



GST distribution reforms

Second Submission from the ACT Government to the Productivity Commission Inquiry into the 2018 Goods and Services (GST) distribution reforms.

Acknowledgement of Country

The Chief Minister, Treasury and Economic Development Directorate acknowledges the Ngunnawal people as traditional custodians of the ACT and recognise any other people or families with connection to the lands of the ACT and region.

We respect the Aboriginal and Torres Strait Islander people, particularly our Aboriginal and Torres Strait Islander staff, and their continuing culture and contribution they make to the Canberra region and the life of our city.

© Australian Capital Territory, Canberra 2026

Material in this publication may be reproduced provided due acknowledgement is made.

Produced by the Chief Minister, Treasury and Economic Development Directorate. Enquiries about this publication should be directed to the Chief Minister, Treasury and Economic Development Directorate.

GPO Box 158, Canberra City 2601

act.gov.au

Telephone: Access Canberra – 13 22 81

If you are deaf, or have a hearing or speech impairment, and need the telephone typewriter (TTY) service, please phone 13 36 77 and ask for 13 22 81.

For speak and listen users, please phone 1300 555 727.

For more information on these services, contact us through the National Relay Service:
www.accesshub.gov.au.

If English is not your first language and you require a translating and interpreting service, please telephone Access Canberra on 13 22 81.



Foreword

The clearest and most sustainable path forward is a return to the pre-2018 GST distribution system, and with any additional assistance to individual jurisdictions provided transparently and funded directly by the Commonwealth outside the goods and services tax (GST) distribution system.

If the Commonwealth chooses to retain the 2018 reforms, it must also accept the ongoing fiscal consequences of that decision through a permanent, legislated and Commonwealth-funded No Worse Off guarantee (NoWO guarantee). The Federation should not be asked to sacrifice equity to preserve a policy outcome that so disproportionately benefits the fiscal position of one State at the expense of others.

The central question before governments should not revolve around the scope of states and territories' tolerance for lower equalisation outcomes, but how Australia's GST system and broader federal financial governance system can be strengthened to ensure all Australians have access to comparable public services regardless of where they live.

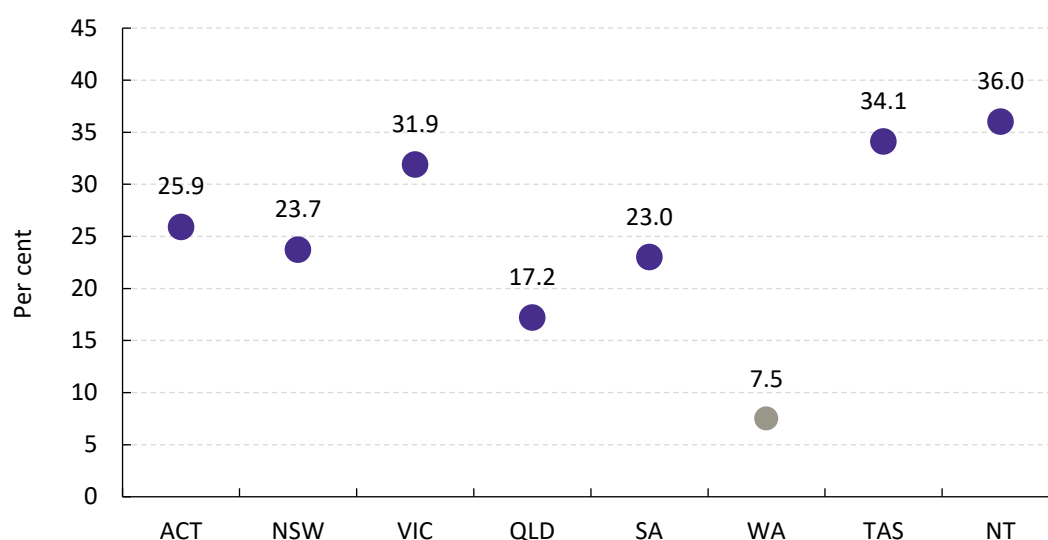
The Productivity Commission's findings confirm the GST's role in promoting equity across states

The ACT welcomes the Productivity Commission's (PC) finding that the 2018 GST distribution reforms have largely failed to achieve their stated objectives and have introduced significant inequity, complexity, and fiscal cost into the GST distribution system. The PC's Interim Report provides compelling evidence that the reforms have disproportionately benefited a single jurisdiction while imposing substantial and growing costs on Australian taxpayers.

As a result of the 2018 GST reforms, Western Australia (WA) has the lowest net financial liabilities to Gross State Product (GSP) — by far — in the Federation (Chart 1). This metric on its own demonstrates the extent to which the intervention of the Commonwealth Government in the GST distribution system has unbalanced HFE.

The PC correctly assesses that the 2018 reforms benefitted one state at the expense of all others, failing in the objective of achieving greater fiscal equalisation.

Chart 1 – Net financial liabilities to gross state product, 2026-27 (budget)



Sources: ACT 2026-27 Budget Outlook, page 46. Note: Ratios for states and territories other than the ACT were determined based on the most updated state budget documents at the time the ACT budget was released.

Consistent with the PC's Interim Report, Australia's GST distribution system should remain primarily grounded in the principle of horizontal fiscal equalisation (HFE). It should enable all states and territories to provide services and infrastructure at comparable standards, while not promoting superior fiscal conditions in a single state.

The ACT agrees with the Productivity Commission's articulation of the fundamental purpose of HFE (p. 33 of the Interim Report):

*"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."*

Note: Emphasis added.

The GST distribution arrangements should be assessed against this overarching objective of equity, while minimising trade-offs with efficiency, fiscal sustainability and certainty.

The PC Interim Report indicates that the 2018 reforms have weakened the coherence of the HFE framework by introducing special treatment and outcomes that are inconsistent with the broader operation of the equalisation system. The PC's assessment that the reforms have reduced equity between jurisdictions and created an increasingly costly and complex system is consistent with concerns previously raised by the ACT and other Australian jurisdictions.

The pre-2018 system equalised each jurisdiction to the fiscal capacity of the strongest state, ensuring that differences in revenue capacity and service-delivery costs arising from circumstances beyond a jurisdiction's control were recognised through the distribution. By contrast, any model that permanently equalises only to New South Wales or Victoria necessarily tolerates unequal fiscal capacities whenever another jurisdiction is fiscally stronger. This undermines the central HFE principle that Australians should have access to comparable state services regardless of where they live. The PC recognises that fiscal equalisation should remain the primary goal of the GST distribution system and that volatility or uncertainty alone is not sufficient justification for reducing the degree of equalisation.

Growing strains on VFI and HFE threaten the sustainability of GST Distribution

The PC correctly observes that GST distribution arrangements cannot be considered in isolation from the broader operation of Australia's federal financial relations system.

As the principal source of untied Commonwealth funding, GST occupies a unique position within this framework in providing states and territories with access to a broad and relatively efficient revenue base while preserving flexibility over expenditure decisions. The distribution of GST is the absolute backstop of resolving vertical fiscal imbalance (VFI) and preserving HFE.

This is significant for the ACT, where GST revenue represents approximately 25 per cent of General Government Sector revenue, making the Territory's fiscal capacity highly sensitive to changes in GST distribution. By preserving access to the GST base according to relative fiscal need, HFE promotes both fiscal equity and economic efficiency, reducing reliance on narrower and more distortionary state revenue measures.

As is noted below, and consistent with the PC's broader findings, recent history shows that VFI has been worsening in tandem with HFE being weakened via the 2018 reforms. Weakening the GST distribution serves only to worsen VFI and then redistribute the fiscal insufficiency within the Federation. In practice, growing VFI leads to an under-provision of services, growing state debt, or relatively inefficient own-source revenue sources across the Federation. In the context of worsening VFI, inequitable HFE represents additional pressures on states that fiscally weaker for the benefit of those that are fiscally stronger.

The PC is correct that equity should remain the primary objective of GST distribution and that efficiency, certainty and sustainability should operate as constraints upon equalisation, rather than substitutes for it. The PC's findings do not demonstrate that the reduction in equalisation achieved through the 2018 reforms has delivered benefits sufficient to justify the resulting loss of equity and increase in complexity.

VFI is worsening as states and territories face growing fiscal pressures

In recent years, vertical fiscal imbalance (VFI) has worsened, as states and territories are carrying growing expenditure responsibilities across areas including health, disability services, infrastructure and disaster recovery, while the Commonwealth continues to retain access to the broadest and most efficient revenue bases.

Between 2014-15 and 2024-25, states' ability to cover their expenditures from within own source revenue deteriorated considerably. While in 2014-15, States had a 'net own source loss' of \$128 million, this figure reduced to \$185 million by 2024-25 — a 5 per cent annual decline over the period. Meanwhile, the Commonwealth saw its own-source budget position improve significantly over the period, demonstrating the growing divide between the Commonwealth and states and territories with respect to their ability to cover their expenses from within.¹

The No Worse Off guarantee was necessary given high levels of VFI

The establishment and subsequent extension of the NoWO guarantee were a fiscal necessity given the pre-existing high levels of VFI. It was imminently clear from the onset that states could not afford to compensate a lower level of horizontal fiscal equalisation (via additional tax raising or otherwise). As a result, the NoWO guarantee was established as a compensatory

¹ Based on figures provided in the PC Interim Report, Figure 1.1., page 8. Expressed in 2024-25 constant prices.

mechanism. While that the NoWO guarantee has ensured that States (excluding Western Australia (WA)) and Territories are no better off than otherwise, it has worsened HFE by allowing WA's fiscal capacity to rise above all others.

For the ACT, the NoWO guarantee is worth an estimated \$124 million in 2025-26, equivalent to the salaries of around 900 teachers (approximately 22 per cent of the teaching workforce) or 600 nurses (approximately 11 per cent of Canberra Health Services' nursing workforce). The scale of these payments demonstrates that the fiscal consequences of the 2018 reforms remain material and ongoing. In a Federation already characterised by significant VFI, states cannot afford to bear the cost of the 2018 reforms.

Without a NoWO guarantee, the 2018 reforms imply that in periods of sustained iron ore price strength, jurisdictions other than WA are required to support the Federation's fiscally strongest state through GST redistribution. In absence of the NoWO guarantee, states and territories other than WA would have been left carrying a \$23 billion cost, with no associated benefits. This cost would be fiscally unsustainable, and the outcome would worsen the already high degree of VFI across jurisdictions. It would worsen HFE even further than under the NoWO guarantee and is fundamentally inconsistent with the core 'equity' purpose of HFE.

While all states and territories would like to see reduced revenue volatility, this objective cannot be achieved at the cost of the primary goals of the HFE system. In addition, this objective remains difficult to implement in practice given high levels of VFI. HFE exists to address structural differences in fiscal capacity that are outside a jurisdiction's control, not to insulate jurisdictions from the consequences of manageable revenue risk.

Increasing mismatch between funding levels and service delivery responsibilities is driving increased VFI

Fiscal sustainability must be considered across the Federation as a whole. Weakened fiscal sustainability is increasingly evident across the Federation, where pressures that originate in one part of the system create pressures in other parts of the system, compounded when funding responsibilities span multiple levels of government and service systems.

This dynamic is clearly evident in the interaction between health, aged care, disability and community services. Independent analysis from Create Health Advisory² found that growing numbers of patients remain in public hospitals despite no longer requiring acute care because appropriate supports are unavailable elsewhere in the system. As a result, public hospitals are increasingly absorbing the downstream consequences of failures at the interface between health, aged care and disability services.

The ACT's experience is consistent with this trend. Improvements in activity reporting have revealed that health services delivered by ACT public hospitals are not fully reflected in existing Commonwealth funding baselines. The ACT estimates this mismatch represented approximately \$40 million in under-recognised activity in 2023-24, increasing to around \$72 million in 2024-25. Left unresolved, the gap between activity delivered and activity funded will continue to grow.

More broadly, growing pressure in public hospitals cannot be separated from the performance of adjacent systems such as aged care, primary care and disability services. Nationally, 30 per cent of emergency department presentations in 2024-25 were classified as lower-urgency care, illustrating how pressures driven by under-investment in primary health care can ultimately present within public hospitals. This illustrates a broader pattern where the

² *The Growth and Drivers of Public Hospital Costs and Prices*, Create Health Advisory, July 2025.

Commonwealth continues to make policy and funding decisions leaving states and territories to bear the operational and fiscal consequences.

Similarly, recent National Disability Insurance Scheme (NDIS) reforms unilaterally decided by the Commonwealth in a co-managed system, reflect a transfer of funding responsibilities. Reduced NDIS expenditure may be realised by the Commonwealth but at greater costs to state and territories (potentially larger overall), and the members of our community with disability.

The examples above highlight the growing burden of VFI, borne from deliberate decisions of the Commonwealth. Fiscal sustainability is most durable when savings are achieved through genuine efficiency improvements rather than by shifting costs to other parts of the Federation.

Achieving equity in the HFE system

Population estimate inaccuracies

The sweeping changes to GST distributions imposed by the 2018 reforms were intended to address perceived inequities in the HFE system. While speculative gains on the fairness around the reforms drove \$23 billion of redistribution, well-evidenced inaccuracies in population estimates — an obvious hole in the GST distribution framework — worsened over time.

The integrity of HFE depends on the three components used to allocate GST:

- the national GST pool;
- state and territory population estimates; and
- state and territory relativities.

Inaccuracies in population estimates impact jurisdictions twice: they alter shares in the national GST pool; and they alter relativities between jurisdictions. The latter often has twice the impact of the former.

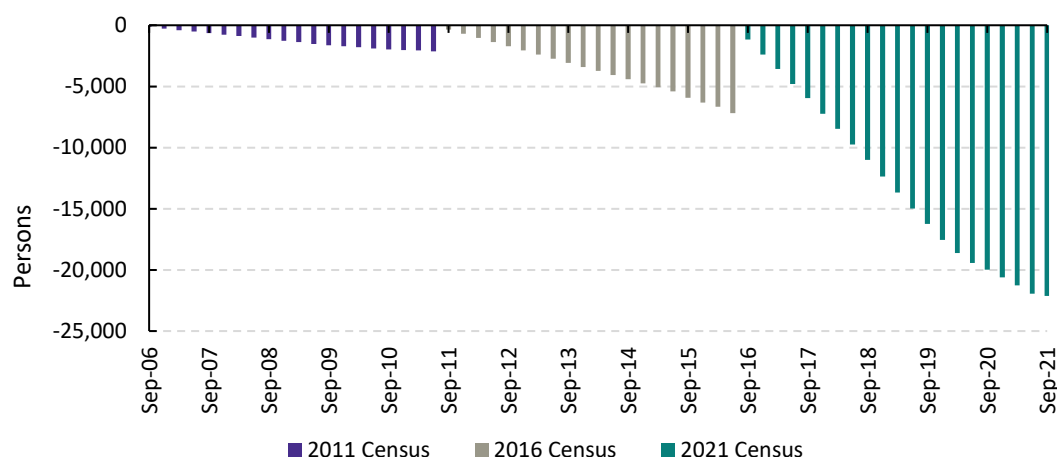
A systemic and growing weakness

The absence of a process to reconcile inaccurate population estimates is a significant weakness in the current system. The under- and over-estimation of state and territory populations have increased with successive censuses and affect the GST allocations of every jurisdiction. For the ACT, population errors are estimated to have reduced the ACT's GST grants by approximately \$550 million between 2016-17 and 2022-23.

Despite the financial consequences of such errors, current arrangements provide no mechanism to reconcile GST distributions where subsequent census outcomes reveal significant inaccuracies in population estimates.

Chart 2 shows the growing underestimation of ACT's population across the last three ABS censuses. In September 2021, the undercount was assessed as being 5.1% of the ACT's total population. This was the highest error of any state or territory.

Chart 2: Underestimation of the ACT's population



Sources: ABS preliminary intercensal discrepancy - 2011, 2016 and 2021 Censuses.

A practical reform

Under the current GST allocation system, estimates of the national GST pool are reconciled against actual collections at the end of each financial year. Relativities are based on actual data and can be revised with data updates. In contrast, GST payments based on population estimates are not reconciled after each census. This is despite rebased population data being published by the ABS, which readily identifies intercensal errors and intercensal discrepancies.

Significant and increasing amounts of GST are wrongly allocated across jurisdictions because of growing population estimation inaccuracies. The magnitude of this misallocation is material and undermines both the fairness and integrity of HFE. Overpayment and underpayment of GST grants must be corrected to uphold the principals of HFE.

Reconciling population estimates against rebased census data is a practical reform that can work within current methodologies and the GST allocation system. It will ensure that states and territories receive their correct and fair entitlements and will impose no additional cost on the Commonwealth.

Given the growing burden of population inaccuracies, any recommendations to improve HFE must therefore include a timely process for reconciling population estimates against rebased census data. This will ensure that Australians are properly funded for services regardless of where they live.

Stronger data is needed

The impact of growing inaccuracies in population estimates, serves to also highlight the importance of data quality and completeness of the datasets required by the CGC in its assessments. The ACT encourages Commonwealth investment to facilitate the development of national consistent, high-quality datasets.

Data quality and completeness are central to achieving equity in the HFE system, yet assessments of state needs are too often constrained by the data available. Appropriate Commonwealth funding, could enable the Commission to collaborate with jurisdictions and relevant data custodians to improve underlying data collection processes, including the capture of information at more granular geographic and population levels.

The CGC Health Assessment provides an example where more detailed data could support more precise measurement of cost drivers and better identify disadvantaged populations. This would enable the Commission to test the effects of data aggregation, strengthen the empirical basis of its assessments and provide greater confidence that GST distributions reflect genuine differences in states' service needs and costs.

Stronger federal financial relations are needed to address emerging pressures

The challenges of worsening VFI and weakened HFE cannot be resolved through the GST distribution system alone. As fiscal pressures and policy challenges increasingly span multiple portfolios, service systems and levels of government, the effectiveness of Australia's federal financial relations framework becomes increasingly important to tackling the growing VFI issue.

Consistent with the PC's broader observations regarding governance and transparency, maintaining an independent Commonwealth Grants Commission (CGC) remains critical to confidence in the GST system. Transparent, evidence-based assessment methodologies and regular review processes ensure the HFE framework continues to evolve alongside emerging evidence and changing circumstances.

Greater transparency is also required where the Commonwealth provides support to individual jurisdictions outside the normal operation of HFE. Where the Commonwealth determines that additional assistance should be provided beyond a jurisdiction's assessed fiscal need, that support should be delivered transparently and separately from the GST distribution system. This would preserve the integrity of HFE while ensuring the costs and objectives of Commonwealth policy decisions remain visible and accountable.

Taken together, the issues outlined above demonstrate that the principal challenges facing the Federation are not the result of equalisation itself, but arise from growing fiscal pressures, the transfer of costs across systems and jurisdictions, and shortcomings in governance and assessment frameworks. The question is therefore not whether HFE should be weakened, but how the system can be improved while preserving its core purpose of equalising fiscal capacity across the Federation.

Interim recommendations

HFE is the primary objective of the GST allocations system. National rules cannot be designed to preserve a privileged outcome for any jurisdiction over others. We cannot have a system where there are two standards of service for Australians. We must return to the system where Australians have access to comparable public services wherever they live. This is a practical expression of fairness, equality of opportunity, and national cohesion. Ultimately, it is one of the defining characteristics of Australia.

Preferred approach: restore the pre-2018 system

The ACT supports the PC's second option: restoring the pre-2018 GST distribution system and full HFE. Any claims of dominant-state effects should occur outside the system. This option needs to preserve the integrity of HFE by continuing to recognise material differences in states' revenue-raising capacities. Where the Commonwealth considers that jurisdiction-specific assistance may be appropriate to manage revenue volatility or support reform, it should be assessed transparently on its merits and delivered outside the GST distribution system.

Established mechanisms are available, including bilateral intergovernmental agreements, Federation Funding Agreements and National Competition Policy payments. Assistance should be linked to agreed policy or productivity reforms. These mechanisms would support clarity about the purpose, scale, duration and conditions of any assistance, while allowing its costs to be met directly by the Commonwealth rather than through changes to other jurisdictions' GST shares.

No mining adjustments

The ACT does not support the PC's first option. Incorporating either a dominant-state adjustment or a broad mining discount into the CGC's mining assessment would not improve on the pre-2018 system and would weaken full HFE.

Mining endowments and the resulting royalty revenues are substantial and unevenly distributed sources of state fiscal capacity. Recognising these differences is central to HFE. Insulating some of the revenue capacity of major resource-producing jurisdictions would weaken both the equity of the GST distribution system and the HFE principle.

What is labelled as a dominant state issue is inherent in the use of a relative yardstick for policy neutrality and deliberate in the design of the system. It does not arise because of an error in the methodology. All states and territories face redistributions where their assessed revenue shares exceed their population shares. Assessed revenue shares are based on weighted rates to reflect the norm. Under CGC assessments, a revenue concentration in any jurisdiction will always pull the weighted rates towards its actual rate to ensure the norm is appropriately captured. Similarly, jurisdictions with small revenue shares can see their relativities impacted by policy changes in the actual rates of larger jurisdictions.

A dominant state adjustment is not necessary to promote efficiency. The evidence does not establish the existing assessment materially discouraged resource-rich jurisdictions from reforming their royalty regimes, developing their resource bases, or adversely affecting Australia's exports. Commodity revenues are driven predominantly by global prices and demand. Queensland's progressive coal royalty rates introduced from 1 July 2022 remain in place, while Western Australian royalty rates have also remained stable. These outcomes do not support the proposition that the consequences of the current CGC assessment framework for GST distribution on royalty decisions are, by themselves, a material impediment to changes in royalty policy.

Further, it is difficult to establish that the GST arrangements prevent policy reform. The ACT is one of the most progressive jurisdictions on tax policy. The ACT has not stopped undertaking significant reform, either before or after the 2018 reforms. However, it could be argued that any jurisdiction that receives a financial advantage over other states may be less likely to change the status quo. For example, gold royalties are extremely low in WA at 2.5 per cent of production, despite record high prices. Is this the optimal tax setting; what incentives are there for reform; and how does this impact all Australians?

Further, a dominant-state adjustment could also weaken certainty by introducing additional judgement about when dominance exists, which minerals or revenues should be adjusted, and the scale and duration of the adjustment—an unclear line around when and where the GST should recognise special factors. The PC acknowledges in its Interim Report that the CGC has not defined the 'dominant state' effect. This discretion would add another layer to the CGC's existing mineral-by-mineral approach. In this context, the redistribution of GST would also make it harder to observe differences in states' revenue-raising capacities. These are not justified where the CGC can continue to assess states' underlying mining revenue-raising capacities through its existing mineral-by-mineral approach.

The ACT considers that the CGC's mineral-by-mineral approach remains the most appropriate basis for assessing mining revenue. It recognises the uneven distribution of individual mineral bases and directly relates each state's revenue-raising capacity to the royalty policies applied to those minerals. This provides an appropriate balance between reflecting what states do and maintaining policy neutrality. A dominant-state adjustment would instead introduce additional judgement, complexity and implementation risk while reducing the extent of horizontal fiscal equalisation.

Resource-producing jurisdictions' costs are also already recognised elsewhere in the CGC assessment framework. Infrastructure supporting mines and ports is accounted for in the roads assessment, while expenditure on mining regulation, exploration, production and rehabilitation is recognised through the services to industry assessment. These costs do not justify insulating mining revenue capacity within the revenue assessment.

The options proposed in the Interim Report to address dominant-state effects are largely structural and enduring in nature. They risk embedding permanent changes to Australia's equalisation framework in response to what is fundamentally a cyclical prominence arising from commodity price movements.

The ACT does not support any recommendations that dominate the first order principle of HFE. Structural changes to the GST system should not be applied to temporary fluctuations in fiscal capacity. The 2018 reforms provide a salient example of the damage that can be caused when HFE is weakened.

Every state and territory should absolutely be free to benefit from their natural resources, natural endowments, industry structures, economic strengths, and specific policy choices. Celebrating the success, innovation, and prosperity of our strongest states is essential for a growing national economy.

However, this regional success must not come at the expense of all other governments and the broader citizens of Australia. Nor does one state's extraordinary economic dominance justify permanent and preferential treatment within our national revenue distribution system. The same rules should apply to every state and territory to ensure that the Federation is maintained equally for all Australians.

Other improvements to the GST distribution methodology are warranted

If the PC makes recommendations to address issues within the current GST distribution system, it must also seek to address other genuine fiscal disabilities. This includes small-jurisdiction service delivery costs, health and justice expenditure pressures, cross-border demand and market constraints—all of which have robust supporting evidence.

The Commonwealth's recent provision and quarantining of the small-state health top-up demonstrates that some scale-related costs are both real and measurable. Where such disabilities can be reliably quantified, strengthening their measurement and assessment within HFE is preferable to addressing them through ad hoc arrangements outside the GST system.

The existence of imperfections within the HFE system does not diminish the importance of equalisation itself. Instead, it highlights the need for continued refinement of the evidence and assessment framework to ensure GST distributions accurately reflect jurisdictions' relative fiscal circumstances. Strengthening HFE is therefore best achieved through improved measurement and assessment, not by reducing the degree of equalisation.

Without this protection, the fiscal effects of the reforms would instead be reflected in weaker revenue positions, higher borrowing requirements, increased debt and growing pressure on governments to either raise taxes or reduce service delivery. The ACT's introduction of a \$100 Health Levy in 2025-26 provides a salient example of the difficult fiscal choices that governments are required to make with worsening VFI. The ACT considers that continuing the 2018 reforms without the NoWO guarantee would not only compromise the equity objective but materially augment the fiscal sustainability constraint.

If the Commonwealth considers ongoing support for Western Australia necessary, it should provide that support directly and transparently outside the HFE system. Alternatively, if support continues to be delivered through the HFE system, the Commonwealth should make the NoWO guarantee permanent. Doing so would preserve the integrity of HFE, provide greater transparency regarding the fiscal costs of Commonwealth policy decisions, and ensure affected jurisdictions are not required to absorb the ongoing consequences of weaker equalisation outcomes.

A permanent NoWO guarantee

The PC's third option would only work with a permanent, legislated and Commonwealth-funded NoWO guarantee. Option 3 would remove the standard state benchmark and the GST pool boost, while retaining the 0.75 relativity floor.

Without the NoWO guarantee, the third option would remain inconsistent with full equalisation and expose jurisdictions other than Western Australia to material fiscal losses. The guarantee should ensure that no state or territory receives less than it would have received under the pre-2018 system.

The PC recognises that this option is not consistent with the equity principle and poses threats to states' fiscal sustainability. The PC therefore recognises that this final option is not viable without the compensatory mechanism of a permanent, legislated NoWO guarantee funded by the Commonwealth.

On its own, the ACT considers this option would still involve significant departure from the equity objective and simultaneously augment fiscal sustainability concerns to states other than Western Australia. It is necessary to add a permanent guarantee as a feature to this option, to ensure that none of states and territories would be worse off than under the pre-2018 system.