Australian Government
Commonwealth Grants Commission

# Occasional Paper

## No. 13: Is the GST distribution system too complex?

November 2025

# Acknowledgement of Country

The Commonwealth Grants Commission acknowledges the Traditional Owners of Country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to Elders both past and present.



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# Summary

- The Commonwealth Grants Commission (the Commission) aims to assess states' needs as simply as possible, consistent with its overarching mandate of pursuing horizontal fiscal equalisation.
- There is inherent complexity in a system that assesses the factors that influence each state's main areas of expenditure (such as health, education, transport and justice) and revenue (such as stamp duties on conveyances, mineral royalites and payroll tax, as well as other Commonwealth payments). Adding to complexity is the need to quantify the extent to which these factors are beyond each state's control, rather than driven by policy. This varies with differences in states' economic, social and demographic characteristics.
- Consistent with its mandate, the Commission attempts to assess all material areas of spending and sources of revenue, and capture all important drivers. In consulting with the states, they will often emphasise their specific cost and revenue pressures, irrespective of added complexity.
- There is a trade-off between assessing states' relative fiscal capacities as comprehensively as possible and simplifying assessment methods. Distributing the GST based on simpler methods that overlook differences in fiscal capacities would depart from the objective of horizontal fiscal equalisation.
- The Commission and external reviews have considered how the GST distribution system could be simplified. All have concluded that it is not possible to achieve fundamental simplification that produces results comparable to the best estimates of states' relative fiscal capacities; that is, without significantly compromising the objective of horizontal fiscal equalisation.
- Any significant move to simplify the system would likely need agreement between the Commonwealth and states.
- The Commission actively works with the states and other stakeholders to explain assessments and help increase understanding of the system.

# Is the GST distribution system too complex?

The Commission provides independent advice to the Australian Government on how to share GST revenue among the states and territories (states). The legislation underpinning the GST distribution arrangements directs the Commission to base its recommendations on the goal of providing all states with the fiscal capacity to provide a broadly comparable standard of services to their residents.

This direction stems from the 1999 *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations* — agreed to by the Commonwealth and all states — which stated that the GST revenue would be distributed according to horizontal fiscal equalisation principles.[1] This remains a core feature of the current *Intergovernmental Agreement on Federal Financial Relations*, which came into effect in 2009.[2]

Equalisation has been a core concept for Australia since Federation, with the first Commonwealth special state grant provided in 1910. Historically, Commonwealth and state governments have supported horizontal fiscal equalisation, recognising the role it plays in helping Australians to enjoy a broadly similar standard of government services, regardless of the state they live in.

The Commission aims to make assessment methods as simple as possible in the context of achieving its overarching mandate of pursuing horizontal fiscal equalisation.

## *There is inherent complexity in distributing GST based on horizontal fiscal equalisation*

The Commission measures all states' relative fiscal capacities to meet its overarching horizontal fiscal equalisation objective. This task is not simple, as state economies and budgets are diverse and complex.

Each state has unique expense needs and differing revenue sources. The Commission identifies the circumstances outside the control of a state that affect its costs of providing services and its ability to raise revenue.

The Commission considers the non-policy factors that influence each state's expenditure (for example, on health, education, transport and justice) and its primary sources of revenue (for example, stamp duties on conveyances, mineral royalties and payroll tax, as well as non-GST Commonwealth payments). The economic, geographic, social and demographic characteristics of each state vary substantially. They represent significant non-policy drivers of expense needs and revenue capacity.

For many state spending responsibilities, it requires the calculation of national average spending levels on key socio-demographic groups. For other areas of spending, such as urban transport and roads, national average spending levels need to be calculated for the key economic and geographic features of states that drive spending in these areas.[3] For revenue, this requires the calculation of national average tax rates and policy-neutral estimates of tax bases for major state revenue sources.

[1] Council on Federal Financial Relations, Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, Federal Financial Relations, 1999, accessed 25 November 2025.

[2] Council on Federal Financial Relations, Intergovernmental Agreement on Federal Financial Relations, Federal Financial Relations, 2009, accessed 25 November 2025.

[3] For information on how the Commission calculates national average tax rates and spending levels see: Commission's Assessment Methodology.

Over time, new state expenses and revenue sources have become relevant to the assessment of GST needs. In other cases, new data have enabled more precise estimates of relative fiscal capacities. For example, in the 2025 Methodology Review the Commission added new assessments for state spending on COVID-19 health and business support. Improvements to data on the use of state community mental health services allowed the Commission to more accurately assess states' mental health expense needs.

In making evidence-based, comparable assessments, the Commission must overcome data challenges. Not all assessment areas have high quality data available. To solve data issues, the Commission uses a variety of techniques, including proxies, weighting, discounting and econometric regressions. The Commission develops these approaches in consultation with the states, primarily through its methodology reviews. As part of this consultation, states propose and support complex approaches when they consider this represents a more comprehensive picture of their specific GST needs.[4]

The Commission's goal is to achieve equalisation in the 'application year' (the financial year following its recommendations). It forgoes some contemporaneity and bases its recommendations on states' fiscal capacities averaged over the previous 3 years of data. This introduces further complexity but comes with the benefit of a more stable assessment of states' relative fiscal capacities. It also improves robustness by incorporating data revisions as they become available.

The *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*, introduced new steps and complexity into the GST distribution system. The Commission now calculates:

- assessed relativities, based on state fiscal capacities
- standard state relativities, ensuring no state's relativity is lower than that of the fiscally stronger of New South Wales and Victoria, or below a floor of 0.75[5], and
- no worse off relativities, based on states not being cumulatively worse off than under the previous arrangements.

## *How does the Commission pursue simplicity?*

The Commission aims to have assessment methods that are as simple as possible, while retaining a focus on its primary mandate of horizontal fiscal equalisation.

Simplicity is put into practice primarily through the application of a 'materiality' threshold, where assessments with an impact on GST per capita distribution below the threshold are excluded because they will have limited influence on the pursuit of horizontal fiscal equalisation. The Commission regularly reviews this threshold and last increased it to $40 per capita for any state as part of the 2025 Methodology Review.

The Commission has developed a set of supporting principles to guide the design and evaluation of assessment methods:

- 'What states do' — the Commission's methods should, as far as possible, reflect what states collectively do, not what they could or should do.
- Policy neutrality — a state's policy choices (in relation to the revenue it raises or the services it provides) should not directly influence its GST share, and the Commission's assessments should not create incentives to choose one policy over another.

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[4] "...States and Territories themselves have often sought greater complexity in order to capture their special circumstances", ACT Government, ACT Government response to the Productivity Commission Draft Report on Horizontal Fiscal Equalisation, Productivity Inquiry into Horizontal Fiscal Equalisation, 2017, p 9, accessed 25 November 2025.

[5] There was a 6-year transition to distributing GST revenue based on standard state relativities. During this period there was additional complexity resulting from the blending of assessed and standard state relativities and the application of the GST relativity floor.

- Practicality — assessments should be based on sound and reliable data and methods and should be as simple as possible, while capturing the major influences on state expenses and revenue.
- Contemporaneity — to the extent reliable data will allow, the distribution of GST in a year should reflect state circumstances in that year.[6]

The concept of simplicity is a key feature of the practicality principle and is actively factored in by the Commission when considering method changes. The Commission considers whether added complexity to an assessment method justifies possible benefits to horizontal fiscal equalisation. For example, in the 2025 Methodology Review, the Commission was not satisfied that the additional complexity and uncertainty of introducing elasticity adjustments to revenue assessments would sufficiently enhance horizontal fiscal equalisation at that time. Noting the importance of policy neutrality, the Commission instead committed to further investigate elasticities as part of its forward work program.

The trade-off between comprehensively assessing relative fiscal capacities and simplifying assessment methods presents challenges for the Commission. As the practicality principle is subsidiary to the objective of horizontal fiscal equalisation, the Commission faces constraints when a simpler method does not effectively capture differences in states' relative fiscal capacities. The Commission continues to review assessments to see if they can be simplified. For example, as part of its forward work program, the Commission will consider whether the health assessment can be simplified and any associated trade-offs that are identified.

## *Should the GST distribution system be further simplified and how?*

The challenge with a complex system was articulated by the Productivity Commission in its 2018 Inquiry Report on Horizontal Fiscal Equalisation:

> Complexity may not be a problem in and of itself — as participants have noted, there are many aspects of public policy that are complex — but an overly complex system can adversely affect both the understanding of the system broadly and the way in which decisions are made.[7]

Over the decades, several states and stakeholders have expressed similar sentiments.

Since the adoption of a comprehensive system of horizontal fiscal equalisation in the late 1970s stakeholders have been conscious of the importance of limiting complexity in the equalisation arrangements (Box 1).

The Commission's most recent exploration of options for significant simplification was in the 2020 Methodology Review. The Commission considered a variety of options for broader assessment methods for expenditure requirements and revenue capacity. These included using a subset of the existing expense assessments; using a subset of socio-economic drivers to assess expenditure needs; and considering a global measure, such as Gross State Product, to approximate states' revenue raising capacities. In each case the Commission found they did not sufficiently account for the specific circumstances affecting each state's expenditure needs or revenue raising capacity. Other than a further increase to the materiality threshold, the Commission concluded it was difficult to find alternatives that were simpler and still consistent with the fiscal equalisation objective.[8]

[6] Further information on the Commission's supporting principles can be found in: Fiscal equalisation, supporting principles and assessment guidelines.
[7] Productivity Commission, Horizontal Fiscal Equalisation, Report no. 88, 2018, p 170, accessed 25 November 2025
[8] Commonwealth Grants Commission, A broader assessment approach, Australian Government, 2018, accessed 25 November 2025

A complex system can adversely affect understanding of the system. Recognising this, the Commission actively works with the states and other stakeholders to explain its assessments to improve familiarity and understanding. For example, over the past 5 years the Commission has introduced its Occasional Paper and Research Paper series. These papers provide non-technical information on the Commission's work and aspects of the distribution of GST. The Commission has made other efforts to explain its work more effectively and works closely with the states and other stakeholders to provide training and address queries.

Helping to improve stakeholder understanding of the system has the benefit of reducing some of the issues caused by complexity without a corresponding reduction in fiscal equalisation. In that regard, the Commission considers that one of its key responsibilities is to work closely and openly with states to aid their understanding of its assessment methods, including by providing greater access to the relevant data and calculations that underpin those assessments.

# Conclusion

Equalisation has been a core concept for Australia in one form or another since Federation. The first Commonwealth special state grant was provided in 1910, with subsequent grants leading to the Commonwealth establishing the Commission in 1933. Since then, successive Commonwealth and state governments have supported horizontal fiscal equalisation, recognising the role it plays in supporting Australians' access to a broadly similar standard of government services. This approach to horizontal fiscal equalisation principles has been embedded in the Commission's enabling legislation and the GST distribution arrangements.

To meet its legislative requirements and overarching mandate, the Commission measures states' relative fiscal capacities by assessing all their diverse areas of spending and sources of revenue, and by capturing all important drivers. In doing this, the Commission has regard to a range of economic, demographic and geographic characteristics to help it assess relative fiscal capacities comprehensively.

The Commission aims to have assessment methods that are as simple as possible, consistent with the overarching mandate of pursing horizontal fiscal equalisation. However, there is a trade-off between the comprehensiveness of measuring fiscal capacity and the simplicity of assessment methods.

Given the implications that significant simplification would have for the calculation of states' relative fiscal capacities, major changes would likely need agreement between the Commonwealth and states.

The Commission remains committed to implementing its mandate and using the practicality principle to reduce complexity in its assessments where possible. The Commission will also continue its focus on improving stakeholders' understanding of the system and communicating its methods and decisions to different audiences.

## Box 1: Evolution of fiscal equalisation and complexity

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| **A systematic approach to revenue sharing for all states was introduced in the late 1970s.** | In 1978, the Commission's role was broadened, and a dedicated pool of funds was to be shared between the states through 'relativities' to be determined by the Commission based on equalisation principles.<br><br>The need to assess states' relative fiscal capacities necessitated more rigorous assessment methods, with a corresponding increase in the complexity of the system. |
| **The 1999 *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* specified that the GST revenue would be provided to the states on an equalisation basis.** | The Commission's role did not change, however in March 2004, a Ministerial Council initiated a review of the Commission's methods, conducted by the Heads of Treasuries, which found a need for simpler methods. |
| **The terms of reference for the 2010 Methodology Review said assessments should be aggregated or eliminated, with a materiality threshold applied to current and future assessments.** | In response, the Commission:<br>• reduced revenue assessments from 21 categories to 8<br>• reduced expense assessments from 39 categories to 14<br>• reduced drivers of need from 344 to 93<br>• introduced materiality thresholds for the inclusion of categories and drivers of need. |
| **Simplicity was a key consideration of both the 2012 GST Distribution Review and the 2018 Productivity Commission Inquiry.** | Both reviews concluded that it was not possible to achieve fundamental simplification that produced comparable results to the best estimates of states' relative fiscal capacities.<br><br>The GST Distribution Review recommended the adoption of additional materiality thresholds to reduce the number of assessments.<br><br>The Productivity Commission Inquiry recommended the Commission 'should provide a strong neutral voice, to facilitate a better-informed public discourse on the horizontal fiscal equalisation system'. |
| **In the 2020 Methodology Review, the Commission explored options for significantly simplifying the assessment of revenue capacity and spending needs.** | It concluded it was difficult to find alternatives that are simpler and still consistent with what states do and the fiscal equalisation objective.<br><br>Instead, the materiality threshold was increased. |