




Australian Government  
Commonwealth Grants Commission

# 2025 Methodology Review

Flexibility to consider method  
changes between reviews

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## Introduction

- 1 Clause 6 of the terms of reference for the 2025 Review asks the Commission to:  
...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 In advancing this aspect of the 2025 Review, the Commission is seeking the views of states and territories (states) on the issues, including the objective, advantages and any challenges arising from changes to assessment methods between reviews. In preparing this paper, the Commission canvassed each state on the issues that should be covered.

## Current situation

- 3 Since 1988, the Commission has been asked to review its assessment methods about every 5 years. Those assessment methods seek to capture, as accurately as possible, states' relative fiscal capacities as the starting point for determining the GST distribution.
- 4 In between method reviews, the Commission has been asked to update its recommendations annually using the latest available data.<sup>1</sup> Annual updates aim to capture changes in state fiscal circumstances over time, and to ensure recommended relativities are appropriate for the year in which they are used to distribute GST revenue.<sup>2</sup>
- 5 Terms of reference for updates, while asking the Commission to use the latest available data, have required it to use 'the same principles, categories and methods of assessment' as the most recent methodology review.<sup>3</sup> However, they have allowed the Commission to change its methods between reviews in the following circumstances.
  - 'If data problems arise, subject to consultation with the states, the Commission should proceed on the basis that...if overcoming the data problems necessitated method changes, revised methods would be used in the first possible update,

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<sup>1</sup> Updated data have included the size and composition of populations, budget revenues and expenditure, revenue bases, data on use and cost of services, and Commonwealth payments.

<sup>2</sup> Terms of reference ask the Commission to provide relativities for distributing GST revenue in a future financial year (the application year). In its position paper on fiscal equalisation, supporting principles and assessment guidelines, the Commission said it would continue to base its recommendations on a 3-year lagged moving average since this approach provided an appropriate balance between contemporaneity, predictability and smoothing the impact of fiscal shocks.

<sup>3</sup> Update terms of reference typically ask the Commission to use the same principles, categories and methods of assessment as the *previous update* to accommodate the limited circumstances in which method changes have been made in updates since the most recent review. These circumstances are set out in paragraphs 5 and 6.

subject to consultation with the states during that update.’ (clause 8(b), 2023 Update Terms of Reference).<sup>4</sup>

- ‘The Commission should consult the Commonwealth and the states before deciding on any changes in methods that arise as a result of a significant change in arrangements which govern Commonwealth-state relations and which are considered appropriate for the Commission to fulfil its obligations in respect of these terms of reference.’ (clause 10, 2023 Update terms of reference).<sup>5</sup>

- 6 In some cases, the terms of reference for an annual update have asked the Commission to change (or consider a change to) a particular method.<sup>6</sup>
- 7 The 5-yearly methodology reviews provide the opportunity to ensure methods appropriately capture changes in ‘what states do’. The focus is on what states are doing at the time of the review.
- 8 In a few cases, however, where future changes in what states do or their circumstances are foreseeable, the Commission has incorporated flexibility in its assessment method. For example, in the 2020 Review the Commission said it would monitor the materiality of the mineral groups in the mining revenue assessment and, in the event another mineral became material or one of the material minerals became immaterial, it would ‘exercise its judgment on whether equalisation would be improved by changing the structure of the assessment’. In its 2025 Review consultation paper on motor taxes, the Commission has proposed to monitor the materiality of a separate assessment of electric vehicle charges and to introduce a separate assessment, in consultation with states, if it becomes material.

## **A case for greater flexibility to consider alternative assessment methods**

- 9 The Commission aims to devise methods that will capture states’ fiscal circumstances as they evolve, for example, revenue assessments based on the actual level of taxable activity.<sup>7</sup> However, not all changes in circumstances can be anticipated when the Commission is finalising a review. In some cases, likely changes can be anticipated but an appropriate assessment method cannot be settled during

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<sup>4</sup> The Honourable Jim Chalmers MP, *Terms of Reference for the 2023 Update of GST Revenue Sharing Relativities: Commonwealth Grants Commission Act 1973*, clause 8(b) [letter], The Department of the Treasury, Canberra, 2023. For example, in the 2023 Update the Commission made an adjustment to its assessment of wage costs to minimise any bias due to COVID-19 lockdowns.

<sup>5</sup> 2023 *Terms of Reference*, clause 10. For example, in the 2013 Update the Commission changed its treatment of Commonwealth payments for specialist disability services for older people in response to the Commonwealth assuming funding and policy responsibility for all aged care services under the National Partnership Agreement on Transition Responsibilities for Aged Care and Disability Services.

<sup>6</sup> For example, terms of reference for the 2011 Update asked the Commission not to move iron ore fines between mineral groups in its mining revenue assessment in response to removal of a concessional royalty rate by Western Australia. Terms of reference for the 2005 Update asked the Commission to review its assessment of the Northern Territory’s debt charges and depreciation needs.

<sup>7</sup> Another example is the capacity to change mineral groups in the 2020 Review mining revenue assessment in response to changes in value of production.

the review. For example, this may be due to uncertainties in identifying reliable data sources to support a differential assessment.

- 10 'Locking in' methods between reviews can compromise the Commission's ability to determine states' relative fiscal capacities if there are major developments that significantly affect those capacities which are not adequately captured by the existing assessment methods.
- 11 Two major developments since the 2020 Review illustrate the limitations inherent in the requirement to use the same methods in updates. In these examples, using the 2020 Review methods produced (or could have produced) measures of state fiscal capacities that were inappropriate and adjusting those methods could have improved the assessment of states relative fiscal capacities.<sup>8</sup>
- 12 The COVID-19 pandemic resulted in major changes to state spending including on health and business support. In the 2021, 2022 and 2023 updates, the Commission said these changes were driven by state circumstances that were not fully reflected in the design of the Commission's health and business support assessments in the 2020 Review. However, the terms of reference for the annual updates required the Commission to use the assessment methods from the 2020 Review.
- 13 A proposal by New South Wales in 2021 to replace stamp duty on conveyances with a new property tax had the potential to result in a large increase in its value of property transactions (known as an 'elasticity effect'). If the large elasticity effect eventuated, the Commission's existing assessment method would have significantly overstated New South Wales' capacity to raise stamp duty on conveyances. The potentially large GST impact could have impeded the proposed reform, contrary to the Commission's policy neutrality supporting principle.<sup>9</sup> While the extent of any elasticity effect may have taken several years to emerge, New South Wales sought assurance, prior to proceeding with the reform, that the Commission would seek to mitigate any unintended GST impact if and when it was able to do so.
- 14 The advantages of flexibility for the Commission to consider method changes, in consultation with states, to ensure its assessment remain as appropriate as possible in the face of significant changes in circumstances, have been previously recognised. In November 1994, the Commission and states agreed on a set of Update Guidelines that specified the circumstances in which the Commission could make changes to assessment methods in updates, in consultation with states. These included circumstances where there had been major changes in Commonwealth-state financial relations (including transferred functions), where data previously used were no longer available, where there were new or better data not previously considered,

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<sup>8</sup> New South Wales' proposed property tax reform did not proceed in its original form.

<sup>9</sup> Policy neutrality implies that a state's policy choices should not directly influence its GST share, and that the Commission's assessments should not create incentives or disincentives for a state to choose one policy over another.

or to accommodate other budget developments such as the abolition of existing state taxes or the introduction of new ones. During the 1990s and 2000s several method changes were made in accordance with the Update Guidelines. Over time, some of the elements of the Update Guidelines were incorporated into update terms of reference.

- 15 The experience since the 2020 Review, with the COVID-19 pandemic and New South Wales' proposed property tax reform, suggests there may be a case for the Commission to have greater flexibility to change methods between reviews in very limited circumstances.

## **In what circumstances could alternative assessment methods be considered?**

- 16 Clause 6 of the terms of reference asks the Commission to consider the case for flexibility to change methods between reviews 'where there is a significant unanticipated shock (such as a pandemic) or where major policy changes are enacted between reviews.' These examples reflect the experience since the 2020 Review. But the case for greater flexibility to change methods is not limited to a repeat of the specific events of the past few years.
- 17 There are several scenarios that may fall within the scope of clause 6. While recent experiences, including the COVID-19 pandemic, are examples, the unanticipated nature of such events or 'shocks' make them difficult to predict and, therefore, to define. In essence, the possible scenarios supporting a method change between reviews would involve a major unexpected event that both:
- has a significant differential effect on one or more state's relative fiscal position
  - results in an existing assessment method or methods no longer appropriately measuring states' revenue raising capacities and/or the relative costs of providing services.
- 18 While not an exhaustive list, examples of circumstances in which it may be appropriate for the Commission to have greater flexibility to change assessment methods include the following.
- A major external shock, such as a biosecurity event, impacting one or a few states could result in significant changes to relative spending needs, for example on measures to contain and control the spread of a disease, preventative public health and support for affected industries, in ways not contemplated by existing assessment methods.
  - Major policy changes to state taxes or service delivery, and their effects on fiscal capacities, may not be captured in existing assessments, particularly where these were not anticipated at the time of the review. To the extent that the existing methods overestimated a state's relative fiscal capacity, they could act as an impediment to the policy change and would be inconsistent with policy neutrality.

- To provide states with certainty when implementing major policy changes. Knowing in advance that the Commission had the flexibility to change methods if needed could give states the confidence to embark on policy changes without the concern that their GST share could be unreasonably impacted. For example, if a state sought to replace stamp duty with a broad-based property tax and that change was likely to have material effects on its GST share, it may be more confident to proceed with the policy change if it knew the Commission could seek to identify and mitigate those effects, in consultation with states.
- 19 While it is difficult to predict how often such events may occur, the Commission expects there would be very limited circumstances where a change in assessment methods between reviews would be required. The Commission would not expect to be frequently proposing changes to assessment methods between reviews.
- 20 Defining what constitutes a significant unanticipated shock or major policy reform that would lead the Commission to consider changing assessment methods is difficult, particularly without first knowing the fiscal impact of the individual events. Such events may be large in terms of size or social consequences but have limited impact on states' relative fiscal capacities. Equally, events may have large fiscal impacts but be localised or have limited social consequences.
- 21 Attempting to define in detail the specific circumstances when a major event supports a change in methods may prove too restrictive given the inherently uncertain nature of 'shocks' and would run counter to the objective of introducing flexibility to respond to the unexpected. The Commission's preliminary view is that the need to consider alternative assessment methods between reviews would only arise in very limited circumstances, and that determining whether an event warrants consideration of alternative assessment methods would involve an element of judgment that would best be exercised in consultation with states once the event is observed.

## Key issues raised by states

- 22 In preparing this paper, the Commission canvassed each state on the issues that should be covered. States raised several challenges with implementing method changes between reviews including scope, stability in methods, resource constraints, the need for time for consultation, as well as availability and timeliness of data.

### Scope

- 23 Some states questioned how a significant shock or major policy reform could be defined, but also acknowledged the difficulty of doing this in a way that did not exclude the very types of situations where an alternative assessment method might be appropriate. The potential for a materiality threshold was also suggested, although some states noted the problems in determining a suitable threshold and



the limitations it could introduce.<sup>10</sup> One state said scenario planning may assist in the development of methods which could respond to shocks.

## Stability of methods and resource constraints

- 24 Restricting method changes mainly to reviews has generally ensured stability of methods across updates and, where there are no significant changes in circumstances, a degree of predictability in states' GST distributions. While states, in producing GST projections, face the challenges inherent in all forecasting (particularly where outcomes depend on developments in other states and economic developments), stability of methods provides a basis for understanding how data inputs will affect their GST shares. More predictable GST outcomes may also facilitate state budget planning.
- 25 The decision to limit changes in updates to data rather than methods, also contributes to manageable workloads for the Commission and states. Indeed, the move from 3-yearly to 5-yearly method reviews with annual updates was intended to reduce the significant workloads associated with reviews for the Commission and states, while allowing the relativities to respond to changes that differentially affect states' fiscal capacities.<sup>11</sup>
- 26 Some states raised concerns around the need for ongoing staff within state agencies to facilitate consultation. During a review, it is common for states to stand up teams to manage consultation with the Commission.
- 27 As mentioned above, the Commission considers that the need to consider alternative assessment methods between reviews would only arise in very limited circumstances. Given this, concerns relating to stability and resourcing should be largely mitigated. In addition, the trade-off between the benefits of introducing more appropriate assessments of fiscal capacities in response to a major shock, against the resource requirements states may face in consulting on a change in methods, needs to be considered.

## Timeliness of data and identification of new methods

- 28 Some states were concerned about the availability of reliable data and robustness of methods when implementing changes to existing methods or developing new methods. While short-term or temporary shocks could have a large impact on state fiscal capacities, reliable data may not be available in a timely manner to facilitate consideration of method changes. However, a method change may not be introduced

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<sup>10</sup> In this context, a materiality threshold was proposed as a 'trigger' for determining if an event was large enough to investigate further. This is separate to the existing materiality thresholds, which would be applied as part of the assessment guidelines to any alternative methods being considered, as outlined in the subsequent section 'How could the Commission implement a change in method?'

<sup>11</sup> The change was suggested by the Commission in its 1988 Review and adopted by the Premiers' Conference on 12 May 1988.

in the year that a shock occurs. It may take a number of years before an alternative method, supported by reliable data, is identified. Some states noted that, depending on where in the 5-yearly review cycle the shock occurs, a method change may not be implemented until the subsequent review. While this may be the case in some circumstances, there may be others where a more appropriate assessment method could be introduced before the next 5-year review.

- 29 Even where a significant development may warrant a change to assessment methods between reviews, developing robust alternative methods could be challenging. It is possible that, despite best endeavours, a reliable alternative might not be able to be developed. In these situations, the Commission may retain the existing assessment method or move to an equal per capita assessment of the revenue or expenditure so that the method does not impact GST distribution.

## How could the Commission implement a change in method?

- 30 As a first step, the Commission would consult with states on whether a major unexpected event or policy change indicated that existing assessment methods were no longer appropriate, and whether alternative assessment method or methods should be investigated.
- 31 Depending on whether a change in assessment methods could be appropriate, the Commission would consider alternative methods in the same way as it does in a method review. Consultation with the states would be a fundamental prerequisite for any change. The Commission would apply its supporting principles and assessment guidelines.<sup>12</sup> That is, there would need to be a sound conceptual case for the change supported by sufficient empirical evidence, the Commission would need to identify a reliable and implementable method and fit for purpose data and any change would have to be material.<sup>13</sup> The Commission would exercise its judgment to balance any trade-offs between its supporting principles.
- 32 If an appropriate alternative method was able to be developed, the Commission would aim to make the change in the earliest practicable update following consultation. This may not be the first update following the change in circumstances, given the availability of reliable data and the need for adequate time to consult with states.

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<sup>12</sup> See Commission [position paper on fiscal equalisation, supporting principles and assessment guidelines](#).

<sup>13</sup> In the 2025 Review, a revenue or expense driver is material if it redistributes more than \$40 per capita for any state compared to an equal per capita assessment.

## Authority to use alternative methods

- 33 Under existing arrangements, the Commonwealth Treasurer can ask the Commission, through terms of reference, to consider particular method changes in an update. However, this places the Commonwealth Treasurer in the position of 'umpire' on changes, where there will always be winners and losers. The Commission's role is to be the independent agency responsible for making the judgements necessary for appropriately determining relative state fiscal capacities for the purposes of GST distribution.
- 34 One option would be for the additional flexibility to be provided in standing terms of reference for updates. Terms of reference that currently allow for method changes as a result of a significant change in Commonwealth-state relations could provide a model.

## Preliminary view

- 35 The Commission's preliminary view is that it would be beneficial for there to be additional flexibility to change methods between reviews, in consultation with the states, where there have been significant changes in state fiscal circumstances that result in existing methods not appropriately measuring state fiscal capacities. The Commission's preliminary view is that it may be too restrictive to seek to define, or introduce quantitative measures, as to what constitutes a major event or shock, and ultimately this will require an element of judgement. However, it should be made clear that the expectation is that this flexibility would only be exercised in very limited circumstances.

## Consultation questions

- 36 The Commission welcomes state views on the consultation questions below and any other relevant issues.

- Q1. Do states agree that there may be situations, such as a significant unanticipated shock or major policy reform, such that there is a case to extend the circumstances when the Commission may need to consider alternative methods between reviews?
- Q2. Do states agree that the circumstances supporting the case to extend the Commission's flexibility to change methods between reviews should include:
- major unexpected developments that have a significant impact on state fiscal positions, are not captured in existing assessment methods, and a change in methods is required for the Commission to achieve the objective of fiscal equalisation?
- Q3. Do states agree that any consideration of whether method changes are warranted between reviews be undertaken in consultation with the states and the expectation should be that this flexibility would only be exercised in very limited circumstances?
- Q4. Should the extended flexibility to change assessments between reviews in certain circumstances be operationalised in standing terms of reference for updates?