



2026

Economic Impacts of Australia's GST Distribution on Queensland

Final Report

© Queensland Productivity Commission 2026

The Queensland Productivity Commission supports and encourages the dissemination and exchange of information. However, copyright protects this document.

The Queensland Productivity Commission has no objection to this material being reproduced, made available online or electronically but only if it is recognised as the owner of the copyright and this material remains unaltered.

Executive Summary

Context

In 1999, the Australian, state and territory governments (hereafter 'states') agreed to reform Commonwealth–State financial relations with the signing of a new intergovernmental agreement (IGA) to remove a range of inefficient taxes and provide states with access to 'a more robust tax base that can be expected to grow over time' (Australian Government 1999b, pp. 2–3).

The agreement was made possible through the introduction of the Goods and Services Tax (GST) and the Australian Government's undertaking that GST revenue would be distributed to the states as untied grants and in accordance with the principle of horizontal fiscal equalisation (HFE); a longstanding feature of Australian Government revenue assistance to the states.

The GST distribution system is intended to equalise the fiscal capacity of states by offsetting differences in revenue-raising capacity and service delivery needs and costs, so that each state has the potential to provide a similar level of services and infrastructure to its residents.

Since the introduction of the GST in 2000, the distribution of GST revenue has been based on the recommendations and methodology of the Commonwealth Grants Commission (CGC).

With GST grant revenue representing an important source of state funding, states are heavily invested in the process of GST distribution. As a result, debate over the appropriate distribution of GST revenue has been an ongoing feature of intergovernmental financial relations in Australia. Numerous reviews have been initiated by the Australian Government and the states into the GST distribution system, with the first review commencing in 2002.

While the focus of these reviews has been wide-ranging, a prominent theme has been the extent to which the GST distribution system can reduce economic efficiency.

Approach and scope

The Queensland Productivity Commission (the Commission) has been asked to provide advice on the economic impacts of Australia's GST distribution system on Queensland.

The distribution of GST revenue is primarily concerned with equity (the division of economic returns) rather than efficiency (the growth of economic returns). The current distribution system aims to deliver equity by equalising the fiscal capacity of state governments, rather than interpersonal equity outcomes more directly. Seeking to achieve fiscal equalisation through the GST distribution system can have consequences for both equity outcomes and economic efficiency, through impacts on the allocation of resources and influence on policy decisions.

Despite long-held concerns and frequent reviews suggesting the GST distribution system has a range of consequences for economic efficiency, quantitative evidence has been limited and there is no consensus on overall economic impacts. Accurately assessing economic impacts is difficult. While fiscal impacts are more direct and measurable, economic impacts are more complicated to measure as the primary impacts are transfers (that is, the redistribution of resources without changing total resources). In addition, the most significant effects are likely to be from indirect impacts. For example, through less efficient allocation of labour and capital across the economy or poor incentives for sound government spending, taxation and reform.

This advice sets out available evidence on the extent to which the GST distribution system delivers against its objectives in an economically efficient manner. HFE involves a set of inherent direct and indirect trade-offs. However, over time other trade-offs have arisen due to economic changes or administrative processes (such as through the distribution methodology applied by the CGC). This advice identifies specific areas where these other trade-offs may result in suboptimal economic outcomes. It does not attempt to assess what the 'optimal' system may be, rather it seeks to provide available evidence on the impact of the current GST distribution system on economic efficiency.

To prepare this advice, the Commission submitted an Interim Report in February 2026, setting out initial evidence and areas where sub-optimal efficiency consequences can arise. This Final Report provides additional evidence on the efficiency consequences of the GST distribution system, including:

- new modelling of the impact of fiscal capacity and GST distribution outcomes on interstate migration
- a broader assessment of impacts on policy, tax and spending incentives
- impacts of interactions between the GST distribution system and other Commonwealth payments.

Queensland's GST experience

Over the long-term, the GST distribution system has provided Queensland with a more favourable revenue outcome compared to alternatives suggested by the Australian Productivity Commission (PC) or other jurisdictions, such as a distribution system based on equal per capita (EPC) shares.

While Queensland's GST grant, total revenue and expenses grew largely in line with each other until 2019, there was then a significant divergence, with a large increase in own-source revenue and expenses.

In 2025–26, Queensland is projected to receive \$16.8 billion in GST grant revenue, \$2.2 billion lower than in 2024–25. This decline represents the largest fall in GST grant revenue in a single year any state has faced since the GST was introduced. Queensland's GST grant revenue in 2025–26 equates to \$2,945 per person, effectively the same amount of revenue received as in 2002–03 in real per capita terms (\$2,943).

Queensland's GST grant revenue is forecast to increase in 2026–27 and over the forward estimates.

The longer-term outlook for Queensland's GST grant revenue is uncertain given the scheduled end to the current No Worse Off (NoWO) guarantee payments in 2029–30. The NoWO guarantee payments are material, as based on the Commission's estimates, Queensland would have been worse off by \$6 billion in GST grant revenue had the current transitional arrangements not been in place. The actual revenue impact of the NoWO guarantee payments ceasing will be dependent on state circumstances, future CGC methodology changes and outcomes of the current PC inquiry into the 2018 GST distribution changes.

Findings

Given its nature, the GST distribution system is primarily associated with fiscal impacts, which can be significant. However, this advice identifies a range of potential impacts on efficient resource allocation, which cumulatively, may have a material (albeit not easily quantifiable) impact on the community. More broadly, the system can divert attention from, and may dampen incentives for, sound policy and spending settings to improve living standards. A better understanding of these impacts can help inform the ongoing discussion of how the GST distribution system can efficiently achieve its objectives.

The Commission has considered impacts of the GST distribution system on labour and capital mobility, growth-enhancing policy decisions and interactions with other Commonwealth grants.

Impacts to labour and capital mobility

The movement of labour and capital across the federation can be affected by the GST distribution.

New modelling in this Report examines motivations for interstate migration. It finds interstate migration in Australia mostly occurs for reasons such as to access employment but is also associated with differences in GST distribution outcomes.

While modest, this effect may accumulate over time given ongoing GST revenue grant flows toward specific states, leading to material impacts on state populations over the longer term.

A foundational argument for HFE is that it may improve incentives for labour and capital to locate where they are most productive rather than where they receive better tax treatment or services. However, in practice, the GST distribution can result in inefficiency by:

- encouraging labour and capital to flow to high-cost or congested locations
- discouraging high-value international skilled labour and capital from flowing to Australia
- dampening market signals, impeding labour and capital from moving to take advantage of structural change or economic opportunities.

Impacts to growth-enhancing policy

The GST distribution system has the potential to influence policy decisions and may promote inefficiency where it compensates states for inefficient policy and penalises states for efficient policy. For example:

- Revenue-raising capacity is assessed narrowly based on the taxes states actually raise and may discourage growth-enhancing policy and increase states' reliance on inefficient taxes by:
 - **disincentivising resource development** — where state dominance in a revenue source means only a small share of a change in revenue is retained in the state, once the full redistribution takes effect. Recent methodology changes have exacerbated this effect for black coal
 - **compensating states that restrict economic activity** — states that choose to ban or restrict resource development do not bear the full cost of their decision, as they are assessed by the CGC as not having the ability to raise this revenue
 - **favouring inefficient taxes** — indicative estimates suggest a 10 per cent increase in transfer duty rates (a comparatively inefficient tax) can result in states receiving additional long run GST grant revenue to the value of 33 to 65 per cent of the additional tax revenue
 - **potentially impeding tax reform** — where such reform has an adverse GST grant revenue consequence
- The GST distribution may also discourage efficient state expenditure by:
 - **enabling transfer dependency of recipient states** — recipient states may rely on the GST distribution system to finance their expenses, rather than pursuing economic growth policies. By 2026–27 the GST distribution system will have cumulatively redistributed \$130 billion in GST revenue from donor to recipient states, relative to an EPC share
 - **dulling incentives for efficiency improvements** — in public services and in risk mitigation
 - **moving pro-cyclically with states' fiscal positions** — the GST distribution system may exacerbate incentives to inefficiently allocate revenue windfalls when GST grant revenue is procyclical with other revenue
 - **compensating states that undertake inefficient borrowing** — recent trends suggest high population growth states are compensating states whose net borrowing is increasing above long-run trends.

Inefficiencies from interactions with other Commonwealth grants

The GST distribution system can interact with other Commonwealth grants, promoting inefficient outcomes when:

- states face incentives to forgo tied grants that are in the national interest and deliver net public benefits
- fiscal and economic resources are directed toward infrastructure or services that do not deliver benefits to the community in excess of costs
- the administration of grants is costly and complex.

Contents

Executive Summary	1
1.0 Background	5
1.1 Introduction	5
1.2 The GST distribution system	6
1.3 Reviews of GST distribution and HFE	13
2.0 Queensland's GST experience	15
2.1 Queensland's budget has generally benefitted from the GST distribution system	15
2.2 In 2025–26 Queensland's GST share fell to a record low	17
2.3 Distribution system changes have a material fiscal impact	21
3.0 Assessing the economic impacts of the GST distribution system	23
3.1 Equity vs Efficiency	23
4.0 Impacts on labour and capital mobility	25
4.1 Impact on the flow of labour and capital	25
4.2 Encouraging inefficient flows of labour and capital	28
5.0 Discouraging growth-enhancing policy	32
5.1 Assessments can encourage inefficient policy	32
5.2 States' reliance on inefficient taxes	33
5.3 The GST distribution may discourage efficient expense management	43
5.4 System changes have not resolved the efficiency costs of the GST distribution	50
6.0 Interactions with other Commonwealth grants	51
6.1 Australia's grants system	51
6.2 Impeding welfare-enhancing outcomes by overriding funding agreements	54
6.3 Quarantining or excluding some grants can result in inefficiency	54
6.4 Economic costs of grant administration	55
Appendix A: Terms of Reference	56
Appendix B: Assessing the effect of the GST distribution on interstate migration	58
Table of acronyms and abbreviations	67
References	68

1.0 Background

1.1 Introduction

Direction

On 17 November 2025, the Queensland Treasurer directed the Queensland Productivity Commission (Commission) to provide advice on the economic impacts of Australia's Goods and Services Tax (GST) distribution system on Queensland ('the direction'). The terms of reference outlining the full direction is provided in Appendix A.

The Commission has been asked to assess the economic impact of GST distribution, including on:

- Queensland's economy and the State's capacity to deliver services to support growth and social outcomes, considering that from 2015–16 to 2025–26 Queensland's GST revenue grew by 28 per cent instead of 75 per cent in line with the growth in national GST payments
- other key economic outcomes for Queensland relative to other states and territories, including capital and labour mobility
- Queensland, relative to other states and territories, as a result of the 2018 GST distribution system changes.

The Commission has also been asked to assess:

- whether GST distribution outcomes have appropriately incentivised sound policy decisions and reform
- the unintended consequences of the interaction between GST distribution and the broader Commonwealth–State funding and policy framework
- any other relevant matter relating to the economic and equity impacts of GST distribution.

Approach

Consistent with the direction, the Commission has focused on providing targeted advice on the economic impacts of the GST distribution system on Queensland.

In preparing the Final Report, the Commission has drawn on the existing body of literature concerning the economics of horizontal fiscal equalisation (HFE) and fiscal federalism, supplemented with its own analysis and modelling.

As this report was commissioned as advice under section 9(1)(d) of the *Queensland Productivity Commission Act 2025* (Qld), the Commission did not undertake formal consultation nor request submissions. To support delivery of this advice and consistent with the requirements of the direction, the Commission has undertaken targeted consultation with Queensland Treasury, the Australian Productivity Commission (PC) (concerning its 2018 Horizontal Fiscal Equalisation Inquiry), the Commonwealth Grants Commission (CGC) and academics with relevant technical expertise in fiscal federalism.

The Commission is grateful for the contributions of these organisations and individuals to the preparation of this advice.

To address the direction, the Final Report:

- provides information on the GST distribution system in Australia, with a particular focus on its policy objectives, recent developments and findings of past reviews (Section 1)
- discusses the fiscal outcomes of the GST distribution system for Queensland over time, including the effects of the 2018 changes to the GST distribution system (Section 2)
- sets out a framework for considering how the GST distribution system affects economic efficiency (Section 3)
- examines how the GST distribution affects labour and capital mobility (Section 4)
- examines how GST assessments can discourage growth-enhancing policy (Section 5) and how interactions with other Commonwealth payments can result in inefficiency (Section 6).

Consistent with the direction, the advice does not examine the broader fiscal, equity, governance and methodological issues of GST distribution, except where these are relevant to discussing economic impacts on Queensland. The advice also does not consider or recommend alternative policy options nor reforms to the system of GST distribution.

The advice relies heavily on publicly available data and materials from the Australian Bureau of Statistics (ABS), federal and state budget papers, past reviews, the economic literature and the CGC. It has also had regard to public submissions to the current PC inquiry into the GST distribution reforms. The Commission has not relied on any proprietary models, such as the CGC's model, as they are confidential and access would require agreement from all states and territories (hereafter 'states').

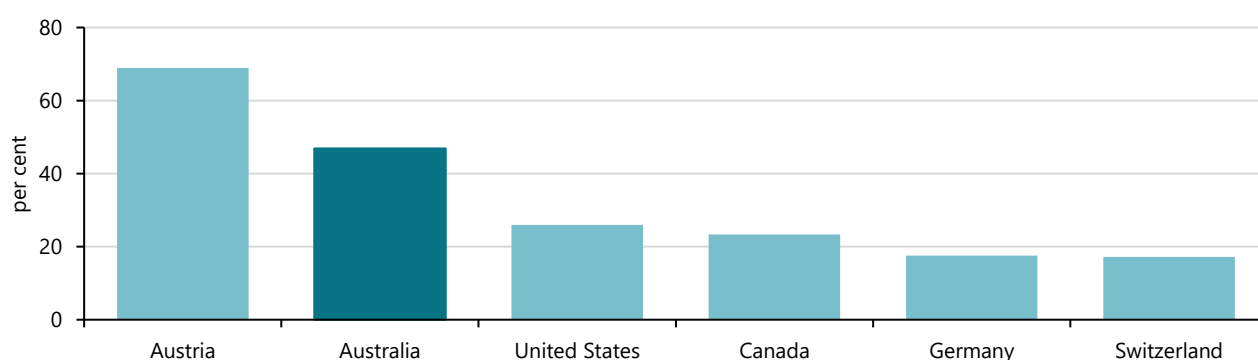
1.2 The GST distribution system

Introduction of the GST

Under Australia's system of fiscal federalism, the Australian Government's revenue-raising effort significantly exceeds its spending responsibilities, while the converse is the case for the states. This results in a vertical fiscal imbalance (VFI), an imbalance between spending responsibilities and revenue-raising powers. Among comparable federations, Australia has a high level of VFI, such that states rely heavily on Australian Government transfers (Figure 1.1).

Figure 1.1 Australia has a relatively high level of vertical fiscal imbalance

Vertical fiscal imbalance across selected, comparable federations, 2020



Note: The VFI measure in Figure 1.1 is calculated as one minus the ratio of subnational governments' own revenue compared to their own spending. As shown, a high level of VFI (such as in Austria and Australia) indicates subnational governments' spending is far greater than their own revenue (Browne 2021, pp. 4–6).

Source: IMF 2026.

In general terms, the introduction of the GST (Box 1.1) and the supporting distribution system attempted to deliver two broad outcomes:

- first, the quarantining of GST revenue for distribution to the states to assist with addressing VFI
- second, the associated distribution system has sought to address differences in fiscal capacities across the states in accordance with HFE (Australian Government 1999b, pp. 3, 14).

Box 1.1 The 1999 Intergovernmental Agreement

The GST was introduced under the 1999 Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations (IGA), which sought to:

1. implement a new national tax system including through reform of state taxes and removal of wholesale sales tax
2. provide state governments with revenue from a more robust tax base that can be expected to grow over time
3. improve the financial position of all state governments (Australian Government 1999b, pp. 2–3).

Central to the agreement was the sharing of the total pool of GST revenue with the states in exchange for the removal of several inefficient state taxes and the cessation of financial assistance grants to the states (Australian Government 1999b, pp. 2–3).

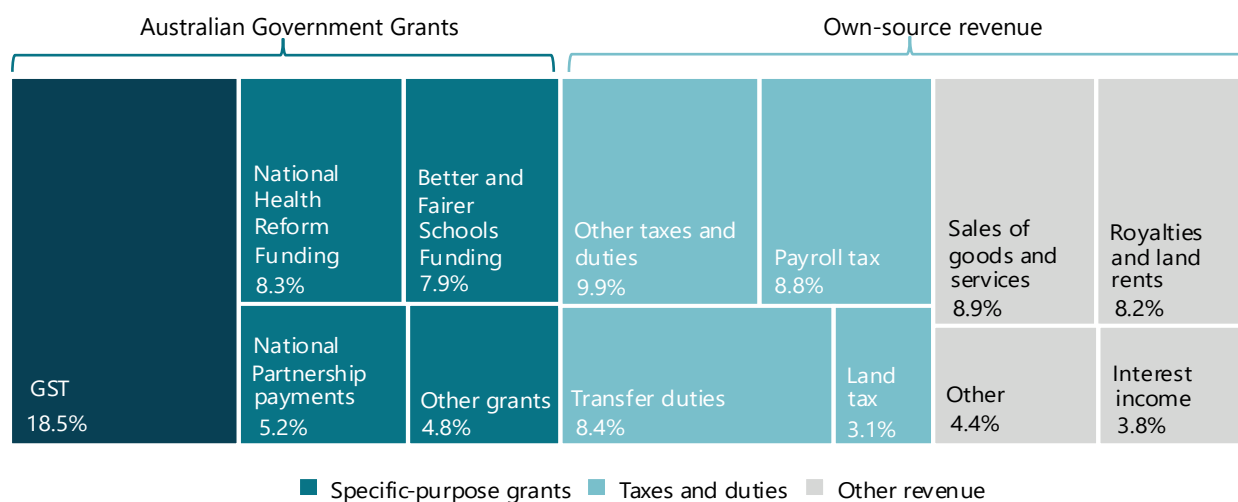
In Queensland, the key taxes abolished through the GST reform process included debits tax, stamp duty on quoted marketable securities, and a range of other inefficient duties (Queensland Government 2000b, pp. 59–60).

The 1999 IGA increased VFI through the replacement of state revenue bases with Commonwealth grants. With this dependence on centrally determined payments, states are heavily invested in the GST distribution system due to its influence on state budget outcomes.

GST payments are a large and important component of Australian Government transfers to the states. Of the \$194.7 billion paid to the states in 2024–25, \$91.2 billion, or 47 per cent, represented GST payments (Australian Government 2025c, pp. 59, 64).¹ GST grant revenue represents, on average, just under one-quarter of total state government revenue (Parliamentary Budget Office (PBO) 2020, p. 2), affording the GST distribution system significant influence over state budget outcomes.

Since its introduction in 2000, the GST has represented the Queensland Government's single largest source of revenue (as in most other states), averaging around 24 per cent of total State revenue. In 2025–26, GST grant revenue is expected to provide 18.5 per cent of total Queensland Government revenue, accounting for 41 per cent of the transfers the State expects to receive from the Australian Government (Figure 1.2).

¹ Or \$96.6 billion and 50 per cent when including NoWO guarantee payments.

Figure 1.2 GST is expected to remain Queensland's largest single source of revenue in 2025–26*Budgeted contributions towards Queensland's total revenue, 2025–26*

Note: Data on grant revenue (including GST grant revenue and payments for specific purposes) is from the Australian Government's Mid-Year Economic and Fiscal Outlook (MYEFO). There is a minor difference in the MYEFO's estimate of Queensland's GST grant revenue (\$16.816 billion) compared to the Queensland Government's Mid-Year Fiscal and Economic Review's (MYFER) estimate (\$16.802 billion). 'Other grants' includes other Australian Government grants and other grants and contributions. Data on own-source revenue is from the MYFER. 'Other' includes dividends and tax equivalents, fines and forfeitures, and revenue not elsewhere classified; and was calculated by subtracting the value of 'Royalties and land rents' and adding the value of 'Dividends and tax equivalents' to the 'Other revenue' category reported in the MYFER. Numbers may not add to 100 per cent due to rounding.

Source: Australian Government 2025e; Queensland Government 2025a.

Horizontal Fiscal Equalisation

HFE has been a core feature of the Australian federation.² While different approaches to the implementation of HFE have been adopted over time, a central principle has been that irrespective of the state in which a citizen resides, that state should have the capacity to deliver a comparable level of public services. Box 1.2 outlines how the definition of HFE has changed under the GST distribution system.

² The history of HFE has been detailed extensively elsewhere, such as in the PC's 2018 inquiry into Horizontal Fiscal Equalisation.

Box 1.2 The evolution of the HFE objective since the introduction of the GST

The 1999 IGA did not include an agreed or explicit definition of HFE.

At the time of signing the IGA, revenue from the GST was treated like other forms of general revenue assistance. This was to provide each state with the capacity to deliver the average standard of public services, if it made the same effort to raise revenue as the states on average and operated at an average level of efficiency (Australian Government 1999a, pp. 15–18).

This approach has been referred to as achieving 'full' equalisation, where the CGC estimates the fiscal capacities of all states, and then aims to comprehensively and fully equalise each state's fiscal capacity to that of the strongest state (PC 2018, pp. 74–76, 82–83).

From 2021–22, following the implementation of the 2018 changes (see p. 12), the objective of HFE transitioned towards a system of achieving 'reasonable' equalisation. 'Reasonable' is described as equalising to the fiscally stronger of New South Wales (NSW) or Victoria, rather than to the strongest state (Commonwealth Parliament 2018, p. 3).

The terms of reference for the current PC inquiry into the 2018 GST distribution reforms requires the PC to consider whether the 2018 legislative changes deliver a 'reasonable' level of HFE (PC 2025, pp. 5, 14).

The CGC's methodology for assessing each state's relative fiscal capacity

The Australian Government determines the GST distribution based on the advice of the CGC (CGC 2025e, p. 230). In general terms,³ the CGC seeks to assess each state's relative fiscal capacity by estimating the amount a state would need to spend to provide services and infrastructure at the average standard, and the revenue it could raise from its own sources if it made the average effort (CGC 2025e, p. 230).

This assessment includes consideration of each state's service delivery needs and costs, and revenue-raising capacities across a set of established categories (see Figure 1.3). It also accounts for 'non-policy' factors that increase a state's costs of delivering services or that hinder a state's ability to raise revenue including demographic factors, population size and dispersion, and natural endowments (CGC 2025e, p. 230; Commonwealth Parliament 2018, pp. 6–7).

The methodology used by the CGC to assess each category can also change over time as part of the CGC's methodology reviews, which are typically undertaken every five years. Additionally, changes in the legislative framework, with the introduction of the 2018 GST distribution approach, have increased complexity through the inclusion of 'standard state relativities' and no worse off (NoWO) guarantee payments (CGC 2026c, pp. 4, 9).

³ The methodology is not discussed in detail in this Report but has been extensively discussed in past reviews and is outlined in the CGC's GST Relativities 2026–27, Attachment B (CGC 2026a, pp. 55–56).

Figure 1.3 Categories considered as part of the CGC's assessment of a state's fiscal capacity

Revenue	Expenditure	Capital
Payroll tax	Schools education	Investment
Land tax	Post-secondary education	Net borrowing
Stamp duty on conveyances	Health	
Insurance taxes	Housing	
Motor taxes	Welfare	
Mining revenue	Services to communities	
Other revenue	Justice	
Revenue from Commonwealth payments	Roads	
	Transport	
	Services to industry	
	Wage costs	
	Geography	
	Socio-economic status	
	Other expenses	
	Depreciation	

Note: 'Other revenue' includes revenue such as gambling taxes, fees and fines, interest and dividend income (CGC 2025e, pp. 37, 224). 'Other expenses' includes expenses such as the expenses of general public services and natural disaster relief (CGC 2025e, p. 183). 'Investment' only refers to investment in new infrastructure and equipment, with the replacement of existing assets assumed to be funded through depreciation expenses (PC 2018, p. 88).

Source: CGC 2025e; PC 2018, p. 88.

The CGC also adopts four supporting principles to guide the application of HFE (Box 1.3).

Box 1.3 The CGC's supporting principles

The CGC uses four supporting principles to guide considerations in designing and evaluating assessment methods:

- 'what states do': the CGC's methods should, as far as possible, reflect what states collectively do, not what they could do 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 CGC'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.

However, these principles are secondary to the objective of achieving HFE and their application can also be affected by guidance from the Australian Government, in the form of the terms of reference from the Australian Treasurer.

For example, the terms of reference for the 2025 Methodology Review asked the CGC to consider whether it should 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 policy reforms have occurred between reviews.'

Source: Australian Government 2025a, p. 1; CGC 2025a, p. 312.

When applying its methodology, the CGC uses the average of three financial years to balance contemporaneity, predictability and stability (CGC 2026c, p. 11).⁴ There is also a two-year lag from the year being calculated to account for data availability (CGC 2026a, p. 56).

Due to the diversity of states' revenue-raising capacities and expenditure needs and the level of equalisation pursued by the system, the CGC's methodology for assessing state fiscal capacities is inherently complex (CGC 2025i, p. 1, 2026c, pp. 4, 19). Stakeholders indicate the complexity of the system can make understanding the GST distribution impenetrable to those unable to invest considerable time and resources into understanding it (Brumby et al. 2012, p. 82; NSW Government 2026b, p. 10; PC 2018, p. 51).

Measurement and data availability challenges can contribute to the complexity of the system and lead to inconsistencies. For example, data deficiencies can result in the CGC applying inconsistent assessment approaches to revenue and expenditure categories, including where discounts are applied to data or a method, or a revenue or expenditure driver is not assessed at all (CGC 2025e, pp. 235–237, 2025i, p. 3).⁵

The GST distribution system is part of the broader system of federal financial relations. As such, the CGC considers other Australian Government payments to the states given they can influence a state's fiscal capacity. The treatment of Australian Government grants depends on a variety of factors including the purpose of the payment, whether the payment is for a state-type service where expenditure needs are assessed by the CGC, and whether the Australian Treasurer has instructed the CGC to 'quarantine'⁶ the payment (CGC 2025d, pp. 208–210, 2026c, pp. 7–8).

A state's share of the GST pool is primarily determined by its relative fiscal capacity, with GST distribution outcomes expressed by the CGC as a GST relativity (Box 1.4).

Box 1.4 GST relativities

The CGC expresses a state's GST distribution outcome in terms of a GST relativity. A GST relativity is a measure of a state's fiscal capacity relative to the all-state average.

States with a stronger-than-average fiscal capacity will record a relativity below 1.0 and receive less GST than their population share of the total GST revenue pool. States with a weaker-than-average fiscal capacity will record a relativity above 1.0 and receive more than their population share. Because the GST pool is fixed, if some states' GST shares increase, the GST shares of other states will decrease. Put simply, the GST is allocated on a 'zero-sum' basis, such that a change in the GST share of one state will affect the shares of all other states.

The CGC updates the GST relativities annually, in response to terms of reference issued by the Australian Government, to reflect developments influencing states' fiscal capacities.

Source: CGC 2025g, p. 2.

⁴ 'Predictability' and 'stability' are considered by the CGC within the context of 'contemporaneity'. The CGC indicates the 'averaging process smooths the effect of data irregularities and short-term events thereby making state shares of GST less volatile. Many states value this over a more up-to-date assessment because it provides some more stability in a major source of revenue, despite volatility in state own-source revenue' (CGC 2010, p. 38).

⁵ The Commission has not examined the extent to which the use of different approaches by the CGC are appropriate, only the extent to which they are contributing to complexity or inconsistencies.

⁶ 'Quarantining' refers to Australian Government payments that are excluded from CGC assessment due to a terms of reference instruction from the Australian Treasurer (CGC 2025e, p. 208).

The 2018 changes to GST distribution

In 2018, the Australian Government announced significant changes to the GST distribution system, identifying four broad aims:

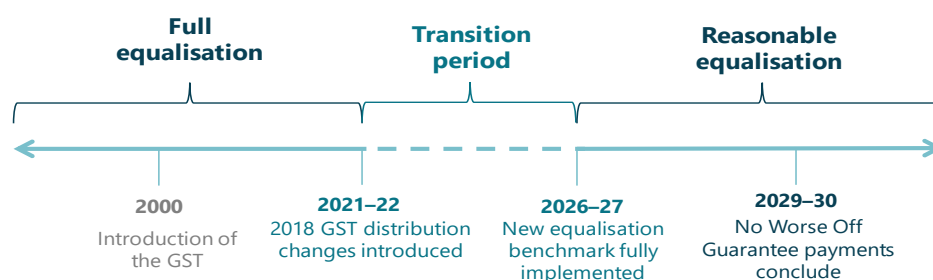
- affirming a commitment to the ‘fair go’ principle of HFE
- maintaining and improving HFE with minimal disruption
- improving the stability of the system, reducing volatility for states’ revenue
- ensuring all states are better off (Australian Government 2018a, p. 11).

The main changes announced by the Australian Government were:

- a **new equalisation benchmark** linked to the fiscally stronger of NSW or Victoria (known as the ‘standard state’) — replacing the ‘fiscally strongest state’ as a benchmark for equalising fiscal capacities. When a state is assessed as having a stronger fiscal capacity than the ‘standard state’ (with a lower relativity), that state will have its assessed relativity increased to the assessed relativity of the ‘standard state’, while all states will have their relativities adjusted down on a population share basis (CGC 2026c, p. 22)
- a **GST relativity floor** was introduced for all states. From 2022–23 every state must receive at least 70 cents for every dollar of GST distributed on an equal per capita (EPC) share basis. The floor increased to 75 cents from 2024–25 (CGC 2021a, p. 2). As GST comes from a fixed funding pool, where a state is raised to the GST relativity floor, all other states will have their relativities adjusted down on a population share basis to accommodate the floor
- **Australian Government funded top-ups** to the GST pool in perpetuity, and for the top-up to grow at an indexed rate. This permanent boost to the GST pool, in addition to the temporary NoWO guarantee payments (discussed below), were designed to ensure all states are better off during and following the transition
- the introduction of **temporary NoWO guarantee payments** to states — to be paid when a state would have received more GST revenue under the previous GST distribution system (CGC 2021a, p. 3). A state’s GST grant may still fluctuate on a year-to-year basis, but the NoWO guarantee is intended to prevent any state from receiving less GST grant revenue than they would have under the previous arrangement, until the NoWO guarantee expires (Australian Government 2018a, pp. 16–22).

These changes were enacted by the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (Cth) (the Act) and were to be introduced over a six-year transition period from 2021–22 to 2026–27 (inclusive). In November 2024, the NoWO guarantee was extended to 2029–30 for all states except Western Australia (WA) (Australian Government 2024). The transition is illustrated in Figure 1.4.

Figure 1.4 The transition from ‘full equalisation’ to ‘reasonable equalisation’



Note: Under the transition period the equalisation moves from ‘full’ equalisation to ‘reasonable’ equalisation through the progressive implementation of the new equalisation benchmark.

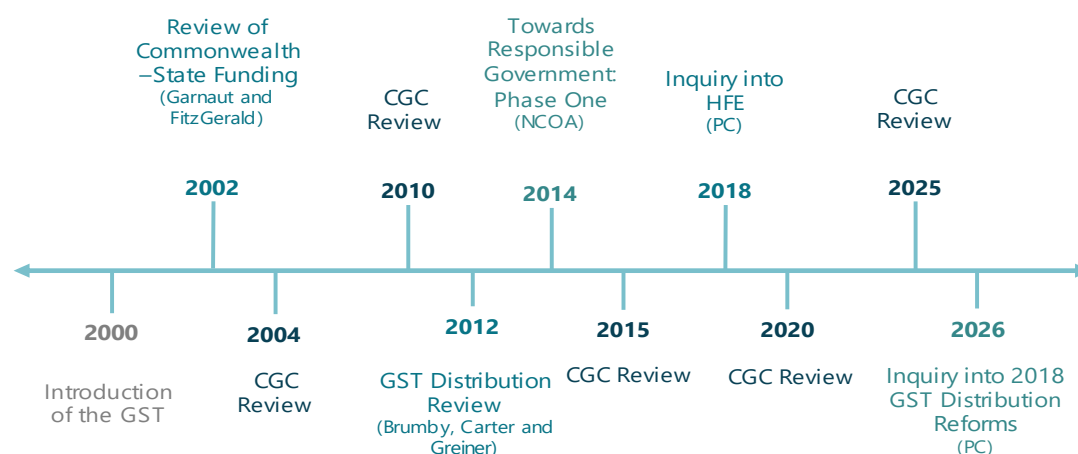
Source: QPC.

The 2018 legislation also provides for a review of the operation of the Act by the PC by 31 December 2026. This review follows several others conducted since the introduction of the GST in 2000. These reviews are discussed in the next section.

1.3 Reviews of GST distribution and HFE

The distribution of GST revenue, and HFE more broadly, have been the focus of several reviews since the introduction of the GST in 2000 (Figure 1.5). The key findings of these reviews are detailed in Box 1.5. Several individual states have also undertaken their own reviews into GST distribution. For example, in 2022, the Economic and Infrastructure Standing Committee of the Victorian Parliament undertook an inquiry into Commonwealth Support for Victoria (Parliament of Victoria 2022).

Figure 1.5 Timeline of reviews into GST distribution and HFE



Note: 'NCOA' refers to the National Commission of Audit. Not included are individual states' reviews into GST distribution.

Source: QPC, PC 2018, p. 54, 2025, p. 5.

A key theme of past reviews has been the complexity and opacity of the CGC methodology along with the efficiency implications of the GST distribution system.

While reviews identified potential efficiency consequences associated with HFE and the GST distribution system, there was limited evidence and consensus on the extent to which these implications play out in practice (Brumby et al. 2012, pp. 7, 18; Garnaut & Fitzgerald 2002, pp. 144, 153; PC 2018, p. 163).

Recent reports from the International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) have also highlighted the need for GST distribution reform on efficiency grounds (IMF 2026; OECD 2026, p. 34).

Box 1.5 Key findings of previous reviews that considered GST distribution and HFE

Review of Commonwealth–State Funding (Garnaut & Fitzgerald 2002)

Commissioned by NSW, Victoria, and WA, the review found the system reduces economic efficiency and does not incentivise productivity and growth-promoting policy.

It recommended allocating GST revenue primarily on an EPC basis, with a reformed and less prescriptive specific purpose payments system used to address state disadvantages and more clearly target equity.

The review was presented to the Australian Government, which advised states to advocate through the CGC's 2004 methodology review (NSW Government 2004, pp. 7–14). The substantive proposals were not adopted, although some of the issues raised informed subsequent CGC methodology reviews (CGC 2004, pp. 81–88, 2010, p. 1).

GST Distribution Review (Brumby et al. 2012)

This review was commissioned by the Australian Government to understand whether the GST distribution system would ensure Australia is best placed to respond to expected significant structural change in the economy and would maintain public confidence in financial relationships within the federation.

The panel found there was little evidence that Australia's system of HFE discouraged states from pursuing their own tax reform. The review identified that while dramatic simplifications were infeasible without compromising equity, small adjustments, such as increasing materiality thresholds and rounding relativities, could improve transparency. The review highlighted the need for a robust GST base and greater state flexibility in revenue-raising to address fiscal pressures.

Key recommendations included improving communication and addressing mining revenue assessments to avoid excessively large GST share effects. The review suggested EPC distribution is not viable in Australia in the short or medium term without 'realignment of national tax bases and service responsibilities' due to the high level of VFI that makes HFE in its current form necessary.

Following the review, GST grant revenue continued to be distributed consistent with the CGC's assessment. In 2014, the Australian Government requested the CGC consider the treatment of GST relativities where a particular revenue source is a large and volatile proportion of a state's revenue. In response, the CGC declined to modify the system (CGC 2015, pp. 1, 14).

Towards Responsible Government: Phase One (National Commission of Audit 2014)

The National Commission of Audit (NCOA) was initiated by the Australian Government to examine the scope and efficiency of government and identify areas for reform in response to growing concerns about Australia's fiscal sustainability. It sought to improve efficiency and support long-term economic growth.

The NCOA recommended the Australian Government withdraw from certain policy areas, providing states with greater autonomy and the ability to raise greater revenue to reduce VFI. The audit recommended EPC distribution, supported by no worse off payments.

While several recommendations from the NCOA were implemented in the 2014–15 Australian Government Budget, the recommended changes to the GST distribution system were not pursued.

Inquiry into Horizontal Fiscal Equalisation (PC 2018)

The inquiry was commissioned by the Australian Government as some states had suggested Australia's approach to HFE does not sufficiently consider each state's individual circumstances or their efforts to manage those circumstances, creating disincentives for reform.

The inquiry noted the need for the HFE system to achieve a better balance between equity and efficiency, finding HFE may distort state policy and discourage large-scale state tax reform.

The PC recommended adoption of 'reasonable' equalisation, by equalising to the average capacity of all states and suggested a relativity floor would only be a 'band-aid solution'. The PC also suggested an EPC approach with top-ups should only be considered with broader reform of federal–state financial relations.

Following the inquiry, the Australian Government decided to implement alternative arrangements through the 2018 GST distribution system changes (see p. 12) (Australian Government 2018a).

CGC Methodology Reviews (2004, 2010, 2015, 2020, 2025)

Every five years the CGC is instructed to review their assessment methodology. The CGC reconsiders the methods and supporting principles it uses to determine the advice it provides on GST distribution. The review process generally takes two to three years, requiring extensive consultation with states.

On the release of the 2025 Methodology Review report, Queensland Treasury estimated the methodology changes introduced by the review would result in Queensland receiving \$5.3 billion less in GST revenue over the three years to 2027–28 (Queensland Government 2025b, 2025c, p. 59).

2.0 Queensland's GST experience

Since the introduction of the GST, Queensland has typically been a recipient state (discussed in Section 2.1). Key factors contributing to this status have included lower revenue-raising capacity in property and payroll taxes and greater expenditure needs from population dispersion, Indigeneity, population growth and natural disaster relief.

However, Queensland's GST relativity — the measure of the state's fiscal capacity relative to the average — fell in 2025–26 to a record low, primarily due to increased revenue-raising capacity from mineral resources and changes to the CGC's methodology, which reduced Queensland's GST share (as discussed in Section 2.2). Queensland's relativity is expected to increase in 2026–27 as transient factors, such as the treatment of COVID-19 payments, substantively move out of the CGC's GST assessment (CGC 2026a, p. 41).

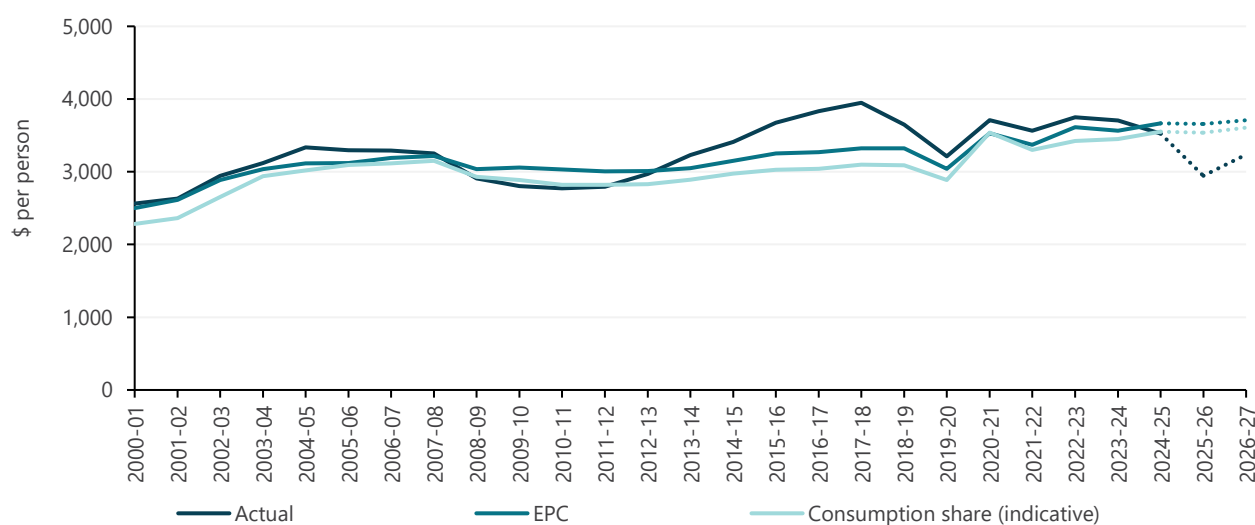
Queensland's GST grant revenue will be directly affected by the 2018 changes to the GST distribution system only once NoWO guarantee payments cease (as discussed in Section 2.3).

2.1 Queensland's budget has generally benefitted from the GST distribution system

The GST distribution system has generally delivered Queensland higher real GST grant revenue per capita than if GST had been distributed under alternative arrangements, such as on an EPC basis or using indicative consumption shares (Figure 2.1).

Figure 2.1 Queensland's real GST grant per capita under three distribution arrangements

Queensland's real GST per capita, 2000–01 to 2026–27, \$2025–26



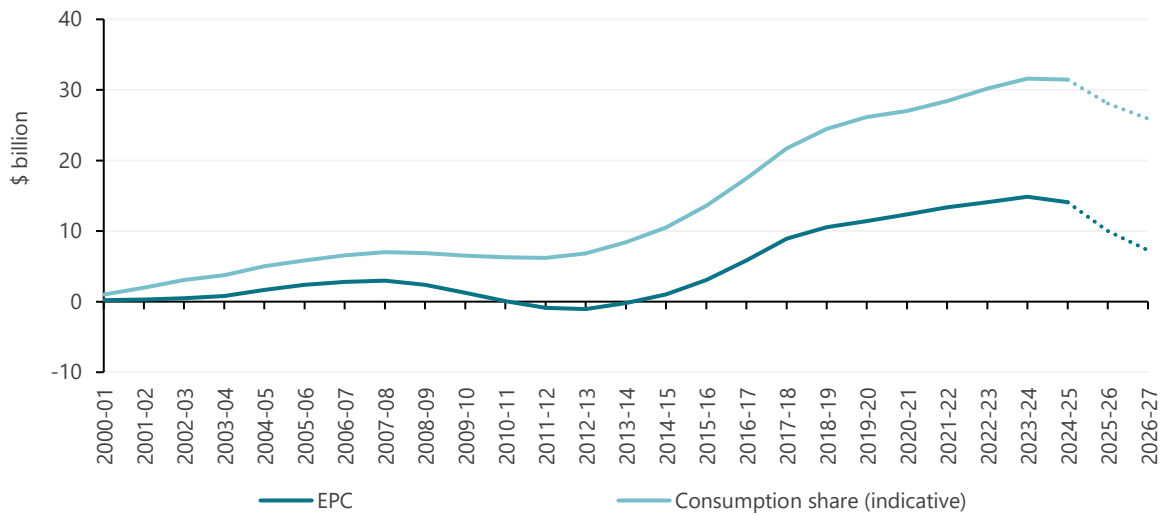
Note: GST grant revenue from 2000–01 to 2024–25 is from each year's Australian Government Final Budget Outcome. Estimated 2025–26 GST is from the Australian Government 2025–26 MYEFO and estimated 2026–27 GST is from the CGC's 2026 update. Population estimates are from the CGC's 2026 GST update. Consumption share of GST includes GST-applicable consumption, following the approaches of Begg (2018) and the PBO (2020). Following Begg, it is assumed GST is collected in proportion to state final consumption relative to national final consumption. GST receipts by state are not tracked, so this is only indicative.

Source: QPC based on ABS 2026b; Australian Government 2001 to 2025c, 2025e; CGC 2026a.

As a result, Queensland has cumulatively received more in GST grant revenue than its EPC and indicative consumption share of GST (see Figure 2.2). The cumulative fiscal gain to Queensland from 2000–01 to 2026–27 is expected to be around \$7.3 billion above its EPC share and an estimated \$25.9 billion above its indicative consumption share. This reflects Queensland having historically been assessed by the CGC as having a slightly lower fiscal capacity than other states, on average.

Figure 2.2 Comparative cumulative benefit of the GST distribution to Queensland

Queensland's cumulative GST grant revenue deviation from EPC and indicative consumption share, 2000–01 to 2026–27, \$2025–26



Note: Data and analysis constructed as per Figure 2.1.

Source: QPC based on ABS 2026b; Australian Government 2001 to 2025c, 2025e; CGC 2026a.

While substantial in dollar terms, the cumulative benefit of the GST distribution to Queensland under HFE should be assessed against Queensland's total revenue. For example, the 'additional' \$7.3 billion accumulated by Queensland under HFE has boosted its real GST grant revenue and real total state revenue by 2.8 per cent and 0.4 per cent, respectively, compared with a GST distribution on an EPC basis. Compared with other states that are net beneficiaries, the benefit Queensland has derived is small.

2.2 In 2025–26 Queensland's GST share fell to a record low

Since its introduction in 2000, Queensland's GST grant revenue has grown in both real and nominal terms (Figure 2.3). Over that time, Queensland's nominal GST grant revenue has increased at an average annual pace of 5.6 per cent, slightly below the growth of the nominal GST pool of 5.9 per cent. The State's share of the GST pool has averaged around 20.4 per cent (Figure 2.4), close to its average population share of 20 per cent.

Figure 2.3 Queensland's GST grant revenue has grown since 2000–01

Queensland's GST grant revenue, 2000–01 to 2026–27

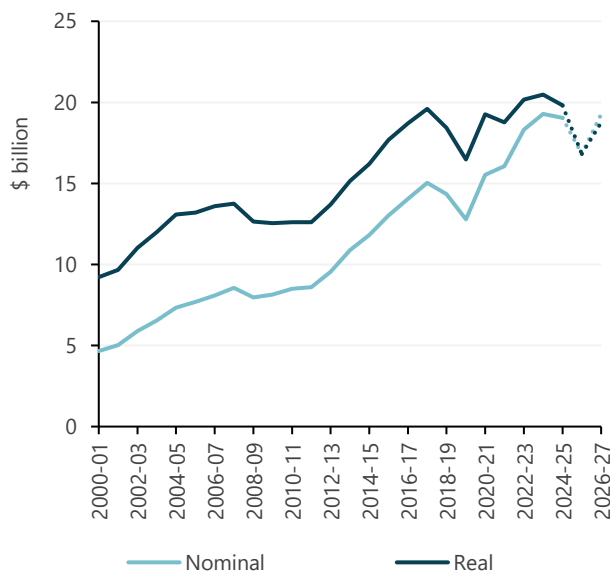
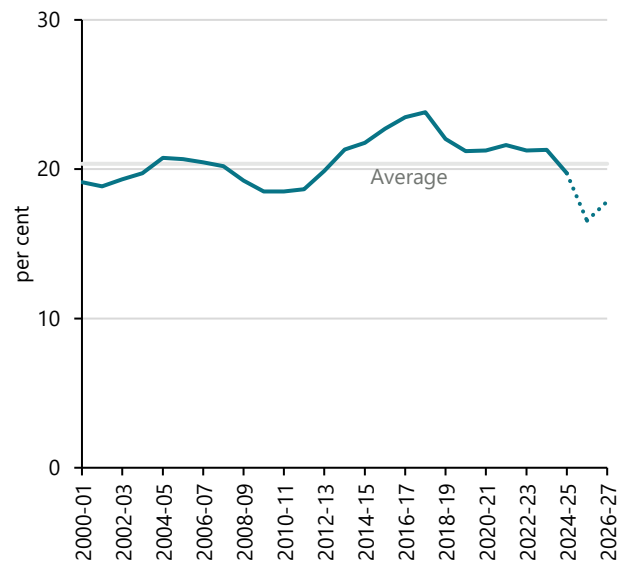


Figure 2.4 Queensland's GST share has fallen below its average

Queensland's share of the GST pool, 2000–01 to 2026–27



Note: GST grant revenue from 2000–01 to 2024–25 is taken from each year's Australian Government Final Budget Outcome. Estimated 2025–26 GST is from the Australian Government 2025–26 MYEFO and estimated 2026–27 GST is from the CGC's 2026 update. GST grant revenues are indexed to 2025–26 prices.

Source: QPC based on ABS 2026b; Australian Government 2001 to 2025c, 2025e; CGC 2026a.

Queensland's GST grant revenue peaked in 2023–24 at \$19.3 billion, fell to \$19.0 billion in 2024–25 and was last forecast (in the 2025–26 MYEFO) to fall to \$16.8 billion in 2025–26 (in nominal terms). The \$2.2 billion decline in 2025–26⁷ represents the largest fall in GST grant revenue in a single year any state has faced since the GST was introduced. In 2026–27 Queensland's GST grant revenue is expected to recover to \$19.3 billion (in nominal terms).

The decline in Queensland's GST grant revenue in 2025–26 reflects a fall in the State's relativity to a record low (see Figure 2.6, p. 19). As a result, GST grant revenue made the smallest relative contribution to state revenue since the introduction of the GST in 2000 (see Figure 2.7, p. 19).

⁷ The terms of reference note a \$2.3 billion contraction but were issued before the release of the Australian Government's MYEFO, which upgraded the estimates for the size of the GST pool. As noted in the Queensland Government's MYFER (2025a, p. 9), the estimated increase in the GST pool resulted in a slightly higher estimate of Queensland's GST grant revenue. The final outcome for 2025–26 will depend on further developments affecting GST-applicable consumption since the MYEFO.

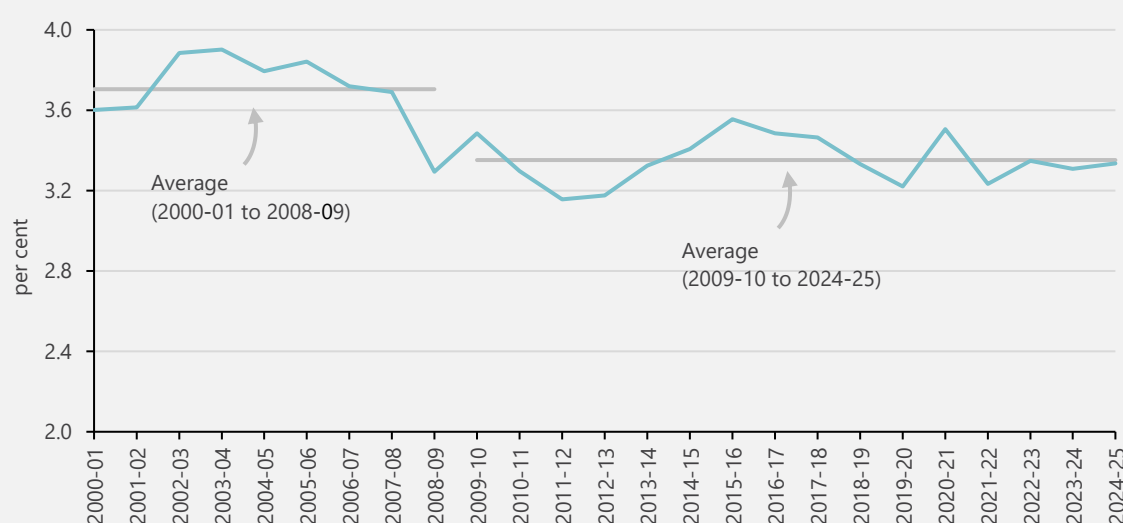
Queensland's 2026–27 relativity has increased but remains at the second lowest level on record. The CGC (2026b, p. 15) estimates Queensland will receive \$1.7 billion more GST grant revenue in 2026–27 than in 2025–26. Key drivers of this recent increase are growth in the GST revenue pool (Box 2.1), less GST grant revenue going to Victoria and NSW for COVID-19 and natural disaster expenses, and lower coal prices.⁸

Box 2.1 The GST pool

Beyond the GST distribution system, a state's GST grant revenue is also affected by the size of the GST pool. As shown in Figure 2.5, the GST revenue pool has declined from 3.9 per cent of Gross Domestic Product (GDP) at its peak in 2003–04, soon after the GST was introduced, to 3.3 per cent in 2024–25. Since 2009–10, GST has averaged around 3.4 per cent of GDP.

Figure 2.5 The GST pool has declined as a share of GDP

Nominal GST pool relative to GDP 2000–01 to 2024–25, national accounts basis



Source: QPC based on ABS 2025a.

If GST revenue had remained at its 2003–04 level as a share of GDP, the GST pool would have been \$17.6 billion larger than currently expected in 2025–26, all other things being equal. This would potentially have provided Queensland with up to \$3.6 billion in additional GST grant revenue.⁹

The factors contributing to the decline in GST revenue as a share of GDP have been well-explored by others (see in particular Evans 2020, pp. 63–65, 77; PBO 2020, p. 3) and concern:

- the changing share of household consumption (as the tax base for GST) compared to GDP
- unequal price growth between GST-applicable and GST-free goods
- changes in spending patterns between GST-applicable and GST-free goods
- compliance gaps in GST collections
- technical measurement issues related to GDP and components of household consumption.

The Queensland State Budget (2025c, pp. 47–50) and MYFER (2025a, p. 9) forecast growth in Queensland's GST grant revenue to improve over the forward estimates, primarily due to growth in the GST revenue pool as well as lower forecast royalty revenue. As a result, the contribution of GST grant revenue to Queensland's total revenue is forecast to revert towards its long-term average of 24.1 per cent from 2026–27 (see Figure 2.7).

⁸ Recent outcomes for Queensland relative to other states have been driven by the CGC's assessment of states' fiscal capacities and methodology changes, rather than the 2018 changes. Section 2.3 includes a discussion of how the 2018 changes will affect outcomes.

⁹ Before the inclusion of Australian Government funded top-ups and assuming additional revenue is provided to states on an EPC basis.

Figure 2.6 Queensland's 2025–26 GST relativity is the lowest level on record

Queensland's GST relativity, 2000–01 to 2026–27

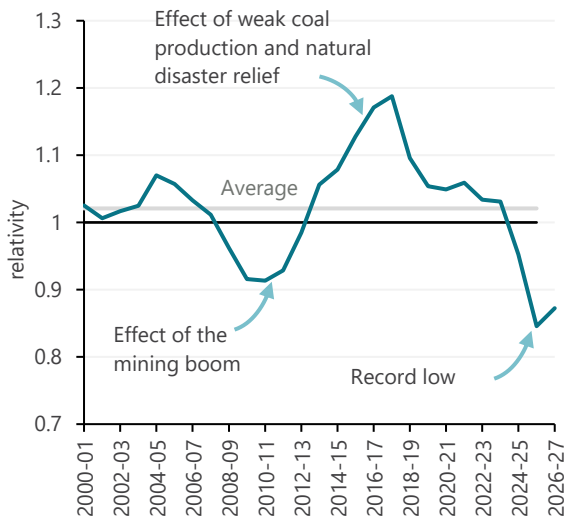
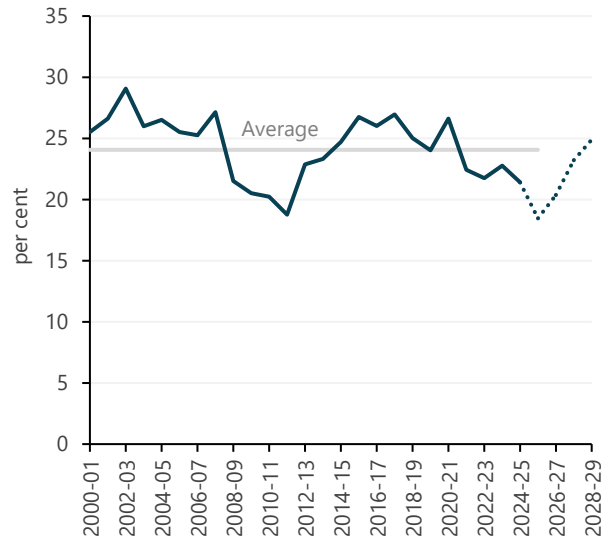


Figure 2.7 Queensland's GST grant revenue has fallen as a share of total state revenue

GST grant revenue, share of total revenue, Queensland, 2000–01 to 2028–29



Note: GST grant revenue from 2000–01 to 2024–25 is taken from Australian Government Final Budget Outcomes. Estimated 2025–26 GST is taken from the Australian Government 2025–26 MYEFO and estimated 2026–27 GST is taken from the CGC's 2026 update. Total revenue until 2023–24 is from ABS Government Finance Statistics (annual). Actual and estimated revenue (2024–25 and 2025–26 onwards) and all projections (2026–27 onwards) are from the Queensland Government 2025–26 MYFER.

Source: QPC based on ABS 2011a, 2015a, 2019, 2025c; Australian Government 2001 to 2025c, 2025e; CGC 2026a; Queensland Government 2025a.

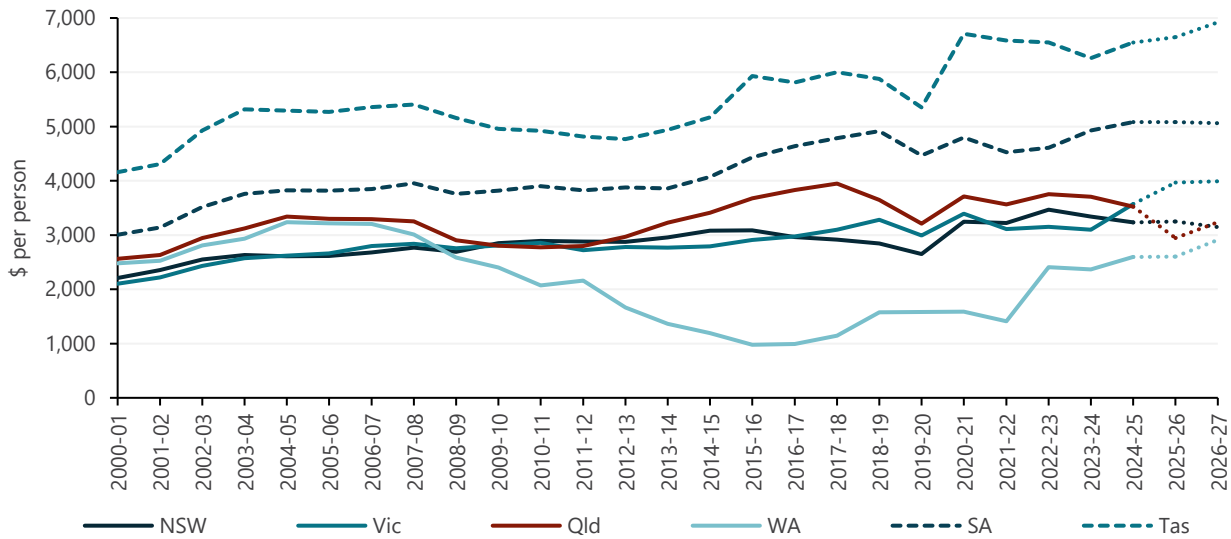
Queensland's real GST receipts have fallen sharply in per capita terms (see Figure 2.8). Queensland is expected to receive \$2,945¹⁰ per person in GST grant revenue in 2025–26, effectively the same revenue received per person as in 2002–03 in real terms. WA is the only state receiving less GST per capita in 2025–26 than Queensland.

Queensland's real GST receipts per capita are expected to increase in 2026–27, to \$3,236 per person.

¹⁰ The minor change from the figure estimated in the Interim Report (\$2,935) reflects the new population estimates in the 2026–27 CGC GST relativity update.

Figure 2.8 Queensland's real GST grant revenue per capita has fallen while most other state's GST grant revenues per capita have grown

GST grant revenue per capita, 2000–01 to 2026–27, \$2025–26



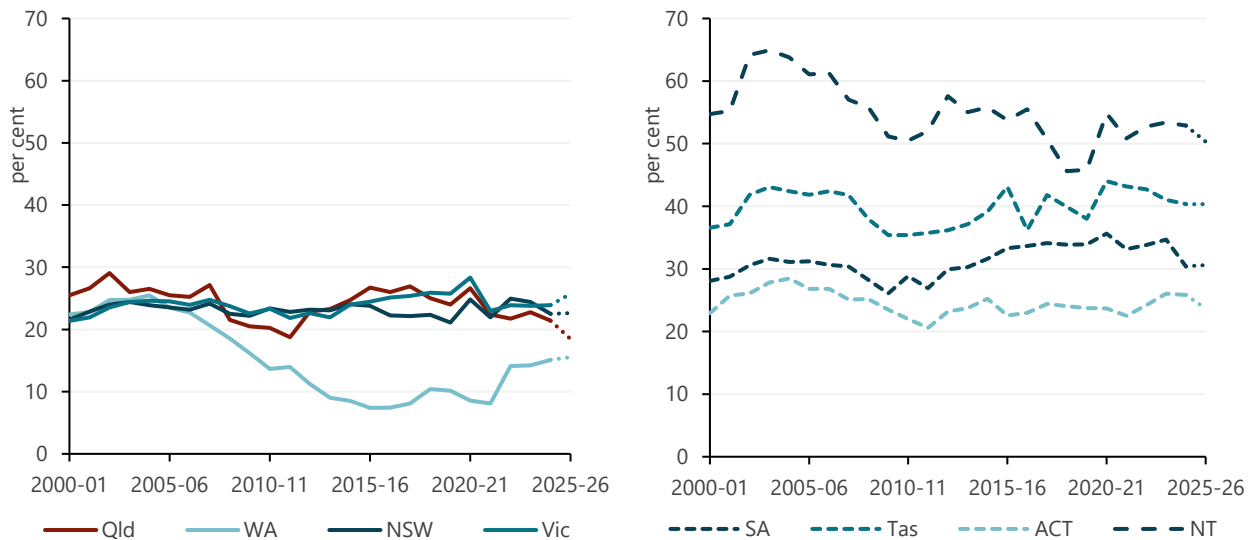
Note: GST grant revenue from 2000–01 to 2024–25 is taken from each year's Australian Government Final Budget Outcome. Estimated 2025–26 GST is from the Australian Government 2025–26 MYEFO and estimated 2026–27 GST is from the CGC's 2026 update. To aid presentation, territories have been excluded. GST grant revenues are indexed to 2025–26 prices.

Source: QPC based on ABS 2026b; Australian Government 2001 to 2025c, 2025e; CGC 2026a.

While the decline in GST grant revenue as a share of total state revenue from 2021–22 to 2025–26 is not unique to Queensland, no other jurisdiction has experienced the same rate of decline (Figure 2.9).

Figure 2.9 Contribution of GST grant revenue to state revenue across states and over time

GST grant revenue as a share of total state revenue, 2000–01 to 2025–26



Note: GST grant revenue from 2000–01 to 2024–25 is from each year's Australian Government Final Budget Outcome. GST for 2025–26 is from the 2025–26 Australian Government MYEFO. States' total revenue for 2000–01 to 2023–24 is from ABS Government Finance Statistics (annual). States' total revenue for 2024–25 and 2025–26 is from state budgets or budget updates. While the CGC has released GST distribution outcomes to 2026–27, at the time of drafting budget-year revenue outcomes were yet to be published for 2026–27.

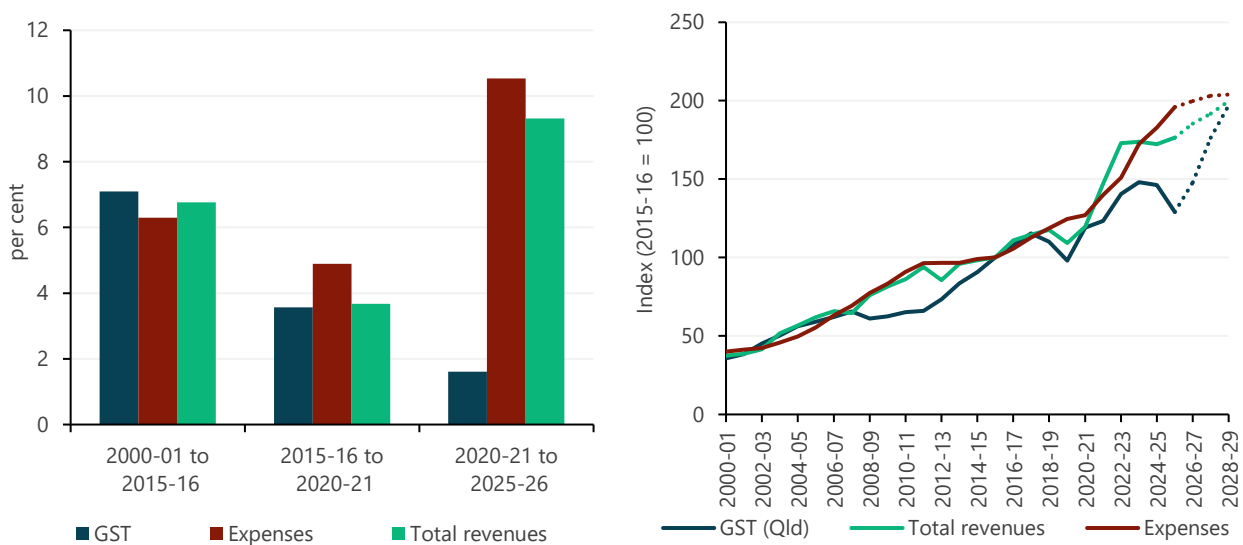
Source: QPC based on ABS 2011a, 2015a, 2019, 2025c; ACT Government 2025; Australian Government 2001 to 2025c, 2025e; Government of SA 2025; Government of WA 2025; NSW Government 2025; NT Government 2025; Queensland Government 2025a; Tasmanian Government 2025b; Victorian Government 2025.

The recent decline in Queensland's GST grant revenue was preceded by a significant increase in both state revenue and expenses. While over the longer-term Queensland's GST grant revenue, total revenue and expenses growth broadly tracked in line with each other, over the last five years in particular there has been a material divergence.

Over the forward estimates, Queensland Treasury expects slower growth in state expenses and total state revenue to coincide with a pickup in GST grant revenue (Figure 2.10).

Figure 2.10 Growth in Queensland's GST grant revenue has diverged from growth in total revenue and expenses

Growth in nominal GST, total revenue and expenses, compound average growth rate (CAGR) (LHS) and index (RHS), 2000–01 to 2028–29



Note: GST grant revenue from 2000–01 to 2024–25 is taken from each year's Australian Government Final Budget Outcome. Estimated 2025–26 GST is from the Australian Government 2025–26 MYEFO and estimated 2026–27 GST is from the CGC's 2026 update. Total revenue and expenses until 2023–24 are from ABS Government Finance Statistics (annual). Actual and estimated revenue and expenses (2024–25 and 2025–26) and all projections (2026–27 onwards) are from the Queensland Government 2025–26 MYFER. The growth rate is calculated as the CAGR. The indexes for revenue and expenses have been adjusted to account for the use of different data series after 2024–25. When calculating the CAGR, data are presented up to 2025–26 only. While the CGC has released GST distribution outcomes to 2026–27, at the time of drafting budget-year revenue and expense forecasts were yet to be published for 2026–27.

Source: QPC based on ABS 2011a, 2015a, 2019, 2025c; Australian Government 2001 to 2025c, 2025e; CGC 2026a; Queensland Government 2025a.

2.3 Distribution system changes have a material fiscal impact

As discussed in Section 1, the Australian Government introduced changes to the GST distribution system in 2018.

To date, WA has been the main beneficiary of these changes and temporary transitional arrangements¹¹ have mitigated the fiscal impact on other states, with the fiscal costs borne by the Australian Government.

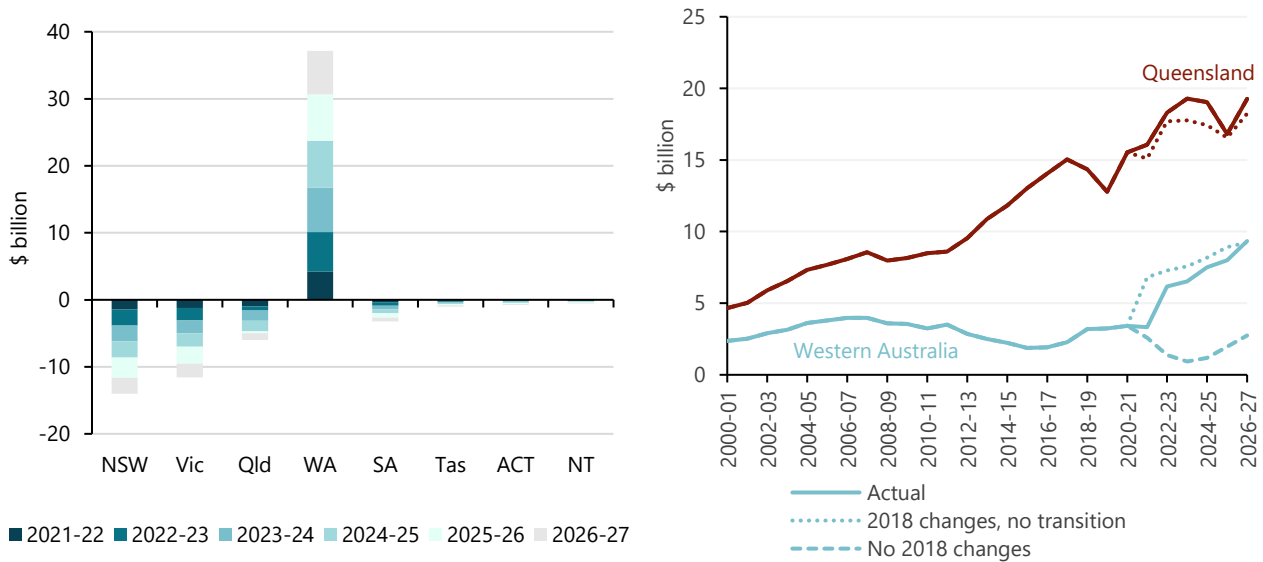
Over the period from 2018–19 to 2024–25, the changes led to the transfer of \$22.7 billion from the Australian Government to the states and is estimated to cost the Australian Government an additional \$26.3 billion over the period 2025–26 to 2028–29 (PC 2025, p. 12).

¹¹ See Section 1 for discussion of the transitional arrangements.

Had no transitional arrangements been in place, WA would have retained an estimated additional \$37 billion in GST grant revenue over the six years to 2026–27, at the expense of other states (Figure 2.11). Queensland would have lost an estimated \$6 billion in GST grant revenue over this period without transitional arrangements.

Figure 2.11 Without transitional arrangements, the 2018 changes would result in WA retaining an estimated additional \$37 billion in GST revenue

Cumulative fiscal impact from the 2018 reforms had transitional arrangements not been in place (LHS) and GST grant revenue with and without the 2018 changes (RHS)



Note: To estimate the effect of the 2018 changes, GST distribution outcomes were estimated using the standard state relativities and using GST collections before the GST top-up was added. This includes removing the effect of the transitional arrangements, whereby equalisation to the standard state was progressively introduced over a period of six years and not fully implemented until 2026–27. These effects are, therefore, larger than the sum of the NoWO guarantee payments and better reflect the underlying impact of the reform. Queensland’s actual GST grant revenue and GST grant revenue without the 2018 changes is the same due to the NoWO guarantee.

Source: QPC based on Australian Government 2022a to 2025c, 2025b; CGC 2026a.

This estimated transfer of fiscal resources, toward WA and away from Queensland and other states, is indicative of the scale of the potential impacts to GST grant revenue when the NoWO guarantee ends. However, outcomes remain uncertain and will ultimately depend on the overall GST pool, changes to all states’ circumstances as assessed by the CGC, any future CGC methodology changes, and the outcomes of the current PC inquiry into the 2018 distribution system changes.

3.0 Assessing the economic impacts of the GST distribution system

A primary objective of Australia's system of intergovernmental financial relations is the improvement of the wellbeing of all Australians through 'the equalisation of fiscal capacities between States and Territories' (Australian Government 2009, p. 3).

As such, the GST distribution system concerns the division of economic returns (equity), rather than the growth of economic returns (efficiency). This involves a trade-off of competing goals.

The equalisation of fiscal capacity across states allows states to provide similar levels of services, with potential benefits for equity and national unity across the federation. Proponents of HFE suggest it can also support efficient outcomes when economic resources flow to take advantage of economic conditions, not preferential tax or service delivery standards (PC 2018, p. 17).

However, the GST distribution system seeks to achieve fiscal equality through equalising state fiscal capacities to cover their expenditure needs — as noted below, this is an indirect way to attempt to achieve equity.

The GST distribution may also impede efficient outcomes where fiscal transfers discourage economic resources from flowing where they are most productive and/or where states do not bear the full cost or gain the full benefit of their policy decisions (PC 2018, pp. 102–104, 151–153).

The implementation of fiscal equalisation being pursued by the GST distribution system also involves complexity and judgement, with the CGC acknowledging pursuing HFE 'is not an exact science' (CGC 2026c, p. 3). Moreover, Australia's high degree of equalisation involves significant prescription in assessing states' relative fiscal capacities, substantial dedicated resourcing from the Australian and state governments, and confidentiality requirements that inhibit transparency (CGC 2025i, 2026c, pp. 4, 19; Garnaut & Fitzgerald 2002, p. 146).

3.1 Equity vs Efficiency

Equity

The specific goal of the GST distribution system is achieved through HFE (Australian Government 2009, p. 5). This refers to the equalisation of states' fiscal capacities, that is, their ability to raise revenue to cover expenditure needs.

Under HFE, transfers are made from fiscally 'strong' states to fiscally 'weak' states. In doing so, the GST distribution system aims to allow the federation to deliver outcomes that are comparable to a unitary model of government.

Underlying HFE is a broader objective, for states to be able to provide their residents with a similar level of services, thereby removing fiscal inequality across states. However, HFE is not a true equity goal. States are not individuals and equalising fiscal capacity between states does not directly deliver an equity outcome for individuals (Buchanan 1950, pp. 586–588; PC 2018, pp. 55–56, 165–166).

Moreover, Australia's GST distribution system does not directly deliver these objectives. Under HFE, states retain policy autonomy in expenditure and revenue decisions as GST is delivered as an untied grant. As a result, HFE does not guarantee equalisation of outcomes (Brumby et al. 2012, pp. 40–41; Garnaut & Fitzgerald 2002, p. 130). This was also recognised by the PC (2018, p. 6), which regarded HFE as seeking 'equal fiscal treatment of jurisdictions, not interpersonal equity'.

Efficiency

While the GST distribution system seeks to deliver an equity objective through HFE, the Commission's terms of reference seeks advice on the economic impacts of GST distribution.

As described by the PC (2013, p. 2):

overall economic efficiency is attained when individuals in society maximise their utility, given the resources available in the economy.

In the context of HFE, Buchanan (2002, p. 7) noted:

efficiency requires that [resources] be used to [their] value maximizing level.

Where economic resources (such as labour and capital) are allocated and utilised efficiently, the productive capacity of the economy is larger without additional effort. Households and businesses also receive a greater return for their efforts.

The Commission's advice considers whether the GST distribution system contributes to or detracts from economic efficiency.

Why efficiency matters

Ultimately, both equity and economic efficiency affect household wellbeing.

The GST distribution system can affect efficiency through its impact on the allocation of labour and capital across the economy, and on incentives for sound government spending, taxation and reform.

While the fiscal outcomes of the GST distribution are clear and quantifiable, there is limited empirical evidence to support a definitive assessment of the overall net economic impacts of the GST distribution system.

This Report examines the extent to which the GST distribution system delivers its objectives in an economically efficient manner by:

- examining how the GST distribution affects the allocation of economic resources, particularly labour and capital, across the economy — that is by discouraging resources from locating where they are most productive (Section 4)
- outlining ways the assessment of states' revenue-raising capacities and expense needs can discourage growth-enhancing policy (Section 5)
- outlining how interactions between the GST distribution system and other Commonwealth grant arrangements can result in inefficiency (Section 6).

4.0 Impacts on labour and capital mobility

Key points

- The movement of labour and capital across the federation can be influenced by the GST distribution.
 - Modelling undertaken by the Commission finds that while interstate migration in Australia mostly occurs for reasons such as to access employment, it is also associated with differences in GST distribution outcomes.
 - Although the direct effects of the GST distribution system on interstate migration are small, they may accumulate over time given the persistence of the GST redistribution toward specific states.
 - Where substantial fiscal transfers result in changes in economic activity, the GST distribution indirectly affects decisions and can result in a reallocation of labour and capital.
- Overall impacts depend on whether the GST distribution system supports a more efficient allocation of economic resources, including labour and capital.
 - Fiscal equalisation transfers may improve incentives for labour and capital to locate where they are most productive rather than where they receive better tax treatment or services.
 - However, in practice, choices about the design and administration of the GST distribution can result in labour and capital flowing in inefficient ways.
- Some characteristics of the GST distribution may dampen market signals, reducing the efficient allocation of resources by:
 - discouraging high-value international skilled labour and capital from flowing to Australia
 - impeding labour and capital from moving to take advantage of structural change or economic opportunities.

4.1 Impact on the flow of labour and capital

One way the GST distribution may have implications for efficiency is through its impact on the allocation of labour and capital between states.

In principle, the GST distribution may affect resource allocation by directly influencing an individual's or firm's migration decisions; or indirectly influencing such decisions through its effect on states' fiscal capacities and their ability to support economic activity.

The GST distribution may also affect the attractiveness of Australian locations for flows of international labour and capital.

Whether the GST distribution system has any material, direct impact on such resource allocation has been a point of discussion in past reviews (Brumby et al. 2012, p. 40; Garnaut & Fitzgerald 2002, p. 153; PC 2018, p. 161).

Various studies identify employment opportunities and family reasons as key determinants of interstate migration flows in Australia (Australian Government 2026, pp. 32–33; CIE 2023, pp. 136, 138, 145; Kalemba et al. 2022, p. 292; PC 2018, p. 162) and abroad (Kaplan & Schulhofer-Wohl 2017, p. 59). Other influential factors include housing affordability and cost of living (CIE 2023, p. 13).

Consistent with such studies, the PC's review (2018, p. 161) and the 2012 GST distribution review (Brumby et al. 2012, p. 40) found the GST distribution is likely not a key consideration for individual's migration decisions.¹²

However, the ability to draw definitive conclusions has been limited by available empirical evidence.

The effect on resource allocation is small but may accumulate over the long run

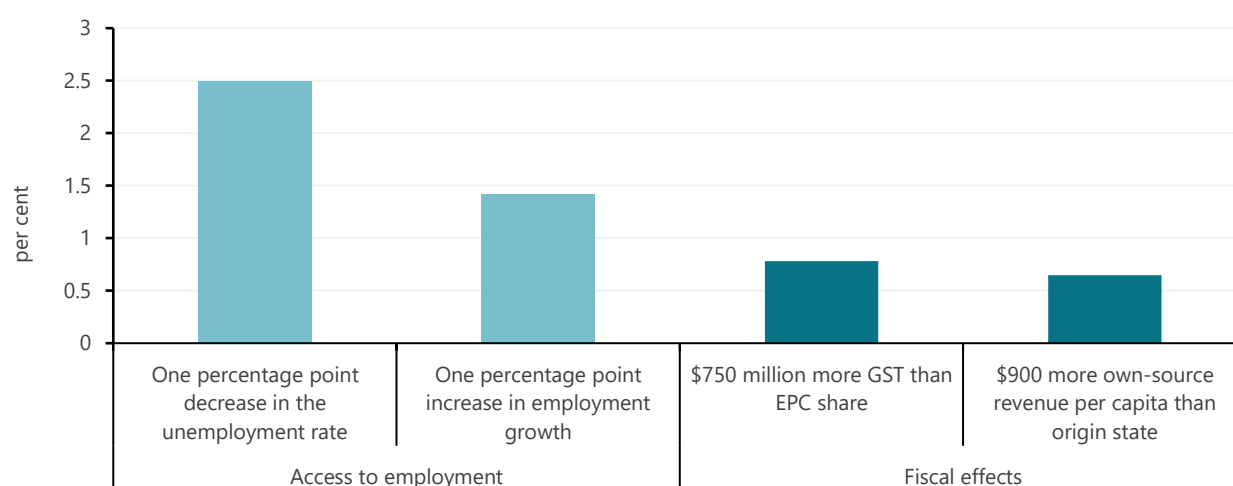
The Commission undertook modelling¹³ to examine the relationship between the GST distribution system and interstate migration. The modelling found people move to states with:

- higher own-source revenue per capita (reflecting fiscal capacity)
- GST grant revenue above their EPC share.¹⁴

While this evidence is explorative and sensitive to different specifications, the results indicate differences in fiscal capacity and GST distribution outcomes affect migration.

Importantly, the findings suggest that, while GST grant revenue and relative state fiscal capacity may affect interstate migration, they are not key drivers (Figure 4.1). For example, the results suggest¹⁵ a one percentage point increase in employment growth is associated with a 1.4 per cent increase in inward interstate migration. This impact is almost twice as large as the effect on interstate migration from a state receiving the median deviation in GST grant revenue above its EPC share, of around \$750 million.

Figure 4.1 Change in interstate migration inflows based on various factors



Note: Own-source revenue is total revenues less current grants (GST and specific purpose payments). The median difference in own-source revenue per capita is \$900 and median GST grant revenue deviation from EPC share for recipient states is \$750 million.

Source: QPC estimates based on gravity modelling. See Appendix B for data sources.

¹² Similarly, Walsh reported that empirical studies have found factors other than government policy are larger drivers of migration, partly due to the cost of moving (PC 2006, p. 72). The CIE (2023, p. 4) found improving government services (an outcome of HFE) resulted in only a modest net population increase, when a region's service level improves.

¹³ The Commission used a 'gravity' model to consider how GST grant revenues affect migration flows between Australian states and territories. A technical paper on the Commission's modelling is available in Appendix B. Modelling only considered migration and so is more applicable to flows of labour than flows of capital. However, flows of labour and capital are likely to be affected in similar ways.

¹⁴ Modelling also suggested lower taxation revenue per capita in the destination state increases inward migration, and the effect is comparable to relatively modest changes in employment growth. These results are discussed in Appendix B but are not covered here as total own-source revenue per capita and GST grant revenue above EPC shares provide better indicators of fiscal capacity and the effect of the GST distribution.

¹⁵ Caution should be taken not to interpret the point estimates directly, rather the point estimates should be taken to reflect the relative importance of employment growth and measures of fiscal capacity.

Nevertheless, the persistence of GST grant revenue flows in excess of EPC shares towards specific states may suggest even modest population effects could accumulate and be material over time.

Indirect effects on migration through the location of economic activity

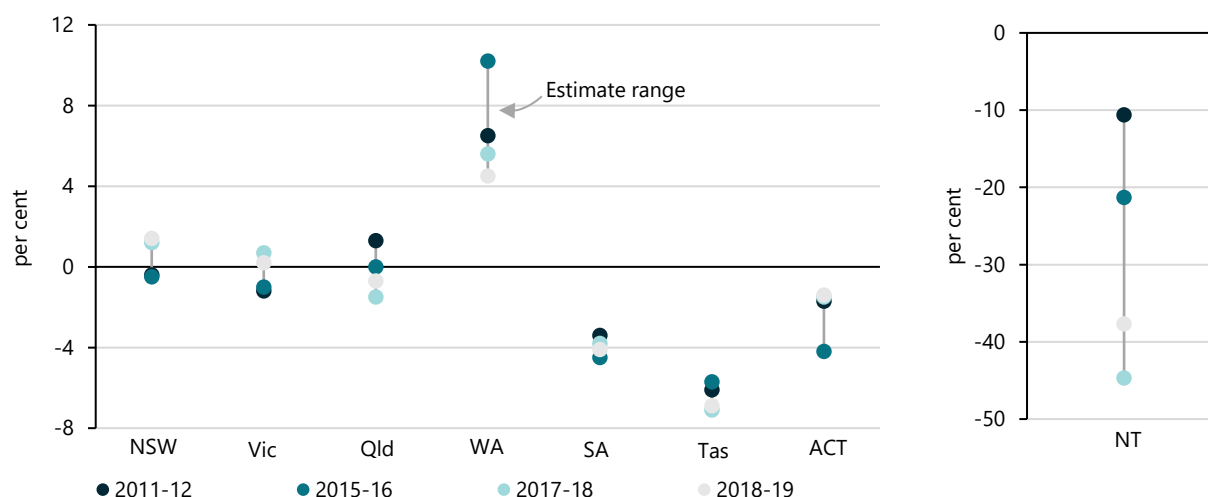
The greater fiscal capacity provided to recipient states allows those states to support a higher level of government service delivery and economic activity than would otherwise be the case, with the converse true for donor states.

Where the substantial transfer of fiscal resources between states results in changes to the location of economic activity and employment, these changes allow the GST distribution system to indirectly influence migration decisions.

This outcome is consistent with modelling conducted by Murphy (2018, 2021; and modelling completed for Independent Economics 2012, 2015), which suggests the GST distribution affects long-run population outcomes. Murphy's modelling suggests in the long-run there could be a population increase of up to 10.2 per cent for WA and a decline of up to 44.7 per cent for the Northern Territory (NT) if an EPC distribution were used instead of the CGC's assessed relativity (Figure 4.2).¹⁶ Similar outcomes have also been observed in international studies.¹⁷

Figure 4.2 Alternative forms of GST distribution deliver material changes to population outcomes

Modelled changes in long run population under an EPC distribution relative to current HFE arrangements, by assessment year



Source: Independent Economics 2012, p. 40, 2015, p. 22; Murphy 2018, p. 33.

¹⁶ These estimates depend on which CGC assessment-year was used, as well as the underlying assumptions. Murphy modelled the assessment years 2011–12, 2015–16, 2017–18, 2018–2019, with the counterfactual being a modified EPC system. Modelling for 2021–22 provides consistent results but uses an alternative counterfactual. Murphy notes six qualifications to the modelling. He assumes labour is fully mobile between states; factors of production are fixed at the national level; states do not alter their behaviour to achieve a GST distribution outcome; there is no fiscal externality for state services (as there is with national services such as defence); the modelling only considers policy influences on migration decisions caused by central government grants, not from central government budgets; and congestion externalities are not taken into account. These assumptions are reasonable for assessing the isolated impacts of fiscal equalisation on migration outcomes. Murphy's overall welfare impacts are not reported here as limitations mean that while estimated impacts on migration outcomes are reasonable, welfare impacts are more contestable.

¹⁷ Tombe & Winter (2021, pp. 522, 542–543) found equalisation transfers in Canada increased recipient provinces' populations at the expense of contributor states, compared to a counterfactual where transfers were distributed according to provinces' output shares.

The GST distribution will also affect the allocation of capital

Labour and capital are similarly mobile between states but with some notable differences:

- once capital is embodied, such as plant or infrastructure, it can become highly immobile. This may vary long-term capital formation patterns in a way that does not necessarily align with migration, although labour can also become less mobile over the lifecycle
- international capital flows are highly mobile and there are fewer restrictions on international flows of capital than labour.

This suggests the GST distribution can similarly have a significant impact on the allocation of capital across the federation. For capital in particular, any impacts on international capital flows will be more significant.

4.2 Encouraging inefficient flows of labour and capital

The overall economic impacts of the GST distribution will depend on whether it results in an improvement of both labour and capital allocation across the federation (PC 2018, pp. 151–152).

Buchanan (1950, p. 589) proposed that HFE, when eliminating differences in taxation and/or government services across borders (so-called net fiscal benefits), can incentivise individuals to live where they are most productive. Similarly, HFE is theorised to improve capital allocation (see Liu 2014). In practice, however, aspects of the GST distribution methodology can result in labour and capital flowing in inefficient ways.

Additionally, inefficiencies can occur where the GST distribution impedes the flow of:

- high-value labour and capital to highly productive regions
- labour and capital in response to structural change.

Impacts of the GST methodology

Efficiency will be achieved in cases where HFE *eliminates* differences in *individual's* net fiscal benefits between states.

However, such elimination is not achievable because the GST distribution delivers fiscal equalisation between states, not individuals. As noted in Section 3, equalising fiscal capacity between states does not directly deliver an equity outcome for individuals.

This can reflect states retaining policy autonomy and so differences in net fiscal benefits facing individuals will continue to arise between states even if HFE fully equalises fiscal capacities across states.¹⁸

The GST distribution methodology is also unlikely to perfectly equalise revenues and costs (sometimes due to unavoidable limitations) which may impede the GST distribution system's ability to encourage efficient flows of labour and capital. This can include cases where the GST distribution methodology:

- equalises transfers based on economic circumstances (such as employment levels and wage rates), dulling otherwise efficient signals for labour to move to its most productive use (Murphy 2018, p. 17)
- equalises transfers based on geographic circumstances, resulting in people located in high-cost or congested locations not facing the full cost of their location decision¹⁹
- relies on simple rules for assessing some revenues and costs where underlying differences in fiscal capacity between states are not observable.

¹⁸ This occurs as individuals may move to states whose services and tax arrangements suit their preferences, even if they are less productive in the destination state (that is they vote with their feet, following Tiebout (1956)).

¹⁹ Garnaut & Fitzgerald (2002, p. 140) and Murphy (2018, p. 17) suggest some elements of the CGC's methodology to equalise for geographic circumstances are either not warranted due to externalities, or work directly against economic efficiency.

Impacts to the flow of high-value labour and capital

The argument for HFE improving the efficient allocation of labour and capital holds for a *fixed, domestic* labour pool and national capital base. However, international labour and capital flows also affect overall economic outcomes.

Garnaut and Fitzgerald (2002, pp. 135, 149) note there is a global marketplace for skilled labour and the systematic transfer of resources from highly-productive regions (which are competitive in the global market for capital and high-value labour) reduces Australia's attractiveness. Overall, HFE transfers may reduce efficiency by reducing inflows of international labour and capital (or increasing out-flows of skilled residents and investment).

When capital bases are not fixed (such as when there are global flows of capital), Bucovetsky & Smart (2006) and Hauptmeier (2008, p. 16) indicate partial equalisation may improve the efficient allocation of capital. This is because in such cases states may become less competitive at the international level if they do not set taxes low enough — and under full HFE tax rates may be higher than would otherwise be the case (Becker & Kriebel 2017).

The flow of labour and capital in response to structural change

Prior to, and for the early years after the introduction of the GST, HFE operated within an environment of relatively predictable conditions.

Since then, the GST distribution system has been affected by adjustments in the economy arising from structural change, unexpected shocks and commodity price cycles that have underpinned marked swings in state revenues and, in some cases, expenses.

These factors motivated the 2012 GST Distribution Review and 2018 PC inquiry (2018, pp. 4–5). For example, the terms of reference for the 2012 GST Distribution Review highlighted:

Australia is facing a number of long-term trends that are driving pronounced and challenging structural change in the economy. (Australian Government 2011a, p. 31)

The GST distribution system may have significant efficiency impacts where it slows down resource reallocation during periods of structural change, such as material commodity price cycles. These periods are challenging, particularly for the resource states (see Box 4.1).

Box 4.1 The GST distribution and commodity price cycles

The significance of the mining industry in specific states interacts with the GST distribution system, leading to potential implications for economic efficiency.

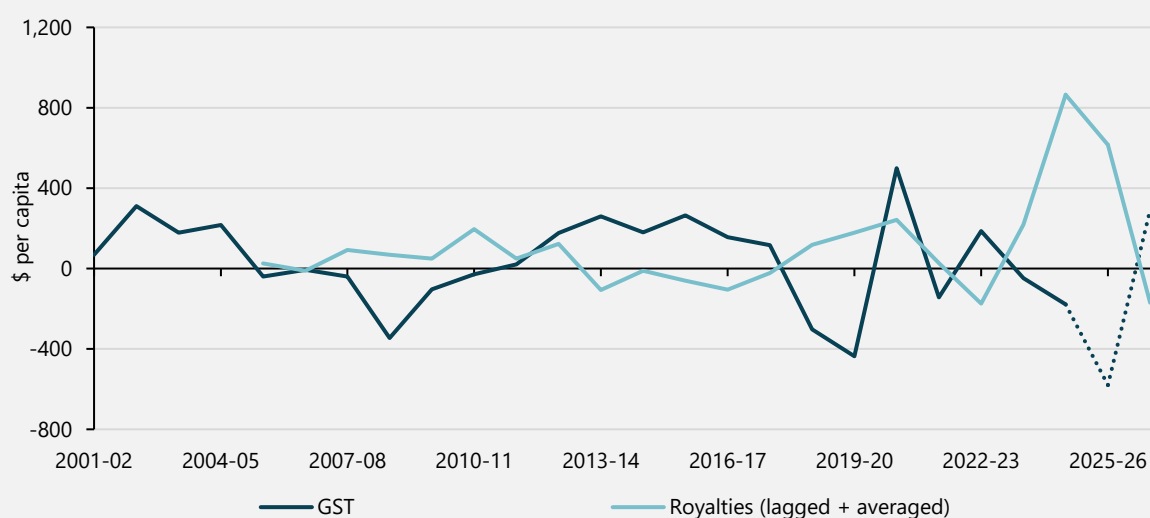
This interaction affects the GST distribution through fluctuations in commodity prices that flow through to royalties. Royalties provide a clear fiscal benefit to Queensland and other states (through redistribution), allowing the community to derive value from Queensland's natural resources. However, they also affect Queensland's (and other resource-exposed states) GST grant revenue because the GST distribution system redistributes above-average own-source revenues, such as royalties (CGC 2025e, p. 31).

Accounting for the two-year data lag and three-year averaging involved in estimating GST needs, growth in royalties moves inversely with growth in Queensland's GST (Figure 4.3).

High commodity prices can be an indicator of structural change associated with resource endowments. An inverse relationship between high commodity prices and the GST distribution can mean fiscal resources are transferred away from states experiencing such structural change.

Figure 4.3 Royalty revenues are a key driver of Queensland's GST distribution outcome

Change in Queensland's GST grant revenue per capita and royalty revenue per capita, 2001–02 to 2026–27, \$2025–26



Note: Royalty revenue has been lagged by two years and averaged over the preceding three years before calculating the growth rate.

Source: QPC based on ABS 2011a, 2015a, 2019, 2025c, 2026b; Australian Government 2001 to 2025c, 2025b; CGC 2026a; Queensland Government 2004 to 2010, 2025a.

The GST distribution system may have significant efficiency impacts where it slows down resource reallocation during periods of structural change.

Australia has faced structural change, most notably through the onset of the mining boom. When structural change occurs, patterns of demand for labour and capital (from both interstate and international sources) also change.

Where GST grant revenue is distributed away from states experiencing welfare-enhancing structural change, it may also reduce the incentives for the efficient reallocation of labour and capital.

The cost of relocating labour and capital increases the time economic resources take to adjust to positive structural change. The GST distribution system could exacerbate these costs. As described by Pincus and Ergas (2012, p. 2), in relation to labour:

there are sunk costs of moving, which hamper interstate movements. These include the psychological cost of disruption of social and family life, and the costs of finding new suppliers of goods and services, including a new school for children. Uncertainty about the outcomes of such moves makes them risky, requiring offsetting compensation if a move is to be made. But there are also artificial costs, like stamp duties on property transactions. These artificial costs mean that the flow of interstate migrants is too low and too slow, which is costly to dynamic economic efficiency.

In such instances, costs to efficiency (and household welfare) arise where the GST distribution system means states advantaged by structural change receive a lower share of the GST distribution pool, consequently lowering the incentive to move to these states. This will mean the federation is unable to adapt to or take advantage of productivity-enhancing structural change as quickly as possible.

Broadly, the GST distribution system may dampen market signals that are otherwise key drivers of efficient migration decisions, such as employment growth and low unemployment rates.

5.0 Discouraging growth-enhancing policy

Key points

- The GST distribution system has the potential to influence policy decisions and may promote inefficiency where the CGC compensates states for inefficient policy and penalises states for efficient policy.
- Revenue-raising capacity is assessed narrowly based on the taxes states actually raise and may discourage growth-enhancing policy and increase states' reliance on inefficient taxes by:
 - **disincentivising resource development** — where state dominance in a revenue source means only a small share of a change in revenue is retained in the state once the full redistribution takes effect. Recent methodology changes have exacerbated this effect for black coal
 - **compensating states that restrict economic activity** — states that choose to ban or restrict resource development do not bear the full cost of their decision, as they are assessed by the CGC as not having the ability to raise this revenue
 - **favouring inefficient taxes** — indicative estimates suggest a 10 per cent increase in transfer duty rates (a comparatively inefficient tax) can result in states receiving additional long run GST grant revenue, to the value of 33 to 65 per cent of the additional tax revenue collected
 - **potentially impeding tax reform** — where such reform has an adverse GST grant revenue consequence.
- The GST distribution may also discourage efficient state expenditure by:
 - **enabling transfer dependency of recipient states** — recipient states may rely on the GST distribution system to finance their expenses, rather than pursuing economic growth policies
 - **disincentivising investment in risk mitigation** — an individual state may underinvest in risk-reduction measures knowing risks are shared between states through the GST distribution system
 - **moving pro-cyclically with states' fiscal positions** — the GST distribution system may exacerbate incentives to inefficiently allocate revenue windfalls when GST grant revenue is procyclical with other revenue
 - **compensating states that undertake inefficient borrowing** — recent trends suggest high population growth states are compensating states whose net borrowing is increasing above long-run trends.

5.1 Assessments can encourage inefficient policy

The GST distribution system may result in inefficient outcomes when the CGC assessment methodology affects states' policy decisions.

Past reviews have found, at least in theory, Australia's GST distribution system discourages reform but have failed to find compelling evidence of disincentives impacting policy decisions in practice (Brumby et al. 2012, p. 136; PC 2018, pp. 111–112).

While past reviews have focussed on whether states directly consider GST distribution consequences when making policy decisions, the way in which the GST distribution may indirectly affect policy decisions has been less-comprehensively considered.

Regardless of whether states directly act on policy incentives or not, the equalisation of cost and revenue differences can result in the GST distribution compensating states for inefficient policy and penalising states for efficient policy. In these cases, it will result in the reallocation of economic resources in inefficient ways, and may be further compounded where other states respond to the loss of GST revenue by resorting to inefficient revenue or expenditure policies.

Whether through direct or indirect means, these effects occur because policy neutrality is not being consistently achieved in practice (Box 5.1), ultimately having implications for economic efficiency.

Box 5.1 Policy neutrality in the CGC's GST distribution approach

The CGC's GST distribution methodology is intended to be 'policy neutral' — that is, it is intended to not influence policy decisions (also see Box 1.3 on the CGC's supporting principles).

Areas recently identified by the CGC as raising policy neutrality concerns include:

- the revenue assessment, which does not currently account for the elasticity of tax bases
- states dominating specific royalty revenue streams
- use of the observed level of production to measure revenue-raising capacity, when states have imposed restrictions on mining activity
- health spending in relation to COVID-19
- forms of expenses where no policy neutral driver of need has been identified, such as for environment protection and net zero transition expenses.

Source: CGC 2025a, pp. 39, 50, 53, 88, 146, 216, 2026c, pp. 14–16.

5.2 States' reliance on inefficient taxes

Where policy neutrality is compromised, the CGC's assessment of revenue-raising capacity can directly or indirectly incentivise inefficient taxation.

A state's assessed ability to raise revenue differs from actual revenue raised and is a function of:

- average tax rates across states
- each individual state's tax base²⁰ (PC 2018, p. 101).

Changes to tax rates have two impacts on the GST distribution.

The tax rate effect: An increase (decrease) in the tax rate in a state will increase (decrease) the 'average tax rate' across all states, from which revenue-raising capacity is assessed. Whether this results in an increase or decrease in GST distributed to any state depends on the size of the tax base in the state initiating the policy change, relative to population.

An individual state's influence over the average tax rate varies according to the state's share of the national tax base. For example, if a state is assessed as having 30 per cent of the national tax base, they will have a 30 per cent weighting on the average tax rate.

The tax base effect: The CGC's methodology typically relies on observed, rather than underlying, tax bases to account for differences in states' revenue-raising capacities (CGC 2023a, p. 12). This means that, as measured by the CGC, an increase (decrease) in the tax rate will result in a decrease (increase) in the tax base as a result of the higher (lower) price point resulting in a reduction (increase) in taxed activity.²¹

²⁰ For the CGC, the tax base (or revenue base) is a measure of the transactions, activities, or assets that are taxed by states (CGC 2026b).

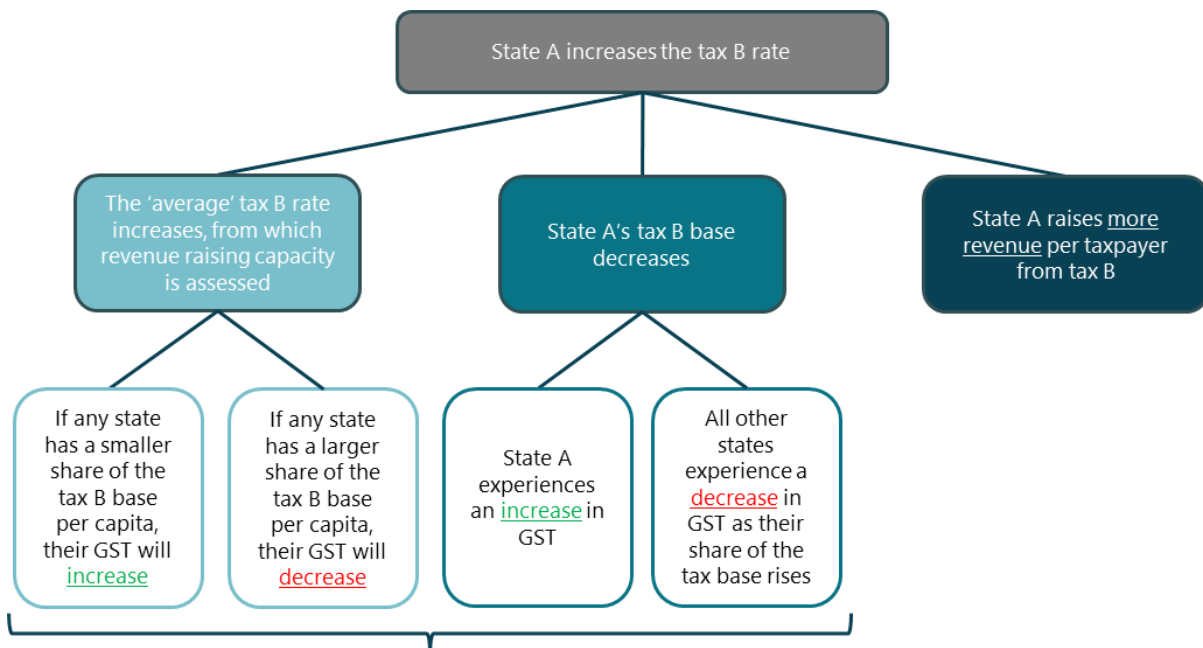
²¹ This can also be referred to as the elasticity impact on the tax base (PC 2018, p. 101).

Due to the tax rate and tax base effects, revenue policy decisions can have a two-fold impact on revenue — firstly through changes to a tax and secondly through the GST distribution.

If a state raises a tax rate, the assessed average tax rate increases for all states, and all states are assessed as having a greater ability to raise revenue. This occurs despite only one state receiving more own-source tax revenue. Additionally, the state raising the tax rate will see a reduction in the size of their assessed tax base and all other states will see their relative share of the tax base increase (Figure 5.1). A state raising a tax rate will often, but not always, see their GST grant revenue increase due to the reduction in their tax base. This produces perverse incentives where a tax change can result in a state receiving both an increase in own-source revenue and a subsequent increase in their GST grant revenue.²²

Figure 5.1 Increasing a tax rate can result in a state also increasing their GST share

The impact of an increase in the tax rate on GST distribution



The balance of these impacts for all states will determine if their GST distribution increases or decreases.

Source: QPC.

If a state reduces or abolishes a tax, the effect is essentially the opposite of raising the tax (and the opposite of that demonstrated in Figure 5.1). If a tax is reduced or abolished entirely in one state, this state is still assessed as having the capacity to raise revenue to a level that is equivalent to the average tax rate. The abolition of the tax results in a larger assessed tax base (as the reduction in tax corresponds with an increase in observed taxable activity), which increases the state's assessed revenue-raising capacity.

²² This effect will occur over time once the two-year data lag and three-year averaging are accounted for.

The tax rate and tax base effects have consequences for efficient policy development through two means:

1. **States are (directly) discouraged from pursuing efficient policies.** Efficient policies expand economic activity and so can expand state's assessed tax bases. Consequently, states that pursue efficient revenue policy can face not only the costs of pursuing the policy but also a loss of GST grant revenue over time.
2. **States are (indirectly) encouraged to continue relying on inefficient taxes.** States that rely on higher and more inefficient taxes are assessed as having lower tax bases and so receive more revenue than they would under an efficient revenue assessment. All other states experience a loss of GST grant revenue over time. Effectively, the GST distribution has a built-in tendency to underestimate the revenue-raising capacity of high-tax states (Barro 2002, p. 10) and states that are more reliant on inefficient taxes. In practice, the GST distribution could be encouraging all states to rely on inefficient taxes and relatively high tax rates.

Each of these direct and indirect effects is discussed in further detail below.

States are discouraged from pursuing efficient policies

The GST distribution system can alter the underlying incentives associated with state policy decisions, as states may not bear the full cost or benefit of their decisions given the effect on GST grant revenue. Similarly, the distribution framework means that where a state does not bear the consequence of a taxation (or expenditure) decision through the GST distribution until several years after the decision is made, it can create poor incentives for sound fiscal and tax policy decision making.

Past reviews have not found conclusive evidence that disincentives arising from the GST distribution system affect tax policy decisions in practice (Brumby et al. 2012, p. 136; PC 2018, pp. 111–112). However, states have provided more recent evidence, including in their submissions to the current PC inquiry, that they do consider the possible GST grant revenue impacts associated with a policy reform (Government of WA 2026, p. 65; Queensland Treasury 2026, p. 32).

The GST distribution may impede tax reform

Apart from the Australian Capital Territory (ACT) Government's move to progressively replace stamp duty (also referred to as transfer duty or conveyance duty) with an increased land tax (ACT Government 2026), there has been no significant, sustained state tax reform since the GST was introduced.

In addition, some modest changes to revenues with GST distribution implications have not been pursued. For instance, the Government of WA (2026, pp. 67–68) cited GST revenue implications as a key reason why a proposed increase to the gold royalty rate in 2017–18 did not proceed.

The first mover disadvantage

There is a disadvantage to being a first mover when it comes to reducing or abolishing taxes, as the first mover has limited influence over the average tax rate, which is used to assess revenue-raising capacity (PC 2018, pp. 328–329). As more states implement reform, the average tax rate will fall to a greater extent on a cumulative basis and the CGC's methodology reflecting 'what states do' will result in less GST being redistributed to equalise for states' ability to raise the affected revenue source. As a result, the first state to reduce or abolish a tax experiences the greatest relative loss in their GST distribution, while also reducing their own-source revenue.

While states may be able to approximate the impact of changes to an existing tax rate, based on their knowledge of the CGC's methodology, the GST impacts of a new tax are subject to much greater uncertainty.

States can contact the CGC to discuss possible GST grant revenue impacts of policy changes. However, the CGC does not provide detailed assessments of the potential impacts, nor do they provide binding advice to states on how a policy change will be treated in their methodology.

Due to the non-binding nature of CGC advice, the treatment of a new tax may change in practice. States bear the risk of losing a share of their GST distribution, particularly when looking to replace an existing tax for an alternative.

The NSW Government recently explored the opportunity to replace stamp duty and land tax with a broad-based property tax but found the GST impacts of the proposed reform to be material (Box 5.2).

Box 5.2 NSW proposal to replace stamp duty and land tax with a broad-based property tax

The CGC typically refrains from providing more detailed estimates of what policy proposals may mean for GST distributions, since the CGC:

- makes their assessments using historical data (and they do not have forecasting capability)
- cannot guarantee what other states will do or what revenues they will collect.

In its 2020–21 budget, the NSW Government proposed gradually replacing stamp duty and land tax with a broad-based property tax. In considering this tax reform, the NSW Government was concerned about what this would mean for their GST grant revenue given its significance as a source of state revenue.

To understand the GST impact of the aforementioned proposal, the NSW Government engaged in discussions with the CGC despite the known limitations.

The NSW Government (2021, p. 53) stated that:

Without progress in this area [NSW] stands to lose up to \$1 billion of GST revenue per year in the long run, which would materially affect the Government's capacity to proceed with the reform.

When the reform was implemented in 2023, it was modified to apply only to first home buyers; although the NSW Government intended to eventually make it available to all home buyers.

While there is no public evidence stating GST grant revenue impacts influenced this decision, the modified reform would have reduced the expected decline in the state's GST grant revenue. This scheme was implemented only for a short timeframe of six months before being replaced with a stamp duty exemption for first home buyers on properties valued at up to \$800,000 (or a concessional rate for properties valued at up to \$1,000,000).

Source: NSW Government 2020, p. 11, 2021, pp. 8, 53, 2022, p. 64, 2023b, 2023a.

States that dominate a revenue source face additional disincentives

The creation of poor policy incentives is particularly apparent where one state is dominant in a specific revenue source. This is most pertinent in the mining assessment, which the CGC has reviewed and considered changes on several occasions, including in the two most recent methodology reviews (CGC 2018b, p. 1, 2025a, pp. 51–53).

Where a state is completely dominant in a specific revenue source, any changes to their tax rate will result in an equivalent change to the average tax rate as assessed by the CGC. This means the state would subsequently see only their population share of the change in revenue retained in the state once the full redistribution takes effect. This occurs even though the underlying activity from which this revenue is raised has not changed.

The dominant state problem is clearly shown in the context of mineral royalties, with the production of several commodities (such as iron ore, onshore gas and black coal) being highly concentrated across one or two states.

The PC (2018, p. 121) notes that, largely due to the high concentration of mineral production in specific states, the GST distribution has potential to distort state policy within the mineral and energy resource sectors.²³

²³ Whether this is an efficient or inefficient outcome is unclear. Studies of the economic costs of royalties have produced wide ranging results (Ergas & Pincus 2013, p. 11; Freebairn 2015a, 2015b; KPMG Econtech 2010, p. 5) and indicate costs depend on the specific royalty, commodity and other factors such as the degree of foreign ownership.

Given there is a high concentration of mineral production in a small number of states, there is no average policy. Rather, the small collection of states with a high concentration of minerals effectively set the average, and hence see most of the revenue from an increase in royalty rates equalised away (PC 2018, p. 168).

As a result of these policy neutrality concerns, the CGC has considered options for a dominant state adjustment in its assessment but no agreement has been reached on a suitable, revised methodology. Further, recent changes have worsened the dominant state problem in minerals (Box 5.3).

The dominant state effect can result in inefficiency and hamper economic growth where a state is disincentivised from pursuing resource development as they do not gain the full revenue benefit of doing so. The consequences for economic efficiency may be compounded if, instead of leveraging mining revenue growth, states raise revenue from alternative, inefficient revenue sources.

Box 5.3 CGC consideration of mining revenues and dominant state issues

Mining revenues

In its 2020 and 2025 Methodology Reviews, the CGC considered several options for changing the way mining revenues are assessed, including the introduction of a dominant state adjustment (CGC 2018c, p. 1, 2025b, pp. 51–53).

Acknowledging states that dominate the production of mining commodities can face a disincentive to increase royalty rates, the CGC has suggested applying a dominant state adjustment to improve policy neutrality. This includes introducing an adjustment that would assess 50 per cent of the increased revenue from the rate change (CGC 2023b, p. 15), as occurs in Canada (Queensland Treasury 2026, p. 41).

Following state consultation on both occasions, the CGC did not implement the potential adjustment (CGC 2020c, p. 80, 2025a, p. 53). However, the CGC acknowledged the ongoing need to find a practical dominant state adjustment that would help to resolve policy neutrality concerns and consistency with the core objective of fiscal equalisation (CGC 2025a, p. 53).

Dominant state issues

In the 2025 Methodology Review, the CGC implemented a change to the assessment of coal royalties. This change involved assessing black coal royalties using a fixed-price band model with two price bands: above and below \$200 per tonne (CGC 2025a, p. 49).

This change was in recognition that states with higher value coal benefit from higher revenue-raising capacity than states with lower value coal. The impact of this change is greater when there is a large price divergence between higher value metallurgical coal and lower value thermal coal.²⁴

Metallurgical coal typically attracts higher prices. During periods where metallurgical coal attracts prices above \$200 per tonne and thermal coal attracts prices below \$200 per tonne Queensland will likely have upwards of 80 per cent of policy influence over the CGC's high value coal royalty revenue assessment, compared with upwards of 60 per cent policy influence prior to the methodology change. NSW will likely have the most policy influence over the CGC's lower value coal royalty revenue assessment.²⁵

The overall effect of the method change is to greatly increase the dominant state effect for black coal.

²⁴ This was notably not the case in 2022–23 (one year of the three-year average data used to inform GST needs for 2025–26), though there was strong price divergence in 2021–22 and 2023–24 (CGC 2025h, p. 32). As a result, some thermal coal was likely to be assessed in the >\$200 per tonne category in 2022–23.

²⁵ Commission estimates based on production data in tonnage terms. Data on the value of production and at different price bands is not consistently publicly available. Estimates are subject to change on an annual basis depending on production volume and the price of coal. When both thermal coal and metallurgical coal are at similar price points (either above or below \$200 per tonne), the dominance of Queensland and NSW in the coal assessment will be similar to their dominance prior to the methodology change.

States do not bear the full cost of policy initiatives that restrict economic activity

The CGC aims to adjust for material factors that impact states' revenue-raising capacities or expenditure needs (CGC 2025e, p. 230). However, where a material factor influencing revenue-raising capacity (or expenditure needs) cannot be identified or measured, the CGC usually does not undertake an adjustment. This is because it is difficult to measure the extent to which resource endowments would be extracted if restrictive policies were removed, particularly since not all resource endowments are economically viable (CGC 2023b, p. 14, 2025a, pp. 54–55).

The effect of the assessment approach is that states can restrict or ban extraction activity while still benefitting from royalties through the GST distribution system. It also discourages states from commencing new onshore petroleum or gas production (Northern Territory Government 2026, p. 15; Queensland Treasury 2026, p. 35).

Presently, there are restrictions on gas and uranium extraction, with gas extraction restrictions having the greatest redistributive impact in the CGC's current assessment (CGC 2023b, pp. 13–14, 2025a, pp. 53–55). Redistribution toward states with restrictions on production, that may otherwise be viable, comes at the cost of states that have developed onshore gas extraction capacity, particularly Queensland (Queensland Treasury 2026, p. 36).

Furthermore, the NSW Government has recently announced a ban on greenfield development of new coal mining sites (NSW Government 2026a, p. 14), which may impact policy neutrality of coal assessments in the future if the CGC's approach remains unchanged.

Without a more policy neutral approach for these instances, the current treatment creates incentives for states to restrict economic activity in certain sectors, leading to economically inefficient outcomes.

States are encouraged to rely on inefficient taxes

Taxes distort the behaviour of households and businesses, resulting in measurable losses in efficiency with implications for overall economic activity. Therefore the tax mix a jurisdiction adopts to fund expenses has important economic implications (Freebairn 2020, pp. 3–4; Freebairn et al. 2015, p. 11; Nassios et al. 2019, p. 14).

States raise revenue from a variety of taxes, each with varying distortionary effects or levels of efficiency loss (Table 5.1). To the extent a state becomes more reliant on distortionary revenue sources, economic activity will be impeded with flow-on impacts to household incomes and living standards. Compared with most state taxes, the GST has a relatively low distortionary effect on economic activity (Nassios et al. 2019, p. 20).

Table 5.1 GST is estimated to be more efficient than most state-based taxes*Marginal excess burden (MEB) of select state taxes and the GST*

Tax	Cao et al. (2015)	Murphy (2016)	Nassios et al. (2019)	Nassios & Giesecke (2025)
GST	0.19	0.18	0.15	0.24
Transfer duty on conveyances	0.72	0.87	1.07	0.76
Land tax	-0.10	0.48	0.08	
Insurance duties		0.58	0.27-0.36	0.38
Payroll tax (rate)		0.37	0.22	
Motor vehicle taxes			0.24 (used) 0.97 (new)	
Gambling taxes			0.46	

Note: Efficiency loss is measured by calculating the economic loss (in dollars) of each additional dollar raised in tax (the marginal excess burden or MEB) and the total economic loss (in dollars) divided by the total taxation revenue (the average excess burden). A MEB of 0.15 means an additional dollar of GST revenue raised would cost 15c in losses. While Nassios et al. (2019) estimate efficiency losses for NSW, the estimates are considered indicative of the relative efficiency of taxes across states. They provide the most contemporary estimate for the largest range of state taxes and are consistent with other studies of Australian state taxes (Murphy 2016; Nassios & Giesecke 2025).

Source: Cao et al. 2015; Murphy 2016; Nassios et al. 2019; Nassios & Giesecke 2025.

Taxes that are more inefficient also tend to have more elastic tax bases (PC 2018, p. 102). That is, the least efficient taxes are those that distort behaviours, and result in more significant changes to demand. For example, transfer duties tend to be inefficient as they result in fewer property transactions because they impose a significant cost at the point of transaction. More efficient taxes, such as land tax, have immovable tax bases and so do not respond to changes in rates (that is, they are inelastic).

When a state increases the rate of an elastic tax (such as transfer duties) it can result in a decline in the assessed tax base (because demand falls in response to the tax). As shown earlier in Figure 5.1, a decline in the tax base results in the state receiving an increased share of GST.

To demonstrate these effects, Table 5.2 provides indicative estimates of the responsiveness of GST grant revenue to an increase in transfer duty and land tax rates if each state unilaterally introduced an increase in the tax rate.

While the GST outcome varies between states depending on the size of the tax base and the state's tax rate, raising more inefficient taxes results in higher compensation over time via the GST distribution system due to the greater influence of the tax base effect for these taxes. Estimates also indicate this compensation could be a significant portion of the total change in tax revenue collected.²⁶

²⁶ Acknowledging this issue, the NSW Government (2026b, p. 23) noted in their submission to the current PC inquiry: 'the absence of elasticity adjustments represents a serious flaw in the CGC's revenue assessment methodology which has significant implications for tax policy development.'

Table 5.2 When states raise an inefficient tax they gain a significant share of GST grant revenue

Indicative long run gain in assessed GST grant revenue as a percentage of the change in actual tax revenue resulting from a 10% increase in the tax rate unilaterally by each state

Tax	NSW	VIC	QLD	WA	SA	TAS
Transfer duty (elasticity of -0.36)	33%	42%	53%	59%	60%	65%
Land tax (elasticity of -0.06)	-13% ²⁷	2%	14%	13%	9%	7%

Note: Table 5.2 presents indicative estimates only, as they are based on a single year of tax revenue data (2023–24), use the average of elasticity estimates from Steinhauser et al. (2019, p. 4) prepared using CGC data for the CGC's 2026–27 estimation of GST relativities, and are estimated based on a 10 per cent increase in the tax rate for each state and each tax. The elasticity estimates from Steinhauser et al. (2019) are point estimates that are assumed to be constant across states, despite variance in tax rates. Actual effects will depend on how a change in tax rate is applied (such as through a change at specific tiers or to a threshold), the application of the CGC's detailed methodology, which assesses taxes at a more disaggregated level and applies three-year averaging and a two-year data lag, and the real world (unobserved) elasticity effect in response to tax changes for each state over time. Estimates are based on assessed revenue-raising capacity and do not account for equalisation to the standard state, which has the main effect of dampening outcomes for any state assessed as fiscally stronger than the standard state.

Source: QPC, based on CGC 2025h; Steinhauser et al. 2019, p. 4.

This outcome is not specific to Australia, as there is some international evidence to suggest other systems of HFE also incentivise reliance on inefficient taxes.²⁸

The GST distribution affects the efficiency of states' tax systems

A state's tax mix is a function of the state's share of GST revenue to total revenue. States that receive more in GST revenue per capita have more efficient tax systems than those that receive less in GST revenue per capita (see Figure 5.2).

As Queensland and WA have become fiscally stronger over time, GST revenue represents a smaller share of state revenue. This has reduced the states' share of revenue raised from comparatively efficient sources, such as the GST, with direct consequences for the overall efficiency of the states' tax systems (see Figure 5.3).

²⁷ A decrease in GST grant revenue is possible where the tax rate effect outweighs the tax base effect. This can occur if the state's tax base is substantially larger than its EPC share and the tax is relatively inelastic (efficient).

²⁸ For example, Buettner and Krause (2021, p. 93) examined the German fiscal equalisation system and found that when subnational governments face full equalisation of their own-source revenues, there can be strong incentives to increase, rather than reduce, tax rates. This effect can occur as a result of the design of HFE systems that account for revenue-raising capacity or as a result of subnational government revenue stress (Buettner & Krause 2021, pp. 91–92).

Figure 5.2 GST distribution outcomes are correlated with the efficiency of states' tax systems

Average share of taxation revenue (own source plus GST) by efficiency, ordered by lowest to highest average GST grant revenue per capita, 2000–01 to 2023–24

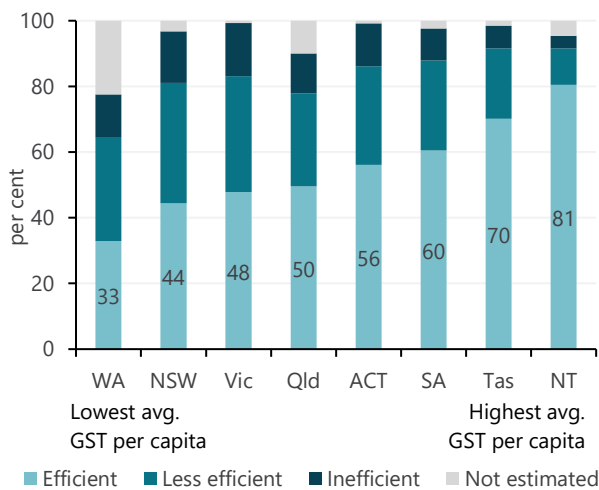
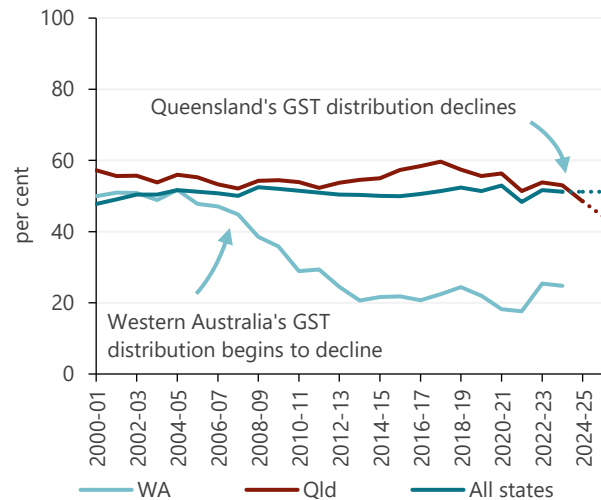


Figure 5.3 Declining contribution of GST revenue is associated with increased state reliance on less efficient own-source tax bases

Share of taxation revenue (own source plus GST) that are efficient, 2000–01 to 2024–25



Note: Taxation revenue includes GST grant and own-source revenue. Efficiency has been defined relative to GST (see Table 5.1) and follows Warren (2006, p. 67) and Nassios (2019, p. 17). The efficiency of royalties is not included as estimates vary widely, from an average excess burden of less than 20 cents to 50 cents for each dollar raised and the literature indicates efficiency costs depend on the specific royalty, commodity and other factors (Ergas & Pincus 2013, p. 11; Freebairn 2015b, 2015a; KPMG Econtech 2010, p. 5).

Source: QPC based on ABS 2011b, 2015b, 2025g; Australian Government 2001 to 2025c, 2025b, Cao et al. 2015; Murphy 2016; Nassios et al. 2019; Nassios & Giesecke 2025; Queensland Government 2025a.

Inefficiency arising from assessing tax bases narrowly

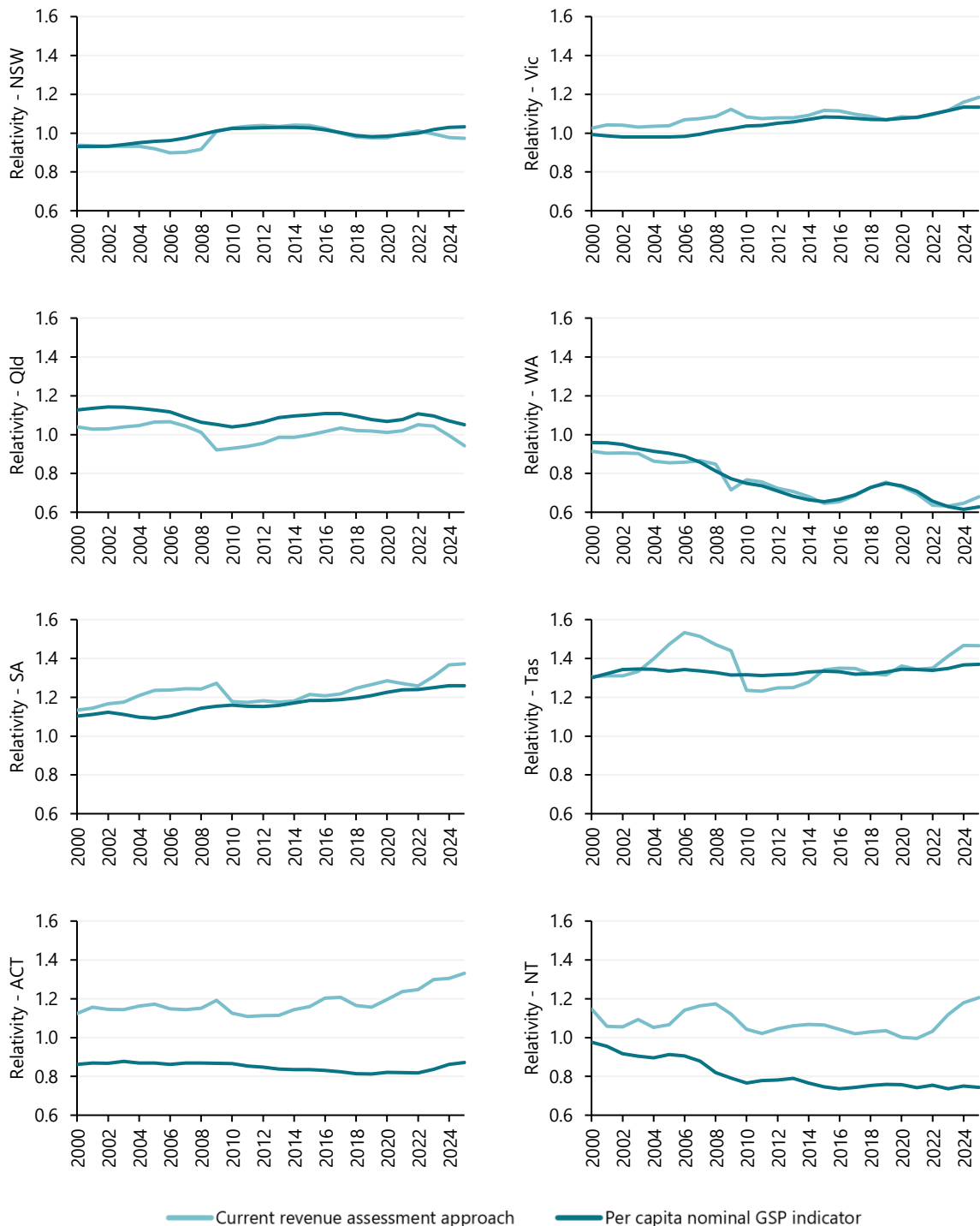
There is considerable debate over the value of assessing revenue-raising capacity narrowly (that is, the taxes states raise) compared with a single, broader indicator, such as per capita nominal Gross State Product (GSP) (ABC 2026, 24:00; Barro 2002; Boadway 2002; Brumby et al. 2012, p. 28; CGC 2020b, p. 53; PC 2018, pp. 194–199).²⁹

The current approach is largely justified on grounds of horizontal equity by addressing differences in actual taxes paid between states. Maintaining the current approach may also avoid large changes in GST entitlements that could result from adoption of an alternative approach, particularly in the transition period (PC 2018, p. 198).

Conversely, a broad indicator can more effectively address the economic incidence of state taxes, rather than their legal incidence. The CGC's revenue assessment does not recognise the incidence of most taxes as falling on individual incomes (Australian Government 2011b, p. 65; Brumby et al. 2012, p. 28), meaning the actual taxes states levy may not be a good indicator of their overall revenue-raising capacity, or horizontal equity.³⁰ Figure 5.4 provides a comparison between current and a broad revenue assessment approaches.

²⁹ For example, the PC's 2018 Inquiry (2018, p. 199, Finding 7.2) found 'Using a single broad indicator to assess States' fiscal capacities offers considerable potential to improve policy neutrality and simplify the HFE system. However, a single indicator that accurately reflects the underlying revenue-raising capacities and expenditure needs of each State remains elusive and arguably does not exist.' In this instance the PC were considering replacing both the revenue and expense assessments with a single broad indicator, not just the revenue assessment.

³⁰ The focus on legal incidence means the GST distribution can adjust for differences in actual tax rates between states and still result in equivalent individuals in different states facing differing effective tax treatments. For example, although payroll taxes are levied on individual firms, the incidence of the tax ultimately falls on workers through reduced real wages, and consumers through higher prices.

Figure 5.4 A broad indicator provides an alternative measure of state revenue-raising capacity*Revenue relativities under the current approach compared with per capita nominal GSP relativities*

Note: The current approach reflects state revenue assessments since 2000 (excluding other elements of the assessment) and applies three-year averaging and the data lag, consistent with the current approach of the CGC. It reflects assessed revenue and does not reflect the standard state, relativity floor or NoWO guarantee payments. The per capita nominal GSP indicator is taken from the latest ABS state accounts and also applies the data lag and three-year averaging. As this advice only assesses the efficiency effects of the revenue assessment, we have not accounted for past data revisions in ABS state accounts, which would be required if assessing an alternative, broad indicator approach.

Source: QPC based on CGC assessed budget 2000 to 2025 (CGC 2025d), ABS 2025b.

This analysis demonstrates the efficiency consequences associated with the CGC's reliance on assessing the narrow, legal incidence of state revenues. In particular:

- for many states, the revenue assessment produces a similar assessment of revenue-raising capacity as indicated by historical per capita nominal GSP. However, the narrow approach to assessing state revenues is inducing incentives to undertake inefficient policy where the broad indicator is less responsive to policy change. For example, state restrictions on taxed areas of economic activity (such as gas development or high transfer duties) can greatly reduce assessed revenue-raising capacity but will have a smaller impact on the broad indicator (GSP) where other economic activity replaces the restricted activity
- Victoria and South Australia (SA) are relatively high tax states³¹ and the wedge between the revenue assessment and the broad indicator may demonstrate the influence of the tax base effect, which artificially lowers these states' assessed tax bases, relative to broader measures of income. As has been shown, states that are more reliant on inefficient taxes or with higher taxes can be overcompensated through the GST distribution with consequences for economic activity in all states. When assessed against the broad indicator, the adverse impacts of the tax base effect are greatly reduced
- similarly, the effect of the dominant state problem may be indicated by Queensland's revenue capacity being assessed as consistently higher than indicated by per capita nominal GSP. Adverse incentives arise when assessments are based on narrow-based taxes. These incentives are largely removed when recognising states' revenue-raising capacity is driven by underlying income, rather than the rates of taxes or royalties imposed³²
- conversely, jurisdictions like the ACT are assessed as having low revenue-raising capacity, largely because the ACT cannot raise payroll tax on Australian Government payrolls. This assessment, however, is based on the legal rather than economic incidence of state taxes. As taxes can be passed through to workers and consumers more generally, the revenue assessment is not recognising that individuals are paying lower effective tax rates in these jurisdictions when assessed against their total income.

It can also be observed from Figure 5.4 that the current revenue assessment approach is leading to more volatility than would be indicated by a broader measure of revenue-raising capacity. On average for all states, the GSP indicator is around 40 per cent less volatile than the current approach when measured based on the mean successive difference in each year's revenue relativity. This may have further implications for efficiency, to the extent the approach contributes to pro-cyclical GST grant revenue and inefficient fiscal policy (see Section 5.3).

5.3 States' efficient expense management

As discussed in Sections 1 and 2, states are reliant on GST grant revenue to fund expenses. However, much like the revenue assessment, the CGC's assessment of states' expenditure needs can lead to adverse outcomes for economic efficiency in practice. As a result, Australia's GST distribution system may:

- dull incentives for efficiency improvements in public services
- increase transfer dependency
- result in states underinvesting in risk mitigation
- contribute to inefficient management of cyclical revenues
- encourage inefficient borrowing.

These efficiency impacts are outlined in further detail in subsequent sections.

³¹ These two states have particularly high rates of stamp duty, for example, in addition to higher rates on other taxes. This was found by analysing the difference between actual and assessed revenue according to data published by the CGC (2025h).

³² While WA is also reliant on royalties, the CGC's revenue assessment and GSP indicator track closely. This may be attributable to the high contribution of mining to state GSP meaning the CGC's approach continues to capture a broad share of state income relative to other states.

The GST distribution may impede efficiency gains in public services

Consistent with the HFE objective of the GST distribution system, the expense assessment is intended to provide additional GST grant revenue to states with greater expense needs. Needs are assessed based on a multitude of factors such as population dispersion, the median age of the population, Indigenous status, and other socio-demographic factors (CGC 2021b, pp. 3, 17).

While the expense assessment is necessary to deliver fiscal equalisation, there are outcomes of the expense assessment that could compromise efficiency.

There are cases where states' expenditure needs are assessed, to some extent, based on how each state's actual expenditure deviates from the average (PC 2018, p. 115). In other words, this approach may not account for some cost inefficiencies that states can avoid. Instead, states may be compensated, via the GST distribution, for inefficiency in their own expense management.

The use of state cost data creates two different incentives that may contribute to inefficient expenditure practices:

- states may overinvest in areas where they are assessed as persistently having a higher cost of service provision. Where states overinvest in these areas, the CGC observes higher costs over time and the expense assessment acts to provide states with a greater share of the GST distribution (Garnaut & Fitzgerald 2002, p. 140; NSW Government 2026b, pp. 21–22)
- states may also obtain a higher share of the GST distribution where they underinvest in prevention that would be effective in addressing an underlying need. If the underlying cost disadvantage were addressed, the state may no longer be assessed as having higher needs and cost savings would be lost through the redistribution of GST to other states (Garnaut & Fitzgerald 2002, p. 136). In its submission to the 2018 PC inquiry, the NSW Government (2017, pp. 7–9) noted many states underinvest (relative to the CGC's assessment) in areas where the state is assessed to have a cost disadvantage.

Like the revenue assessment (see Section 5.2), efficient expenditure management is also affected by the first mover disadvantage. The first state to introduce any cost-reducing innovation may see proportionately more GST distributed away from them, than any other state that subsequently introduces the innovation.

While incentives are present, there is no public evidence available that supports the view that states are manipulating expenses to seek a higher share of GST grant revenue (Industry Commission 1993, p. 284; NSW Government 2026b, pp. 21–22; PC 2018, p. 99). States are only partially compensated for inefficient costs through the GST distribution, so they still face incentives, albeit dampened, to address inefficient costs (Garnaut & Fitzgerald 2002, p. 140; Industry Commission 1993, p. 284). Further, the PC noted that states adjusting their expenses to 'game' their GST share are likely to receive limited benefit, and other policy priorities faced by state governments would likely take precedent over such action (PC 2018, p. 117).

Nevertheless, even where states do not act on incentives, the allocation of fiscal resources has a flow-on effect to the allocation of economic resources; and the GST distribution may act to allocate more economic resources to states with inefficient expense management.

The GST distribution may support transfer dependency

Transfer dependency (and the closely associated flypaper effect³³) are often discussed in the context of Australia's high level of vertical fiscal imbalance (see Section 1) and high degree of fiscal equalisation. They refer to the idea that states may rely on fiscal transfers to finance their current expenses, rather than pursuing growth policies to support revenue or manage expenses growth.

Transfer dependency can have consequences for economic efficiency where states are not incentivised to pursue growth policies and efficient service delivery.

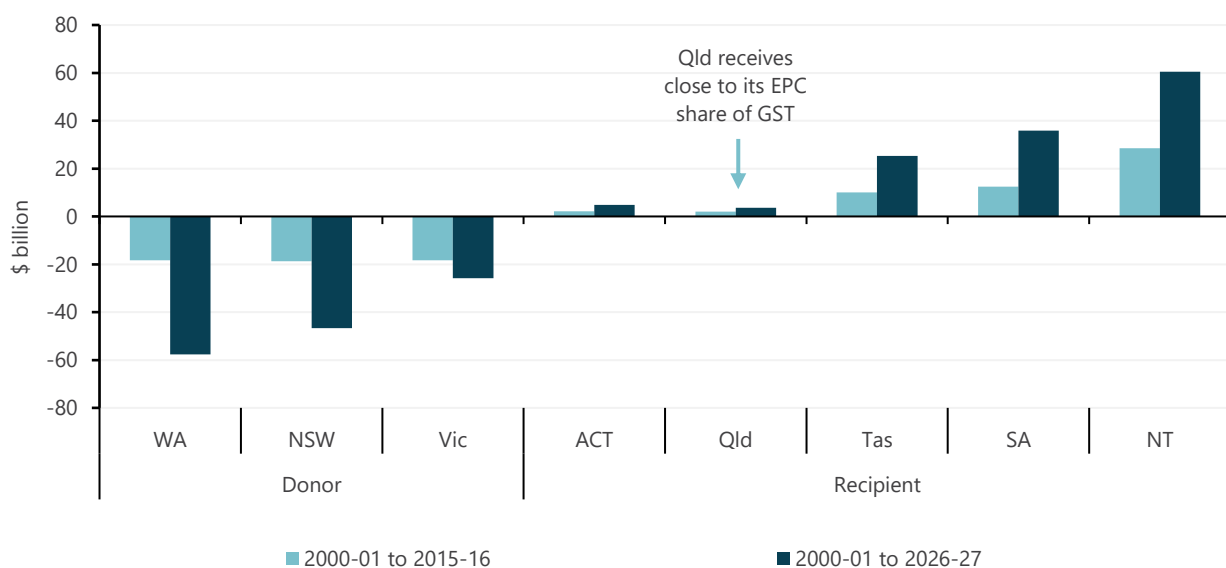
Over time, recipient states may prioritise policy in a way that is less favourable to productivity and economic growth. For example, some claim Australia's recipient states have historically given higher priority to social and environmental objectives and less priority to economic development objectives, which may reinforce dependence on transfers and increase the relative size of states' public sectors (Garnaut & Fitzgerald 2002, p. 13). Under such conditions, recipient states may become structurally reliant on transfers to sustain existing service levels.

Similarly, as Australian states do not bear the direct cost of collecting GST revenue, they may not account for the efficiency cost of the GST system in broader decision-making. As recipient states receive an even higher share of their revenue via intergovernmental transfers relative to donor states, they have a higher chance of having inefficiently high spending due to the flypaper effect (Garnaut & Fitzgerald 2002, pp. 145–146).

Since the introduction of the GST, states have typically been entrenched in their role as either a donor or recipient of GST, which gives some weight to the potential for transfer dependency (Figure 5.5).

Figure 5.5 Over the last 10 years, states have typically been entrenched in their roles as donors or recipients of GST revenue

Cumulative GST grant revenue above EPC share, 2000–01 to 2015–16 and 2000–01 to 2026–27



Source: QPC based on Australian Government 2001 to 2025c, 2025b; CGC 2026a.

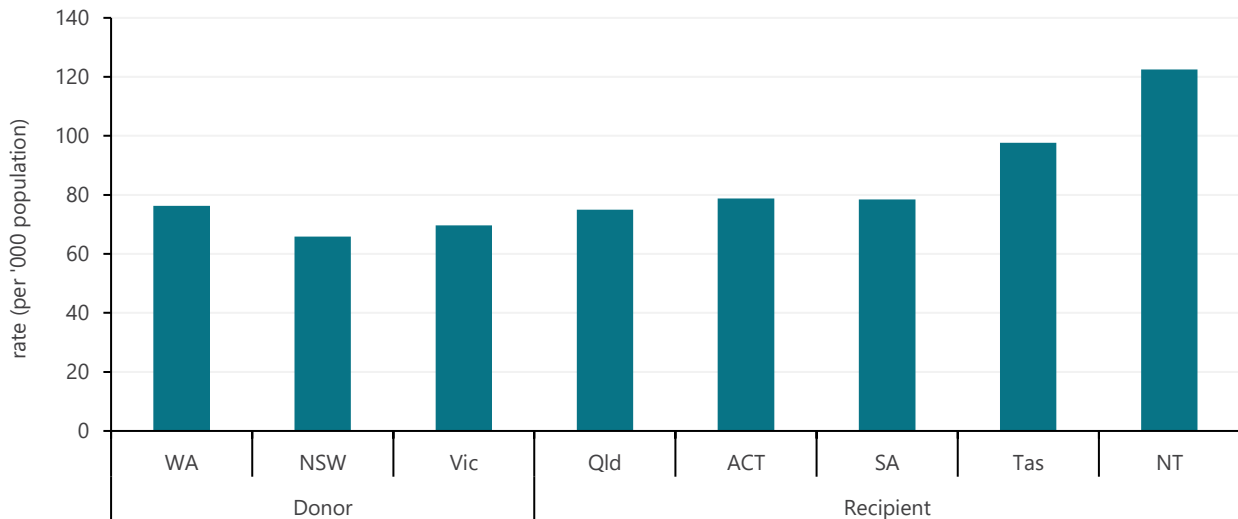
Transfer dependency is difficult to measure as it is not clear what policies recipient states would pursue had GST distribution not been in place.

³³ The flypaper effect refers to the idea that money 'sticks where it hits', in that money received by subnational governments through intergovernmental transfers tends to remain with and be spent by government, such that sub-national government spending is higher than it would have been if the revenue were raised at the sub-national government level (Courant et al. 1979, p. 6). If this effect was not occurring, a smaller portion of government revenue from transfers would be used for public services (similar to what private citizens would spend on public services via income tax), with the rest being passed on to taxpayers via tax cuts (Brumby et al. 2012, pp. 31–32; Singhal 2007, p. 1). Both the transfer dependency and flypaper effect relate to states not bearing the full cost of revenues they receive.

Typically, studies have focused on measures of public and private sector shares of employment to examine transfer dependency (Australian Government 2011b, pp. 34–35; Garnaut & Fitzgerald 2002, p. 145). Over time, these studies have consistently observed that recipient states typically have a larger public service (Figure 5.6).

Figure 5.6 Recipient states tend to have a larger public service than donor states

State government employees per '000 population, June 2025



Note: This chart does not account for full time equivalent employees, only persons employed. The proportion of part-time public sector workers can vary a little between states.

Source: ABS 2025f, 2025e.

These types of indicators should be viewed cautiously as they may not reflect transfer dependency but rather genuine need. For example, providing a full range of services in a small, regional or remote jurisdiction will always be more challenging due to the small absolute size of the public sector (Johnson et al. 2024, p. 489).

There is no consensus on whether transfer dependency and the flypaper effect are an outcome of the GST distribution system. More recent international studies suggest there is transfer dependency arising from fiscal equalisation, albeit in different contexts to Australia's GST distribution system:

- Yaroshevych et al. (2024, pp. 13–14) examined the mechanism for aligning horizontal fiscal imbalances in Ukraine, and found transfers can reduce incentives for recipient communities to expand their own revenue base. The mechanism can instead encourage recipient communities to continue dependence on transfers and, in some cases, increase borrowing to fund expenses
- Banaszewska (2023, p. 61) studied Poland's equalisation grant system and found higher equalisation transfers are associated with lower local tax effort. This indicates recipient jurisdictions partially substitute grants for own-source revenue.³⁴ This suggests equalisation payments may soften budget constraints and reduce incentives for fiscal autonomy, particularly where grants are untied and not linked to development outcomes.

States may underinvest in risk mitigation

As states do not bear the full cost of their decisions, the GST distribution system introduces an element of risk sharing between states. This includes cyclical and structural risks, such as the reliance of a state economy on mineral revenue, and risks associated with costly events, such as natural disasters. This may create adverse incentives for states to take on risk, in addition to lowering incentives for states to reduce risk.

³⁴ This study considers both horizontal and vertical fiscal equalisation, the latter of which Poland relies heavily on. This means the conclusions largely stem from vertical equalisation payments coming from central government funds.

An individual state may underinvest in risk-reducing measures knowing that risks are shared between states via the GST distribution system (PC 2018, p. 134). This could result in a risk of moral hazard where states collectively underinvest in risk reduction in the knowledge that they will be at least partly compensated for the negative outcomes of risky decisions.

The inclusion of natural disaster recovery expenditure in the GST distribution methodology, for example, acts as a mutual insurance for the cost of natural disaster recovery between states. However, it may also reduce incentives to invest in mitigation measures, particularly in areas with frequent disasters. This can have adverse effects by reducing the cost borne by a state for enabling people to locate in more disaster-prone areas instead of lower-risk areas.

Regardless of whether states bear greater risk due to these incentives or not, the equalisation of the consequences of decisions means states who have better judged risks will bear some of the cost of other states' decisions.

GST assessments can contribute to inefficient budget management

While the GST distribution system acts to equalise and smooth states' fiscal capacities over the long term, it can also have the unintended consequence of exacerbating fluctuations in fiscal capacity in the short term. A specific state's GST grant revenue can be procyclical in the short term (CGC 2022b, p. 18; PC 2018, pp. 134–135) when a state experiences a structural shift or a sudden change in its fiscal capacity (CGC 2017, p. 3).

The data lag and three-year averaging present in the CGC's methodology can mean procyclicality is a particular issue for resource states. Fluctuations in royalties are disconnected from the subsequent redistribution of fiscal capacities among states (see Box 4.1, p. 30).

The effect of procyclical GST grant revenue means states experiencing a strengthening (or weakening) fiscal or economic position do not immediately have access to offsetting lower (or higher) GST grant revenue.

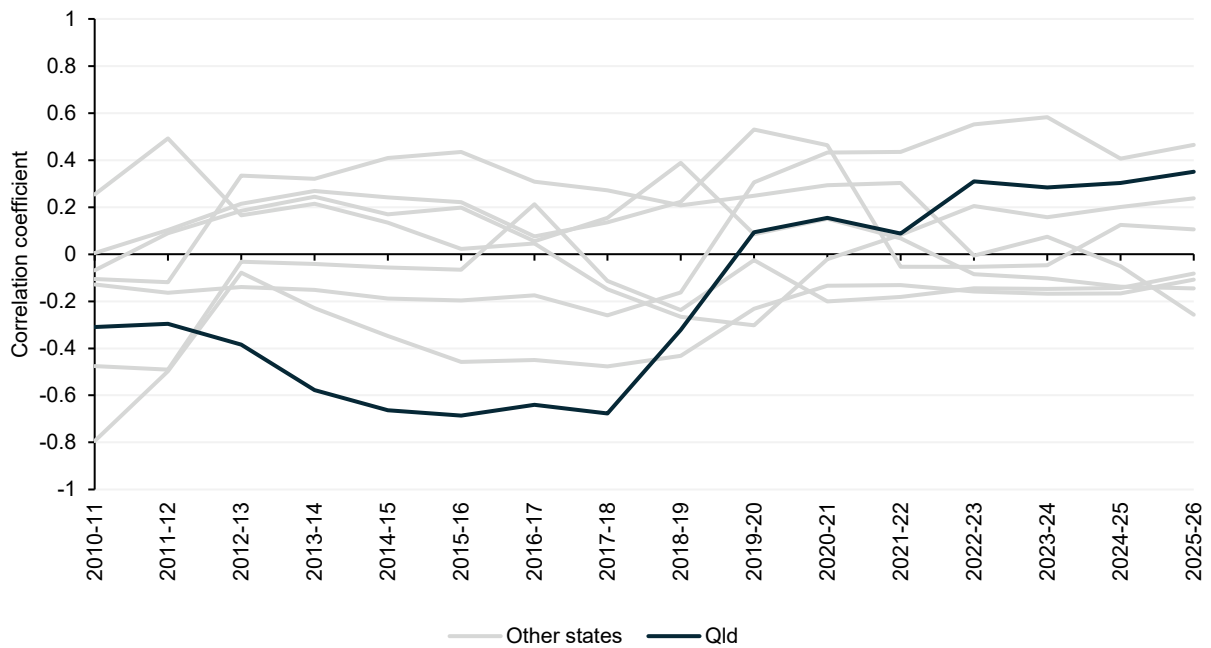
Between 2000–01 and 2018–19, Queensland's GST grant revenue was inversely correlated with total revenue excluding GST grants (see Figure 5.7). By 2017–18, Queensland's ten-year correlation coefficient was -0.68. This indicates GST grant revenue was assisting with smoothing out revenue fluctuations over this period.

Since 2019–20, GST grant revenue has been positively correlated with total revenue excluding GST grants. In 2025–26, Queensland's ten-year correlation coefficient is expected to be 0.35, indicating GST grant revenue has become increasingly procyclical, which may be exacerbating fluctuations in state own-source revenue.

The correlation between GST grant revenue and other state revenue for other states has been more stable over this time.

Figure 5.7 Queensland's GST revenue has become increasingly positively correlated with total state revenue

Rolling ten-year correlation of growth in GST grant revenue and other state revenue



Note: Data has been de-trended using difference in log-GST grant revenue and log-other state revenue.

Source: QPC based on ABS 2011a, 2015a, 2019, 2025c; Australian Government 2001 to 2025c, 2025e.

The recent procyclical nature of Queensland's GST grant revenue has the potential to reduce economic efficiency where it contributes to suboptimal government decision-making on the treatment of revenue windfalls.

Rather than saving windfall revenues in one year to offset lower revenue in following years, states tend to spend windfalls. This was demonstrated by Freebairn and Griffiths (2023, p. 202), who found empirical evidence that state governments overspend revenue windfalls from higher-than-expected royalties and suggested that 50 to 64 per cent of a revenue windfall was allocated to an increase in expenditure. While it is the responsibility of state governments to efficiently manage revenue windfalls, a procyclical GST distribution can further exacerbate windfall incentives.

GST grant revenue has also returned to being somewhat positively correlated with real GSP in Queensland over the last decade (with the ten-year rolling correlation coefficient increasing from effectively zero in 2018–19 to 0.56 in 2024–25), indicating additional GST grant revenue is less readily available when it is most needed to efficiently respond to economic conditions (see Figure 5.8).

Figure 5.8 Most states have a positive correlation between GST revenue and GSP
Correlation coefficients of growth in GST grant revenue and GSP



Source: QPC based on ABS 2025b; Australian Government 2001 to 2025c, 2025e.

As GST grant revenue has become more correlated with both total revenues and GSP, the result of any induced spending can also be to over-stimulate the economy during periods where it is already operating at capacity, thereby exacerbating economic cycles as well as future budget pressures when revenue declines.

The GST distribution may support inefficient borrowing

The CGC's assessment also considers changes in net borrowing among states. The assessment equalises for states' ability to service net borrowing based on population growth.³⁵ In doing so, the CGC assesses states with faster growing populations as having a greater capacity to 'dilute' net debt among a larger population (CGC 2025e, p. 203) and so assesses such states as requiring less GST grant revenue to service increases in borrowing.

The implication is the GST distribution compensates states that are higher net borrowers per capita, with a portion of the cost of their borrowing being borne (via the GST distribution) by states with faster population growth. In some instances, states may also receive more GST grant revenue over time when they choose to undertake borrowing rather than raise revenue or reduce spending. Where states are not bearing the full cost of borrowing and this results in decisions to borrow additional funds, there may also be implications for intergenerational equity.

This assessment may introduce incentives for some states to take on greater levels of net borrowing and receive compensation through the GST distribution. While there is no evidence indicating states act on this incentive, the net borrowing assessment may direct fiscal and economic resources toward states choosing to increase their borrowing, rather than increasing their revenue or reducing expenses.

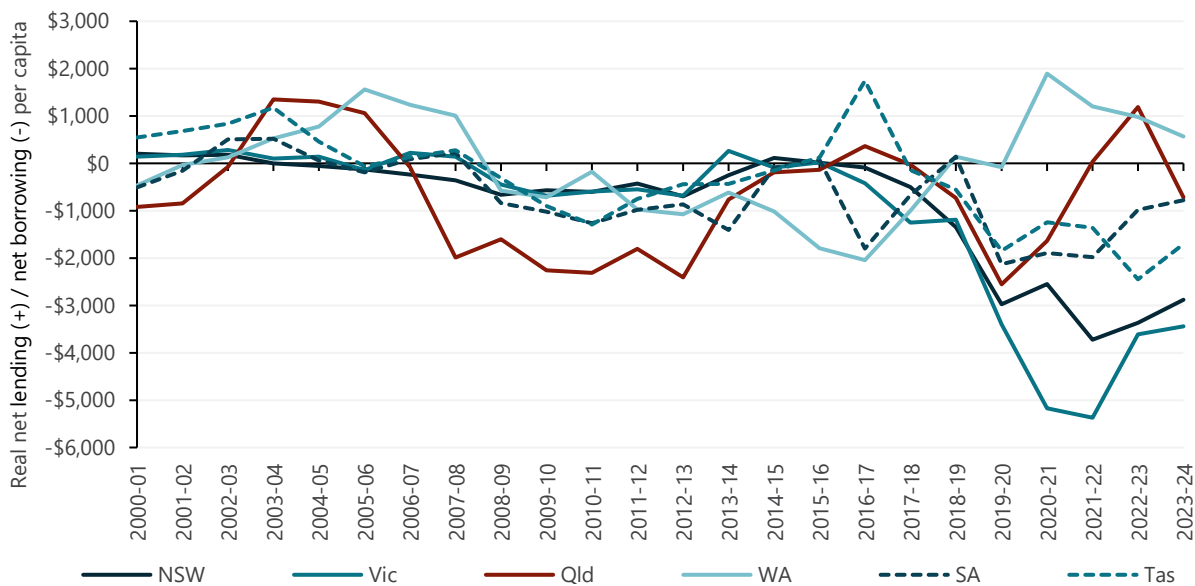
³⁵ The assessment observes 'what states do' and therefore observes the level of net borrowing that occurs across states as a residual of state revenue, less expenses and investment.

Borrowing can be inefficient in instances where it crowds out private investment by competing for the same limited pool of funds and economic resources, without delivering a commensurate benefit to residents' welfare. In doing so, borrowing can place upward pressure on interest rates. Borrowing is particularly an issue when the economy is already experiencing capacity constraints and if public expenditure is put to less productive uses (such as to cover recurrent expenses) than it would have been in the private sector.

The potential inefficient outcomes are less significant when state net borrowing patterns are reasonably similar over time. Historically, this has generally been the case, with states following similar patterns of net borrowing or net lending from 2000–01 to 2018–19. However, state net borrowing patterns have since diverged (Figure 5.9).

Figure 5.9 Net borrowing trends have significantly diverged since 2019–20

Annual net lending or borrowing per capita from 2000–01 to 2023–24, real 2025–26 dollars



Note: Net lending / borrowing per capita is presented in real, 2025–26 dollars.

Source: ABS 2011a, 2015a, 2019, 2025c, 2025e.

The recent divergence and magnitude of net borrowing suggests high-population-growth states are assessed as requiring less GST grant revenue, which instead goes to other states that have made decisions to borrow more.

5.4 System changes have not resolved the efficiency costs of the GST distribution

As discussed in Section 2.3, the 2018 changes to GST distribution will have large fiscal impacts for individual states, including Queensland, once the NoWO guarantee expires. Beyond these impacts, the changes have not resolved the efficiency costs that are a longstanding feature of the GST distribution system.

As noted by the CGC, the changes did not have a direct impact on the CGC's methodology for measuring states' relative fiscal capacities. Rather, these changes add additional layers to determining the final GST share for each state (CGC 2020b, p. 72).

These additional layers do not fundamentally change effects on the:

1. efficient allocation of labour and capital
2. efficient revenue and expense policy
3. efficient management of revenues.

6.0 Interactions with other Commonwealth grants

Key points

The GST distribution system can interact with other Commonwealth grants, promoting inefficient outcomes when:

- states face incentives to forgo tied grants that are in the national interest and deliver net public benefits
- fiscal and economic resources are directed toward infrastructure or services that do not deliver benefits to the community in excess of costs
- the administration of grants is costly and complex.

6.1 Australia's grants system

The Australian Government provides both tied and untied grants to states. While states can spend untied grants how they see fit, they are required to use tied grants to provide specific services or invest in specific infrastructure projects, as outlined by the grant's accompanying agreement.

GST grant revenue is the single largest funding transfer by the Australian Government to the states and is the only form of untied funding most states receive,³⁶ accounting for around 51 per cent (including NoWO guarantee payments) of total grants in 2025–26. Most of the remaining funding is delivered through tied grants (Australian Government 2025e, p. 297).

Funding delivered to the states as either tied or untied grants has differing implications for efficiency, as discussed in Box 6.1.

³⁶ The ACT receives 'ACT municipal services' funding as general revenue assistance, while WA receives royalty payments for the North West Shelf project as general revenue assistance (Australian Government 2025b, pp. 5, 126–127).

Box 6.1 Tied and untied grants can have different implications for efficiency

Tied grants can be used to support activities that deliver a net benefit to the nation, such as to:

- deliver infrastructure or services that have benefits to the broader federation, not just to the state
- support economic reform or other welfare-enhancing activity where the state does not have the appropriate incentives to undertake this activity on its own.

Conversely, untied grants can align more with the principle of subsidiarity by providing states with greater autonomy in their fiscal decision-making. This can produce more efficient outcomes where states are better placed to allocate resources to activities that reflect their residents' preferences.

Matched or unmatched tied grants also have different efficiency implications. While matched grants encourage state ownership of funded activities, they can distort budget allocations when states then underfund other priorities due to budget constraints.

Tied and untied grants also trade-off other objectives, including addressing VFI, facilitating state autonomy, providing residents across states with similar access to services, ensuring states do not detract from other national objectives, and minimising administrative costs. The PC has previously noted there appears to have been little consideration of whether the current system results in an optimal balance between tied and untied funding.

Source: Boadway & Shah 2009, pp. 309–314, 333–339; Lago et al. 2024, p. 2; OECD 2013, p. 110; PC 2018, pp. 165, 274–275.

In Queensland, GST grant revenue peaked at 57.5 per cent of grant funding in 2004–05. This share has since declined to 41 per cent in 2025–26 (Figure 6.1). In recent years increases in other Australian Government grants to Queensland have coincided with declines in GST grant revenue (Figure 6.2).

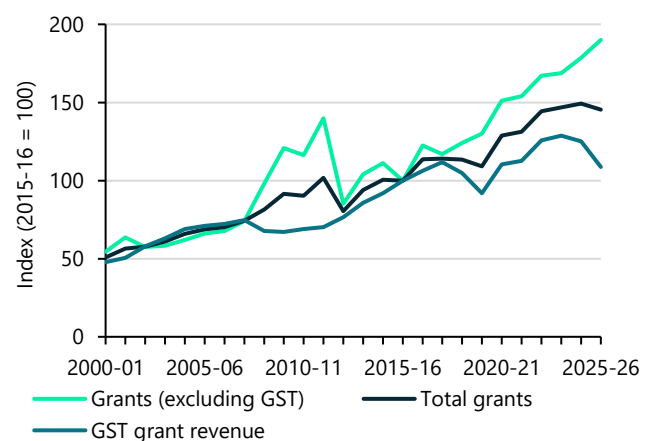
Figure 6.1 Queensland has received less revenue through GST grants than other grants in recent years

Share of Queensland's grant revenue received through GST grants, 2000–01 to 2025–26



Figure 6.2 Increases in other Australian Government grants to Queensland have coincided with declines in the state's GST grant revenue

Growth in Queensland's GST grant revenue, total non-GST grant revenue, and total grant revenue, 2000–01 to 2025–26



Note: GST grant revenue from 2000–01 to 2024–25 is from the Australian Government's annual Final Budget Outcome. GST grant revenue for 2025–26 is from the Australian Government 2025–26 MYEFO. Other grant revenue from 2000–01 to 2023–24 are actuals from Queensland Budget papers. Other grant revenue for 2024–25 is estimated actual from the 2025–26 Queensland Budget. Other grant revenue for 2025–26 is the budget value from the 2025–26 Queensland Budget.

Source: QPC based on CGC 2018a, 2020a, 2024, 2025b, 2025c; Australian Government 2001 to 2025, 2025e; Queensland Government 2002 to 2025; Queensland Government 2000a to 2025c.

Interactions between tied grants and the GST distribution

In 2024–25, around 45 per cent of Australian Government tied grants to states were treated like own-source state revenues in the GST distribution process, while the remaining 55 per cent were treated as not impacting the GST distribution (CGC 2026c, p. 7). Differing treatment can occur due to a number of reasons, including the Australian Treasurer deciding to ‘quarantine’ the payment or the CGC deciding to exclude the payment (Box 6.2).

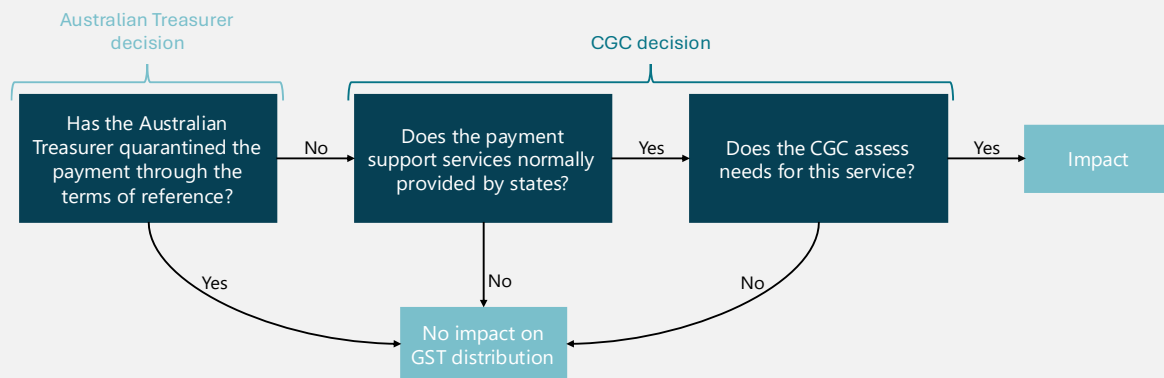
Box 6.2 Quarantined and excluded payments

As illustrated in Figure 6.3, payments can be ‘excluded’ from impacting GST calculations when the CGC determines payments are for services that either the CGC does not assess expenditure needs for or are not normally provided by states. Payments can also be excluded when the Australian Treasurer directs the CGC to ‘quarantine’ specific payments via the annual terms of reference issued to the CGC. Payments appear to be quarantined when:

- they support an activity that delivers benefits beyond the recipient state³⁷
- the Australian Government does not want the payment to effectively be redistributed among states
- the state negotiates an agreement on the condition their payment will be quarantined.

There are also payments that do not fit into this framework. For example, grants for some transport infrastructure can have benefits to the recipient state as well as the nation more broadly. In this instance the CGC applies a rule where 50 per cent of payments for the construction of infrastructure that is part of the national network are excluded from impacting the GST distribution (CGC 2025a, p. 189).³⁸

Figure 6.3 CGC’s decision framework for the treatment of Australian Government payments



Source: QPC based on CGC 2022c, p. 3

The CGC (2022a, p. 4) notes including tied grant funding in its assessment methodology can, in some instances, be appropriate. If all tied grant payments were excluded, then states that received less other Australian Government funding relative to their assessed needs, would have a lower fiscal capacity than other states.

Conversely, treating tied grants as ‘not impacting’ may be also appropriate in some instances, such as when the payments support state activities that deliver benefits beyond the state.

The treatment of tied grants within the GST distribution system can have implications for efficiency when:

1. separate funding agreements are overridden
2. inefficient grants are excluded from measures of revenue capacity
3. the administration of grant funding is not efficient and/or promotes rent-seeking.

³⁷ For example, reward and facilitation payments (such as for National Competition Policy), which are recognised as providing for state activities that support national objectives, are often quarantined by the Australian Government (Australian Government 2025f, p. 10).

³⁸ The network as declared by the Australian Minister for Infrastructure in the National Land Transport Network Determination 2020.

6.2 Impeding welfare-enhancing outcomes by overriding funding agreements

To the extent tied grants differ from the CGC's assessment of needs, states will receive proportionately less or more GST grant revenue.

The CGC (2014, p. 50) explains that when tied funding impacts the GST distribution, the tied payment will still be required to be used by the state on the specified service. Even so, the state's consequent change in GST grant revenue will effectively mean the Australian Government's funding allocation is overridden (Brumby et al. 2012, p. 85; Garnaut & Fitzgerald 2002, p. 57; NSW Government 2017, p. 10; NT Government 2026, pp. 23–24; Queensland Government 2017, pp. 10–11).

The overriding of tied grants through the GST distribution system may, as previously remarked by the PC (2018, p. 274), disincentivise states from signing up to multilateral or bilateral agreements in order to receive additional untied funding.

Where states forego signing tied agreements because of the implications for the state's GST grant revenue, activities that deliver net positive social outcomes may be underfunded and/or endeavours to coordinate policy efforts with net benefits to the nation may be compromised.

While there is limited evidence to indicate any state has actually forgone signing an agreement because of its implications for the state's GST grant revenue, there is some evidence to suggest states consider how payments may be treated prior to signing agreements and, where possible, seek to have agreements quarantined from the GST distribution process. Examples include:

- the Government of WA (2023, p. 87) has stated it assesses how a particular payment will be treated before signing any agreement
- the NT Government (2026, p. 24) has indicated states should be cautious about signing funding agreements where they will receive more funding than they are assessed as needing by the CGC
- the NT's bespoke bilateral Better and Fairer Schools Agreement (BFSA) was excluded from GST calculations. The main effect of this exclusion was to prevent the NT losing GST grant revenue as a consequence of signing the agreement (Australian Government 2025a, p. 5; NT Government 2026, p. 26)
- the supplementary 2025 Methodology Review terms of reference issued by the Australian Treasurer to the CGC (2025a, p. 5) required the CGC ensure no state receive a 'windfall gain in GST grant revenue from non-participation in BFSA funding arrangements'. This is an instance of removing an incentive for states to forgo an agreement due to the GST grant revenue consequences
- stakeholders suggested the Tasmanian Government considered withdrawing from the bilateral agreement covering the Macquarie Point stadium due to the potential GST grant revenue consequences (Government of WA 2026, p. 68). The Australian Treasurer subsequently directed the CGC to quarantine this funding from the GST distribution process (Australian Government 2025a, p. 4).

6.3 Quarantining or excluding some grants can result in inefficiency

The treatment of some grants as not impacting the GST distribution can be appropriate. However, in other instances it can support inefficient outcomes, when the grant is not directed towards a service or infrastructure project that will provide a net benefit to the nation as a whole (for example, as indicated by a Benefit Cost Ratio (BCR) of greater than one).

Over time the treatment of quarantined payments, seems, at times, to have been arbitrary in nature. This has the potential to undermine the GST distribution system's integrity, especially through inefficient outcomes arising across the states (PC 2018, p. 173) or where payments are quarantined for infrastructure or services that do not deliver a net benefit.

The Commission has not undertaken a review of grants, to determine where they have or have not supported efficient outcomes. However, other entities or reviews have identified instances across all states where grants have been excluded from impacting the GST distribution for projects where costs exceed benefits.³⁹

Multiple states have called for a framework or guidelines to be implemented (Government of SA 2026, p. 12; Queensland Treasury 2026, p. 20), or for greater transparency around the rationale behind quarantining decisions to improve efficiency (NSW Government 2026b, p. 20; Victorian Government 2026, p. 52).

6.4 Economic costs of grant administration

The current system by which the Australian Government administers grants to states imposes both economic and fiscal costs. States can devote considerable resources in an attempt to influence grant outcomes for both tied and untied grants.

Tied grants impose administrative costs on recipient states to prove that grant conditions have been met. The Australian Government also faces administrative costs to monitor and assess states' evidence. All parties must invest resources in a grant's initial negotiations.

The interaction of tied grants and the GST distribution system can additionally induce states to invest resources in understanding how a given tied grant will affect their GST grant revenue; this interaction may also incentivise rent-seeking behaviour, with states potentially attempting to influence these outcomes.

The ability to influence transfers is lessened where grants are determined through a formula; however, this effect may be reversed where the formula is complex, as is the case with the GST distribution.

The current system of distributing GST grant revenue requires funding the CGC, which in 2024–25 totalled \$8.8 million (CGC 2025g, p. 41), with state treasuries also allocating material resources.

These direct costs may be relatively small compared to the indirect or opportunity costs of the current system. As noted by Garnaut and FitzGerald (2002, p. 146):

many of the most talented officers in the State public services are engaged in the task of marshalling evidence to maximise their States' expenditure disabilities, minimise their revenue disabilities and criticise other jurisdictions' arguments.

Given how much states rely on GST grant revenue, their investment of resources regarding its allocation is unsurprising. However, this may result in an inefficient allocation of resources from a national perspective.

³⁹ The following projects are illustrative examples where a grant for a project with a BCR of less than 1 (as identified by an independent party) has been excluded or partly excluded from impacting the GST distribution:

- \$730 million in funding for the Gippsland rail line, part of the Regional Rail Revival Program (Australian Government 2018b, p. 2, 2025d; Victorian Government 2021), with a BCR of 0.28 as assessed by Infrastructure Australia (Infrastructure Australia 2020, p. 2).
- \$240 million in funding for the Macquarie Point stadium (Australian Government 2025a, p. 4; Tasmanian Government 2025a, p. 17) with a BCR of 0.69 as assessed by KPMG (2024, p. 31).
- \$170 million in funding for part of the Princes Highway West (Australian Government 2022b) with a BCR of less than 0.1 as assessed by Infrastructure Australia (2015, p. 3). This project is part of the national transport network, for which the CGC discount 50 per cent of any grants.

Appendix A: Terms of Reference

QUEENSLAND PRODUCTIVITY COMMISSION ACT 2025

Section 38

DIRECTION

Direction

Under sections 9(1)(b), 9(1)(d) and 38 of the *Queensland Productivity Commission Act 2025*, I direct the Commission to undertake research and provide advice in accordance with the request set out below.

TERMS OF REFERENCE

ECONOMIC IMPACTS OF AUSTRALIA'S GST DISTRIBUTION SYSTEM ON QUEENSLAND

Context

Australia is a federation of eight states and territories with diverse economic, social and geographic circumstances. This often leads to differences in the cost of providing services to residents and different capacities to raise revenue.

Yet, all Australians, regardless of the state in which they live, should be able to receive comparable levels of health, education, justice, welfare, public housing and other services.

Australia's Goods and Services Tax (GST) distribution system was originally designed to help ensure all states and territories could provide comparable services, if they all made a similar effort to raise revenue from their own taxes. In this regard, a greater share of the GST collected nationally by the Australian Government should theoretically go towards states or territories with growing populations and higher need.

GST is the single largest revenue stream for the Queensland Government, and it therefore plays an integral part in the State's ability to deliver essential services to all Queenslanders across our regions, where they need it and when they need it.

Concerningly, over the 10 years from 2015-16 to 2025-26, Queensland's GST grant revenue has only grown by 28 per cent, well below national GST growth of 75 per cent and even below consumer price index (CPI) growth of 33 per cent. In real terms, Queensland is receiving less GST grant revenue today than it did 10 years ago and is the only jurisdiction to face this highly detrimental outcome.

Over the same period, Queensland's population has grown significantly above Australia's population growth, while the underlying demand, complexity and cost of delivering essential services has also risen significantly.

The fact that Queensland will receive less GST grant revenue in 2025-26 than it did in 2015-16 in real terms, despite the continued growth of the national GST pool and the significant increase in Queensland's need, suggests the current GST distribution framework is not meeting Queensland's growing expenditure needs adequately or sustainably.

Additionally, there are public concerns around whether the GST distribution system creates fiscal disincentives for states to make good policy decisions or undertake helpful policy reforms. For example:

- Queensland is effectively paying other jurisdictions \$8.7 billion of GST in 2025-26 because it has successfully supported the development of Queensland's coal and gas industries while ensuring Queenslanders receive a fair share of royalties for the natural endowment that belongs to them and future generations
- current GST arrangements will redistribute up to around \$3 billion of the \$7.2 billion in funding committed by the Australian Government to deliver critical safety improvements to the national Bruce Highway, meaning that Queensland will effectively need to raise \$3 billion more in revenue to fund that shortfall

- Queensland is effectively paying Victoria and NSW around \$800 million of GST in 2025-26 because those states had less effective COVID-19 policies and implemented more costly business support measures.

Queensland is the only jurisdiction to face a year-on-year decline in GST grant revenue in 2025-26, with the \$2.3 billion reduction being the largest in the history of the GST. In contrast, Queensland's GST grant revenue in 2025-26 would have been \$22.7 billion if it had grown in line with national GST payments. The fiscal and economic implications of a \$6.1 billion difference in a single year are profound.

Scope

The Queensland Productivity Commission (the Commission) is therefore directed to analyse and assess the economic impacts of Australia's GST distribution system on Queensland and the implications for the State to deliver essential services and infrastructure.

The Commission should assess the economic impact of GST distribution including on:

- Queensland's economy and the state's capacity to deliver services to support growth and social outcomes, considering that from 2015-16 to 2025-26, Queensland's GST grant revenue grew by 28 per cent instead of 75 per cent in line with the growth in national GST payments
- other key economic outcomes for Queensland relative to other states and territories, including capital and labour mobility
- Queensland, relative to other states and territories, as a result of the 2018 GST distribution system changes.

The Commission should also assess:

- whether GST distribution outcomes have appropriately incentivised sound policy decisions and reform
- the unintended consequences of the interaction between GST distribution and the broader Commonwealth-State funding and policy framework
- any other relevant matter relating to the economic and equity impacts of GST distribution.

Consultation

The Commission should consult with Queensland Treasury to ensure the analysis is appropriately informed by Treasury's economic, demographic and fiscal forecasts and projections, as well as Treasury's knowledge of data and other matters relating to the Commonwealth Grants Commission's assessment methodology.

The Commission should also consult where appropriate with key stakeholders to incorporate diverse perspectives on the sustainability of Queensland's GST grant revenue.

Queensland Government agencies should provide data and other information as required for the Commission to complete its analysis, in accordance with section 35 of the *Queensland Productivity Commission Act*.

Reporting

The Commission is to provide an Interim Report on the economic analysis to the Treasurer by 4 February 2026.

The Commission is to provide the Final Report to the Treasurer by 17 April 2026.

Appendix B: Assessing the effect of the GST distribution on interstate migration

Whether the GST distribution has an impact on interstate migration has been a point of discussion in past reviews (see Section 4). While the economic theory in support of HFE assumes people migrate based on net fiscal benefits (Buchanan 1950), some are critical of this view, suggesting that HFE has a limited impact on migration decisions (Brumby et al. 2012, p. 40; PC 2018, p. 161). That said, there is limited empirical evidence for these views.

This modelling seeks to test whether fiscal capacity affects interstate migration decisions in Australia by:

- exploring whether there is any evidence that differences in GST grant revenue directly affect interstate migration
- assessing whether, given the level of GST transfers, differences in own-source taxation revenue induce interstate migration.

To do this, this model uses interstate migration data between all Australian states and territories over the period 2000–01 to 2024–25.

B.1 Modelling migration flows

A 'gravity' approach is often employed to model migration flows (see Cavalleri et al. 2021; Czaika & Parsons 2016; Saavedra & Inchauste 2023). Inspired by models of international trade flows (Tinbergen 1962), gravity models assume migration flows between two regions (for example, states or countries) are directly proportional to their size (population or GDP) and inversely proportional to the physical distance between them (Ramos 2016, p. 1). For example, two populous states will have larger migration flows than two states with smaller populations.

A range of economic theory underpins gravity models and dictates what variables should be included. In the context of migration, the gravity model is underpinned by 'random utility maximisation' (Beine et al. 2014, pp. 2–3), where the benefits and costs an individual receives from living in one location is compared with the expected benefits and costs from migrating to another (Ramos 2016, p. 2).

The gravity model has two key strengths when applied to interstate migration:

- it can account for factors that both 'push' (or origin characteristics that encourage outward migration) and 'pull' (or destination characteristics that encourage inward migration) migration — such as unemployment rates in both the origin (a push factor) and destination (a pull factor) (Cavalleri et al. 2021, p. 44)
- it includes a component that captures the *unobserved* factors of the individual utility associated with each choice — such as an individual's preference for warm weather (Ramos 2016, p. 2).

Gravity models can estimate separate effects for characteristics in origin and destination regions or estimate the effect of the difference or the ratio of characteristics in origin and destination regions. The latter strategy simplifies the analysis, allowing a reduced number of variables in the model thereby limiting risks of overfitting and multicollinearity, especially when the pairs of regions are similar in characteristics. However, such a specification does not allow the model to disentangle the dissimilar impact of the same factor on inward versus outward migration or to identify whether both push and pull effects matter (Cavalleri et al. 2021, p. 11).

By using data with a time dimension, gravity models can also flexibly account for unobserved factors that influence migration patterns (Czaika & Parsons 2016, p. 606; Ramos 2016, p. 5), such as underlying preferences for weather or geographic features without explicitly measuring them. It can also account for 'multilateral resistance' — which is the idea that migration between, say, NSW and Queensland is affected by the relative attractiveness of other states (such as WA). These unobserved factors are typically accounted for by including various specifications of fixed effects (specifically origin by time and/or destination by time).

B.2 Estimation strategy

To explore the effects of the GST distribution system two broad specifications are used. These regressions are estimated using Poisson Pseudo Maximum Likelihood, which is the accepted approach for gravity models (Santos Silva & Tenreyro 2006).

The first specification is developed to understand the direct effects of GST grant revenues:

$$M_{o,d,t} = \beta_1(GST_{d,t} - EPC_{d,t}) + \beta_2Tax_{d,t} + X_{d,t}\gamma + \alpha_{o,t} + \alpha_{o,d} + \varepsilon_{o,d,t} \quad (1)$$

Where $M_{o,d,t}$ is the gross flow of migrants between the origin, o , (the state where migrants live initially) and destination, d , (the state to which migrants move) states in a given year (t), $GST_{d,t} - EPC_{d,t}$ is the amount of GST grant revenue the destination receives above its EPC share and $Tax_{d,t}$ is destination's per capita own-source taxation revenue.

In addition, a range of pull factors⁴⁰ ($X_{d,t}$) common in the interstate migration literature are included alongside origin by time fixed effects (to account for multilateral resistance) and origin by destination fixed effects (to account for unobserved preferences for the amenity between the origin and destination states). Note that including origin by destination fixed effects account for distance between the origin and destination states.

This first regression yields an understanding of the effects of the GST distribution system but cannot identify the effect of taxation revenue per capita. This is because tax revenues per capita are relatively stable over time, making them highly collinear with the fixed effects that control for unobserved heterogeneity.⁴¹ To understand the effects of differences in own-source tax revenue, the specification is adjusted.

$$M_{o,d,t} = \beta_1(GST_{d,t} - GST_{o,t}) + \beta_2(Tax_{d,t} - Tax_{o,t}) + X_{d,t}\gamma + X_{o,t}\delta + \alpha_o + \alpha_d + \alpha_t + \alpha_{o,d} + \varepsilon_{o,d,t} \quad (2)$$

Where $GST_{d,t} - GST_{o,t}$ is the difference between the destination's GST grant revenue and the origin's GST grant revenue and $Tax_{d,t} - Tax_{o,t}$ is the difference between the destination's per capita own-source taxation revenue and the origin's per capita own-source taxation revenue (models 5 and 6) or the difference between the destination's per capita own-source revenue and the origin's per capita own-source revenue (models 7 and 8).⁴²

In addition, a range of pull factors ($X_{d,t}$) and push factors ($X_{o,t}$) common in the interstate migration literature are included. Unobserved factors are accounted for in various ways. In the baseline model, origin x destination fixed effects are included. In the sensitivity analysis, destination, origin and year fixed effects are included.

Due to limitations in the data, 'multilateral resistance' cannot be accounted for (through inclusion of origin x time or destination x time fixed effects) in the second set of regressions. Inclusion of these fixed effects would not allow the fiscal effects to be identified — broadly because $GST_{o,t}$ and $Tax_{o,t}$ would be collinear with origin x time fixed effects. It is unlikely that the sample size ($N = 8$) is large enough to use the common correlated effects estimator to account for this issue. While this is a limitation for the findings of this second set of regressions, other sources of unobserved heterogeneity are still accounted for.

Several variations are run for each specification as a sensitivity analysis, including different specifications of tax revenue and different specifications for the fixed effects. This results in eight models (four models for specification one and four models for specification two). Full results are presented in Table B.1 and Table B.2.

⁴⁰ See data section for description of included control variables.

⁴¹ While Variance Inflation Factor (VIF) tests suggest there is an issue with collinearity when per capita taxation revenue is included, this collinearity is unlikely to affect the term on the GST term. This is because the correlation between taxation revenue and the GST variable is -0.38 across the whole sample and between -0.78 and 0.96 on a state-by-state basis.

⁴² Taxation revenues include revenue raised through state-based taxation such as payroll taxes or conveyancing duties but excludes royalty revenue and other state-based sources of income. Own-source revenue is all state government revenue less current and capital grants — for example it includes taxation revenue, royalties, interest income and other revenue sources but excludes GST, specific purpose payments and capital grant revenues.

Sensitivity tests included testing for:

- a differing effect after the implementation of the 2018 changes in 2021, with no effect found. This may be explained by the NoWO guarantee payments having kept most GST grant revenues unchanged
- the impact of including the difference in other Commonwealth grant revenue per capita between the origin and destination, with results in models five and six stable to this inclusion.

Data

Data were collected from a range of published sources, with the model estimated over the period 2000–01 to 2024–25 (using financial year data).

The outcome variable is gross interstate migration, aggregated into financial years (ABS 2025d accessed using data explorer). GST grant revenue was collected from each year's Australian Government Final Budget Outcomes (Australian Government 2001 to 2025c) while own-source taxation revenue and own-source revenue were collected from the Government Financial Statistics (for 2000–01 to 2023–24) (ABS 2011a, 2015a, 2025c) and from each state's most recent budget (or budget update) for 2024–25 (ACT Government 2025; Government of SA 2025; Government of WA 2025; NSW Government 2025; NT Government 2025; Queensland Government 2025a, 2025a; Tasmanian Government 2025b).

Other economic data used in the regressions as pull and push factors include:

- GSP (real) (ABS 2025b)
- Unemployment rate (ABS 2026c)
- Employment growth (ABS 2026c)
- Ordinary time earnings (full-time, adult workers) (ABS 2026a)
- Median house prices⁴³ of detached housing in the respective capital city (ABS 2001, 2003, 2026e)
- Working age population — that is, the per cent of people aged 24 to 64 (ABS 2026d, accessed using data explorer).

To aggregate quarterly data into yearly frequency wages, the unemployment rate and house prices were averaged over their respective year. Employment growth was calculated as year-on-year growth at June of the respective financial year. Population variables are also at June of the respective financial year.

Collinearity

The nature of the Australian labour market and state taxation revenues may lead to a relatively high level of multicollinearity (where two variables are linearly related) across a range of variables that may affect interstate migration. This becomes particularly apparent for some factors, limiting their interpretability across the specifications.

Typically, collinearity is an issue where it affects the variable of interest. VIF tests were used to adjust each specification to reduce the risk of collinearity. Given the nature of the variables of interest, this resulted in the omission of certain variables from the two specifications. The correlations between the primary variables of interest and variables with high VIF scores were assessed to understand whether the collinearity would impact the primary estimates.

The main impact of this approach is that, to identify the effect of taxation revenue, it is included as a difference in the per capita taxation revenues between the destination and origin states. As discussed above, this necessitates the exclusion of origin by time fixed effects. It also means that the coefficient on the taxation variables in specification one are not interpretable, given the risk that collinearity can reverse the sign of a variable.

⁴³ Median house prices before 2001–02 were calculated by deflating the median house price in 2001–02 using the detached house price growth rates reported by the ABS.

In addition, throughout the discussion, comparisons are limited to variables that had low (around 5 in most cases, but under 10 in the case of the difference in taxation revenues) generalised VIF scores⁴⁴, to limit the risk of interpreting results that are affected by collinearity.

In specification one, GST above EPC, employment growth and the unemployment rate are all likely comparable given low levels of collinearity. In specification two, taxation difference, GST above EPC, employment growth and the unemployment rate are all likely comparable given low levels of collinearity.

Due to high levels of collinearity, coefficients on GSP, house prices, wages, working age population, taxation revenue (in specification one) and difference in GST (specification two) are not compared with the variables of interest. These variables are only included to control for relevant factors.

Based on VIF testing, considerations include:

- tax revenue and tax revenue per capita are highly colinear with the fixed effects required when using a gravity approach, suggesting that tax revenue per capita is highly stable across time within each state. They are also colinear with other controls
- similarly, GST per capita is highly colinear with the fixed effects required when using a gravity approach. As a result, GST is included as GST above EPC share. Accordingly, regressions include only GST above EPC share as a primary variable, with other variations of GST only included as a background control variable
- ordinary time earnings are strongly related to own-source taxation revenue per capita (given dominance of payroll tax as a source of taxation revenue) as well as with ordinary time earnings in other states (through their relationship with origin by destination fixed effects). Given this, only wages in the destination (rather than both destination and origin) are included
- house prices are strongly related to own-source taxation revenue per capita (given dominance of transfer duties as a source of taxation revenue) and to median rents (which are not included due to inclusion of median house prices already acting to control for affordability)
- the working age population is also highly colinear with the fixed effects required when using a gravity approach.

B.3 Net fiscal benefits appear to affect migration

The results of these regressions (see Table B.1, p. 65 and Table B.2, p. 66) find people move to states with:

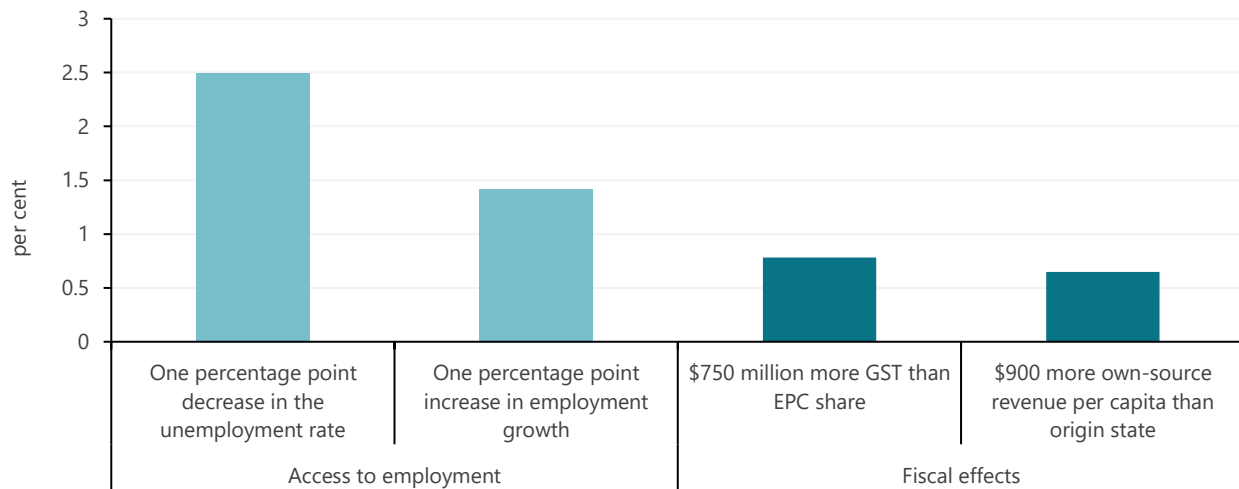
- lower taxation revenue per capita
- higher own-source revenue per capita (or overall fiscal capacity)
- a GST share above their EPC share.

The findings suggest while GST grant revenue and overall fiscal capacity may affect interstate migration, they are not key drivers of interstate migration in Australia (see Figure B.1). For example, the results suggest⁴⁵ a one percentage point increase in employment growth is associated with a 1.4 per cent increase in inward interstate migration. This is almost twice as much as the effect of an extra \$750 million of GST grant revenue above a state's EPC share, which the results suggest is associated with a 0.78 per cent increase in inward interstate migration.

⁴⁴ Collinearity inflates the variance explained by the model, leading to large R-squared values. By running a series of regressions, a VIF score can be calculated for each variable using the R-squared from regressing the given variable on all other intended controls. Rules of thumb suggest a VIF score of over 5 or 10 reflect high levels of collinearity.

⁴⁵ Caution should be taken not to interpret the point estimates directly. Rather the point estimates should be taken to reflect the relative importance of employment growth and net fiscal benefits.

Figure B.1 Change in interstate migration inflows based on various factors



Note: Own-source revenue is total revenues less current grants (GST and specific purpose payments). The median difference in own-source revenue per capita is \$900 and median GST grant revenue deviation from EPC share for recipient states is \$750 million. Based on the modelling results, lower taxation revenue per capita in the destination state also increases inward migration, this provides an indicator of 'fiscal costs', however, total own-source revenue per capita provides a better indicator of fiscal capacity more generally. Coefficients for the unemployment rate, employment growth and GST above EPC share are drawn from model one. The coefficient for the difference in own-source revenue is drawn from model seven.

Source: QPC based on gravity models.

Based on the modelling results, lower taxation revenue per capita in the destination state also increases inward migration, and the effect is comparable to relatively small changes in employment growth. For example, \$600 less taxation revenue per capita in the destination than in the origin state is associated with an increase in inward migration by about 2.5 per cent.

Taxation revenue per-capita provides an indicator of state-specific 'fiscal costs' whereas total own-source revenue per capita provides a better indicator of fiscal capacity more generally. The latter may better encapsulate the *net* effect of fiscal differences — that is, it also reflects the level of services a state is able to deliver whereas the former may more closely reflect the cost-side of the equation. This may partly explain why taxation revenue per capita has a relatively large effect compared with own-source revenue per capita.

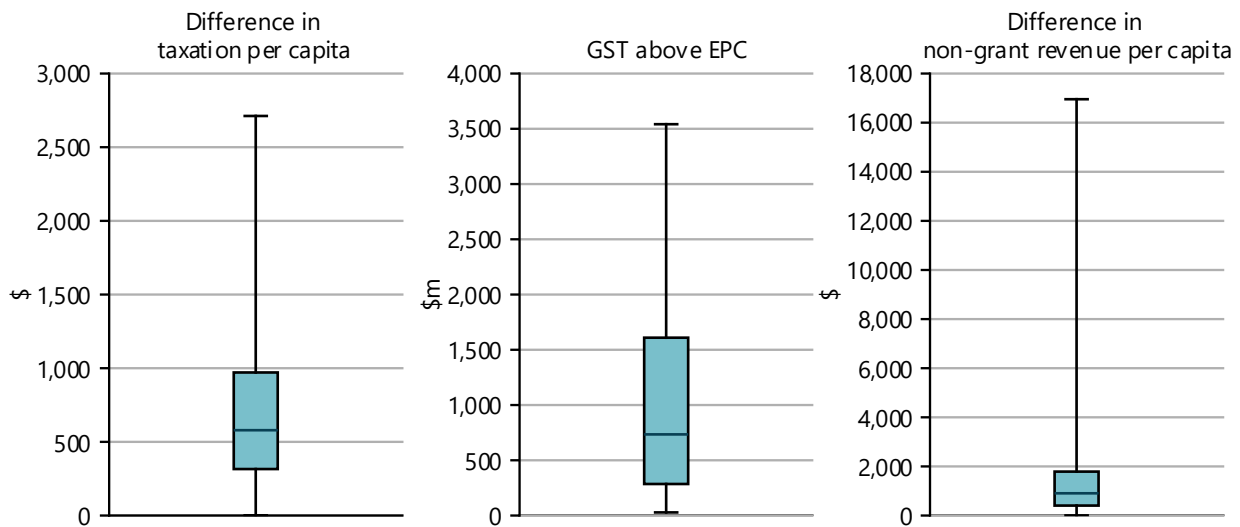
The broader reasons why differences in taxation revenue per capita across states affect interstate migration are not the focus of this report.

While this evidence is explorative and sensitive to different model specifications, it adds to a body of literature that has relatively strong theoretical and empirical foundations (Buchanan 1950; Murphy 2018, 2021).

As illustrated in Figure B.2, the scenarios used above are reasonable examples:

- With respect to 'differences in taxation per capita between destination and origin states', the median difference in per capita taxation revenue is around \$600, while the largest divergence in per capita taxation revenue between destination and origin states is around \$2,700.
- For destination states that receive GST receipts above an EPC share (that is, the destination state is a recipient state), at the median GST receipts exceed an EPC share by around \$750 million while the largest divergence between actual GST receipts and an EPC share of GST is around \$3.5 billion.
- With respect to 'differences in own-source revenue per capita between destination and origin states', the median difference in per capita own-source revenue is around \$1,000 while the largest divergence in per capita own-source revenue between destination and origin state is around \$17,000.

Figure B.2 Scenarios presented on the effects of net fiscal benefits on migration appear to be reasonable
Distribution of data on key variables of 'difference in taxation revenue per capita', 'GST above EPC' and 'difference in own-source revenue per capita'



Source: QPC.

The direct effect is small, but may accumulate over time

The overall effect of both the GST distribution and differences in taxation are relatively small, especially when compared with the effect of variation in labour market opportunities (see Figure B.1). This is consistent with findings from the broader literature on internal migration, and with critiques of Buchanan's (1950) theory — namely that, fiscal capacity is not a major factor for people when migrating (Brumby et al. 2012, p. 40; PC 2018, pp. 160–162).

Nevertheless, the GST distribution may have a larger impact on migration where the effects of the GST distribution accumulate over time. Given certain states have been persistently either donor states (receiving less GST than their EPC share) or recipient states (receiving more GST than their EPC share) since the introduction of the GST, these effects could aggregate to material differences in state populations over the long run.

There are also likely indirect effects, as economic activity follows the fiscal transfers resulting in differences in employment opportunities than would have occurred otherwise.

Modelling conducted by Murphy (2018, 2021; and modelling completed for Independent Economics 2012, 2015) is also consistent with these modelling results, with both studies indicating material changes in state populations can occur over time.

Sensitivity to how taxation is included

Although the main specification (model 1 of specification 1) is preferred — as it accounts for the extent to which a state is subsidised by the GST, the taxation effort through taxation per capita and unobserved multilateral preferences — the statistical significance of the GST term in specification one varies depending on how own-source taxation revenue is included. For example:

- if taxation revenue *per capita* (destination) is included, GST above EPC share (destination) is significant in model one and GST above EPC share (origin) is significant in model two
- if taxation revenue (destination) is included (model three), the effect of GST above EPC share is smaller, and only significantly different from zero at the 10 per cent level
- if taxation revenue per capita (origin) is included (model four), GST above EPC share (for either destination or origin) is not significantly different from zero.

Despite model one providing the best specification of fixed effects, this sensitivity suggests there may be some limitations to the finding that GST distribution outcomes affect inward migration.

Similarly, GST above EPC share does not have a significant effect on migration when considering taxation effort (model six).

Other limitations

There are several limitations to the model which limit the extent to which regressor coefficients can be meaningfully interpreted. Caution should be taken when interpreting coefficient point estimates. Instead, findings should be used as an indication of the direction and the relative magnitude of the effect of the variable on migration flows. These limitations and the approaches adopted to overcome these limitations are discussed in detail below.

As noted above, the taxation variables in specification one suffer from collinearity, potentially making the coefficients uninterpretable. As such, the positive coefficients (particularly on tax revenue per capita, or taxation effort) may reflect issues of collinearity rather than conflicting with results from specification two (which suggests higher relative tax effort reduces migration). An inherent limitation of using a random utility maximisation model is that the attractiveness of a destination is assumed to not be affected by migration. For instance, if a destination is attractive due to its low levels of unemployment, large inflows of migrants could increase unemployment in the destination while decreasing it in the origin state. Gravity models do not capture these second-round effects, which is an important point to consider to appropriately interpret the model's results.

One way to account for this is by lagging variables that are likely to respond to migration flows (for example, see Cavalleri et al. 2021, p. 13). As a sensitivity test, regressions were re-run with GSP, the unemployment rate and employment growth all lagged by one period while house prices were lagged by two periods. This sensitivity test found:

- when GSP and house prices variables are lagged but employment opportunity variables (employment growth and the unemployment rate) are kept contemporaneous, the coefficient on the variable 'difference in taxation revenue per capita' is statistically significant
- when employment opportunity variables are also lagged, the coefficient on the 'difference in taxation revenue per capita' is no longer significant
- the statistical significance of 'GST above EPC' is maintained throughout.

That said, lagging variables only resolves the bias from reverse causality in specific circumstances (Bellemare et al. 2017). These circumstances are unlikely to hold,⁴⁶ as such these sensitivity tests may provide limited value.

An argument can be made that interstate migration in Australia is relatively small — net migration has been between -1.3 per cent and 1 per cent of a state's population over the last 25 years. As such, there may be a limited scope for reverse causality to be an issue for factors such as unemployment and employment growth, which are more likely to be affected by macroeconomic factors than by interstate migration.

This model cannot meaningfully account for people moving based on family reasons, despite family being a driver of interstate migration at the individual level (PC 2018, p. 162). One potential way to account for this would be to include a measure of previous migration from the respective state (to account for historic 'out of state' networks as a proxy for family).

⁴⁶ For example, for lagging to be a valid instrument for reverse causality it requires either (1) only the variable at time t-1 to be correlated with the outcome or (2) no auto correlation for the outcome. Both are unlikely to be true. For example, people are more likely to migrate based on current employment opportunities than based on conditions the year prior. Additionally, trends in interstate migration have typically been somewhat persistent year-on-year across Australia.

No sensitivity testing for this was undertaken because:

- including lags of dependent variables in dynamic panels leads to bias that only diminishes in N (not in T) — and in a setting with N = 8 states, the sample is extremely small in the required dimension, despite the data covering T = 25 years
- this control would be more appropriate for international migration, where existing expat communities play an important role in migration decisions due to larger cultural differences in international settings.

To the extent that migration patterns between two states are stable overtime, some of the effect of family factors will be accounted for through the origin by destination fixed effects.

Table B.1 Regression outputs, specification 1

<i>Model</i>	<i>Semi-elasticity</i> <i>[95% confidence interval]</i>			
	(1)	(2)	(3)	(4)
GST above EPC share (d), \$m	0.00104*** [0.00026, 0.00181]	0.00059 [-0.00037, 0.00155]	0.00071* [-0.00007, 0.00148]	0.00063 [-0.00035, 0.0016]
GST above EPC share (o), \$m		-0.00102** [-0.00195, -0.00008]		0.00001 [-0.00098, 0.00101]
Employment growth (d), %	1.41883*** [1.00821, 1.83112]	1.45596*** [0.97274, 1.94149]	1.58514*** [1.17624, 1.99568]	1.41332*** [0.92855, 1.90041]
Employment growth (o), %		-0.83593*** [-1.2322, -0.43806]		-0.98563*** [-1.37152, -0.59823]
Unemployment rate (d), %	-2.49701*** [-3.56257, -1.41968]	-2.51135*** [-3.94341, -1.05793]	-2.4694*** [-3.58277, -1.34318]	-2.47022*** [-3.89699, -1.02226]
Unemployment rate (o), %		-1.87899*** [-2.91588, -0.83101]		-0.67174 [-1.77937, 0.44838]
Full-time adult wages (d), \$	0.01761* [-0.00307, 0.0383]	0.00558 [-0.01797, 0.02914]	0.01957 [-0.00472, 0.04387]	0.00329 [-0.02019, 0.02677]
Median house price (d), \$'000	-0.01427*** [-0.02241, -0.00613]	-0.00998 [-0.02264, 0.00267]	-0.00123 [-0.01001, 0.00755]	-0.01146* [-0.02368, 0.00075]
Working age population (d), %	4.29672*** [2.60924, 6.01194]	3.4492*** [1.58954, 5.3429]	5.59835*** [3.75644, 7.47296]	4.06379*** [2.24291, 5.91709]
GSP (d), \$m	0.00 [-0.00002, 0.00001]	-0.00001 [-0.00003, 0.00001]	0.00003 [-0.00001, 0.00006]	-0.00001 [-0.00003, 0.00002]
Taxation revenue per capita (d), \$	0.00812*** [0.00502, 0.01121]	0.00679*** [0.00291, 0.01068]		0.00775*** [0.00391, 0.0116]
Taxation revenue per capita (o), \$				0.01056*** [0.00739, 0.01373]
Taxation revenue (d), \$			-0.00024 [-0.00062, 0.00014]	
Origin by year FE	YES		YES	
Origin by destination FE	YES	YES	YES	YES
Destination FE	YES	YES	YES	YES
Origin FE		YES		YES
Year FE	YES	YES	YES	YES

Note: Destination factors are labelled with (d) and origin factors labelled with (o). Fixed effects are labelled with FE. Units for each variable are reported. Semi-elasticity calculated using $100*(\exp(\beta) - 1)$. Statistical significance: *** p <= 0.01; ** p <= 0.05; * p <= 0.1.

Table B.2 Regression outputs, specification 2

Model	Semi-elasticity [95% confidence interval]			
	(5)	(6)	(7)	(8)
GST above EPC share (d), \$m		0.0002 [-0.00078, 0.00117]		0.00042 [-0.00054, 0.00138]
GST above EPC share (o), \$m		-0.00068 [-0.00166, 0.0003]		-0.00126*** [-0.00221, -0.00031]
Difference in Taxation revenue per capita, \$	-0.00408*** [-0.00646, -0.00169]	-0.0036*** [-0.00615, -0.00105]		
Difference in own-source revenue per capita, \$			0.00072** [0.00012, 0.00131]	0.00102*** [0.00037, 0.00166]
Employment growth (d), %	1.65016*** [1.15962, 2.14308]	1.65595*** [1.16817, 2.14607]	1.56195*** [1.08583, 2.0403]	1.58591*** [1.11196, 2.06209]
Employment growth (o), %	-0.90708*** [-1.30326, -0.5093]	-0.88456*** [-1.28211, -0.48542]	-0.86512*** [-1.25888, -0.46979]	-0.8434*** [-1.23423, -0.45103]
Unemployment rate (d), %	-2.70356*** [-4.20114, -1.18256]	-2.67968*** [-4.15726, -1.17933]	-2.48811*** [-3.95868, -0.99502]	-2.32511*** [-3.7709, -0.85759]
Unemployment rate (o), %	-1.26367** [-2.37745, -0.13719]	-1.49724*** [-2.58753, -0.39474]	-1.71099*** [-2.79353, -0.61638]	-2.05616*** [-3.09756, -1.00358]
Full-time adult wages (d), \$	0.00965 [-0.01127, 0.03057]	0.01564 [-0.00744, 0.03873]	-0.00249 [-0.02348, 0.01851]	0.00632 [-0.01675, 0.0294]
Median house price (d), \$'000	0.00273 [-0.00895, 0.0144]	0.00174 [-0.00983, 0.01332]	0.00056 [-0.01074, 0.01186]	0.0011 [-0.00995, 0.01216]
Working age population (d), %	5.10447*** [3.1663, 7.07906]	4.99969*** [3.07782, 6.95739]	4.2556*** [2.2935, 6.25533]	4.26005*** [2.27659, 6.28198]
GSP (d), \$m	0.00001 [-0.00001, 0.00004]	0.00001 [-0.00002, 0.00003]	0.00 [-0.00002, 0.00003]	0.00 [-0.00002, 0.00002]
Difference in GST, \$m			-0.00016 [-0.00044, 0.00012]	
Origin by year FE				
Origin by destination FE	YES	YES	YES	YES
Destination FE	YES	YES	YES	YES
Origin FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES

Note: Destination factors are labelled with (d) and origin factors labelled with (o). Fixed effects are labelled with FE. Units for each variable are reported. Semi-elasticity calculated using $100 * (\exp(\beta) - 1)$. Statistical significance: *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$.

Table of acronyms and abbreviations

ABC	Australian Broadcasting Corporation
ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
BFSA	Better and Fairer Schools Agreement
CAGR	Compound annual growth rate
CGC	Commonwealth Grants Commission
CIE	Centre for International Economics
CPI	Consumer price index
EPC	Equal per capita
GDP	Gross domestic product
GSP	Gross state product
GST	Goods and services tax
HFE	Horizontal fiscal equalisation
IGA	Intergovernmental Agreement
IMF	International Monetary Fund
LHS	Left hand side
MEB	Marginal excess burden
MYEFO	Mid-Year Economic and Fiscal Outlook
MYFER	Mid-Year Fiscal and Economic Review
NCOA	National Commission of Audit
NoWO	No worse off
NSW	New South Wales
NT	Northern Territory
OECD	Organisation for Economic Co-operation and Development
PBO	Parliamentary Budget Office
PC	Australian Productivity Commission
Qld	Queensland
QPC	Queensland Productivity Commission
RHS	Right hand side
SA	South Australia
Tas	Tasmania
VFI	Vertical fiscal imbalance
Vic	Victoria
WA	Western Australia

References

- ABC 2026, 'WA's Special Deal: Fair Reward or Billion-Dollar Rort?', The Economy, Stupid, ABC.
- ABS 2001, *House Price Indexes: Eight Capital Cities*.
- 2003, *House Price Indexes: Eight Capital Cities*.
- 2011a, *Government Finance Statistics, Annual*.
- 2011b, *Taxation Revenue, Australia*.
- 2015a, *Government Finance Statistics, Annual*.
- 2015b, *Taxation Revenue, Australia*.
- 2019, *Government Finance Statistics, Annual*.
- 2025a, *Australian National Accounts: National Income, Expenditure and Product*.
- 2025b, *Australian National Accounts: State Accounts*.
- 2025c, *Government Finance Statistics, Annual*.
- 2025d, *Interstate Migration by States and Territories of Arrival and Departure by Sex*.
- 2025e, *National, state and territory population, June 2025*.
- 2025f, *Public sector employment and earnings 2024-25 financial year*.
- 2025g, *Taxation Revenue, Australia*.
- 2026a, *Average Weekly Earnings, Australia*.
- 2026b, *Consumer Price Index, Australia*.
- 2026c, *Labour Force, Australia*.
- 2026d, *Quarterly Population Estimates (ERP), by State/Territory, Sex and Age*.
- 2026e, *Total Value of Dwellings*.
- ACT Government 2025, *Budget 2025-26*, Budget Paper, 1.
- 2026, *Tax reform*, viewed 27 March 2026, <<https://www.revenue.act.gov.au/tax-reform>>.
- Australian Government 1999a, *Australian Government Budget 1999-2000 Budget Paper 3 Federal-Financial Relations*.
- 1999b, *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*.
- 2001, *Final Budget Outcome 2000-01*.
- 2009, *INTERGOVERNMENTAL AGREEMENT ON FEDERAL FINANCIAL RELATIONS*.
- 2011a, *GST Distribution Review Issues Paper*.
- 2011b, *Submission to the GST distribution review*.
- 2018a, *Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response*, viewed 22 December 2025, <<https://assets.pc.gov.au/inquiries/completed/horizontal-fiscal-equalisation/hfe-government-response.pdf>>.
- 2018b, *Terms of Reference for the 2018 update of GST revenue sharing relativities*.
- 2022a, *Final Budget Outcome 2021-22*.
- 2022b, *Princes Highway West – Winchelsea to Colac Duplication*, Department of Infrastructure, Transport, Regional Development, Communications, Sport and the Arts.
- 2024, *Extension of the GST No Worse Off Guarantee Funding Agreement*, viewed 22 December 2025, <<https://federalfinancialrelations.gov.au/sites/federalfinancialrelations.gov.au/files/2025-01/Signed%20Extension%20of%20the%20GST%20No%20Worse%20Off%20Guarantee%20Funding%20Agreement.PDF>>.
- 2025a, *2025 Methodology Review - supplementary Terms of Reference*.
- 2025b, *Budget 2025-26 - Federal Financial Relations - Budget Paper No. 3*.
- 2025c, *Final Budget Outcome 2024-25*.
- 2025d, *Gippsland Rail Line Upgrade*, Department of Infrastructure, Transport, Regional Development, Communications, Sport and the Arts.
- 2025e, *Mid-year economic and fiscal outlook: 2025-26*.
- 2025f, *National Competition Policy Federation Funding Agreement*.
- 2026, *2025 Population Statement*, Centre for Population.
- Banaszewska, M 2023, 'Equalisation Grants and Local Taxation', *The Polish Journal of Economics*, vol. 314, no. 2, pp. 47–65.
- Barro, S 2002, *Macroeconomic versus RTS measures of fiscal capacity: Theoretical foundations and implications for Canada*.
- Becker, J & Kriebel, M 2017, 'Fiscal equalisation schemes under competition', *International Tax and Public Finance*, vol. 24, pp. 800–816.
- Begg, M 2018, *Time to end GST redistribution: 2018 update*, Institute of Public Affairs.
- Beine, M, Bertoli, S & Moraga, J 2014, *A Practitioners' Guide to Gravity Models of International Migration*, Working Paper, 2014-03, FEDEA.
- Bellemare, M, Masaki, T & Pepinsky, T 2017, 'Lagged Explanatory Variables and the Estimation of Causal Effect', *The Journal of Politics*, vol. 79, no. 3.
- Boadway, R 2002, *Revitalising equalization again: RTS vs macro approaches*.
- Boadway, R & Shah, A 2009, *Fiscal Federalism: Principles and Practice of Multiorder Governance*.
- Browne, B 2021, *State revival: The role of the states in Australia's COVID-19 response and beyond*, July, The Australia Institute.
- Brumby, J, Carter, B & Greiner, N 2012, *GST Distribution Review*.
- Buchanan, J 1950, 'Federalism and Fiscal Equity', *The American Economic Review*, pp. 583–599.
- 2002, 'Fiscal Equalisation Revisited', paper presented at Equalization: Welfare Trap or Helping Hand?
- Bucovetsky, S & Smart, M 2006, 'The Efficiency Consequences of Local Revenue Equalization: Tax Competition and Tax Distortions', *Journal of Public Economic Theory*, vol. 8, no. 1.
- Buettner, T & Krause, M 2021, 'Fiscal equalization as a driver of tax increases: empirical evidence from Germany', *International Tax and Public Finance*, vol. 28, pp. 90–112.

- Cao, L, Hoskings, A, Kouparitsas, M, Mullaly, D, Rimmer, X, Shi, Q, Stark, W & Wende, S 2015, *Understanding the Economy-Wide Efficiency and Incidence of Major Australian Taxes, 2015–01*, Treasury Working Paper, The Treasury.
- Cavalleri, M, Luu, N & Causa, O 2021, *Migration, Housing and Regional Disparities: A gravity model of inter-regional migration with an application to selected OECD countries*, OCED.
- CGC 2004, *Report on State Revenue Sharing Relativities 2004 Review*.
- 2010, *Report on GST Revenue Sharing Relativities - 2010 Review: Volume 1 - Main Report*.
- 2014, *2015 Review: Draft report on state revenue sharing relativities*.
- 2015, *GST shares in the presence of large and volatile state revenues*.
- 2017, *Options for improving contemporaneity*.
- 2018a, *2018 Update: The adjusted budget*.
- 2018b, *Improving the policy neutrality of the mining revenue assessment*.
- 2020a, *2020 Methodology Review: The adjusted budget*.
- 2020b, *Report on GST Revenue Sharing Relativities 2020 Review - Volume 2 (Part A)*.
- 2020c, *Report on GST sharing relativities: 2020 Review*.
- 2021a, *New arrangements for distributing GST, Occasional Paper*, November.
- 2021b, *Research paper 2: Why states get different shares of GST*.
- 2022a, *Occasional Paper No.6: Why are some Commonwealth payments to states included in calculations of GST needs?*
- 2022b, *Some international themes in fiscal equalisation: an Australian perspective*, Research Paper, 3.
- 2022c, *The framework for the treatment of Commonwealth payments in GST distribution*, Research Paper, 5.
- 2023a, *2025 Methodology Review: Commission's position on fiscal equalisation, supporting principles and assessment guidelines*.
- 2023b, *2025 Methodology Review: Mining revenue consultation paper*.
- 2024, *2024 Update: The adjusted budget*.
- 2025a, *2025 Methodology Review - Review Outcomes*.
- 2025b, *2025 Methodology Review: Population data supporting the assessments*.
- 2025c, *2025 Methodology Review: The adjusted budget*.
- 2025d, *2025 Methodology Review: The assessed budget*.
- 2025e, *Commission's Assessment Methodology, March*.
- 2025f, *Commonwealth Grants Commission Annual Report 2024-25*.
- 2025g, *FAQs on the misconceptions of GST distribution*.
- 2025h, *GST Relativities 2025-26*.
- 2025i, *Occasional Paper No. 13: Is the GST distribution system too complex*, November.
- 2026a, *2026 Update GST Relativities 2026-27*.
- 2026b, *Glossary*.
- 2026c, *Submission Productivity Commission Inquiry into the 2018 GST Distribution Reforms*, February.
- CIE 2023, *Internal Migration in Australia and the impact of government levers*.
- Commonwealth Parliament 2018, *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018 Explanatory Memorandum*.
- Courant, P, Gramlich, E & Rubinfeld, D 1979, 'The stimulative effects of intergovernmental grants: Or why money sticks where it hits', *Fiscal Federalism and Grants-in-aid*.
- Czaika, M & Parsons, C 2016, *The gravity of high-skilled migration policies*, Working Paper, 13, KNOMAD.
- Ergas, H & Pincus, J 2013, *Have mining royalties been beneficial to Australia?*
- Evans, M 2020, 'GST, where to next?', *eJournal of Tax Research*, vol. 18, no. 1, pp. 45–98.
- Freebairn, J 2015a, 'Reconsidering Royalty and Resource Rent Taxes for Australian Mining', *The Australian Journal of Agricultural and Resource Economics*, vol. 59, pp. 586–601.
- 2015b, *Royalties or resource rent taxes?*, viewed 9 April 2026, <<https://www.austaxpolicy.com/which-is-more-efficient-and-effective-comparing-royalty-and-resource-rent-taxes/>>.
- 2020, 'Reform State Taxes to Increase Productivity', *The Australian Economic Review*.
- Freebairn, J & Griffiths, W 2023, 'Volatile Mining Revenues and State Government Budget Decisions', *The Australian Economic Review*, vol. 56, no. 2, pp. 192–203.
- Freebairn, J, Stewart, M & Liu, PX 2015, *Reform of State Taxes in Australia: Rationale and Options*, Melbourne School of Government.
- Garnaut, R & Fitzgerald, V 2002, *Review of Commonwealth–State Funding*, The Committee for the Review of Commonwealth–State Funding.
- Government of SA 2025, *Mid-Year Budget Review 2025-26*, Budget Paper, 3.
- 2026, *Productivity Commission Inquiry: GST distribution reforms - Submission from the Government of South Australia*.
- Government of WA 2023, *Western Australia's submission to the Commonwealth Grants Commission's 2025 Methodology Review: Tranche 1 assessments*, Department of Treasury.
- 2025, *Government Mid-year Financial Projections Statement, 2025-26*.
- 2026, *Western Australia's submission to the 2026 Productivity Commission inquiry into the GST distribution reforms*.
- Hauptmeier, S 2008, *Fiscal competition and the impact of fiscal equalisation: Theory and evidence from Germany*, *Inaugural-Dissertation*, Ludwig-Maximilians-Universitat Munich.
- IMF 2026, *IMF Data: Fiscal Decentralization (FD)*, viewed 9 January 2026, <[https://data.imf.org/en/Data-Explorer?datasetUrn=IMF.STA:FD\(6.0.0\)](https://data.imf.org/en/Data-Explorer?datasetUrn=IMF.STA:FD(6.0.0))>.
- Independent Economics 2012, *Horizontal Fiscal Equalisation: Modelling the welfare and efficiency effects*.
- 2015, *Horizontal Fiscal Equalisation: Modelling update and Scenarios*.

- Industry Commission 1993, *Impediments to regional industry adjustment*.
- Infrastructure Australia 2015, *2014-2015 Assessment Brief: Princes Highway West - Winchelsea to Colac duplication*.
- 2020, *Project business case evaluation: Gippsland Line Upgrade*.
- Johnson, L, Eccleston, R & Lester, M 2024, 'Tasmania', in M Evans, P Dunleavy & J Phillimore (eds), *Australia's Evolving Democracy: A New Democratic Audit*, LSE Press, London.
- Kalemba, SV, Bernard, A, Corcoran, J & Charles-Edwards, E 2022, 'Has the decline in the intensity of internal migration been accompanied by changes in reasons for migration?', *Journal of Population Research*, vol. 39, no. 3, pp. 279–313.
- Kaplan, G & Schulhofer-Wohl, S 2017, 'Understanding the long-run decline in interstate migration', *International Economic Review*, vol. 58, no. 1, pp. 57–94.
- KPMG 2024, *Cost Benefit Analysis: Macquarie Point Multipurpose Stadium*.
- KPMG Econtech 2010, *CGE analysis of the current Australia tax system*.
- Lago, M, Lago-Penas, S & Martinez-Vasquez, J 2024, *Side effects in designing intergovernmental grants*, OECD.
- Liu, Y 2014, 'Does competition for capital discipline governments? The role of fiscal equalization', *International Tax and Public Finance*, vol. 21.
- Murphy, C 2016, *Efficiency of the tax system: a marginal excess burden analysis*, Working Paper, 4/2016, Australian National University, Tax and Transfer Policy Institute.
- 2018, *Optimal fiscal equalisation and its application to Australia: updated*, Working Paper No. 2018/13, Working Papers in Trade and Development, Australian National University.
- 2021, 'Inquiry into Commonwealth Support for Victoria - How to share GST revenue among the states'.
- Nassios, J & Giesecke, J 2025, 'Inefficient at any level: a comparative efficiency argument for elimination of property transfer duties and insurance taxes', *Applied Economics*, pp. 1–18.
- Nassios, J, Madden, J, Giesecke, J, Dixon, J, Tran, N, Dixon, P, Rimmer, M, Adams, P & Freebairn, J 2019, *The Economic Impact and Efficiency of State and Federal Taxes in Australia*, G-289, Working Paper, CoPS/IMPACT.
- National Commission of Audit 2014, *Towards Responsible Government: The Report of the National Commission of Audit Phase One*, February.
- Northern Territory Government 2026, *GST distribution reforms: Initial submission - Northern Territory Government*.
- NSW Government 2004, *Budget Statement 2004-05*.
- 2017, *NSW Submission to the Productivity Commission Inquiry into Australia's system of Horizontal Fiscal Equalisation*.
- 2020, *NSW Government Budget Speech 2020-21*.
- 2021, *NSW Property Tax Proposal: Progress paper for June 2021*.
- 2022, *NSW Budget 2022-23: No. 01 Budget Statement*.
- 2023a, *First Home Buyer Choice*, viewed 27 January 2026, <<https://www.revenue.nsw.gov.au/grants-schemes/previous-schemes/first-home-buyer-choice>>.
- 2023b, *Ministerial media release: Stamp duty axed for thousands of first home buyers from 1 July*, viewed 27 January 2026, <<https://www.nsw.gov.au/media-releases/stamp-duty-exemptions-increase>>.
- 2025, *Half-Yearly Review 2025-26*, Budget Paper, 1.
- 2026a, *NSW Coal Industry 2026-50*.
- 2026b, *NSW Government Initial Submission to the Productivity Commission Inquiry into the 2018 GST distribution reforms*, 61.
- NT Government 2025, *2025-26 Mid-Year Report*, Budget Paper, 2.
- 2026, *GST distribution reforms: Initial submission - Northern Territory Government*.
- OECD 2013, *Fiscal federalism 2014: Making decentralisation work*.
- 2026, *OECD Economic Surveys: Australia 2026*.
- Parliament of Victoria 2022, *Inquiry into Commonwealth support for Victoria*, March, Legislative Assembly Economy and Infrastructure Committee.
- PBO 2020, *Structural Trends in GST, 02/2020*.
- PC 2013, *On efficiency and effectiveness: some definitions*, PC staff research note.
- 2018, *Horizontal Fiscal Equalisation*, 88, Canberra.
- 2025, *GST distributions reforms Issues paper*.
- Pincus, J & Ergas, H 2012, *Comments on Independent Economics report for the SA Government, entitled "Horizontal Fiscal Equalisation: Modeling the welfare and efficiency effects"*.
- Queensland Government 2000a, *State Budget 2000-2001: Budget paper no. 2 - Budget overview*.
- 2000b, *State Budget 2000-2001: Budget paper no. 3 - Economic and Revenue Outlook*.
- 2002, *State Budget 2002-03: Budget paper no. 2 - Budget statement*.
- 2004, *State Budget 2004-05: Budget paper no. 2 - Budget strategy and outlook*.
- 2010, *State Budget 2010-11: Budget paper no. 2 - Budget strategy and outlook*.
- 2017, *Queensland Government submission to the Productivity Commission Inquiry into Horizontal Fiscal Equalisation - Draft Report*.
- 2025a, *2025-26 Mid-Year Fiscal and Economic Review*.
- 2025b, *Queensland Productivity Commission to review GST flaws*, viewed 6 January 2026, <<https://statements.qld.gov.au/statements/103964#:~:text=Queensland%20is%20set%20to%20lose,by%20the%20former%20Labor%20Government.>>>.
- 2025c, *State Budget 2025-26: Budget paper no. 2 - Budget strategy and outlook*.
- Queensland Treasury 2026, *Productivity Commission Inquiry into GST distribution reforms: Queensland submission to the Issues Paper*.
- Ramos, R 2016, *Gravity models: A tool for migration analysis*, IZA Word of Labor.
- Saavedra, T & Inchauste, G 2023, *Why do people move across state borders?*

-
- Santos Silva, J & Tenreyro, S 2006, 'The log of gravity', *The Review of Economics and Statistics*, vol. 88, no. 4, pp. 641–658.
- Singhal, M 2007, *Flypaper and Fungibility: Evidence from the Tobacco Master Settlement*, June, Taubman Center Policy Briefs, Harvard University.
- Steinhauser, R, Sinning, M & Sobeck, K 2019, *State tax elasticities of revenue bases*.
- Tasmanian Government 2025a, *Macquarie Point Multipurpose Stadium Government Response*.
- 2025b, *The Budget*, Budget Paper, 1.
- Tiebout, C 1956, 'A Pure Theory of Local Expenditures', *The Journal of Political Economy*, vol. 64, no. 5.
- Tinbergen, J 1962, *Shaping the World Economy: Suggestions for an International Economic Policy*, The Twentieth Century Fund, New York.
- Tombe, T & Winter, J 2021, 'Fiscal integration with internal trade: Quantifying the effects of federal transfers in Canada', *Canadian Journal of Economics*, vol. 54, no. 2, pp. 522–556.
- Victorian Government 2021, *Upgrades to deliver more train services for Gippsland*, Victorian Infrastructure Delivery Authority, viewed 20 March 2026, <<https://bigbuild.vic.gov.au/news/regional-rail-revival/gippsland/upgrades-to-deliver-more-train-services-for-gippsland>>.
- 2025, *Budget Update 2025-26*.
- 2026, *Productivity Commission Inquiry into 2018 GST distribution reforms - Victorian Government response*, Submission, 59.
- Warren, N 2006, *Australia's Intergovernmental Fiscal Arrangements Final Report*.
- Yaroshevych, N, Kondrat, I & Kalaitan, T 2024, 'The Impact of the Mechanism for Aligning Horizontal Fiscal Imbalances on the Stability of the Financial System', *Journal of Risk and Financial Management*, vol. 17, no. 2.



QPC

