

Flexibility to consider method changes between reviews

Review outcomes

- The terms of reference for the 2025 Review asked the Commission to consider if there is a case for the Commission to be given the flexibility to consider alternative assessment methods in cases where there is a significant unanticipated shock (such as a pandemic) or where major state policy reforms are enacted between reviews.
- The Commission considers it would be beneficial to have additional flexibility to change methods between reviews in very limited circumstances, and in full consultation with states.
- Those limited circumstances would include major unexpected developments or major state policy changes where all of the following conditions apply:
 - there is a significant impact on the fiscal positions of one or more states
 - the impact is not captured in existing assessment methods
 - a change in assessment methods before the next review would better achieve the objective of fiscal equalisation.
- The Commission would consult closely with the states on whether an event falls within the circumstances that may warrant consideration of alternative methods and, if it does, all aspects of possible changes to assessment methods.
- The Commission supports operationalising flexibility to change methods between reviews in a standing clause in terms of reference for updates.
- The Commission does not support retrospectively adjusting GST shares in cases where an assessment method is changed between reviews.

Introduction

- 1 On 6 July 2024, the Commission published the [Draft Report](#) for the 2025 Methodology Review.
- 2 The Draft Report included a detailed analysis and response to issues raised by states and territories (states) in their [submissions](#) on the Commission's [consultation paper](#).
- 3 State submissions on the Draft Report can be viewed [here](#).
- 4 This chapter includes:
 - an overview of the issues considered throughout the review
 - the Commission's response and position on each issue.

Issues considered

- 5 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.¹
- 6 The Commission engaged with states on issues relevant to increasing the flexibility to change assessment methods between reviews through bilateral meetings, as well as through a consultation paper and the Draft Report. In particular, the Commission sought states' views on whether there is a case for greater flexibility to change methods between reviews, the circumstances in which methods could be changed and how such flexibility could be operationalised.

The case for greater flexibility to change assessment methods between reviews

- 7 The terms of reference for the Commission's annual updates traditionally asked it to use 'the same principles, categories and methods of assessment' as the most recent methodology review. 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
- 8 The Commission proposed circumstances where it considered there was a case for extending the flexibility to change assessment methods between reviews, beyond data problems and major changes in Commonwealth-state relations. These circumstances were outlined in the Draft Report, namely:
- there is a significant impact on the fiscal positions of one or more states
 - the impact is not captured in existing assessment methods
 - a change in assessment methods before the next review would better achieve the objective of fiscal equalisation.

State views

- 9 Most states said they supported the Commission having additional flexibility to change methods in very limited circumstances and in full consultation with states. New South Wales said the existing arrangements, while allowing for flexibility through annual terms of reference, had not functioned effectively. Victoria said

¹ J Chalmers, [Terms of Reference for the 2025 Methodology Review: Commonwealth Grants Commission Act 1973](#), 9 February 2023.

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

³ In a few cases, update terms of reference have also asked the Commission to consider a change to (or not to change) a particular method. For example, the 2011 Update Terms of Reference directed the Commission not to move iron ore fines between its mineral groups in the mining revenue assessment. Terms of reference for the 2005 Update asked the Commission to review its assessment of the Northern Territory's debt charges and depreciation needs.

additional flexibility would ensure that fiscal equalisation could be achieved in light of significant uncertain events and that it would not impede efficiency-enhancing policy reforms.

- 10 Victoria said it had presented extensive arguments that the treatment of COVID-19 related spending under the 2020 Review methods was inappropriate. It said steps to prevent a future diminution of fiscal equalisation in such circumstances, as well as ensuring the fairness of the system, were critical.
- 11 Western Australia said it was encouraged by the Commission's statement in the Draft Report that a method change may not be introduced in the first update following the change in circumstances. It said that reliable data may not be available immediately and there is a need for adequate time for consultation. South Australia said it did not have any major concerns with the Commission having the flexibility to consider alternative methods between reviews on a case-by-case basis for unexpected developments in very limited circumstances.
- 12 South Australia and Tasmania said, while methodology reviews should be the primary process for determining method changes, unforeseen circumstances could arise that may not be accommodated by existing flexibility to change methods in updates.
- 13 Queensland and the Northern Territory said they did not support the Commission having greater flexibility to consider alternative methods between reviews. Queensland said additional flexibility would require a rigorous framework, agreed by states, to guide any proposed changes. It said the Draft Report did not consider a higher materiality threshold, a higher degree of consultation than usual and an annual review of any changes. It said, in the absence of such safeguards, there was a risk of arbitrary changes and continuous method reviews. Queensland said the heavy reliance on Commission judgement, particularly on trade-offs between supporting principles, could result in increased volatility in methods and potentially large changes to GST distributions. The Northern Territory said existing terms of reference provided sufficient and appropriate flexibility to respond to major shocks.

Commission response

- 14 The Commission considers that, in almost all circumstances, the approach of 5-yearly reviews and annual updates appropriately balances 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 and the objective of fiscal equalisation.
- 15 While the Commission aims to develop methods that capture states' fiscal circumstances as they evolve, not all changes in circumstances can be anticipated when the Commission is finalising a methodology review. The Commission agrees

with New South Wales that the existing approach, where specific terms of reference are needed to address significant unanticipated events, has not worked well. This is illustrated by 2 major developments since the 2020 Review – the COVID-19 pandemic and a major property tax reform proposal by New South Wales – where 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, or implement adjustments to assessment methods in response to unanticipated developments prior to the 2025 Review could have improved the assessment of state fiscal capacities, including in the context of major state reforms.

- 16 The Commission notes that it is required to exercise a degree of judgement, including in balancing supporting principles, when developing all its methods. In making judgements on method changes between reviews, the Commission would continue to follow the processes outlined in its assessment guidelines and seek to make its judgements as consistent, transparent and understandable as possible. Further, consideration of changes to methods would involve extensive consultation with states. Queensland’s proposal for a higher materiality threshold is addressed in the next section.
- 17 The Commission acknowledges the concerns about continuous method changes. The next section deals with circumstances in which method changes could be considered. While it is difficult to predict how often such events may occur, the Commission expects a change in assessment methods between reviews would only be made in very limited circumstances.

Commission position

- 18 The Commission considers that it would be beneficial for it to have additional flexibility to change methods between reviews in very limited circumstances, and in full consultation with states.

Circumstances that would justify a change in assessment methods between reviews

- 19 The terms of reference ask the Commission to consider the case for flexibility to change methods between reviews ‘where there is a significant unanticipated shock (such as a pandemic) or where major policy changes are enacted between reviews’.⁴ These examples reflect the experience since the 2020 Review. But the case for greater flexibility to change methods is not limited to the specific events of the past few years.

⁴ Chalmers, *Terms of Reference for the 2025 Methodology Review*.

- 20 The Commission proposed that the limited circumstances in which it should have flexibility to consider method changes include major unexpected developments or major policy changes where all of the following conditions apply:
- there is a significant impact on the fiscal positions of one or more states
 - the impact is not captured in existing assessment methods
 - a change in methods before the next review would better achieve the objective of fiscal equalisation.

State views

- 21 Most states said they supported the Commission's proposed circumstances in which changes to methods could be considered. Victoria said specific wording or quantitative triggers would be difficult to define. Victoria accepted the Commission's view that its proposal to conduct scenario planning may be difficult to implement. South Australia said the Commission must also consider the availability of reliable and policy neutral data on which to base an alternative assessment. It said COVID-19, while a major unanticipated shock, was a clear example of where it was not possible to construct an alternative assessment based on reliable, policy neutral data.
- 22 South Australia and Tasmania said the case for allowing flexibility for major policy changes, including taxation reform, was less strong. South Australia said major policy changes were not unexpected events and usually had a relatively long development timeline. It said they were best addressed as part of methodology reviews. South Australia said a state seeking assurances on a particular assessment approach in advance of committing to a policy reform was a separate issue. It said alternative assessment decisions should not be based on proposed legislation or on estimated future impacts involving untested assumptions.
- 23 Queensland said it did not support the proposed circumstances in which changes to methods could be considered. It said the proposed approach would afford the Commission too much discretion. It said method changes between reviews should be subject to a materiality threshold at double the current level. It said the method change should exceed the materiality threshold in the states directly impacted by the shock or reform.

Commission response

- 24 Most states supported the Commission's view that greater flexibility to change methods between reviews should only be considered in very limited circumstances. As emphasised in the Draft Report, it is difficult to specify in advance the precise nature or characteristics of what would constitute a significant unanticipated event.
- 25 Instead, the Commission considers the more pragmatic approach is to define what constitutes such an event based on its consequences, as outlined in paragraph 20.

- 26 In considering a change in methods in consultation with states, the Commission would apply its assessment guidelines. The availability of fit-for-purpose data, as well as a reliable method, is a key feature of those guidelines. (The next section discusses the process the Commission would follow).
- 27 The Commission does not consider introducing a specific higher materiality threshold is an appropriate trigger for considering a change in assessment methods. A specific higher materiality threshold may prove too restrictive, for example, if an alternative method clearly improves fiscal equalisation but falls just below this higher threshold.

Commission position

- 28 The Commission considers that the limited circumstances in which the Commission could change an assessment method would include major unexpected developments or major policy changes where all of the following conditions apply:
- there is a significant impact on the fiscal positions of one or more states
 - the impact is not captured in existing assessment methods
 - a change in methods before the next review would better achieve the objective of fiscal equalisation.

How would the Commission implement a change in method?

- 29 In the Draft Report, the Commission proposed a process for considering whether method changes were warranted. The first step in that process would be to consult with states on whether an event falls within the circumstances in which method changes may be warranted (outlined in paragraph 28). The Commission would issue a consultation paper to the states on these issues.
- 30 Having considered state views, if the Commission judged that a change in method may be warranted, it would undertake research and analysis to identify alternative methods and consult with states on all aspects of possible changes to assessment methods. The Commission proposed that it would consider changes in assessment methods in the same way as it does in a methodology review, involving extensive consultation with states.

State views

- 31 All states said they agreed that consideration of whether method changes were warranted should be undertaken in consultation with states. New South Wales noted the proposed process for considering method changes between reviews would be via a consultation paper to states on the relevant issues, before a wider consultation with states on all aspects of possible changes to assessment methods.
- 32 Western Australia was concerned that any change could be rushed without adequate consideration and consultation or allowing the implications of the shock to be gauged. It said it was important that the Commission was prepared to take time for extensive consultation, which may take more than one annual update.

- 33 South Australia said the Commission and states would have to agree on a case-by-case basis whether existing methods captured the impact of the shock or whether exploration of alternative methods was warranted. It said it supported the Commission having the ability to change methods between reviews after detailed consultation with states where there was a sound conceptual case for the change supported by sufficient empirical evidence, an alternative method based on reliable and fit-for-purpose data, and the change was material. It said those circumstances were likely to be very rare.

Commission response

- 34 The Commission proposes a structured process of consulting with the states on whether method changes in response to unanticipated shocks or major state policy reforms are warranted in the very limited circumstances outlined above. As a first step, the Commission would consult with states on whether an event falls within those circumstances in which changes to methods may be warranted before the next review.
- 35 Having considered state views, if the Commission judged that a change in method may be warranted, it would undertake research and analysis to identify alternative methods and consult with states on all aspects of possible changes to assessment methods.
- 36 The Commission would consider changes to 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 need 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 consultation paper to states on any proposed change.
- 37 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. Any change in assessment method would require the identification of reliable data and adequate time for consultation with the states. It could also be possible that, notwithstanding the circumstances that initiated the process, a reliable alternative method cannot be identified, and no change would be made, but could continue to be considered in the next review. In the case of policy reforms, some states said that

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.

a long implementation period would preclude the need to consider method changes between reviews. However, a state may seek an indication of how a proposed major policy reform would be assessed, prior to proceeding with the reform. This was the case with the property tax changes being considered by New South Wales. It was concerned that the existing assessment methods would be a significant constraint in proceeding with the reform.

- 38 The Commission is cognisant of the extra workload for states in considering potential method changes. Given it expects consideration of changes in methods in very limited circumstances, concerns relating to resourcing should be minimal.

Commission position

- 39 The Commission proposes a process for considering, in close consultation with states, whether an event falls within the circumstances that warrant a change in methods and, if it does, all aspects of possible changes to assessment methods.

How greater flexibility could be operationalised

- 40 In the Draft Report, the Commission proposed that additional flexibility could be provided in a standing clause in 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 would build upon the existing flexibility in terms of reference to overcome data problems or in response to major changes in Commonwealth-state relations.

State views

- 41 Victoria said it broadly supported the mechanism to implement flexibility through a standing clause in terms of reference. However, its preference was for flexibility to be actioned as a condition of the 2025 Review methods. It said the Commission's proposed approach implies the Commission will direct the Commonwealth Treasurer to amend its terms of reference, which it cannot do. South Australia said it was open to terms of reference allowing method changes between reviews, subject to appropriate processes for the review of any changes. The ACT said standing terms of reference should be accompanied by written guidelines elaborating on the circumstances that would trigger the exercise of such flexibility.
- 42 Victoria said it did not support the proposal from another state for the Commission to make separate recommendations to the Treasurer to alter the terms of reference while providing recommendations on the distribution of GST based on existing methods. It said there would not be enough time to respond to the late direction from the Treasurer and it would re-create the current issue where the Treasurer is the arbiter of method changes.

- 43 Queensland said it did not support operationalising flexibility in standing terms of reference.

Commission response

- 44 The Commonwealth Treasurer has asked the Commission to provide advice on whether it should be given additional flexibility to change methods between reviews.
- 45 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. In the absence of a specific terms of reference direction on a method change, the Commission is required to use the ‘same principles, categories and methods of assessment’ as the most recent methodology review.
- 46 Providing for additional flexibility in a standing clause in terms of reference for updates 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. Contrary to Victoria’s view, the Commission is not proposing to ‘direct’ the Treasurer to amend the standing terms of reference for an update to provide the Commission with greater flexibility to change methods between reviews. This is the Commission’s recommendation to the Commonwealth Treasurer. It is always open to the Commonwealth Treasurer not to accept the Commission’s recommendations.
- 47 Including additional flexibility in a standing clause in terms of reference for updates would complement the existing flexibility to change methods where there are data problems or in response to significant changes in Commonwealth-state relations. A standing clause in 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 position

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

Retrospectively adjusting GST shares for method changes

- 49 Victoria said, in cases where the Commission is unable to implement new methods in an update, it could consider ‘backwards adjustments’ in future years.

State views

- 50 Queensland and South Australia said that, if the Commission were given flexibility to make changes, they did not support any retrospective adjustments to GST relativities for method changes between reviews.

Commission response

- 51 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 (either in reviews or in updates). It considers retrospective adjustments may move away from fiscal equalisation in the years in which they are made and increase budget uncertainty for states.

Commission position

- 52 The Commission does not support retrospectively adjusting GST shares in cases where an assessment method is changed between reviews.