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Productivity Commission
4 National Circuit
Barton ACT 2600, Australia

Submission to the Productivity Commission

2026, Interim report - GST distribution reforms, Interim report, Canberra, August

The 2026 Productivity Commission review of GST distribution oversimplifies the challenge and appears to have substantially overlooked Commission-recognised weaknesses in the underpinning Horizontal Fiscal Equalisation (HFE) approach that existed prior to 2018 revisions, yet favours return to that approach. In essence, that approach focusses on fiscal equality *above* equity and fairness complexities that should not be ignored in the HFE calculation basis – with tweaking by either the Grants Commission under some sort of direction by the Treasurer, or directly by the Commonwealth Government. It is particularly unfortunate to see:

- in the wake of the 2018 HFE review, no resolution of the HFE approach principles and shortcomings with governments and the public that could have improved understanding and consideration of this matter now
- insufficient recognition of the enhanced Commonwealth revenue stream and/or revenue expectation that came with the continuation of the ‘mining boom’ that in 2018 had been projected to ease
- a very light recognition of and needed solution(s) for the mining anomaly(s) impact from un-equal mineral wealth endowment across the states, and no apparent recognition of the related mineral sovereignty issue.
- prominent hypothetical argument for asserted ‘perverse outcomes’ from State benchmarking included in assertion that the current system does not work
- internally conflicting assessment of migration impact from unequal HFE outcomes

The Commission 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”. (p.2) The supporting arguments for this determination are at-best hollow:

- **asserted “perverse outcomes” from State benchmarking is described simply as a “possibility”.**

The supporting example of cost impact from a natural disaster bushfire in NSW that might change the GST allocation for NSW, and in-turn WA, overlooks Disaster Recovery Funding Arrangements that would be available to NSW – with which the hypothetical example would presumably have relatively minor impact. Further attempt to support this *determination* does not address the ‘mining anomaly’ and related policy neutrality issues that the Commission carefully considered in its 2018 review of HFE. The concluding characterization of a (current) “two-tiered GST distribution system” also relies on omission of solution for these significant considerations.

- **description of WA as the only beneficiary of the 2018 reforms overlooks the primary driver(s) for the 2018 reforms, and gives no meaningful recognition to the enhanced Commonwealth revenue and/or expected revenue stream that came with the (by many) un-forecast continuation of the ‘mining boom’.**

The concluding assessment that “Consequently, the cost of revenue volatility has not been eliminated; it has merely been shifted and spread between governments.” (p.4) should have been expected, and should have been recognised as a positive outcome from the 2018 reforms.

Given these significant omissions, it is concerning that the Commission now favours some sort of return to the pre-2018 system.

- **claim of significant ongoing ‘no worse off’ liability costs on the Australian Government (again) overlooks the enhanced Commonwealth revenue and/or expected revenue from mining, and, as was the case in 2018, is simply based on a forecast.**

➤ **Minimal efficiency gains**

The Commission has linked policy choices with efficiency but substantially overlooked examination of true efficiencies.

It notes that “..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.” (p.4), but with “limited evidence” of any impact, and makes no mention of the significant mining royalties anomaly or the related issue of minerals sovereignty.

It recognizes but downplays that the 2018 reforms “..reduced dominant-state effects in the mining assessment..” (p.5) for a *marginal* improvement in reform incentives – based on Commission *modelling*.

It concludes that “...the 2018 reforms have made the GST distribution system more complex and less consistent with its core purpose.” (p.5) without providing any substantial evidence of either facet, or of the full Federation-VFI-HFE context needed to frame ‘core purpose’. Much of the ‘added’ complexity is computational. Core facets of these reforms improve general reasonableness and transparency.

Solution

Prime Minister Albanese’s 24 August promise to not change current arrangements renders consideration of solutions somewhat moot – for now.

The current approach for GST distribution should be maintained until-and-unless all States can:

- settle a solution for the ‘mining anomaly’, and
- acknowledge the impact of State and Commonwealth spending choices and control on overall fiscal sustainability.

Yours sincerely

Rowan Roberts

Appendix

Submission Context

A) 2018 Horizontal Fiscal Equalisation (HFE) Review

(Ref.: Productivity Commission 2018, Horizontal Fiscal Equalisation, Report no. 88, Canberra. (PC 2018))

The following aspects of the 2018 Productivity Commission review of HFE are germane context for considering the Commissions 2026 interim report of GST distribution reforms.

Overview

“Australia’s system of horizontal fiscal equalisation (HFE) transfers GST between the States and Territories (hereafter States) with the aim of equalising States’ fiscal capacities to deliver public services.” (PC 2018, p.3)

HFE Acceptance

The view of the 2018 Productivity Commission on how HFE is viewed by stakeholders seems *contradictory* – presumably highlighting a foundational flaw with its application – ref.:

“The basic premise of Horizontal Fiscal Equalisation — fiscal equality in the Australian federation — has broad support from all levels of government.” (PC 2018, p.2)

But that:

“HFE has often been a point of contention with the States, as each has vied for a larger share of the funding pool.” (PC 2018, p.3)

And that:

“Since its inception, the way any State views the operation of HFE at any point in time is largely subject to Miles’ law — ‘where you stand depends on where you sit’.” (PC 2018, p.3)

One inference from the subordinated observations of conflict, is that the Commission needs to be highly sceptical of input on HFE from key stakeholders. The conundrum this creates is of a foundational nature, presenting a realistic need for a measure of compromise and

pragmatism in solutions (eg. use of relativity benchmarks, a relativity floor, & mining discounts).

HFE Deficiencies

The 2018 Productivity Commission made the following pointed findings on HFE system deficiencies:

“...the current approach also has significant weaknesses. Reform and development opportunities are likely being missed at the expense of community wellbeing over time.

- There is much scope for the system to discourage State policy for major tax reform and desirable mineral and energy policies (royalties and development).

- Full fiscal equalisation does not systematically allow States to retain the dividends of their policy efforts. This raises concerns about the fairness of equalisation outcomes and corrodes public confidence in the system.

- The system is very poorly understood by the public and indeed by most within government — lending itself to a myriad of myths and confused accountability.” (PC 2018, p.2)

While relegated to ‘below’ a status of being “Key points”, the 2018 Productivity Commission also recognised:

- a) that more broadly driven inequities can be created through spending choices of individual States – ref.: “For the States, some of this (vertical fiscal inequities) ‘gap’ is of their own volition, due to how they choose to use their tax bases.” (PC 2017, p.6), and,

- b) a valid context for assessing that ‘fairness’ than simply as equality – ref.: “Balancing fiscal equality and fairness through this broader equity lens (of equity, efficiency, transparency and accountability) means that States’ fiscal capacities do not necessarily have to be equal.” (PC 2017, p.5)

The 2018 Productivity Commission highlights the ‘mining problem’ and actual, forecast and possible anomalous impacts on esp. Western Australia with HFE as a consequence, but does not seem to account for the direct or indirect knock-on financial benefits for Commonwealth revenue – from which all states will be beneficiaries.

It seems clear that none of these weaknesses have been resolved subsequently – other than through the pragmatism of the 2018 revision.

Qualification for HFE Determination

In noting the scope of work conducted by the Commonwealth Grants Commission to calculate GST relativities between the States, the 2018 Productivity Commission recognised that it is a complex task, requiring a moderately high level of per-capita based work-around methodology, and yields an *imperfect result* – ref. “This comprehensive scope does not mean that all activities are differentially assessed (that is, have ‘disabilities’ that reflect a State’s structural disadvantages applied to them) or that HFE achieves perfect equalisation. Some disabilities cannot be reliably measured or have an immaterial impact and are either discounted or assessed on an equal per capita (EPC) basis. Due to this, in 2016-17, nearly 40 per cent of revenues, and about 20 per cent of expenditures were assessed on an EPC basis, or near EPC basis.” (PC 2018, p.7)

Broad Principle Change Recommended

The 2018 Productivity Commission recognised that exclusive focus on financial equality denied HFE improvement opportunity – ref. :

“In striving for full fiscal equalisation, it is likely that opportunities are being missed to achieve broader equity outcomes (that incorporate fairness by rewarding States for their policy efforts) and to improve efficiency for the benefit of the Australian community.” (PC 2018, p.18)

To enable improvement, the Commission recommended:

“(to better balance equity from and efficiency) The Commonwealth Government should set a revised objective for HFE to provide States with the fiscal capacity to deliver a **reasonable standard** of services. Changing the objective is an essential precursor to further improvements to the HFE system.” (PC 2018, p.2)

Wrap-up

“Improving HFE will deliver benefits to the Australian community. But ultimately, greater benefits will only come from more fundamental reforms to Australia’s federal financial relations: namely, to spending and revenue raising responsibilities and ensuing accountabilities.” (PC 2018, p.2)

B) 2026 GST Distribution Reforms

(ref. Productivity Commission 2026, Interim report - GST distribution reforms, Interim report, Canberra, August.)

Overview

“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.” (PC 2026, p.2)

After making this claim, the 2026 Productivity Commission then describes:

- Possibility of perverse outcomes from application of a state benchmark (eg. bushfire costs in NSW)
- Suggested *inequity* from benchmark linking WA to the populous states of NSW or Vic
- GST distribution benefits that have flowed to WA, without balancing that outcome with actual or expected revenue benefits that have flowed to the Commonwealth as a result of the extended mining ‘boom’ and could reasonably be used to fund the NoWo payments

HFE Acceptance

The 2026 Productivity Commission acknowledges ‘historically’ differing views on fiscal equalisation, but portrays that it “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.” (PC 2026, p.1)

This description significantly simplifies the full history, and focusses on equalization efforts from the 1970’s. Prior history is also relevant to at least public perceptions, and arguably as context for the setting and interpretation of principles.

HFE Deficiencies

The 2026 Productivity Commission seems to simplify and even dismiss some of its earlier and generally more nuanced view(s) of previously recognised HFE weaknesses. It clearly favours a financial ‘equality’ mindset, floats speculated/asserted opportunity for social cohesion benefits, and effectively advocates for HFE to neutralise related migration incentives (p.10) that the 2018 Commission substantially dismissed as being of an *academic*

debate and for which it concluded “..HFE is unlikely to have a significant effect on interstate fiscal differences, and hence on incentives to relocate” (PC 2018). The more opinionated 2026 view(s) is a concerning reflection for the Productivity Commission to consider.

Notwithstanding HFE weaknesses recognised and explained in 2018, the 2026 Productivity Commission seems clearly to favour some form of return to the pre-2018 system without resolving those deficiencies.