

Flexibility to consider method changes between reviews

Overview

- 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 On 19 October 2023, the Commission issued a [consultation paper](#) on flexibility to consider method changes between reviews.
- 3 The Commission's preliminary view was that it would be beneficial for there to be additional flexibility to change methods between reviews. This would only occur in consultation with states and territories (states), and where there have been significant changes in state fiscal circumstances as a result of unanticipated shocks or major policy reforms between reviews that result in existing methods not appropriately measuring state fiscal capacities. The Commission considered it may be too restrictive to define, or introduce quantitative measures of what constitutes, a major unanticipated shock. Instead, it would require an element of judgement by the Commission. The Commission expected flexibility would only need to be exercised in very limited circumstances.
- 4 The Commission sought state views on the case to extend the circumstances in which the Commission could consider alternative methods between reviews, in consultation with states, and how such flexibility could be operationalised.
- 5 A summary of state responses to each consultation question is included below, as well as the Commission's draft position.
- 6 State submissions can be viewed [here](#).

Consultation questions

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?

State views

- 7 New South Wales, Victoria, Queensland and the ACT agreed there may be situations that require flexibility to consider alternative methods between reviews. Tasmania said there were some benefits in greater flexibility to change methods, but it had concerns about how that flexibility would be implemented in practice. New South Wales said, while the existing arrangements technically allow for flexibility through the annual terms of reference, that process has not functioned effectively.
- 8 New South Wales and Victoria said there can be circumstances in which existing methods limit the achievement of, or actively undermine, fiscal equalisation. They said examples included the Commission's inability to make adjustments to reflect the fiscal impacts of the COVID-19 pandemic on the health and services to industry assessments, or for New South Wales' proposed property tax reform. They said such flexibility must be appropriately managed and balanced against stability, predictability and public confidence in the robustness of the Commission's methods. New South Wales said flexibility should be used sparingly and any new process must not unintentionally create an annual review of methods.
- 9 Queensland said there may be exceptional circumstances where the Commission could consider alternative methods between reviews, such as unanticipated shocks or major policy reforms. It said the threshold for that should be high and the default position should be for method changes to be considered in reviews, providing greater certainty. Tasmania said while the existing arrangements are sufficient to cover most situations that arise, there could be unforeseen circumstances in future that may not be covered by the existing flexibility. It said no state should be disadvantaged through the GST distribution as a result of undertaking a major reform, but in most cases these issues should be addressed in methodology reviews.
- 10 Western Australia, South Australia and the Northern Territory did not agree there could be situations that require flexibility to consider alternative methods. Western Australia said it could not identify a shock that would impact just one or 2 states, or where one or 2 states are impacted to a greater degree, without being due to policy differences. South Australia said the current approach appropriately balances stability in methods with reflecting changing state circumstances. It said the COVID-19 pandemic demonstrated the difficulty in developing a robust, policy

neutral alternative assessment based on reliable data in a limited time. The Northern Territory said sufficient and appropriate flexibility exists through the terms of reference process to respond to major shocks.

- 11 South Australia said GST distributional impacts are not a material or driving issue in developing major tax reform proposals. It said the gradual implementation of many reforms, together with the Commission's averaging process, meant those reforms were unlikely to have a material impact of GST distribution between 5 yearly reviews.

Commission response

- 12 Terms of reference for the Commission's annual updates have asked it to use 'the same principles, categories and methods of assessment' as in the most recent methodology review.¹ However, they have allowed method changes between reviews, in consultation with states, to overcome data problems or in response to major changes in Commonwealth-state relations.² Method changes in updates for those 2 reasons have not been common.³
- 13 Terms of reference for updates have also asked the Commission, while using the same assessment methods, to base its assessments on the latest available, fit for purpose data. The aim is to have a set of GST relativities that reflect, to the extent available data allow, the relative fiscal circumstances of states in the year in which those relativities will be used to distribute GST revenue.
- 14 Limiting most method changes to 5-yearly reviews has ensured stability of methods across annual updates.⁴ It has allowed states, in their forecasting and budget planning, to focus on changes to GST relativities in updates that arise from changes in state fiscal circumstances as reflected in the latest available data.
- 15 The Commission considers that, in most cases, the approach of 5-yearly reviews and annual updates has appropriately balanced stability in methods with the need to capture changes in state circumstances over time. However, in rare circumstances, developments can significantly affect states' relative fiscal capacities in ways that are not adequately captured by the existing assessment methods. In those very limited circumstances, it would be beneficial for the Commission to have flexibility to change methods, in consultation with states, such that they better reflect changed state circumstances.

¹ 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 (for example, due to data problems or changes in Commonwealth-state circumstances).

² For example, see clauses 8(b) and 10 of the 2024 Update Terms of Reference.

³ Examples in the last 12 years include an adjustment to data used in the wage costs assessment in the 2023 Update to minimise any bias due to COVID-19 lockdowns, and a change in the treatment of Commonwealth payments for specialist disability services for older people in the 2013 Update in response to the Commonwealth assuming responsibility for all aged care services.

⁴ Since 1988, the Commission has been asked to review its assessment methods about every 5 years, with annual updates in between (starting in 1989).

- 16 While the Commission aims to develop methods that will capture states' fiscal circumstances as they evolve, not all changes in circumstances can be anticipated when the Commission is finalising a methodology review. In its consultation paper, the Commission cited 2 major developments since the 2020 Review – the COVID-19 pandemic and a proposed New South Wales property tax reform – which illustrated that the requirement to use the 2020 Review methods resulted (or could have resulted) in measures of state fiscal capacities that were inconsistent with fiscal equalisation. In both cases, the ability to consider, consult on and implement adjustments to assessment methods prior to the 2025 Review could have improved the assessment of state fiscal capacities.
- 17 Western Australia said a shock that mainly affects one or 2 states would likely involve differences in state policies. As with its approach to all assessments, the Commission would seek to identify, and only adjust for, those influences that were beyond a state's direct control. The process the Commission would follow is discussed under question 3 below.

Commission draft position

- 18 The Commission considers that it would be beneficial for it to have additional flexibility to consider alternative methods between reviews in very limited circumstances, and in full consultation with states. Those circumstances are outlined in the next section.

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?**

State views

- 19 Victoria, Queensland and the ACT agreed. Victoria said it broadly supported the proposed circumstances, but the wording should be amended to include major policy reforms. It said limiting changes to 'unexpected developments' does not adequately allow for changes in response to policy reforms. Queensland said the scope to make method changes in updates should only be exercised in very exceptional circumstances and must be appropriately constrained by an agreed decision-making framework. It said that framework could include a high materiality threshold, a greater than standard level of consultation, an annual review of the change and a clear process for unwinding temporary changes. The ACT recommended the Commission develop guidelines, in consultation with states, that define what constitutes a major unexpected event.

- 20 New South Wales, South Australia and Tasmania said it would be difficult to define the circumstances in which flexibility to change methods should apply. New South Wales and Tasmania said while having too broad (or no) criteria risked uncertainty and arbitrariness, the Commission's proposed circumstances may prove too restrictive. New South Wales said they should extend to major policy reforms.
- 21 South Australia and Tasmania said states were likely to disagree on what constitutes a major unexpected development. South Australia said it would be difficult to assign a threshold and it may have to be determined, in consultation with states, on a case-by-case basis.
- 22 Western Australia and the Northern Territory said they did not support the case to change methods between reviews in the proposed circumstances. Western Australia said it was problematic to define 'major' developments and 'significant' impacts.

Commission response

- 23 A key issue for most states was that alternative methods should only be considered in very limited circumstances. This is also the Commission's view. The Commission agrees with New South Wales, South Australia and Tasmania that it is difficult to specify in advance the precise nature or characteristics of what would constitute a significant unanticipated event that warrants the initiation of a process of consultation with the states between reviews to consider alternative methods.
- 24 Instead, the Commission proposes defining what constitutes such an event based on its consequences. Those consequences include:
- a major adverse fiscal impact on one or more states
 - an existing assessment method is inappropriate and would produce outcomes that are clearly inconsistent with the objective of fiscal equalisation, and
 - there is a reasonable basis to conclude that an alternative method, if one were able to be identified, should be introduced before the next review.
- 25 The Commission agrees with New South Wales and Victoria that these circumstances should include major policy reforms, where those reforms require a change in method to be introduced before the next review.

Commission draft position

- 26 The Commission considers that the limited circumstances in which the Commission should have flexibility to consider method changes include major unexpected developments that:
- have a significant impact on the fiscal positions of one or more states
 - are not captured in existing assessment methods, and
 - there is a reasonable basis to conclude that a change in methods before the next review would better achieve the objective of fiscal equalisation.

- 27 This would include major policy changes where a change in method needs to be introduced before the next review to better 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?

State views

- 28 All states agreed that consideration of whether method changes between reviews are warranted should be undertaken in consultation with states.
- 29 South Australia said it strongly believed the Commission, in close consultation with states, would have to agree on a case-by-case basis what constitutes a shock. This included whether the shock was material and whether existing methods captured the impact of the shock. It also included whether there were differences in policy responses and, if those policy differences could be addressed, whether an alternative method should be pursued.
- 30 Tasmania said without further guidance around the concepts of major development and significant impact, states may disagree on whether a particular event warrants consideration of a method change.
- 31 All states said that, if there was flexibility to make method changes between reviews, it should only be used in very limited circumstances.

Commission response

- 32 The Commission's expectation is that flexibility to consider method changes would be exercised in the very limited circumstances outlined in paragraphs 26 and 27. The first step in the process would be to consult with states on whether an event falls within those circumstances, the case for why existing methods may no longer be appropriate and the case for why alternative methods should be considered before the next review. The Commission would issue a consultation paper to the states on these issues.
- 33 Having considered state views, if in the Commission's judgement consideration of alternative methods was warranted, it would then consult with states on all aspects of possible changes to assessment methods.
- 34 The Commission would consider alternative methods in the same way as it does in a methodology review, involving extensive consultation with states. The Commission

would apply its supporting principles and assessment guidelines.⁵ 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.⁶ The Commission would exercise its judgement to balance any trade-offs between its supporting principles. After consulting states on the development of an alternative method, the Commission would issue a final consultation paper to states on any proposed change.

- 35 If, after considering state views, the Commission decided to change an assessment method, it 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. It could also be possible that, notwithstanding the circumstances that initiated the process, a reliable alternative method may not be able to be identified, and no change would be made, but could continue to be considered in the next review. In the case of policy reform, a state may be seeking an indication of how a proposed reform would be assessed, prior to proceeding with the reform. This was the case with the New South Wales proposed property tax reform.

Commission draft position

- 36 The Commission proposes that consideration of whether method changes are warranted between reviews be undertaken in consultation with states on a case-by-case basis, and in accordance with the process outlined in paragraphs 32 to 35.

Q4. Should the extended flexibility to change assessments between reviews in certain circumstances be operationalised in standing terms of reference for updates?

State views

- 37 Queensland, Western Australia and the ACT supported extended flexibility being operationalised in standing terms of reference for updates.
- 38 Queensland said the standing terms of reference should note the Commission would have the capacity to respond to events in extreme circumstances, with the Commission to review and consider whether this should be addressed through the distribution of the GST rather than through other means.

⁵ See Commission [position paper on fiscal equalisation, supporting principles and assessment guidelines](#).

⁶ 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.

- 39 Western Australia said, if flexibility were given to the Commission, it should be operationalised in standing terms of reference for updates. It said it should also be written into the Commission’s Update Guidelines document.
- 40 Victoria said a standing terms of reference clause in updates may be an adequate mechanism to operationalise flexibility, but its preference was for flexibility to be established as a condition of the 2025 Review methodology. It said there should be a mechanism to monitor implementation and allow for review, if required.
- 41 South Australia said 5 yearly reviews should be the primary vehicle for method changes and that any changes to the standing terms of reference for updates to allow method changes between reviews would need to be carefully considered.
- 42 Tasmania said it was not opposed in principle to standing terms of reference allowing flexibility in certain circumstances, but it would like to see the proposed wording.
- 43 New South Wales and the Northern Territory did not support extended flexibility being operationalised in standing terms of reference for updates.
- 44 New South Wales said it was concerned that operationalising flexibility in standing terms of reference, without a definition of events that necessitate a method change, would require significant judgement from the Commission and introduce an element of uncertainty. It proposed an alternative process in which the Commission would recommend to the Commonwealth Treasurer (after consulting states) where method changes might be warranted. The Treasurer would then provide a formal response to the Commission’s recommendation as part of the terms of reference for the annual update.
- 45 The Northern Territory said no extended flexibility was warranted and therefore standing terms of reference were not needed. It said the Commonwealth Treasurer can change terms of reference on a needs basis by exception.

Commission response

- 46 The Commonwealth Treasurer has asked the Commission to provide advice on whether it should be given additional flexibility to consider alternative methods between reviews.
- 47 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.
- 48 In its consultation paper, the Commission said an option would be for additional flexibility to be provided in standing terms of reference for updates. Such an approach would be consistent with the Commission’s role as the independent agency responsible for advising the Commonwealth Treasurer on states’ relative

fiscal capacities for the purposes of GST distribution. It is always open to the Commonwealth Treasurer not to accept the Commission's recommendations.

- 49 Including the additional flexibility in the standing terms of reference for updates would also complement the existing flexibility in the terms of reference to change methods where there are data problems or in response to significant changes in Commonwealth-state relations. Standing terms of reference could require that the Commission send a separate report and recommendation to the Commonwealth Treasurer on the alternative method adopted in the update.

Commission draft position

- 50 The Commission supports operationalising flexibility to change methods between reviews in standing terms of reference for updates.

Other issues raised by states

Timing of consideration and implementation of alternative methods

- 51 Victoria said the Commission should address the timing of the process for method changes between reviews. It said the Commission could take a scenario planning approach to identify key risks and potential responses, which may alleviate some time pressures to develop methods between update years. Victoria said, in cases where the Commission is unable to implement new methods in an update, it could consider backwards adjustments in future years.

Commission response

- 52 In exercising flexibility to consider alternative methods, the Commission would follow the processes (including consultation) outlined in its response to question 3. The Commission considers a scenario planning exercise may be problematic since the unforeseen or unexpected scenarios and their implications would, by definition, be difficult to predict. However, the Commission would be willing to work with states on such an exercise and is always open to discussing the GST distribution implications of possible or planned policy reforms.
- 53 The Commission does not consider it appropriate to make retrospective adjustments to GST relativities for method changes between reviews. The Commission has not made retrospective adjustments to GST shares for previous method changes. It considers retrospective adjustments may increase budget uncertainty for states.

Commission draft position

- 54 The Commission does not propose to retrospectively adjust GST shares for method changes between reviews.

Draft 2025 Review approach

- 55 The Commission considers that it would be beneficial for it to have additional flexibility to consider alternative methods between reviews in very limited circumstances, and in full consultation with states.
- 56 Those circumstances would include major unexpected developments that:
- have a significant impact on the fiscal positions of one or more states
 - are not captured in existing assessment methods, and
 - there is a reasonable basis to conclude that a change in methods before the next review would better achieve the objective of fiscal equalisation.
- 57 This would include major policy changes that require a change in method to be introduced before the next review.
- 58 The Commission proposes that consideration of whether method changes are warranted between reviews be undertaken in consultation with states on a case-by-case basis, and in accordance with the process outlined above.
- 59 The Commission supports operationalising flexibility to change methods between reviews in standing terms of reference for updates.
- 60 The Commission does not propose to retrospectively adjust GST shares for method changes between reviews.