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Commonwealth Grants Commission

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Summary

- The Commonwealth Grants Commission is an independent and specialist Australian Government body that has been operating since 1933. Since its inception, the Commission has been providing advice to the Commonwealth Government on how to provide financial assistance to Australia's states and territories (states) to bring their fiscal capacities closer together so they can provide a similar standard of services to their citizens.
- The arrangements for Commonwealth financial assistance to the states have changed over time.
- Initially, the Commission made recommendations relating only to fiscally weaker states. Under the Fraser Government's New Federalism in the 1970s, its role expanded to equalising the fiscal capacities of all states.
- Since July 2000, the Commission's recommendations have formed the basis of states' shares of Goods and Services Tax (GST) revenue.
- This paper provides a concise history of the important role the Commonwealth Grants Commission has played in Australia's federal financial arrangements since 1933.

Introduction

For the past 90 years, the Commonwealth Grants Commission (the Commission) has been an independent body providing advice to the Commonwealth Government consistent with the objective of 'horizontal fiscal equalisation'. This has involved providing advice to bring the fiscal capacities of Australia's states and territories (states) closer together so they can provide a similar standard of services to their residents.

Today, the main responsibility of the Commission is to advise the Australian Government on the distribution of GST revenue to the states.[1] Due to their different service delivery needs and revenue raising abilities, each state requires a different amount of GST per person to be able to provide similar services and infrastructure to its residents.[2]

The Commission currently comprises a chairperson and 3 Commissioners, appointed by the Australian Government. Supporting them is an agency of around 35 staff. The Commission works closely with states to develop evidence-based recommendations on GST distribution.

While many federations have equalisation arrangements, Australia is distinct in having an ongoing, independent and specialist agency for this purpose. Australia also has a more comprehensive approach to equalisation than other countries, covering both service delivery needs and revenue raising capacities.[3]

This occasional paper presents a concise history of the Commission's work over the past 90 years. It describes the Commission's activities in the context of broad developments in Australia's Commonwealth-state financial relations.

The Commission's 90-year history has 2 distinct eras. Initially, the Commission made recommendations on 'special grants' for the fiscally weaker states. Since the late 1970s, funds have been distributed to states on a zero-sum basis, meaning a change in the share of one state affects the shares of all other states. The fiscally weaker states receive a greater per person share of the pool of funds than the fiscally stronger states. During both periods, the principle of financial need has informed the Commission's deliberations.

This Occasional Paper draws on 4 histories of the Commission:

- R Williams, 'Federal-State Financial Relations in Australia: The Role of the Commonwealth Grants Commission', *Australian Economic Review*, 2005, 38(1):3
- R Williams, 'History of federal-state fiscal relations in Australia', *Australian Economic Review*, 2012, 45(2)
- the second edition of *Equality in Diversity*, covering the period from 1933 to 1993
- *The Commonwealth Grants Commission: The Last 25 Years*, covering the period from 1983 to 2008.[4]

1 The Commission has had several other responsibilities. Most recently, the Commission conducted inquiries for Norfolk Island (2019), the Jervis Bay Territory (2017), and into local government funding (2013).
2 For more information on why a state's share of GST revenue differs from its population share, see CGC Research Paper #2 Why states get different shares of GST.
3 For more information on equalisation arrangements around the world, see CGC Research Paper #3 International themes in fiscal equalisation: an Australian perspective.
4 Commonwealth Grants Commission (CGC), Equality in Diversity (second edition), CGC, Australian Government, 1995; Commonwealth Grants Commission (CGC), The Commonwealth Grants Commission: The Last 25 Years, CGC, Australian Government, 2008.

Horizontal fiscal imbalance and Vertical fiscal imbalance

Within the Australian Federation there is a fiscal imbalance between the states, but also between the Commonwealth and the states. Much of this paper discusses the fiscal imbalances that exist *between* states, which is known as a horizontal fiscal imbalance, and the process that mitigates this, horizontal fiscal equalisation.

Vertical fiscal imbalance refers to the difference in fiscal capacity between the Commonwealth and the states. This reflects the greater capacity of the Commonwealth to raise revenue, while states remain responsible for providing many services. In this paper, it is only discussed where it is relevant to the Commission's work.

Post-federation: before the Commission

The establishment of the Commission in 1933 has its roots in Australia's federation.

When the colonies unified in 1901, they granted the Commonwealth the authority to collect customs and excise duties, while they retained responsibility for delivering most government services. For 3 decades, the Commonwealth gave states equal per person grants as compensation.

Starting in 1910, additional 'special grants' were given to the financially weaker states — Western Australia, Tasmania and South Australia – often on an *ad hoc* basis – for the purpose of strengthening their fiscal positions.

In the 1920s, it emerged that the fiscal disparities between states were more significant and persistent than initially thought. The process for determining special grants frequently led to disputes between the fiscally weaker states and the Commonwealth.

The late 1920s and early 1930s brought the Great Depression and the 1933 secession referendum in Western Australia. In this environment, the idea of creating a permanent, independent institution to offer systematic advice to the Commonwealth regarding special grants gained momentum.

The government of Prime Minister J A Lyons embraced this proposal and established the Commission with the hope that impartial guidance would help mitigate political conflicts surrounding the issue. The *Commonwealth Grants Commission Act 1933* passed in May 1933.

Special grants for fiscally weaker states

1930s and 40s: determining special grants

States applied to the Commonwealth for 'special grants', which would allow them to function at a standard not significantly lower than that of other states, provided they made reasonable and efficient efforts to achieve these standards. This objective continues to guide revenue distribution today.

The Commission set out its approach to assessing states' needs in 1936:

> *...special grants are justified when a State through financial stress from any cause is unable efficiently to discharge its functions as a member of the federation and should be determined by the amount of help necessary to make it possible for that State by reasonable effort to function at a standard not appreciably below that of other States.*

In the early years, only Western Australia, Tasmania and South Australia were considered to require additional revenue, above that given to the other states. To determine the amount required, the Commission observed state patterns in revenues and expenses. As states frequently ran deficits in spending, the aim was to reduce weaker states' deficits to levels comparable to stronger or 'standard' states.

The Commission maintained a principle of ensuring that a weaker state's policy choices did not result in it receiving a larger grant. 'Policy neutrality' has endured as one of the 'supporting principles' that continues to guide the Commission.

Another longstanding characteristic of the Commission's approach is a reliance on quantitative analysis. While exercising judgment where necessary, successive Commissions have based recommendations on the best available data. By 1945, the Commission had become established in the institutional structure of Australia's federal finances and developed a reputation for its expertise and impartiality.

In 1942, vertical fiscal imbalance increased when the Commonwealth became solely responsible for levying income tax in World War II.[5] It compensated each state with a payment similar to the revenue forgone. Until 1946, a state could apply to the Commission for further compensation, giving the Commission a dual role in this period.

Late 1940s to 1970s: shifts in Commonwealth-state fiscal relations

The role of the Commission evolved alongside changes in Commonwealth fiscal policy over this period.

- From 1947, the Commonwealth Treasury adjusted grants based on population. From 1959, it introduced other *ad hoc* adjustments to grants.
- In the late 1960s, specific purpose payments were introduced by the Commonwealth Government as a means of influencing the delivery of services and infrastructure.
- In 1971, the Commonwealth ceded payroll tax to the states.

5 Although income taxation by the Commonwealth was intended to be temporary, it became permanent after decisions of the High Court.

The role of the Commission also changed. Its core business, special grants, began to decline in importance. Towards the end of the period, states often agreed to not apply for special grants as part of deals with the Commonwealth in return for increased general revenue assistance.

Revenue sharing for all states

From the late 1970s: a systematic approach

In 1978, the Commission's role was broadened, and a dedicated pool of funds was to be shared between the states. The 1977 Premiers Conference had determined that these funds would be shared through 'relativities' to be determined by the Commission based on equalisation principles. This period marked a significant increase in the Commission's responsibilities.

The 1978 legislation tasking the Commission with determining the tax sharing relativities specified:

> *.. the respective payments to which the States are entitled … should enable each State to provide, without imposing taxes and charges at levels appreciably different from the levels of the taxes and charges imposed by other States, government services at standards not appreciably different from the standards of government services provided by the other States; … taking account of: differences in the capacities of States to raise revenues; and differences in the amounts required to be expended by the States in providing comparable government services.*[6]

Relativities: The per person share of funding is expressed as a 'relativity'. If all states had the same fiscal capacity, each would have a relativity of 1 and receive the same funds per person. Because their needs are different, fiscally stronger states have a relativity below 1 (and receive less than the average funding per person), and fiscally weaker states have a relativity above 1 (and receive more than the average funding per person).

The Commission's recommendations provided revenue to all states, not just the fiscally weaker states. While all states benefited from this change, from this point, the allocation to the states also became 'zero-sum'.[7] As with previous general revenue grants, all funds would be untied, meaning states could use the grants for any purpose.

In 1981 and 1982, the Commission established the methodology that it broadly follows today.

In 1989, the Commission adopted a 5-yearly methodology review. Assessments of state needs for spending and capacity to raise revenue would be updated annually with the latest data. This practice continues today with the Commission currently undertaking its 2025 Methodology Review.

6 *States (Personal Income Tax Sharing) Amendment Act 1978* (Cth).
7 With self-government in the Northern Territory (1978) and the ACT (1989) these jurisdictions were also included in the Commission's deliberations.

From 2000: distributing the GST

The GST was introduced in 2000. The 1999 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations specified that the GST revenue raised from goods and services purchased would be provided to the states on an equalisation basis. The Commission's role did not change, with it continuing to assess state revenues and expenses and recommend relativities for distributing the new pool of funding.

In March 2004, a Ministerial Council initiated a review of the Commission's methods, conducted by the Heads of Treasuries. It found a need for simpler methods, and this led to the Commission's 2010 Review focussing on reducing the number of assessments and improving data quality. The Commission also adopted a simpler approach to assessing state capital requirements.

Equalisation objective and supporting principles

The Commission's approach to equalisation is based on the concept of financial need, with the broad objective of putting all states on a level footing in terms of their ability to provide government services without having to impose higher tax rates. Successive Commissions have sought to express this objective in different ways to enhance clarity. However, the essence of what the Commission seeks to achieve has not changed. Most recently, it articulated the equalisation objective as:

> *Australia gives effect to horizontal fiscal equalisation by distributing the GST pool to states to ensure that each has a similar fiscal capacity, under average policies and efficiency, to provide services and associated infrastructure to its citizens.*[8]

The supporting principles informing the Commission's decisions have developed over time and stem from its earliest work. These principles aim to:

- comprehensively account for state government activities — that is, consider **what states do**
- minimise the influence of a state's policy choices on its grant allocation, and minimise the effect of assessments on policy choices — ensuring **policy neutrality**
- provide advice relevant to the year of grant distribution, but as much as possible using recent statistical information — to achieve **contemporaneity**
- use the best available data to measure fiscal capacities as simply and reliably as possible — summed up in the **practicality** supporting principle.

In 2018, the Commonwealth legislated a new way to distribute GST revenue amongst the states. A key part of the new approach is to ensure that no state's per person share of GST revenue can fall below a minimum level. The Commission's *Occasional Paper #4 - New arrangements for distributing GST* provides more information.

8 Commonwealth Grants Commission (CGC), GST Revenue Sharing Relativities 2023 Update, CGC, Australian Government, 2023.

Conclusion

The intent of equalisation is to put all Australian states on a similar fiscal footing, enabling them to provide similar services to their residents. The challenge is how to achieve this, particularly given the diversity of Australia's states in terms of revenue capacity, geography and demography.

Other countries have various approaches to achieving this goal. Australia stands out as having a distinctive model, particularly in the existence of an independent, expert body and the comprehensiveness with which it has pursued equalisation. Other notable features of Australia's approach include the reliance on data and other evidence, and the Commission's close partnership with states in determining the methodology for distributing general revenue assistance.

Over the past 90 years, the Commonwealth Grants Commission's methodology has evolved, building on the work of successive commissions. The early commitment to addressing financial need and reducing fiscal differences, while maintaining policy neutrality has remained. The use of relativities to encapsulate the different needs of states has also endured since the 1980s, as has the critical feature of impartiality and transparency, so states can be confident of a fair process and robust methods.

Changing Times: Then and Now

Throughout its history, the Commission has adapted its approach. Changes can be seen in the shift from formal, quasi-judicial proceedings to more informal arrangements, with changes to data availability and technology also affecting day-to-day operations.

THEN: Early Commissions adopted a quasi-judicial approach to their work. During this time, Members held hearings and called upon 'witnesses' who provided sworn testimony. Members often travelled to states to hear evidence and undertake site inspections. The Commission's reports were often technical in nature and not accessible to the average reader.

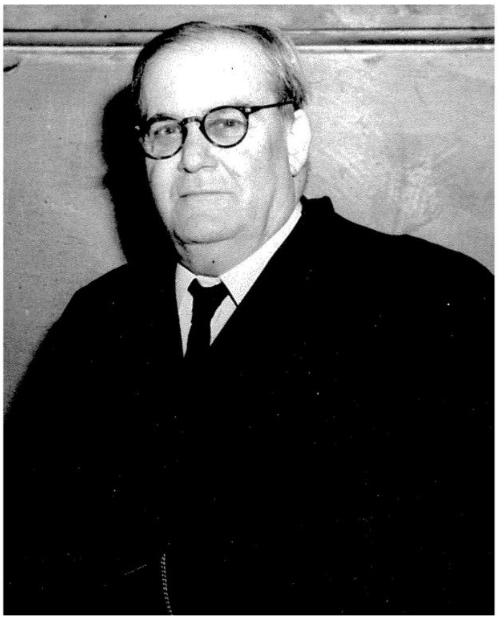
NOW: During the 1993 Review, formal hearings and the swearing in of witnesses was abandoned and replaced with less formal interactions. Today, the Commission seeks to maintain continuous and open dialogue with states, whilst also providing the opportunity for written submissions on consultation issues. The Commission no longer conducts site inspections, preferring to hear from central agency officials about the circumstances affecting state budgets. The Commission also focuses on improving accessibility of the materials it produces, so that a broader range of people can understand its deliberations and recommendations.

THEN: The first meeting of the Commission was in Melbourne in July 1933. In July 1934, the first report was handed, incomplete, to the Governor-General in Canberra by all 3 Members, having been prepared on a ship while returning from 'hearings' in Western Australia.

NOW: The Commission's reports are completed in the agency's offices, and meetings with states are mostly conducted remotely. In addition, electronic copies of reports are presented to the Australian Government, with state Governments usually able to access the reports at the same time as the Commonwealth.

THEN: The first Commission under the leadership of The Hon Sir Fredrick Eggleston comprised 3 men.

NOW: The first female Commissioner, Hilda Rolfe, was appointed in 1999. Three of the 4 current Commissioners are women.



Sir Frederick Eggleston (1875-1954), first Chairman of the Commission

The Commission and Secretary, along with Commission staff, celebrate the 90th anniversary of the Commission

From left to right: Mr Mike Callaghan AM PSM (Chairperson), Professor Anne Tiernan (Member), Dr Lynne Williams AM (Member), Mr Jonathan Rollings (Secretary) and Dr Angela Jackson (Member)

Boarding a ship for inspections in Swansea, Tasmania (March 1956)

The Commission and Secretary, along with Commission staff (online) meet with officials during the state visit to the Northern Territory as part of the 2025 Review

Inspecting a mine in Wittenoom Gorge, Pilbara, WA (June 1963)

'Is she boiling?' Car breaks down near Morawa, WA during a state visit (1953)