

Fiscal equalisation, supporting principles and assessment guidelines

Review outcomes

- The Commission will retain its approach to horizontal fiscal equalisation as the first step in determining the GST distribution in accordance with GST distribution legislation.
- The Commission will retain its 4 supporting principles ('what states do', policy neutrality, practicality and contemporaneity) and will not introduce new supporting principles.
- The Commission will retain its assessment guidelines, while increasing the materiality threshold for drivers to \$40 per capita and for data adjustments to \$12 per capita.
- The Commission will retain its discounting framework and will apply 6 discounts.

Introduction

- 1 On 21 April 2023, the Commission published a [consultation paper](#) outlining its preliminary views on horizontal fiscal equalisation, supporting principles and assessment guidelines and invited [state submissions](#).
- 2 On 9 June 2023, the Commission published its [position](#) on horizontal fiscal equalisation, supporting principles and assessment guidelines. This provided guidance for the Commission's review of its assessment methods.
- 3 The Commission reviewed the consistency of its use of discounting across assessments and published its outcomes in November 2024 in [Significant changes since the Draft Report](#).
- 4 This chapter includes:
 - a high-level overview of the issues considered throughout the review
 - the Commission's response and decision on each issue.
- 5 More detail on these issues can be found in the Commission's [position paper](#) on horizontal fiscal equalisation, supporting principles and assessment guidelines. It includes a detailed analysis and response to the issues raised by states and territories (states).
- 6 A description of the Commission's approach to horizontal fiscal equalisation, supporting principles and assessment guidelines, incorporating the changes made in the 2025 Review, can be found in the *Commission's Assessment Methodology*.

Horizontal fiscal equalisation

- 7 The Commission provides independent advice to the Commonwealth on how GST revenue should be distributed among the state and territories (states). The distribution of GST revenue is governed by legislation and terms of reference issued by the Commonwealth Treasurer.
- 8 The terms of reference require the Commission to take into account the *Intergovernmental Agreement on Federal Financial Relations*. This agreement provides that GST revenue will be distributed in accordance with the principle of horizontal fiscal equalisation.
- 9 The GST distribution legislation includes an equalisation benchmark linked to the fiscally stronger of New South Wales or Victoria, a GST relativity floor, and transitional arrangements. Under this benchmark, the concept of horizontal fiscal equalisation remains relevant to the first step in determining states' GST distributions — calculating states' relative fiscal capacities, or 'assessed relativities'. This first step is necessary to identify the fiscally stronger of New South Wales or Victoria, which is the benchmark set by the legislation.
- 10 The Commission's preliminary view was that the approach to horizontal fiscal equalisation articulated in the 2020 Review remained appropriate for the first step in determining GST distributions, including the calculation of transitional 'no worse off relativities'.¹ In line with the conclusion in the 2020 Review, it proposed that the assessment of state relative fiscal capacities continues to be determined such that:

'after allowing for material factors affecting revenues and expenditures, each state would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own-sources and operated at the same level of efficiency.'
- 11 In assessing each state's GST needs in line with horizontal fiscal equalisation, the Commission assesses the amount the state would need to spend to provide all-state average services and infrastructure, and the revenue it could raise from its own sources if it made the average effort. The Commission also takes into account payments other than GST that each state receives from the Commonwealth.²

¹ Terms of reference ask the Commission to provide the relativities that would have applied if the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018* had not been enacted. Horizontal fiscal equalisation is also relevant to calculating 'no worse off' relativities in accordance with Section 5 of the *Federal Financial Relations Act 2009*.

² Not all Commonwealth payments are taken into account. Some payments are excluded by the Treasurer's terms of reference ('quarantined payments'). In the case of payments that are not quarantined, the Commission includes those that relate to state-type services for which the Commission assesses states' expenditure needs. The Commission's approach to other Commonwealth payments will be covered in a subsequent paper.

State views

- 12 All states supported the view that the approach articulated in the 2020 Review is the appropriate first step in determining the GST distribution.
- 13 Victoria said that, while horizontal fiscal equalisation should be the primary objective, it would like to see a reweighting towards the supporting principles. Western Australia noted that the horizontal fiscal equalisation objective was only ever aspirational because it is not possible to calculate true horizontal fiscal equalisation.
- 14 Several states said that horizontal fiscal equalisation is no longer achieved in practice as a result of the legislation requiring the distribution of GST being linked to the fiscally stronger of New South Wales or Victoria. The role of assessed relativities in informing the transitional ‘no worse off relativities’ that are included in legislation was also noted. Tasmania said a permanent extension to the no worse-off guarantee is needed.
- 15 The Northern Territory said equalisation gives states the fiscal capacity to deliver state-average services but does not provide additional capacity to address persistent pre-existing structural disadvantage. It sought consideration of changes to the Commission’s framework for the treatment of Commonwealth payments to ensure the GST distribution does not impede the objectives of such funding.

Commission response

- 16 The Commission has consistently stated that equalisation is not an exact science — it depends on the availability of appropriate data and requires the Commission to undertake estimates, apply judgement, and make trade-offs. In making these judgements, the Commission will continue to follow the processes outlined in its assessment guidelines and will seek to make its reasoning as consistent, transparent and understandable as possible.
- 17 While the Northern Territory did not seek to amend the definition of horizontal fiscal equalisation, it sought to clarify the treatment of Commonwealth payments provided to a state to address pre-existing structural disadvantage. These issues are discussed in the Commonwealth payments chapter of *Review Outcomes*.

Commission decision

- 18 The Commission will retain the 2020 Review approach to horizontal fiscal equalisation as the first step in determining the GST distribution in accordance with GST distribution legislation.³

³ *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of the GST) Act 2018 (Cth)*.

Supporting principles

- 19 The Commission identifies influences ('drivers') beyond the direct control of states that cause their relative fiscal capacities to diverge. By quantifying these drivers, the Commission estimates the GST share each state requires to have the capacity to provide the same (average) level of services — that is, each state's relative fiscal capacity as represented by its 'assessed relativity'.⁴
- 20 Since the 2010 Review, the Commission has developed and refined a set of supporting principles.⁵ These are guiding considerations for the Commission in designing and evaluating alternative assessment methods and are subsidiary to the objective of horizontal fiscal equalisation. They are:
- 'what states do' — the Commission's methods should, as far as possible, reflect what states collectively do, not what they could or should do
 - policy neutrality — a state's policy choices (in relation to the revenue it raises or the services it provides) should not directly influence its GST share; and the Commission's assessments should not create incentives to choose one policy over another
 - practicality — assessments should be based on sound and reliable data and methods and should be as simple as possible, while capturing the major influences on state expenses and revenue
 - contemporaneity — to the extent reliable data will allow, the distribution of GST in a year should reflect state circumstances in that year.
- 21 The Commission's preliminary view was that the 4 supporting principles remained appropriate.

State views

- 22 All states supported the 'what states do' principle, with assessments being based on the weighted average policy of all states. However, several states noted the difficulty of determining an average policy when an assessment is dominated by one state (such as in the case of mining), or when what states do is changing (for example, tax reform), or where a state is trying to address structural disadvantage.
- 23 All states supported the policy neutrality supporting principle as being appropriate, with assessments being based on the weighted average policy of all states. However, many recognised the difficulty of determining an average policy when an assessment was dominated by one state. Some states also asked the Commission to provide greater clarity and consistency on how it weighed the primary objective of horizontal fiscal equalisation and supporting principles in reaching its decisions on assessments that involved a trade-off between supporting principles.

⁴ Assessed relativities are calculated for each assessment year by comparing each state's relative ability to raise revenue with its relative cost of providing services. See Box 1-1 in [GST Revenue Sharing Relativities 2023 Update](#).

⁵ The supporting principles evolved from the '3 pillars of equalisation' first articulated in the 2004 Review: capacity equalisation, internal standards, and policy neutrality.

- 24 All states supported the practicality principle. Several states said simplicity, transparency and quality assurance were central to trust in, and understanding of, horizontal fiscal equalisation. They called for a greater focus on each of these aspects of the practicality principle.
- 25 All states broadly supported the Commission's approach to contemporaneity, noting that the 3-year lagged average approach will achieve equalisation over time. There were differing views on the use of forecasts as well as historical data.
- 26 Western Australia proposed 2 new principles (policy consistency and conservatism).

Commission response

- 27 The Commission notes that significant experience, expertise and effort have gone into developing, refining and improving the supporting principles since they were introduced. In particular, the 2020 Review involved extensive consultation on, and consideration of, the supporting principles.⁶ The Commission's view is that there are no developments that require the need to introduce new principles.
- 28 The Commission acknowledges the challenges in determining average policy and the limitations of the 'what states do' principle in some circumstances. These issues are addressed in the relevant chapters of *Review Outcomes*.⁷ Overall, the Commission is satisfied that 'what states do' continues to be the best way to determine average policy.
- 29 The Commission recognises that the supporting principles can often be in conflict. For example, there may be cases where the Commission needs to balance the trade-off between 'what states do' and policy neutrality. Where trade-offs are required, the Commission will outline the reasons for its decisions.
- 30 The Commission endorses many of the points raised about the practicality principle, particularly the importance of its consistent application and the role of transparency. The Commission recognises that assessed relativities provide an approximation of horizontal fiscal equalisation and that false precision needs to be avoided. Nevertheless, the primary objective of assessed relativities is to minimise as far as possible differences in the fiscal capacities of the states to deliver services.
- 31 With respect to the contemporaneity principle, the 3-year lagged moving average provides an appropriate balance between contemporaneity, predictability and smoothing the impact of fiscal shocks. The Commission does not support the use of forecasts because it would require an ex-post adjustment to address inaccuracies in

⁶ Further detail on the Commission's consideration of supporting principles and their implementation in the 2020 Review can be found in Vol 2 Chapters 2 and 3 of the [Report on GST Revenue Sharing Relativities, 2020 Review](#).

⁷ Concern that the GST distribution arrangements can be a disincentive for some tax reforms is covered in the stamp duty on conveyances and flexibility chapters of *Review Outcomes*. The issue of determining the average policy when one state dominates expenditure or revenue is covered in the mining chapter of *Review Outcomes*. The Northern Territory's views on pre-existing structural disadvantage are addressed in the Commonwealth payments chapter of *Review Outcomes*.

those forecasts. This would add an additional layer to the equalisation process, with the Commission updating its relativities when final data become available.

32 The Commission does not support the introduction of a ‘policy consistency’ principle. While there will be a range of different policies affecting a state’s revenue capacity, it would be impractical to identify and make reliable adjustments for every difference. The Commission considers that calculating a weighted average tax rate for each state’s tax base, across all states, is the most practical approach to assessing a state’s own source revenue capacity (with some adjustment to the tax base as required and the application of the policy neutrality principle). The Commission also does not support a conservatism principle – which would require the Commission to err on the side of smaller GST redistributions in the face of uncertainty by moving towards an equal per capital distribution. There is an element of uncertainty with all assessments, but it is not evident that such general uncertainty materially affects the assessment of state fiscal capacities. The Commission seeks to reduce differences in the fiscal capacity of the states in all assessments and the degree of uncertainty will depend on the circumstances of each assessment. The Commission’s approach to discounting assessments is discussed below in the section on assessment guidelines.

33 The Commission maintains its position that there should not be an explicit weighting or hierarchy of the supporting principles. It considers that wherever possible, assessment methods should be chosen having regard to all the supporting principles.

Commission decision

34 The Commission will retain the 4 supporting principles and will not introduce new principles. There will not be a weighting or hierarchy of the supporting principles.

Assessment guidelines

35 Since the 2004 Review, the Commission has used assessment guidelines to support a consistent approach to developing assessment methods and to ensure conceptual soundness, reliability, transparency and simplicity with the application of those methods. The guidelines are a key part of the Commission’s quality assurance process.

36 The Commission has applied materiality thresholds to its assessments since the 2010 Review, increasing the level of the thresholds in the 2015 and 2020 Reviews. The materiality thresholds help to simplify the assessments.

37 In the 2025 Review, the Commission considered 2 options for basing an increase in the thresholds:

- the State and Local Government Final Consumption Expenditure chain price index — the approach used in the 2020 Review
- state expenditure per capita.

- 38 The Commission proposed that the thresholds be increased broadly in line with state spending per capita. This would increase the threshold for assessing drivers to \$45 per capita and the data adjustment threshold to \$15 per capita.

State views

- 39 Victoria, Queensland, Western Australia, South Australia and Tasmania supported the continued use of the 2020 Review guidelines.
- 40 New South Wales, the ACT and the Northern Territory raised concerns about materiality thresholds, discounting and the timeliness and use of data.
- 41 Victoria supported the guidelines while seeking a more transparent decision-making process for how a proposed method change meets each element of the assessment guidelines. It said quality assurance and transparency could be improved through peer review and periodic external review of calculations and documenting the reasons for Commission decisions.
- 42 The ACT broadly supported the assessment guidelines but suggested they include a reference to the timeliness of data in the definition of fitness for purpose. The ACT also suggested amending the guidelines to reflect that the Commission will endeavour to use the best available data if a fully compliant source was not available.
- 43 Several states supported increasing materiality thresholds, preferring the State and Local Government Final Consumption Expenditure chain price index to the Commission's proposal. Others did not support indexation or felt it would raise the threshold too high. Western Australia noted that the thresholds proposed by the Commission were rounded to the nearest \$5 per capita, which was appropriate for simplicity, but suggested the Commission continue to apply its indexation to the same base year so that rounding errors did not accumulate over time.
- 44 The ACT and the Northern Territory did not support materiality thresholds. The ACT suggested an additional, less onerous, test. The Northern Territory preferred the State and Local Government Final Consumption Expenditure chain price index if indexation of the materiality threshold were to occur.

Commission response

- 45 The Commission considers the 2020 Review assessment guidelines remain appropriate, although it will increase the materiality threshold levels.
- 46 The Commission's view is that there is no need to amend the definition of fitness for purpose to incorporate the timeliness of data because the contemporaneity principle provides sufficient guidance on the use of timely data. Similarly, the guidelines provide the Commission with the flexibility to use the best available data, with adjustments, if necessary, when data that fully comply with the guidelines are unavailable. Timeliness of data is also a consistent requirement of terms of reference issued by the Commonwealth Treasurer which direct the Commission to

'have assessments that are simple and consistent with the quality and fitness for purpose of the available data' and to 'use the latest available data consistent with this.'

- 47 The Commission acknowledges the Northern Territory's concerns that the use of materiality thresholds can contribute to inaccuracies over time. However, they are an important aspect of simplifying assessments and they are the means by which the Commission determines the material factors to comply with the horizontal fiscal equalisation objective. The Commission recognises that materiality thresholds cannot be applied mechanistically and that judgement is required.
- 48 The Commission was persuaded by state arguments in relation to the appropriate basis for increasing materiality threshold levels. The Commission will increase the materiality thresholds to \$40 per capita for the assessment of a driver and \$12 per capita for a data adjustment. These increases are broadly in line with the State and Local Government Final Consumption Expenditure chain price index. This was the approach used in the 2020 Review and it is consistent with most state views that materiality thresholds should be increased to maintain their value in real terms over time.
- 49 In response to Western Australia's concern that rounding errors can accumulate over time, the Commission recalculated the thresholds using the same base year and they did not change. In addition, the Commission rounded down the data threshold.
- 50 The Commission considered the test proposed by the ACT involving a 2-part materiality threshold that included an aggregate redistribution materiality threshold. However, it is satisfied that the state-based approach to thresholds is appropriate and the number of cases where an assessment is material overall but not for any state are likely to be small and do not warrant the additional complexity of a 2-part materiality test.
- 51 The Commission agrees that the materiality of all factors and assessments should be reconsidered in a review. It retested the materiality of all drivers of need and assessments as part of the 2025 Review.

Commission decision

- 52 The Commission will retain the 2020 Review assessment guidelines, although it will increase the level of materiality thresholds.
- 53 The Commission will increase its materiality thresholds to \$40 per capita (for the assessment of a driver) and \$12 per capita (for a data adjustment).

Discounting assessments

- 54 As part of the 2025 Review, the Commission reviewed its use of discounting to ensure consistency across assessments.

55 The Commission proposed to retain the 2020 Review discounting framework and the discount levels. That is:

Where a case for assessing a driver in a category is established, but the Commission has concerns with the underlying data or assessment method, a uniform set of discounts will be used — low (12.5%), medium (25%), high (50%) or no assessment (100%). The Commission will use higher discounts when the Commission has greater concerns with the underlying data or assessment method.

56 Under the discounting framework, discounts are used where there are concerns with data or methods and not applied in cases of general uncertainty or to address policy neutrality.

57 The Commission invited state views on whether the 2020 Review discounting framework remained appropriate and the case for discounting particular assessments was considered as part of consultation on those assessments.

58 The Commission considered the consistency of its use of discounting across assessments towards the end of the review and published the outcomes in *Significant changes since the Draft Report*.

State views

59 Queensland, South Australia, Tasmania and the ACT supported the 2020 Review approach to discounting. Queensland and South Australia said there was a need for regular reviews of discounts, so they reflect the degree of uncertainty and unreliability of the data and methods. They identified assessments where they considered a higher level of discount should be applied.

60 New South Wales was concerned that discounting was arbitrary. It said the Commission applies a discount where it considers data to be unreliable, but discounting was only ever in one direction, towards an equal per capita distribution. Discounting could be moving the outcomes further away from true horizontal fiscal equalisation. New South Wales supported greater consistency in the use of discounts. It suggested that assessments with a discount be given greater attention in order to improve them. It also suggested the Commission increase its efforts to collect more reliable data from states with the aim of removing discounts over time.

61 Victoria sought greater clarity over the definition and application of discounts. It said that where a high discount is applied, there were concerns with the appropriateness of the data or method and as such, it raised the question whether an assessment should be made. Victoria noted that discounts were not applied to judgement-based estimates, whereas Victoria considered there was a greater case for using discounts in these situations.

62 Western Australia said the Commission should be using discounting more often. It supported the use of discounts in cases of general uncertainty and policy neutrality.

It also suggested that an alternative to discounts to individual assessments would be a discount to the assessed relativities or a floor on relativities.

- 63 The Northern Territory was opposed in principle to extensive discounting. It said that general uncertainty and methodological difficulties did not always warrant a discounting approach.

Commission response

- 64 The Commission acknowledges that discounting involves judgement. However, discounting allows the Commission to capture states' fiscal capacities while recognising the limitations of data and methods in some circumstances. The Commission will continue to consider discounts on a case-by-case basis, explain the reason for any discount and ensure consistency of approach across assessments.
- 65 The Commission agrees with New South Wales' suggestion that it should increase efforts to collect more reliable data from states with the aim of removing the need for discounting.
- 66 As New South Wales noted, discounting moves assessments closer to equal per capita. The Commission considers this to be the only practical way to deal with situations where there is evidence that material differences exist between states in the level of use or unit costs, or both, in providing services or in their capacities to raise revenue, but there is uncertainty over the reliability of the data or the method. In such situations, discounting the assessment method for this uncertainty will be more consistent in moving towards horizontal fiscal equalisation than not undertaking an assessment. However, if the level of uncertainty is too large, it agrees with Victoria that an assessment should not be made.
- 67 The Commission does not apply discounts to judgement-based estimates because, in determining those estimates, it has already considered the degree of uncertainty involved.
- 68 The Commission does not consider that discounting assessed relativities is an alternative to discounting individual assessments. When deciding on whether to apply a discount, the Commission takes into account the circumstances of the individual assessment.
- 69 The Commission has not changed its view that discounts should only be used for concerns with data or methods. Discounts will not be applied in cases of general uncertainty or to address policy neutrality.

Commission decision

- 70 The Commission will retain the 2020 Review discounting framework.
- 71 In the 2025 Review methods there will be 6 discounts. It will retain the 4 discounts from the 2020 Review at the same levels and add 2 new discounts: applied to the

entirety of the roads assessment and the non-state sector adjustments in the health assessment.

72 Table 1 indicates the assessments where the Commission has applied a discount to an assessment, including the rationale for the discount and its level. More detail on individual discounts, and consideration of state proposals regarding discounts, is provided in the relevant assessment chapters.

Table 1 Discounts in the 2025 Review

Assessment	Component	Rationale for discount	Level of discount
Land tax	Whole assessment	Uncertainty about the reliability and comparability of taxable land value data.	12.5%
Health	Community health socio-demographic	Reliance on a proxy measure of activity for a significant share of community and public health expenses.	12.5%
Health	Non-state sector adjustments	Uncertainty about the reliability of data and the robustness of the methods for determining the adjustments.	12.5%
Roads	Whole assessment	Uncertainty about the reliability of data included in several aspects of the assessment, including the reliability of the rural road synthetic network as a proxy measure of what states do.	12.5%
Wage costs	A range of category assessments	Uncertainty about the reliability of private sector wages as a proxy for public sector wage pressures, and the capacity of the model to control for all differences in employee productivity.	12.5%
Geography	Regional costs general gradient, applied to a range of category assessments	Uncertainty about the reliability of the gradient, given it is applied where a gradient cannot be directly measured.	25.0%