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Commonwealth Grants Commission

# Occasional Paper

No.8: Commonwealth Grants  
Commission: Commencement  
of 2025 methodology review

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## Summary

On 9 February 2023, the Treasurer released the terms of reference for the Commonwealth Grants Commission (the Commission) to review the methodology it uses in advising the Commonwealth Treasurer on the distribution of GST revenue to the states and territories (states). The Commission is to report by February 2025, and the process is referred to as the '2025 Review'.

Each year, the Commission advises the Treasurer on how to distribute the GST revenue to the states. In 2021–22 this revenue was around \$83 billion.

In preparing this advice, the Commission estimates states' different fiscal capacities to provide state services. The aim is to recommend how the distribution of GST revenue could bring states closer together in their fiscal ability to provide these services.

To do this, the Commission applies analytical and statistical 'methods' to assess state budget expenditure needs and revenue capacities. These methods, together with principles that support the Commission's approaches, comprise the Commission's assessment methodology.

Around every 5 years, the Treasurer tasks the Commission to review its methodology. The aim is to consider the ongoing appropriateness of the assessment methods, and whether improvements can be made, having regard to changes in state spending and revenue activities along with new data and analytical tools. These reviews typically take 2 to 3 years.

As with past reviews, the 2025 Review will be conducted in close consultation with the states, and the material prepared for the review will be released on the Commission's [website](#).

## Introduction

Each year the Commonwealth Grants Commission provides recommendations to the Commonwealth Treasurer on the distribution of GST revenue. The aim is to give states the fiscal capacity to provide comparable services if they make a similar effort to raise revenue. This is known as horizontal fiscal equalisation. The factors taken into account include the revenue raising capacity available to each state, including the Commonwealth payments it receives, along with each state's cost of providing services.

Around every 5 years, the Commonwealth Treasurer asks the Commission to review the methodology it uses to assess states' fiscal capacities. The aim is to ensure the Commission's overall approach remains fit for purpose, and the data sources and calculations reflect states' circumstances, or to advise whether improvements can be made.

Previous Commission reports on methodological reviews were released in 2010, [2015](#) and [2020](#). Each review took 2 to 3 years to complete.

On 9 February 2023, the Treasurer gave the Commission [terms of reference](#) to review its methodology and to provide a report in February 2025 (2025 Review).

This paper provides background information on methodology reviews and an overview of how the Commission will conduct the 2025 Review.

## The Commission's 'methodology'

The Commission uses a framework to assess each state's relative fiscal capacity. This framework, or methodology, comprises assessments of 21 expenditure and revenue categories, and is guided by 4 supporting principles. An assessment draws on specified methods (calculations and data) to derive each state's assessed GST needs in that area, with the aim of bringing states closer together in their fiscal capacity to deliver services.

The Commission uses a range of analytical and statistical tools to calculate states' relative spending needs having regard to the demand for, and cost of, delivering services, along with each state's relative revenue raising capacity. It applies econometric and other analytical techniques to a range of national and state datasets. The areas of state revenue and expenditure assessed by the Commission are in the table below.

**Table 1 2020 methodology assessments**

Revenue assessments	Expenditure assessments	
Payroll Tax	Schools	Transport
Land tax	Post-secondary education	Services to industry
Stamp duty on conveyances	Health	Other expenses
Insurance Tax	Housing	Investment
Motor taxes	Welfare	Net borrowing
Mining revenue	Services to communities	
Other revenue	Justice	
Commonwealth payments	Roads	

Source: 2020 Methodology Review.

The Commission combines all the assessments to derive a measure of each state's relative need for GST revenue. This is the basis of the recommendations the Commission provides the Commonwealth Treasurer each year.

An assessment of states' revenue raising capacities for a tax typically involves:

- quantifying each state's revenue base (for example, for stamp duty on conveyances the tax base is the value of property sales in each state)
- calculating the average tax rate (in the case of stamp duty on conveyances this is the national stamp duty revenue collected divided by the national value of property sales)
- applying the average tax rate to each state's revenue base to determine its revenue raising capacity for that tax (for example, applying the national average stamp duty rate to each state's value of property sales).

The Commission divides each state's revenue raising capacity by its population to determine which states have an above-average or below-average revenue raising capacity for that tax. States with an above-average revenue raising capacity are assessed to have a reduced need for GST revenue compared with those with a below-average revenue raising capacity. For example, Western Australia has an above-average revenue raising capacity for mining royalties, whereas the ACT has a below-average capacity to raise revenue from mining.

An assessment of states' expenditure needs typically involves:

- identifying average expenditure per person in a policy area (for example, expenditure per person for hospitals)
- identifying and quantifying 'drivers' of expenses, where a state would need to spend more or less than the average, per person, for reasons beyond its control (for example, it costs more to deliver services to regional and remote areas)
- applying each state's drivers to the average per person spend, to calculate its need for that area of spending on a per person basis.

For example, the Northern Territory has an above-average expense need for rural roads, whereas Victoria has a below-average expense need in this area.

The supporting principles that guide the Commission's deliberations are:

- what states do: seeks to ensure assessments reflect actual state behaviour, on average, avoiding any judgement of policy settings
- policy neutrality: seeks to ensure that state policy choices do not influence GST distribution and the Commission's assessment methods do not influence state behaviour
- contemporaneity: aims to avoid unnecessary delays between the Commission's assessment of GST needs and the corresponding GST distribution
- practicality: supports simple assessment methods, using reliable data.

## How the 2025 Review will be conducted

The primary stakeholders of the 2025 Review are the Commonwealth and state treasurers and their departments. The Commission will consult closely with them throughout the process. This will include releasing consultation papers on each of the 21 assessments of spending needs and revenue raising capacities and inviting state comments, along with a series of meetings and visits by the Commission to the states.

As part of the 2025 Review, the states will have opportunities to provide detailed input on:

- the detail of the Commission's proposed approach for reviewing assessment methods and the work program for the review
- how the supporting principles and assessment guidelines have been operating and whether changes should be made
- what changes are emerging in states' responsibilities that could affect their relative fiscal needs
- how individual assessments can be made more robust, for example by drawing on new data sources or incorporating new evidence.

The terms of reference for the 2025 Review require the Commission to provide a Draft Report to the states in 2024. The Commission will then have detailed consultations with the states on where it is heading. The Commission will provide the Final Report to the Commonwealth Treasurer in February 2025.

Once the 2025 Review is finalised, the Commission will generally use the assessment methods in the report to update future relativities on an annual basis. This will begin with the Commission's recommendations for the distribution of GST revenue in 2025–26.

The material prepared for the 2025 Review will be available on the [Commission's web page](#).

## Conclusion

The objective for the 2025 Review is to ensure, through close consultation with the states, that the Commission's overall approach to assessing state fiscal capacities, and in turn their GST requirements, is appropriate and draws on rigorous, fit for purpose data.

The Commission will regularly update its website with information relating to the 2025 Review.