




Australian Government  
Commonwealth Grants Commission

# Discussion paper

Proposed approach and  
work program for the  
2025 Methodology Review

February 2023

Paper issued	14 February 2023
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Submissions sought by	<p>22 March 2023. Submissions should be placed in your private state channel in CGC Engagement Teams, with a post notifying Rose Verspaandonk.</p> <p>Submissions of more than 10 pages in length should include a summary section.</p>
Confidential material	<p>It is the Commission's normal practice to make state submissions available on its website under the CC BY licence, allowing free use of content by third parties.</p>  <p>Further information on the CC BY licence can be found on the Creative Commons website (<a href="http://creativecommons.org">http://creativecommons.org</a>).</p> <p>Confidential material contained in submissions must be clearly identified or included in separate attachment/s, and details provided in the covering email. Identified confidential material will not be published on the Commission's website.</p>

# 2025 Methodology Review

## Overview of proposed phases and consultation

### *Phase 1 (February 2023–Early June 2023)*

- discussion paper on the proposed approach and draft work program (this paper)
- online meeting between states and territories (states) and the Commission to launch the review
- discussion paper on fiscal equalisation, supporting principles and assessment guidelines

### *Phase 2 (Late June 2023–October 2023)*

- first tranche of consultation papers on assessment methods
- the Commission meets with each state on the case for changes in methods between reviews

### *Phase 3 (November 2023–May 2024)*

- second tranche of consultation papers on assessment methods
- consultation paper on changes in methods between reviews

### *Phase 4 (June 2024–September 2024)*

- release of Draft Report

### *Phase 5 (October 2024–February 2025)*

- paper on changes since Draft Report, including new issues for 2025-26 GST relativities
- release of Final Report to the Commonwealth and states

### *Post-Review*

- release of Final Report to the public
- evaluation of the review process

States are welcome to meet with the Commission at any point during the review.

# Introduction

1. On 9 February 2023, the Commonwealth Treasurer issued [terms of reference](#) for the Commonwealth Grants Commission (the Commission) to:
  - review and report on the methodological approach used to calculate the GST revenue sharing relativities from 2025-26 (the 2025 Review)
  - report on the recommended GST revenue sharing relativities to be used to distribute GST revenue among the states and territories (states) in 2025-26
  - consider if there is a case for the Commission to be given the flexibility to consider alternative methods in cases where there is a significant unanticipated shock (such as a pandemic) or where major policy reforms are enacted in between reviews.
2. The Commission welcomes views from state treasuries and the Commonwealth Treasury on the proposed approach and work program for the 2025 Review canvassed in this discussion paper. Submissions are sought by Wednesday 22 March 2023. Following consideration of state and Commonwealth views, the Commission will release the final version of the approach and work program for the 2025 Review in April 2023.
3. The Commission proposes that the key objectives for the 2025 Review should be:
  - close consultation with states, so that they can:
    - provide their views on the appropriateness of assessment methods
    - make the case for changes they consider necessary
    - have input to, and understand, Commission decisions.
  - both the Commonwealth and the states have confidence that, following the 2025 Review, the overall approach to measuring state fiscal capacities is sound; and all assessment methods are appropriate and rigorous, and draw on high quality, fit for purpose data.
4. The 2025 Review will be conducted over 24 months. For comparison, the 2020 Review was undertaken over 39 months, and the 2015 Review over 20 months.
5. With a 5 yearly cycle for methodology reviews, the Commission believes it is important that the 2025 Review considers the appropriateness of all of the assessment methods, rather than only considering a limited set. The Commission is committed to meaningful consultation with states and the Commonwealth throughout the review. The proposed approach to the review, as outlined in this paper, has been designed to make the most efficient use of the time available so that these priorities can be achieved.
6. The terms of reference (Attachment 1) state that the 2025 Review does not include examining the arrangements for GST distribution legislated by the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018*.
7. Since the Commission has been asked to review the current methods that underlie its assessments to calculate the GST relativities, it considers alternative approaches to GST distribution, such as on an equal per capita basis, to be outside the scope of the 2025 Review.

# Proposed approach to reviewing supporting principles and assessment methods

## *Proposed approach*

8. Significant experience, expertise and effort by the states and the Commission have gone into developing, refining and improving the supporting principles and assessment methods, which have been the basis for fiscal equalisation for many years. Mindful of the need for the 2025 Review to be focused and make efficient use of the time available, the Commission proposes to build on this body of work and use the current supporting principles and assessment methods as the starting point for analysis.
9. The Commission is committed to using this review to improve its approach wherever appropriate. It is keen to respond to changes in the environment in which states operate, and to take advantage of opportunities provided by new sources of data and analytical methods.
10. With these considerations in mind, the Commission is proposing a consistent framework to apply to reviewing all assessment methods and supporting principles. The framework will be the basis for assessing whether there may be a case for change that requires further investigation through the review process. Essentially it proposes to ask, *‘what is different since the 2020 Review, and what is an appropriate response?’* The thrust of the proposed review framework is to identify if there has been a change in circumstances since the 2020 Review that has either:
  - brought into question the suitability of the existing supporting principles or assessment methods
  - suggested that a supporting principle or assessment method can be improved.
11. In keeping with this approach, if states consider that an assessment method or supporting principle should be changed, it is proposed they also identify what they consider are the developments since the 2020 Review that support the need for any change.

## *Rationale*

12. The Commission’s intention is that this approach will allow the review to be:
  - comprehensive, considering the appropriateness of all methods and supporting principles
  - responsive, addressing changes in the environment and leveraging new data and analytical tools
  - efficient, focusing effort where there may be a case for improvement
  - consistent, applying the same lens to all supporting principles and assessment methods
  - rigorous, seeking out new developments in state policies, and in data, evidence and analytical tools.

## *Some possible changes in circumstances since the 2020 Review*

13. The Commission is conscious that state governments operate in an environment subject to ongoing, and sometimes rapid, change. This influences their revenue raising opportunities and their spending requirements. Changes to this environment may intersect with the Commission’s work on the distribution of GST revenue.

14. By way of example, following are some ways in which relevant circumstances may have altered since the 2020 Review such that a supporting principle or assessment method may warrant detailed review and possible amendment. These examples, which are not exhaustive, have been organised under the headings below.

#### *States may be behaving differently*

15. 'What states do' is a building block of the Commission's analysis. If states change their approach to expenditure or revenue raising, the Commission should have regard to this change in considering its assessment of state fiscal capacities.
16. This review provides an opportunity to scan states' spending and revenue activities to ensure that assessments continue to be based on what states do. There have been a range of developments that may increasingly impact on the environment in which states operate, and in turn the methods for determining the distribution of GST revenue.
17. These developments include changes to the natural environment, and economic, social, and demographic changes, along with technological and geopolitical shifts. It is also possible that there have been shifts in Commonwealth–state relations that require consideration. To the extent that these trigger changes in states' behaviour, it is important that the Commission considers these as part of the review.

#### *There may be new evidence of an issue relevant to the Commission's approach*

18. New evidence, for example, coming from experience with the application of a supporting principle or method, may suggest that improvements can be made. This evidence would generally be information that has become available since the 2020 Review, or has not been considered previously. This might involve evidence of significant volatility or complexity, or incomplete coverage. It could also include instances of measurement problems.

#### *There may be changes in data availability or new statistical methods*

19. Technological developments may be expanding the range of data sources and analytical tools available to inform the Commission's work. These could involve 'big data' and machine learning. Collaborations between the Commonwealth and states could also produce more nuanced datasets. Over time these datasets may mature and become more nationally consistent.
20. Datasets used in assessment methods may no longer be available. In this situation, the Commission will search with states for a robust alternative.

#### *How the proposed framework would be applied in reviewing the supporting principles*

21. Since the 2015 Review, the Commission has used 4 supporting principles to guide its approach to designing methods for assessing the fiscal capacities of states. These are:
  - what states do
  - policy neutrality
  - practicality
  - contemporaneity.
22. This review provides an opportunity to consider if these supporting principles remain appropriate or alternatively, require adjustment or change. To assess the appropriateness of both principles and methods since the 2020 Review, the proposed framework starts with the question 'what is different since the 2020 Review, and what is an appropriate response?' Potential questions exploring 'what is different' could include the following:

- Are rapid changes in state circumstances becoming more common? Would this raise new challenges for achieving contemporaneity?
  - Are the right settings in place to ensure revenue assessments are policy neutral in the context of potential reforms to states' revenue bases?
23. The Commission intends to consult with the states on the appropriateness of the supporting principles in the first half of 2023, with the aim of clarifying its views before states make submissions on assessment methods.
24. Similarly, the Commission will consider developments that might indicate that the assessment guidelines should be changed. For example, it may be appropriate to adjust materiality thresholds to ensure simplicity benefits are not eroded.

*How the proposed framework would be applied in reviewing assessment methods*

25. The Commission intends to review all assessment methods. The proposed framework would start by asking the question, 'what is different since the 2020 Review, and what is an appropriate response?' As noted above, what has changed since the 2020 Review might include a change in state behaviour, new evidence of a problem with an assessment, or a new, improved data source or analytical method. In the course of the review, states will have the opportunity to identify what they consider are relevant developments since the 2020 Review.
26. If no developments are identified that suggest a method may need to be changed, the Commission proposes to ensure, in consultation with the states, that current methods meet materiality guidelines, and the most up-to-date data are being used. Examples of possible changes to existing assessment methods include:
- combining expenses/revenues into a single component where it is not material to assess them separately
  - updating data to inform cost and/or use rates that were calculated in the 2020 Review and fixed for the period of that review.
27. If developments since the 2020 Review are identified that question the appropriateness of an assessment method, the Commission proposes to explore this thoroughly and see whether the method can be improved. This might include incorporating different analytical techniques or underlying drivers, using alternative datasets, or revising the number of components within a method. Similarly, if states identify that developments suggest an assessment method is no longer appropriate, it is proposed they also identify how it could be improved.
28. Alternative approaches would be tested against the assessment guidelines, which currently consider whether:
- a conceptual case exists
  - the conceptual case is supported by evidence
  - the method can be supported by data that are fit for purpose
  - the assessment method outcome would be material.
29. It is proposed that the assessment guidelines would be reviewed simultaneously with the supporting principles.
30. Identifying that there may be a case for changing an assessment method does not necessarily mean that the method will be changed. If a better alternative cannot be identified, the Commission may decide to maintain its current approach. However, in instances where there is uncertainty in the quality of a particular dataset, the Commission can apply discounts or weighted sets of data to a particular assessment

calculation. The Commission would only apply such changes after consulting with the states.



## Proposed work program

31. The proposed work program is guided by 2 related objectives:
- ensuring meaningful state engagement with the Commission
  - spreading the workload over the review period.

### *Ensuring meaningful state engagement*

32. The Commission is committed to ensuring all states have ample scope to engage with the review. The aim is to enable states to convey their views comprehensively, as well as ensuring they understand the basis for the Commission's decisions.
33. During the course of the review, the Commission welcomes opportunities to meet with each state. Meetings with the Commission would be in addition to the ongoing discussions states have with Commission staff. While most bilateral meetings with the Commission and staff are likely to be conducted online, the Commission will endeavour to visit each state as part of the 2025 Review. States will be invited to nominate their preferred timing for this visit.

### *Ensuring the underlying principles and assessment methods are rigorous*

34. The proposed work program tries to allocate the time available in a way that seeks to ensure all aspects of the review can be completed to a high standard. This is important given the timeframe for the review and keeping in mind the demands on state officials.
35. In preparing the proposed work program, the Commission has been mindful of the constraints associated with school holidays, budget reporting periods, and annual updates. Where possible, it has sought to reduce the burden on states at these times.
36. The proposed work program:
- incorporates a single iteration of each consultation paper
  - divides the release of consultation papers on assessment methods into 2 tranches (Attachment 2) rather than circulating them all at the same time
  - provides more time than previous reviews for states and the Commonwealth to consider, and respond to, consultation papers
  - takes advantage of technology to offer more opportunities to meet with the Commission
  - allocates time for consultation, analysis, explanation, designing and building assessments and calculation of 2025 GST relativities.
37. The proposed work program for the 2025 Review is outlined below. Unless otherwise specified, 'Commission' refers to Commissioners, and 'staff' refers to CGC employees. States are welcome to initiate discussions with the Commission or staff at any time.

### *Considering changes to methods between reviews*

38. The terms of reference ask the Commission to consider if there is a case for it to be given the flexibility to consider changes to assessment methods in between reviews in cases where there is a significant, unanticipated shock (such as a pandemic) or where major policy reforms are enacted.
39. The Commission proposes bilateral meetings with states in the second half of 2023, and prior to releasing a consultation paper on this issue.

- The bilateral meetings will provide the opportunity for a general discussion on the purpose, benefits and risks of method changes between reviews.
  - Drawing on the views raised in the meetings with the states, the consultation paper will summarise the issues and present the Commission's preliminary position on method changes between reviews. States will be invited to comment on the consultation paper.
40. In addition to the proposed bilateral meetings with the Commission, states can, of course, raise this issue with the Commission at any time during the review.
41. In summary, the Commission proposes to conduct a comprehensive, efficient, and consistent review of its supporting principles and all assessment methods in close consultation with the states. The Commission welcomes state feedback on its proposed approach.

## 2025 Review: proposed work program

Date	Event
<b>2023</b>	
<b>9 February</b>	Terms of Reference received.
<b>14 February</b>	Commission issues a paper seeking views from the states and Commonwealth Treasury on its proposed approach and work program.
<b>15 March</b>	Online multilateral meeting between the Commission and the states to launch the review.
<b>22 March</b>	State submissions on the proposed approach and work program are due.
<b>21 April</b>	Commission finalises and releases the approach and work program. Commission issues a paper seeking state views on fiscal equalisation, supporting principles and assessment guidelines.
<b>19 May</b>	State submissions on fiscal equalisation, supporting principles and assessment guidelines paper are due. Each state is invited to advise its timing preference for a Commission visit for a bilateral meeting in either 2023 or 2024.*
<b>9 June</b>	Commission releases its view on fiscal equalisation, supporting principles and assessment guidelines.
<b>30 June</b>	Commission issues tranche 1 of assessment consultation papers to states.
<b>July</b>	Commission commences bilateral online meetings with states on the case for changes in method between reviews
<b>September</b>	State submissions on tranche 1 papers are due.
<b>November</b>	Commission issues tranche 2 of assessment consultation papers to states. Commission issues a consultation paper on the case for changes in method between reviews.
<b>2024</b>	
<b>March</b>	State submissions on tranche 2 papers are due.
<b>June</b>	Commission issues Draft Report to states.
<b>August</b>	State submissions on Draft Report are due.
<b>October</b>	Commission issues a paper on New Issues for 2025-26 GST relativities, in particular to consider treatment of new Commonwealth payments.
<b>November</b>	State submissions on New Issues paper are due. Commission issues a paper seeking state views on changes since the Draft Report.
<b>December</b>	State submissions on changes since the Draft Report are due.
<b>2025</b>	
<b>28 February</b>	Release of Final Report (and supporting information) to the Commonwealth and states.
<b>14 March</b>	Public release of Final Report.
<b>May</b>	Commission issues a paper seeking state views on the review process.
<b>June</b>	State submissions on the review process are due.

Notes:

- This table does not include discussions between Commission staff and state treasury officers. These will be ongoing and scheduled to accommodate state preferences. Similarly, bilateral training for state treasury officers on current principles and methods will continue to be available. They will be scheduled and tailored according to state needs.
- Timing of the proposed work program is indicative, and subject to change if required.

\*States will be invited to nominate a preference for the timing of the Commission in-person visit during the review process.

## Conclusion

43. Mindful of the shorter time frame for this review compared with the 2020 Review, the Commission has focused on the importance of:
  - facilitating effective consultation with states, through:
    - leveraging technology to allow multiple direct conversations with the Commission
    - spreading work so states have sufficient time to respond to Commission consultation papers.
  - ensuring the supporting principles and resulting assessment methods are rigorously based, through:
    - leveraging state expertise
    - allocating sufficient time to all aspects of the review (consultation, analysis, explanation, assessment design and build, and calculation)
    - using current supporting principles and assessment methods as the starting point, with the focus on those assessments where developments since the 2020 Review indicate there is a case for change.
44. The Commission is seeking states' views on:
  - the proposed approach to reviewing assessment methods and supporting principles
  - the proposed work program, including:
    - phases and associated timing
    - deadlines for state submissions
    - timing of direct interactions between states and the Commission.
  - any other matters that states consider relevant.

## Attachment 1: Terms of Reference



**THE HON JIM CHALMERS MP**  
TREASURER

**09 FEB 2023**

Ref: MS23-000149

Mr Michael Callaghan AM PSM  
Chairperson  
Commonwealth Grants Commission  
GPO Box 1899  
CANBERRA ACT 2601

Dear Mr Callaghan

I am writing to you to convey the enclosed terms of reference for the Commonwealth Grants Commission's *2023 Update of GST Revenue Sharing Relativities* (2023 Update) and *Report on GST Revenue Sharing Relativities 2025 Review* (2025 Methodology Review).

The terms of reference for the 2023 Update require the Commission to report by 14 March 2023, with an embargoed copy of the report to be provided to the Commonwealth and the states and territories by 28 February 2023.

The terms of reference for the 2025 Methodology Review require the Commission to undertake a review of the methodologies underpinning its calculation of the GST relativities, with a draft report due in 2024. The final report for the review should be provided to the Commonwealth and the states and territories by 28 February 2025 and be released publicly on 14 March 2025.

Yours sincerely

A blue ink handwritten signature, appearing to be 'J. Chalmers', with a long horizontal stroke extending to the right.

The Hon Jim Chalmers MP

Enc Terms of references for the 2023 Update and the 2025 Methodology Review

**Terms of Reference for the 2025 Methodology Review**  
**COMMONWEALTH GRANTS COMMISSION ACT 1973**

I, Jim Chalmers, Treasurer, pursuant to sections 16, 16A, 16AA and 16 AB of the *Commonwealth Grants Commission Act 1973*, refer to the Commission for inquiry into and report upon:

- a) the methodological approach used to calculate the GST revenue sharing relativities to distribute GST revenue among the states, the Northern Territory and the Australian Capital Territory (the states) from 2025-26 (*Methodology Review*); and
- b) the recommended GST revenue sharing relativities to be used to distribute GST revenue among the states in 2025-26.

*Methodology Review*

2. The Commission should undertake a review of the methods that underlie its assessments to calculate the GST revenue sharing relativities used to distribute GST revenue among the states.
3. The Commission will consult with the Commonwealth and the states on:
  - a) the development of a work program for the methodology review, including the provision of a draft report in 2024; and
  - b) any substantive changes to the revised methodology following the draft report.
4. The outcome of the review will be a revised methodology for calculating the GST revenue sharing relativities, which the Commission will apply to its assessments of GST relativities from 2025-26. The revised methodology should be described in the final report for this inquiry.
5. In undertaking the review, the Commission should take into account the *Intergovernmental Agreement* as defined under the *Federal Financial Relations Act 2009*, which provides that GST revenue will be distributed among the states in accordance with the principle of horizontal fiscal equalisation.
6. The Commission should also consider if there is a case for the Commission to be given the flexibility to consider alternative methods in cases where there is a significant unanticipated shock (such as a pandemic) or where major policy reforms are enacted in between reviews.
7. The scope of this inquiry does not include examining the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018*.
8. In reviewing the methodology underlying its assessments, the Commission should:
  - a) aim to have assessments that are simple and consistent with the quality and fitness for purpose of the available data;
  - b) use the latest available data consistent with this; and
  - c) ensure robust quality assurance processes.



9. In reviewing the methodology underlying its assessments, the Commission should treat Commonwealth payments to the states as follows:
- a) National Specific Purpose Payments (NSPPs), National Health Reform (NHR) funding, National Housing and Homelessness funding, Quality Schools funding (for government schools) and National Partnership project payments should affect the relativities, recognising that these payments provide the state with budget support for providing standard state services.
    - (i) NHR funding and corresponding expenditure relating to the provision of cross border services to the residents of other states should be allocated to states on the basis of residence.
  - b) National Partnership facilitation and reward payments should not affect the relativities, so that any benefit to a state from achieving specified outputs sought by the Commonwealth, or through implementing reforms, will not be redistributed to other states through the horizontal fiscal equalisation process.
  - c) General revenue assistance, excluding GST payments, will affect the relativities, recognising that these payments are available to provide untied general budget support to a state.
  - d) Notwithstanding subparagraphs 9(a) – (c), the Commission may determine that it is appropriate for particular payments to be treated differently, reflecting the nature of the particular payment and the role of the state governments in providing particular services.
  - e) Those payments which, prior to its assessment of the 2025-26 relativities, the Commission had been directed to treat as having no direct influence on the relativities, including payments for which the Commission has been directed to apply a 50 per cent discount, should continue to be treated in that way. Where those payments are replaced, the treatment of the new payment should be guided by subparagraphs 9(a) – (d), unless otherwise directed.

#### *GST relativities for 2025-26*

10. The Commission should undertake an assessment of the GST revenue sharing relativities recommended to be used to distribute GST revenue among the states in 2025-26, consistent with the objective in subsection 16AB(2) of the Act, the transitional proportions in subsection 16AB(3) of the Act, the GST revenue sharing relativity factor in subsection 8(2B) of the *Federal Financial Relations Act 2009* and the pool top-ups for a payment year as outlined in section 8A of the *Federal Financial Relations Act 2009*.
- a) The Commission's assessment should be based on the assessment years 2021-22 to 2023-24 inclusive.
  - b) To assist in ensuring that each state and territory will get the better of the current or the former GST distribution, the Commission should also provide relativities that would have applied if the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018* had not been enacted.
11. This assessment should be made on the basis of the revised methodology from the Commission's review of its methodological approach.

12. The Commission will provide the final report for this inquiry, including both the revised methodology and the recommended GST revenue sharing relativities for 2025-26, under embargo, to the Commonwealth and the states by 28 February 2025. The Commission should release the report publicly on 14 March 2025.
13. The Commission will consult regularly with the Commonwealth and the states as it considers these terms of reference.
14. Supplementary terms of reference may be provided prior to finalisation of the inquiry outcomes.



DR JIM CHALMERS

9 / 2 / 2023



## Attachment 2: Indicative allocation of assessment methods to tranches

Tranche 1		
Revenue	Expenses	Other
Payroll tax	Schools	Commonwealth payments
Land tax	Post-secondary education	Wages
Stamp duty on conveyances	Health	Socio-economic status
Insurance tax	Services to communities	
Motor tax	Justice	
Mining revenue	Transport	
	Native title and land rights	

Note: 'Other' column includes Commonwealth payments, capital, common factors and revenue/ expense projects.

Tranche 2		
Revenue	Expenses	Other
Other revenue	Housing	Tax reform and elasticity adjustments
	Welfare	Investment
	Roads	Net borrowing
	Services to industry	Regional costs/remoteness
	Other expenses – service expenses	Adjusted budget
	Natural disaster relief	
	Administrative scale	
	National capital	

Note: 'Other' column includes Commonwealth payments, capital, common factors and revenue/ expense projects.