue source or governed by an alternative indexation mechanism. Broader changes to the GST rate or base could also be assessed as part of comprehensive tax reform.

More broadly, it would be worthwhile for the final report to address three distinct but related questions clearly. First, how should GST revenue be distributed in the immediate term? Second, how should the transition from the current system be managed? And third, how should the size and funding basis of the aggregate untied transfer pool be determined over the longer term?

Whole-of-System Fiscal Effects

The final report should clarify whether its estimates of the Commonwealth cost of the reforms and the fiscal benefits to individual States are gross or net of changes in tied and other non-GST Commonwealth payments. Where feasible, it should provide a jurisdiction-by-jurisdiction reconciliation of GST payments, NoWO payments, the Commonwealth-funded GST pool boost, and other material Commonwealth payments, while distinguishing changes connected with the 2018 reforms from unrelated funding decisions.

An implicit assumption in Section 2 of the Interim Report is that the increase in Commonwealth HFE payments to the States under the post-2018 HFE system has not been partially offset by subsequent reductions in aggregate tied grants to the States, particularly those paid to Western Australia, the major revenue beneficiary of the policy change. The existence and scale of any such offsets should be tested through careful modelling rather than assumed. The modelling should test whether second-round adjustments partially reduce both the net revenue cost to the Commonwealth and the net revenue gain to Western Australia. If systematic offsets are identified, the final report should present both the gross and net fiscal effects on the Commonwealth and on each State.

Governance and Transparency

We also support stronger cross-jurisdictional consultation, more regular and substantive engagement through the Council on Federal Financial Relations, and greater transparency in the treatment of non-GST Commonwealth payments. The CGC should continue to provide independent technical advice, supplemented by accessible, plain-English public explanations of the operation and distributional consequences of HFE. Predictability, institutional mediation, and public intelligibility are critical not only to sound fiscal design but also to the durability and legitimacy of Australia's federal financial relations. This is supported by recent comparative studies: even a technically sophisticated equalisation model can become politically fragile where complexity exceeds public comprehension.

We hope these comments assist the Commission in developing its final recommendations on GST distribution reform and fiscal sustainability. Thank you for the opportunity to comment.

Kind regards,

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