

SEPTEMBER 2026

Victorian response to interim report

PC inquiry into GST distribution reforms
2026

The Secretary
Department of Treasury and Finance
1 Treasury Place
Melbourne Victoria 3002
Australia
Telephone: +61 3 9651 5111
dtf.vic.gov.au

Authorised by the Victorian Government
1 Treasury Place, Melbourne, 3002
Printed on recycled paper.

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1. Executive summary

This submission responds to the Productivity Commission's (PC) interim report released on 14 August 2026 as part of its inquiry into the 2018 GST distribution reforms. The submission builds on Victoria's initial submission to the inquiry, made in March 2026.¹

Victoria commends the PC on a high-quality, well evidenced and presented report. As the interim report acknowledges in part, the debate around the GST distribution has been mired by self-interested public media campaigns and exploiting misconceptions to achieve specific outcomes for a small number of Australians. Victoria appreciates the independent, forthright and clear policy analysis the interim report provides.

Victoria's position is that the 2018 changes are inherently inequitable and must be reversed. The 2018 changes have failed to meet their own objectives and fail to meet any independent evaluation of an ideal GST distribution system. If allowed to continue, the 2018 changes would only serve to provide one state, WA, more revenue than it needs, at the expense of all other states.

Victoria agrees with the interim report that the 2018 changes "should not be an ongoing feature of the GST distribution system", "are not operating efficiently, effectively or as intended" and have "not markedly improved efficiency, fiscal sustainability or certainty".² The interim report validly notes that the 2018 changes were motivated by political pressure and misconceptions.³

The interim report also rightly finds that the 2018 changes must be overturned – they haven't improved efficiency or predictability for states' budget planning and have cost far more than anticipated. Worse, they spend billions of dollars of Australian taxpayers money without any reward – none of the promised productivity-enhancing reform has eventuated.

All Australians deserve access to the same standard of services and infrastructure, no matter where they live. The people of Victoria, NSW, Queensland, SA, Tasmania, the ACT and the NT all deserve to have the same access to basic public services and infrastructure as the people of WA. The interim report clearly finds that the 2018 changes significantly detract from the horizontal fiscal equalisation (HFE) that delivers this.

Without the no-worse-off guarantee (NoWO guarantee), Victoria would have been \$4.3 billion worse off since 2018-19 and the other states would have lost out on \$14.6 billion. Over the same time, WA has been \$22.4 billion better off from the 2018 changes and has reported surpluses of \$26 billion.

The implications for the services and infrastructure Australians rely on are serious. Victoria's 2025-26 guarantee payment of \$1.9 billion is equivalent to funding the salaries of around 17,000 additional nurses, teachers or police officers.

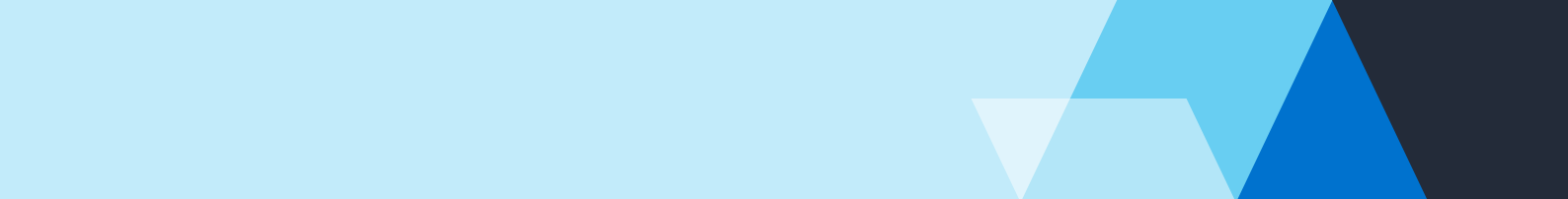
The interim report also finds the 2018 changes may have even disincentivised WA from pursuing reforms to its royalties or other revenue sources by giving it too much revenue.⁴ This is borne out by

¹ [Productivity Commission Inquiry into GST distribution reforms, Victorian Government Response](#) (hereafter, "Victoria's initial submission").

² Interim report, pp 28, 39 and 70.

³ For example, Interim report, p.14. "...misconception may have played a role in shaping the public discourse which ultimately led to pressure to change Australia's HFE system", and p.7. "Political pressure from the Western Australian Government and public, alongside broader concerns that the HFE system could act as a barrier to state policy reform ultimately led the Australian Government to introduce reforms to the system in 2018."

⁴ Interim report, p 49.



Victoria's analysis showing WA has made no major revenue reforms since 2018, while most other jurisdictions, including Victoria, have done so.

Victoria maintains that the best solution for Australia is to return to the pre-2018 system. Victoria agrees with the interim report that equalisation is the primary objective of the GST distribution – and the former system does this best.

The interim report finds that any of the supposed shortcomings of the former system – that it was too volatile or created policy disincentives – are not borne out in the evidence. Victoria agrees with the interim report's assessment that the Commonwealth Grants Commission (CGC) has robust processes to determine its methods in the interest of HFE as the independent technical expert.

Victoria strongly supports the overarching message of the PC's recommendations – the 2018 changes must be reversed, and if not, the other states must not be made worse off. However, Victoria has suggestions to bolster the interim report's recommendations for the final report.

Crucially, Victoria does not support the interim report's preferred solution of returning to the former system with directions to the CGC to adjust for mining dominant state issues (interim recommendation 4.1). The PC's focus on dominant state effects appears based on theory, but actions speak louder than words: the interim report does not make the case that dominant state issues are substantiated in practice, when it rightly notes that other policy incentive effects are not.

The interim report also does not address practically how a dominant state adjustment will be implemented without significantly undermining HFE.

The mining assessment is pivotal to achieving HFE and is one of the only mechanisms that effectively shares Australia's mineral wealth among Australians. Any adjustments to address dominant state issues materially undermine the core aim of HFE, are infeasible to practically implement, or both.

Victoria opposes a flat discount to the mining assessment suggested by some other submissions to the inquiry.⁵ A discount would deliberately reduce HFE and deliver a permanent windfall to mining states with no requirement to actually undertake reform. This goes well beyond managing the claimed aims of addressing volatility or policy neutrality and would be a permanent structural advantage granted only to states fortunate enough to enjoy an abundance of mineral resources.

The CGC is best placed as the independent expert to decide on any potential methods, in consultation with states – as it has done since its inception in 1933. The CGC has consistently determined not to apply dominant state adjustments, and in fact has made its mining assessments more granular – all in the service of best achieving HFE.

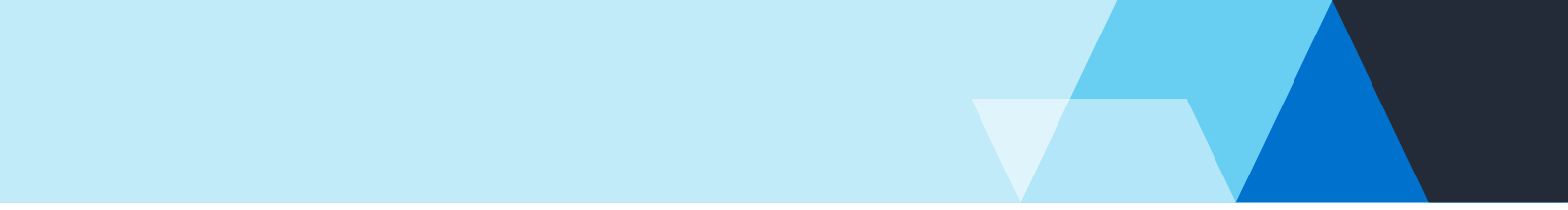
Victoria supports interim recommendation 4.2 in-principle on the basis that if the Commonwealth decides to continue to provide WA with additional funding, it is simpler and more transparent to do so outside the GST system.

However, this option clearly doesn't achieve equalisation and is only supported as a fallback. It would create a two-speed country where residents of WA can have access to better schools, roads and hospitals. The PC estimates that to allow the other states to provide the same level of services as WA, the Commonwealth would have needed to spend another \$47 billion in 2024-25.⁶

This submission makes extensive suggestions to provide further safeguards around recommendation 4.2. These aim to ensure any payments get value for taxpayers' money by being tied specifically to

⁵ For example, see [Submission 62 - Queensland Government - GST distribution reforms - Public inquiry](#) or [Submission 37 - Government of Western Australia - GST distribution reforms - Public inquiry](#).

⁶ Interim report, p 26.



reform, and that only genuine issues with GST policy incentives or uncertainty are compensated. This would be a significant improvement on the expensive and inequitable free ride the 2018 changes have provided to WA.

Victoria also supports the interim report's recommendation 4.3 as a fallback: if the Commonwealth continues with the 2018 changes, it must ensure the other states are at least not worse off. Victoria agrees that the NoWO guarantee must be made permanent in this case.

Victoria makes further suggestions to bolster recommendation 4.3, to ensure it cannot be used as a bargaining chip, held over states' heads in any future negotiations with the Commonwealth. The NoWO guarantee must be permanently legislated, with ironclad safeguards that it cannot be used to trade-off other concessions from states or replace any other funding.

Victoria urges the PC to continue to remain vigilant in its independent evaluation of the 2018 changes for the final report, and its recommendations.

Victoria again thanks the PC for the opportunity to provide feedback on the interim report. Department of Treasury and Finance staff are available and would welcome the continued opportunity to discuss the details of Victoria's suggestions with the PC.

2. Summary tables of Victoria's responses to the interim findings and recommendations

2.1 Summary of Victoria's response to the interim findings

PC interim finding	PC finding detail	Victoria's view
1.1 A lack of understanding of the HFE system has undermined the quality of public debate on the topic	The complex nature of the horizontal fiscal equalisation (HFE) system has contributed to a lack of public understanding of the system and caused several misconceptions to become prominent in public debate. The prominence of these misconceptions has undermined the quality of public discourse surrounding the HFE system and resulted in debate which is often based on mischaracterisations of the system.	Agree. See Section 5.2.
1.2 An unprecedentedly low relativity – arising from the impacts of the mining boom – strained community acceptance of the HFE system in Western Australia and was a catalyst for the 2018 reforms	<p>Strong and sustained demand for key mining commodities has resulted in a significant and prolonged increase in Western Australia's own-source revenue-raising capacity. This caused Western Australia's relativity to reach unprecedented lows, straining community acceptance of the horizontal fiscal equalisation (HFE) system in the state.</p> <p>Dissatisfaction with the HFE system in Western Australia further intensified when GST payments began to fall at the same time as royalty revenues due to the Commonwealth Grants Commission's use of lagged data. Political pressure from the Western Australian Government and public, alongside longstanding criticisms of the incentive effects and volatility of the HFE system, led the Australian Government to introduce the 2018 reforms.</p>	<p>Agree – however, based on misconceptions.</p> <p>Victoria recommends that the role of political pressure and public advocacy are highlighted further in the finding – see Section 5.1.</p>
2.1 The new fiscal equalisation standard creates perverse outcomes that invert the logic of HFE – it should not be an ongoing feature of the GST distribution system	The new fiscal equalisation standard has introduced perverse outcomes to the GST distribution system. One example is the ability for states that have a greater fiscal capacity than the standard state (currently only Western Australia) to receive additional GST revenue following a natural disaster in New South Wales (currently the standard state). This outcome runs counter to the logic of horizontal fiscal equalisation (HFE) and could undermine community support for the current GST distribution system.	Agree. See Section 6.2.

PC interim finding	PC finding detail	Victoria's view
2.2 The 2018 reforms are not operating efficiently, effectively or as intended	<p>In some respects, the 2018 reforms are operating as intended.</p> <ul style="list-style-type: none"> The new fiscal equalisation standard and relativity floor limit the extent to which a state's share of the GST pool can fall in response to a positive economic shock. The No Worse Off (NoWO) guarantee has ensured that, to date, no state has been fiscally worse off following the reforms. <p>However, the 2018 reforms are not operating as intended in other ways.</p> <ul style="list-style-type: none"> Only one state is fiscally better off following the reforms: Western Australia. The 2018 reforms have not provided more stable and predictable GST revenues for all states, with the scheduled expiration of the NoWO guarantee reducing the longer-term predictability of GST revenues and creating fiscal uncertainty for most states. There is widespread and deeply felt dissatisfaction with the 2018 reforms among most states, limiting the likelihood that the reforms will be a long-term solution to the pressures facing the GST distribution system. <p>Other impacts of the 2018 reforms – including the introduction of perverse outcomes into the GST distribution system (interim finding 2.1), increased complexity, and costs to the Australian Government being significantly higher than expected – detract from their efficiency and effectiveness.</p>	<p>Agree.</p> <p>See Section 6.</p>
3.1 The GST pool boost has, so far, contributed to a divergence in fiscal capacities between the states and failed to meet its intent	<p>Because all states except Western Australia have received No Worse Off (NoWO) payments since the introduction of the pool boost, it has only increased Western Australia's GST revenue. This is both contrary to the intent of the reform (to make every state better off) and to the objective of horizontal fiscal equalisation (by increasing fiscal divergence check between the states).</p>	<p>Agree.</p>

PC interim finding	PC finding detail	Victoria's view
3.2 The GST distribution system was and is broadly policy neutral, with some exceptions that are best managed through targeted responses	<p>The GST distribution system was and is broadly policy neutral for most expenditure decisions and incremental non-mining tax changes. There are impacts to GST payments, but these are small compared to the larger constraints to reform such as transition funding, distributional impacts and public acceptance.</p> <p>The effect on GST payments can add to the fiscal cost and uncertainty of large state tax reforms, particularly stamp duty to land tax reform and mining royalty changes. However, the evidence since 2018 suggests these effects are not decisive. States have proceeded with reforms despite material changes to their GST payments, and reducing this effect has not necessarily led to reform.</p> <p>The PC therefore places less weight than the 2018 PC review on the effect of policy changes on GST payments as a rationale for system-wide horizontal fiscal equalisation reform. Where effects to GST payments are material and measurable, they are better managed through targeted Commonwealth Grants Commission assessment changes or, especially where the main barrier is the revenue transition, direct Australian Government support.</p>	<p>Agree that the system was and is broadly policy neutral, but that the CGC is best placed to decide how to manage any issues.</p> <p>See Sections 5.4 and 7.1.</p>
4.1 The reduction in equalisation under the current system, with or without a permanent NoWO guarantee, has not markedly improved efficiency, fiscal sustainability or certainty	<p>Relative the pre-2018 system, the current system – even if No Worse Off (NoWO) payments were made permanent – reduces equity without making marked improvements to efficiency, fiscal sustainability or certainty.</p> <p>The reforms have also created the possibility of perverse outcomes by introducing a mechanism whereby states with higher fiscal capacities can receive increased GST payments.</p> <p>The reforms, with the NoWO guarantee expiring as scheduled, will add to existing fiscal sustainability pressures on a range of states. Even if the NoWO guarantee was made permanent, the reforms ensure any state with a greater fiscal capacity than New South Wales and Victoria can retain a fiscal advantage over the rest of the Federation. This could undermine public support for the system.</p> <p>The reforms have marginally improved the predictability of GST revenue for some states and, if the NoWO guarantee is not made permanent, marginally reduced it for others. For all states, the reforms have introduced additional methodological complexity and created interactions which increase the risk of forecasting error.</p>	<p>Agree – the 2018 changes certainly reduced equalisation and have not improved efficiency – but the finding should make clear they also made fiscal sustainability and certainty worse.</p> <p>See Sections 6.1 and 6.4.</p>

PC interim finding	PC finding detail	Victoria's view
4.2 Some alternatives perform better at lower cost to HFE than the 2018 reforms	<p>All alternatives considered by the inquiry to date involve trade-offs between equity, efficiency, fiscal sustainability and certainty. Nevertheless, some alternatives have better equity outcomes than the current system, without marked costs to efficiency, state fiscal sustainability, and certainty.</p>	<p>Agree – particularly that the former system is a much preferred alternative.</p> <p>See Section 7.</p>
5.1 The CGC has adopted an independent, consultative and transparent approach to its role, but should strive for continuous improvement	<p>By recommending how GST revenue should be distributed, the Commonwealth Grants Commission (CGC) has a critical role in Australia's horizontal fiscal equalisation (HFE) system.</p> <p>The CGC performs this role with a high degree of independence, maintains highly productive and consultative relationships with state treasuries, and undertakes its work with reasonable transparency. These characteristics strengthen the system.</p> <p>However, HFE arrangements are complex, and efforts to continuously improve transparency are important. Given this, there would be value in the CGC exploring any opportunities to:</p> <ul style="list-style-type: none"> • more fully disclose how it weighs up its primary objective of HFE and its different supporting principles when considering changes to its methodological approach • further address data confidentiality restrictions so that more data can be shared with key stakeholders • make greater use of public data sources – including linked administrative data – to improve consistency between public-facing data and the data it uses • better disclose the nature and basis of any adjustments it makes to public-facing data where those adjustments are necessary because of data limitations. <p>The CGC should also consider trialling a wider approach to consultation as part of its 5-yearly methodological review by accepting public submissions from interested parties beyond state governments.</p>	<p>Agree.</p> <p>See Section 8.1.</p>

2.2 Summary of Victoria's response to the interim recommendations

PC interim recommendation	PC recommendation detail	Victoria's view
4.1 Australia should return towards the pre-2018 system but the Australian Treasurer should direct the CGC to address dominant-state effects	Australia should move back towards the pre-2018 GST distribution system but the Australian Treasurer should direct the Commonwealth Grants Commission (CGC) to address costly dominant-state effects where they arise.	<p>Do not support.</p> <p>Victoria supports a return to the pre-2018 system, but does not support directions from the Commonwealth Treasurer to the CGC to address dominant state effects.</p> <p>Victoria does not support directions to address dominant state effects as:</p> <ul style="list-style-type: none"> any change would significantly detract from HFE real-world (as opposed to theoretical) effects are not established in the evidence there are no clear, robust methods to implement adjustments directions would impede the independence of the CGC. <p>See Section 7.1.</p>
4.2 If the Australian Government is not minded to pursue interim recommendation 4.1, Australia should return to a pre-2018 system and the Australian Government should make direct payments to states it considers are affected by dominant-state issues	Australia should move back towards the pre-2018 GST distribution system and it is recommended that the Australian Government make direct payments, outside of the GST pool, to states it considers materially affected by dominant-state effects.	<p>Do not support payments to states the Commonwealth considers are affected by dominant state issues, but if the Commonwealth is committed to addressing dominant state issues this approach is preferred to that in recommendation 4.1.</p> <p>The GST pool should be reserved for HFE: asking it to achieve too many objectives undermines all of them. Any other payments should be funded transparently and outside the GST system.</p> <p>Victoria proposes specific guardrails and amendments to this recommendation to ensure Commonwealth payments outside the GST system are cost effective and only used under appropriate circumstances.</p> <p>See Section 7.2.</p>

PC interim recommendation	PC recommendation detail	Victoria's view
4.3 If the Australian Government does not pursue interim recommendation 4.1 or 4.2, it should make the minimum changes to address the critical issues in the current system	<p>If the Australian Government does not pursue interim recommendation 4.1 or 4.2, the minimum changes to address critical issues with the current system are as follows:</p> <ul style="list-style-type: none"> remove the standard state benchmark remove the pool boost make the No Worse Off guarantee, or broadly equivalent payments outside of the GST distribution system, to the states permanent. 	<p>Support making the no-worse-off guarantee permanent, should the Commonwealth retain any elements of the 2018 changes, and/or implement recommendation 4.1.</p> <p>Any change that does not revert to the system of full HFE must include a NoWO guarantee.</p> <p>Victoria makes additional suggestions to strengthen this recommendation and the NoWO guarantee to ensure long-term certainty for states.</p> <p>See Section 7.3</p>
5.1 Monitoring the potential for the HFE system to contribute to diverging state outcomes	<p>If the Australian Government's policy settings for the horizontal fiscal equalisation system allow one or more states to maintain a fiscal capacity that is significantly stronger than that of others – as current settings do – the Government should undertake regular analysis that examines the extent to which this is contributing to diverging state outcomes.</p>	<p>Do not support.</p> <p>Diverging outcomes can occur regardless of whether HFE is being achieved. Diverging state outcomes should be considered in consultation with states and territories separately from the policy neutral HFE system.</p> <p>See Section 8.3.</p>
5.2 There should be a more transparent approach for quarantining Commonwealth payments	<p>Where a state government seeks a payment to be quarantined from GST distribution calculations, it should be required to publicly write to the Australian Treasurer to formally request this. Requests should articulate why the state believes that the payment should be permitted to increase their fiscal capacity outside the horizontal fiscal equalisation system.</p> <p>The Australian Treasurer should be required to publicly respond to all requests with a decision and their supporting reasons. In their response, the Treasurer should address the substantive elements of the application, including outlining any factors that distinguish the payment from previous similar payments.</p> <p>To support transparency, all applications and their associated decisions should be tabled in Parliament at the time they are made and published in an appendix to the annual GST relativity update terms of reference provided to the Commonwealth Grants Commission.</p>	<p>Support – but recommend the Commonwealth Treasurer justify exemptions in the Terms of Reference where payments are exempted.</p> <p>See Section 8.3.</p>

PC interim recommendation	PC recommendation detail	Victoria's view
5.3 Ensure Federation Funding Agreement schedules provide net benefits for the community	<p>To maximise the benefits of intergovernmental funding agreements, the Australian Government and state governments should abide by the federal financial relations principles to which they have already agreed, including minimising the number of low value agreements with highly localised benefits.</p> <p>This would ensure that the benefits resulting from agreements outweigh the costs associated with them, including the administrative costs of negotiation, compliance and monitoring.</p>	<p>Support – but small agreements can be valuable. Focus on minimising unnecessary prescriptiveness.</p> <p>See Section 8.2.</p>
5.4 Update the IGAFFR, its schedules, and the enabling legislation	<p>The Intergovernmental Agreement on Federal Financial Relations (IGAFFR) and its schedules, and the Federal Financial Relations Act 2009 (Cth) should be updated to reflect the current federal financial relations architecture. This should include:</p> <ul style="list-style-type: none"> • replacing references to National Partnerships with Federation Funding Agreement schedules in the IGAFFR, or where references to national partnerships are essential, amending the reference to the past tense • removing references to the COAG Reform Council in Schedule C of the IGAFFR and clarifying which body has taken over as the independent assessor of eligibility for reward funding • removing references to historical payment schedules in Schedule D of the IGAFFR or at least consolidating the active elements of the schedule to the front of the document • amending the Federal Financial Relations Act 2009 (Cth) to remove provisions for now ceased payments, and to add provisions for active payments that are not referenced in the Act. 	<p>Support these administrative changes. Moreover, the original intent of state flexibility has been diminished so should be strengthened if the IGAFFR is updated.</p> <p>See Section 8.2.</p>

PC interim recommendation	PC recommendation detail	Victoria's view
5.5 Improving the functioning of CFFR	<p>The Council on Federal Financial Relations (CFFR) should:</p> <ul style="list-style-type: none"> commit to a more regular meeting cadence and review the agenda-setting process to ensure that state-led items are given sufficient time for discussion publish its outcomes as a communiqué rather than as a media release by the Australian Treasurer, and publish these outcomes on an enduring central repository, such as the Australian Treasury or Federal Financial Relations websites provide clearer guidance on when Ministerial Councils are expected to refer matters to CFFR for consideration. <p>Additionally, CFFR should work with National Cabinet to clarify the circumstances when CFFR should escalate matters to National Cabinet for First-Ministers' consideration.</p>	<p>Support.</p> <p>See Section 8.2.</p>
5.6 Enhancing the GFS	<p>To further enhance the accuracy and utility of the Government Financial Statistics (GFS):</p> <ul style="list-style-type: none"> state governments should strengthen their processes for validating GFS data before it is submitted to the Australian Bureau of Statistics (ABS) the ABS should explore opportunities to improve its public-facing documentation explaining the structure, classifications and relationships within the GFS. 	<p>Support pending further details on the problems with state data – the interim report does not describe in detail.</p> <p>See Section 8.3.</p>
5.7 Improving governments' long-term fiscal sustainability reporting	<p>Governments should ensure that they produce regular, long-term fiscal sustainability reporting – such as a 5-yearly intergenerational report – that demonstrates the fiscal impacts of maintaining existing government policies over the long term. A legislative requirement to produce this reporting should be introduced in jurisdictions that do not already have this.</p>	<p>Do not support – states should retain autonomy to decide.</p> <p>See Section 8.3.</p>

3. Introduction

On 14 August 2026, the Productivity Commission (PC) released the interim report as part of its inquiry into the GST distribution reforms. The GST distribution reforms refer to the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (the Act). This submission provides Victoria's response to the interim report. This submission builds on the evidence provided in Victoria's initial submission to the inquiry provided in March 2026. Victoria again thanks the PC for the opportunity to provide further comment on this important issue.

The inquiry is a legislative requirement of the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*. The changes to the GST distribution system made through this Act are referred to as the 2018 changes.

Following the legislation, the Commonwealth Treasurer issued the PC Terms of Reference for inquiry that it is to review the operation of the 2018 changes, including:

- The extent to which they:
 - Deliver a reasonable level of equalisation.
 - Appropriately balance responsiveness, reducing volatility and providing certainty for states' fiscal planning.
 - Support states to pursue reforms, including to the efficiency of service delivery or revenue bases.
 - Are fiscally sustainable for the Commonwealth and states and territories.
- Whether alternative arrangements would better achieve some or all of these outcomes.
- The interaction between GST and other Commonwealth payments, and the principles for exempting payments from the Commonwealth Grants Commission's (CGC's) assessments.

The Terms of Reference also state that the PC should include an assessment of implementation feasibility and risks, as well as being mindful of the Commonwealth's policy commitments in relation to the GST.

3.1 Structure of Victoria's response to the interim report

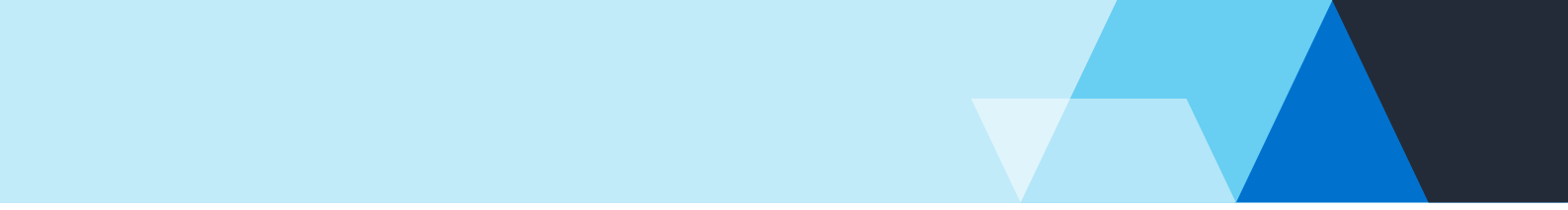
Victoria's response to the interim report commences with Section 4, outlining a principled framework for assessing alternative GST distribution systems. This aligns with the PC's assessment framework, detailing the primacy of equalisation as the key feature of any GST distribution system.

Section 5 details again why the originally stated rationales for the 2018 changes were largely unfounded. Victoria supports the interim report's findings that the 2018 changes were motivated by misconceptions, that GST is a relatively predictable source of state revenue and policy incentives are broadly mitigated through the CGC's existing assessments.

In Section 6 the submission outlines how the 2018 changes fail to address their own stated aims, and are a poor equalisation system evaluated against the principles outlined. The 2018 changes will leave most states fiscally disadvantaged, only marginally improve predictability for one state and have not motivated any state policy reform.

Section 7 evaluates the alternative HFE systems included the interim report or from other submissions, and finds none are preferable to the former, pre-2018 system of equalisation. Victoria outlines why recommendation 4.1 as drafted is not acceptable, due to the loss of HFE, lack of evidence for dominant state issues, and overly impedes on the independence of the CGC.

Finally, Section 8 provides Victoria's response to the PC's other recommendations. Victoria supports in-principle most of the PC's other recommendations 5.1 through 5.7, with some exceptions noted in



Section 8. Victoria's initial submission already stated however that it considers the inquiry should focus solely on issues regarding the GST distribution. Broader Federal Financial Relations (FFR) issues are complex, and any changes should be considered holistically, beyond the scope of the current inquiry.

4. The primary goal of the GST distribution system should be to achieve HFE

Victoria broadly supports the PC's framework for evaluating potential HFE systems presented in the interim report. Victoria appreciates the detail provided by the PC in outlining its evaluation framework, as well as the thorough analysis of different options.

Victoria agrees that the primary goal of the GST distribution system should be to achieve HFE, with other considerations or supporting principles as secondary concerns. Victoria understands the PC's evaluation framework places equity as the primary goal, with efficiency, sustainability and certainty as a second tier of objectives.

The PC's view in the interim report is that the GST distribution should deliver a 'reasonable' level of HFE, where reasonable achieves equity to the fullest extent possible without materially detracting from the other objectives (efficiency, sustainability and certainty) noting other objectives may be able to be addressed through other means.

Victoria broadly supports this framework however, suggests some revisions. Victoria's framework for assessing alternative options, and suggestions for how the PC could amend its analysis, are outlined in this section.

Ultimately any framework, principles and their prioritisation are judgements. However, Victoria aims to provide the rationale for its framework to achieve the objectives all states and the Commonwealth agreed to in establishing the GST, and for the best outcomes for all Australians.

A summary of Victoria's proposed principles for evaluating HFE systems are provided at Table 1. The following sections describe the rationale for these principles and their weighting, and differences from the PC's framework.

Table 1: Summary of Victoria's principles and evaluation framework for HFE systems

Principle	Description	Trade-offs	Suggested weighting
Horizontal Fiscal Equalisation	States should have the same ability to provide services, given the same revenue raising effort	Policy neutrality: HFE on outcomes could incentivise behaviour Simplicity: accurately representing fiscal capacities may be complex	High
Political neutrality	GST distributions should be set by an impartial, independent arbiter without political negotiation	N/A	High

Principle	Description	Trade-offs	Suggested weighting
Policy neutrality	Distribution methods should not incentivise states' policies, and states' policies should not directly influence their GST revenues	Accuracy, simplicity: representing policy neutral fiscal capacities requires estimation and judgement as observed fiscal capacities are influenced by policies	Moderate
Predictability	States should be able to plan confidently for future expenses and investment	HFE: accurate representations of HFE may change suddenly	Moderate
Simplicity	Distribution methods should be able to be understood by states	HFE, policy neutrality, accuracy, contemporaneity: complex methods may be required to estimate fiscal capacities	Low
Contemporaneity	GST distributions should reflect states' fiscal capacities close to the time they're received	Simplicity, predictability and accuracy: accurate data are only available for the past	Low

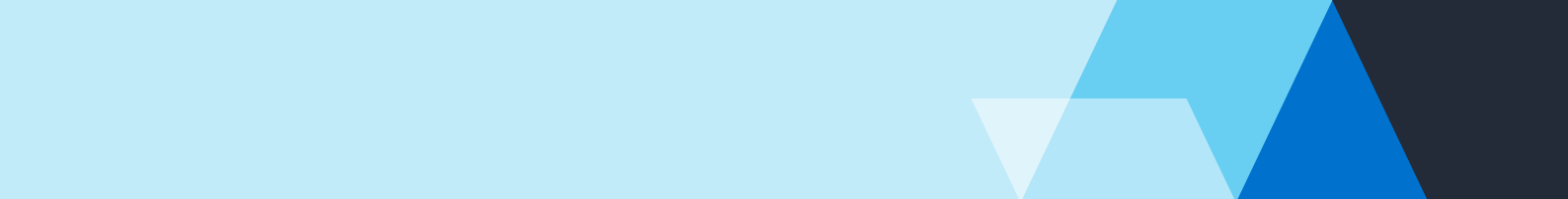
4.1 Victoria favours HFE and political neutrality as key principles to evaluate HFE systems

The rationale for the inclusion of the principles, and distinctions from the analysis conducted by the PC are provided below.

Horizontal Fiscal Equalisation

Victoria considers HFE should be the primary aim of the GST distribution and should be weighted above the other principles – aligning with the PC's position.

Victoria agrees with the interim report's assessment of HFE that it has been widely supported by Australians as a core feature of our federation. The interim report and Victoria's initial submission



showed there was broad support for HFE as a principle in the previous 2018 PC inquiry, as well as from initial submissions to this inquiry.⁷

It may be useful for the final report to also note that even without explicit HFE between sub-national governments, countries with unitary governments also effectively achieve HFE by allocating resources between geographic locations or demographic groups depending on need or demand.⁸ As such, it is not reasonable or practical to expect that without HFE through the GST in Australia that resources would not be redistributed in other, more costly and less transparent ways in Australia (for example, further tied grants).

Political neutrality

While the interim report does not highlight political neutrality in evaluating GST systems, Victoria considers it should be elevated as a distinct principle for the PC's evaluation.

As outlined in Victoria's initial submission, political considerations in HFE systems are not desirable, and a strength of Australia's former system was its rules-based independence. Negotiated outcomes entrench unequal political and power dynamics and can lead to an inefficient and inequitable distribution of resources.

As outlined in its initial submission, Victoria strongly opposes any system of HFE based on negotiated tied grants due to their impractical, resource intensive nature and the likelihood of misallocating resources. Victoria's initial submission also noted the detrimental effect to national cooperation of the linking of changes to the GST and other negotiations, such as the recent health and disability agreements, which the interim report references.

The interim report appears to favour an independent HFE system and is complimentary of the CGC's approach and processes. It notes, for example, that "equal per capita +" (EPC+) options are not preferred as they would require "NoWO style" payments that, due to their public visibility and exposure to budget decision making, create "risks politicising the distribution of NoWO-style payments which could weaken confidence in the durability of the system among the smaller states reliant on these payments."⁹

Victoria considers explicitly outlining the importance of this independence and how it has been factored into the PC's evaluation of HFE systems would be beneficial.

Policy neutrality

Victoria supports the interim report's consideration of policy neutrality, referred to generally as 'efficiency' in the PC's evaluation. Victoria's interpretation is that there is not a significant distinction between the terms in how the PC has structured its analysis.

Policy neutrality means the GST distribution should not incentivise or direct the states in how they operate their services and infrastructure, and states should not be able to influence the GST distribution through their policies.

Victoria would prefer if this principle was instead referred to as policy neutrality, rather than efficiency. Efficiency may imply there is an element of 'reward for effort', rather than the pure neutrality the GST distribution should aim to achieve.

⁷ See Interim report, p 10, Victoria's initial submission, p 51, and, for example, [Tasmanian government initial submission](#), p 2, [South Australian government initial submission](#), p 4.

⁸ OECD, 'Fiscal equalisation in OECD Countries', Working Papers on Fiscal Federalism No. 4, p 5.

⁹ Interim report, p 82.

Predictability

The interim report refers to ‘certainty’ aligning with Victoria’s principle of predictability. However, in Victoria’s view certainty implies that actual revenues received should be less variable over time, whereas predictability acknowledges variance is manageable with the right tools.

Overall, the interim report aligns on this principle and the relatively low weighting applied, given it notes GST is generally predictable for states, and that states have now, and have always had, reasonable revenue certainty.¹⁰

Simplicity and contemporaneity

Simplicity and contemporaneity are not part of the PC’s framework and are considered to be lower order, though desirable, objectives by Victoria.¹¹ Victoria notes they are supporting principles used by the CGC in evaluating its own methods.¹² Overall, Victoria accepts the PC not assessing these principles given their lesser importance, however Victoria also considers that they may be valuable to help choose between two otherwise similar systems.

The interim report implicitly supports simplicity as a principle for evaluation in critiquing the 2018 changes as introducing more complexity. While Victoria supports simplicity, given the significance of the GST distribution as the single largest source of funding for state government services, some complexity should be accepted.

Contemporaneity is a worthwhile objective, however a lower order priority than the other principles outlined. Given the timing of when government financial statistics are collected and published in Australia, it is not possible to have significantly more contemporaneous HFE than is currently the case. Forecasting is considered an undesirable approach as it would detract from simplicity and predictability and given the uncertainty unlikely to in practice better reflect contemporaneous circumstances.

4.2 Victoria does not consider some cited principles should be included

4.2.1 Victoria does not support the PC’s framing of fiscal sustainability

Victoria has not included “fiscal sustainability” in its set of principles to evaluate alternative HFE systems. Victoria considers an evaluation of the fiscal sustainability of the 2018 changes, and whether alternative arrangements better achieve this aim, are already acquitted by considering the achievement of HFE, policy neutrality (efficiency) and predictability (certainty).

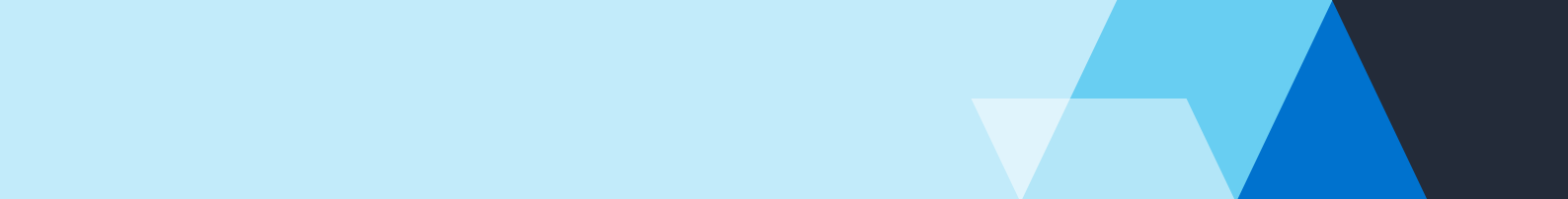
The interim report suggests one of the three main supporting or ‘constraining’ principles is “a fiscally sustainable GST distribution system would not force large and sudden policy changes or pose a threat to solvency in the longer term for state governments or the Australian Government”.¹³

¹⁰ Interim report p 60.

¹¹ See Interim report, ‘Scope of the inquiry’, p v. “The Commission is to investigate ... Appropriately balancing the objective of responsiveness to changing circumstances”.

¹² Noting simplicity enters the CGC’s evaluation of its methods via the supporting principle of ‘practicality’, which also encompasses using sound and reliable data and methods. See [CGC 2025 Methodology review, Commission’s position on fiscal equalisation, supporting principles, and assessment guidelines](#), p 13.

¹³ Interim report, Appendix B, p 6.



Victoria agrees it is critical for the welfare of Australians that the states are fiscally sustainable, and that the GST and Commonwealth funding play a significant role in achieving this. The GST contributes 23 per cent of states' revenues in total, and significantly more for some states.¹⁴ Victoria strongly agrees that the GST distribution should also not “force large or sudden policy changes or pose a threat to solvency” for state governments.¹⁵

However, the utility of sustainability as a separate objective in evaluating alternative HFE systems is not clear. The stated aims will already be achieved if the core goals of HFE and policy neutrality are achieved:

- Consideration of policy neutrality already captures that the GST distribution should not create any incentive for states to change their policies, therefore it already would not force “large and sudden policy changes”.
- If HFE is achieved, states would likely have enough resources to deliver services at a similar level, so solvency risks may not need separate consideration.
- Hypothetically, fiscal unsustainability could be due to a state's policy choices, and therefore inappropriate to rectify with HFE and GST distribution.
- To the extent fiscal challenges are caused by non-policy factors, the GST distribution should already provide more support to states under the principle of HFE.

If fiscal sustainability becomes an issue despite the functioning of HFE, it would likely be due to external factors, such as a deficiency in the GST pool to meet HFE. That could be appropriately addressed through other means, such as other direct Commonwealth support, or revising the parameters around GST as a tax and the GST pool.

In essence, risks to financial sustainability are most likely to be an issue where the GST distribution system does not achieve HFE – for example, in the case of the 2018 changes or other GST distributions with less than full HFE.

The interim report made the same conclusion, that not achieving HFE under the 2018 changes could pose sustainability risks to states other than WA: “the NoWO guarantee lapsing could worsen fiscal sustainability risks”.¹⁶

Victoria also does not support the framing of the sustainability criteria to include fiscal impacts to the Commonwealth. The GST distribution should aim to achieve HFE between the states. Commonwealth fiscal sustainability is not a relevant metric to compare the feasibility of HFE systems. If the Commonwealth chooses to provide additional support for certain states that is its own prerogative, but not an objective of a HFE system.

Ultimately the interim report finds the Commonwealth is better placed to bear fiscal risks. Victoria strongly supports the interim report's finding that “the Australian Government is better placed to bear the costs of reform by introducing a permanent NoWO guarantee”.¹⁷

¹⁴ Interim report, p 51.

¹⁵ Interim report, Appendix B, p 6.

¹⁶ Interim report, p 54.

¹⁷ Interim report, p 60.

4.2.2 Victoria does not support commentary around breaking the nexus between the GST pool, HFE and vertical fiscal imbalance

Victoria does not support the possibility indicated in the interim report that the nexus between the GST pool and HFE could be broken, questioning whether it is “desirable or sustainable”.¹⁸

Having the GST pool set to achieve HFE mitigates the sovereign risk for states, as with more flexible or negotiated arrangements they may become overly reliant on Commonwealth decision making for a significant share of funding.

GST presents a significant risk for funding to the states, given its near complete control by the Commonwealth. Despite initial agreement and legislation that the GST be provided wholly to the states,¹⁹ the Commonwealth can:

- make unilateral changes to the GST base and rate, given tax changes would be made through Commonwealth legislation which the states cannot veto, following the Constitution²⁰
- decide not to follow the CGC’s advice, and distribute the GST as it sees fit.²¹

The legislation governing the distribution of the GST specifies a formula GST should be distributed by with reference to “the GST revenue sharing relativity”, but that these are essentially set at the Commonwealth Treasurer’s discretion.²²

As the interim report notes, Commonwealth Treasurers have always taken the CGC’s recommendations in full.²³ However, real risks to states remain.

The risks to states from this approach are clearest from the unilateral implementation of the 2018 changes, despite the opposition of all states other than WA.²⁴ Ironically, the 2018 changes were the first time a specific equalisation objective were included in the GST legislation.²⁵

HFE is not mentioned in the governing legislation. It is agreed to as the objective of the GST distribution in the Intergovernmental Agreement of Federal Financial Relations 2009 (IGA FFR 2009), however agreements are not legally binding.²⁶

¹⁸ Interim report, Section 3.4, p 56.

¹⁹ Council of Australian Governments Archive (1999) ‘Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations’

²⁰ Bain, K & Boccabella, D (2015), Why the Commonwealth can change the GST without the states, *The Conversation*, 28 January

²¹ Interim report, p 11.

²² Federal Financial Relations Act 2009, Part 2, Division 1 and Section 8.

²³ Interim report, p 11.

²⁴ Interim report, p 2.

²⁵ The 2018 legislation introduces specific reference to the GST enabling states to “have the fiscal capacity to provide services (including associated infrastructure) at a standard that is at least as high as the standard for whichever of New South Wales and Victoria has the higher standard.” Prior to this, the GST legislation did not specify a standard the distribution was aiming to achieve, only outlining the distribution formula with reference to the GST relativities (Section 5 of the Act). See Section 16AB at: <https://www.legislation.gov.au/C2018A00143/asmade/text>.

²⁶ Section 21 of the Federal Financial Relations Act stipulates that the Minister need only ‘have regard’ to the IGA FFR, see [Federal Financial Relations Act 2009 - Federal Register of Legislation](#). The Commonwealth’s Federation website notes “[Intergovernmental Agreements] are not legally binding”, see <https://federation.gov.au/resources/agreements>.

The PC should consider recommendations to increase the transparency and certainty of GST distributions for states, by recommending changes to the legislation such that:

- the Commonwealth must implement the CGC's recommended relativities, except in cases with unanimous support from states
- HFE is mentioned as the aim of the GST distributions.

4.2.3 Victoria does not support other principles cited by initial submissions

The suggested principles Victoria has cited for evaluating HFE systems do not include a number of principles noted in the interim report or by initial submissions to the inquiry. These are outlined below, along with Victoria's rationale for not including them.

Principle cited by other submissions	Victoria's rationale for exclusion
<p>Efficiency or 'reward for effort'</p> <p><i>Cited by the PC interim report (p. 75) and submissions from:</i></p> <ul style="list-style-type: none"> • WA (p 3, Section 3) • NSW (pp 9, 19, 21-22) • Qld (pp 6, 36-37, 43) • Chamber of Commerce and Industry WA (p 4-5, 13-14) • Institute of Public Affairs (p 1-3) 	<ul style="list-style-type: none"> • The GST is designed to achieve HFE, to ensure residents of all states have access to the same standard of services and infrastructure. • As opposed to promoting 'reward for effort', the GST distribution should be policy neutral – that is, it should have no impact on state decision making. This aligns with the original intent that GST is untied funding for the states to choose to spend as they decide is most appropriate. • Victoria supports the interim report's finding that the GST distribution has been largely policy neutral and has not caused material policy incentive issues for states, and that this claimed motivation for the 2018 changes is not supported by the evidence (see Section 5.4). • This is distinct from incentivising or rewarding certain policies or outcomes as raised by some other submissions. The interim report agrees with this distinction and a preference for neutrality rather than incentivising outcomes.²⁷ If desired, as noted by the interim report, the Commonwealth has other avenues to incentivise states' policies, primarily through tied grants like the National Competition Policy payments. • However, the interim report also notes a rationale for adjustments to the CGC's mining assessment is that "Submissions from the Western Australian Government and members of the public highlighted ... that the previous system was not fair and did not adequately reward effort".²⁸ • This is incongruous with how the PC has defined its assessment of "efficiency", or policy neutrality. • The final report should remove mentions of "reward for effort" as a rationale to decide between HFE systems, given it also notes the primacy of "equity" or HFE.

²⁷ See Interim report, p 33: "The fundamental purpose of HFE is supporting states to deliver a similar standard of services and infrastructure ... not promoting economic investment or superior fiscal conditions".

²⁸ Interim report, p 75.

Principle cited by other submissions	Victoria's rationale for exclusion
Cohesion of the federation or "institutional sustainability" <i>Cited by the PC interim report, p 74</i>	<ul style="list-style-type: none"> The interim report notes a rationale for not returning to the full pre-2018 system is that it "would not address concerns about institutional sustainability and fairness".²⁹ Victoria agrees that well-functioning HFE systems can promote cohesion and cooperation between sub-national governments. However, adjusting funding distributions based on public commentary or political influence would introduce the issues Victoria identified with negotiated outcomes in its initial submission.³⁰ Any weighting towards cohesion of the federation in funding allocations would be impractical to implement (it is unclear how this would be measured or acquitted) and would lead to perverse incentives (funding could be directed to those with the best public advocacy strategy rather than greatest need). The 2018 changes would fail on an evaluation of federal cohesion, as they create a disparity in fiscal strength, standard of services and infrastructure between WA and the other states. The interim report notes that prior to 2018, all states received sufficient GST revenue to meet 100 per cent of their assessed fiscal needs. However, as a result of the reforms, WA received enough GST revenue to meet 113 per cent of its assessed fiscal needs in 2024-25, compared with 98 per cent for all other states.³¹ They also damaged interjurisdictional cooperation and created an increasingly uncertain federal fiscal environment for states – see Sections 6.1 and 6.5.
"Fairness" not further defined, and distinct to HFE <i>Cited by the PC interim report, p 74-75</i>	<ul style="list-style-type: none"> As noted above, the interim report refers to perceptions of "fairness" as motivating community concerns around the former GST system. The interim report suggests alternative HFE systems (e.g. recommendations 4.1. and 4.2) should address these concerns.³² Victoria considers that "fairness" is poorly defined in this context, and it is unclear how it differs from HFE. Fairness is intrinsic to HFE, as it ensures residents of all states have access to the same standard of services and infrastructure. HFE is fair in that it recognises the states' different starting positions – with some having much greater per person expenditure needs like the NT, and others far greater ability to raise own-source revenues, like WA. The interim report rightly rebuts some other perceptions of "fairness" often referred to in media commentary including receiving a certain "cents in the dollar", a population share, or reward for poor fiscal management.³³ The final report should not include the same mentions of "fairness" to motivate its recommendations, or any evaluation of different HFE systems.

²⁹ Interim report, p 74.

³⁰ Victoria's initial submission, Section 7.2, pp 45-47.

³¹ Interim report, p 3.

³² Interim report, p 86.

³³ Interim report, p 14.

Principle cited by other submissions	Victoria's rationale for exclusion
Public support for specific equalisation methods <i>Cited by the PC interim report, p 7, WA People's submission, pp 6-7</i>	<ul style="list-style-type: none"> Public support for any policy is key to its continued implementation in our democratic system. HFE has long been supported in Australia. However, public perception should not be a determinative metric used when evaluating technical distinctions between HFE systems. The PC also identifies misconceptions about GST distribution are prevalent, which suggests that public perceptions may not provide a reliable basis for assessment.³⁴ As with "cohesion of the federation", specific reliance on public perception may lead to perverse outcomes where fiscally stronger states can resource public campaigns, potentially leading to greater capacity to fund future campaigns to secure more revenue and so on. This would be antithetical to the principles of HFE and political neutrality, and is not theoretical – WA has engaged in such well-resourced advocacy (including advertising campaigns in other jurisdictions) to secure and then sustain support for the 2018 changes, to the nation's detriment.³⁵
Ensuring a minimum GST share <i>Cited by submission from WA, p 20</i>	<ul style="list-style-type: none"> HFE should aim to provide states the ability to provide a similar standard of services, rather than ensuring a fixed dollar funding amount or share of the GST pool. In theory, it would be appropriate for a very fiscally strong state to receive no support from the GST pool. Misconceptions around receiving GST proportional to revenue collected in a state should also not be considered – there is currently no data reliably demonstrating how much GST is collected in a state.

³⁴ Interim report, p 13.

³⁵ „WA to 'educate' Sydney and Melbourne about how good GST carve-up is." Australian Financial Review, 3 November 2025

5. The 2018 changes were not justified

Victoria strongly supports the interim report's findings that the 2018 changes have not achieved their own stated aims. However, as outlined extensively in Victoria's initial submission to the inquiry, Victoria further maintains that the key cited motivations for the 2018 changes – volatility of GST revenues and disincentives from reform – were never actual issues for states. As the interim report notes, GST revenue volatility is and has always been manageable within the states' fiscal tools, and there has never been clear evidence of policy incentives.

Victoria agrees with the interim report that there was political pressure from WA that eventually led to the reforms.³⁶ Victoria also agrees with the interim report's finding that misconceptions played a significant role in the public debate eventually leading to the 2018 changes.³⁷

However, Victoria considers the framing of the motivations behind the 2018 changes in section 1.2 of the interim report could be further strengthened to highlight the role advocacy and misconceptions played. Victoria recommends the final report strengthens the framing of section 1.2 to avoid confusion and be clear that there was not a legitimate, broad-based and principled critique of HFE in the community or amongst practitioners and experts.

5.1 The final report should be clear that the 2018 changes were driven by a concerted advocacy campaign

Victoria appreciates that the interim report explicitly calls out the role WA's public advocacy and political pressure played in leading to the 2018 changes. For example, interim finding 1.2 rightly notes:

“Political pressure from the Western Australian Government and public, alongside longstanding criticisms of the incentive effects and volatility of the HFE system, led the Australian Government to introduce the 2018 reforms”.³⁸

Victoria considers these aspects were influential to making the changes, and likely more so than principles-based policy arguments. This could be reflected more prominently in the title of interim finding 1.2, which currently reads as follows:

“Interim finding 1.2: An unprecedentedly low relativity – arising from the impacts of the mining boom – strained community acceptance of the HFE system in Western Australia and was a catalyst for the 2018 reforms.”³⁹

Victoria considers this finding in the final report could highlight the role of political and public advocacy more clearly. Currently, this finding and other commentary may be read as though there was a broad-based, grassroots groundswell of dissatisfaction for the GST distribution, whereas it has been publicly reported that this was a concerted public advocacy campaign, led by well-resourced and

³⁶ Interim report, interim finding 1.2, p 22.

³⁷ Interim report, interim finding 1.1, p 16.

³⁸ Interim report, p 22.

³⁹ Interim report, p 22.

sophisticated politicians and business leaders.⁴⁰ WA's low GST relativity through the mining boom cited in interim finding 1.2 did not independently create community dissatisfaction, but rather the public response was created in conjunction with an advocacy campaign, that leveraged misconceptions around the role and intent of the GST distribution.

Therefore, Victoria does not support the framing of interim finding 1.2 that "Dissatisfaction with the HFE system in Western Australia further intensified when GST payments began to fall at the same time as royalty revenues due to the Commonwealth Grants Commission's use of lagged data".⁴¹

Given the PC has found states are largely able to manage the fluctuations in GST and other revenue sources, it is incongruous to suggest that the previous GST distribution method independently created this "strain on community acceptance".⁴²

5.2 Misconceptions were a factor in justifying the 2018 changes

Misconceptions about the GST distribution system were likely a contributing factor to the success of the advocacy campaign resulting in the 2018 changes.

Victoria agrees with the interim report finding 1.1 that "a lack of understanding of the HFE system has undermined the quality of public debate on the topic".⁴³

For example, misunderstanding of the purpose and functioning of the HFE system has likely led to the misconception that states are entitled to a minimum amount of GST, regardless of their fiscal capacity. As the interim report notes:

*"the argument that states are not 'getting back' their population share of the GST does not align with attitudes towards other key federal taxes in Australia. For example, there is no public expectation that income tax paid by an individual is returned to the state or postcode in which they live."*⁴⁴

On the contrary, the objective of HFE is to provide all Australians with a similar level of services and infrastructure, and that's what the former system did.

Another misconception is that the GST distribution punishes good fiscal management or rewards poor fiscal management. This is not the case, as clarified by the CGC in a recent Occasional Paper:

⁴⁰ See for example:

- Australian Financial Review, 'Business leaders to meet PM armed with suggestions on fixing WA's GST share', 11 April 2017
- Business News 'Barnes plays defence on GST', 21 January 2026
- Australian Financial Review, 'WA business warns GST shake-up risks AUKUS, mining sector', 26 November 2025
- ABC, 'GST redistribution deal prompts a political stampede as MPs scramble to take credit', 6 July 2018.

⁴¹ Interim report, p 22.

⁴² Interim report, p 62.

⁴³ Interim report, p 16.

⁴⁴ Interim report, p 14.

“the GST distribution arrangements do not compensate a state for poor fiscal management. A state is not rewarded with an increased share of GST revenue if it runs larger budget deficits than other states because of its policy choices. GST is based on states’ relative, policy neutral fiscal capacities, not their fiscal policies.”⁴⁵

Underlying some of the concerns motivating the 2018 changes was a sentiment that it was not “fair” for a state to receive a low GST relativity. However, a low GST relativity is not a problem that needs addressing. Rather, it’s simply a representation of the high relative fiscal strength of that state at that particular time. It is a plausible and reasonable outcome of a functioning HFE system, whereby a fiscally stronger state needs relatively less federal assistance than other states through distribution of the GST pool.

5.3 Volatility was not a significant issue

Victoria supports the interim report’s conclusions that volatility in GST revenues was not a significant issue for states’ budget management. Victoria’s initial submission provided evidence supporting the same conclusion.

In the interim report, the PC notes that “a key criticism of the pre-2018 system was that it was too volatile”.⁴⁶ Similarly, the Terms of Reference claimed that “in 2018, the Commonwealth Parliament changed the way GST revenue is distributed among the states to address concerns about the volatility of this revenue source”.⁴⁷

In contrast, Victoria’s initial submission outlined that GST volatility was not actually a significant issue for states, including for WA. For example, Victoria’s initial submission demonstrated that WA largely predicted the changes in its royalty revenues and the subsequent impacts on its GST revenue through the first mining boom from around 2003 to 2013.⁴⁸

Victoria supports the similar conclusions the PC has drawn in the interim report, noting that:

- “states have now, and have always had, reasonable revenue certainty”⁴⁹ and that for most states, including WA, “GST revenue has been relatively stable: year-on-year changes in GST revenue have averaged around 1 per cent of total revenue”⁵⁰
- many state governments indicated in their initial submissions that GST revenue specifically is adequately predictable and that any effects from GST revenue volatility can be managed through standard budget processes⁵¹
- state governments have access to debt markets that can smooth any intertemporal mismatches between their expense needs and their revenue.⁵²

As such, Victoria supports the PC’s conclusion that certainty or predictability should have a lower weighting in assessing alternative GST distribution system (see Section 4).

⁴⁵ CGC (2023) Occasional paper No. 12: GST distribution - Addressing Some Misconceptions, p 1.

⁴⁶ Interim report, p 4.

⁴⁷ Interim report, page iv.

⁴⁸ Victoria’s initial submission, pp 29-31.

⁴⁹ Interim report, p 60.

⁵⁰ Interim report, p 61.

⁵¹ Interim report, p 62.

⁵² Interim report, p 62.

Victoria considers that volatility of GST revenue was not a valid justification for the 2018 reforms and supports the PC's conclusion and approach.

5.4 Policy incentives were controlled for under the former system

Victoria supports the interim report's findings that HFE did not cause material policy incentive issues for states, and that this claimed motivation for the 2018 changes is not supported by the evidence.

The initial issues paper for the inquiry provided in November 2025 asked whether the GST system impedes states' reforms, citing concern around whether HFE impeded reform in the past, and how the 2018 changes impact this.⁵³

In its initial response, Victoria noted that "HFE is not an impediment to reform, and the CGC's policy neutrality approach largely removes any direct effects of the GST system on states policies".⁵⁴

Victoria maintains that there is no substantial international or academic evidence that equalisation hinders sub-national government reforms. The interim report notes, "there is limited evidence of these disincentives existing in practice".⁵⁵

Victoria continues to support the CGC's existing policy neutrality approach, which is largely successful and already accounts for the vast majority of potential policy influences on states from the GST system. The CGC's assessments do not deter states from developing their economies, revenue sources or efficiency of service delivery.

Victoria considers the CGC is well equipped to identify and propose solutions to material policy neutrality issues in consultation with all states as they might arise. For example, it is currently doing so on a dominant state adjustment to its mining assessment through its Forward Work Program.

Victoria supports the interim report's finding 3.2 that HFE is broadly policy neutral through the CGC's policy neutral application of HFE.⁵⁶ The PC found that the impacts on GST payments of changes in service delivery spending are small on average.⁵⁷ This is in alignment with previous inquiries.⁵⁸

The interim report found that revenue choices have a more visible effect on GST payments than expenditure choices. However, it also found outside mining they are usually modest, under both the former system and current system, with or without the NoWO guarantee.⁵⁹

The interim report noted that "mining royalties create a challenge for the policy neutrality of the GST distribution because mining revenue is highly concentrated in a small number of states, creating dominant-state effects".⁶⁰ The report and other submissions do not provide substantive evidence of these effects in practice, and that they do not require external adjustments or directions, as outlined in Sections 6.3 and 7.1.

⁵³ [Productivity Commission \(2025\) Issues paper - GST distribution reforms](#), p 15.

⁵⁴ Victoria's initial submission, p 35.

⁵⁵ Interim report, p 21.

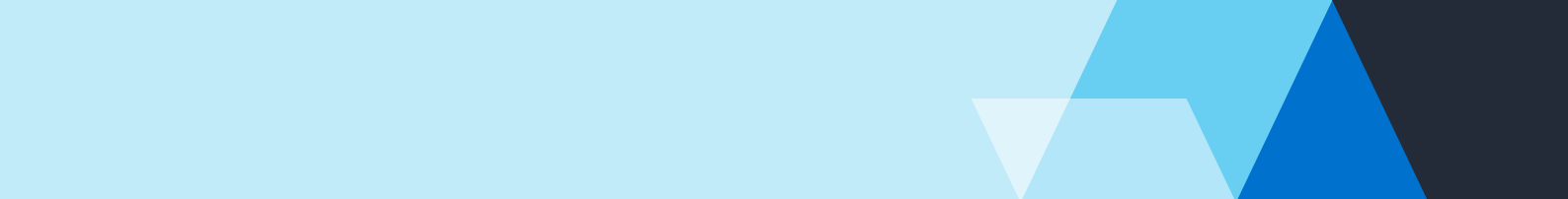
⁵⁶ Interim report, p 51.

⁵⁷ Interim report, p 44.

⁵⁸ For example, [the Commonwealth Treasury 2012 GST Distribution review](#) found "there is no evidence that HFE acts as a material disincentive to State tax reform", Finding 9.1, p 18. On service delivery specifically, [the Productivity Commission \(2018\) Horizontal Fiscal Equalisation inquiry](#) found "changes in State service delivery policies can impact on GST payments, but the impacts are mostly trivial", Finding 3.2, p 37.

⁵⁹ Interim report, p 45.

⁶⁰ Interim report, p 48.



Victoria recognises that there will always be some degree of trade-off between potentially competing objectives under HFE. However, as the PC recognised in the interim report, the primary role of the GST distribution is to achieve HFE.⁶¹

⁶¹ Interim report, p 39.

6. The 2018 changes have failed to meet their objectives

Victoria's position is that the 2018 changes are inherently inequitable and must be reversed. The 2018 changes have failed to meet their own objectives and fail to meet any independent evaluation of an ideal GST distribution system. If allowed to continue, the 2018 changes would only serve to provide one state, WA, more revenue than it needs, at the expense of all other states.

Victoria was pleased to see that the PC's interim report delivers an unequivocal rejection of the 2018 changes. The interim report is clear, stating the 2018 changes have "largely not met their intent and have introduced a range of undesirable features into Australia's HFE system."⁶²

Victoria strongly supports the interim report's findings 2.1, 2.2. and 4.1 critiquing the 2018 changes.

*Interim finding 2.1: The new fiscal equalisation standard creates perverse outcomes that invert the logic of HFE – it should not be an ongoing feature of the GST distribution system.*⁶³

*Interim finding 2.2: The 2018 reforms are not operating efficiently, effectively or as intended.*⁶⁴

*Interim finding 4.1: The reduction in equalisation under the current system, with or without a permanent NoWO guarantee, has not markedly improved efficiency, fiscal sustainability or certainty.*⁶⁵

Victoria's case to repeal the 2018 changes in its initial submission is compelling, providing extensive evidence that the changes:

- Are fiscally unsustainable for states other than WA if the NoWO guarantee is allowed to expire, and risk leaving Australians in need short of essential services
 - Do not deliver a reasonable level of equalisation, as they take away from states that need support to provide the wealthiest state, WA, funding it does not require
 - Over-emphasised any issues with volatility in GST distributions and largely leave volatility unchanged for all states other than WA
 - Have not encouraged any state efficiency or productivity reforms, and there is no practical or theoretical evidence that they will in future.⁶⁶

As shown in Table 2 below, Victoria's assessment was shared in all of the states' initial submissions to the inquiry, other than WA.

⁶² Interim report, p 2.

⁶³ Interim report, p 29.

⁶⁴ Interim report, p 38.

⁶⁵ Interim report, p 70.

⁶⁶ Victoria's initial submission, p 1.

Table 2: Summary of support for HFE in initial submissions

State	Position	Comments
South Australia	Support full HFE	“South Australia recommends a return to the full HFE system – distributing GST in a manner that seeks to ensure all states have the capacity to provide a similar standard of services and infrastructure to their residents.” ⁶⁷
Australian Capital Territory	Support full HFE	“The pre-2018 HFE system reflected Australia’s unique circumstances – no other federation equalises expenditure needs to the extent of Australia, undertaken by an independent body. It also delivered this funding in a way that respects the autonomy of States to make expenditure and revenue decisions.” ⁶⁸
Northern Territory	Support full HFE	“It is submitted that ‘reasonable’ HFE is a misnomer. There is no ‘reasonable’ level of inequity. It is not reasonable that some Australians should receive below-average services due to the state where they live.” ⁶⁹
Tasmania	Support full HFE	“There has never been evidence that there was a need to ‘fix’ elements of the full HFE GST distribution system, or that it was not working as intended.” ⁷⁰
Queensland	HFE with mining adjustments	“[The] reasonable level of HFE has been eroded significantly by the Australian Government’s 2018 GST distribution reforms, due to the arbitrary design of the new benchmark of equalisation to the ‘standard state’ as well as the GST relativity floor.” ⁷¹
New South Wales	EPC distribution	“The 2018 legislative changes to HFE and associated top-up funding to states introduced by the Australian Government have weakened the achievement of HFE. While the 2018 legislative changes have delivered favourable outcomes for WA, they have resulted in significant inequity for residents in other parts of Australia.” ⁷²
Western Australia	Support 2018 changes ⁷³	

⁶⁷ South Australian Government initial submission, p 4.

⁶⁸ ACT Government initial submission, p 4.

⁶⁹ Northern Territory Government initial submission, p 6.

⁷⁰ Tasmanian Government initial submission, p 2.

⁷¹ Queensland Government initial submission, p 3.

⁷² New South Wales Government initial submission, p 14.

⁷³ Government of Western Australia initial submission, p 2.

6.1 The 2018 changes have a significant fiscal impact on the states and Commonwealth

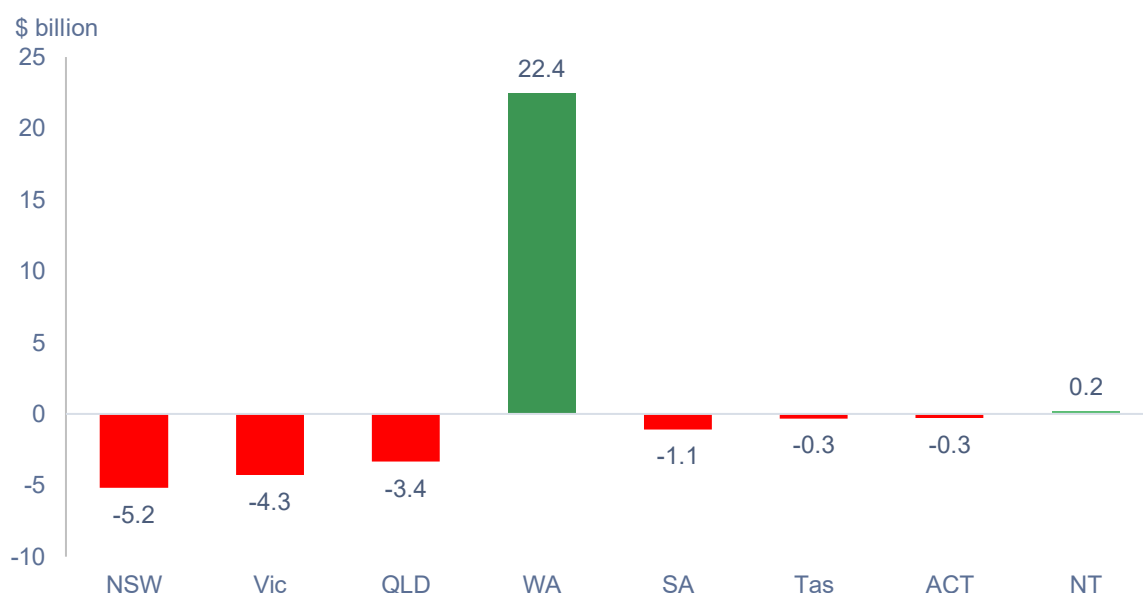
Victoria strongly supports the interim report's findings that the 2018 changes are not fiscally sustainable, and only benefit one state, WA, at the expense of all others or the Commonwealth.

Interim finding 2.2 makes this clear: "only one state is fiscally better off following the reforms: Western Australia".⁷⁴

Figure 1 shows that since the introduction of the new system, WA has received an additional \$22.4 billion. Over the same time, the other states would have been \$14.6 billion worse off without the NoWO guarantee. With the NoWO guarantee in place, this cost has been transferred to the Commonwealth and Australian taxpayers.

Figure 1: WA has received an additional \$22.4 billion from the 2018 changes

Difference in GST distributions between new and former systems, including transitional top-up payments, 2019-20 to 2024-25



Source: Past CGC update reports, Commonwealth Final Budget Outcomes and Victorian Department of Treasury and Finance calculations.

Note: The sum of the impacts to the other states and benefits to WA are not equal as the other states were only partially exposed to the effects of the 2018 changes from 2021-22 through a gradual transition, whereas WA received the full benefit via separate payments from the Commonwealth since 2019-20 to 2021-22. The Commonwealth's boost to the GST pool also partially offsets the negative fiscal impacts on the other states from the 2018 changes, whereas it is included in the benefit to WA. The Northern Territory (NT) has a positive total impact over this period due to the transitional top-up payment it received in 2019-20. It has since been worse off from the new system, requiring NoWO guarantee payments from 2022-23.

Victoria's initial submission highlighted how the loss of the NoWO guarantee would significantly impact its ability to provide services and infrastructure. Victoria has already received \$4.3 billion in NoWO guarantee payments from 2021-22 to 2024-25. The state's estimated NoWO guarantee

⁷⁴ Interim report, p 38.

payment of \$1.9 billion in 2025-26 would be sufficient to pay the salaries of approximately 17,000 extra nurses, teachers or police officers.⁷⁵

The Commonwealth's most recent 2026-27 Budget forecasts that Victoria will receive a total of \$6.4 billion in NoWO guarantee payments over the budget and forward estimates from 2026-27 to 2029-30. NoWO guarantee payments to all states will total \$21.8 billion over this time.

Adding what has already been paid, this would mean without the guarantee Victoria would be \$12.6 billion worse off from 2021-22 to 2029-30, and states in total by \$41.5 billion. WA will be better off by approximately the same amount over that period.

As outlined in Table 3, other initial submissions also noted the devastating impacts the loss of the NoWO guarantee would have for their states or organisations.

Table 3: Summary of impacts of removing the NoWO guarantee from initial submissions

Organisation	Comments
Queensland	"The proposed cessation of these payments will have direct consequences for Queensland in its ability to provide services to their residents. For example, A NoWO payment of \$1.2 billion represents essential funding for frontline services equivalent to 8,200 teachers, 3,400 doctors, 7,700 nurses, 6,700 police officers or 5,200 ambulance officers." ⁷⁶
Tasmania	"To date, Tasmania has received \$321 million in no-worse-off guarantee payments. In terms of service delivery, this level of funding equates to around 10 000 hospital admissions annually, indicating the scale of service delivery reduction that would be required under the 2018 reforms should the no-worse-off guarantee be allowed to expire." ⁷⁷
Australian Capital Territory	"Over the period 2021-22 to 2025-26, the Commonwealth provided \$405 million in NWOG payments to the ACT... In the absence of this funding, the ACT would have needed to reduce spending, increase taxes, or incur higher debt, relative to WA." ⁷⁸
Break O'Day Council	"Although GST revenue is distributed to states rather than directly to local government, Tasmania's fiscal capacity materially affects regional councils through infrastructure co-funding, disaster resilience programs, and service partnerships" ⁷⁹
City of Melbourne	"Where state and federal funding falls short, the City is often required to step in to fill very real gaps in service provision, despite having no additional revenue base to do so. If Victoria's fiscal position is weakened further by the continuation of the current GST reforms—particularly once the No Worse Off Guarantee expires—there will be a direct and significant cost to the City of Melbourne community." ⁸⁰

⁷⁵ Victoria's initial submission, p 8.

⁷⁶ [Queensland Government initial submission](#), p 14.

⁷⁷ [Tasmanian Government initial submission](#), p 18.

⁷⁸ [ACT Government initial submission](#), p 4.

⁷⁹ [Break O'Day Council initial submission](#), p 1.

⁸⁰ [City of Melbourne initial submission](#), p 2.

Organisation	Comments
Municipal Association of Victoria	<p>"The Municipal Association of Victoria supports the Victorian Government's call to restore an equitable GST distribution. The distortion of the allocation formula legislated in 2018-19 should be revoked. Failing that, the No Worse Off Guarantee should be made permanent ... Cessation of the No Worse Off guarantee would result in significant harm to all states other than Western Australia. Removing billions of dollars of distributed revenue from Victoria would necessarily reduce the State's capacity to support local government. We are particularly concerned this would disproportionately affect small rural shires. The degree to which these councils are dependent on state grants has been increasing over the last decade – standing at 18.5% per cent for 2023-24."⁸¹</p>

The interim report makes clear the fiscal implications of providing the already fiscally strongest state around \$6 billion additional revenue each year. The interim report notes "the combined real net debt of all states other than Western Australia rose by more than 200% (\$129 billion to \$425 billion), while Western Australia's net debt levels fell by 32% (\$50 billion to \$34 billion)".⁸²

Victoria's initial submission noted since 2018 WA has had the highest operating surpluses of all the states.⁸³ Incorporating recent 2026-27 state budget data, WA's operating surpluses continue to be greater than every other states' in every year over the budget and forward estimates period, 2026-27 to 2029-30.

In fact, comparing only states with operating surpluses in total over 2026-27 to 2029-30, WA's total surpluses are around the same as all other states combined – a total of \$11.8 billion for WA and \$11.9 billion for all other states.⁸⁴ With all other states, including those with aggregate deficits, the difference is even more stark. In total over 2026-27 to 2029-30 the other states roughly break even with a minor deficit of \$20 million, compared to WA's surplus of \$11.8 billion.⁸⁵

S&P Global noted:

*"the rules changed in 2018 in a way that allowed Western Australia to keep a greater share of GST revenue. Since then, the state has delivered some of the strongest fiscal outcomes in the world. This and strong commodity prices were the impetus behind our decision to upgrade Western Australia's rating to 'AAA' on June 27, 2022."*⁸⁶

While WA benefits from the 2018 changes, S&P Global noted other states are likely to be worse off if the NoWO guarantee is not made permanent beyond 2030.

*"The "no worse off" payments are supporting state and territory credit ratings that would otherwise be running even larger deficits than they already are. If the arrangements are not continued beyond fiscal 2030, most states will likely run larger deficits."*⁸⁷

⁸¹ [Municipal Association of Victoria initial submission](#), p 2.

⁸² Interim report, p 33.

⁸³ Victoria's initial submission, p 21.

⁸⁴ Other states with total surpluses over 2026-27 to 2029-30 are Victoria, NSW, SA, Tas and NT.

⁸⁵ Queensland and the ACT have net operating deficits over the period 2026-27 to 2029-30.

⁸⁶ [Standard and Poors, 2026, Australian States And Territories: A Timely Rise In Investor Interest](#), 12 April.

⁸⁷ [Standard and Poors, 2026, Australian States And Territories: A Timely Rise In Investor Interest](#), 12 April.

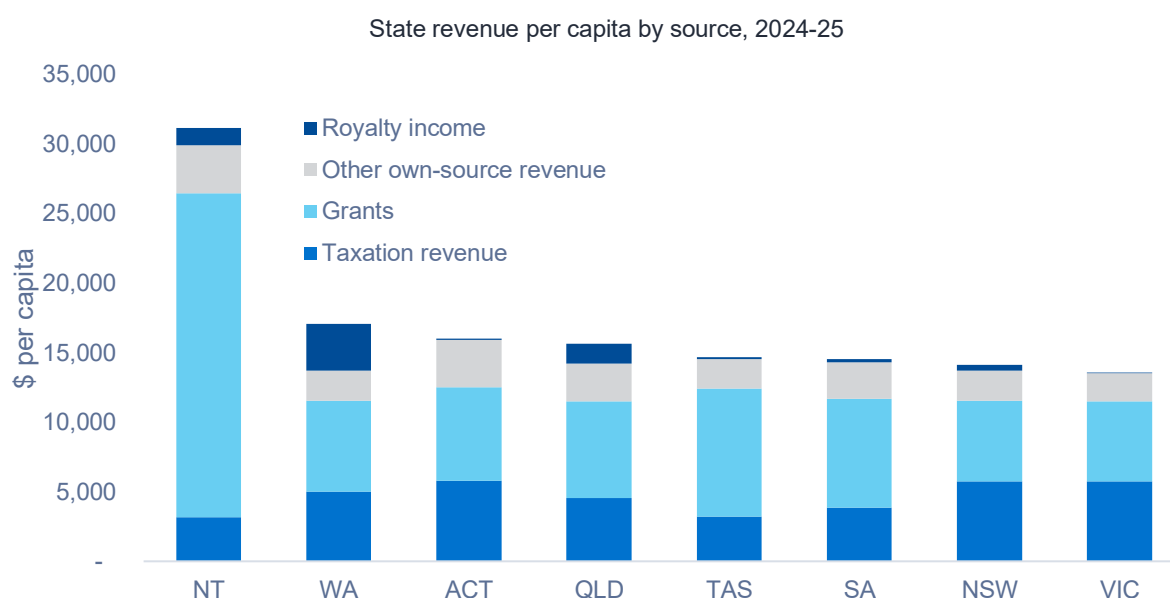
Victoria strongly supports the finding in the interim report that the expiry of the NoWO guarantee creates fiscal uncertainty for states. The interim report notes “due to the uncertainty around the future of NoWO payments, the current GST distribution system exacerbates fiscal sustainability concerns”.⁸⁸

This uncertainty is a real, live issue for states now. Critically, the expiry of the NoWO guarantee will enter into state upcoming 2027-28 state budgets.

Victoria’s budget is often released earlier than other jurisdictions (including the Commonwealth’s), typically in early May. The expiry of the NoWO guarantee will be a critical issue for Victoria’s budget preparations leading into early 2027, with real impacts on how it is able to manage revenue and expenditure decisions.

Victoria’s initial submission noted the external constraints on its fiscal capacity. This limits the ability to respond to unilateral shocks to its revenue from the Commonwealth, such as the expiry of the NoWO guarantee. The ABS’ annual GFS for 2024-25 reconfirmed Victoria receives the lowest total revenue per capita of all the states and territories, see Figure 2.

Figure 2: Victoria has access to the lowest revenue per capita of all the states



Source: Australian Bureau of Statistics.

In its GST Relativities 2025-26 Media Release, the CGC noted “the absence of a significant coal industry in Victoria resulted in it having a lower capacity to raise mining revenues compared with the major coal-producing states.”⁸⁹ The CGC’s 2026 Update report similarly highlights the constraints on Victoria’s fiscal capacity from its lack of mining resources and lower receipt of non-GST Commonwealth payments.⁹⁰

⁸⁸ Interim report, p 68.

⁸⁹ Commonwealth Grants Commission, *GST Relativities 2025-26, Media Release*, 14 March 2025, p 1.

⁹⁰ *CGC 2026 Update*, See Table 2-10, p 35, where Commonwealth payments are a more significant driver of the difference to an EPC distribution for Victoria than the other states.

Victoria also strongly supports the interim report's finding that the Commonwealth must bear the cost of the 2018 changes and the NoWO guarantee, if required. The interim report notes:

*"NoWO payments are unlikely, on their own, to threaten the Australian Government's fiscal sustainability, accounting for less than 1% of annual Australian Government revenue. Even so, they represent a material, volatile and open-ended budget cost, with corresponding trade-offs for other spending and revenue priorities."*⁹¹

*"For these reasons, and its relatively stronger fiscal position, the Australian Government is better placed to bear the costs of reform by introducing a permanent NoWO guarantee."*⁹²

The interim report's recommendation 4.3 aligns with this finding, recommending that if the 2018 changes are maintained, the Commonwealth must bear the cost and continue the NoWO guarantee. Victoria's assessment of recommendation 4.3 in relation to the NoWO guarantee is in Section 7.3 of this submission.

6.2 The 2018 changes detracted from equalisation, and did not achieve a reasonable standard of HFE

Victoria supports the interim report's findings that the 2018 changes do not achieve HFE and do not deliver a 'reasonable' level of equalisation – noting Victoria supports the PC's definition of reasonable equalisation, as outlined in Section 4. Given the interim report and Victoria place priority on achieving HFE above other supporting principles, it follows that the 2018 changes are highly inappropriate as a GST distribution system.

The interim report is clear that the 2018 changes reduce the level of equalisation, thereby reducing the equity achieved from the GST distribution. It states that "the current system, with or without NoWO payments, reduces equity in GST distribution compared with the pre-2018 system".⁹³

The interim response's findings 2.1, and 4.1 note the 2018 changes are detrimental to HFE:

*"Interim finding 2.1: the new fiscal equalisation standard creates perverse outcomes that invert the logic of HFE – it should not be an ongoing feature of the GST distribution system."*⁹⁴

*"Interim finding 4.1: The reduction in equalisation under the current system, with or without a permanent NoWO guarantee, has not markedly improved efficiency, fiscal sustainability or certainty."*⁹⁵

The interim report also notes the significant extent of this difference in fiscal capacity: "the Australian Government would have needed to provide these states with about \$47 billion in additional assessed revenue to ensure they had the same relative fiscal capacity as Western Australia in 2024-25".⁹⁶

⁹¹ Interim report, p 57.

⁹² Interim report, p 60.

⁹³ Interim report, p 67.

⁹⁴ Interim report, p 29.

⁹⁵ Interim report, p 70.

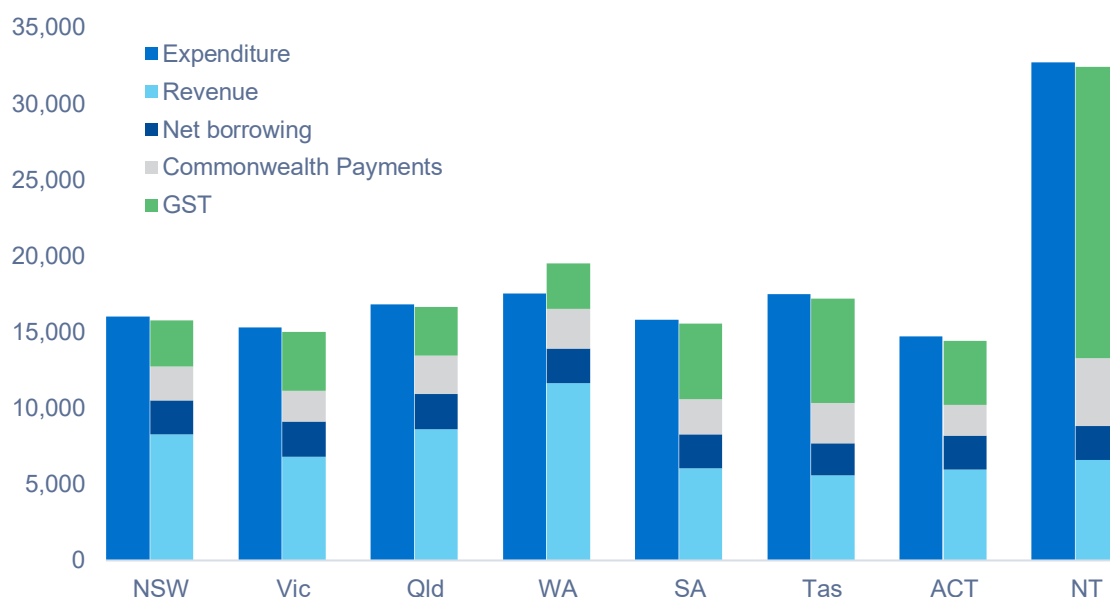
⁹⁶ Interim report, p 26.

The interim report highlights the practical implications of providing a higher fiscal capacity to one state. It notes the 2018 changes mean “states with persistently higher fiscal capacities are structurally advantaged to provide higher quality public services to its residents”.⁹⁷

Victoria’s initial submission noted the ultimate effect of the 2018 changes is to effectively provide WA with a significantly higher fiscal capacity per person than the other states, and more than the CGC as independent arbiter calculates it needs to deliver the same level of services as the other states (see Figure 3).

Figure 3: The 2018 changes provide WA more revenue than required to meet its assessed expenditure needs while leaving all other states without enough

CGC Assessed fiscal capacities and GST requirements of states and territories 2025-26 (dollars per capita)



Source: CGC 2026 Update

Defences of the 2018 changes have failed to justify this transfer to WA, funded by Commonwealth taxpayers or the other states. It has not ‘purchased’ any reform (see Section 6.3). The potential for theoretical efficiency gains, as argued by some submissions and the PC’s 2018 inquiry, would almost never be sufficient grounds for a \$6 billion expense with no commitments to tangible output or outcome benefits in return.

⁹⁷ Interim report, p 68.

The interim report also highlights the potentially perverse outcomes that can arise by linking the strongest state's relativity (WA) to that of either New South Wales (NSW) or Victoria (see interim finding 2.1). It details examples where if NSW or Victoria experienced significant natural disasters and increased spending, WA would benefit from additional GST under the 2018 changes. The interim report notes:

"The policy case for increased GST revenue for Western Australia in response to a natural disaster in New South Wales is unclear and this could create community concerns about the fairness of the GST distribution system".⁹⁸

The framing of these perverse outcomes in the context of the PC's interim recommendation 4.3 could be adjusted in the final report. Victoria considers the PC currently overemphasise the negative aspects of the standard state benchmark, while not being sufficiently critical of relativity floors. This position is expanded upon in more detail in Section 7.3.

As noted in Section 4, HFE systems need to navigate competing principles, which inevitably requires trade-offs. Victoria, and the interim report, state a preference for achieving HFE or equity first, with other considerations in service of that aim.

The 2018 changes were initially argued to be a trade-off between equalisation and 'efficiency' or policy incentives. The argument was that a reduction in HFE was worthwhile if it resulted in improved incentives for states' reforms. In its 2018 inquiry into HFE, the PC noted "the potential for States to lose significant GST payments in some instances can deter them from the politically difficult task of improving the efficiency of their tax mixes or expanding their tax bases".⁹⁹

This claim was supported by advocacy and theorisation only, not empirical evidence.¹⁰⁰ In practice, the former system achieved HFE without materially detracting from policy neutrality – as noted in Section 5.4. Victoria appreciates that the PC has revised its position since the 2018 report, noting that "the GST distribution system was and is broadly policy neutral for most expenditure decisions and incremental non-mining tax changes".¹⁰¹

Given the stated objective to trade off HFE for policy neutrality, one of the interim report's most important findings is that the 2018 reforms did not even advance this objective despite the significant cost to HFE and the Commonwealth budget.

6.3 The 2018 changes have not incentivised any state reforms

Victoria supports the interim report's findings that the pre-2018 system was "broadly policy neutral" and that "there have been limited efficiency gains from reducing the level of equalisation in the current system."¹⁰² The interim report's finding 4.1 notes that: "the reduction in equalisation under the current system, with or without a permanent NoWO guarantee, has not markedly improved efficiency, fiscal sustainability or certainty".¹⁰³

⁹⁸ Interim report, p 27.

⁹⁹ Productivity Commission (2018) Horizontal Fiscal Equalisation: Productivity Commission Inquiry Report, p 18.

¹⁰⁰ Ibid. p 15

¹⁰¹ Interim report, p 51.

¹⁰² Interim report, p 67.

¹⁰³ Interim report, p 70.

The interim report makes clear that the evidence for policy incentive effects from the GST distribution is limited, noting:

- “To the extent disincentives for reform exist, there is limited evidence they have played a role in state policy decisions. Other fiscal tools are available outside the HFE system to mitigate any disincentives”.¹⁰⁴
- “The pre-2018 system was also broadly policy neutral, with the exception of the dominant-state effect in the mining assessment. The inquiry’s preliminary analysis suggests that there have been limited efficiency gains from reducing the level of equalisation in the current system.”¹⁰⁵

Victoria’s review of the evidence reached a similar conclusion – there is little practical or theoretical evidence that HFE systems have an impact on state reform.¹⁰⁶

The experience of states reforms since 2018 provides no evidence of policy incentives. With the 2018 changes, WA has been effectively freed from the GST impacts of its policy changes. On the other hand, other states still facing the theoretical disincentives should therefore be discouraged from undertaking reform.

Despite this – as shown in Victoria’s initial submission and the interim report – the other states have led the way on reform, while WA has done relatively little.¹⁰⁷

WA’s royalty rates have not changed since 2018 for any mineral, despite being freed from any supposed impacts from the GST system by the 2018 changes. At the same time, many other states have undertaken significant reform, despite the theoretical disincentives (see Table 4).

Victoria’s initial submission highlighted the examples of Queensland’s 2023 introduction of a progressive royalty rate system and NSW’s increase to its coal royalty rates in 2024-25 – both made despite the GST implications.¹⁰⁸

Table 4 outlines examples of major revenue policy changes undertaken by states since 2019, based on published initiative costings in state budgets.

WA did not have any revenue initiatives with impacts above this threshold since 2019, while almost all other states have made changes to taxes included in CGC assessments over that time.

Victoria agrees with the interim report’s suggestion that the additional revenues from the 2018 changes, along with its already strong fiscal position, mean WA has been under less pressure than the other jurisdictions to reform its revenues. In this way, the 2018 reforms may have even disincentivised WA from undertaking revenue reform – as noted by the interim report.¹⁰⁹

¹⁰⁴ Interim report, p 5.

¹⁰⁵ Interim report, p 67.

¹⁰⁶ Victoria’s initial submission, Section 6.1, p 35.

¹⁰⁷ For example, see Victoria’s initial submission, Section 6.2, p 36, and Interim report, p 47, notes “despite the impact on GST revenue some states have pursued tax reform” and p 49, notes “yet even with these impacts to GST payments removed Western Australia has not increased its gold, or any other of its royalty rates.”

¹⁰⁸ Victoria’s initial submission, p 41.

¹⁰⁹ Interim report, p 49: “indeed, the 2018 reforms may have even weakened the case for reform in Western Australia by easing the budget pressure that motivated the earlier proposal.”

Table 4: State policy reforms made since the 2018 GST changes

State	Year	Policy reform
New South Wales	2024	Coal royalty increase
	2024	Land tax thresholds indexation arrangements
Victoria	2024	Commercial and Industrial Property Tax reform to withdraw from commercial and industrial land transfer duty in favour of a charge based on land values
	2023	Gradual abolition of business insurance duty
Queensland	2022	Progressive royalty rate system
	2022	Mental Health levy
Western Australia		No initiatives
South Australia	2018	Abolition of commercial and industrial stamp duty
Tasmania	2022	Increased land tax threshold
Australian Capital Territory	Ongoing	Stamp duty-property tax swap

Source: State budget papers

The lack of evidence around policy incentives from the GST distribution applies equally to development of industries or revenue bases as it does to the revenue policies outlined above. Victoria's initial submission presented evidence that despite being free from theoretical incentive effects, WA has lagged nationally on industry development since the introduction of the 2018 changes:

- since 2014-15, WA's expenses on the CGC's services to industries mining sub-component remained stable, while total expenses grew in the rest of Australia
- WA had the second lowest levels of government investment as a share of GSP since 2018, at only 1.9 per cent of GSP
- WA mining industry gross value added per hour worked falling by 21 per cent between 2018-19 and 2023-24
- Since 2018-19 WA has had the lowest productivity growth in the country, declining by five per cent.¹¹⁰

Victoria's initial submission noted this was not to say that WA didn't make effort to develop its industries, but that mining investment and development are driven by cyclical and global factors, rather than theoretical GST impacts. This is shown in the evidence, given the removal in the 2018 changes of supposed incentives had no impact of WA's policy effort or outcomes.

States pursue reform and develop their industries for many reasons – to grow employment opportunities, develop their economies and strengthen their budgets to fund service delivery and infrastructure. In this broader context GST considerations are, at most, a relatively minor factor and usually aren't considered at all.

¹¹⁰ Victoria's initial submission, Section 6.3, p 38.

By way of example, outside highly controlled settings such as Victoria's Early Intervention Investment Framework, it is not typical practice in setting government budgets to cost policy initiatives' fiscal second-round effects – such as:

- The revenue consequences of policies' implications for economic activity, labour markets, property markets, other tax revenue lines, or the GST distribution.
- The downstream implications for use of demand-driven public sector services, or cost recovered services and activities.

To do so would frequently be unduly speculative, given many second-round effects are difficult to measure, or elasticities are uncertain. Even where GST distribution impacts are measurable, it would be inconsistent to cost these but not other second-round fiscal effects.

In any event, the primary point remains that in making policy choices, states will prioritise direct outcomes for their citizens, not the GST distribution. While it is natural to look closely at GST considerations in preparing a report on GST, this and other evidence put to the Commission are salient reminders not to overstate GST considerations in the policy decision-making of sovereign governments accountable to their voters in their jurisdiction.

6.4 The 2018 changes do little to improve predictability

Victoria maintains, as stated in its initial submission, that the 2018 changes have not improved the predictability of GST revenues for states, or states' fiscal planning.

Victoria supports the interim report's similar findings. The interim report found that "states have now, and have always had, reasonable revenue certainty".¹¹¹ Adding that, "historically, states have been able to predict their total revenues with a reasonable degree of accuracy."¹¹²

Unsurprisingly, the 2018 reforms have failed to meet the stated "objectives of reducing volatility and improving the certainty of GST revenue streams to support state fiscal planning".¹¹³

Victoria supports the interim findings 2.2 and 4.1 that:

*Interim finding 2.2: "the 2018 reforms have not provided more stable and predictable GST revenues for all states, with the scheduled expiration of the NoWO guarantee reducing the longer term predictability of GST revenues and creating fiscal uncertainty for most states."*¹¹⁴

*Interim finding 4.1: "the reforms have marginally improved the predictability of GST revenue for some states and, if the NoWO guarantee is not made permanent, marginally reduced it for others. For all states, the reforms have introduced additional methodological complexity and created interactions which increase the risk of forecasting error."*¹¹⁵

Overall, the PC found that "the 2018 reforms have had mostly minimal effects on GST revenue certainty"¹¹⁶ and that "the 2018 changes had little effect on year-on-year volatility".¹¹⁷

¹¹¹ Interim report, p 60.

¹¹² Interim report, p 61.

¹¹³ Interim report, Terms of Reference, page V.

¹¹⁴ Interim report, p 38.

¹¹⁵ Interim report, p 70.

¹¹⁶ Interim report, p 62.

¹¹⁷ Interim report, p 34.

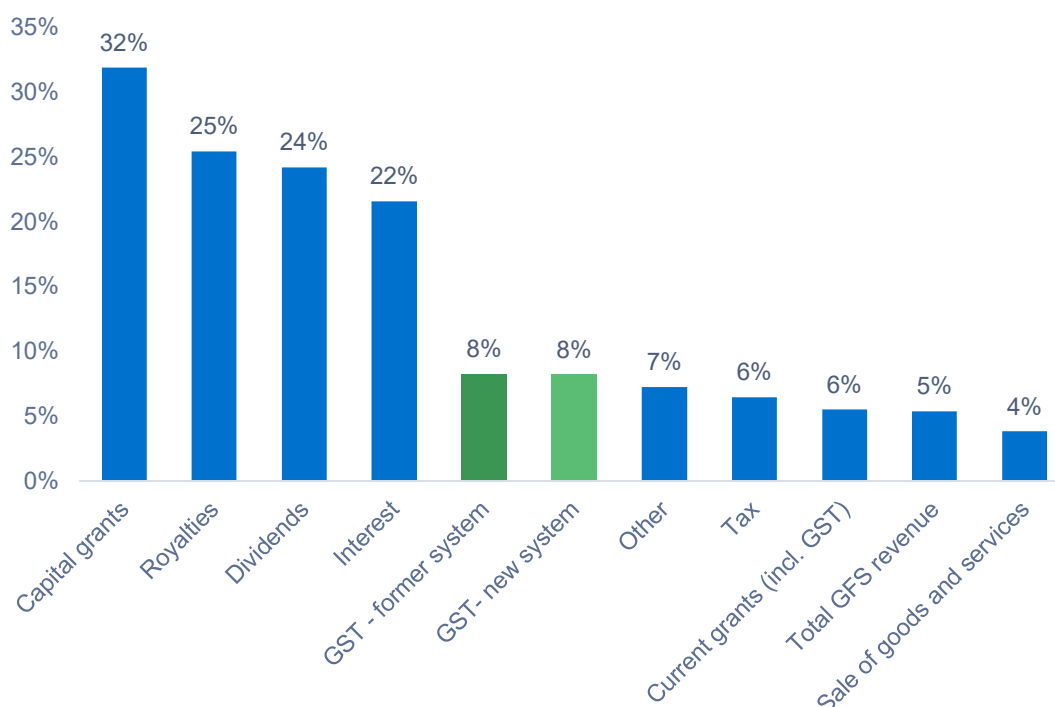
Victoria's additional analysis presented in Figure 4 below shows that the variation of GST is around the middle of states' revenue sources.¹¹⁸

Crucially, Victoria's analysis finds the 2018 changes didn't significantly alter the variation in GST revenue. Variation in revenue under the former and new systems (applied in full to the time period considered) were not significantly different.

Victoria supports the interim report's conclusion that "due to the uncertainty around the future of NoWO payments, the current GST distribution system exacerbates fiscal sustainability concerns."¹¹⁹ Victoria considers interim recommendation 4.3 could be strengthened recognising the uncertainty time-limited, rolling guarantees have on the states – see Section 7.3.

Figure 4: GST is as predictable as any other state revenue source, which the 2018 changes didn't significantly alter

Standard deviations of annual growth rates - state revenue sources 2015-16 to 2024-25



Source: ABS Government Finance Statistics, Commonwealth Final Budget Outcomes – various.

Note: State revenues and their variation for former and new GST systems were modelled as though those systems were in place for the full time period considered.

¹¹⁸ Noting that within these broader categories there may revenue sources be greater or lesser variation. For example, within the 'tax' grouping, land transfer duty and land tax may have different variances.

¹¹⁹ Interim report, p 68.

6.5 The 2018 changes have weakened Federal Financial Relations

In its initial submission to the inquiry, Victoria noted that the 2018 changes created additional uncertainty for states by damaging trust in the Commonwealth's willingness to follow through on its funding and other commitments to states.

Victoria's initial submission noted the damage the 2018 changes have had on interjurisdictional cooperation and increasingly uncertain fiscal environment states face from Commonwealth-State relations. This was highlighted by the Commonwealth's effective linkage between health and disability negotiations and the extension of the NoWO guarantee at National Cabinet in December 2023 – noted by the Commonwealth Treasurer and the Board of Treasurers at the time.¹²⁰

The PC also noted the fiscal uncertainty created by the time-limited, and negotiated NoWO guarantee:

“without NoWO payments, states with less capacity will bear the cost of a reform they did not support, when introduced, potentially through higher debt, reduction in services or tax increases. Under temporary NoWO guarantee arrangements, states face ongoing fiscal uncertainty as the Australian Government could withdraw support at any point.”¹²¹

The interim report includes several recommendations on improving the governance of Federal Financial Relations (FFR), and highlights issues with sustainability within the federation. See Section 9 for further detail on Victoria's positions on these recommendations.

If the NoWO guarantee is needed in the future, Victoria calls on the PC to strengthen its recommendations on the NoWO guarantee to avoid this uncertainty and possibility of negotiating with other funding sources – see Section 7.3.

¹²⁰ Victoria's initial submission, p 34.

¹²¹ Interim report, p 60.

7. The former system remains the best available option

The interim report's key recommendations 4.1, 4.2 and 4.3 broadly align with Victoria's proposals in its initial submission – with some key differences.

Victoria's first preference is for a full return to the pre-2018 system – partially aligning with the PC's recommendations 4.1 and 4.2. Reverting to the former system will restore the independent, rules-based process that allowed all states' voices to be heard, and all states' needs to be met.

Failing that, Victoria's position is that if the Commonwealth decides to continue to provide additional funding to WA, it must do so simply and transparently outside the GST system – aligning with the PC's recommendation 4.2. Other states and their residents – 89 per cent of the national population – must not be made to bear the cost of the Commonwealth's unilateral decision to favour WA.

If the Commonwealth retains the 2018 changes (wholly or in part) it must make the NoWO guarantee permanent – aligning with the PC's recommendation 4.3. Victoria has further suggestions to strengthen the NoWO guarantee, to ensure it is permanent, and not able to be traded off for other concessions (see Section 7.3).

Interim recommendations 4.1 and 4.2 include measures to specifically address dominant state effects, either through the CGC or direct and Commonwealth payments. Victoria does not support addressing dominant state effects as:

- they detract from the primary principle of HFE, undermining equalisation for only theoretical benefits for secondary supporting principles like policy neutrality
- the Commission has not shown in its draft report, and Victoria has not been able to identify substantial evidence they exist in practice or materially influence states' decision making
- many potential approaches to addressing them within the CGC's methods have significant flaws or technical barriers to implementation (see Appendix A).

While Victoria does not support addressing theoretical dominant state effects or additional unjustified payments to WA, it considers recommendation 4.2 is an acceptable fallback, and preferable to 4.1. Despite referring to dominant state issues, recommendation 4.2 is considered acceptable as ultimately the Commonwealth will decide how it provides funding outside the GST system to the states.

Victoria has suggestions to improve the design of any potential payments under recommendation 4.2, to ensure they are used only when appropriate – see Section 7.2.

However, Victoria does not support recommendation 4.1 and specific directions from the Commonwealth Treasurer to the CGC to implement dominant state adjustments. Victoria does not support adjustments for dominant state mining effects as they reduce HFE, and are not well supported by the evidence in practice. Victoria also considers the direction to address dominant state issues is unnecessary, and undermines the independence of the CGC – see Section 7.1.

The interim report expresses a confidence in the CGC's processes and methods, which Victoria shares. Interim finding 5.1 notes that the CGC has “adopted an independent, consultative and transparent approach” and that:

“The CGC performs this role with a high degree of independence, maintains highly productive and consultative relationships with state treasuries, and undertakes its work with reasonable transparency. These characteristics strengthen the system.”¹²²

Given this confidence, Victoria does not support specific directions from the Commonwealth Treasurer on specific methodology issues – see Section 7.1 for more information.

If the Commonwealth decides to retain the 2018 changes, wholly or in part, or give effect to the Commission’s recommendation 4.1 to consider dominant state effects in the GST system, they must be accompanied by a permanent NoWO guarantee. Victoria only supports this option as a fallback if the Commonwealth is unwilling to return to the pre-2018 system.

The alterations to the 2018 changes in recommendation 4.3 maintain the majority of the loss of HFE due to the GST relativity floor remaining in place. Removing the standard state benchmark and pool boost would improve simplicity and slightly reduce inequity and perverse incentives. However, as the interim report notes, there would remain significant fiscal disparities associated with a GST relativity floor.¹²³

The NoWO guarantee shifts the burden of financing WA’s excess fiscal capacity from the states to the Commonwealth. This is appropriate given it unilaterally made the decision to provide WA more funding, and the interim report notes it is better placed to bear the costs.¹²⁴ It does not, however, eliminate the significant opportunity cost of these payments, and the ongoing risk to states of the Commonwealth suspending or removing the NoWO guarantee.

7.1 Victoria does not support recommendation 4.1 and directions for the CGC to address dominant state effects



PC interim recommendation 4.1

Australia should return towards the pre-2018 system but the Australian Treasurer should direct the CGC to address dominant-state effects

Australia should move back towards the pre-2018 GST distribution system but the Australian Treasurer should direct the Commonwealth Grants Commission (CGC) to address costly dominant state effects where they arise.

Victoria does not support recommendation 4.1, as:

- any adjustments would likely reduce HFE, trading off the primary aim for a secondary objective of policy neutrality
- dominant state effects have not been found to affect states’ behaviour in practice
- it is overly prescriptive and undermines the work of the CGC, which is already well equipped to address any policy incentive issues in its methods.

While Victoria strongly agrees with the PC’s assessment that returning to the pre-2018 system is superior to the 2018 changes, the inclusion of specific direction to the CGC on dominant state

¹²² Interim report, p 92.

¹²³ Interim report, p 81.

¹²⁴ Interim report, p 60.

adjustments is unnecessary. Furthermore, direction from the Commonwealth risks an outcome which compromises its core principle of HFE to address purely theoretical disincentives.

If the Commonwealth decides to prescribe a dominant state adjustment that compromises HFE, it would be better placed to fund it directly and transparently, as per recommendation 4.2. Otherwise, recommendation 4.1 risks repeating the mistakes of the 2018 changes by:

- making the GST try to do too much
- reducing HFE by making other states or the Commonwealth worse off to address only theoretical disincentives
- delivering no actual reform.

As stated in Section 4, Victoria and the PC are aligned that the aim of the GST distribution is first and foremost equalisation, with supporting principles necessary constraints in service of equalisation.

7.1.1 Dominant state adjustments fundamentally reduce equalisation for a supporting principle, policy neutrality

There are three components of any proposed dominant state adjustment which, when combined, would undermine HFE:

- First, an adjustment would be an explicit decision to reduce HFE (the core principle) to improve policy neutrality (a subsidiary principle). This differs from other judgements in the CGC's assessments which are typically made to account for uncertainty or data quality issues.¹²⁵
 - For example, applying a discount in the absence of quality data generally has an uncertain impact on the level of HFE being achieved, as the data is not available to understand each state's true fiscal capacity. This means the Commission's decision to apply a discount is relatively neutral.
 - The mining assessment is not uncertain and is informed by high-quality data, and therefore a decision to discount or adjust it would consciously ignore robust data to move away from HFE for the benefit of specific states.
- Second, an adjustment would require subjective judgements around the extent to which an adjustment should blunt the effect of an assessment in order to improve policy neutrality, or in other words, how much HFE should be compromised to achieve policy neutrality.
- Lastly, as there is no evidence to support the rationale that policy neutrality could even be improved by such an adjustment, there is also no evidence to justify, guide or support a decision on a particular level of adjustment or discounting.

Appendix A to this submission demonstrates that in many proposed methods, an adjustment would create a series of implementation problems that require arbitrary judgments to resolve.

Put together, a dominant state adjustment would require judgements with the sole objective of reducing HFE, without any data or evidence to support its decision. If the CGC is directed to implement such an adjustment it would go beyond the CGC's mandate and set a questionable precedent for any future method changes.

¹²⁵ CGC 2025 Review outcomes, p 9.

7.1.2 Theoretical dominant state effects have not affected state behaviour

As Victoria has outlined in its previous submission, and in Section 5.4 and 6.3 Victoria does not consider dominant state effects, or other policy disincentives to be salient in practice, despite the theory.¹²⁶ Victoria does not support diluting HFE and granting permanent windfalls to fiscally strong states purely on the basis of theoretical disincentives.

As noted in Section 6.3, the 2018 changes removed almost all dominant state effects affecting WA's GST share, while retaining them for everyone else. The 2018 changes had no material impact on WA's royalty policies or overall industry development spending, despite granting WA a \$22.4 billion windfall.¹²⁷

In that same period, other states enacted royalty policy changes despite geopolitical uncertainty, opposition from industry and real GST impacts. This proves beyond a doubt that HFE is not standing in the way of states pursuing reform and should not be compromised for theoretical disincentives.

7.1.3 The CGC is already well equipped to handle dominant state issues

Should dominant state issues, or any other policy neutrality issues, arise the CGC is well equipped to identify, propose, assess and implement solutions. While requiring directions from the Commonwealth Treasurer to commence its annual updates or methodology reviews as a formality, the CGC does not require specific direction on how to do its technical and methodological work.

Importantly, the CGC has a core principle of achieving HFE and supporting principles of practicality, what states do, policy neutrality and contemporaneity which it aims to balance in its methodology. These principles and their relationship to the objective of HFE are explained in the CGC's methodology

*To assist in designing and evaluating alternative assessment methods, the Commission has 4 supporting principles: 'what states do', policy neutrality, practicality, and contemporaneity. They are subsidiary to the objective of horizontal fiscal equalisation. Ideally, assessment methods would embody each of the supporting principles. In practice, alternative assessment methods often involve trade-offs between supporting principles, with the objective of fiscal equalisation always being the primary consideration.*¹²⁸

Its independence, combined with these principles and thorough consultation with states, ensures that it will arrive at solutions that first and foremost achieve HFE, while managing other objectives to the best of its ability. The 2025 Review is an example of this, where states were provided extensive opportunity for consultation, including 11 formal requests for submissions through issues papers or draft reports over two years. The interim report rightly noted a focus on HFE is a positive outcome, and "relying on the GST distribution system to achieve too many goals risks none of these goals being achieved particularly well."¹²⁹

¹²⁶ Victorian initial submission, p 42.

¹²⁷ WA's \$22.4 billion additional windfall is based on DTF calculations based on Interim report p, 2 and ABS Government Finance Statistics. See also Victoria's initial submission, Section 6, from p 35 and in this submission Section 6.3.

¹²⁸ CGC 2025 Commissions Assessment Methodology, p 233.

¹²⁹ Interim report, p 39.

The interim report found that the former system was broadly policy neutral with the exception of dominant state effects in the mining assessment.¹³⁰ As detailed extensively in this and Victoria's initial submission, Victoria considers the focus on dominant state effects unnecessary and there is no evidence HFE has hindered reform in the past.¹³¹ In addition, as the interim report notes, the CGC can address any impacts from policy changes under its existing policy neutrality principle.¹³²

In particular:

- the CGC has already investigated adjustments to account for dominant state effects in the 2025 Review¹³³
- the CGC continues to consult with states regarding dominant state effects and tax elasticity effects through its forward work program¹³⁴
- as part of its 2025 methodology review, the CGC committed to increasing its flexibility to assess ad-hoc method changes where necessary in response to changes to policy or state circumstances between its usual 5-yearly methodology cycle.¹³⁵

Where a state has committed to reform, and there are tangible, measurable disincentives that could be mitigated through adjustments that do not compromise on HFE, the CGC is well equipped to investigate solutions to address policy neutrality. This is noted in the interim report with reference to the CGC's engagement with NSW's proposed property tax reform.¹³⁶

Victoria noted in its initial submission that where potential issues with its policy neutrality approach arise, the CGC has already committed to changing its methods to remove these issues. This includes through a new process from its 2025 methodology review to enable method changes between its usual 5-yearly cycles.¹³⁷

Through its usual processes, the CGC can tailor its methods to the reforms states actually undertake. In this way, its methods remain consistent with what states do, ensuring that assessments of fiscal capacity remain as accurate as possible while maximising policy neutrality.

Changing assessments based on what states might do – as is contemplated with the proposed mining dominant state adjustments – could lead to a repeat of the mistakes of the current system, where the GST distribution does not reflect HFE and grants a windfall to one state for making no change to its policies, while penalising other states that have actually undertaken reform.

Considering this, there is limited rationale for prescriptive Commonwealth directions for the CGC to address policy neutrality issues, and Victoria's position remains that the 2018 changes should be repealed unconditionally.

7.1.4 The CGC has already considered dominant state adjustments and has not found viable methods

The CGC has already considered dominant state adjustments extensively, and concluded there was not a viable technical method that could be implemented.

¹³⁰ Interim report, Finding 3.2, p 51.

¹³¹ Victoria's initial submission, section 6.1.

¹³² Interim report, p 46.

¹³³ CGC- 2025 Review outcomes - Mining revenue paragraph 20-28.

¹³⁴ CGC- 2025 Review outcomes - Forward work program paragraphs 41-44, 53-54.

¹³⁵ CGC- 2025 Review outcomes - Flexibility to Change methods between reviews paragraph 18.

¹³⁶ Interim report, p 47.

¹³⁷ Victoria's initial submission, p 35.

The CGC consulted states on a possible dominant state adjustment in its 2025 methodology review and is continuing to do so as part of its forward work program. In its 2025 Review, while the CGC acknowledges the conceptual basis of a dominant state adjustment, it notes there remain “implementation issues that needed to be resolved before any adjustment would be practical.”¹³⁸

This recognises that there is no easy solution to this issue, as the CGC has already identified that simple solutions such as aggregation or discounting:

“would not have captured states’ revenue capacity nor achieved the same degree of fiscal equalisation. For example, grouping major minerals together might dampen volatility in Western Australia’s GST distribution, but it would produce a poorer assessment of its revenue capacity because it would have diluted its iron ore capacity.”¹³⁹

The CGC is currently addressing these implementation issues through consultation with states as part of its forward work program. Several different options have been proposed by the PC and the CGC’s processes, which Victoria has evaluated in Appendix 1 and summarised in Table 5 below.

Many proposed solutions are poorly targeted at the theoretical incentives, face data limitations, or present new definitional questions requiring judgements which ultimately return to a direct trade-off between policy neutrality and HFE. Importantly, there is no easy fix to the tension between policy neutrality and HFE, which is likely why the CGC has been so thorough and careful in its consideration of this issue.

Table 5: Victorian position on selected dominant state adjustment proposals

Method	Victorian position	Rationale
Discounting assessment (entire assessment or specific minerals)	Do not support	Poorly targeted, unconditional, and compromises HFE
Discounting mining policy changes	Support in principle	Targeted, but reliance on assumptions and judgement is problematic, meaning this approach is practically infeasible
International benchmark royalty rate	Do not support	Infeasible to estimate an appropriate benchmark
Increase the duration of mining assessment smoothing	Support in principle	Still achieves HFE over time, with a direct trade-off with contemporaneity – noting the potential to exacerbate the impact of cyclical changes as occurred when this approach was implemented prior to 2010
Historical average royalty rate	Support in principle	Still largely achieves HFE over time, with a direct trade-off with contemporaneity
Hotelling rule-based discount	Do not support	Highly sensitive to assumptions and deviates significantly from what states do
Sovereign wealth fund discount	Do not support	Highly sensitive to assumptions and deviates significantly from what states do

¹³⁸ 2025 Review - Review outcomes - Mining revenue, paragraph 26.

¹³⁹ CGC Research Paper 1 - Fiscal equalisation and mining booms, p 11.

Aggregation by royalty rate	Do not support	Risk of large unpredictable swings due to 'category switching', when changes to royalty rates mean minerals cross the set rate thresholds, likely to not achieve HFE and over or underrepresent some fiscal capacity
Aggregation by price band	Do not support	May not capture differences in market conditions between minerals, likely to not achieve HFE and over- or under-represent some fiscal capacity
Aggregation by profitability	Do not support	Currently infeasible due to data constraints
Endowment assessment	Do not support	Deviates from what states do, difficult to consistently estimate reserves

7.1.5 Direction from the Commonwealth Treasurer is unnecessary and potentially counterproductive

The CGC has demonstrated that it is sufficiently empowered to investigate and make adjustments for dominant state issues. It is not clear what further direction from the Commonwealth would achieve in addressing an issue the CGC is already considering.

The only possible way in which direction from the Commonwealth could accelerate the achievement of an outcome is if that direction either:

- undermined the independence of the CGC by prescribing a solution (for instance predetermining a higher weighting for (perceived) policy neutrality, regardless of other considerations or the evidence it finds), or
- instructed the CGC to compromise the principle of HFE in arriving at an approach.

Neither of these possibilities are consistent with the independent, rules-based system focussed primarily on achieving HFE that the PC highlighted in the interim report.¹⁴⁰

By issuing directions to the CGC the Commonwealth could essentially use recommendation 4.1 to shift the cost of WA's current top-up to other states – as would be the case if there are no changes to the current arrangements with the expiry of the NoWO guarantee. One of the most ill-advised and ineffective possible adjustments, the 50 per cent mining discount, was discussed in the interim report and estimated to have comparable adverse HFE outcomes to the 2018 changes.¹⁴¹

If the Commonwealth engages in this level of interference in the GST system, the outcome would be no better than the 2018 changes, likely to repeat the same mistakes, and further damage federal financial relations. Given the technical challenges in implementing an adjustment, a blunt instrument could end up being used to grant a windfall to mining states based on factors outside any state's control, regardless of whether they actually do reform, at the expense of HFE and all other states. Therefore, this recommendation must also be accompanied by a permanent NoWO guarantee, to make up any difference between what states would receive in absence of Commonwealth intervention on the dominant state issue.

A better role for the Commonwealth, in line with recommendation 4.2, is to directly and transparently support states to implement reform where there may be barriers – for example, with National

¹⁴⁰ Interim report, p 39.

¹⁴¹ Interim report, p 77.

Competition Policy style payments as noted by the interim report.¹⁴² Victoria does not consider that in such situations that the CGC should have to compromise on HFE, or that other jurisdictions should have to foot the bill for reducing only theoretical disincentives to reform. See Section 7.2 for more detail on the design of potential payments.

7.2 Recommendation 4.2 could be a solution that is more transparent and less damaging to HFE

PC interim recommendation 4.2



If the Australian Government is not minded to pursue interim recommendation 4.1, Australia should return to a pre-2018 system and the Australian Government should make direct payments to states it considers are affected by dominant-state issues

“Australia should move back towards the pre-2018 GST distribution system and it is recommended that the Australian Government make direct payments, outside of the GST pool, to states it considers materially affected by dominant-state effects.”

Noting Victoria’s concerns with recommendation 4.1, and the superiority of the pre-2018 system, Victoria is supportive in-principle of recommendation 4.2 as a fallback option, if the Commonwealth decides to make additional payments to WA, or any other state that benefit from high levels of mining royalties thanks to larger minerals endowments.

Providing targeted general revenue assistance to states is within the Commonwealth’s role and discretion.¹⁴³ If the Commonwealth determines it should provide additional funding to the fiscally strongest state, it is simpler and more transparent to do so outside the HFE system. Perverting GST distribution to achieve the same outcome, as occurred under the 2018 changes, is significantly less transparent, weakens trust in federal financial relations, and places on states other than WA both the cost of reduced GST shares and the risk associated with the expiry of the NoWO guarantee.

7.2.1 Direct payments improve transparency and reduce the risk to other states

In comparison to the 2018 changes, or interim recommendation 4.1, the separate payments noted in recommendation 4.2 have the benefit of being transparent and clearly identifiable.

Separate, direct and transparent payments would force the Commonwealth to clarify its objective, and allow them to be clearly and independently evaluated. The interim report found that the objectives of the 2018 changes were unclear, and that the 2018 changes meant the GST system was being asked to do too many things.¹⁴⁴

The PC has noted in other inquiries that direct, targeted support with clear policy aims is more effective than broad assistance or concessions. The 2019-20 Review of Remote Area Tax Concessions and Payments noted for concessions more broadly:

¹⁴² Interim report, p 33.

¹⁴³ Victoria’s initial submission, p 47.

¹⁴⁴ Interim report, p 24 and 39.

“Tax concessions in general have inherent drawbacks, regardless of the objective they are intended to advance. They are less transparent than direct government outlays, subject to little public scrutiny and review, and introduce complexity into the tax system. These significant drawbacks led the Henry Tax Review to recommend that programs should not be delivered as tax concessions ‘unless there is a clear countervailing benefit in terms of efficiency, equity, complexity, sustainability and policy consistency’.”¹⁴⁵

If the Commonwealth were to agree to direct and transparent payments with WA or any other state, the associated agreements could clearly state their purpose and any conditions. This could include whether they are for reducing supposed GST disincentives, revenue certainty, rewarding a perceived contribution to the national economy, or delivery of reform.

Whatever the objective, Victoria considers it would be far more transparent, and potentially more effective for the Commonwealth to leave the GST system alone, and arrange a direct and transparent funding agreement with WA for the amount it considers the fiscally strongest state needs. The same goes should it wish to provide greater support to any other mining state.

Regardless of the final payments to WA (or any other state), the risk of any changes to this agreement would no longer be borne by the other states through redistributions of GST, but instead by the Commonwealth and WA (that is, the risk is borne by two parties rather than eight). This would also remove the additional complexity added to the calculation and interpretation of GST revenues by the 2018 changes.

While this is not the most desirable outcome due to the opportunity cost of Commonwealth transfers to the strongest state for little demonstrable benefit, this option would allow the Commonwealth to maintain its commitment to the “current arrangements” by providing additional funding to WA.

Consistent with recommendation 4.2, specific payments to WA could be calculated based on the recently reported commitments by the Commonwealth to maintaining the outcomes under the 2018 changes for WA. They could be delivered as direct support on terms agreed between WA and the Commonwealth. At the same time, the GST distribution could be returned to the former system.¹⁴⁶

If these separate payments are effectively used to achieve the outcomes of the 2018 changes it would be a poor result, and not in the spirit of the PC’s recommendation 4.2. The final report should make clear that this is not the intent of recommendation 4.2, and that any separate payments for dominant state issues should be based on another metric, more targeted toward the specific benefits intended to be achieved.

The interim report is unclear on a preferred dominant state adjustment, which could leave the door open to the Commonwealth taking a broader interpretation and implementing sub-optimal options. For example, paying equivalent to the 2018 changes or a 50 per cent mining discount, which the interim report assesses as being worse for equity and fiscal sustainability than the former system.

Victoria has suggestions for an improved approach to making such payments in Section 7.2.3 and 7.2.4 of this submission, which may address some of these concerns.

Overall, recommendation 4.2 would improve simplicity and transparency in the GST system and greatly improve certainty by eliminating the fiscal cliff currently faced by other states. This outcome

¹⁴⁵ [Remote Area Tax Concessions and Payments - Study Report](#), p 265.

¹⁴⁶ Interim report, p 86.

would also foster intergovernmental trust and cooperation more than the current system, as it does not directly interfere with the GST system that states all agreed to in 1999.

The PC should however clarify the recommendation to avoid the risk that it is simply used to maintain many of the poor outcomes of the 2018 changes.

7.2.2 Direct and transparent payments have the potential to improve flexibility and address perceived policy neutrality issues

The focus on dominant state issues in the context of recommendation 4.2 is overly narrow. While the CGC is well equipped to deal with the majority of policy neutrality issues within its assessments, there may be cases where external support would be beneficial to promote reform, address any policy incentive concerns and states' potential concerns around the timing or uncertainty of GST impacts.

Recommendation 4.2 presents an opportunity to relieve the tension between policy neutrality, practicality and HFE when and if it arises more broadly, by facilitating a more flexible solution that avoids the zero-sum calculus and high burden of evidence required for CGC methodology changes.

The most pressing recent example is land tax reform. The interim report notes the Australian Capital Territory's (ACT's) implemented and NSW's potential land tax reforms were unlikely to have been significantly impacted by the GST distribution.¹⁴⁷ However, in Victoria's view they have as much rationale for support as dominant state issues, and are likely to have greater, and broader, economic and welfare gains.

Therefore, it would also be worthwhile to open up the option for additional assistance from the Commonwealth to reduce the barrier to these important reforms. There is a case for external support in the case of land tax reforms, as these are also a potential productivity enhancing reform with significant GST impacts. The CGC and the PC have identified the required elasticity adjustments would be difficult to accurately estimate, and could not be confirmed before the reforms were in place.¹⁴⁸

A key difference between recommendations 4.1 and 4.2 is in the burden of proof required for changes, and therefore the flexibility available. Under recommendation 4.1, where the CGC is instructed to investigate (and potentially implement) a dominant state adjustment, the cost of trading off HFE for policy neutrality is borne by other states through redistributions of GST. The CGC has a necessarily high threshold of evidence and robustness for considering changes, ensuring that its methodology does not compromise HFE.

However, under recommendation 4.2, the Commonwealth would bear the cost of addressing states' concerns, and may be more flexible or subjective in when support should be provided – given it considers it is an appropriate use of Commonwealth funds, and payments are transparent, and tied to clearly defined objectives.

This concept is explored further in Section 7.2.4, whereby Commonwealth support could be provided to any state to promote reform where the GST impacts may be of concern to states, including in cases where they may be uncertain or unable to be determined until a future time. The Commonwealth's discretion in deciding whether or not to grant support under such an approach would allow for subjective judgements that may be required in dealing with cases where GST impacts may not be able to be robustly measured at the time of committing to reforms.

¹⁴⁷ Interim report, p 47.

¹⁴⁸ Interim report, p 46.

7.2.3 Any adjustment should be guided by clear principles

Through the 2018 changes, policy neutrality was used as a justification to deliver a windfall of GST revenue to WA, with no resulting increase in productivity enhancing policies or tax and royalty reforms, illustrated in Victoria's previous submission and Section 6.3.

The design of any future system must not allow this to happen again. Within recommendation 4.2 there is an opportunity for direct and transparent Commonwealth payments to relieve the tension between policy neutrality and HFE, and provide targeted support to states to undertake productivity enhancing reforms where needed.

Victoria agrees with the PC where it states:

*"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. In particular, if state activity generates material, uncompensated, policy relevant fiscal spillovers to the Australian Government and there is evidence that in the absence of payments, the state's activity would be inefficiently low, there is a straightforward policy solution available: the Australian Government can subsidise these activities directly, in a way that reflects the economic characteristics and magnitude of the spillover."*¹⁴⁹

As noted in Section 4, Victoria supports the interim report's definition of reasonable equalisation as:

*"the highest level of equalisation that can be maintained without creating material costs to efficiency, sustainability or certainty that cannot be addressed by other parts of the federation's policy toolkit."*¹⁵⁰

This provides a useful overarching principle, but further detail is required to be able to assess potential solutions. With this in mind, Victoria considers that any mechanism for direct payments should be guided by the following principles, which may be viewed as an extension of the PC's proposed definition of reasonable equalisation.

7.2.3.1 Conditional on policy changes

Any mechanism to mitigate GST impacts arising from policy neutrality concerns should be tied to, or conditional upon, policy changes being made. This would avoid reducing HFE and compensating states for the theoretical impacts of potential policies, irrespective of whether they occur.

The CGC has indicated with regard to elasticity adjustments for example, it would still need to consider the details of each individual reform and consult with states on the appropriate response before making any adjustments.¹⁵¹

¹⁴⁹ Interim report, p 33.

¹⁵⁰ Interim report, p 39.

¹⁵¹ [CGC 2025 Review outcomes - Stamp duty on conveyances](#) paragraph 44.

7.2.3.2 Targeted to policy impacts

Any mechanism should aim to only reduce the GST impact of a policy change, without compromising the underlying assessment of fiscal capacity, ensuring that the assessment still reflects underlying fiscal disparities.

7.2.3.3 Accessible to all and policy agnostic

Any policy change that generates material GST impacts is a policy neutrality risk, not just dominant state effects. These should all be able to be addressed if they are proven to have an impact on the GST distribution. Policies that may create similar policy driven GST impacts should have the same adjustments applied in the HFE system.

Structural changes should not be made to provide some states advantages that other states cannot reasonably access. For example, the 0.75 floor and standard state insulated WA from theoretical dominant state effects, but not Queensland despite the fact that Queensland actually undertook policy change, as identified in the interim report.¹⁵²

7.2.3.4 Transparent

Any measures to improve policy neutrality should clearly identify what policy change is being targeted, and the reduction in HFE or GST impacts caused by the measure.

7.2.3.5 Feasible

The mechanism should consider whether the CGC is able to deal with the issue within the GST system without compromising on its core principles, or if it presents an unavoidable trade-off between policy neutrality and HFE.

Section 7.2.4 explores these principles further in the form of a proposed system of direct Commonwealth payments to mitigate the adverse GST impacts of specific state reforms.

7.2.4 If the Commonwealth wants to incentivise reform, there are better options available without touching the GST

As noted in Section 7.2.1, Victoria supports interim recommendation 4.2 as a fallback, if the Commonwealth decides to provide additional funding to states outside the GST system. However, Victoria does not support the framing to focus only on dominant state issues, which are largely unsupported and overly narrow.

Instead, Victoria makes the following suggestions the PC could incorporate into its final recommendations, to:

- broaden the scope of potential additional payments to not only focus on mining, including to areas where there may be tangible impediments to a state's reform like an inability to confirm approaches with the CGC in advance
- create guardrails around payments to ensure they are used only where necessary, including where the CGC cannot commit to a methodology, and where there are material barriers relating directly to the reforms
- safeguards around implementation, to ensure, for example, states aren't compensated twice through the CGC's methods and by the Commonwealth.

¹⁵² Interim report, p 49.

Instead of the proposed payment ‘to address dominant state issues’ under recommendation 4.2, a system of ‘GST insulation grants’ could be implemented. Victoria’s amendments aim to improve the PC’s proposed solution, and avoid resorting to expensive and divisive redistributions of GST revenue. The PC notes in the interim report that separate mechanisms for the Commonwealth to incentivise states’ activity already exist, for example payments under National Competition Policy.¹⁵³ If separate payments are to be made in the context of GST policy neutrality issues, these could operate with a similar structure and rationale.

Importantly, these would not be confined to dominant state issues, but any policy neutrality issue affecting reform by any state, guided by clear principles. As previously noted in section 7.2.2, dominant state effects are not the only issue that affects or could affect states in the future.

A system of GST insulation grants could entail the following steps:

- A state developing or considering a policy that could materially affect its GST allocation would then make an application to the Commonwealth Treasurer.
 - The application should outline the proposed policy, and how the GST distribution impacts implementing the policy in such a way that requires support.
 - This should include estimates of the GST implications of the policy. The CGC could assist states in quantifying the potential GST impacts of the policy.
 - The application could also include the productivity or economic benefits of the policy to show the benefits of the reform and Commonwealth support to alleviate any concerns from the GST distribution.
 - The application should demonstrate that these issues are unable to be resolved through CGC method changes within the GST distribution. Along with evidence of engagement with the CGC on this issue, reasons for this may include:
 - The CGC is unable to provide definitive guidance on potential methods and the revenue impacts in advance of states committing to reform.
 - A method may only be feasible after the reform is implemented and appropriate data or external advice is available, and the state would benefit from revenue certainty from the Commonwealth.
 - Any method changes to address policy impacts would entail an unacceptable trade-off between improving policy neutrality and compromising the overarching objective of HFE.
 - A method has been identified, but would be based on assumptions, judgements or estimates rather than robust data.
- The Commonwealth Treasurer would consider whether to approve the state’s application. Factors influencing the Commonwealth Treasurer’s decision could include:
 - The extent to which the issue can already be addressed within the CGC’s existing frameworks, and the case for additional support outside of this. This may include planning or timing issues.
 - The materiality of the change.
 - The strength of the relationship between the policy and the estimated outcomes.
 - The wider benefits of the policy in terms of the Commonwealth’s policy priorities, for example to productivity.
- If approved, and the state proceeds with the policy reform, the Commonwealth would provide a grant for the agreed amount. This would ideally relate to estimates of the difference from the

¹⁵³ Interim report, p 33.

GST allocation the state would have received if it had not undertaken the policy, however this may not be possible to exactly estimate in advance.

- The state, the CGC and Commonwealth Treasury would have a role in forecasting the possible payment to the best of their abilities.
 - Given the payments would be made separately to the GST distribution and funded by the Commonwealth, the standard of proof is lower than the CGC's methods. The CGC's approach rightly has a higher burden of proof because any method change in favour of one state is funded by other states' lower GST shares.
 - The Commonwealth may be able to accept more indicative estimates to commit to grants either ahead of the impacts flowing through the CGC's methods or where a method is not able to be robustly quantified.
 - The grants would likely be quarantined from GST calculations.
 - Due to the uncertainty of estimating GST impacts, a reconciliation could occur in the year the GST impacts are able to be quantified by the CGC (much like the current accounting adjustment that occurs for state GST payments).¹⁵⁴
 - In cases where the CGC can adjust its methods to address policy neutrality with appropriate data, the grants could function as a loan, and states could repay the Commonwealth if they are compensated again through the GST distribution. Alternatively, the CGC could assess these payments and the later revisions to its methods in such a way that the state is not compensated twice.
 - Final payments or a reconciliation would require ongoing policy monitoring and evaluation to quantify the effects of the policy to establish counterfactual data on assessed revenue, expenditure and GST distributions. This monitoring would also ensure the reform is actually undertaken and achieves its objectives.
 - The Commonwealth could also limit the duration of the grant, for example to be for a certain number of years after the introduction of the policy. Ideally the timing is tied to overcoming any uncertainty states' face when enacting reforms, or to align with the later impacts to states' GST revenues.
- The benefit of these amendments to recommendation 4.2 are that they:
 - Are conditional – they only result in material changes in Commonwealth payments if states actually undertake reform.
 - Allow scope to consider a broader range of policy areas – for example, including land tax reform.
 - Are more targeted, as they would only come into effect where the CGC cannot address policy incentive issues independently, and only address the GST impacts of the policy change.
 - Promote improved policy rigour, as work to quantify the GST impact of the policy may also result in more thorough policy monitoring and evaluation activity.
 - This contrasts with the 2018 changes, which granted WA a windfall of GST revenue at the Commonwealth's expense even though it did not undertake productivity enhancing policy. These amendments would likely result in a lower cost relative to the 2018 changes, and would actively incentivise reform with a direct conditional link between reform and targeted payments.

¹⁵⁴ Commonwealth 2024-25 Final Budget Outcome, Table 3.10, p 67.

7.3 The no-worse-off guarantee must be made permanent if the 2018 changes are retained



PC interim recommendation 4.3

If the Australian Government does not pursue interim recommendation 4.1 or 4.2, it should make the minimum changes to address the critical issues in the current system

If the Australian Government does not pursue interim recommendation 4.1 or 4.2, the minimum changes to address critical issues with the current system are as follows:

- remove the standard state benchmark
- remove the pool boost
- make the No Worse Off guarantee, or broadly equivalent payments outside of the GST distribution system, to the states permanent.

Victoria considers that the pre-2018 system is superior to recommendations 4.1, 4.2 and 4.3, and that a return to the pre-2018 system – with or without Commonwealth payments to dominant states outside the GST system – delivers greater certainty and transparency than the NoWO guarantee, and could be more affordable to the Commonwealth.

Nevertheless, interim recommendation 4.3 closely aligns with Victoria's fallback position in its initial submission that should the Commonwealth maintain the 2018 changes, the NoWO guarantee must be extended permanently so that states are not adversely impacted.

Most direct fiscal impacts of the current system to the states have been mitigated by the NoWO guarantee, resulting in outcomes for states other than WA similar to the former system. Without the guarantee, states other than WA face significant uncertainty and fiscal risks.

However, there remains a significant opportunity cost to the indirect Commonwealth support for WA through the NoWO guarantee, both through the damage it has done to federal financial relations, as well as the quantum of funding which could have spent on other things. The interim report states:

"By way of context, the \$6.4 billion spent on the 2018 reforms in 2024–25 could deliver a more than \$450 tax cut for each Australian taxpayer,⁸ or fund an increase in JobSeeker payments to 90% of the Age Pension including supplements."¹⁵⁵

If the Commonwealth is committed to maintaining the current system which delivers additional revenue for WA, at a minimum, the NoWO guarantee must be maintained indefinitely to ensure states do not foot the bill for it. Extending the NoWO guarantee permanently would also significantly reduce risk and improve fiscal sustainability for the other states, by eliminating the fiscal cliff of the NoWO guarantee expiry.

Victoria agrees with the PC's conclusion that if support for WA is to be retained, removing the pool boost, and the standard state benchmark reduce the cost of the system, and slightly improve simplicity. However, a floor of 0.75 remains a significant deviation from HFE at a significant cost for no demonstrated improvement in policy neutrality or other outcomes.

¹⁵⁵ Interim report, p 31.

Due to the transition mechanism for the 2018 changes, the relativity floor (initially set at 0.7, but raised to 0.75) has been the main driver of deviations from HFE under the current system, and delivered all of the \$22.4 billion GST windfall to WA up to 2024-25.¹⁵⁶ While the new equalisation standard had an increasing weight in recommended GST relativities across the transition period 2021-22 to 2025-26, WA's fiscal capacity was so far above other states in 2026 that the floor was still binding in the penultimate year of the transition.

The floor also remains an extremely poor method of improving policy neutrality, as it only reduces the GST impacts of policy changes for the strongest state. The PC itself touched on this dynamic in the interim report with regard to the standard state benchmark – however, the same issues apply to the floor. The interim report noted:

“The standard state benchmark has created a two-tiered GST distribution system where a state like South Australia that has a lower fiscal capacity than New South Wales or Victoria does not benefit from the equalisation benchmark. This means that if South Australia improves their financial position, they receive less GST revenue. On the other hand, a state with greater fiscal capacity, like Western Australia, now has its relativity automatically increased to the same as Victoria or New South Wales. This means that if Western Australia improves its financial position, it can receive the same or even more GST revenue than it otherwise would.”¹⁵⁷

Similarly, only states below the 0.75 floor benefit from an improvement in their financial position and receive the same GST, while a state above the 0.75 floor would have its relativity reduced. If the objective of the 2018 changes is to improve policy neutrality, retaining the 0.75 floor would continue to reduce disincentives only for one state, and maintain a significant disparity in service delivery at a significant cost to the Commonwealth.

Nevertheless, if the Commonwealth decides to retain any elements of the 2018 changes, including any combination of the standard state and relativity floor, the NoWO guarantee must be made permanent, not just extended. Bearing the cost of the 2018 changes is the Commonwealth's responsibility to states as a direct consequence of its own policy choice, and not a bargaining chip to be leveraged in other funding negotiations.

Victoria considers the final report could go further with recommendation 4.3. Given the PC's independent finding that the 2018 changes are unsupported on policy grounds, and the broad-based criticism of the changes, if the Commonwealth chooses to continue with the 2018 changes, or similar arrangements, it will purely be its unilateral prerogative. As such, as the sole decision maker against independent advice, it should be the Commonwealth that bears the fiscal responsibility and consequences.

The guarantee was necessary because of the Commonwealth's unilateral decision to implement the 2018 changes to benefit only WA. Addressing the impacts of the 2018 changes is the responsibility of the Commonwealth, without being tied to additional concessions from states that already abolished a range of state taxes at the introduction of the GST. The NoWO guarantee should never have been linked to any other agreements, as it effectively was in 2023 to health and disability negotiations.¹⁵⁸

¹⁵⁶ CGC Update reports, 2021-2024.

¹⁵⁷ Interim report, p 3.

¹⁵⁸ Commonwealth Treasurer Media Release, Extension of 'No Worse Off' deal to help fund essential services, 6 December 2023.

The states need ironclad assurances that if extended, the NoWO guarantee must:

- **Be made permanent**, and not subject to wasteful periodic negotiation, halting progress on other important FFR issues (as was the case with health and disability in 2023) and creating uncertainty for states' fiscal planning (as the PC noted with the current expiry of the NoWO guarantee).
- **Not come at the cost of any other Commonwealth payments to states**, as was promised as part of the original NoWO guarantee, but not explicitly codified.
- **Not be traded against other concessions from states**, as implicitly was the case with the 2023 extension of the NoWO guarantee, where a deal on health and disability was linked to the extension of the NoWO guarantee.

A system of rolling extensions to a temporary NoWO guarantee would provide the Commonwealth with significant leverage over states whenever the NoWO guarantee is due to expire. The Commonwealth has proven itself willing to exploit this leverage to extract concessions from states to achieve short-term transactional goals by linking the NoWO guarantee extension in 2023 to an agreement on health and disability funding¹⁵⁹, and recent reported comments have suggested the Commonwealth may look to exploit the NoWO guarantee in federal financial relations:

*"there was the no-worse-off guarantee and that has meant it's the Commonwealth that essentially is footing the bill... but we'll bear that in mind as well when we're talking about other funding arrangements with the States."*¹⁶⁰

The interim report found that the Commonwealth is best placed to bear the cost of the NoWO guarantee.¹⁶¹ The cost of providing the NoWO guarantee is positively correlated with periods of high growth in its other tax revenues, for example, company tax driven by strong profits from mining activity.

As highlighted in the interim report, the Commonwealth receives more from company tax receipts when iron ore prices are high, which is when guarantee payments are higher due to WA's strong fiscal capacity. Conversely, if iron ore prices drop, lower guarantee payments are required as the 2018 changes provide less of a windfall to WA.¹⁶² Victoria also demonstrated this in its initial submission based on the Commonwealth Budget's sensitivity analysis and estimated NoWO payments.¹⁶³

As a result, the guarantee has a limited impact on the Commonwealth's budget position and is manageable with the flows of its other revenues. The guarantee payments are far more critical to state budgets with real impact should they be withdrawn. As noted in the interim report, due to the Commonwealth's stronger fiscal position, it has the capacity to continue funding the guarantee with increased company tax windfalls, and is generally better placed to bear the costs of reform by making the NoWO guarantee permanent.¹⁶⁴

¹⁵⁹ Commonwealth Treasurer Media Release, *Extension of 'No Worse Off' deal to help fund essential services*, 6 December 2023.

¹⁶⁰ The West Australian, *GST battle shifts to eastern front*, 26 August 2026.

¹⁶¹ Interim report p 60.

¹⁶² Interim report, p 56.

¹⁶³ Victoria's initial submission, p 49.

¹⁶⁴ Interim report, p 60.

8. Response to other PC findings and recommendations

8.1 PC Interim findings

The following section responds to PC interim findings not fully addressed elsewhere in this submission.



PC interim finding 1.1

A lack of understanding of the HFE system has undermined the quality of public debate on the topic

“The complex nature of the horizontal fiscal equalisation (HFE) system has contributed to a lack of public understanding of the system and caused several misconceptions to become prominent in public debate. The prominence of these misconceptions has undermined the quality of public discourse surrounding the HFE system and resulted in debate which is often based on mischaracterisations of the system.”¹⁶⁵

Victoria agrees with the PC’s interim finding 1.1 that a lack of understanding of the HFE system has undermined the quality of public debate on the topic.

The interim report outlined the following clarifications on common misconceptions in the GST distribution system:

1. Relativities do not represent ‘cents in the dollar’ of GST raised in a state
2. States are not entitled to receive their population share of the GST pool
3. The GST distribution does not reward states with poor fiscal management
4. A larger share of the GST pool is not, on its own, a fiscal win – it means more support is needed
5. GST payments are not intended to influence state policy decisions
6. GST payments are not intended to address structural disadvantage.¹⁶⁶

Whether intentional or not, the misconceptions clarified above underpin many of the claims in the public discourse that support the 2018 reforms. Without them, it’s difficult to justify why one state should be favoured above all others.

¹⁶⁵ Interim report, p 16.

¹⁶⁶ Interim report, pp 14-15.



PC interim finding 5.1

The CGC has adopted an independent, consultative and transparent approach to its role, but should strive for continuous improvement

“By recommending how GST revenue should be distributed, the Commonwealth Grants Commission (CGC) has a critical role in Australia’s horizontal fiscal equalisation (HFE) system.

The CGC performs this role with a high degree of independence, maintains highly productive and consultative relationships with state treasuries, and undertakes its work with reasonable transparency. These characteristics strengthen the system.

However, HFE arrangements are complex, and efforts to continuously improve transparency are important. Given this, there would be value in the CGC exploring any opportunities to:

- more fully disclose how it weighs up its primary objective of HFE and its different supporting principles when considering changes to its methodological approach
- further address data confidentiality restrictions so that more data can be shared with key stakeholders
- make greater use of public data sources – including linked administrative data – to improve consistency between public-facing data and the data it uses
- better disclose the nature and basis of any adjustments it makes to public-facing data where those adjustments are necessary because of data limitations.

The CGC should also consider trialling a wider approach to consultation as part of its 5-yearly methodological review by accepting public submissions from interested parties beyond state governments.”¹⁶⁷

Victoria supports improvements to the transparency and administration of the GST distribution system. Victoria has previously led efforts to improve the governance, including through actions of the through the Board of Treasurers and continues to recommend further standardisation, increased transparency and de-politicisation of the GST distribution system.

Victoria supports in principle the concept of broad consultation on GST distribution matters.

Opening up CGC methodology reviews to public submissions is not without risk. It could potentially overburden the CGC and states and territories with processing and responding to irrelevant contributions. It could also allow for states with greater fiscal capacities to bombard the CGC with submissions, for example, from paid consultancies or advocacy groups, creating a false public sense of consensus.

But there is also the potential to promote trust and reduce misconceptions through wider engagement.

The CGC already makes targeted use of external consultations with relevant experts, including recently on its Transport methodology assessment as part of its Forward Work Program.

Victoria supports the PC’s finding that the CGC could “more fully disclose how it weighs up its primary objective of HFE and its different supporting principles when considering changes to its methodological approach”.¹⁶⁸ In a submission to the CGC’s 2025 Review of the GST distribution methodology Victoria argued “greater clarity and consistency on how the Commission weighs each

¹⁶⁷ Interim report, p 92.

¹⁶⁸ Interim report, p 92.

principle and HFE to reach its decisions would assist states to understand the CGC's decision making processes and provide transparency for the public".¹⁶⁹

Victoria also supports the PC's finding that the CGC could "further address data confidentiality restrictions so that more data can be shared with key stakeholders".¹⁷⁰ Victoria is working with the CGC in its Data Working Group and engaging with data providers to ensure the appropriate data confidentiality levels are applied.

Victoria notes the PC's finding that the CGC could "make greater use of public data sources – including linked administrative data – to improve consistency between public-facing data and the data it uses" where those data are suitable.¹⁷¹ The PC references PLIDA and BLADE datasets specifically.

The CGC regularly reviews the availability and suitability of datasets, including the Person Level Integrated Data Asset (PLIDA) and Business Longitudinal Analysis Data Environment (BLADE) datasets. For example, during the recent 2025 Review of the GST distribution methodology the CGC engaged the ABS to examine the feasibility of using BLADE or PLIDA data in its payroll tax assessment but found that the data were not suitable.¹⁷² The CGC's Data Working Group includes an ABS representative and the CGC is highly engaged with the ABS in finding the best available data.

Victoria supports the PC's finding that the CGC could "better disclose the nature and basis of any adjustments it makes to public-facing data where those adjustments are necessary because of data limitations".¹⁷³ For example, in a submission to the CGC 2025 Review of the GST distribution methodology Victoria raised several concerns with adjustments to Census housing data, including various imputations. Victoria argued "there was not sufficient justification or robustness" for the adjustments and recommended the CGC consult with the ABS and report back to states on future adjustments to the data.¹⁷⁴

While improving the transparency of the CGC's methods, these suggestions risk being unachievable with the CGC's already limited resources. The PC should consider bolstering finding 5.1 by adding a recommendation for the Commonwealth to consider appropriate increases to the CGC's resourcing to manage additional consultation, and source improved data.

¹⁶⁹ [Victorian response to the 2025 Methodology Review Principles Paper.pdf](#), p 3.

¹⁷⁰ Interim report, p 92.

¹⁷¹ Interim report, p 92.

¹⁷² [CGC 2025 Methodology Review, Payroll Tax consultation paper](#)

¹⁷³ Interim report, p 92.

¹⁷⁴ [Victorian response to 2025 Review Tranche 2 papers - final.pdf](#), p 29.

8.2 Recommendations on Federal Financial Relations



PC interim recommendation 5.3

Ensure Federation Funding Agreement schedules provide net benefits for the community

“To maximise the benefits of intergovernmental funding agreements, the Australian Government and state governments should abide by the federal financial relations principles to which they have already agreed, including minimising the number of low value agreements with highly localised benefits.

This would ensure that the benefits resulting from agreements outweigh the costs associated with them, including the administrative costs of negotiation, compliance and monitoring.”¹⁷⁵

Victoria supports interim recommendation 5.3 and agrees that Federation Funding Agreement (FFA) schedules should be used in a way that deliver clear public value while minimising the number of small agreements with highly localised benefits.

Small and highly localised agreements can still deliver significant benefits despite their size, including by supporting essential services, targeted projects and meaningful community outcomes.

As a result, stronger emphasis should be placed on minimising unnecessary prescriptiveness in FFA schedules to ensure that their administrative costs do not outweigh the value of the funding provided. In particular, FFA Schedule requirements should be proportionate to the risk, size and complexity of a proposed initiative, with states offered significant flexibility and autonomy for small and low risk initiatives. This should be underpinned by clearer Council on Federal Financial Relations (CFFR) guidance on the drafting of FFA Schedules.

Victoria also notes that in some instances the Commonwealth currently uses FFA schedules to deliver Commonwealth election commitments, which can result in material delivery and administrative requirements for states. As a result, there is value in the Commonwealth exploring whether alternative delivery mechanisms are available outside the FFA process, or ways to alleviate the administrative impacts for jurisdictions where state involvement is necessary for constitutional reasons.

¹⁷⁵ Interim report, p 99.



PC interim recommendation 5.4

Update the IGAFFR, its schedules, and the enabling legislation

“The Intergovernmental Agreement on Federal Financial Relations (IGAFFR) and its schedules, and the *Federal Financial Relations Act 2009* (Cth) should be updated to reflect the current federal financial relations architecture. This should include:

- replacing references to National Partnerships with Federation Funding Agreement schedules in the IGAFFR, or where references to national partnerships are essential, amending the reference to the past tense
- removing references to the COAG Reform Council in Schedule C of the IGAFFR and clarifying which body has taken over as the independent assessor of eligibility for reward funding
- removing references to historical payment schedules in Schedule D of the IGAFFR or at least consolidating the active elements of the schedule to the front of the document
- amending the *Federal Financial Relations Act 2009* (Cth) to remove provisions for now ceased payments, and to add provisions for active payments that are not referenced in the Act.”¹⁷⁶

Victoria supports in principle the proposal to update the overarching intergovernmental framework to reflect the current federal financial relations architecture.

However, Victoria notes that the original collaborative intent of the IGA FFR has not been fully realised in practice. In particular, state flexibility has diminished over time. This is reflected in the development of increasingly prescriptive National Agreements, and the use of detailed FFA Schedules.

If the IGA FFR is updated, provisions relating to state flexibility, genuine collaboration, budget autonomy, policy independence, and limited Commonwealth prescription should not only be retained, but strengthened. Without this, there is a risk that an updated agreement would simply embed the ongoing shift towards more prescriptive funding arrangements that carry higher transaction and efficiency costs. It will also be crucial that any updated IGA FFR is underpinned by stronger oversight and guidance to ensure the IGA FFR is consistently upheld during negotiations.

Victoria also notes that the shift towards more prescriptiveness has been reinforced by the significant vertical fiscal imbalance within Australia, which can limit the capacity of states to negotiate on an equal footing with the Commonwealth.

This was evident in 2023, when the Commonwealth effectively linked the extension of the GST NoWO guarantee and additional health funding through National Health Reform Agreement negotiations with securing state support for disability reform. In Victoria’s view, this is inconsistent with the collaborative spirit of the IGA FFR, which was intended to support genuine intergovernmental cooperation and respect for state responsibilities.

Stronger safeguards are therefore needed in any refreshed framework to ensure that states are not placed under pressure to trade policy concessions in order to secure critical funding, and to reduce the risk of similar practices arising in future – including any further extension of the NoWO guarantee.

¹⁷⁶ Interim report, p 100.



PC Interim recommendation 5.5 **Improving the functioning of CFFR**

“The Council on Federal Financial Relations (CFFR) should:

- commit to a more regular meeting cadence and review the agenda-setting process to ensure that state-led items are given sufficient time for discussion
- publish its outcomes as a communiqué rather than as a media release by the Australian Treasurer, and publish these outcomes on an enduring central repository, such as the Australian Treasury or Federal Financial Relations websites
- provide clearer guidance on when Ministerial Councils are expected to refer matters to CFFR for consideration.

Additionally, CFFR should work with National Cabinet to clarify the circumstances when CFFR should escalate matters to National Cabinet for First-Ministers’ consideration.”¹⁷⁷

Victoria supports the interim recommendation 5.5, including CFFR meeting more regularly, publicly publishing its outcomes, and providing clearer guidance on referrals.

8.3 Other PC interim recommendations

The following section responds to PC interim recommendations not already addressed in other sections.



PC interim recommendation 5.1 **Monitoring the potential for the HFE system to contribute to diverging state outcomes**

“If the Australian Government’s policy settings for the horizontal fiscal equalisation system allow one or more states to maintain a fiscal capacity that is significantly stronger than that of others – as current settings do – the Government should undertake regular analysis that examines the extent to which this is contributing to diverging state outcomes.”¹⁷⁸

Victoria supports in principle the objective of measuring outcomes that result from Commonwealth Government policy that reduces equality in states’ fiscal capacities, as the 2018 changes do.

However, the monitoring of outcomes and assigning causality to them is a more difficult proposition. Outcomes are determined by a range of factors, including underlying differences between states, but also factors under states’ control like funding choices and policies implemented. An improvement or deterioration in outcomes would not necessarily be an indicator that a state is receiving too little or too much money via HFE.

An important feature of Australia’s HFE system is that, prior to the 2018 changes, it provided states with sufficient untied funding to provide the average level of services and infrastructure, whilst retaining state autonomy to decide the most appropriate policies.

¹⁷⁷ Interim report, p 103.

¹⁷⁸ Interim report, p 94.

The Commonwealth Government should focus on equalisation of fiscal capacity as the primary objective of the HFE system. Structural disadvantage (or advantage) in a particular policy area should be assessed in consultation with the relevant state or territory and addressed separately from the HFE system.



PC interim recommendation 5.2

There should be a more transparent approach for quarantining Commonwealth payments

“Where a state government seeks a payment to be quarantined from GST distribution calculations, it should be required to publicly write to the Australian Treasurer to formally request this. Requests should articulate why the state believes that the payment should be permitted to increase their fiscal capacity outside the horizontal fiscal equalisation system.

The Australian Treasurer should be required to publicly respond to all requests with a decision and their supporting reasons. In their response, the Treasurer should address the substantive elements of the application, including outlining any factors that distinguish the payment from previous similar payments.

To support transparency, all applications and their associated decisions should be tabled in Parliament at the time they are made and published in an appendix to the annual GST relativity update terms of reference provided to the Commonwealth Grants Commission.”¹⁷⁹

Further to the above, the PC considered that “guidelines which govern when payments should be quarantined would improve consistency” but that “states have not reached agreement about how prescriptive guidelines should be and which types of payments should fall within them”.¹⁸⁰

Victoria supports transparency in the Commonwealth Treasurer’s exemption of Commonwealth Payments from GST calculations.

In its initial submission to the inquiry, Victoria noted that “rather than prescribing specific requirements for payments that can or cannot be excluded, and to retain the intention of flexibility, it is preferable to make the Commonwealth’s decision making more transparent”.¹⁸¹

Victoria recommended that “the Commonwealth should provide reasoning for its decisions in the terms of reference to limit the risk of political interference with the CGC’s independent process”.¹⁸²

Victoria considers its own recommendation preferable to the requirement to table letters in Parliament and publish them with the annual CGC GST relativity updates. The latter creates an additional administrative burden without necessarily enforcing the requirement to justify the decision to exempt a payment from GST calculations. Requests for exemption, whether they be in a formal letter or through conversations, may require the sharing of commercial in confidence information, or modelling that states may not wish to be shared with other states. In addition, a requirement to publish letters may result in substantive discussions around requests occurring behind closed doors, and letters containing fairly little content.

The most important outcome is that the Commonwealth Treasurer publicly justify the reasons for the exemption. The annual Terms of Reference for the updates to GST relativities are where the

¹⁷⁹ Interim report, p 97.

¹⁸⁰ Interim report, p 97.

¹⁸¹ Victoria’s initial submission, p 53.

¹⁸² Victoria’s initial submission, p 53.

Commonwealth Treasurer requests the exemption, so it's logical that those would also contain a justification for each exemption. This would also be the simplest and most efficient approach to address the issue.



PC interim recommendation 5.6 **Enhancing the GFS**

“To further enhance the accuracy and utility of the Government Financial Statistics (GFS):

- state governments should strengthen their processes for validating GFS data before it is submitted to the Australian Bureau of Statistics (ABS)
- the ABS should explore opportunities to improve its public-facing documentation explaining the structure, classifications and relationships within the GFS.”¹⁸³

Victoria supports the continual improvement of the Government Finance Statistics and encourages the publishing of clear documentation.



PC interim recommendation 5.7 **Improving governments' long term fiscal sustainability reporting**

“Governments should ensure that they produce regular, long-term fiscal sustainability reporting – such as a 5-yearly intergenerational report – that demonstrates the fiscal impacts of maintaining existing government policies over the long term. A legislative requirement to produce this reporting should be introduced in jurisdictions that do not already have this.”¹⁸⁴

Victoria does not support a legislative requirement for states to produce regular intergenerational reports. States should maintain the freedom to produce and publish the reports they consider necessary.

In response to the COVID-19 pandemic, the Victorian Government developed a comprehensive fiscal strategy in the *2020-21 Budget* to protect Victorian households and businesses and provide a strong foundation for recovery. This initially involved a four-step plan to support Victorians, grow the economy and return to surpluses over the medium term. The Victorian Government has consistently reported on its progress over the last five years, and updated the plan in the *2024-25 Budget* to introduce a fifth step. The Government remains on track to deliver an operating surplus in 2025-26.¹⁸⁵

¹⁸³ Interim report, p 104.

¹⁸⁴ Interim report, p 105.

¹⁸⁵ [Victorian Budget 2026-27, Budget Paper No.2](#), p 4.

9. Appendix A: Evaluation of dominant state adjustment options

9.1 Mining discount, and discount just for dominant state

Queensland, WA and the NT proposed a discount of the CGC's assessment of mining revenue raising capacity in their submissions, suggesting that it would reduce volatility and disincentives for developing mineral resources or raising more royalties.¹⁸⁶

As illustrated in the interim report, a discount would reduce the amount of revenue assessed, and subsequently redistributed by the mining assessment. The discounted proportion of revenue would be assessed EPC, while the remainder would continue to be assessed by the value or volume of production.¹⁸⁷

Discounting assessments due to data quality concerns is a common technique applied by the CGC to account for uncertainty. The practical implementation of this proposal is straightforward, however discounts are currently not applied to any assessment due to policy neutrality concerns. The CGC explicitly state in the 2025 Review:

Under the discounting framework, discounts are used where there are concerns with data or methods and not applied in cases of general uncertainty or to address policy neutrality.¹⁸⁸

For the purpose of this analysis, Victoria will evaluate a repeal of the 2018 changes accompanied by a discount to the entire mining assessment, however these conclusions also apply to a discount for specific minerals.

Currently, and over the past ten years, the mining revenue assessment is the single largest source of disparities in fiscal capacity, and accordingly the single largest driver of redistribution through the GST, as shown in Figure 5. In 2026-27 it redistributed \$16.5 billion away from WA and Queensland compared to an EPC share, due to their above-average revenue raising capacity.¹⁸⁹ This revenue is shared amongst the other states.

¹⁸⁶ Queensland Government initial submission, p 40, and WA Government initial submission, p 93.

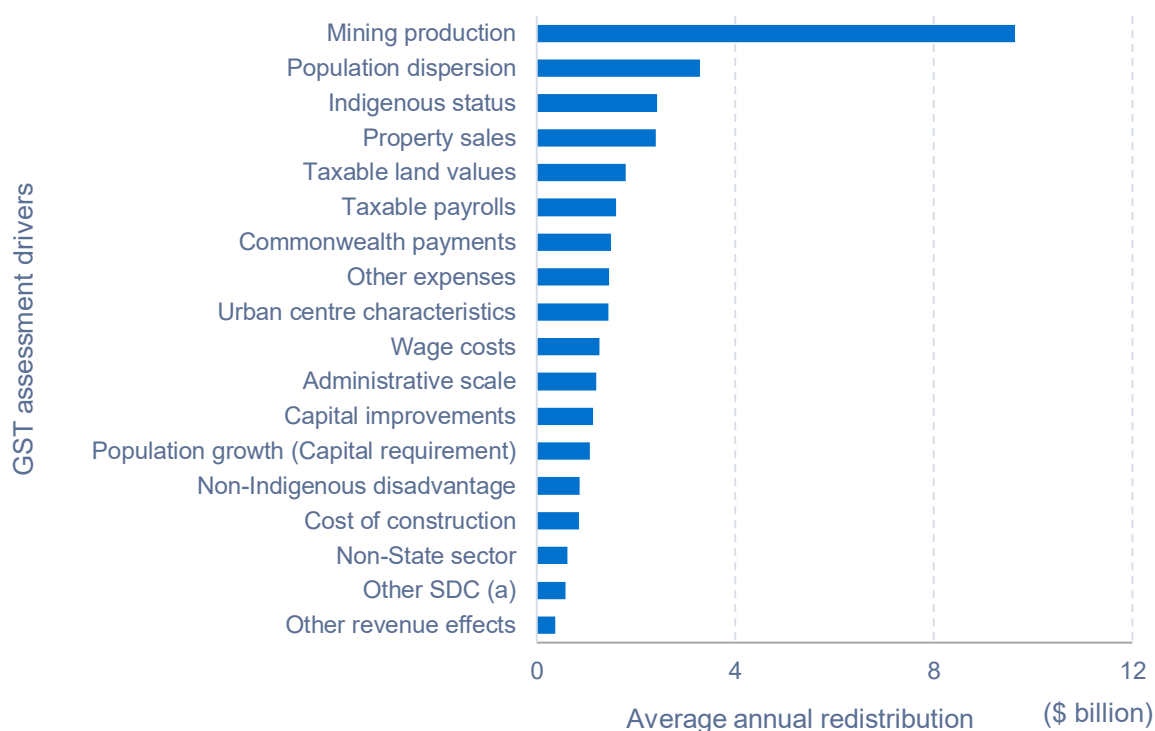
¹⁸⁷ Interim report, p 77.

¹⁸⁸ CGC 2025 Review outcomes, p 9.

¹⁸⁹ CGC 2026 Update, Table 2-10, p 35.

Figure 5: Mining has redistributed the most GST (compared to an EPC share) by a wide margin

Drivers of difference from equal per capita share of GST, 2015-16 to 2026-27



Source: CGC update reports

Notes:

(a) Other socio-demographic composition (SDC) includes the effects of age, Indigenous disadvantage, household size, state contributions to the National Disability Insurance Scheme (NDIS) and the full effect of SDC in Commonwealth funded government schools.

The data underpinning the mining revenue assessment are robust, transparent and simple, as it only relies on two variables: state and Commonwealth royalty revenue data, and the value or volume of production in different minerals.¹⁹⁰ The assessment equalises for real and measurable differences in state fiscal capacities and delivers on the CGC's core principle of achieving HFE.

The CGC rejected calls for a discount on several grounds in its 2015 and 2020 reviews, stating:

*"We consider discounting appropriate when it helps us achieve a better HFE outcome, for example, when we are concerned about data quality... We do not think this is the case with our proposed mining assessment so, we did not apply a discount."*¹⁹¹

The CGC also decided against implementing a discount for policy changes (discussed in Section 7.1.4) in its 2025 review, but continues to consider other potential dominant state adjustments in its forward work plan.

¹⁹⁰ CGC Commissions Assessment Methodology 2025, Mining Revenue, Table 4, p 32.

¹⁹¹ CGC 2015 Review report, Volume 2, p 117.

Victoria strongly opposes any discount to the mining assessment. In its current form, the mining assessment is pivotal in achieving the overall objective of HFE, and one of the only mechanisms that effectively shares Australia's mineral wealth among Australians. Any discount would deliberately compromise on the core objective of HFE, in order to deliver a windfall to mining states with no evidence that it would improve policy neutrality.

The windfall from a mining discount would also be permanent. This goes well beyond managing the claimed aims of addressing volatility or policy neutrality and would be a permanent structural advantage granted only to states fortunate enough to enjoy an abundance of mineral resources.

Furthermore, mining states would receive more GST revenue regardless of whether they actually undertake any of the reforms they claim are being inhibited by HFE. This would be a poorly designed policy neutrality control, as it grants windfall gains to select jurisdictions that do not make any policy changes, and continues to penalise them (albeit by less) if they do. Furthermore, the windfall gains would be based exclusively on geological and commodity market factors outside a jurisdiction's control, meaning that other jurisdictions could not access the benefits even if they tried.

As outlined in Table 6, Victoria agrees with the PC's conclusion in the interim report that there are other mechanisms more appropriate to promote productivity enhancing reforms than the GST system.¹⁹²

Table 6: Evaluation of broad discount

Pros	Cons
<ul style="list-style-type: none"> Simple to implement 	<ul style="list-style-type: none"> Moves away from HFE – underlying revenue-raising disparities are not recognised Not conditional – no relation to policy changes and no requirement for jurisdiction to undertake changes Not targeted – affects entire assessment, not just the impact of a policy change Not effective – underlying theoretical disincentive remains, just smaller

9.2 Mining discount only for policy changes

During the 2025 Review, the CGC raised the idea of a 50 per cent discount to additional revenue from policy changes by a dominant state to address policy neutrality concerns.¹⁹³ While the proposal has the potential to reduce theoretical policy disincentives in a targeted way, there are several key assumptions and judgements required that make it infeasible to implement within the GST system.

Some of these specifics that are difficult to determine in practice, and were not defined by the CGC in the 2025 Review, include:

- the definition of a dominant state
- what the baseline rate would be
- when the baseline rate would be selected

¹⁹² Interim report, p 33.

¹⁹³ [CGC Commissions Assessment Methodology 2025](#), Mining Revenue, paragraph 21, p 35.

- whether this baseline would persist into perpetuity, and if not, how long for.

This leaves dominant states with potential loopholes to exploit, to obtain the largest discount from royalties being included in the assessment.

This would also depend on how the CGC sets the baseline rate, which has its own complexities. The baseline assumes that the rate set as the baseline, whether it be the current national average rate or some other rate, is the most appropriate baseline for all assessments of this royalty going forward. This is risky and highlights the rationale behind the CGC's principle of measuring what states actually do, rather than what states should do.

Overall, Victoria does not support a policy change discount implemented within the CGC's methodology, due to feasibility concerns, the opportunities for gaming and the likely conflicts with the CGC's principles – as outlined in Table 7. It does not mitigate potential policy neutrality issues, rather shifts them in a way that can in theory advantage a dominant state.

A policy discount is likely to pose information constraints and arbitrary judgements which mean it cannot be robustly integrated into the CGC's methods. If such an approach were to be implemented, some of these issues could be mitigated if payments were facilitated through external support from the Commonwealth (see Section 7.2). The technical issues would remain, however agreement through the Commonwealth may be able to be reached with a lower standard of evidence than the CGC, and introduce guardrails that avoid gaming (for example, conditioning grants on retaining certain royalty rates).

Table 7: Evaluation of discount for policy changes

Pros	Cons
<ul style="list-style-type: none"> • Conditional – only applies when there is a policy change • Targeted – only applies to impact of policy change • Largely consistent with what states do, based on the value of production • Could address policies which increase revenue bases 	<ul style="list-style-type: none"> • Infeasible to implement – requires significant judgement from CGC regarding baseline for changes • Does not unambiguously improve policy neutrality – potentially creates another set of policy incentives by creating the opportunity for gaming • Detracts from HFE – underlying revenue raising disparities are still recognised, however underrepresents mining states fiscal capacity

9.3 International benchmark royalty rate

The CGC consulted states on using an international benchmark royalty rate for each mineral to address dominant state concerns during its 2025 methodology review.¹⁹⁴ An international benchmark rate would be fixed, and exogenous to the mining assessment. Therefore, it would not move in response to any state (including a dominant state) changing its royalty rates.

However, Victoria does not support the use of an external standard for the mining revenue assessment. An external standard would involve the CGC replacing the dominant state's royalty rate with an externally sourced rate, such as an international rate. The CGC has noted that if the external

¹⁹⁴ CGC 2025 Review, Tranche 1 Consultation, Mining Revenue, paragraph 33.

rate is higher than the rate in Australia, it has the potential to overstate the dominant states' capacity, and if it is lower, understate their capacity.¹⁹⁵

A decision to use an external standard would compromise the supporting principle of what states do as well as undermine HFE – as outlined in Table 8. Victoria considers that this approach also has additional flaws in benchmarking a comparable rate, which include differences between Australia and proposed countries in:

- economic circumstances of the country of the external rate
- other tax settings that apply to the mining operations such as income tax and tax concessions
- macroeconomic factors such as interest rates, exchange rates and inflation
- the legal and regulatory environment, including environmental protection
- investment strategies of the country
- geographic region and how this impacts the marketable final price of the commodity and the end buyer
- the application of the external rate, including purity of the ore body that is being taxed.

As such, it is unlikely that there is any sufficiently similar country to Australia to benchmark iron ore royalties against.

Table 8: Evaluation of international benchmark rate

Pros	Cons
<ul style="list-style-type: none"> • Somewhat conditional – decouples dominant state policy changes from GST impacts • Targeted – only applies to impact of policy change 	<ul style="list-style-type: none"> • Complex to implement – requires significant judgement from CGC regarding international benchmark • Not consistent with “what states do” • Introduces uncertainty to the assessment if the international standard needs to be adjusted • Does not address policies which increase revenue base • Detracts from HFE – underlying revenue raising disparities are still mostly recognised, however, the difference between the national average rate and international benchmark will misrepresent fiscal capacities

9.4 Increase the duration of smoothing in the mining assessment

Currently the CGC uses a 3-year average of data in all its assessments to determine revenue raising capacity and expenditure needs.¹⁹⁶ To address theoretical dominant state issues, the CGC could extend this average over a longer time period such as 5 or 10 years for the mining assessment.

NSW's initial submission to the inquiry proposed a mechanism by which the mining assessment was calculated using a 5-year moving average, as opposed to the 3-year moving average used for the rest

¹⁹⁵ CGC 2025 Review, Tranche 1 Consultation, Mining Revenue, paragraph 37.

¹⁹⁶ CGC Commissions Assessment Methodology 2025, p 240.

of the GST assessment.¹⁹⁷ This would slow the change in the GST distribution that occurs as a result of policy changes to mining, reducing the theoretical incentives on policy changes.

Smoothing would in theory reduce the potential disincentive for a states to increase their royalty rates by delaying the GST impact. This means states would 'keep' more of the additional revenue from any policy change for longer, before it is eventually recognised in the GST distribution. A longer moving average could also reduce volatility by diluting the impact of changes in commodity prices or the revenue base, and making it less likely for declining GST relativities to coincide with falls in royalty revenue.

Compared to other options to address dominant state effects, a longer smoothing period largely continues to achieve HFE, albeit over a longer time period, and less directly relevant to the year GST is paid (reduced contemporaneity).

However, a longer moving average window would be less contemporaneous, and less responsive to changes in states circumstances such as commodity prices – as outlined in Table 9. Victoria notes that the prior to 2010, the CGC's methodology previously operated on a 5-year moving average, and was reduced to three years due to concerns from states about a lack of contemporaneity.¹⁹⁸

Furthermore, the three-year average resulted in the scenario in 2015 when WA's royalty revenue fell concurrently with GST revenue, reflecting higher royalty revenue from previous years.¹⁹⁹ A longer moving average window could exacerbate these potential impacts, where moving average windows and commodity price cycles do not align.

Table 9: Evaluation of increasing the duration of smoothing

Pros	Cons
<ul style="list-style-type: none"> • Consistent with what states do • Addresses policies which increase revenue base • Reduces in GST revenue volatility • Consistent with HFE – fiscal disparities recognised in full, albeit over a longer time frame than under the former system 	<ul style="list-style-type: none"> • Lack of contemporaneity • Potential to exacerbate impact of cyclical changes – potential increase in total revenue volatility • Limited effectiveness at reducing perceived policy neutrality concerns, as impact of policy changes is delayed, not removed • Not well targeted – states retain benefits of cyclical movements as well as policy changes

9.5 Historical average royalty rate

A similar solution which builds on the idea of smoothing changes in Section 9.4 would be to determine the national average royalty rate for each mineral as a long-term average. For example, to average over 20 or 30 years rather than 3 years. This long-term average rate could be applied to current production values to derive assessed revenue with minimal change in the CGC's methodology or data requirements. This approach could be applied exclusively to minerals which have a dominant state.

¹⁹⁷ NSW Government Initial Submission, p 24.

¹⁹⁸ CGC Report on 2010 GST Revenue Sharing Relativities – 2010 Review, Volume 1 – Main report, p 55.

¹⁹⁹ Interim report, p 20.

The advantages of this method are that it maintains general consistency with the CGC's principle of 'what states do', to the extent a longer timeframe reflects what states currently do. It would also operate similarly to a benchmark rate without the need to find international comparators, as states' past policies effectively become the benchmark.

The long-term national average rate would be less responsive to any change in states' royalty policies, as they would only affect a relatively small portion of the moving average window. Any theoretical disincentive on policies would be reduced, as the response from GST revenue would be dispersed and smoothed over time.

The key trade-offs for this method are to:

- Reduce contemporaneity of the mining revenue assessment – GST distributions would not reflect current fiscal strength in the years GST is distributed
- Reduce HFE, to be potentially made up over a longer time period,
- Policy neutrality is strengthened in theory, reducing any potential dominant state effects (if they are believed to be material).

Table 10: Evaluation of historical average royalty rates

Pros	Cons
<ul style="list-style-type: none"> • Conditional – only results in different GST treatment if there is a policy change and targeted – only applies to impact of policy change • Consistent with what states do • Simple to implement based on available data 	<ul style="list-style-type: none"> • Reduction in contemporaneity • Does not address policies which increase revenue bases • More consistent with HFE than most dominant state adjustment options – however may differ from the current approach where royalty rates change and are applied to different values of production over time than they would have under the former system

9.6 Hotelling rule-based discount

The interim report refers to the potential to use a "Hotelling Rule-based discount", which would assess royalties revenue net of the run down of states' natural resources as an asset or capital stock. This approach would reduce the total mining royalties revenue assessed by the CGC. Only part of royalties revenue would be assessed and considered "income", with the remainder representing states running down a finite, non-renewable stock of natural capital.

Under this approach, mining revenue would be assessed net of the change in the present value of the state's remaining resource stock, rather than as gross royalty receipts. The interim report does not outline a specific methodology for a Hotelling-based discount. Victoria's assessment is on the assumption that an established application of the method, the El Serafy "user cost" approach, would be used, as described below.²⁰⁰

²⁰⁰ El Serafy, S. (1989), "The Proper Calculation of Income from Depletable Natural Resources," in Y.J. Ahmad, S. El Serafy and E. Lutz (eds.), *Environmental Accounting for Sustainable Development: Selected Papers from Joint UNEP/World Bank Workshops, A World Bank Symposium*, The World Bank, Washington, DC, p 10.

In formula terms, sustainable income (X, representing the portion of royalties income that would be assessed for the GST distribution) is calculated as royalty revenue (R) less the year-on-year fall in the net present value of the remaining reserve (Z). That value (Z) is the discounted sum of projected future royalty payments at an assumed discount rate.

X is defined as the constant, perpetual income stream with the same present value today as receiving royalty revenue (R) for each of the remaining years of the reserve's life. This gives:

$$\frac{X}{R} = 1 - \left[\frac{1}{(1+r)^{n+1}} \right]$$

where n is the number of years of reserve life remaining (falling by one each year as extraction proceeds, and subject to revision if reserve estimates change) and r is the assumed discount rate.

Sustainable income is therefore:

$$X = R \left[1 - \frac{1}{(1+r)^{n+1}} \right]$$

And user cost — the capital component excluded from the GST distribution assessment — is the remainder of royalty revenue:

$$Z = R - X$$

The underlying rationale for this approach is a distinction between income and capital. It assumes that a portion of mining royalty revenue reflects the sale of a finite asset, rather than a recurring income stream. That is, it assumes only the income-equivalent portion of royalties revenue is comparable to other states' recurring revenue bases, such as for example from taxes on property or business' payrolls.

As an illustrative example, consider a hypothetical state coal royalty stream of \$2.0 billion per year, a discount rate of 4.0 per cent, and a remaining reserve life of 29 years.

Applying the formula:

$$X = R \times \left[1 - (1+r)^{-(n+1)} \right] = \$2.0\text{bn} \times \left[1 - (1.04)^{-30} \right] = \$1.38 \text{ billion}$$

$$Z = R - X = \$2.0\text{bn} - \$1.38\text{bn} = \$0.62 \text{ billion}$$

Under this method, only \$1.38 billion (69.2 per cent) of the \$2.0 billion royalty stream would be counted toward the state's assessed fiscal capacity. The remaining \$0.62 billion (30.8 per cent) is treated as capital drawdown and excluded from the assessment, as this is the proportion of royalty revenue which reflects a decline in the value of the underlying reserve — a capital cost rather than sustainable income — and is therefore excluded from the assessment.

Applying this method in practice raises several data and design issues – as outlined in Table 11. Reserve estimates are compiled from company disclosures, are commercially sensitive, and vary materially by resource category. The method is also inherently forward-looking, requiring projections of future royalty payments, and therefore future prices, extraction volumes and the resource's remaining life, discounted at a chosen rate.

This raises concerns with reliability and volatility. These data requirements deviate from the CGC's principles of practicality and contemporaneity, and a preference for using reliable, near-term historical data over forecasts.

Such an approach would also deviate from the 'what states do' principle: no state currently manages royalty revenue as if income and capital were separated in this way. The notional reinvestment of the "capital" component (in risk free assets) assumed by the method also does not correspond to

real-world practice. Furthermore, treating mineral reserves as a non-financial asset would theoretically mean that any changes in this stock should also be reflected in the CGC's investment assessment.²⁰¹

This method is also subject to significant volatility from inputs unrelated to a state's underlying mining activity. The discount rate applied to future royalty payments could plausibly track long-term government bond yields. In Australia these have moved substantially over short periods with corresponding swings in the calculated split between "sustainable income" and "capital drawdown" that are unrelated to any change in a state's mining sector.

Reserve estimates add a further source of volatility, reflecting reclassification, exploration activity and reporting standard changes rather than physical depletion or discovery. Finally, extraction volumes and commodity prices would continue to be a source of volatility and uncertainty as they are in the current value of production approach.

The combined effect is that both key inputs to the calculation are liable to material year-on-year movement for reasons unconnected to a state's current mining circumstances.

Table 11: Evaluation of hotelling rule-based discount

Pros	Cons
<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> Practically infeasible, with difficulty sourcing accurate data including valuations of proven reserves Flow on impacts to the investment assessment if mineral reserves are treated as an asset Decreased predictability and accuracy requiring forward-looking projections, not historical data Doesn't reflect 'what states do' and how states actually manage royalty revenue Discount rate and reserve estimates both add unrelated volatility

9.7 Sovereign wealth fund discount

The sovereign wealth fund approach (referred to in the interim report as 'sustainable income approach') applies the same underlying logic as the Hotelling Rule-based discount, that mining royalties are only partly "income", but arrives at an assessed income figure differently.²⁰²

Rather than deducting the year-on-year fall in the present value of the resources reserve (denoted as Z in the equations above), this approach assumes royalty revenue is notionally paid into a sovereign wealth fund. Only the fund's sustainable income – the amount that could be withdrawn indefinitely without eroding the fund's value – is counted toward fiscal capacity. States' assessed revenue would therefore, likely be lower than is currently assessed, and therefore in theory not as responsive to royalty policy changes due to the effective discounting.

²⁰¹ Commonwealth of Australia, GST Distribution Review: Final Report (Canberra: The Treasury, 2012), 109.

²⁰² Interim report, p 78.

The explicit use of an investment fund should theoretically have a return rate higher than the discount rate used under the Hotelling rule-based discount. Subsequently, a lower level of capital drawdown and higher level of sustainable income are also assumed.

Sustainable income (X) is calculated as: $X = R[1 - \frac{1}{(1+r)^{n+1}}]$

Where R is royalty revenue, r is the assumed discount or reinvestment rate and n is the resource's remaining reserve life. The remainder (R – X) is treated as capital notionally reinvested into the fund, rather than as fiscal capacity.

As set out earlier, this formula is equivalent to the net present value-based calculation above under the Hotelling rule-based discount, provided the reserve is valued as the present value of its remaining royalty stream. The difference is one of framing rather than substance, with this approach making the reinvestment assumption explicit via a notional fund rather than leaving it implicit in a change in reserve value.

Because royalty revenue R scales the resulting sustainable income X linearly, the assessed sustainable-income share depends entirely on the assumed rate and reserve life, not on the size of a state's royalty revenue. Table 12 below shows how this share changes with the discount or reinvestment rate, holding reserve life at 50 years.

A higher discount or reinvestment rate increases the share of royalties revenue accounted as 'sustainable income' and therefore that would be assessed as revenue in the GST distribution. This reflects that the hypothetical investment fund is deemed to be able to generate more returns, and therefore less of the annual royalties R need to be reinvested. As such, the assessment is highly sensitive to assumptions around the assumed discount or reinvestment rate.

Table 12: Sustainable income share by discount or reinvestment rate (reserve life held at 50 years)

Assumed discount or reinvestment rate	Sustainable share
0.92 per cent (10-year Australian Government Bond yield, 2020)	37.3 per cent
3.01 per cent (10-year Australian Government Bond yield, 2022)	78.0 per cent
5.02 per cent (10-year Australian Government Bond yield, 2026)	91.8 per cent

Source: Reserve Bank of Australia, Statistical Table F2 (Capital Market Yields – Government Bonds),

Changes to the assumed reserve life *n* has a comparable effect, shown in Table 13. The table below shows how the sustainable income share changes with the remaining reserve life, holding the discount rate *r* at 3.0 per cent. As the remaining life of the reserve *n* is higher, the hypothetical investment fund is calculated to be able to produce more income, increasing the 'sustainable revenue' and revenue that would be assessed for the GST distribution.

Table 13: Sustainable income share by reserve life (discount rate held at 3.0 per cent)

Remaining reserve life	Sustainable share
25 years	53.6 per cent
50 years	77.9 per cent
65 years	85.8 per cent

Source: Victorian Department of Treasury and Finance calculations

A further inconsistency arises in how this discount or reinvestment rate is chosen. The reserve should, in principle, be valued using a risk-free rate, since royalty receipts are a relatively certain cash flow. Real sovereign wealth funds, however, do not invest risk-free, but represent the rate a state might reasonably expect the notional fund to earn in practice.²⁰³ Using a rate consistent with actual fund performance rather than the risk-free rate produces a materially different assessed sustainable-income share, as shown below in Table 14.

Victoria's evaluation of a sovereign wealth fund discount approach is included at Table 23.

Table 14: Sustainable income share at risk-free versus sovereign-wealth-fund rates (reserve life held at 50 years)

Assumed discount or reinvestment rate	Sustainable share
1.0 per cent (low bond yield environment)	39.8 per cent
3.0 per cent (typical risk-free rate)	77.9 per cent
6.9 per cent (real-world sovereign wealth fund target returns) ²⁰⁴	96.7 per cent

Source: Australian Future Fund Year in Review 2023-24, DTF calculations

²⁰³ Vladimir Gorshkov and Elliot Hentov, "Investment Trends Among Sovereign Wealth Funds," State Street Investment Management, March 18, 2026.

²⁰⁴ Future Fund Board of Guardians (2024), FY24 Performance, Future Fund – Year in Review 2023–24, Australian Government

Table 15: Evaluation of sovereign wealth fund discount approach

Pros	Cons
<ul style="list-style-type: none"> Compared to the Hotelling rule-based discount, this approach makes the reinvestment assumption explicit via a notional fund 	<ul style="list-style-type: none"> Has the same issues with sensitivity to assumptions on the discount rate and reserve life as the Hotelling rule-based approach Requires uncertain assumptions on the notional fund's returns A risk-free valuation and real-world fund returns diverge, materially changing the result – further judgement and assumptions are required

9.8 Aggregation by royalty rate or price band

An aggregated assessment would pool state revenue and values of production across multiple mining products and reduce the influence of any one state on the overall average tax rate. This therefore reduces the potential GST impacts of policy changes, and the theoretical disincentive to raise royalty rates.

This approach was in place prior to the CGC's 2015 methodology review. The 2010 review method assessed mining revenues in three components, rather than separated by minerals:

- high royalty minerals — comprising onshore oil and gas, export coal, lump iron ore and bauxite
- low royalty minerals — the remaining minerals
- grants in lieu of royalties.²⁰⁵

The interim report noted the flaw in this methodology was the threshold between high and low royalty minerals, which resulted in “category switching” if changes to royalty rates occur. This means that small policy changes could have disproportionate GST impacts by crossing thresholds between categories, which was the case when WA modified its iron ore royalties in 2010.²⁰⁶

The CGC has previously raised concerns around aggregation in Research paper 1: Fiscal equalisation and mining booms. It noted that:

“Other options the Commission considered to reduce volatility would not have captured states’ revenue capacity nor achieved the same degree of fiscal equalisation. For example, grouping major minerals together might dampen volatility in Western Australia’s GST distribution, but it would produce a poorer assessment of its revenue capacity because it would have diluted its iron ore capacity.”²⁰⁷

The proposal in the interim report does not address how the method of grouping minerals would address the CGC's previous concerns.

²⁰⁵ CGC 2015 Review report, Volume 2, p 118.

²⁰⁶ Interim report, p 50.

²⁰⁷ CGC Research Paper 1 - Fiscal equalisation and mining booms, p 11.

A modification on this approach could be to aggregate minerals, but stratify the assessment by mineral price rather than royalty rate. This would avoid the category switching issue, and be consistent with the value distribution adjustment currently applied to the CGC's stamp duty on conveyances and land tax assessments.²⁰⁸ It would also be consistent with what states do in some cases, acknowledging the recent method changes to account for price differences in the coal assessment and Queensland's progressive royalty rate regime.

The primary drawback with this approach remains that minerals are heterogeneous, and production of these minerals face different cost structures. This means that states with a concentration of a high value mineral would be assessed to have a higher fiscal capacity, even if that mineral costs relatively more to extract, potentially necessitating a lower royalty rate.

They key issue with this approach remains that aggregating by royalty categories or price value bands masks some of the discrete differences in states' ability to raise royalty revenue between minerals. As such, compared to the current approach it will likely over-state the revenue raising capacity of some states, and under-state the capacity of others.

As with the majority of options to potentially address dominant state issues, the trade-off between the objective of equalisation and other aims (addressing volatility or policy neutrality concerns) is not justified. This has been borne out in practice, given the CGC has moved over time to more granular mining revenue assessments, to better capture differences in states' fiscal capacities and achieve HFE.²⁰⁹

Victoria's evaluation of aggregating by royalty rate or price bands is outlined in Table 16 below.

Table 16: Evaluation of aggregation by royalty rate or price band

Pros	Cons
<ul style="list-style-type: none"> Somewhat conditional and targeted – dilutes the influence of dominant states, minimising the impact of policy changes. Maintains contemporaneity 	<ul style="list-style-type: none"> Detracts from HFE – all revenue and revenue raising disparities recognised, but less accurate than mineral-by-mineral assessment Less consistent with what states do – states have different royalties for different minerals For price-based assessments, requires states to provide additional data on value of production by price.

9.9 Aggregated profitability assessment

A profitability assessment would attempt to derive a policy neutral measure of states' tax bases by estimating the profitability of mining operations within that state.

To result in any theoretical improvement in policy neutrality, it would need to be combined with an aggregated assessment – that is, total combined royalties revenue would be assessed, rather split by minerals as is currently the case.

²⁰⁸ 2025 CGC Assessment Methodology, pp 18-21.

²⁰⁹ Interim report, Box 3.1, p 50.

This approach would have a similar theoretical impact on state policy decisions as aggregation by royalty rate or price bands, as it is unlikely a state would have a dominant share of total mining profits (see Section 9.8).

A key problem outlined in Section 9.8 with other options to aggregate the mining assessment is the heterogeneity of mining costs and market structures for different minerals. Unlike aggregating the total value of production, a profitability approach does not assume the profit margin is the same for each mineral. Estimating net profitability by operation would account for those different cost structures, and create a uniform estimate of economic rent available for states to tax.

While states levy royalties on the value or volume of production for administrative efficiency, a profitability approach would imply the overall profitability of the mining industry is a better indicator of the capacity to pay royalties and therefore a state's capacity to levy royalties.

However, this approach deviates from what states do, as most states do not directly impose royalties on a profitability basis, and to do so would require detailed financial information on each mining operation in a state to determine revenue and costs. As many mining companies operate multiple mines across multiple states, comprehensive financial statements to calculate this profitability measure are unlikely to be available.

Even if data were available, businesses may be able to structure activity such that a profitability assessment may still result in significant inconsistencies between minerals, with some industries able to structure their activity to significantly reduce their profitability on paper.

Victoria notes that a profitability assessment was used by the CGC prior to 2004, but was changed when the underlying dataset from the ABS National Accounts was discontinued. The ABS' previous measure of profitability for the mining industry used by the CGC was derived from gross value added: deducting wages and salaries and related on-costs (such as superannuation), a 5-year average of on-lease exploration expenses and a 10-year average of capital expenditure.

It may be possible to use the unadjusted gross value-added data, which continues to be collected by the ABS, but it is not clear whether this data is fit-for-purpose.

To the extent that mining industry gross value added includes activity which is currently not subject to any royalties by any state, or does not account for important differences between minerals, this method could potentially distort the assessment of revenue raising capacity, which highlights the importance of the CGC's principle of 'what states do'.

Finally, using profitability as a revenue base is likely to magnify the volatility in the mining assessment, as net profitability is generally more sensitive to commodity price changes than the gross value of production.

Victoria's evaluation of an aggregation by profitability approach is outlined in Table 17 below.

Table 17: Evaluation of aggregation by profitability

Pros	Cons
<ul style="list-style-type: none"> Somewhat consistent with HFE – all revenue and revenue raising disparities recognised based on industry capacity to pay Somewhat conditional and targeted – dilutes the influence of dominant states, minimising the impact of policy changes More consistent treatment of different minerals than other aggregation approaches 	<ul style="list-style-type: none"> Less predictable than value of production Does not reflect what states do Infeasible to implement – data not available and profitability difficult to measure

9.10 Endowment assessment

This option, included in the interim report, would assess fiscal capacity based on the estimated value of states' mineral endowments or reserves rather than production. Because resource endowments can be less concentrated than actual production, this may reduce theoretical dominant-state effects.

Endowments or reserves, as a stock are also generally less volatile than production. However, endowments vary in viability and as such are difficult to evaluate, which is why value of production is considered more reliable as it is based on revealed prices. The CGC acknowledged this in 2015, stating:

"There are many differences between State reserves in:

- the quality and grade of mineral*
- social, economic and environmental values of mine area*
- access to infrastructure and associated costs of developing the mine.*

These differences make it very difficult to determine whether one State is developing its resources at a faster rate than another."²¹⁰

If a mineral-by-mineral approach is maintained, this approach would do little to alleviate theoretical dominant state effects, because a dominant state's revenue (and any potential changes) would continue to have a significant influence on the national average tax rate as they would have a dominant share of national royalty revenue (which would continue to be based on value of production).

Victoria's evaluation of an endowment-based assessment is outlined in Table 18 below.

Table 18: Evaluation of endowment assessment

Pros	Cons
<ul style="list-style-type: none">• Potentially more stable than value of production• Potentially less geographically concentrated than value of production	<ul style="list-style-type: none">• May be affected by exogenous factors,• Does not reflect what states do• Complex to implement – data not available and profitability difficult to measure• Ineffective at reducing potential policy influences – dominant states in royalty revenues would still influence the national average rate

²¹⁰ CGC 2015 Review report, Volume 2, p 116.

