The 2018 GST distribution ‘reforms’ – the Worst Public Policy Decision of the 21st Century Thus Far

A submission to the Productivity Commission’s enquiry into GST distribution reforms

by

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Executive Summary

- One of the things that has made Australia a fairer, and thus 'better', country than others with federal systems of government is that the quality of schooling which children get, the quality of health care which families get, or the quality of policing and environmental protection which communities get doesn't depend on the state or territory which people happen to live in nearly as much as it does in other federations (in particular, the United States).
- Australians tend to take this dimension of 'fairness' somewhat for granted. But it is in fact the result of conscious efforts by successive governments of both major political parties, over nine decades, to ensure that state (and since the 1980s, territory) governments have a similar capacity to provide public services to their respective populations whilst levying on them similar levels of taxes and charges.
- The principle vehicle for achieving that objective has been via the distribution of 'untied' grants from the Federal Government to the states and territories (the total of which has, since 2000, been equal to the revenue generated by the Federal Government's goods and services tax) such that those states and territories where the 'need' for public services is relatively greater, or the 'unit cost' of providing them is relatively higher, or the revenue generated by given rates of state taxes and other charges is relatively lower, than the corresponding averages for all states and territories receive more financial assistance per head of population than they would if those grants were distributed on an equal-per-capita basis (and conversely, those states or territories where the need for or cost of providing services is relatively lower, or the revenue generated by average rates of taxes and charges is relatively higher, receive less per head of population than they would have done under an equal-per-capita distribution).
- This long-standing practice is known as 'horizontal fiscal equalization', and it is something which Australia has long taken further than other democracies with federal systems of government – although it implicitly mirrors the way that national governments in countries with unitary systems of government would allocate their spending geographically.
- The 2018 changes to the principles governing the distribution of revenue from the GST among the states and territories represent a fundamental assault on the concept of 'horizontal fiscal equalization'. If maintained – and especially if the so-called 'No Worse Off guarantee' (that the Federal Government will 'top up' the 'pool' of GST revenue so as to ensure that no state or territory will receive less than it would have done had the 2018 changes not been made) is allowed to expire at the end of the 2030-31 financial year, as currently envisaged – the 2018 changes will ultimately result in the residents of Australia's richest state, Western Australia, enjoying better public services whilst paying lower state taxes and charges than other Australians. That would represent a major break with traditional Australian notions of 'fairness'.

- In the short term, the 2018 changes have allowed the Western Australian Government to run successive budget surpluses, whilst the governments of the other states and territories, and in all but two of the financial years since then the Federal Government, have run successive budget deficits – not because successive Western Australian governments have been more disciplined or prudent in their spending, but because the 2018 legislation has resulted in WA receiving $20.3 billion more, between 2018-19 and 2024-25, by way of GST revenue than it would otherwise have received, and prospectively another $22.5 billion more than it would otherwise have received between 2025-26 and 2028-29. That's almost $43 billion in 'excess' GST revenue, over a period in which the WA Government also reaped $105 billion in mineral royalty revenues.

- By 2030-31 the cost to the Federal Budget of the 2018 changes will almost certainly have exceeded $50 billion, and will likely be approaching $60 billion. When compared with the original estimate of the cost to the Federal Budget when these changes were legislated, of $9 billion over eight years, this represents the biggest 'blow-out' in the cost of any single Federal policy decision, ever, with the possible exception of the National Disability Insurance Scheme.

- The arguments advanced by successive Western Australian Governments in support and defence of the 2018 changes have been utterly specious:

  - the GST is not a "state tax", it is collected by a Federal agency (the Australian Taxation Office) under a Federal law enacted by the Federal Parliament – and neither the ATO nor anyone else knows how much GST is collected in, or from the residents of, any individual state or territory – so Western Australian assertions that it was "only" getting some low percentage of "its" GST "back" have been completely without any basis;

  - the assertion that Western Australia's share of revenue from the GST would, in the absence of the 2018 changes, have fallen to a low relative to would have obtained under a notional equal-per-capita distribution that would have been 'unprecedented' does not mean, contrary to assertions made by successive WA Governments, that such a result would have been 'unfair', when regard is had to the unprecedented extent to which WA's revenue-raising capacity has exceeded that of every other state and territory over the past two decades;

  - the assertion that Western Australia 'needs' a larger share of GST revenue than it would have obtained in the absence of the 2018 changes in order to fund the infrastructure required by WA's resources sector is completely without foundation, firstly because most of the infrastructure used by WA resources companies has been provided by those companies themselves (in contrast to the infrastructure used by coal mining companies in New South Wales and Queensland), and secondly because infrastructure spending by the WA state public sector represents a smaller proportion of WA's gross state product than that of any other state or territory;

- there is absolutely no evidence to support Western Australia's repeated assertions (also long made by New South Wales and until recently by Victoria) that the pre-2018 system of horizontal fiscal equalization provided 'disincentives' for states and territories to pursue productivity- and growth-enhancing reforms for fear of losing GST revenues: four successive enquiries (including the PC's 2018 inquiry) have not been able to find any evidence for this assertion, and the changes made in 2018 do not appear to have prompted the Western Australian Government to become a leader in implementing economic reforms;
- Western Australia has not been 'deserving' of a bigger share of GST revenue because it has been 'the powerhouse of the Australian economy', as repeatedly asserted by the Western Australian Government: on the contrary, over the past decade (and during the period during which the 2018 changes have been 'phased in'), Western Australia's real gross state product has grown at a slower rate than that of any other state or territory, and in per capita terms Western Australia's gross state product has not grown *at all* over the past decade.

- The Productivity Commission should:
  - conclude that the 2018 changes to the arrangements governing the distribution of revenue from the GST among the states and territories are *not* working 'efficiently, effectively and as intended';
  - recommend that the nexus between revenue from the GST and general revenue assistance to the states and territories should be broken;
  - consider whether it is possible to achieve the broad, long-standing, objective of 'horizontal fiscal equalization' through a more readily comprehensible, transparent and predictable system than the one which has evolved over the past ninety years, using a limited number of widely understood and readily accessible economic, demographic, social and fiscal indicators;
  - and, if so, recommend that such a system be adopted.

Introduction

The Productivity Commission has been asked to conduct an inquiry into the "2018 GST distribution reforms" – the changes made by the Orwellianly-titled *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act* 2018 which altered the long-standing principles governing the distribution of 'untied' financial assistance from the Federal Government to the governments of Australia's states and territories (dating back to the mid-1930s) with a view to increasing the share of that assistance accruing to Western Australia.

I have described this legislation as 'the worst public policy decision of the 21st century thus far' (see, eg, Eslake 2024). Whilst I acknowledge that there are other contenders for such an 'award', I think the "2018 GST distribution reforms" merit it because:

- they relate to **the largest single expenditure program** in the Federal Budget, at over $100 billion per annum (Chalmers and Gallagher 2025a: 119);
- they have resulted in **one of the biggest 'over-runs' in the cost of any single 'policy decision', ever** – from just under $9 billion over eight years when first proposed (Frydenberg 2018: 4 and 18) to (on the most recently available Forward Estimates) in excess of $50 billion over the ten years to 2028-29 (Chalmers and Gallagher 2025b: 64 and equivalent tables in previous issues; and 2025c: 305);
- they have **allowed Western Australia to run a string of budget surpluses** whilst every other state and territory, and the Federal Government in all but two of the years since the changes were made, have run successive deficits – there are **many more worthwhile things which that $50 billion could have been applied to** (including smaller Federal Budget deficits); and
- they have **fundamentally undermined the principle of 'horizontal fiscal equalization'** which, as it had been practiced for almost ninety years prior to the implementation of the changes legislated in 2018, had helped to make Australia a 'better country' than others with federal systems of government.

This submission argues that the Productivity Commission cannot credibly conclude that the present GST distribution system is working "as intended", pursuant to Section 4 of the aforementioned 2018 legislation, given its substantially greater cost to the Federal Budget than originally envisaged.

But it does *not* advocate a return to the pre-2018 system for distributing 'untied' financial assistance from the Federal Government to the states and territories.

Rather, it proposes that the long-standing objective of 'horizontal fiscal equalization' can and should be achieved through a simpler, more readily understandable, and more transparent system, one which will achieve (from the perspective of state and territory governments) more predictable outcomes, than the one which had evolved since the establishment of the Commonwealth Grants Commission in 1933.

The GST as a 'states tax'

When the GST was introduced in 2000, the revenue generated by it was allocated to the States and Territories as a replacement for the financial assistance grants which (under that and other names) the Federal Government had been making to the states since the Federal Government assumed a monopoly of personal and company income tax (as a 'temporary wartime measure') in 1943 and to the territories since they gained self-government in the 1980s[1].

This decision had two consequences, one of them lasting, the other temporary (as it turned out).

First, it meant that the Federal Government no longer had to make a conscious decision as to the amount of [untied] financial assistance it would provide to the states and territories each year. While that eliminated a major recurring source of tension between the Federal Government and its state and territory counterparts, the GST has not turned out to be the 'growth tax' for the states and territories as was envisaged at the time of its introduction. On the contrary, revenue from the GST has declined from 3.8% of GDP in 2002-03 and 2003-04, to less than 3.5% of GST in the 2020s, as consumer spending has shifted towards GST-exempt services.

Moreover, together with the 1994 decision by the Keating Government effectively to abolish the Loan Council, this decision has meant that the Federal Government has no 'levers' to influence the fiscal policies of the states and territories, something which has arguably contributed to the on-going deterioration in the aggregate fiscal position of the states and territories over the past decade.

Second, the Howard Government took the view that the GST was a state, not a federal tax, and therefore excluded the revenue from the GST and the payment of that revenue to the states and territories from the revenue and expenditure sides of the Federal Budget (Costello and Fahey 2000: 4-12, 5-3, 6-64, 8-4 and 8-26).

This treatment was reversed in the 2008-09 Budget (Swan and Tanner 2008: 3-24, 5-26).

The allocation of the revenue from the GST to the states and territories, as required under the *Intergovernmental Agreement on Federal Financial Relations* (2009) and the *Federal Financial Relations Act* (2009), constitutes a significant barrier to wide-ranging tax reform in Australia. No Federal Government is likely to be willing to wear the political odium of raising the rate and/or broadening the base of the GST (as repeatedly recommended by bodies such as the OECD (2023: 44-45) and the IMF (2025)), and the financial burden of compensating up to one-third of the population for the impact on them of doing so, whilst the states and territories reap all of the resulting increase in revenue.

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[1] Those grants had in turn, between the late 1960s and mid-1970s, incorporated the 'special grants' which the Federal Government had been making to Queensland, South Australia, Western Australia and Tasmania since 1910.

The Productivity Commission could, therefore, usefully recommend that the nexus between revenue from the GST and Federal financial assistance to the states and territories should be broken.

A second issue pertaining to the GST which the Commission could usefully address in the context of this inquiry is the perception that specific amounts of GST revenue can be attributed to individual states and territories.

This is a perception that has been repeatedly used by successive Western Australian state governments and their supporters to argue for larger shares of the revenue from the GST. For example, the then Chief Economist (now CEO) of the Chamber of Commerce and Industry in Western Australia recently asserted that "without that deal in 2018, WA would be getting just 18 cents for every dollar we pay in GST" (Morey 2025). Echoing (almost verbatim) that assertion, Western Australian Liberal Senator Dean Smith wrote that "without that reform [sic], WA's relativity for 2025-26 would have been just 0.18 – only 18 cents for every GST dollar raised" (Smith 2025). Assertions such as these have routinely been taken at face value by otherwise disinterested commentators: for example in 2018 the ABC's business editor wrote, "In the aftermath of the resources boom, West Australia's share of the GST fell below 30 cents for every dollar it had collected" (Verrender 2018).

The truth is that nobody knows how much GST is collected in each state or territory. That's because the Australian Tax Office doesn't ask businesses, when completing their Business Activity Statements from which their GST liabilities are ascertained, where their customers and suppliers are located. To do so would impose a very heavy compliance burden on businesses. And even if that data were collected, it wouldn't necessarily provide an accurate answer to the question, "how much GST is collected in state X". For example, when a resident of Victoria purchases wine from a Margaret River winery, should the GST on that purchase be attributed to Victoria, or to Western Australia? If a resident of Perth books a flight to Sydney, should the GST on the purchase price of the ticket be attributed to Western Australia, or to either New South Wales or Queensland (depending on which airline the flight was booked with)?

The assertions made by Western Australian Governments and their supporters implicitly assume that GST is paid on an equal-per-capita basis by the residents of each state and territory. But there is no way of verifying the accuracy or otherwise of that assumption. Moreover, it makes no allowance for the distribution of GST refunds among states and territories. It is highly likely that mining companies based in Western Australia receive substantial refunds of GST paid on their inputs, since they do not collect GST from most of their customers who are located overseas (exports being exempt from GST). Hence if it were possible to assign GST revenues to individual states and territories, it seems plausible that the net amount of GST collected in Western Australia would be less – and perhaps substantially less – as a proportion of the national total than Western Australia's share of Australia's total population.

Hence the Commission could also usefully make it clear that there is in fact no basis for assertions as to what proportion any individual state or territory is 'getting back' by way of its share of revenue from the GST.

The importance of the principle of 'horizontal fiscal equalization'

Until the changes imposed by the 2018 legislation, revenue from the GST – and, prior to the introduction of the GST, financial assistance grants – had been distributed among the states and territories in accordance with a principle known as *horizontal fiscal equalization*. That principle was first spelled out in the Third Report of the Commonwealth Grants Commission (which had been established in 1933, in the aftermath of the Western Australian secession referendum):

> " … 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 found necessary to make it possible for that State by reasonable effort to function at a standard not appreciably below that of other States" (Commonwealth Grants Commission 1936: 75, 1995: 42 and 2023: 5).

This principle was embedded in legislation (the *States (Personal Income Tax Sharing) Amendment Act*) in 1978, which provided that:

> "the respective payments to which the States are entitled under this Act 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 the other States, government services at standards not appreciably different from the standards of the government services provided by the other States; taking account of differences in the capacities of the States to raise revenues; and differences in the amounts required to be expended by the States in providing comparable government services."

And that principle was in turn embedded in the 1999 *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* which provided for the distribution of the revenue from the GST to the states and territories.

Australia has taken the principle of 'horizontal fiscal equalization' further than other nations with federal systems of government (such as the United States, Canada, Germany and Switzerland), partly because the Australian federation is also characterized by a high level of 'vertical fiscal imbalance' – thanks to the way in which the Australian Constitution was originally written, and has subsequently been interpreted by the High Court, so that the Federal Government's has the capacity to raise far more revenue than required to meet its expenditure obligations, while the states and territories have been left in the opposite position – but also partly because of distinctly Australian notions of 'fairness' or 'equity' (Fenna and Phillimore 2025: 3).

In plainer language, it matters far less in Australia which state or territory in which a person happens to reside, as to the quality of schooling his or her children receive, the quality of health care his or her family gets, or the quality of policing and environmental protection his or her community gets, and how much he or she contributes by way of state taxes to the provision of those and other services, than it does in other federations. And that has, in turn, contributed materially to Australia being a 'less unequal' society (in terms of the distribution of income and wealth) than most other countries with federal systems of government (Chancel et al 2025: 63-64 and 86-87).

It is perhaps also worth noting that if Australia were to have a two-tiered system of government (ie, a national government and local governments, without states or territories) like (for example) New Zealand, France or the pre-devolution United Kingdom, it is likely that the spatial pattern of spending and revenue-raising by the national government would be similar to that produced by Australia's system of 'horizontal fiscal equalization'.

That is, if Australia didn't have state and territory governments, it is likely that the national government would spend relatively more on the provision of school education, hospitals, policing and other government services to, and collect relatively less by way of taxation revenue from, people living in relatively poorer parts of Australia – and, conversely, spend relatively less on the provision of government services to, and collect relatively more by way of taxation revenue from, people living in relatively more affluent parts of Australia – producing outcomes similar to those which have resulted from the application of 'horizontal fiscal equalization' in practice.

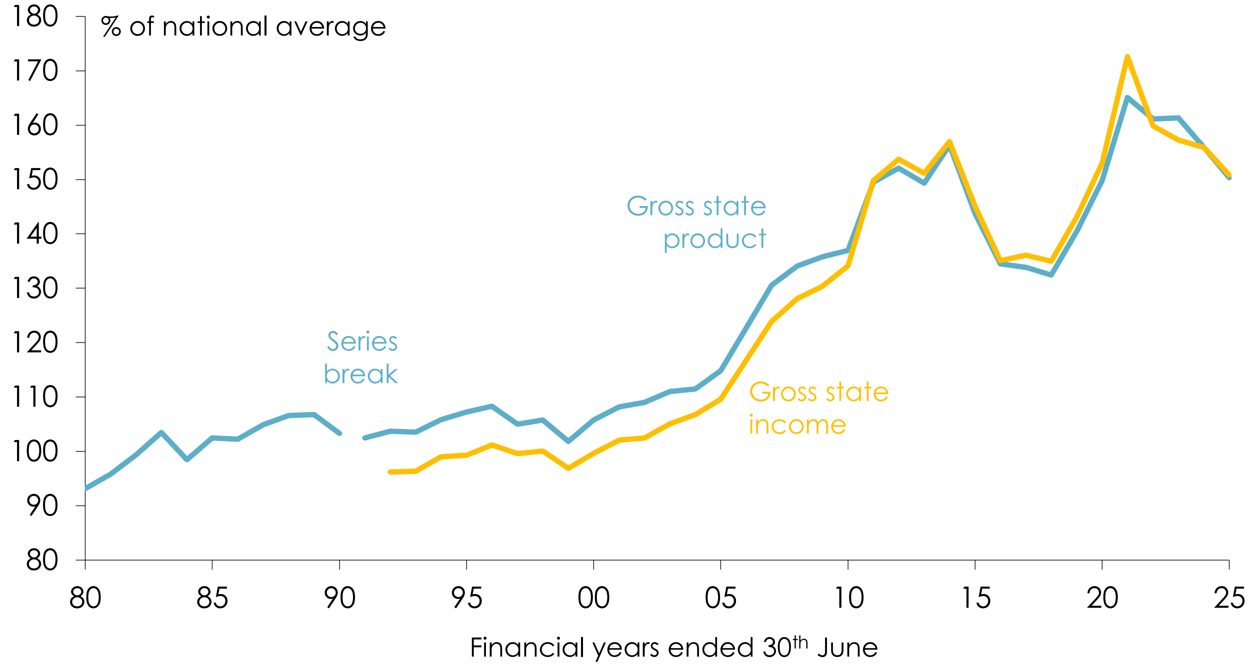
'Horizontal fiscal equalization' undermined by the 2018 changes

The 'WA GST deal' imposed by the Morrison Government (with the support of the then Labor Opposition) in 2018 and extended by the Albanese Government in 2023 represents a full-frontal assault on the long-standing principle of 'horizontal fiscal equalization' described above.

That's because the 'WA GST deal' – by design – results in Western Australia receiving substantially more revenue from the GST 'pool' (topped up from the Federal Budget as required by the 2018 legislation) than is required, according to the annual assessments by the Commonwealth Grants Commission, to enable the Western Australian State Government to provide Western Australians with a similar level of services as are provided by other state and territory governments to their populations whilst levying on them a similar burden of state taxes and charges.

That is despite the fact that Western Australia has been Australia's 'richest' state – as measured by per capita gross state product or per capita gross state income – since 2007-08, and since that time by a larger margin than New South Wales or Victoria ever were when they were (by these or other measures) the 'richest' states in Australia as they were throughout the twentieth century (Chart 1).

Chart 1: Western Australia's per capita gross state product and per capita gross state income relative to national averages



Source: Australian Bureau of Statistics (2025a).

The increase in Western Australia's per capita gross state product relative to the national average is roughly equally due to faster growth in *real* gross state product (150% over the twenty-five years to 2024-25, compared with 85% for the 'eastern' states and territories) and larger increases in the prices of the goods and services produced in Western Australia (as measured by the implicit price deflator of gross state product, 165% for Western Australia over the first quarter of this century compared with 111% for the rest of Australia)[2].

Both of these developments have been largely driven by the enormous increases in both the volumes and prices of Western Australia's minerals and energy resources exports, in turn largely as a result of rapid increases in demand for (in particular) iron ore and other minerals with which Western Australia is richly endowed.

The substantial increases in Western Australia's per capita gross state product, or gross state income, relative to the rest of Australia have greatly increased the Western Australian State Government's capacity to raise revenue, in particular from mineral royalties, relative to that of other state and territory governments (Chart 2).

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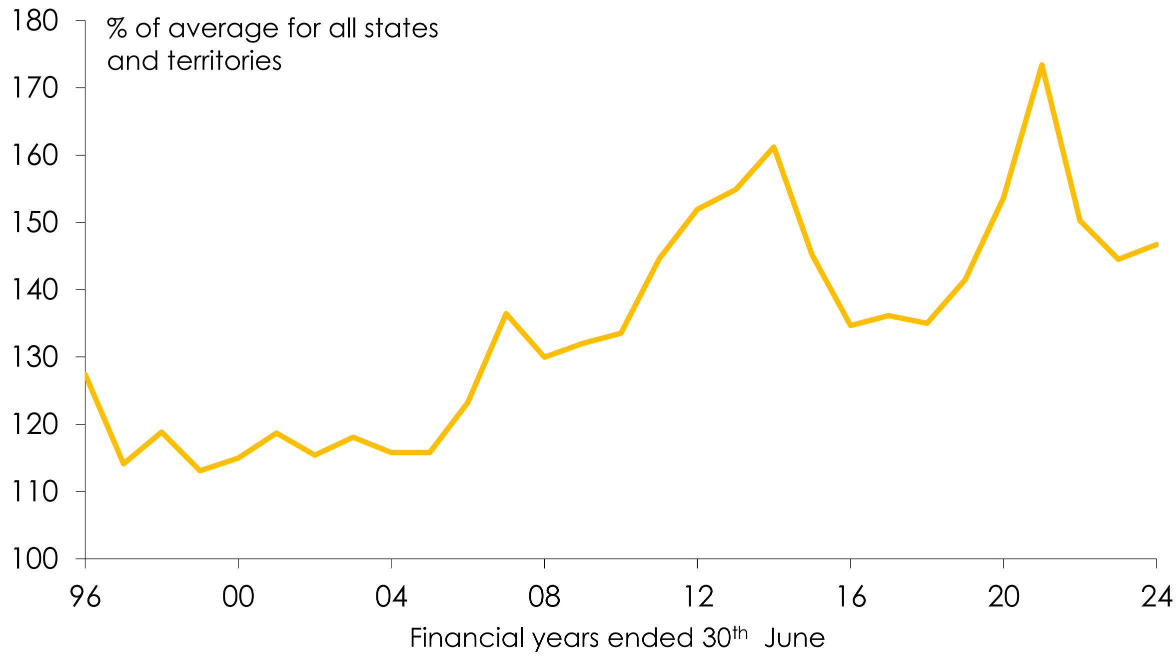
[2] It is worth noting that the faster growth in WA's real gross state product thus far into the 21st century occurred during the first fifteen years of this period, when WA's real GSP grew by 110%, as against 47% for the rest of Australia. Over the past ten years, WA's real GSP has increased by 19%, *less* than the 26% increase in real GSP in the 'eastern' states and territories. By contrast, increases in the implicit price deflator of WA's GSP have continued to outpace those for the rest of Australia during the past ten years, as they did over the previous 15 years.

Chart 2: Western Australia's revenue-raising capacity relative to the average for all states and territories



Note: 'revenue-raising capacity' is the ratio of a state or territory's capacity to raise revenue (as assessed by the Commonwealth Grants Commission) from its own sources relative to that of all states and territories. *Source:* Commonwealth Grants Commission (2025 and data supplied by the Commission).

In the first decade of the present century, Western Australia's revenue-raising capacity (from its own sources) was 24% above the average for all states and territories; in the second decade it was 46% above the average for all states and territories; and thus far during the current decade it has been 54% above the average for all states and territories. As far as it possible to tell from available records, neither New South Wales nor Victoria had a capacity to raise revenue from their own sources as far above the average for all states and territories as Western Australia has had during the past fifteen years.

So although Western Australia's share of the revenue from the GST relative to its share of Australia's population (its so-called 'relativity') fell to an unprecedented low during the middle of the second decade of this century – and would have fallen further during the current decade if not for the changes to the GST distribution system legislated in 2018 – those outcomes were (and would have been) *entirely consistent* with the principles used to determine the distribution of 'untied' financial assistance (and since 2000, revenue from the GST) since the 1930s.

However, Western Australia equated 'unprecedented' with 'unfair' – and succeeded in persuading both the Morrison Government and the then federal Opposition that this equation was justified.

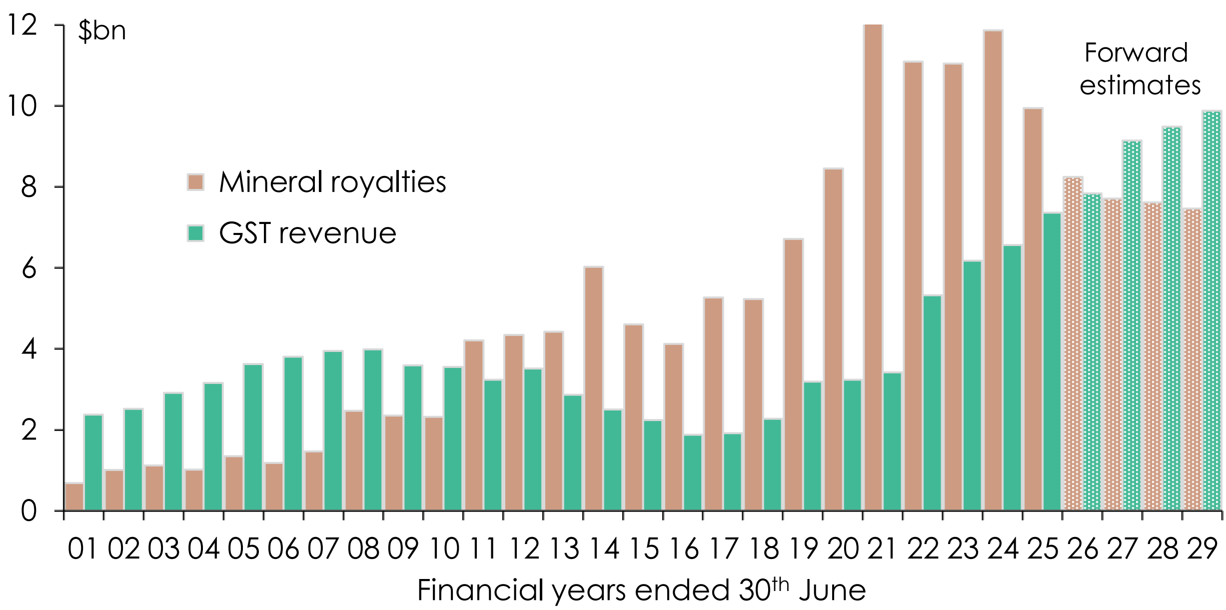
Between 2018-19 and 2020-21, Western Australia received $2.8 billion in 'transitional GST top-up payments' from the Federal Government, ahead of the commencement of the six-year transition to the new system legislated in 2018 (Frydenberg and Birmingham 2021 and previous issues). Between 2022-23 and 2024-25, Western Australia received $17.5 billion more by way of revenue from the GST than it would have done had the 2018 changes not been legislated (Chalmers and Gallagher 2025b and previous issues). And on current Forward Estimates, Western Australia will receive $22.5 billion more by way of revenue from the GST over the four years to 2028-29 than it would have done in the absence of the 2018 changes (Chalmers and Gallagher 2025c).

In total, therefore, by 2028-29 Western Australia will have received a total of $42.9 billion more than it 'needs', based on the Grants Commission's assessments, in order to be able to provide the same level of services to Western Australians whilst levying on them a similar level of state taxes and charges as the other states and territories.

As a result of the 'no worse off guarantee' provided to the other states and territories, the cost of this generosity to Western Australia has been borne by the Federal Budget. Including the 'top-ups' to the GST pool which were also provided for under the 2018 legislation, the total cost to the Federal Budget over the ten years to 2028-29 is likely to exceed $50 billion.

During the same period, Western Australia will also have collected at least $105 billion in mineral royalties – almost $53 billion more than it would have had its mineral royalty revenues remained at their average level over preceding decade, or about $31 billion more than if they had remained at their 2018-19 level (Chart 3).

Chart 3: Western Australia's mineral royalty and GST revenue

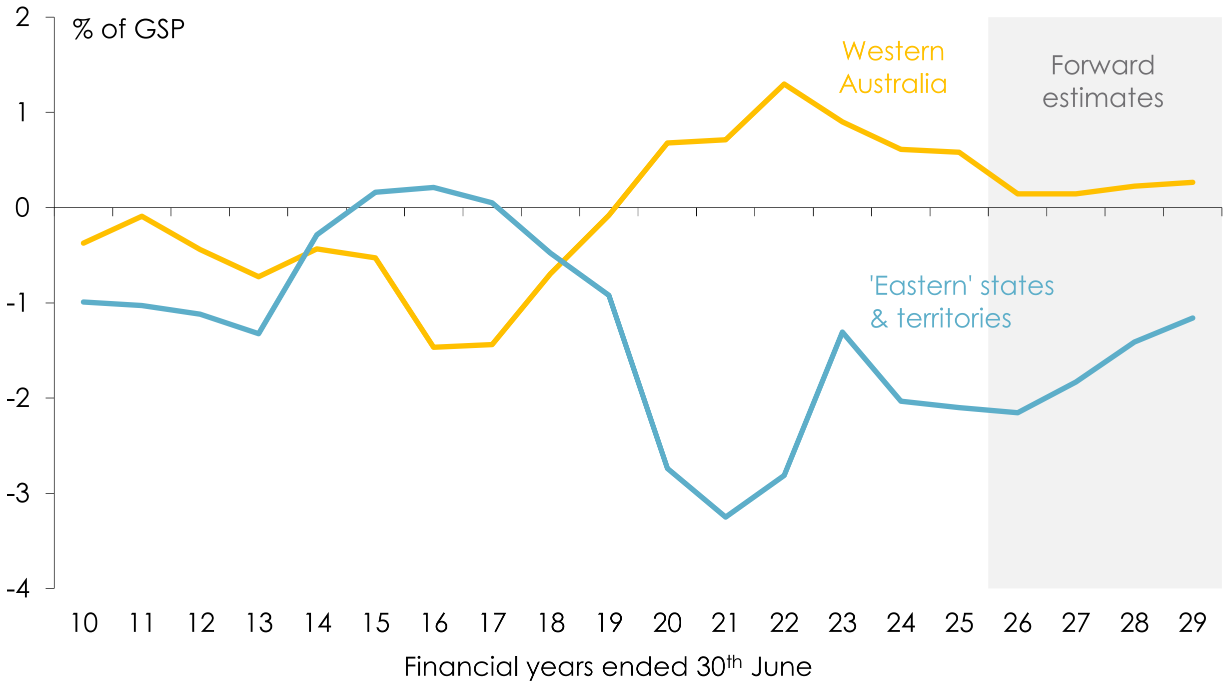


Sources: Government of Western Australia (2025b and previous issues, 2025c). Forward estimates of mineral royalty revenue assume the iron ore price drops to US$72/tonne (cif) from 2026-27 onwards.

In other words, Western Australia has received an increasing share of GST revenue (as 'topped up' from the Federal Budget) even as its revenues from mineral royalty revenues have been burgeoning. This is the *exact opposite* of the intention of 'horizontal fiscal equalization'.

In the short-term, the result of this generosity on the part of successive Federal Governments to Australia's richest state has been to enable Western Australia to run successive ('general government') budget surpluses whilst every other state and territory has been running deficits (Chart 4).

Chart 4: 'General government' cash surpluses, Western Australia and other states & territories

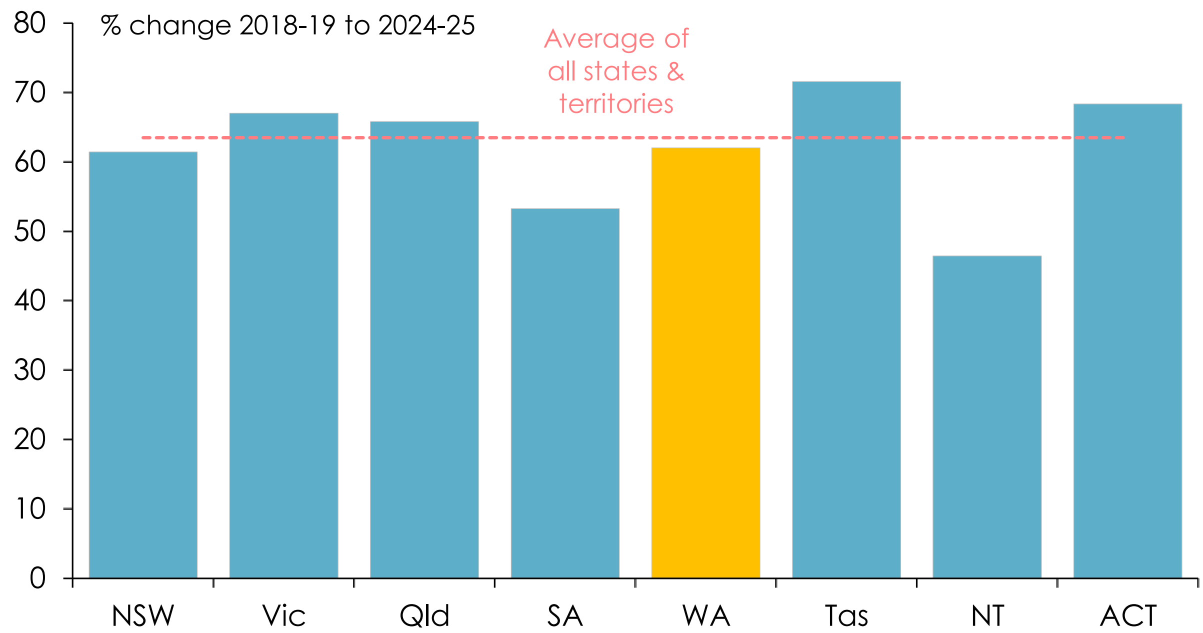


Sources: Government of Western Australia (2025b and previous issues, 2025c), and equivalent publications by other states and territories; author's calculations.

It bears emphasizing that Western Australia's surpluses are *not* the result of any conspicuously greater discipline over government spending by its governments than its counterparts in other states and territories.

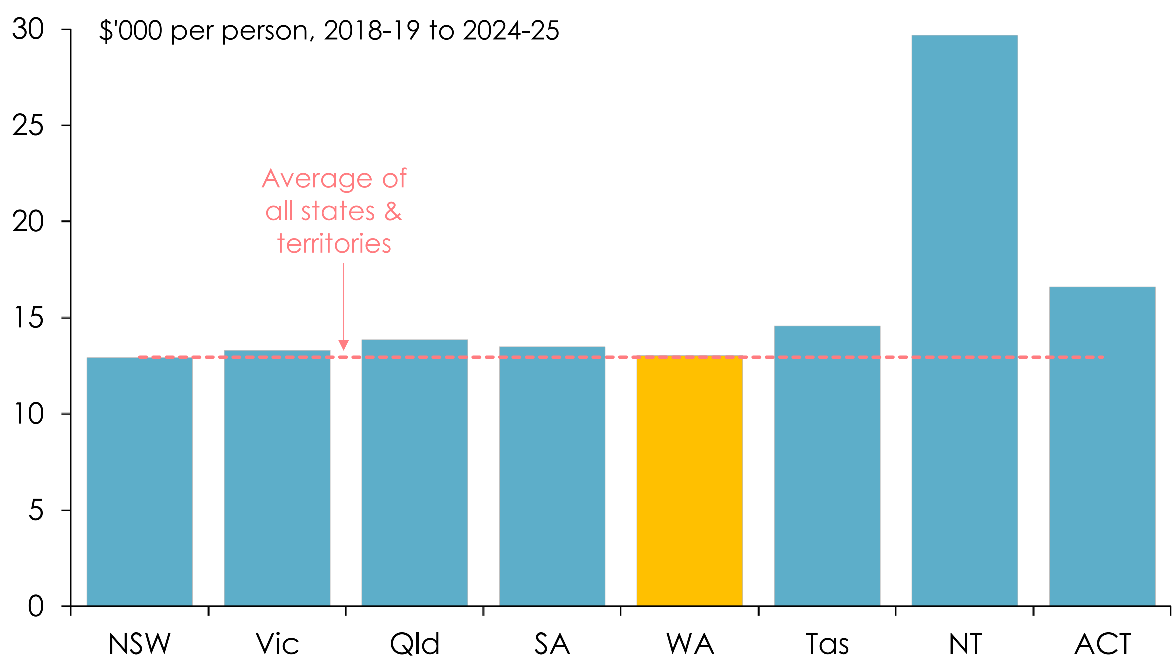
Over the period 2018-19 through 2024-25, 'operating expenses' of Western Australia's general government sector rose by 62%, only marginally below the average for all states and territories of 63.5%, and faster than in the Northern Territory, South Australia or New South Wales (Chart 5). Over this period, Western Australia's general government sector 'operating expenses' averaged $13,032 per head of population, slightly above the all-states-and-territories average of $12,942 per person (and only marginally below Victoria's average of $13,295 per person (Chart 6).

Chart 5: Growth rate of general government 'operating expenses', 2018-19 to 2024-25



Sources: Government of Western Australia (2025b and previous issues, 2025c), and equivalent publications by other states and territories; author's calculations.

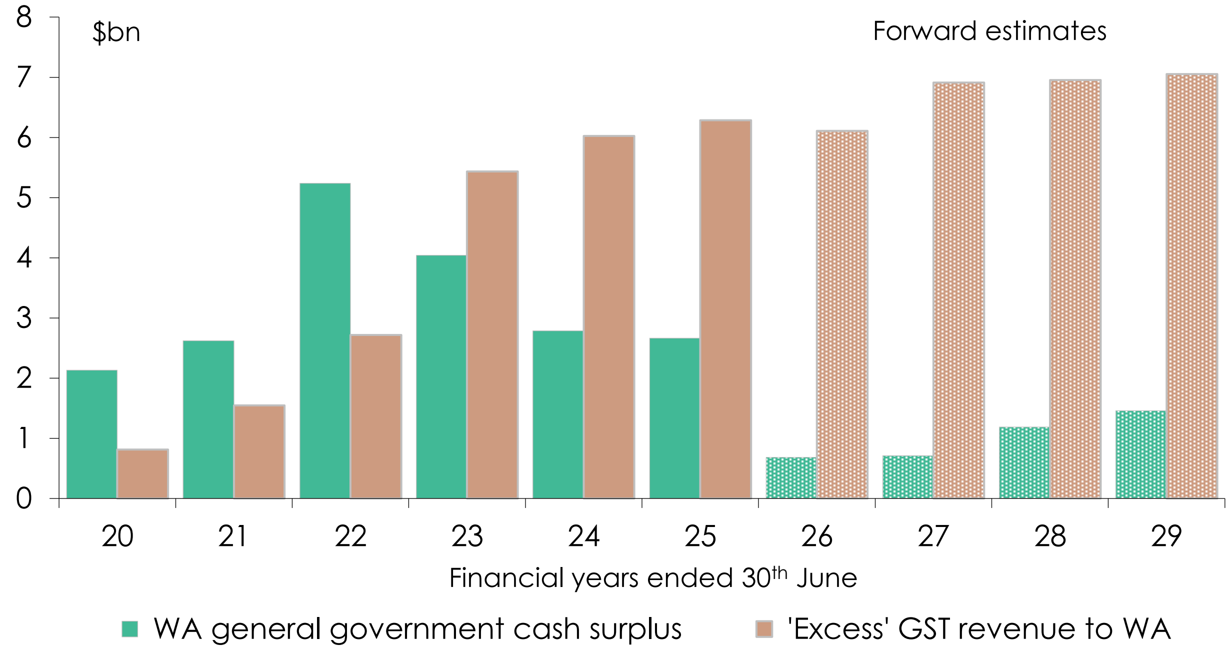
Chart 6: General government 'operating expenses' per capita, 2018-19 to 2024-25



Sources: Government of Western Australia (2025b and previous issues, 2025c), and equivalent publications by other states and territories; author's calculations.

Rather, Western Australia's budget surpluses have, since 2022-23 and prospectively through to at least 2028-29, been underpinned by the 'excess GST' which it has received as the result of the 2018 changes, as shown in Chart 7.

Chart 7: Western Australia's 'general government' cash surpluses and 'excess' GST revenue payments to Western Australia



Note: 'Excess' GST revenue payments to WA are the difference between the amounts which WA would have received based on the Grants Commission's assessments of 'relative needs', and what it has received or will receive as a result of the 2018 changes. *Sources:* Government of Western Australia (2025b and previous issues, 2025c); Chalmers and Gallagher (2025b and c).

Over a longer horizon, if the changes made by the 2018 legislation remain in place, and depending on what happens to the volume and prices of Western Australian commodity exports, Western Australians may come to enjoy a wider range and/or higher 'quality' of public services, and lower state taxes and charges, than residents of other states and territories.

That would be especially likely if the 'no worse off' guarantee to the other states and territories were to be allowed to expire at the end of the 2029-30 financial year as currently envisaged, with the result that the cost of the 'excess' GST revenue payments to WA would shift from the Federal Budget to the eastern states and territories.

This prospect arises because the 2018 changes shifted the objective of 'horizontal fiscal equalization' from ensuring that each state and territory had the capacity to provide an average level of services if each made the same effort to raise revenue based on average tax rates, to (in effect) raising the 'fiscal capacity' of each state and territory to the stronger of New South Wales or Victoria (which in all but three of the past ten years has been, and is likely to be in the foreseeable future, New South Wales).

In practice that means that if Western Australia is 'fiscally stronger' than New South Wales, 'horizontal fiscal equalization' no longer seeks to lift the 'fiscal capacity' of the weaker states to that of Western Australia, but only to that of New South Wales.

One of the more perverse features of the system instituted by the 2018 legislation is its *asymmetry* with regard to Western Australia.

The 2018 legislation put a 'floor' under Western Australia's GST relativity (of 70% of a notional equal per capita distribution in 2022-23 and 2023-24, rising to 75% of a notional equal per capita distribution in 2024-25, and then from 2026-27 onwards, whatever New South Wales's relativity happens to be), which limits the extent to which Western Australia's relativity can decline when commodity prices (and hence its mineral royalty revenues) are high.

But there is no 'ceiling' on Western Australia's GST relativity when commodity prices are low (by historical standards).

Thus, if – most likely because of a sharp fall in the price of iron ore and other commodities which are exported from Western Australia – Western Australia's 'fiscal capacity' were to fall below that of New South Wales, then GST revenues would be distributed in such a way as to raise Western Australia's 'fiscal capacity' to that of New South Wales.

But if – as has been the case since the commencement of the system imposed by the 2018 legislation in 2022-23, and is likely to remain the case in the foreseeable future – Western Australia's 'fiscal capacity' exceeds that of New South Wales and every other state, the post-2018 system does not seek to raise the 'fiscal capacity' of New South Wales and the other states and territories to that of Western Australia.

In other words, the post-2018 system is, in effect, "heads – Western Australia wins; tails – the Federal Government (or, if the 'no worse off' guarantee were allowed to expire, the other states and territories) lose".

An Australia where Australians who happened to live in the richest state in the nation were to have better schools and hospitals, better policing and environmental protection, or more adequate social housing, whilst paying lower state taxes and charges, than Australians who happened to live in other parts of the nation, would be a fundamentally different Australia than the one in which Australians have lived over the past ninety years.

Yet that is what Australia is likely to become if the changes to the system of distributing GST revenues among the states and territories remain in place – and especially if the 'no worse off' guarantee expires at the end of 2029-30, as it will under current arrangements.

Western Australia's specious arguments in support (and defence) of the 2018 changes

In addition to its claim that the decline in its GST relativity between the early 2000s and the late 2010s was 'unprecedented' and – for that reason alone – 'unfair', successive Western Australian Governments have advanced a series of other utterly specious arguments in support of the changes to the GST distribution system embodied in the 2018 legislation. The Commission's current inquiry provides an opportunity to reject these arguments.

Since its 'relativity' (its share of GST revenues relative to its share of the national population) first dropped below 1.0 in the early 2000s, Western Australia has joined New South Wales and Victoria in arguing that the system of 'horizontal fiscal equalization' as practiced in Australia provided 'disincentives' to state and territory governments to pursue growth-enhancing reforms, for fear that to do so would result in a loss of GST revenues (a concern that had never previously been raised by any Western Australian Government).

In 2001, the Western Australian Government joined its New South Wales and Victorian counterparts in funding a report by two eminent economists which argued, inter alia, that "in states that receive higher grants, there is an anti-growth bias associated with artificial contraction of private economic activity" (Garnaut and FitzGerald 2002: 133 and 150-53). Unsurprisingly, this report recommended that the revenue from the GST be distributed on an equal per capita basis: as the Federal Parliamentary Library noted, "the Review's proposals reflect the fact that it had to meet the objectives of the three governments that commissioned it" (Webb 2002).

Proponents of this argument have never been able to present convincing evidence for it.

As far back as 1993 the Productivity Commission's predecessor, the Industry Commission, pointed to a lack of conclusive empirical evidence about the efficiency costs of fiscal equalization" as a reason leading it to conclude that "a case for radical reform of fiscal equalisation has not been established" (Industry Commission 1993: xxx).

The 2012 GST Distribution Review, whose three members included two former state premiers who, when in office, had been vigorous proponents of more limited horizontal fiscal equalization, concluded that "the current system can and does create perverse incentives in theory, but that there is little evidence of those incentives having any effect in the real world. In particular, there is no evidence that HFE acts as a material disincentive to State tax reform" (Brumby, Carter and Greiner 2012: 135).

The Productivity Commission's 2018 Inquiry likewise was unable to find any conclusive evidence to support the assertion, specifically contained in its Terms of Reference, that 'horizontal fiscal equalization' inherently acts a 'disincentive' for states and territories to pursue productivity- or growth-enhancing reforms.

Despite that, in a manner quite contrary to the Productivity Commission's tradition of basing its conclusions and recommendations on evidence, the Commission's 2018 Inquiry asserted that "absence of evidence isn't equivalent to evidence of absence" (Productivity Commission 2018: 15) – the same rationale as used by US President George W. Bush, UK Prime Minister Tony Blair and Australian Prime Minister John Howard to justify the invasion of Iraq in 2003 despite the failure of UN weapons inspectors to find any evidence that Saddam Hussein possessed 'weapons of mass destruction' (because, as it turned out, he didn't).

In some ways it is particularly galling for Western Australia to be lecturing other states and territories about their failure to promote the development of mineral and other resources, given that it (in contrast to, most obviously, South Australia) bans uranium mining, maintains the most restrictive retail trading hours legislation in Australia, and until as recently as eleven years ago prescribed where and by whom potatoes could be grown, and at what prices they could be sold (Economic Regulation Authority of Western Australia 2014, pp. 13, 233-264 and 265-291).

Western Australia and Tasmania are the only states where the entire electricity system remains in public ownership. Yet given that Western Australia and Tasmania are polar opposites under the GST revenue distribution arrangements, it's not at all obvious how their decisions in this regard have been affected by the system of horizontal fiscal equalization.

As a long-time critic of the failure of successive Tasmanian Governments to pursue meaningful growth-enhancing reforms, this author has never once heard a Tasmanian politician or public servant cite a fear of losing GST revenue as a reason for 'maintaining the status quo'.

For many years Western Australia's annual state Budget Papers have included a chapter purporting to document the extent to which Western Australia 'subsidizes' the rest of Australia (see, for example, Government of Western Australia 2025a: 353-356). It does this using estimates of the share of Federal personal and company income tax revenue "derived" from Western Australia, and the level of Federal spending on personal benefit payments and services in Western Australia, as well as Western Australia's "low GST grant share compared to other States". The most recent of these estimates suggest that Western Australia "contributed" $39 billion "to the Federation" in 2023-24, with the only other positive "contributor" being New South Wales ($6 billion), and all the other states and the Northern Territory making negative "net contributions". Western Australia uses these figures to buttress its arguments in support of the changes to the GST distribution system legislated in 2018.

However it's not at all clear how these estimates are derived – or that the conclusions which the Western Australian Government draws from them are in fact justified.

The estimates for the share of Federal personal income tax "contributed" by Western Australia are presumably drawn from the ATO's Taxation Statistics website.

ATO figures for 2022-23 indicate that residents of Western Australia accounted for 12.0% of the personal income tax paid in that year, 1.2 percentage points above Western Australia's share of Australia's total population in that year (although only 0.3 percentage point above its share of the number of individuals filing tax returns).

However, that is the outcome to be expected of a progressive personal income tax system, given that the average taxable income of Western Australian taxpayers was, at $79,360 in 2022-23, higher than for any other jurisdiction except the ACT and 7.3% above the national average; and that 6.7% of Western Australian taxpayers were in the top tax bracket, again higher than in any other jurisdiction except the ACT and almost 2½ percentage points above the national average of 5.3% (ATO 2025a: Table 4).

Indeed, statistics such as these are consistent with the proposition that Western Australians are, on average, more affluent than other Australians – and hence that they have a greater capacity to pay state taxes, and less need for many of the services provided by state and territory governments than other Australians.

In that vein, the same ATO statistics indicate that 68.2% of Western Australian taxpayers had private health insurance in 2022-23, the highest proportion of any state or territory, and almost 12 percentage points above the national average of 56.3% - which in turn implies that there is proportionately less demand for state government-funded public hospital services in Western Australia than in other states and territories, and thus that Western Australia doesn't 'need' as much GST revenue (relative to its share of the national population) in order to be able to provide the public hospital services to the smaller proportion of its population who require them.

ATO data on company tax are only available on a state and territory basis for 'micro companies', that is, those with incomes (as defined by the ATO) of less than $2 million (ATO 2025b: Table 6B). Western Australian companies accounted for 11.4% of total company tax paid by 'micro' companies in that year, which is not appreciably different from Western Australia's share of Australia's total population. However these companies accounted for only 9.2% of the total amount of company income tax paid in 2022-23.

It's therefore not clear how Western Australia's Department of Treasury and Finance concludes that Western Australia "contributed" $28.5 billion to the Federal Budget by way of company tax in 2022-23 (19% of total company tax collections) – let alone $26.7 billion in 2023-24 (Government of Western Australia 2025a: 355), given that ATO company income tax data for 2023-24 are as yet not available).

Separately the Western Australian Government asserts that "WA's four largest iron ore producers contributed more than $100 billion in company tax to the Commonwealth in the first five years of the [2018] reforms" (Cook and Saffioti 2025).

Assertions such as these assume that all of the profits generated by operations undertaken by corporate entities in Western Australia can and should be attributed to Western Australia.

However, since profits are a return on capital, and the capital employed – especially in the large mining and energy companies operating in Western Australia – is largely sourced from shareholders domiciled in the 'eastern states' or overseas, it is a gross exaggeration to attribute all of however much company tax is actually paid on profits generated from operations in Western Australia (if such data is indeed available) *to* Western Australia as an entity.

Another part of the Western Australian Government's argument in support of the 2018 changes to the GST distribution system is that it needs the additional GST revenue it derives from these changes in order to "invest in the infrastructure that drives the national economy forward" (Cook and Saffioti 2025).

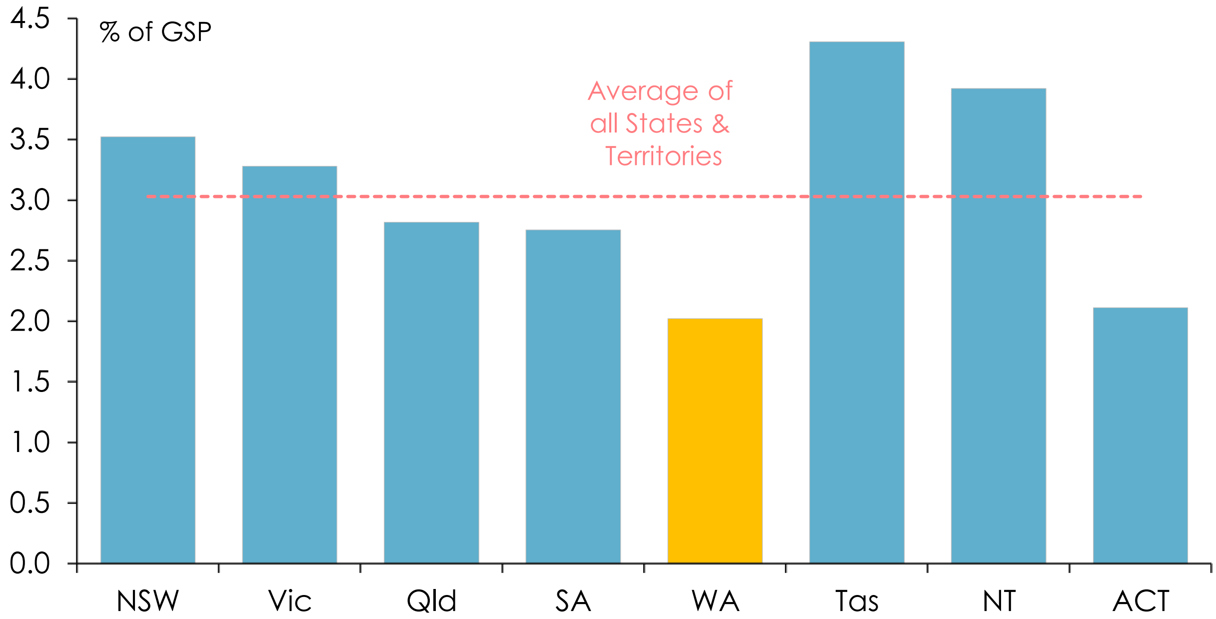
Once again, this assertion is fictional. Much of the infrastructure used by mining companies operating in Western Australia (in particular, railways) has been funded by mining companies themselves – in contrast to New South Wales and Queensland where most of the infrastructure used by coal mining companies was originally funded and maintained by state government instrumentalities (now privatized). And of the port infrastructure used by Western Australian mining companies which has been provided by governments, a significant proportion has been funded by the Federal Government. For example, of the $736 million cost of the Lumsden Point development at the Port of Port Hedland, $450 million was provided by the Federal Government, compared with $129 million by the Western Australian Government (Infrastructure Australia 2024).

More broadly, over the seven years to 2024-25, during which (as noted above) Western Australia has received $20 billion more by way of GST revenue and other 'untied' financial assistance from the Federal Government than it would have otherwise, total 'purchases of non-financial assets' by the Western Australian non-financial public sector as a whole (ie, including public non-financial corporations owned by the Western Australian Government) amounted to just 2.0% of gross state product – the smallest proportion of any state or territory, and one-third below the average for all states and territories of 3.0% (see Chart 8).

And over the four years to 2028-29, during which the Federal Government estimates that Western Australia will receive $22.5 billion more by way of GST revenues than it would have done in the absence of the 2018 changes (Chalmers and Gallagher 2025c: 305), 'purchases of non-financial assets' by the Western Australian non-financial public sector will represent 2.1% of gross state product, according to its latest forward estimates (Government of Western Australia 2025a: 77) – which is, along with the ACT the lowest of any state or territory and 1.1 percentage point below the average for all states and territories of 3.1% (Chart 9).

Moreover, an inspection of the components of the Western Australian Government's 'Asset Investment Program' (Government of Western Australia 2025a: 308-310) suggests that the vast majority of it will be spent on infrastructure in and around Perth, rather than in support of resources development projects.

Chart 8: 'Purchases of non-financial assets' by state and territory non-financial public sectors, 2018-19 through 2024-25, as percentages of gross state product (GSP)



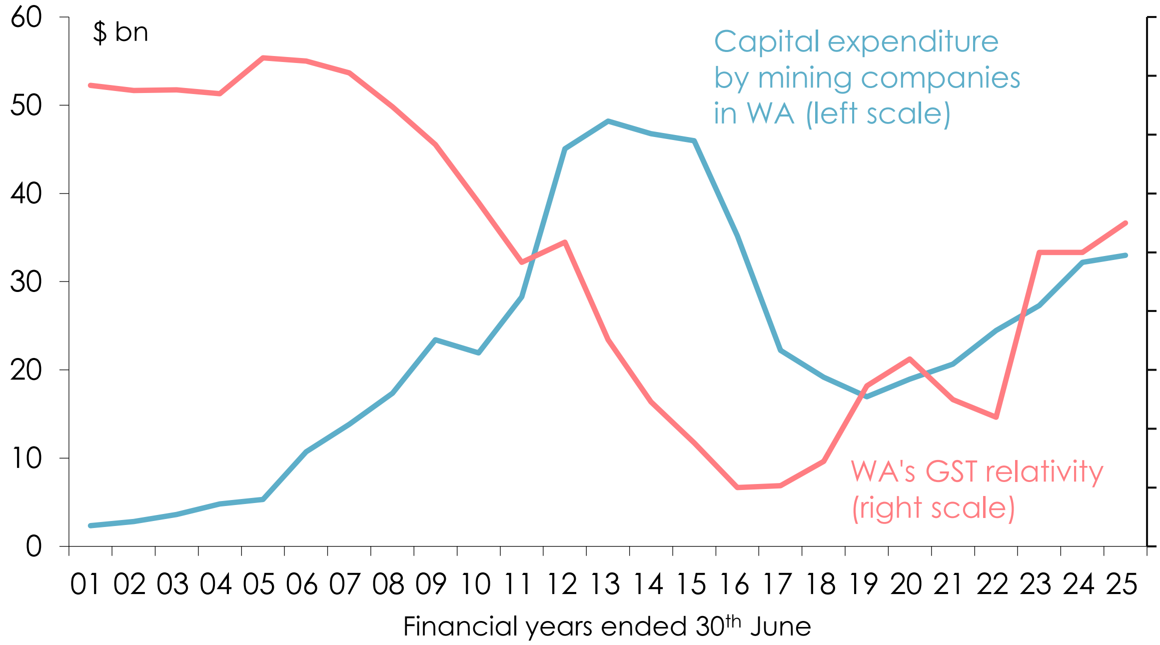
Sources: Government of Western Australia (2025b and previous issues), and equivalent publications by other states and territories; author's calculations.

Chart 9: Forward estimates of 'purchases of non-financial assets' by state and territory non-financial public sectors, 2025-26 through 2028-29, as percentages of GSP

Sources: Government of Western Australia (2025c), and equivalent publications by other states and territories; author's calculations.

The suggestion that investment in mineral and energy projects in Western Australia "wouldn't happen" without the excess GST revenues that the Western Australian Government is now receiving as a result of the changes made by the 2018 legislation is simply fanciful. On the contrary, capital expenditure in Western Australia by mining companies was at its highest level in the first half of the 2010s when Western Australia's GST relativity was declining to its lowest level (Chart 10).

Chart 10: Mining industry capital expenditure in Western Australia and Western Australia's GST relativity



Sources: Australian Bureau of Statistics (2025b) and Commonwealth Grants Commission (2025a).

This is not intended to imply that there is an 'inverse correlation' (or any kind of causal link) between the level of mining industry capital expenditure in Western Australia and Western Australia's GST relativity, but rather that the suggestion that there is any connection at all between the two is completely without foundation.

Instead, the fact that the Western Australian Government has been able to finance its infrastructure program without relying to the same extent as other states and territories on debt – because, as shown above, the 'excess GST' which it has been receiving since 2018-19 has enabled its general government sector to run successive cash surpluses – and without needing to impose tolls on users of some of that infrastructure (as has been deemed necessary in other states), provides another illustration of the way in which the 2018 changes have undermined the principle of 'horizontal fiscal equalization', and will (if left in place) ultimately result in the residents of Australia's richest state (Western Australia) enjoying better public services (in this case, infrastructure) whilst paying lower taxes and charges (including tolls) than residents of other parts of Australia.

A third argument routinely advanced by the Western Australian Government in support of the 2018 changes is that Western Australia has "become the economic powerhouse of the nation" and that it "creates wealth that benefits all Australians", and hence that "maintaining Western Australia's fair share [sic] of the GST is in the national interest" (Cook and Saffioti 2025).

Again, this assertion is not supported by the evidence. Western Australia's real gross state product *did* grow at a significantly faster pace over the first fifteen years of this century – an average annual rate of 5.0% - than that of the rest of Australia – 2.6% per annum. In passing, it is perhaps worth noting that this was the period during which WA's GST relativity fell sharply (refer back to Chart 10). Over the past ten years, however, Western Australia's real gross state product has risen at an average annual rate of just 1.8%, slower than that of any other state or territory except the Northern Territory, and well below the average for all of the other states and territories of 2.4% per annum (Chart 11).

Chart 11: Growth in real gross state product, 2014-15 through 2024-25

Source: Australian Bureau of Statistics (2025a).

Western Australia's economic under-performance over the past decade is even more apparent after abstracting from the effects of population growth – which has been faster for Western Australia (averaging 1.8% per annum) than for any other state or territory, and for the 'eastern states' as a whole (averaging 1.5% per annum).

In *per capita* terms, Western Australia's real gross state product growth rate over the past decade has been *zero* – yes, *zero* – the lowest of any state or territory, and well below the average for the other states and territories of 0.9% per annum (Chart 12). Indeed Western Australia's per capita real GSP has *declined* in four of the past eight years – including the past two years (2023-24 and 2024-25), notwithstanding that its GST relativity has increased from 0.34 to 0.75 over this period (Chart 10).

Chart 12: Growth in real per capita gross state product, 2014-15 through 2024-25

Source: Australian Bureau of Statistics (2025a).

So, clearly, Western Australia has hardly been the 'economic powerhouse of the nation', as its Government claims, over the past decade or indeed more recently than that: and the extra GST revenue which Western Australia has received over the past eight years has done nothing to improve Western Australia's economic performance.

In sum, *none* of the arguments put by successive Western Australian Governments as to why Western Australia should receive a bigger share of the revenue from the GST than that which it objectively 'needs' in order to provide its population with a similar range and standard of public services whilst levying on them a similar burden of state taxes and charges as the other states and territories is supported by the available evidence.

It is to be hoped that this is what the Productivity Commission will also conclude from its examination of the available evidence, and hence find (pursuant to its Terms of Reference) that the 2018 changes to the GST distribution system are ***not*** operating 'efficiently, effectively and as intended', but have instead:

- had a ***material adverse impact*** on the Federal Budget, some five-and-a-half times larger, and lasting considerably longer, than envisaged at the time the 2018 changes were legislated;
- ***egregiously undermined*** the long-standing principles and objectives of 'horizontal fiscal equalization', ultimately resulting in the residents of Australia's richest state coming to enjoy better public services whilst paying lower taxes and charges than other Australians; and
- ***done absolutely nothing*** to boost productivity or economic growth, or improve the efficiency with which resources are allocated across the Australian federation.

Towards a more transparent, comprehensible and predictable system

While this submission unequivocally advocates that the Commission should recommend that the 2018 changes to the GST distribution should be scrapped, it does not suggest that the distribution of GST revenues should simply revert to the system which existed prior to those changes.

There are legitimate criticisms which have been made over a long period of time of the way in which the pre-2018 system operated – and some of these criticisms continue to apply to the system which is now in place.

In particular:

- the pre-2018 system was, and the current system still is, poorly understood outside of a narrow circle of state and territory Treasury officials, the small number of Federal Treasury officials who deal with federal-state financial relations, and the staff of the Commonwealth Grants Commission – notwithstanding the commendable attempts the Grants Commission has made in recent years to explain its assessments and recommendations more clearly (Commonwealth Grants Commission 2025b and c) – which is probably part of the reason why Western Australia was able to get away with such specious arguments to advance its case for changes to the 2018 system to its substantial benefit;
- the pre-2018 system occasionally did, and the current system occasionally does, produce abrupt changes in individual states' relativities as a result of seemingly arbitrary classification changes – such as (in the past two years) the remoteness category assigned to particular cities and towns (Commonwealth Grants Commission 2024: 32), or the re-classification of health expenses and assistance programs to individuals and businesses during the Covid-19 pandemic and the introduction of a distinction between metallurgical and thermal coal (Commonwealth Grants Commission 2025a: 25-26 and 32).

Public understanding of the way the system works – both before and after the 2018 changes – isn't assisted by the practice of politicians and others from states which regard themselves as 'donors' (ie, which have a GST relativity of less than 1) referring to states and territories with relativities of less than 1 as 'mendicant states' (see eg The *West Australian* 2023 and 2024b, Speakman 2024, and Hewitt 2025). Such language evokes memories of politicians and others deriding people receiving unemployment benefits as 'dole bludgers', terminology which is nowadays widely (although not universally) regarded as socially unacceptable (Hutchens 2021).

It may be possible to achieve broadly the same objective of 'horizontal fiscal equalization' – that is, enabling each state and territory to offer its population a similar range of public services whilst levying on them a similar burden of taxes and charges and other states and territories – using a limited number of readily-available and broadly understood indicators which have some bearing on the demand for public services and/or on a government's capacity to raise revenue.

Such indicators could include:

- population (in so far as it results in ‘economies of scale’ in the provision of public services);
- population dispersion (which also affects the relative cost of providing public services to a population of any given size);
- the proportion of the population meeting particular criteria, such as being under the age of 18 or over the age of 65, living with disability, identifying as First Nations people, speaking a language other than English at home, owning their own home, or being in the lowest (or lowest and second-lowest) socio-economic status quintile (all of which have an impact on the demand for different types of public services typically provided by state and territory governments);
- the extent of public transport usage and the length of roads for which state or territory governments are responsible;
- gross state product per head (which is a major determinant of a state government’s capacity to raise revenue from taxes on businesses, including through mineral royalties);
- employment-to-population ratios (as an indicator of capacity to raise revenue from payroll tax);
- average wages (as another indicator of capacity to raise revenue from payroll tax, but also as an indicator of public sector employment costs);
- total and average residential land values (as an indicator of capacity to raise revenue from land tax and stamp duty on residential land transfers);
- motor vehicle ownership (as an indicator of capacity to raise revenue from duties on the purchase of motor vehicles, and annual registration fees); and
- Commonwealth Government employment and land ownership (as an indicator of the extent to which a state or territory government’s capacity to raise revenue is circumscribed by the Constitutional prohibition on imposing taxes on other governments).

The above list is not intended to be exhaustive or comprehensive. The point is, rather, that all of the above indicators are readily available (in most cases from ABS publications), widely understood and capable of being forecast by state and territory Treasuries or other agencies. They are also, in most cases, unlikely to be subject to abrupt change.

Nor is it suggested that the above indicators should be given equal weight in determining GST relativities. Rather, those weights could be determined following modelling of different weighting patterns in order to ascertain which combination of indicators, weighted in what proportions, best achieves a ‘reasonable degree of fiscal equalization’.

This submission is conscious that the Commonwealth Grants Commission has previously considered a 'broad indicator' approach to measuring states' and territories' fiscal capacities, and concluded that it was not possible to find options that were "both simpler and consistent with the [horizontal fiscal] equalization objective" (Commonwealth Grants Commission 2018: 12 and 21). However, this submission advocates that the Productivity Commission should consider examining this conclusion in greater depth.

Conclusion

Australia is a better and fairer country than it would have been if it mattered as much as it does in most other democracies with federal systems of government (in particular, the United States) which part of the country a citizen lived as to the quality of education, health, policing and other public services received, and how much she or he had to pay for them. The fact that Australia has consciously sought to achieve that objective to a greater extent than other democratically-governed federations is something to be applauded – and which most Australians would, if asked, applaud – rather than bewailed.

But while the role of Australia's relatively progressive (by comparison with most other 'advanced' economies) tax-transfer system in contributing to that outcome appears to be fairly broadly understood, the same can not be said of the role played by 'horizontal fiscal equalization', as it has been practiced in Australia since the mid-1930s. That is at least partly because of the inherent complexity of the system for achieving the objectives of 'horizontal fiscal equalization' which has evolved over the past ninety or so years.

The changes made to the principles governing the distribution of revenue from the GST – the vehicle through which the objective of 'horizontal fiscal equalization' has been pursued since 2000 – in 2018 will, if maintained, fundamentally undermine the aforementioned long-standing objective of ensuring that it matters far less in Australia than it does in other countries with similar forms of governance where a citizen lives as to the quality of education, health, policing and other public services she or he receives, and how much she or he has to pay for them.

Those changes, if maintained, will result in the residents of Australia's richest state – a state whose unparalleled prosperity, relative to the rest of the nation, has come about largely through fortune (nature's endowment of mineral and energy resources, combined with China's appetite for them) as opposed to the consistent pursuit of ambitious economic and social reform – enjoying better public services and lower taxes and charges than other Australians.

While that prospect understandably appeals to many (if not most) Western Australians, most other Australians would likely consider it 'un-Australian'.

All state and territory governments regard it as part of their responsibilities to extract as much money out of the Federal Government as they possibly can. In that respect, Western Australia has been no different from any other state or territory.

But the arguments put by successive Western Australian Governments, and their supporters in the media and elsewhere, in support of the 2018 changes – both before they were made, and subsequently in defence of them – are almost entirely fallacious, and unsupported by the available evidence.

In truth, the 2018 changes to the principles governing the distribution of revenue from the GST were not the result of widespread acceptance of the validity of the arguments put by successive Western Australian Governments, but rather resulted from the unusually strong political power that Western Australia was able to exercise between the 2016 and 2025 Federal elections – when the majority of the political party forming government in Canberra (the Liberal-National Coalition after the 2016 and 2019 elections, and Labor after the 2022 election) depended entirely on the size of its delegation from Western Australia in the House of Representatives.

The rawness of the political power driving the 2018 changes was accurately summarized by Western Australia's Deputy Premier and Treasurer when she said, in February 2024, that "any federal government that walks back the current GST deal would lose every seat in Western Australia" (*The West Australian 2024a*).

Government policy shouldn't be determined by raw political power in this way.

The Productivity Commission should, at the very least, recommend that the 2018 changes to the system for governing the distribution of revenue from the GST among the states and territories should not continue beyond the currently stipulated expiry date for the 'No Worse Off' guarantee to the eastern states and territories at the end of the 2029-30 financial year (if not sooner). It should re-affirm the importance of the objective of 'horizontal fiscal equalization' to the kind of country most Australians want Australia to be. And it should recommend options for achieving that objective in a manner which is more transparent, more readily comprehensible, and more predictable than the one which has evolved over the past nine decades.

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Important notice