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GST reform

How to stop the states being shortchanged

States have lost out on $231 billion since the GST was introduced. This is because revenue has failed to keep up with national income. Rising inequality is making this revenue shortfall worse. Applying the GST to private health insurance and private school fees, and adding other taxes to the pool of money that flows to the states, could help pay for the services Australians deserve.

Discussion paper

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The Australia Institute - Research that matters

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Summary

The Goods and Services Tax (GST) is a broad-based tax of 10% on most goods, services and other items sold or consumed in Australia. Revenue from the GST was supposed to grow over time, so that state and territory governments would have a reliable income source to help them fund the important services they provide long into the future. But it has failed to live up to that goal. The reality is that GST revenue has failed to keep up with national income (Gross Domestic Product) and this has meant that the states have found it increasingly difficult to fund the important services they are responsible for.

If GST revenue had grown at the same rate as national income, then the states would have received an additional $231 billion in revenue over the 23 years from the introduction of the GST in 2000-01 to 2023-24. This includes $22 billion in lost revenue in 2023-24 alone.

The anemic growth of GST revenue in the last two decades has been caused, in large part, by rising inequality in Australia. Slow wage growth for low-income earners, coupled with rapidly rising rents, has constrained consumer spending in Australia and, inevitably, constrained the growth of GST. Similarly, the more rapid increase in the incomes of high-income Australians means that expenditure on GST-free items — like private school fees, private health insurance and overseas holidays — has grown, and this has also cut into the amount of GST revenue that could be provided to the states.

Broadening the GST to include private school fees and private health insurance would generate $1.8 billion per year, overwhelmingly from high income households. In contrast, any attempt to simply increase the GST rate above 10 percent would exacerbate the inequality already caused by the exclusion of so many goods and services preferred by the highest income households.

A simple solution to the impact of rising inequality on the decline in GST growth would be for the Commonwealth to collect new taxes to add to the pool of revenue the Commonwealth provides to the states. This could include new taxes on wealth, sugar, or a simple royalty on gas exports from commonwealth water that are currently given away royalty-free. Alternatively, the Commonwealth could end tax concessions such as the Fuel Tax Credits Scheme, which currently costs about $11 billion per year.[1] The additional revenue could be allocated to the states and used to better fund public schools, hospitals, and other essential services.

[1] Australian Government, *Budget 2025-26: Budget strategy and outlook: Budget paper no. 1*, https://budget.gov.au/content/bp1/download/bp1_2025-26.pdf

Introduction

The GST was designed to be a tax that would grow over time, so that state and territory governments would have a stable pool of revenue to properly fund services long into the future. When first introducing the GST in his budget speech, then Treasurer Peter Costello said:

> On 1 July we introduce a New Tax System, one of the largest structural changes to the Australian economy — probably the largest — since World War II. …Every dollar raised by Goods and Services Tax is paid to the State and Territory Governments. …From 1 July they have a revenue base that grows in line with the economy. It will provide a secure base to fund their services.[2]

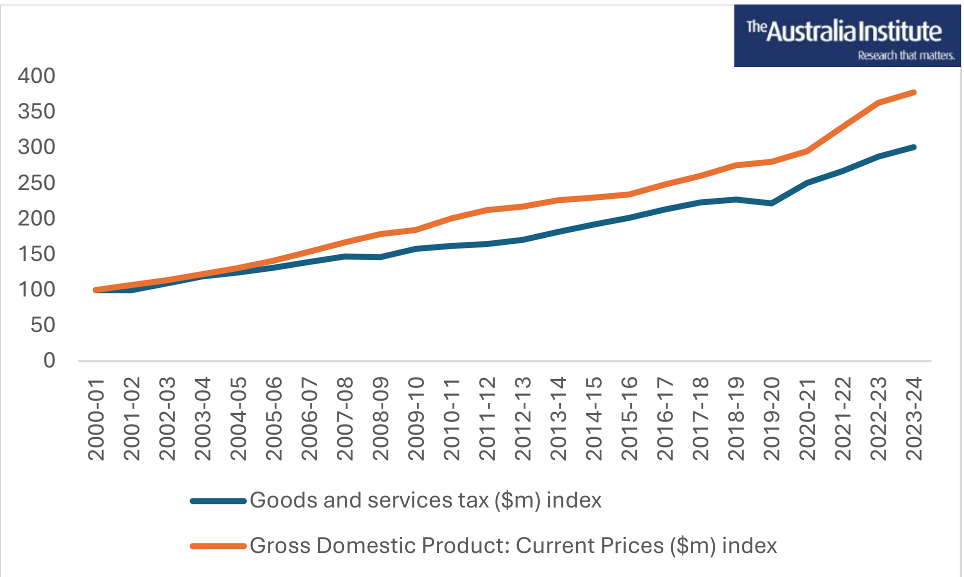
Despite Peter Costello's promise, the combination of rising inequality and the exclusion of expensive items that are preferred by high-income earners (like private school fees and private health insurance) has undermined the sustainability of the GST as a reliable source of revenue for the states.

[2] Costello (2000) *Budget 2000-01, Budget speech*, https://archive.budget.gov.au/2000-01/speech/speech.pdf

Decline in the GST

Partly because of the decline in the wage share of GDP and the rise in the share of consumer spending on things that are exempt from the GST, states have missed out on around $231 billion over the 23 years from the introduction of the GST in 2000-01 till 2023-24. The problem is accelerating rapidly and, last year alone, states missed out on $22 billion in revenue when compared to the revenue that would have been collected if the GST had grown at the same rate as national income. The diverging relationship between the GST and national income is shown in Figure 1.

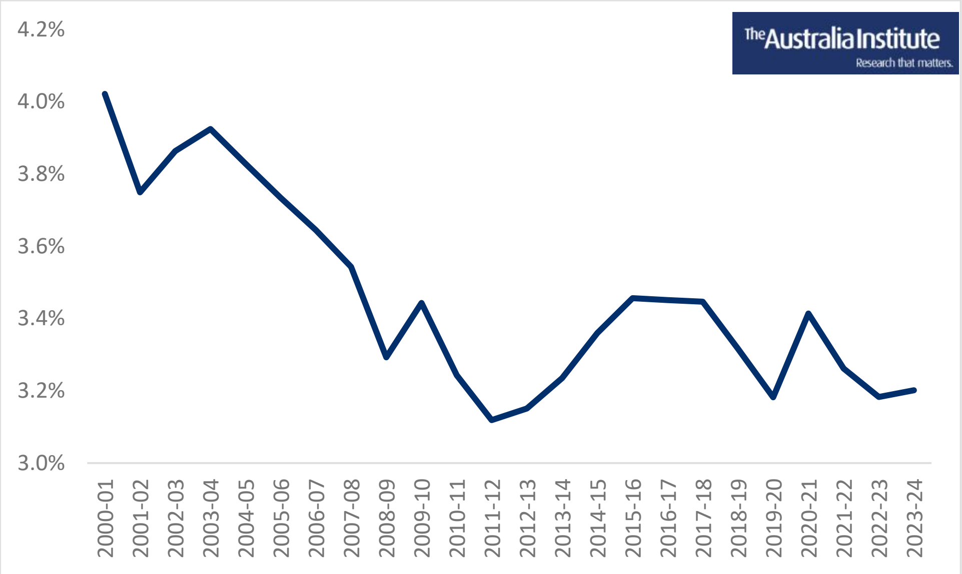
Figure 1: GST vs GDP growth, indices with 2000-01 = 100



Source: ABS (2024) *Australian System of National Accounts: 2023-24*, and ATO (2025) *Taxation Statistics 2022-23, GST – Table 1*

As a result, despite Peter Costello's promise to provide state governments with 'a revenue base that grows in line with the economy', in reality the GST has declined significantly as a share of GDP, as shown in Figure 2.

Figure 2: GST as a share of GDP, % 2000-01 to 2023-24



Source: ABS (2024) *Australian System of National Accounts: 2023-24*, and ATO (2025) *Taxation Statistics 2022-23, GST – Table 1*

Put simply, the design of the GST means that states are being asked to meet the rising expectations of citizens for high-quality government services with a declining share of national income.

As Table 1 shows, if the Commonwealth Government restored the relative size of funding to the states to the level first delivered by the Howard Government, then all states would have significantly smaller budget deficits — Queensland, South Australia and Northern Territory would in fact be in surplus. This could be done by either broadening the base of the GST, or by including new Commonwealth taxes in the pool of revenue provided to the states.

Table 1: State and Territory budget outcomes in 2023-24 if they received the same GST/GDP share provided in 2001

State	Actual Budget cash balance ($m)	Additional revenue ($m)	Potential cash balance ($m)
NSW	-18,046	6,312	-11,734
VIC	-16,213	4,778	-11,435
QLD	-4,049	4,624	575
WA	2,054	1,644	3,698
SA	-994	2,148	1,154
TAS	-1,159	877	-282
ACT	-1,226	460	-766
NT	-884	1,074	190
Total	**-40,517**	**21,917**	**-18,600**

Source: Source: ABS (2025) *Government Finance Statistics, Annual*

As discussed below, the reasons for the steady decline in the proportion of GDP collected by the GST and provided to the states are driven by:

- the steady reduction in the share of national income flowing to workers (which means they spend less money and in turn pay less GST);
- the rapid rise in housing rents (on which no GST is payable but which further reduce household spending on other items); and
- the inequitable decision to exclude private school fees and private health insurance from the GST (as the percentage of income received by those at the top increases the percentage of consumption spending on private health and education rises).

The goods and services tax

The GST is a value-added tax on various goods and services. It is levelled at a rate of 10%, but there are a number of goods and services that are excluded. These include:

- Most staples and basic foods like fresh fruit and vegetables, fish, dairy products, bread, and meat.
- Healthcare.
- Education.
- Childcare.
- Financial supplies.
- Exports.

A range of other items are ‘input taxed’. This means that no GST is payable on the supply of these services, but the supplier cannot claim input tax credits. In other words, they cannot claim back the GST payable on their inputs into the supply of the item. This notably includes the supply of private residential accommodation, which means that rent is not subject to GST. Financial services are also taxed in this way.

Why the GST is growing slower than national income

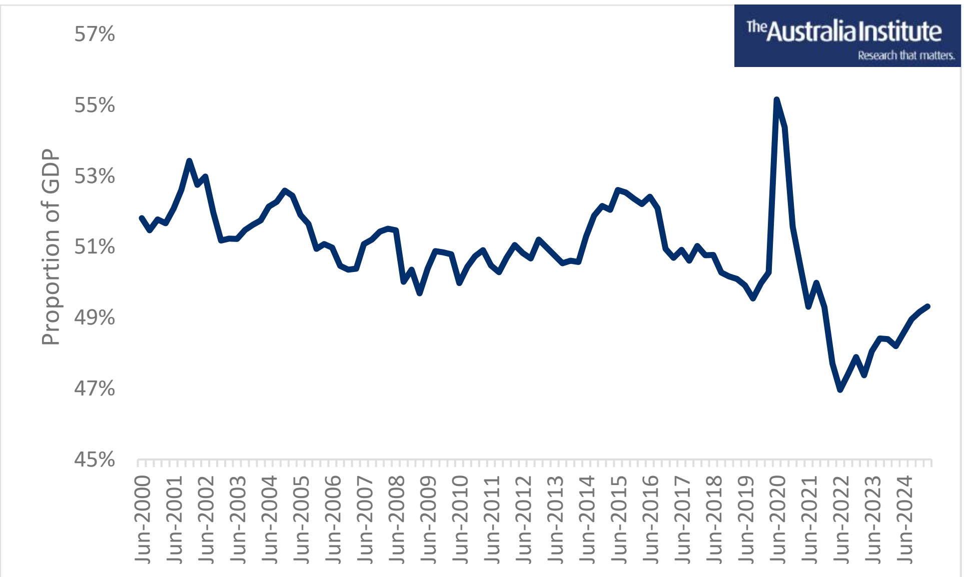
There are several reasons that GST revenue is growing more slowly than national income. These include:

- The decline in the share of national income going to wages
- The decline in the share of items subject to the GST
- Changes to the design of the Commonwealth income tax system that encourage people to purchase vehicles through their small business or ‘salary sacrifice’ via their employer. This system allows participants to avoid paying GST on the purchase price of the vehicles as well as petrol, tyres, maintenance, insurance and other running costs.

The decline in the share of national income going to wages

There has been a substantial decline in the share of national income going to wages since the GST was first introduced. This trend is shown in Figure 3.

Figure 3: Wages plus Mixed income share of GDP (%)[3]



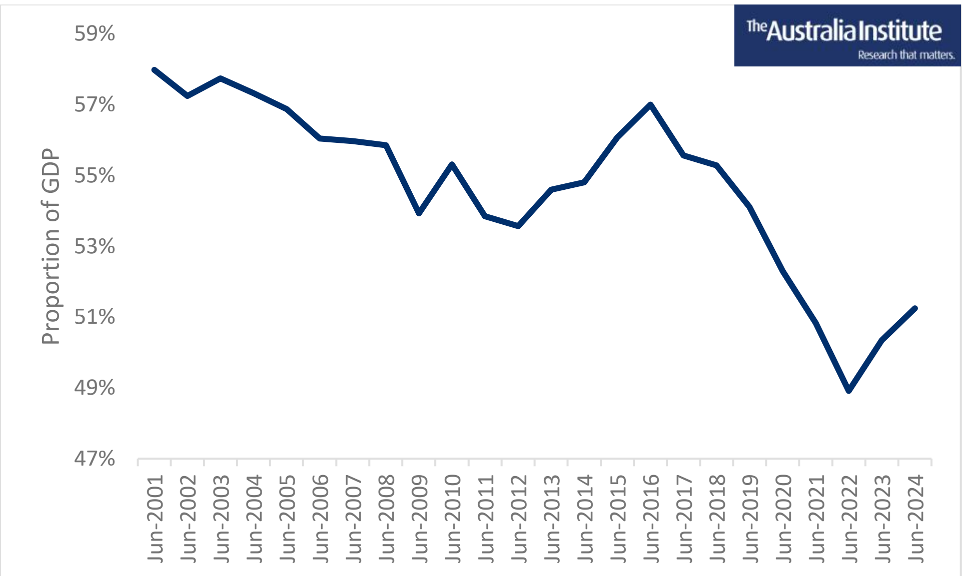
[3] Mixed income refers to income from unincorporated enterprises such as sole traders and partnerships, for instance, self-employed tradespeople. The mixed income share of national income has been falling over this period.

Source: ABS (2025) *Australian National Accounts: National Income, Expenditure and Product, March 2025*.

The falling wages share of GDP is driving inequality up and the GST/GDP ratio down. Workers have less income, as a per cent of GDP, to spend on consumer goods, which reduces consumption tax revenue. Meanwhile, the profit share of GDP has increased. As profits flow strongly to the highest income households, and because high-income earners spend a lower share of their income, consumption spending and the GST/GDP ratio has been further suppressed. This effect is exacerbated by the high level of foreign ownership of businesses in Australia, which means more income flowing offshore where no GST can be collected.

Figure 4 shows how the consumption share of GDP has declined since the GST was first introduced, as wages have grown more slowly than profits, and as a greater share of GDP has flowed offshore. The result is significantly less revenue for the states.

Figure 4: Consumption share of GDP (%), 2000-01 to 2023-24



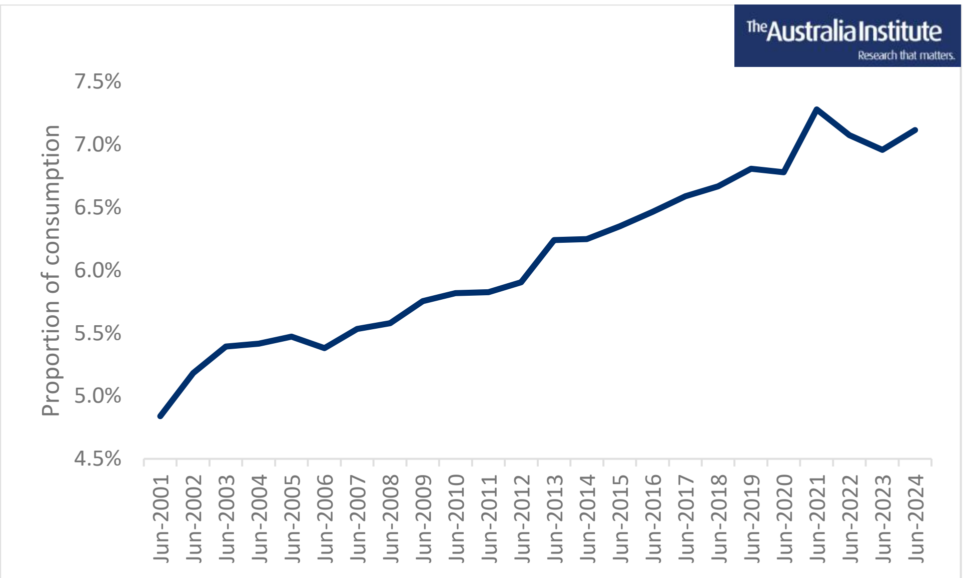
Source: ABS (2024) *Australian System of National Accounts, 2023-24*.

The decline in the share of items subject to the GST

It is not just because consumption spending is falling as a share of national income that GST revenue for the states has fallen. As inequality has increased, overall expenditure patterns have changed in line with the consumption preferences of higher-income people. As services like private school fees and private health insurance, which are exempt from GST, are strongly preferred by the highest income households, this change in spending patterns has cost the states dearly.

Figure 5 shows that health spending by households, as a share of total consumption spending, has risen since the introduction of the GST — from 4.8% to 7.1%. The largest single item of health spending is private health insurance. According to Consumer Price Index (CPI) weightings, private health insurance is the main component of medical and hospital services which, in turn, makes up three-quarters of household spending on health.[4]

Figure 5: Health share of consumption (%)



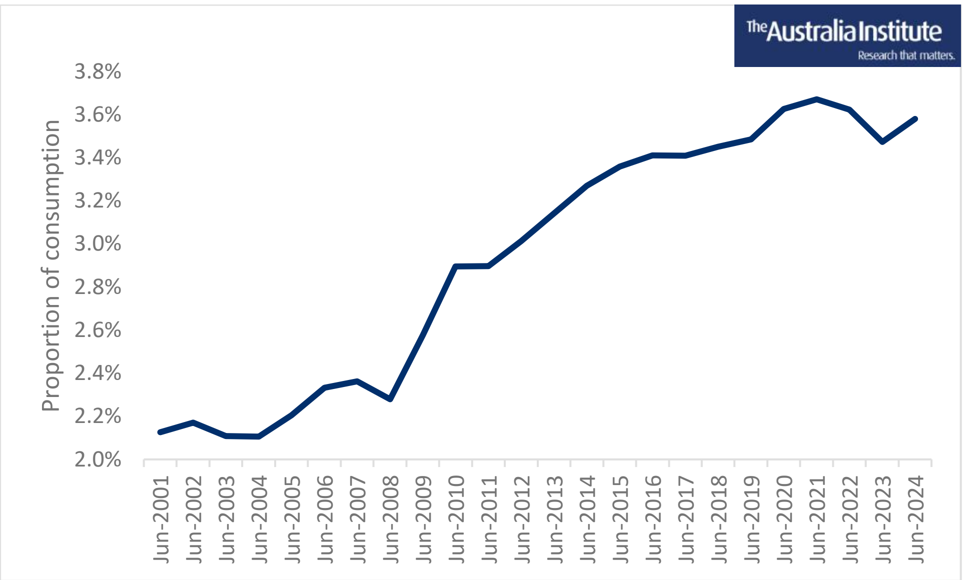
Source: ABS (2024) *Australian System of National Accounts, 2023-24.*

As shown in Figure 6, education spending as a share of consumption spending has also increased — from 2.1% to 3.6%. The largest part of household spending on education (90%) is on private schools.[5] An increasing proportion of students are going to private schools, which are charging increasingly higher fees. Put simply, the more children who go to private schools and the higher the fees those schools charge, the less revenue is given to the states to fund public schools.

[4] ABS (2024) *Annual weight update of the CPI and Living Cost Indexes, December 2024*, https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/annual-weight-update-cpi-and-living-cost-indexes/dec-2024; and ABS (2019) *Concepts, sources and methods, price collection, health*, https://www.abs.gov.au/statistics/detailed-methodology-information/concepts-sources-methods/consumer-price-index-concepts-sources-and-methods/2018/price-collection#health

[5] ABS (2017) *Household Expenditure Survey, 2015-16*, https://www.abs.gov.au/statistics/economy/finance/household-expenditure-survey-australia-summary-results/2015-16 and ABS (2025) *Australian National Accounts: Input-Output Tables, 2022-23*, https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-input-output-tables/latest-release

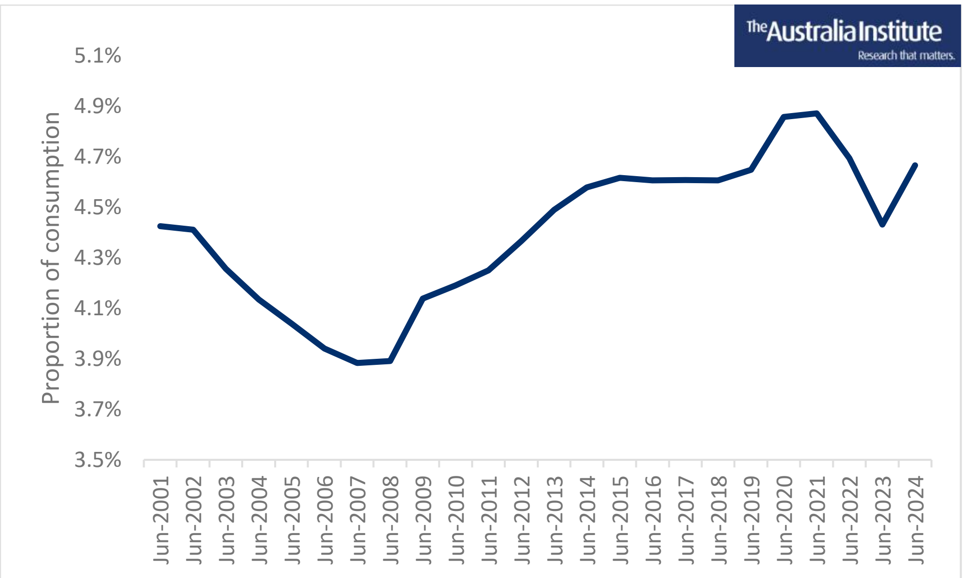
Figure 6: Education share of consumption (%)



Source: ABS (2024) *Australian System of National Accounts, 2023-24*.

Similarly, rent does not attract GST, but it too has grown as a share of consumption spending since the GST was introduced (Figure 7).

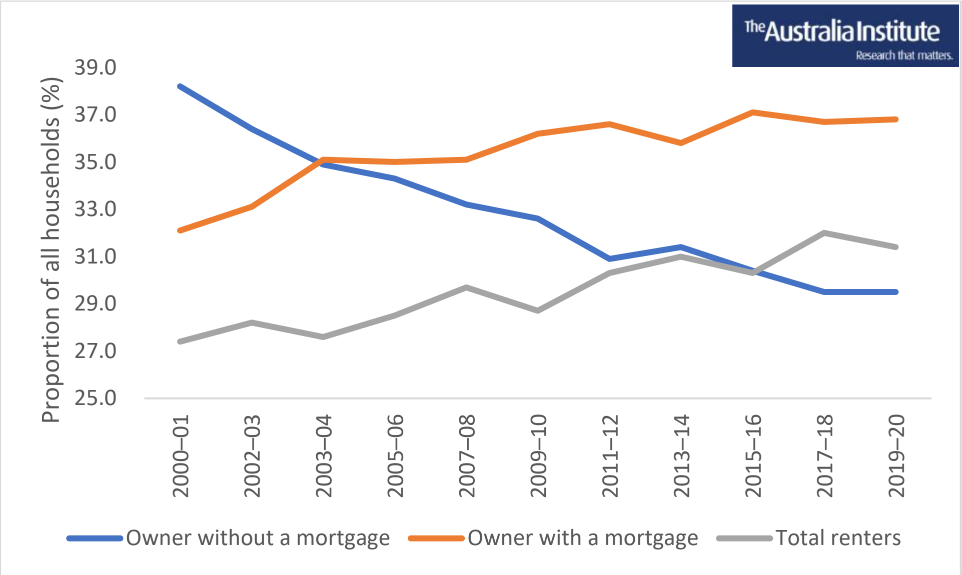
Figure 7: Rent share of consumption (%)



Source: ABS (2024) *Australian System of National Accounts, 2023-24*.

This is likely due to a combination of factors, such as rising rental prices and the growing proportion of households who rent rather than own their property. The proportion of homeowners with mortgages has also risen, in large part because rising house prices have meant larger mortgages that take longer to pay off. Mortgage repayments do not attract GST, but they also reduce a household's disposable income, which could be spent on items that *do* attract GST. The increase in renters and those with mortgages is shown in Figure 8.

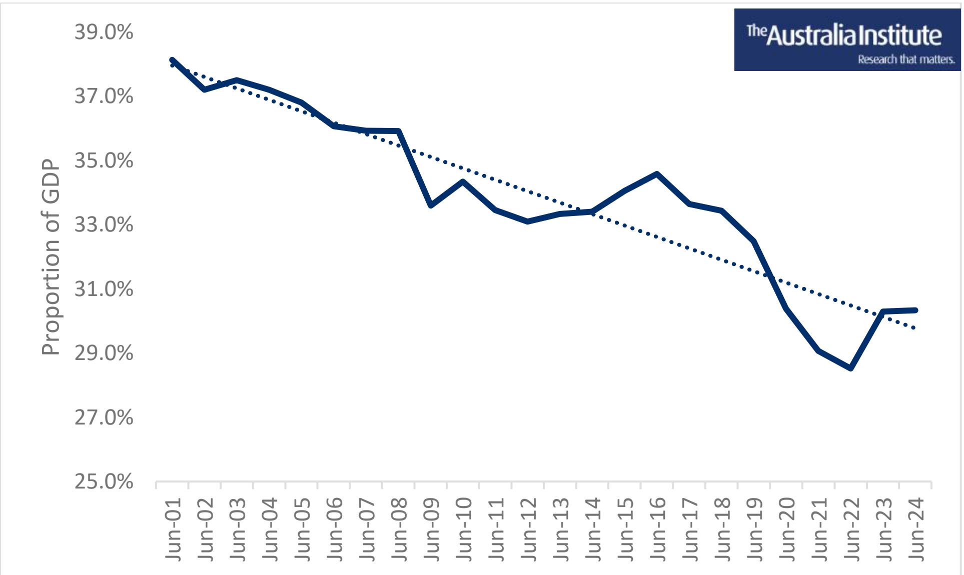
Figure 8: Housing by occupancy as a % of all households



Source: ABS (2022) *Housing Occupancy and Costs, 2019-20, Table 1*, https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/2019-20

In Figure 9 we plot the aggregate value of all the consumption items that attract the GST and show the result as a share of GDP. The items that attract the GST are estimated by taking the total consumption figure from the national accounts and deducting those items that do not attract the GST.[6]

Figure 9: Consumption items subject to GST (%)



Source: ABS (2024) *Australian System of National Accounts, 2023-24*.

[6] Those categories include food, rent for housing, imputed rent for owner-occupiers, health, education services, insurance and other financial services.

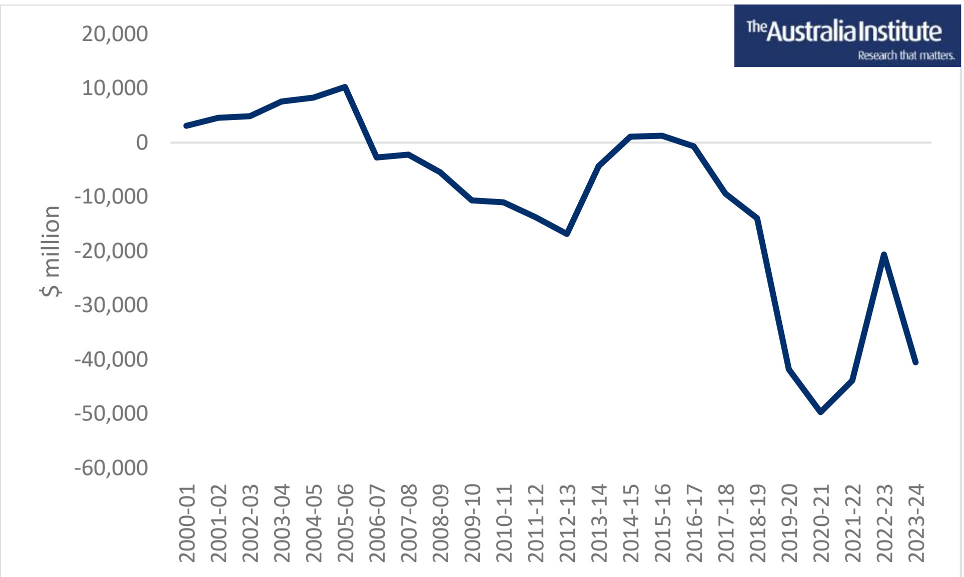
Figure 9 clearly shows that the proportion of items that are subject to the GST is falling and has consistently done so since it was introduced in July 2000.

State and Territory Government budgets and lost GST revenue

The consequence of the decline in GST revenue relative to national income is that the states' revenue has been declining relative to the cost of the services they need to provide. To maintain the same level of services, the states must either raise more revenue from other sources, or see their budget bottom line deteriorate.

Figure 10 shows the combined budget outcomes of all states and territories since the introduction of the GST. It shows that while they had an aggregate surplus when the GST was introduced, they have an aggregate deficit today. This trend was evident even before the COVID-19 pandemic.

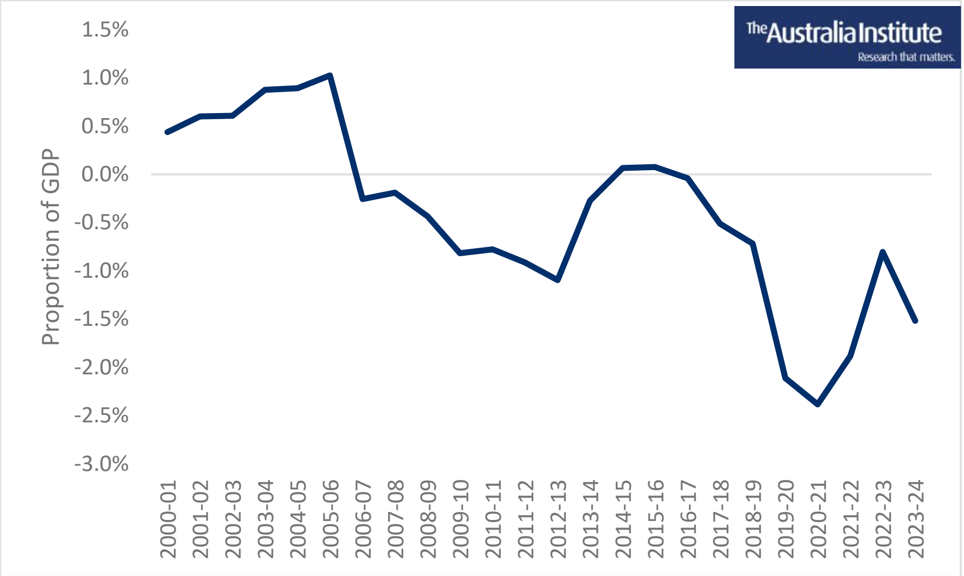
Figure 10: Combined State and Territory Government budget outcome ($m)



Source: ABS (2025) Government Finance Statistics, Annual

Figure 11 depicts the same combined budget outcomes shown in Figure 10 but expresses them as a proportion of national income rather than in dollars.

Figure 11: Combined State and Territory Government budget outcome (% of GDP)



Source: ABS (2025) *Government Finance Statistics, Annual* and ABS (2024) *Australian System of National Accounts, 2023-24*

Other ways used to avoid the GST

There are ways to avoid paying the GST that are available to certain groups of people. These groups are more likely to be on higher incomes.

Many employees have salary sacrifice schemes with their employers. A benefit of these schemes is that, for the employer, the GST paid is refundable and that refund is usually shared with the employee. Hence, the purchase and operation of a motor vehicle can involve significant GST refunds. Phones, computers and gym membership are also popular salary sacrifice items and give another way of avoiding the GST.

The benefits of salary sacrificing are higher for those who face higher marginal rates of tax. For this reason, those on higher incomes are more likely to salary sacrifice. In 2022-23, reportable fringe benefits valued at $22.5 billion were provided to employees.[7] Many of those would have involved salary sacrifice arrangements.

People who travel overseas can make purchases without paying GST and can usually get credit for any equivalent tax levied in the countries they visit. That means travel, accommodation, and any other purchases overseas are GST-free.

Children that go to private schools can get swimming and music lessons, sporting activities and similar services without paying GST because these are often treated as part of the school's curriculum. Children that go to public schools must often use commercially provided services that attract the GST.

[7] ATO (2025) *Taxation Statistics 2022-23*,https://data.gov.au/data/dataset/taxation-statistics-2022-23

How to equitably restore State and territory finances

One solution to the problem of falling GST revenue relative to national income is to increase the rate of the GST or broaden its base. The problem with this solution is that the GST is regressive, and so this would worsen inequality.

But there is a way that more GST revenue could be raised in a progressive way. The GST could be broadened to include two items that are currently excluded but are consumed at much higher rates by those on higher incomes. These items are private health insurance and household spending on private schools. These two items, as we have seen above, are also growing at a rapid rate and adding to the decline in GST revenue relative to national income.

Table 2 shows the revenue raised by broadening the GST to include private health insurance and private schools, as well as how much would be paid by each income quintile.[8]

Table 2: Additional revenue and distribution by broadening the GST to include private health insurance and private schools

	Q1	Q2	Q3	Q4	Q5	Total
Private health insurance						
GST $million	53	67	97	126	167	510
% of total revenue	10%	13%	19%	25%	33%	100%
Private schools						
GST $million	$76	$178	$211	$216	$601	$1,282
% of total revenue	6%	14%	16%	17%	47%	100%
Total						
GST $million	$128	$246	$308	$342	$768	$1,792
% of total revenue	7%	14%	17%	19%	43%	100%

Source: Private health insurance total from Treasury (2024) *Tax Expenditure and insight Statement, 2024-25*, with distribution from Grudnoff (2014) *How to extend the GST without hurting the poor*. Private schools from ABS (2017) *Household Expenditure Survey, 2015-16* and ABS (2025) *Australian National Accounts: Input-Output Tables, 2022-23*.

Table 2 shows that including private health insurance and private school fees in the GST would raise $1.8 billion in additional revenue. Almost half the revenue (43%) would come from the top 20% of income earners, while only 7% would come from the bottom 20% of households.

8 Income quintiles divide all households into 5 equal groups with the 20% of households on the lowest incomes in Q1, with the next 20% being those with the second lowest incomes in Q2, with Q5 being the 20% of households on the highest incomes.

While $1.8 billion per year is a significant increase in GST revenue, it does not make up for the $22 billion in 2023-24 in lost revenue due to the structural decline of the GST tax base. This lost revenue could, however, be made up through other means. When the GST was introduced, the Commonwealth Government came to an agreement with state and territory governments that all the revenue it generated would go to the states and territories. But there is no reason that the GST must be the only tax that is passed onto the states in this way. Additional taxes, alongside the GST, could simply be added to the pool of revenue given to the states.

The additional taxes could be new or existing taxes. Examples of new taxes or other revenue measures to fund state services could include a tax on wealth, a tax on sugar, or a new royalty on gas exports from Commonwealth waters. Existing taxes could be expanded, and the additional revenue added to the pool. An example of this includes scrapping tax concessions like the Fuel Tax Credits Scheme and allocating the increase in fuel excise to the state pool of revenue.

All of these are efficient and equitable taxes that could fully compensate the states for the drop in GST revenue relative to national income.

Conclusion

The difficulties that the states are facing because of declining GST revenue relative to national income are becoming increasingly large. This problem is not insurmountable and does not require large wholesale changes to the GST. Instead, there could be a small broadening of the GST to include private health insurance and private schools.

Importantly, adding additional taxes to the pool of revenue, alongside the GST, could bridge the funding gap and give the states a more sustainable revenue stream into the future. This could come in the form of new taxes, or by expanding existing taxes by closing tax concessions. The GST funding shortfall is an opportunity for broader tax reform that could include the introduction of more efficient and equitable taxes.