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Insofar as Australia has made an original contribution to the development of federal systems, it has done so through economic and financial ideas and institutions rather than through political and legal forms and processes. The Australian system of political and administrative federalism and the federal Constitution on which that system is based have been essentially derivative and static, whereas to a significant extent fiscal federalism in Australia has been innovative and dynamic. Some of the innovations — tax-sharing and debt arrangements, general provision for intergovernmental grants, and formal machinery for dealing with vertical financial balance — were embodied in the Constitution itself, but the subsequent development of the Australian federal system has been replete with economic and fiscal initiatives which have not only changed the character of intergovernmental relationships but have also had a profound effect on the shape of Australia’s economy and the pattern of its society. These initiatives have resulted in the creation of institutions or the development of processes many of which remain unique in federal countries. These include the Australian Loan Council, the Commonwealth Grants Commission, the co-ordination of taxation policy in general and uniform tax in particular, and the establishment of independent statutory commissions to advise on intergovernmental specific purpose grants.

The principal purpose of this book has been to bring together in a single volume those articles and documents produced during the first sixty-odd years of federation which, in the view of the editors, most clearly illustrate the origins of the innovatory ideas on fiscal federalism and their subsequent development and transformation into
instruments of policy. It will be seen that many of the proposals for change came from academic economists in papers which first appeared in economic journals. Others had their origin in official documents prepared by politicians, public servants and commissions or committees of inquiry. Most of the important developments in federal financial arrangements up to the time of World War II are thus represented by papers written by the advocates of change or reform.

The influence of academic economists in the formulation of federal financial policies during the period 1925-45 is vividly illustrated by Professor L. F. Giblin's original work on taxable capacity and fiscal equalisation and by Professor R. C. Mills's advocacy of uniform taxation. But reference should be made more generally to the enormous influence which the small band of academic economists, most of whom are represented in this book, exerted on all aspects of policy during the period between the two World Wars.

In retrospect, this was the golden age of Australian economics. It was a period of important advances in theoretical, conceptual and empirical knowledge but above all it was a period in which Australian academic economists contributed to the development of fiscal, monetary, trade and other economic policies as never before or since. Economics and public policy were virtually synonymous and although, by today's standards, most economists were generalists with interests across the whole spectrum of economic problems they tended to have a special preoccupation with public finance. Although strongly individualistic in outlook, they were gregarious in their attempts to influence economic policy and were continually joining together in government committees and ad hoc groups. Their work won international as well as local recognition and it seemed to economists on the other side of the world that, like their counterparts in Sweden, they enjoyed great success in having their academic ideas and proposals translated into government policies. In the words of Professor D. H. Robertson:

There are said to be, in the far north and the far south, happy lands where economists all give the same advice, where the government listens to it, where the public understands why the government has listened — and where, the cynic might add, the very prices of timber and wool play, as though by magic, their appointed part in the harmonious scheme.

The second major purpose of the book has been to describe and review the important developments in Australian federalism through the eyes of contemporary observers, some of whom were participants in the events they portray. For this purpose, the contributors include
not only politicians, public servants and academic economists but also political scientists, constitutional lawyers and other students of federalism (and even a mathematician).

A third purpose which the editors have had in mind in compiling this book has been to examine the views of earlier generations of politicians, administrators and scholars on issues of intergovernmental fiscal relations which remain relevant today. These issues include the general questions of vertical and horizontal financial balance, principles and methods of fiscal equalisation, borrowing arrangements and debt management, the assignment and coordination of revenue-raising and expenditure powers, and intergovernmental grants arrangements generally.

Criteria for selection have included, in addition to the relevance of the papers to the major objectives of the collection and their significance as historical studies in Australian fiscal federalism, their accessibility and time of publication. No papers written after 1965 have been included, partly because these are usually readily available in other publications and partly because the collection is not intended to survey recent developments in federalism, most of which have been the subject of analysis and evaluation in other publications of the Centre for Research on Federal Financial Relations. This has meant that some important recent developments in federal financial relations are not reviewed in this book. These include: the rapid growth of specific purpose payments during the 1960s and 1970s and the establishment of advisory commissions to advise on these payments; the changes in taxation, general revenue grants and debt arrangements which occurred during the early 1970s in an attempt to redress the vertical financial imbalance between the Commonwealth and the States; the refinements which occurred in the principles and methods used by the Commonwealth Grants Commission in the assessment of equalisation grants; the federalism policy of the Whitlam government, with its emphasis on Commonwealth involvement in specific purpose programs, its extension of those programs into new fields and its support for local, urban and regional programs; the work of the Australian Constitutional Convention and the Advisory Council for Inter-government Relations; and the federalism policy of the Fraser government, including the reversal of many of the Whitlam policies and the substitution of tax-sharing entitlements for the formula-based general revenue grants which had been paid to the States since 1942 and for the equalisation grants which had been paid to local governments since 1973.

The journals represented in the collection include many of the major English-language economic journals as well as journals in
related fields which were in existence in the period covered by the collection.* The editors are grateful to the publishers and editors of these journals and to the publishers of the books and official publications from which other contributions have been drawn (Longman Cheshire, the Australian Bureau of Statistics and the Australian Government Publishing Service) for permission to reprint the papers. Special mention should be made of the twenty-one papers included from *The Economic Record*, which first began publication in 1925 as the journal of the newly established Economic Society of Australia and New Zealand. Prior to this date, there was no recognised forum for the discussion of economic policy in Australia. As a result, this collection reflects a relative dearth of articles relating to the earlier period of federation.

The editors also thank the surviving authors whom they have been able to trace for agreeing to the publication of their papers without payment of royalties.

The editors have been ably assisted in the compilation and editing of the papers by Mrs V. J. Murray, Mrs K. J. Fisher and Mrs A. M. Wilkinson of the Centre for Research on Federal Financial Relations and by the staff of ANU Press. Special thanks are due to Mrs Wilkinson for preparing the reading lists and index.

The book has been published with financial support from the Centre for Research on Federal Financial Relations as part of the Centre's program for extending the range of information and analysis in respect of the working of the Australian federal system.

As far as possible, the original text of papers has been retained, but some readings consist of extracts from larger articles and in most cases minor editorial changes have been made to remove extraneous or dated material and to ensure consistency of style. A clear indication is given where editorial omissions or other changes have been made. To assist the reader, bibliographical references have been inserted by the editors in respect of politicians and other persons named in the readings. The units of currency in use in Australia until 1966 (pounds, shillings and pence) have been retained in references to monetary amounts, but to assist the reader shillings and pence have as far as possible been decimalised in terms of their pound equivalents and the decimalised amounts inserted in brackets. When the Australian currency was decimalised in 1966, the old unit of one pound (£1) was replaced by a new unit of one dollar ($1), $2 being equal to £1.

The significance of the papers and their relationship to contemporary developments are discussed in the editors' commentary which precedes each of the five parts of the book. The organisation of the papers into these five parts is partly chronological and partly according to subject matter. Thus Part One — The Formative Years — is concerned with developments in financial relations generally during the first quarter-century of the Australian federation, including grants arrangements, taxation and proposals for constitutional change; while Part Five — Post-War Developments — is also concerned with general questions of Commonwealth-State financial relations which emerged after World War II. The other three parts are devoted to the Australian Loan Council (Part Two), the Commonwealth Grants Commission (Part Three) and Taxation (Part Four) respectively.

January 1979

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PART ONE

THE FORMATIVE YEARS
One of the major issues in the federal constitutional debates during the 1890s had been the distribution of financial powers between the Commonwealth and the States. Although both the Commonwealth and individual States were given wide-ranging powers to raise their own taxes and to borrow on their own behalf, under the federal Constitution the States were necessarily precluded from imposing customs duties, and the Constitution further provided that the Commonwealth was to have exclusive power to impose excise duties (which might otherwise have been used by individual States to hinder interstate free trade).

The loss of customs and excise duties by the States was significant because, at the time of federation, they collectively derived more than 75 per cent of all taxation revenues from these sources and because the Constitution left the States with most of the responsibility for financing government expenditures. The main constitutional response to this financial problem was to make provision for the payment of at least three-quarters of Commonwealth customs and excise revenue to the States during a transitional period of at least ten years (section 87, known as the Braddon clause). More generally, provision was made for the payment of surplus Commonwealth revenue to the States after the end of the so-called book-keeping period (section 94) and for the Commonwealth to make grants to the States on its own terms and conditions (section 96) and to take over State debts (section 105).

The book-keeping system was to operate for at least five years from the date when uniform customs and excise duties were imposed. The Constitution provided that until the imposition of uniform duties the Commonwealth was to pay to each State the revenues collected in that
State less amounts designated to finance Commonwealth expenditures in the State (section 89). In the event, uniform duties were imposed in October 1901, except in Western Australia which was permitted to impose its own customs duties on goods originating in other States, on a diminishing scale for five years after the imposition of uniform duties (section 95).

Under the book-keeping system, the amount payable to each State was to be calculated by reference to the State from which the revenue was derived rather than the State in which it was collected; this was to be achieved, in respect of goods passing from one State to another after importation or manufacture, by attributing the customs and excise duties to the State in which the goods were consumed and not to the State of importation or manufacture (section 93).

The distribution of Commonwealth payments among the States thus changed from a collection to a derivation basis in 1901. Provision had been made (in section 94) for the Commonwealth Parliament to determine the distribution of surplus revenue payments after five years of uniform customs duties on such basis as it deemed fair. But this option was not exercised and the book-keeping system continued until 30 June 1910, when the payments under the Braddon clause were replaced by the equal per capita payments under the *Surplus Revenue Act* 1910.

During the period of the transitional arrangements, the Commonwealth at first returned more to the States than the minimum three-quarters share of customs and excise revenues that the Braddon clause required. However, after the introduction of a new tariff and a program of invalid and age pensions in 1908, the Commonwealth restricted its payments to the minimum required under section 87 and avoided any obligation to pay additional surplus revenue to the States by paying its surpluses into a Trust Account (thereby nominally ceasing to record them as surpluses).

Meanwhile, the States had significantly increased their own taxes and their business undertaking surpluses had also grown. State recurrent expenditures but not capital works had increased significantly since federation. However, by the end of the first decade it was becoming clear that some States had been able to adapt to the new system more easily than others, and in some quarters it was beginning to be recognised that the problem of federal financial balance had a horizontal as well as a vertical dimension. Fiscal inequality among the States was thus becoming an issue as well as inequality between the Commonwealth and the States collectively.

Reading I, which contains Mr Alfred Deakin's famous 1902 prophecy that the Constitution left the States 'legally free, but financially bound to the chariot wheels of the central Government'.
shows that even within eighteen months of federation there was one man who predicted the future course of Commonwealth-State relations by reference to what he regarded as an inevitable financial dependence of the States on the Commonwealth. After the first ten years of federation, Deakin said, the States ‘will be able to claim nothing as of right, and must be content with any amount the Federal Parliament chooses to spare them’. Deakin distinguished the problem of horizontal balance from that of vertical balance but apparently considered that the former would eventually be subsumed by the latter: ‘The less populous will first succumb; those smitten by drought or similar misfortunes will follow; and, finally, even the greatest and most prosperous will, however reluctantly, be brought to heel.’

In the event, Deakin’s prophecy was not fulfilled until 40 years later and even then it depended on events which Deakin could not have foreseen (in particular the war-time necessity for uniform taxation, the course of High Court decisions about State taxing powers and the Financial Agreement of 1927) in order to become effective. During the period of the transitional arrangements, many conferences were held between the Commonwealth and the States for the purpose of establishing a more satisfactory system in place of the revenue-sharing arrangements (imposed by the Braddon clause) and the book-keeping system.

Proposals discussed included arrangements for the transfer of State debts and for some system of grants from the Commonwealth to the States in place of the arrangements for sharing customs and excise revenues. The basis of distribution of Commonwealth payments was itself an issue, the principal concern at that stage being the extent to which payments should reflect State collections (as under the arrangements for sharing customs and excise revenues) or be distributed on a population basis. Although New South Wales had initially rejected even the modest degree of horizontal equalisation that would have resulted from a per capita distribution, by the end of the transitional period this basis of distribution had been generally agreed and was incorporated in what was now intended to be a permanent system of Commonwealth grants to the States.

Reading II contains a number of documents which throw light on developments between 1905 and 1910 which led to the substitution of the system of per capita payments for the revenue-sharing arrangements of the first ten years of federation. These include:

(1) A memorandum from the Commonwealth Treasurer (Sir John Forrest) to the Prime Minister (Alfred Deakin) dated 25 September 1905, proposing the take-over of State debts and the substitution of fixed grants to the States for the transitional revenue-sharing arrangements. The continuation of Commonwealth payments to the States
Fiscal Federalism

was considered necessary to enable them to meet their interest liabilities whether or not State debts were taken over by the Commonwealth. The proposal for fixed grants had the support of New South Wales as a means of giving greater certainty to the States in their budgeting.

(2) A summary of a later memorandum dated 9 July 1906 from Sir John Forrest to Deakin, in which revised and somewhat different proposals are described. Under these, the sharing of customs and excise revenue was to continue for at least a further ten years after 1910, but the States were to receive guaranteed fixed minimum grants equal to three-quarters of customs and excise revenue in the preceding five years, leaving a full one-quarter to the Commonwealth. Any subsequent increase in customs and excise revenue was to be similarly shared, but distributed among the States on a per capita basis (thereby dispensing with the book-keeping system). The Commonwealth was also to have the right to impose 'earmarked' duties for specific purposes which it would not need to share with the States except for any unexpended balances.

(3) A paper presented to the Tasmanian Parliament in 1907 by Mr R. M. Johnston, the State Registrar-General and Government Statistician. This criticised the Forrest proposals on the grounds that they were even more rigid than the Braddon clause, and that the per capita supplements did not adequately provide for anticipated increases in State expenditure as their populations increased. Johnston calculated that in 1905-6 the return of customs and excise revenue to the States had amounted to 36s. 5d. (£1.82) per capita. He therefore proposed that the States should be guaranteed a similar annual per capita payment in future. They would thus be protected against the possibility of rising Commonwealth needs having an adverse effect on the division of revenue between them, and against the effects of rising population on their own expenditure needs. For its part, the Commonwealth would be free to determine tariff rates without having to increase the share of the States. Alternatively, if State debts were to be taken over by the Commonwealth, as Johnston had advocated since 1900, it could meet their interest liability to the extent of 36s. 5d. per capita.

(4) An extract from the Commonwealth Year Book No. 3, which describes the course of Commonwealth-State Conferences following Forrest's proposals up to the financial agreement which was reached between the Commonwealth and the States in August 1909, and which gives the terms of that agreement. The question of a Commonwealth take-over of State debts was in effect deferred, but a system of per capita payments to the States was accepted, although at a rate of only £1.25 per capita as compared with Johnston's proposal of £1.82 per capita.
(5) An extract from the *Commonwealth Year Book No. 4*. This sets out the main provisions of the *Surplus Revenue Act 1910* which gave effect to the 1909 agreement. It will be noted that although the new arrangements were to apply from 1 July 1910, that is six months before the time when the Braddon clause could be suspended by the Commonwealth Parliament, provision was made for the Commonwealth’s obligations under the Braddon clause to be subsumed in the new arrangements.

As well as ending the application of the Braddon clause in this way and providing for the payment of 25s. (£1.25) per head of population to each State with effect from 1 July 1910, the *Surplus Revenue Act 1910* made special provision for assistance to Western Australia, half of which was to be financed by the other States from their shares of the per capita payments. It may be observed, however, that this was justified in the agreement on the ground of the large per capita contribution of Western Australia to customs revenue. As already noted, Western Australia had been allowed to continue the imposition of duties on interstate trade for a limited period after federation, but the reference in this Reading is presumably to the uniform duties imposed by the Commonwealth. A high per capita yield from the uniform duties could have arisen because of a greater dependence upon imports, consequential upon a relatively low level of industrial development. The uniform tariff also discriminated against Western Australia in another way. Before federation the State’s own tariffs had been relatively high and their revenue yield was greater than that from the new uniform tariff. On the other hand, the New South Wales tariffs had been relatively low, and their yield had therefore been lower than that from the uniform tariff. The return of the same proportion of customs revenue therefore imposed a fiscal sacrifice on Western Australia but conferred a fiscal benefit on New South Wales.

Tasmania was in the same position as Western Australia and this point was cogently argued by R. M. Johnston in papers presented to the Tasmanian Parliament in 1900 and again in 1910. The special assistance to Western Australia in 1910-11 was followed by similar assistance to Tasmania in 1911-12. This marked the beginning of horizontal equalisation arrangements, and henceforth one of the main issues in Commonwealth-State financial relations concerned the problems of individual States.

Insofar as the States collectively were concerned, the chief areas of contention shifted from grants arrangements to borrowing arrangements and the division of taxing powers, especially after the Commonwealth began to borrow for its own purposes in 1912 and imposed income taxes for the first time in 1915. The Commonwealth also introduced land tax in 1910, entertainments tax in 1916, estate duties in 1914 and war-time profits tax in 1917.
Reading III by Professor D. B. (later Sir Douglas) Copland reviewed the attempts to achieve 'harmonisation' of Commonwealth and State taxation between 1920, when the Commonwealth appointed a Royal Commission to consider the problem, and 1923, when the Commonwealth offered to abandon its personal income taxes altogether if the States would forgo the per capita payments and give up company income taxes to the extent necessary to permit a Commonwealth tax of 2s. 6d. in the £ (12.5 per cent) to be imposed without increasing total tax payable by companies. After New South Wales stood out against this arrangement, collection agreements were entered into with the States whereby all States except Western Australia collected Federal income tax on the basis of a uniform return. It had already been agreed that the Commonwealth would collect Western Australian tax on a similar basis. The Copland paper incidentally summarised the developments which occurred in Commonwealth and State taxes between 1910 and 1923; referred to the pioneering work of L. F. Giblin on the differences in taxable capacity and tax severity among the States; and described attempts after 1916 to achieve uniform returns and collection arrangements.

The question of financial inequality among the States was one of the issues taken up by Mr (later Professor) L. F. Giblin in Reading IV, while in Reading V Professor R. C. Mills proposed not merely uniform collection arrangements for income and inheritance taxes, but rather uniform taxes imposed solely by the Commonwealth and associated with increased per capita payments to the States.

Giblin suggested in his 1926 paper that the Australian 'combination of Federal direct taxation with per capita distributions to the States makes an adjusting factor of the greatest nicety' in relation to financial inequalities among the States, but that the existing Australian arrangements did not go far enough. Both Federal income tax collections and per capita payments to the States needed to be larger if the differences in taxable capacity among the States were to be alleviated. Even this would not wholly compensate for differences in taxable capacity, and Giblin drew on Canadian experience to suggest a system of differential per capita payments to the States, based on periodical recommendations from 'an Economic Committee' which would have regard to differences in taxable capacities. In this way Giblin foreshadowed the establishment of the Commonwealth Grants Commission, the methodology of which he played such an important part in developing.

In Reading V, Mills likewise foreshadowed the uniform income tax arrangements, which the Commonwealth adopted in 1942 on the basis of recommendations by a Committee which Mills chaired (see Reading XXI). By the time of Mills's paper in 1928, the system of per capita
grants instituted in 1910 had come to an end as one aspect of the 1927 Financial Agreement between the Commonwealth and States. The Financial Agreement also established the Australian Loan Council on a permanent basis; introduced far-reaching changes affecting Commonwealth and State debts, borrowing arrangements and debt management; and provided for Commonwealth debt charges assistance to the States in place of the per capita payments (see Part Two below).

Mills reviewed the discussions between the Commonwealth and States about the division of taxing powers, the growing dissatisfaction of the Commonwealth over the per capita payments (which the Treasurer, Dr Earle Page, described as involving 'the vicious principle of one authority raising taxation for another authority to spend') and the other events which led to the abolition of the per capita payments and to the Financial Agreement.

Mills generally approved of the debt and borrowing arrangements which resulted from the Financial Agreement, but was critical of the fact that what he called 'the problem of double taxation' was hardly touched by the Agreement. His solution to the problem of Commonwealth-State financial relations was to hand 'over entirely to the Commonwealth the two chief direct taxes, income and inheritance, on the understanding that payments should be made to the States to compensate for the resulting loss of revenue'.

By contrast with Mills's centralising approach, the N.S.W. New State Commission Report reviewed by Professor F. A. Bland in 1925 in Reading VI considered the case for devolution of powers. The Commission decided that the creation of a new State or States in New South Wales was neither desirable nor practicable, but recommended that much larger powers should be given to local government. In particular, the Commission proposed the establishment of District Councils at a level above that of shires and municipalities, and the transfer to the District Councils of State functions in the fields of health, land settlement, education, public works and the like.

Neither these proposals nor those made in 1929 by the Royal Commission on the Constitution of the Commonwealth (reviewed by Professor K. H. (later Sir Kenneth) Bailey in Reading VII) had much impact on subsequent developments in intergovernmental relations. The Report of the Commonwealth Royal Commission is interesting chiefly because of the division among the Commissioners on whether a federal type of constitution should be retained or a unitary form of government adopted; four Commissioners favoured the former while three (including the two Labor representatives) favoured the latter. The Commission considered detailed proposals for constitutional amendment, extended Commonwealth powers, changes in parlia-
Fiscal Federalism

mentary and electoral machinery, and the establishment of new States, but seems to have given little consideration to financial relations between the Commonwealth and the States.

Notes

1 This reading has been reproduced from J. A. La Nauze, 'The Chariot Wheels of the Central Government', The Economic Record, November 1952, in the form as edited by Professor La Nauze but without including Professor La Nauze's own commentary on the background of Deakin's article.

2 Journals and Papers of the Parliament of Tasmania, Vol. 43 (1900), No. 56, and Vol. 63 (1910), No. 50. See also Craufurd D. W. Goodwin, Economic Enquiry in Australia, Duke University Press, Durham, N.C., 1966, pp. 480-3 (and pp. 630-1 for a brief account of discussions prior to federation). Johnston's conclusion was that the only 'true and natural' basis for Commonwealth payments to the States was compensation for fiscal losses arising from the transfer of customs and excise duties to the Commonwealth. It is interesting to note that compensation for fiscal losses arising from the transfer of State income taxes to the Commonwealth was in fact the basis adopted for reimbursement grants under the uniform tax scheme 32 years later. See Readings in Part IV below.

3 It is of interest to note that in 1922-23 income taxes still accounted for only £22.6 million (£12.9 million Commonwealth and £9.7 million States) compared with £32.9 million for customs and excise duties.
Further Reading

Articles

Books of Readings and Symposia

Monographs and Books

Official Documents
I

The Chariot Wheels of the Central Government*

settled, and by other means. A new boy at a public school has his place in class allotted to him, but he must win his way among his fellows outside and attain his real rank among them by fighting for it. So the Commonwealth could only make its authority good and could only extend it by force. Ever since its inauguration fifteen months ago it has been asserting its rights as against those of its component colonies, who had enjoyed up till then a practical independence. The trial of strength has proceeded quietly, but with steadily increasing stress and strain, until at last it is about to culminate in an open wrestle for mastery.

In the first instance there have been encounters between the federal Parliament and individual States on particular proposals. The Ministry and Legislature of Queensland sought for the indefinite retention of Kanaka immigration, Mr Philp and one or two members associated with the sugar planters personally visiting Melbourne to plead their cause. They failed so utterly that not a handful of supporters could be rallied in the House, and a barely respectable minority in the Senate. The next State that met in open combat was Tasmania. Mr Lewis, supported by a majority of his Legislature, protested in vain against the refusal of the federalised Post Office to carry to Hobart the remittances from all parts of the continent of those who desired tickets in the great 'Tattersall's' lottery established under a local law. The electors of the island are apparently equally indignant at what they consider to be a federal invasion of their self-governing rights, for they have just returned to the House in place of the late member, who was adverse to the lottery, a new representative who is heartily in favour of it. Yet the House of Representatives for its part is even more unanimous against allowing the Post Office to be made a means for continuing in Tasmania the gambling which has been prohibited in every other State than it was in putting a period to the introduction of Pacific island labourers from the South Seas. Other complications are now brewing.

Some months ago, a conference of State Premiers met at the invitation of Mr Barton to discuss the proposal made in his Property Acquisition Bill to pay the States for the properties taken over from them by the Federation with the Customs and Post Office. He offered something very like a mere book entry. Naturally enough, they declined to accept it or anything less than cash. They had expended large sums of borrowed money on the buildings and works of the transferred departments, and would still be required to pay interest on them. Why should they retain the liabilities when he took the assets? Incidentally they commenced to discuss other questions in which their joint interests were being affected by federal aggressions and to concert measures for united and systematic resistance to each and all
of them. Nothing was finally agreed then, but it was understood that the conference would assemble again at the end of last year, and the Prime Minister was lately requested to call the State Premiers together. This, however, he distinctly declined to do. If the Premiers chose to meet he would be happy to receive any representations or lend any assistance they might desire, but his Ministry was not prepared to meet them officially or on an equality as if the transaction of federal business belonged to any other than federal representatives elected for the purpose. His Cabinet and those of the States might properly consider together the completion of bargains between the Commonwealth and the States as such, but could not expect to discuss in the same fashion any legislative or administrative matter within the powers of the federal Parliament. Considerably disconcerted by this reminder of the difference of their spheres of action the Premiers, who had hoped to constitute themselves an Advisory Board to the Commonwealth, have not been able to rally since this polite rebuff. A great deal of correspondence has passed between them and a number of dates have been tentatively fixed, but so far no definite appointment has been made. The conference will meet before long, and will not be the last at which an attempt will be made to patch up an alliance, offensive and defensive, between the State Parliaments and Cabinets as against the Parliament and Cabinet created by the Union between the electors of all the colonies in the Commonwealth.

The weakness of any such combination lies in the circumstance that on many matters the State Ministries are hopelessly divided among themselves. Queensland alone wishes to retain Kanaka immigration, Tasmania alone is anxious to preserve 'Tattersall's' sweeps, just as in the tariff scramble South Australia alone seeks for a protective duty on salt, and Victoria on matches. All the remainder are in each instance antagonistic. It is therefore on few subjects only that organised action of the States is possible, and even in these instances the final word lies not with their Cabinets but with the electors of Australia as a whole, and with the majority in the Parliament representing them. The vapourings of the Premier of Queensland, the polite protests of Mr Lewis, the laments of Mr Butler as Treasurer of South Australia, or of our own Mr Waddell, are of no avail. Power has departed from them, and they are just discovering the fact. They might have been lulled in their repose a little longer had not the policy of pin pricks instituted by Mr Philp assisted to hasten the inevitable, and to tear away the mask that concealed his impotence and that of his fellow-Premiers. States in the great Republic are not overpowered by Congress, because their direct taxation is sufficient for their own needs, while the provinces of the Canadian Dominion enjoy under the British North America Act fixed annual subsidies from Ottawa. Their
finances are thus solely under their own control, and their independence is safeguarded against aggression. In addition to this, both States and Provinces are practically free from debt. Neither undertakes the many risks of State railways, waterworks, or the many minor enterprises which the Australian colonies have provided for their citizens at public expense. The Australian States have thus incurred liabilities the annual interest on which absorbs more revenue than they have been accustomed to raise, or are likely to raise, by direct taxes. They are therefore dependent on receipts from the customs, which are now out of their hands, to pay their way; in other words, they are dependent on the Commonwealth. It is true that for ten years to come they are entitled to a certain proportion of the duties collected by the Federal department, but this is already insufficient to maintain their existing establishments. After the decade they will be able to claim nothing as of right, and must be content with any amount the federal Parliament chooses to spare them. Subject, therefore, to the consent of the voters of Australia, the independence of our States is doomed.

The importance of the refusal of the House of Representatives to impose duties on tea and kerosene is that for the first time it demonstrates to the astounded politicians of the States the flimsy financial foundation on which they have been resting. Mr Barton’s election programme last year was properly Federal in its provisions and so far was it endorsed by Mr Reid that the several local treasurers had come to rely on its general acceptance as a matter of course. They had counted without the Labor Party, without Mr Reid’s defection for strategic purposes, and without the Protectionist dislike to merely revenue duties. The shock received has consequently been sudden and severe. The reflections it has begotten has been most uncomfortable. Assuming the Senate to accept the policy adopted by the House, every State budget will require to be revised. Their financial years will close on the 30th of June, with a quarter’s loss on two of their chief revenue-producing imports. The prospects for next year will be still more alarming. Mr Barton has announced that, should experience demonstrate the failure of the reduced tariff, to meet the necessities of the less populous States, he will again propose those imports or some substitute for them. But should he submit them they need not be passed. He had been defeated now, and may be equally unsuccessful then. It will not be safe for the States to count on any addition to their incomes. They must cut their coats according to their cloth as it is now diminished. All that the Prime Minister’s promise does is to introduce an element of embarrassing uncertainty into their calculations, which must be the despair of the prudent, and may be the apology of reckless, treasurers.
The federal Parliament — if its Chambers agree together — having tasted the sweets of supremacy — will not consent to finance the local treasuries except for value received. If it provides money for the States it will exact tribute from them in some shape. As the power of the purse in Great Britain established by degrees the authority of the Commons, it will ultimately establish in Australia the authority of the Commonwealth. The rights of self-government of the States have been fondly supposed to be safeguarded by the Constitution. It left them legally free, but financially bound to the chariot wheels of the central Government. Their need will be its opportunity. The less populous will first succumb; those smitten by drought or similar misfortunes will follow; and, finally, even the greatest and most prosperous will, however reluctantly, be brought to heel. Our Constitution may remain unaltered, but a vital change will have taken place in the relations between the States and the Commonwealth. The Commonwealth will have acquired a general control over the States, while every extension of political power will be made by its means and go to increase its relative superiority.

Anticipations of this kind, even if premature, have their uses. They explain many incidents otherwise irrelevant and point the direction in which the current of events is now sweeping. The political circumstances of Australia are singular and its developments are persistently misinterpreted by misleading analogies. Our economic situation differs absolutely from that of the United States or Canada in their earliest years or at the present time. Doubtless, our history, like theirs, will prove progressive, but it will be by different paths. When our droughts are dissipated or provided against, when our tariff is passed, and when necessary reductions of public expenditure have been insisted on, we shall have at least as favourable prospects before us as they had when they set up housekeeping. But in the meantime we have to pass through the federal crucible, from which we shall emerge with our States subordinated and with their institutions and political parties transformed, in some cases almost out of recognition. The process has already begun, although scarcely anyone seems to be aware of it. The narrow prejudices, the petty jealousies and miserable envies of our days of division have to be gradually crushed out under the play of the federal forces that were created by union, but at present they exist and require to be allowed for.

[There follows a discussion of the problem of the use of the River Murray waters, and of the difficulties of getting any agreed action among the States. 'Terms will be insisted on by our (i.e. N.S.W.) provincialists which the sister States cannot accept, and are not intended to accept. The whole enterprise is to be blocked if possible.']
It is doubtful if any of the States concerned will agree to remit the settlement of the question to the Commonwealth unless it were simply to give effect to a bargain between them complete in all its details and meeting with Federal approval. Such a bargain appears impracticable on the part of this State [i.e. N.S.W.] unless on impossible conditions. We have reached a deadlock. Those who criticize the divagations of the federal Parliament with scorn have reason to note how entirely incapable even three of the States are of arriving at an agreement in regard to a plain practical undertaking offering splendid prospects of permanent advantage to large portions of their territories. The Commonwealth may not work without a prolific crop of friction, blunders and heart-burnings, but at all events it does work, and, as reiterated experiences prove, is palpably the one and only way in which the States can be brought to act together. *Aut Caesar aut nullus.*

**Notes**

1. The persons mentioned, and the offices they held at the time the article was written, are: Alfred Deakin (Victoria), 1856-1919, Attorney-General of the Commonwealth; (Sir) Edmund Barton (New South Wales), 1849-1920, Prime Minister of the Commonwealth; (Sir) Robert Philp, 1851-1922, Premier of Queensland; (Sir) Elliot Lewis, 1858-1935, Premier of Tasmania; (Sir) Richard Butler, 1850-1925, Treasurer of South Australia; Thomas Waddell, 1854-1940, Treasurer of New South Wales; (Sir) George Reid, 1845-1918, Leader of the Opposition in the Commonwealth Parliament.

2. These are the sentences (not italicized in the original) quoted by Murdoch, *Alfred Deakin — A Sketch*, 1923, p. 234.
II
Origins of the Per Capita Payments

1. Proposal for a Fixed Grant to the States (Memorandum by Sir John Forrest, dated 25th September, 1905)*

The Honorable the Prime Minister.

In my Budget speech of the 22nd August, I said —

'Unless some arrangement can be made under which a fixed sum shall be returned to the States each year, it seems to me that we have no alternative but to continue the bookkeeping method — at any rate until the expiration of Section 87 of the Constitution.' (Hansard, p. 1211.)

And again —

'I am of opinion that the bookkeeping system will never be acceptable as a permanent system to the people of Australia. It hampers both States and Commonwealth, and although it has been serviceable and will do good service for years to come, it cannot be looked upon as a permanent arrangement.' (Hansard, p. 1211.)

And again —

'My judgment leads me to believe that it will be found advisable to consider whether it is not possible to adopt the Canadian plan

or some scheme which will be equitable and acceptable, under which it might be agreed that a fixed amount, subject, if necessary, to periodical adjustment, should be annually returnable to each State. If some such proposal could be given effect the Commonwealth and the States would be in a position of financial independence, and would be able to work out their financial problems in their own way.' (*Hansard*, p. 1217.)

2. The more I have considered this question the more I am convinced that the plan outlined in my Budget speech, and now proposed by the Premier of New South Wales (Mr. Carruthers), is the only one that will be permanently satisfactory to the Commonwealth and to the States.

3. It is scarcely likely that the Federal Parliament will continue the Braddon Clause beyond the 31st December, 1910, and, therefore, after that date, the whole Customs and Excise revenue will be at the disposal of the Commonwealth, subject only to the provision in Section 94 of the Constitution that 'the Parliament may provide on such basis as it deems fair for the monthly payment to the several States of all surplus revenue of the Commonwealth.'

4. The taking over by the Commonwealth of the State Debts is not necessarily connected with the return of any surplus revenue to the States, as, whether the Debts are taken over or not, the States will have to pay the interest. The necessities of the States in this respect cannot, however, be ignored by the Commonwealth, as they have at the present time to pay £8,400,000 annually in interest on their Public Debts, and largely rely upon the surplus returned by the Commonwealth to enable them to do so. There cannot in any case, I think, be any doubt as to the accuracy of the statement in my Budget speech —

'That the Commonwealth, with its great and exclusive power over Customs taxation, is in a far stronger and better position to deal with this great financial matter than are the States either collectively or separately.' (*Hansard*, p. 1216.)

5. But the taking over of the States Debts under Section 105 of the Constitution will in no way limit the spending power of the Commonwealth after the 31st December, 1910, as Section 105 provides that —

'The States shall indemnify the Commonwealth in respect of the debts taken over, and thereafter the interest payable in respect of the debts shall be deducted and retained from the portion of the surplus revenue of the Commonwealth, payable to the several States, or if such surplus is insufficient, or if there is no surplus, then the deficiency or the whole amount shall be paid by the several States.'
It will be noticed that the Constitution even seems to infer the possibility of there being no surplus returnable to the States by the words used, viz., ‘or if such surplus is insufficient, or if there is no surplus, then the deficiency or the whole amount shall be paid by the several States.’

6. Unless, therefore, some mutually satisfactory arrangement is arrived at between the Commonwealth and the States before the end of 1910, the States will have to rely solely upon the Commonwealth Parliament and not upon any legal obligation, in respect of the return of surplus revenue.

7. That being so, it is manifestly a very urgent and important matter for the States that no time should be lost in endeavouring to make a binding arrangement with the Commonwealth in regard to the amount to be annually returned to them after the end of 1910.

8. The duty of the Commonwealth and the States is, of course, to do that which is best for Australia as a whole, and viewing the question solely from that stand-point, the proposal foreshadowed in my Budget speech, and now submitted by the government of New South Wales, seems to me to be the only possible satisfactory basis for the future in the interests of both the Commonwealth and the States.

9. The proposals of the Premier of New South Wales (Mr. Carruthers) are —

   (a) The return of an adequate fixed amount of the Customs revenue to each State from the expiration of the Braddon Clause.

   (b) The continuation of the bookkeeping period to the end of 1910 (the expiration of the Braddon Clause).

10. The effect of this proposal would be that —

   (1) The States would be no longer under any financial obligation to the Commonwealth, and would know exactly what amount they were to annually receive.

   (2) The Commonwealth would have the responsibility of making its own financial arrangements, and of raising what revenue it required to carry out its obligations.

   (3) Both the Commonwealth and the States would have the burden of making both ends meet, and not as would be the case in the future if no arrangement is come to, that burden being altogether (as it is at present) placed upon the States.

11. The solvency and prosperity of the States must always be of vital importance to the Commonwealth Parliament, and therefore, although it may be thought by some that in giving favorable consideration to the proposals of the Premier of New South Wales (Mr. Carruthers) the Commonwealth is relinquishing some of its powers, I am of opinion that to do so will be to the advantage of Australia, and
2. Financial Problems of the Constitution, with Proposals for Solving Them (Summary of a Further Memorandum to the Prime Minister from Sir John Forrest, dated 9 July, 1906)*

SUMMARY
The following is a summary of the recommendations . . .

(1) That the State Debts, 'as existing at the establishment of the Commonwealth', amounting to about £202 millions (as provided by Section 105 of the Constitution), be taken over as soon as possible . . .

(2) That the balance of the total existing State Debts, amounting to about £35 millions, be 'taken over,' so soon as an amendment of Section 105 of the Constitution, enabling it to be done, is obtained . . .

(3) That Section 87 (the Braddon Clause) be not continued beyond the 31st December, 1910 . . .

(4) That after 31st December, 1910, up to 31st December, 1920, and thereafter until Parliament otherwise provides, the net Customs and Excise revenue be divided between the States and the Commonwealth as follows:—

The States to have —

(a) A guaranteed fixed annual payment for ten years to each State on the basis of three-fourths of the net revenue from Customs and Excise which that State contributed (excluding the special revenue in the case of Western Australia) during (say) the five years preceding such 31st December, 1910 . . .

(b) If three-fourths of the total net revenue from Customs and Excise in any year (not 'ear-marked') exceeds the aggregate of the guaranteed fixed payments to all the States — a per capita return of such excess . . .

(c) A per capita return of three-fourths of any surplus of 'ear-marked' net Customs and Excise revenue (new or additional) after providing for the specific purposes for which it was specially appropriated . . .

The Commonwealth to have —

(d) Subject to the annual payment of the guaranteed fixed sum

Origins of the Per Capita Payments

to the States one-fourth of the net Customs and Excise revenue (not ‘ear-marked’) . . .
(c) Any new or additional net Customs and Excise revenue, ‘earmarked’ for specific purposes . . .
(f) One-fourth of any surplus of ‘ear-marked’ net Customs and Excise revenue, after providing for the specific purposes for which it was specially appropriated . . .
(5) That the bookkeeping system should cease on 31st December, 1910 . . .
(6) That the States undertake not to borrow on the London market, except through the Commonwealth, up to 31st December, 1920 . . .
(7) That Sections 94 and 105 of the Constitution be amended or an agreement entered into between the Commonwealth and the States . . .

JOHN FORREST,
9th July, 1906.

(Paper presented to Tasmanian Parliament by the Government Statistician, Mr R. M. Johnston, 9 May 1907)*

Having summarised the various difficulties arising out of the incommensurate relegation of public functions and financial obligations, as compared with the relegated proportion of revenue-raising and controlling powers of States and Commonwealth respectively, it is made obvious that the failure, on the part of the latter, to take over such fair proportion of the public functions and financial obligations as would approximately correspond with its relegated powers to raise and control the major sources of revenue, necessarily involved the creation, and a return, permanently, to the States of a Federal surplus.

It cannot be too firmly grasped that this creation and return of a Federal surplus is the foundation of all our financial and other State difficulties, under the present bonds of Federation. If, therefore, we see a way whereby this primary difficulty may be removed, nearly the whole of the existing difficulties to States and Commonwealth disappear, and will leave each comparatively free and independent to manage the respective functions entrusted to it by the people, each one being supreme and unhampered within its own legitimate domain.

It is now pleasing to find that one of Australia’s ablest statesmen, Sir John Forrest, the present Acting Prime Minister, has a perfect

*Extracts reproduced from Journals and Printed Papers of the Parliament of Tasmania, 1907, Vol. LVII, No. 34.
grasp of our financial difficulties, which are mainly the outcome of the combined effect of the imperfect and unscientific provisions popularly known as the ‘Book-keeping System’ and the ‘Braddon Blot.’ Sir John Forrest frankly admits that the book-keeping system of distribution of the necessary surplus, as well as the ‘Braddon Blot’ provision for guaranteeing, in the aggregate, an adequate share of Customs and Excise revenue, ‘will never be acceptable as a permanent system to the people of Australia, for, apart from their imperfect and unfederal character, they unmistakably,’ as he asserts, ‘hamper both States and Commonwealth.’

Sir John’s ‘way out of the difficulty’ has many points of great value, and must receive the most respectful attention of all who would wish to see our financial and other difficulties satisfactorily disposed of. His own scheme, apart from the question relating to the transfer of all, or a portion, of State debts, has been clearly summarised by him in his splendid and comprehensive Budget Review for the year 1906-7

Sir John Forrest’s Scheme

There is much of sound wisdom in these provisions of Sir John’s, but there are practical difficulties which still remain to be surmounted before a satisfactory result can be arrived at.

Of objections that must be considered, it may be of some profit to consider the provision [4](a) by itself, which perpetuates in a crystalised or fixed form the evils of the ‘book-keeping’ form of distribution until the end of the year [1920] in its very worst form, so far as the needs of the smaller States are concerned, and even as regards the larger States, or rather as regards the aggregate returnable surplus to all States, per year, even with the additional per capita provision [4](b), there might possibly be an absolute shortage of more than £3,500,000 per year 20 years hence, as compared with the average which the Commonwealth actually returned to the six States during the four financial years ending in June 30, 1906.

There is more in this objection than appears on the surface, for it must be borne in mind that the absolute cost of carrying out the assigned and legitimate functions and obligations of government increases year by year, taking the average of a considerable period, by a fixed amount according to the ratio of increase of population. The cost per capita, on the other hand, varies very slightly, on the average, over a considerable number of years. To adopt, therefore, not only a fixed amount [4](a) on the basis of a standard lower by £996,663 per annum, but also to ignore the increasing needs of each caused by a population, whose normal increase of late years, on the whole, has been at the rate of 1.77 per cent per annum, is a grave oversight.
Apart from this, Why should the worst form of distributing the Federal surplus be perpetuated beyond the time originally contemplated by the framers of the Constitution [in Section 94].

In the year 1905-6 the amount of surplus ‘actually returned to the States’ represented 36s. 5d. per head of the population of the six States. So long as the States are responsible for carrying on 87 per cent of the functions and obligations of government, while only 13 per cent is carried on by the Commonwealth government, the former must claim at least a fairly commensurate share of the great source of taxation (Customs and Excise).

This share cannot be in fixed form, as regards aggregate amount, but should move onwards in harmony with the needs of a progressive population. The only way to harmoniously and effectively fix the share of this important source of revenue, to each State, and for all the States, would be to base it upon the ascertained average amount, per head, found to be necessary in the average of the immediately preceding years. If we, therefore, take the year 1905-6 as a base, whose surplus returned to the six States was exactly 36s. 5d. per head: Why should this standard not be chosen, for a time, to give assurance to the States that their finances would be secured, instead of a fixed amount incompatible with the growing needs of progressive States?

It is true that Sir John’s provision [4](b) promises a per capita return (additional) of any (if any) excess of the ‘three-fourths,’ but, as he himself points out, this provision is very unsatisfactory, for he affirms, in his admirable Budget address, that the Constitution even seems to infer the possibility of there being no surplus returnable to the States, by the words used, viz., ‘or if such surplus is insufficient, or if there is no surplus, then the deficiency or the whole amount shall be paid by the several States.’ [Section 105]

Of course this specially applies to transfer of debts, but, even under the Braddon clause, it might in some years injuriously affect the smaller States . . .

The Simplest and Best Way Out of the Present Financial Difficulties

(1) Abolish the hampering Braddon clause as soon as practicable, in favour of the fixed per capita return of 36s. 5d. per head to the States, so long as the 87 per cent of functions and responsibilities of States and Commonwealth, together, remain with the States.

(2) The Commonwealth to be free from the ‘Braddon clause’ trammels of the ‘not more than one-fourth’ of the Customs and Excise revenue, and in lieu thereof, to give her perfect freedom to determine what amount she will draw from the aggregate net Customs and Excise duties, subject to No. 1; also to be free to determine the tariff rate to secure the necessary aggregate revenue. The control of its
own expenditure — no longer affecting the necessary requirements of the States’ surplus — can then be safely left to her own citizen taxpayers and to her own Parliament.

(3) Discontinue, at once, the present unfederal, imperfect, and incomplete ‘Book-keeping’ method of returning a surplus to the States, and in lieu thereof make provision to distribute the surplus under the modified per capita basis . . .

This modified per capita scheme provides that if, at any time, the unmodified per capita scheme of distribution should happen to be unsatisfactory or inadequate to any State (owing, say, to some more or less temporary abnormality of the constitution of its population, as is now the experience of West Australia), let an arrangement be made, say for a period of three to five years, to make up the monetary inadequacy it might suffer through the operation of the ordinary or unmodified per capita scheme of distribution . . . and make a deduction from the total available surplus as derived from the assured 36s. 5d. rate (vide par. (1)), the balance of the available aggregate surplus then to be distributed to each State on a truly federal per capita basis.

The adoption of the modified per capita scheme for distributing the necessary Federal surplus briefly described in pars. (1), (2), and (3), together with the adoption of a fixed rate per head instead of a fixed amount, would at once remove all the financial and other difficulties which must ever attend any book-keeping system, and at the same time the fixed rate would accomplish all the good that was ever contemplated by the author of what is termed the Braddon clause, without hampering the freedom of the States and Commonwealth respectively, to manage the particular functions entrusted to them by the people, each being left supreme within its own realm.

While the modified per capita scheme differs in some of its details from either Sir John Forrest’s or from Mr Carruthers’ ideals, as already indicated, it is satisfactory to realise that it in all respects is in perfect harmony with the Federal spirit and statesman-like ideals of the Acting Prime Minister of the Commonwealth of Australia . . .

Another merit of the modified fixed per capita idea is that it would equally accommodate itself to any reasonable scheme for transferring all or a portion of the State debts to the Commonwealth.

Alternative Proposal for Transfer of State Debts
Instead of creating and returning to the States a federal surplus:

(1) Let the Commonwealth at once assume absolutely such a proportion of State debts, the interest obligation of which (say, 36s. 5d. per capita, as in the surplus distribution scheme) to be paid
directly out of Commonwealth *general Revenue* would be in exact correspondence with the proposed adequate surplus proposed to be returned to the States.

(2) In addition to the proportion of State debts so proposed to be assumed by the Federal government, let it also assume *the control and management of the whole of* remaining portion of the State debts, under terms to be agreed upon, but with the understanding that the interest for this or for any further additions to it will be a charge by the Commonwealth upon the respective revenues. The functions of the Commonwealth for this remaining portion of State debts will only embrace all responsibility as to renewals, consolidation, management, and control. The States, in proportion to the *per capita* of debt ascribed to each, will be responsible to the Commonwealth for their respective *per capita* proportions of interest thereon for such portion remaining which exceeds the, say, 36s. 5d. *per capita* limit which the Commonwealth assumes as her share of interest burden.

(3) The proportion of the total debt absolutely assumed by the Commonwealth, the interest obligation of which exactly corresponds with the 36s. 5d. *modified fixed per capita* surplus scheme, will be transferred equally on a *per capita* basis. Where any State's interest is above the limit of 36s. 5d. per head, it will be debited with the difference. When any State transfers under the limit (36s. 5d. per head) it will be credited by the amount which its own interest falls short of this limit. This simple but accurate and just method will ever be in accord, in the future, with the growing needs of the various States and the Commonwealth.

His Honour Mr Justice Clark,² from the inception of the ideal of Australian Federation, has ever advocated the transfer of State debts in some equitable way, as being the very best *way out* of all our financial and other difficulties. As his views upon this important matter are so valuable, the following extract from his pamphlet 'The Federal Financial Problem and its Solution,' published as a [Tasmanian] parliamentary paper in the year 1900, is given as a fitting conclusion to this report:

Mr Clark, in his valuable pamphlet, gives expression to the following views of this question of debts transfer:

My proposal for the solution of the financial problem of federation is, that the Commonwealth shall take over the largest possible proportionate amount of the public debt of each State, measured by population, and shall discharge each State from all
liability to provide, in any manner, for the payment of the interest of such transferred portion of its debt, or for the redemption of it at any future time. In other words, I propose that the proportionate part of the debt of each State, which shall be taken over by the Commonwealth, shall cease to be a part of the debt of the State, and shall become a part of the debt of the Commonwealth as fully and as exclusively as if it had been incurred by the Commonwealth for its own purposes, and that the interest upon it shall not be charged against the revenue collected by the Commonwealth in the State by which the debt was originally incurred, but shall be paid out of the total annual revenue of the Commonwealth, irrespective of the sources of any portion of that revenue or the place of its collection.

The final ground upon which I urge the assumption of the public debts of the States by the Commonwealth is that the financial dependence of the States upon a contribution from the Federal Treasury is contrary to the fundamental character of the type of federal government which the Constitution purports to establish, and if it becomes permanent, it will subjugate the whole financial policy of the Commonwealth to a consideration of its results upon the separate treasuries of the several States. But the assumption of the public debts of the States by the Commonwealth in the manner which I have proposed will put an end to all compensatory distributions of surplus federal revenue among the States, and therefore will put an end also to any consequent keeping of accounts between the Commonwealth and the States. The fundamental feature of the type of federal government exhibited by the Constitution of the Commonwealth is the perfect independence of the States and the Commonwealth inter se in the exercise of the governmental powers respectively assigned or reserved to them. To secure this result in its entirety, the financial independence of the States and of the Commonwealth inter se is indispensable. If a relationship of financial dependence on the part of the States is maintained between them and the Commonwealth, the financial policy of every State will be inevitably controlled by the financial policy of the Commonwealth, and questions of Federal politics will become intermingled with the local politics of every State to an extent which will make every political conflict in each State a reflection and repetition of a contemporaneous conflict in the sphere of federal politics. But this departure from the true ideal of federal government will not be confined to the subordination of the political life of the separate States to the politics of the Commonwealth. It will extend to the political life of the Commonwealth; and the intermingling of local and national questions will frequently cause the local questions to have a determining influence in the elections of members of the Federal Parliament; and thus produce a counter dependence of the politics of the Commonwealth upon the politics of the States.
The inevitable result will be a lower level of statesmanship in the Parliament of the Commonwealth than that which the national life of Federated Australia ought to evolve, and the predominance of provincialism in an arena into which it ought never to enter. If these observations are well founded, it is evident that the emancipation of the States from financial dependence on the Commonwealth means also the emancipation of the Commonwealth from the entanglements and drag-weights of the local politics of the States, and a free course for the Federal Parliament in the pursuit of the national welfare, and in the expression and manifestation of the national life and aspirations of the Australian people. This emancipation of the Commonwealth from influences that threaten to degrade its statesmanship and its legislation would be cheaply purchased by its assumption of the public debts of the States, and every debt taken over by the Commonwealth for that object would be a debt incurred to enable it to fulfil more perfectly the highest purposes of its existence, and, therefore, in the truest sense of the word, would be a debt incurred for the benefit of all the States.

R. M. JOHNSTON,
Government Statistician,
Tasmania.

9th May, 1907

4. The 1909 Financial Agreement*

Interstate Conferences

Since the establishment of the Commonwealth, conferences of State Ministers have been held from time to time, at which proposals for adjusting the financial relations between the States and the Commonwealth have been considered. At the conference held in Melbourne in October, 1906, and that held in Brisbane in May, 1907, the scheme put forward by Sir John Forrest was very fully discussed, and, in so far as the proposals for the allocation of surplus Commonwealth revenue are concerned, was, with some minor amendments, agreed to. The proposals made by Sir John Forrest for the transfer of State debts did not, however, meet with the approval of the conferences. After the retirement of Sir John Forrest from the Commonwealth Ministry, his scheme was abandoned by the Commonwealth Government. A fresh proposal by Sir William Lyne\(^3\) was substituted for it, and was considered by the Conference of Premiers held in Melbourne in 1908, who expressed their dissent from its provisions. A further Conference of Premiers was held in Hobart in March, 1909, at which a scheme was drawn up providing for the unlimited extension of the Braddon clause in an amended form, the amount returnable to the States to be not less than three-fifths of the gross revenue from Customs and Excise nor

less than £6,750,000 in any one year, and a special concession to be made in the case of Western Australia. In August, 1909, a conference between Commonwealth and State authorities was held in Melbourne at which an agreement was arrived at between the Prime Minister of the Commonwealth and the Premiers of the several States. This agreement was subsequently made the basis of a bill proposing an amendment of the Federal Constitution, which, during the session of 1909 was passed by the statutory majority in both Houses of the Federal Parliament. The matter will consequently be submitted to referendum on 13th April, 1910, in connection with the general elections to be held on that date.4

Terms of the Financial Agreement between Commonwealth and States

The exact terms of the agreement arrived at between the Prime Minister and the several State Premiers are as follows:—

In the public interests of the people of Australia, to secure economy and efficiency in the raising and the spending of their revenues, and to permit their governments to exercise unfettered control of their receipts and expenditure, it is imperative that the financial relations of the Federal and State governments — which, under the Constitution, were determined only in part and for a term of years — should be placed upon a sound and permanent basis.

It is therefore agreed by the Ministers of State of the Commonwealth and the Ministers of the component States in conference assembled, to advise:—

1. That to fulfil the intention of the Constitution by providing for the consolidation and transfer of State debts, and in order to insure the most profitable management of future loans by the establishment of one Australian stock, a complete investigation of this most important subject shall be undertaken forthwith by the Governments of the Commonwealth and the States. This investigation shall include the question of the actual cost to the States of transferred properties as defrayed out of loan or revenue moneys.

2. That in order to give freedom to the Commonwealth in levying duties of Customs and Excise, and to assure to the States a certain annual income, the Commonwealth shall, after the first day of July, one thousand nine hundred and ten, pay monthly to the States a sum calculated at the rate of one pound five shillings per annum per head of population, according to the latest statistics of the Commonwealth.

3. That in recognition of the heavy obligations incurred in the payment of old-age pensions, the Commonwealth may, during the current financial year, withhold from the moneys returnable to the States such sum (not exceeding six hundred thousand
pounds) as will provide for the actual shortage in the revenue at the end of the said year. If such shortage amounts to six hundred thousand pounds the basis of contribution by the States shall be three shillings per head of population in the pension States (viz., New South Wales, Victoria, and Queensland) and two shillings per head of population in the non-pension States (viz., South Australia, Western Australia, and Tasmania). If such shortage be less than six hundred thousand pounds the contributions shall be reduced proportionately per head of population as between the pension and the non-pension States.

4. That in view of the large contribution to the Customs revenue per capita made by the State of Western Australia, the Commonwealth shall (in addition to the payment provided for in paragraph No. 2) make to such State special annual payments, commencing at two hundred and fifty thousand pounds in the financial year one thousand nine hundred and ten and One thousand nine hundred and eleven, and diminishing at the rate of ten thousand pounds per annum. The Commonwealth shall in each year deduct on a per capita basis from the moneys payable to the States of the Commonwealth an amount equal to one-half of the sum so payable to the State of Western Australia.

5. That the Government of the Commonwealth bring before the Parliament during this session the necessary measure to enable an alteration of the Constitution (giving effect to the preceding paragraphs, Nos. 2, 3, and 4) to be submitted to the electors.

ALFRED DEAKIN, Prime Minister of the Commonwealth of Australia.

C. G. WADE, Premier of the State of New South Wales.

J. MURRAY, Premier of the State of Victoria.

W. KIDSTON, Premier of the State of Queensland.

A. H. PEAKE, Premier of the State of South Australia.

N. J. MOORE, Premier of the State of Western Australia.

N. E. LEWIS, Premier of the State of Tasmania.


5. The Surplus Revenue Act 1910*

Financial Arrangement between Commonwealth and States
The financial relations between Commonwealth and States are now regulated by the 'Surplus Revenue Act 1910,' which amended the 'Surplus Revenue Act 1908.' The most important sections are given hereunder in full:

*Extract from Official Year Book of the Commonwealth of Australia, No. 4, 1910, pp. 800-1.
3. From and after 31st December, 1910, section 87 of the Constitution shall cease to have effect, so far as it affects the power of the Commonwealth to apply any portion of the net revenue of customs and excise towards its expenditure, and so far as it affects the payment of any balance by the Commonwealth to the several States, or the application of such balance towards the payment of interest on the debts of the several States taken over by the Commonwealth.

4. (a) The Commonwealth shall during the period of ten years beginning on 1st July, 1910, and thereafter until the Parliament otherwise provides, pay to each State by monthly instalments, or apply to the payment of interest on debts of the State taken over by the Commonwealth, an annual sum amounting to twenty-five shillings [£1.25] per head of the number of the people of the State:

Provided that in the six months ending the 30th June, 1911, the Commonwealth may deduct from the amounts payable in pursuance of this section the amounts set out in the Schedule.

(b) If in order to comply with section 87 of the Constitution the sums paid and applied under this section during the six months ending on 31st December, 1910, amount to more than twelve shillings and sixpence [£0.625] per head of the number of the people in the several States, the amounts paid and applied under this section during the next six months shall be correspondingly reduced, so that the amounts so paid and applied during the whole of the financial year ending on 30th June, 1911, shall not amount to more than twenty-five shillings per head of the number of the people of the several States, less the deductions provided for in the proviso to the last sub-section.

5. (a) The Commonwealth shall during the period of ten years beginning on the 1st July, 1910, and thereafter until Parliament otherwise provides, pay to the State of Western Australia, by monthly instalments, an annual sum which in the first year shall be two hundred and fifty thousand pounds, and in each subsequent year shall be progressively diminished by the sum of ten thousand pounds.

(b) One-half of the amount of the payments so made shall be debited to all the States (including the State of Western Australia) in proportion to the number of their people, and any sum so debited to a State may be deducted by the Commonwealth from any amount payable to the State in pursuance of this Act.

Section 6 provides for the final payment of any surplus revenue there may be to the States 'in proportion to the number of their people.'
Section 7 provides that 'the number of the people' in any financial year shall be deemed for the purposes of this Act to be the number estimated by the Commonwealth Statistician as existing on the 31st December falling in that financial year.

The Schedule referred to in section 4, sub-section (a) is as follows:—

**THE SCHEDULE**

Amounts to be deducted from payments to the States in the financial year ending 30th June, 1911.

<table>
<thead>
<tr>
<th>State</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>£178,973</td>
</tr>
<tr>
<td>Victoria</td>
<td>143,092</td>
</tr>
<tr>
<td>Queensland</td>
<td>63,788</td>
</tr>
<tr>
<td>South Australia</td>
<td>30,529</td>
</tr>
<tr>
<td>Western Australia</td>
<td>20,113</td>
</tr>
<tr>
<td>Tasmania</td>
<td>13,505</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£450,000</strong></td>
</tr>
</tbody>
</table>

**Notes**


2. [Andrew Inglis Clark, 1848-1907. Attorney-General of Tasmania 1894-8; Justice of Supreme Court of Tasmania 1898-1907; Vice-Chancellor (Hon.) University of Tasmania 1901-3.]

3. [Sir William Lyne, 1844-1913. Premier of New South Wales 1899-1900; Federal Treasurer 1907-9.]

4. [The referendum proposal was defeated but the terms of the agreement were incorporated in the *Surplus Revenue Act* 1910.]
III
Some Problems of Taxation in Australia*

D. B. Copland

Need for Review of Taxation
Federation in Australia was not achieved without misgivings regarding the future powers of the member States. There was much opposition to proposals calculated to reduce the taxing powers of the colonies; yet it was impossible to restrict the taxing power of the Commonwealth. Believing that 'no Commonwealth can exist without possessing unlimited powers of taxation', as a delegate to the 1891 Convention declared, the founders of our Constitution gave the Commonwealth Parliament unlimited powers to make laws with respect to taxation, provided there was no discrimination between States or parts of a State.¹ At the time it was thought that indirect taxation through customs and excise would yield much more revenue than would be required by Federal authority, and by the famous Braddon clause (87 of the Constitution) it was provided that only one-fourth of the revenue from customs should be retained by the Commonwealth, the balance being paid over to the States. This was to continue for ten years and thereafter until Parliament determined otherwise.

In this way it was hoped that the revenue of the States would not be unduly disturbed and there was little thought of the Commonwealth levying direct taxation. But time and circumstance and the centripetal tendency of government have altered the situation beyond

¹Reproduced from The Economic Journal, September 1924, pp. 387-97.
recognition. By 1910 the federal government, despite increases in the tariff, was finding the arrangement inconvenient and Parliament reviewed it. For the succeeding ten years and until Parliament decided otherwise the States were to receive 25s per head of the population from the Commonwealth. In the same year the Labor government introduced land taxation with a double object of providing revenue and breaking up the large estates. This committed the Commonwealth to direct\(^2\) taxation, and on the outbreak of war further steps were taken. Succession duties were introduced in 1914, a federal income tax levied in 1915, and later a war-time profits tax and an entertainments tax. These measures were somewhat hastily devised to meet a pressing situation, and during the war there was little serious criticism of the financial policy of the federal government.\(^3\) But the situation was embarrassing to the States, there was much duplication of activities and many inconsistencies, and the steady increase in both State and federal taxation brought to light grave blemishes in the taxation system of the country.\(^4\) Up to 1919 the government had made some efforts to come to an understanding through conferences on at least five occasions of Premiers and Treasurers and taxation officers, and an agreement with respect to the collection of taxes had been entered into between the federal government and West Australia. It was all mere patchwork, and nothing less than a complete review of the whole problem would suffice. Hence the appointment in September 1920 by the federal government of a Royal Commission. The Commissioners chosen were representative of the commercial, farming and labour interests, and though some were recognised as close students of economics and had carried out social and economic investigations for the government, there was no recognised economist as such. This is generally the case in Australia, where the study of economics is still very backward despite the great interest of the average man in economic and social problems. But the evidence of the expert and the interested party alike was eagerly sought by the Commission, and business and commercial organisations throughout the country prepared memoranda or appointed official witnesses. Sittings were held in all the States and altogether 191 witnesses were examined. A great mass of evidence upon the trade and finance of the country was collected which, together with that collected by the Royal Commission on the Basic Wage in the same year, should provide a mine of information for the future research student. Unfortunately the evidence is not published, but the Commission has prepared five lengthy reports upon all problems relating to direct taxation as well as ‘the harmonisation of Commonwealth and State taxation’. It is with this latter problem, discussed in the Commission’s second report, and later the subject of an important conference of Commonwealth and State authorities, that this article is concerned.
Some Problems of Taxation in Australia

Taxation in Australia

Before dealing directly with this problem it is necessary to outline some of the main features of the taxation system of Australia. Customs and excise taxation is the prerogative of the federal Parliament, and thanks to the growing protectionist sentiment in the country it has been a fruitful source of revenue. The 1920 tariff schedule is the highest on record. Favoured by heavy importations and increases in prices, the customs and excise revenue rose from £21,574,559 in 1919-20 to £31,809,906 in 1920-21. This represents 61 per cent of the taxation of the Commonwealth and 44 per cent of that of the Commonwealth and States together. The position in recent years is shown in the following table:

<table>
<thead>
<tr>
<th>Year ended June 30th</th>
<th>Taxation by Commonwealth Government</th>
<th>Taxation by State Governments</th>
<th>Total Taxation</th>
<th>Percentage to total Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Customs and Excise</td>
<td>Other</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td></td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
<td>£'000</td>
</tr>
<tr>
<td>19110</td>
<td>11,593</td>
<td>—</td>
<td>4,115</td>
<td>15,708</td>
</tr>
<tr>
<td>19116</td>
<td>15,553</td>
<td>1,565</td>
<td>5,065</td>
<td>22,183</td>
</tr>
<tr>
<td>19120</td>
<td>16,934</td>
<td>6,599</td>
<td>8,142</td>
<td>31,675</td>
</tr>
<tr>
<td>19220</td>
<td>21,574</td>
<td>20,273</td>
<td>14,292</td>
<td>56,139</td>
</tr>
<tr>
<td>19221</td>
<td>31,810</td>
<td>20,617</td>
<td>18,204</td>
<td>70,631</td>
</tr>
<tr>
<td>19222</td>
<td>27,630</td>
<td>22,048</td>
<td>17,848</td>
<td>67,526</td>
</tr>
<tr>
<td>19223</td>
<td>32,872</td>
<td>17,013</td>
<td>18,740</td>
<td>68,625</td>
</tr>
</tbody>
</table>

N.I.B. — As already indicated, the proportions given in the last column are not to be regarded as indicating the relative importance of direct and indirect taxation. Taking the year 1922-23, income and probate taxes yielded £26,182,000 (see Table II). This leaves at total of £9,569,000 for land tax, other stamp duties, licences and all other taxes. Assuming half of this to be direct taxation, the direct taxes would amount to approximately £31,000,000, or 44 per cent of the total, and not 48 per cent as might be assumed from the above table if customs and excise be regarded as the only form of indirect taxation, as is frequently the case in public discussion in Australia.

An encouraging feature of this table is the general decline of the proportion of taxation through customs and excise. But the high tariff of 1920 and the slight reductions in Commonwealth income tax recently is having the effect of increasing this proportion again.

The relatively lower yield of indirect taxation indicated by this table is in line with developments elsewhere and in keeping with recent thought on taxation.
Fiscal Federalism

As noted above, the Commonwealth levies probate duties, land and income tax, entertainments tax and war profits tax. Land and income taxes and probate or succession duties and stamp duties are levied in all the States. In addition there are various licences and fees through which considerable revenue is obtained. The following table shows the amount raised by these taxes for the year ending 30 June 1923:

Table II
Taxation (other than Customs and Excise) in Commonwealth and States, 1922-23

<table>
<thead>
<tr>
<th>Taxation</th>
<th>C'wealth £'000</th>
<th>N.S.W. £'000</th>
<th>Vic. £'000</th>
<th>Q'land £'000</th>
<th>S.A. £'000</th>
<th>W.A. £'000</th>
<th>Tas. £'000</th>
<th>Total £'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probate and Succession Duties</td>
<td>1,173</td>
<td>1,175</td>
<td>697</td>
<td>257</td>
<td>205</td>
<td>46</td>
<td>57</td>
<td>3,610</td>
</tr>
<tr>
<td>Other Stamp Duties</td>
<td>2,019</td>
<td>3</td>
<td>393</td>
<td>418</td>
<td>197</td>
<td>80</td>
<td>97</td>
<td>3,207</td>
</tr>
<tr>
<td>Land</td>
<td>12,905</td>
<td>4,196</td>
<td>1,514</td>
<td>2,150</td>
<td>903</td>
<td>579</td>
<td>325</td>
<td>22,572</td>
</tr>
<tr>
<td>Income</td>
<td>917</td>
<td>723</td>
<td>19</td>
<td>54</td>
<td>71</td>
<td>54</td>
<td>60</td>
<td>1,898</td>
</tr>
</tbody>
</table>

This table shows that there are many differences in the taxation systems of the several taxing authorities. The varying emphasis given to the different taxes is due partly to the financial condition of the State (principally the burden of debt and the yield of public works) and partly to considerations of general policy. Some States have levied heavy land taxes or sought to obtain a large proportion of estates passing at death, whilst others prefer the income tax. Some, e.g. Queensland, have imposed a heavy burden on the upper classes, and others have relied as in Tasmania, mainly upon those of moderate incomes. Social purpose has entered largely into Budget policy, and the States have sought to a greater or less extent to promote a more equal distribution of wealth or to break up land monopoly and promote settlement. Some governments have attempted to use taxation as an instrument of social change, while others have been content to adopt the line of least resistance. In this way a great diversity has arisen, making very difficult any attempt to promote uniformity. Further complications arise owing to the varying necessities of the States. Space does not permit an examination of the geographic, economic and social factors that affect financial policy, but the conditions are by no means alike in all six States. Victoria, for instance, thanks to its relatively low debt, its land legislation, the more closely settled nature of its territory, the greater profits of its public works, and a long-standing tradition of careful and cautious finance,
Some Problems of Taxation in Australia

is able to ‘balance the ledger’ with a comparatively small income tax. West Australia, on the other hand, has an accumulated deficit which amounts to over £6,000,000, against which there is a sinking fund of nearly £9,000,000. Table III gives an interesting comparison of the sources of revenue and expenditure and debt in the several States.

### Table III

**Percentage of Revenue raised by Taxation and Public Works, Debt per Head, and Percentage of Expenditure upon Debt Charges, 1922-23**

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage of Total Revenue</th>
<th>Debt per head (30/6/23)</th>
<th>Debt Charges</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Taxation Per cent</td>
<td>Public Works Per cent</td>
<td>£</td>
</tr>
<tr>
<td>N.S.W.</td>
<td>22</td>
<td>63</td>
<td>84</td>
</tr>
<tr>
<td>Victoria</td>
<td>19</td>
<td>59</td>
<td>75</td>
</tr>
<tr>
<td>Queensland</td>
<td>26</td>
<td>45</td>
<td>112</td>
</tr>
<tr>
<td>S.A.</td>
<td>22</td>
<td>60</td>
<td>122</td>
</tr>
<tr>
<td>W.A.</td>
<td>14</td>
<td>56</td>
<td>170</td>
</tr>
<tr>
<td>Tasmania</td>
<td>34</td>
<td>40</td>
<td>103</td>
</tr>
<tr>
<td>All States</td>
<td>21</td>
<td>58</td>
<td>95</td>
</tr>
</tbody>
</table>

This table shows the varying yields of taxation and public works, and the great differences in the debt charges in the different States. Such divergencies increase the complexity of the problem already depicted in the statistics quoted in Table II above. But this may be more fully shown by a comparison of the yield per head of various taxes as under:

### Table IV

**Yield per Head of Taxes in the States and Commonwealth, 1922-23**

<table>
<thead>
<tr>
<th>State</th>
<th>Income Tax</th>
<th>Land Tax</th>
<th>Probate and Succession Duties</th>
<th>Total Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£  s. d.</td>
<td>£  s. d.</td>
<td>£  s. d.</td>
<td>£  s. d.</td>
</tr>
<tr>
<td>New South Wales</td>
<td>1 18 8</td>
<td>10 10</td>
<td>3 11 10</td>
<td></td>
</tr>
<tr>
<td>Victoria</td>
<td>19 1</td>
<td>8 10</td>
<td>2 11 3</td>
<td></td>
</tr>
<tr>
<td>Queensland</td>
<td>2 14 6</td>
<td>6 6</td>
<td>4 4 6</td>
<td></td>
</tr>
<tr>
<td>South Australia</td>
<td>1 15 2</td>
<td>8 0</td>
<td>3 10 10</td>
<td></td>
</tr>
<tr>
<td>West Australia</td>
<td>1 13 9</td>
<td>2 8</td>
<td>2 17 6</td>
<td></td>
</tr>
<tr>
<td>Tasmania</td>
<td>1 9 8</td>
<td>5 2</td>
<td>3 6 6</td>
<td></td>
</tr>
<tr>
<td>Commonwealth</td>
<td>2 5 10</td>
<td>4 2</td>
<td>8 17 1</td>
<td></td>
</tr>
<tr>
<td>General Average</td>
<td>4 0 2</td>
<td>12 10</td>
<td>12 3 8</td>
<td></td>
</tr>
</tbody>
</table>
It is not to be assumed that the figures in the last column indicate the relative tax burdens of the several States. This aspect of the problem has come into prominence recently owing to the appeal of Tasmania for further assistance from the Commonwealth government. With State taxation at £2 9s. 0d. (now £3 1s. 10d.) per head compared with an Australian average of £3 5s. 11d., it might appear that Tasmania had a weak case, but investigations carried out by the Government Statistician for Tasmania (Mr L. F. Giblin) have shown that the tax-paying capacities of the States differ greatly. Using the information available in the federal and State Income Tax Returns and the Census of Wealth and Income, 1915, Mr Giblin has computed an index of taxable capacity. The most valuable data for this purpose were found to be the assessments of the federal income tax, which, operating uniformly in all the States, gives a direct measure of tax-paying capacity for an income tax which in its graduation is fairly typical of the Australian State income taxes. Working on this basis Mr Giblin arrives at the following striking results:

Table V
Severity of Taxation in the States

| State               | Tax per head (1922-23) | Index of Tax-paying Capacity (1919-22) | Severity of Taxation, $A \times 1000$
|---------------------|------------------------|----------------------------------------|------------------------------------------
|                     | $s. \quad d.$         | $s. \quad d.$                          | $s. \quad d.$                            |
| New South Wales     | 71 10                  | 1006                                   | 71 5                                     |
| Victoria            | 51 2                   | 1158                                   | 44 2                                     |
| Queensland          | 84 0                   | 789                                    | 106 6                                    |
| South Australia     | 71 0                   | 1075                                   | 66 1                                     |
| West Australia      | 57 6                   | 867                                    | 66 4                                     |
| Tasmania            | 49 8                   | 588                                    | 84 5                                     |
| Six States          | 65 11                  | 1000                                   | 65 11                                    |

These results show very clearly how unevenly the burden of taxation is distributed and emphasise the great difficulties of promoting uniformity in State taxation or arranging a general scheme for the delimitation of spheres of taxation between State and Federal authority. Owing to the varying burdens of taxation any proposal, while offering relief to some States, will create hardships for others and the pressing financial needs of most States are at present an insurmountable obstacle to uniformity.
Harmonisation of Commonwealth and State Taxation
The most pressing and in some respects the most difficult question with which the Royal Commission had to deal was the delimitation of spheres of taxation by State and Federal authority. As noted above, much consideration had been given to this problem by the respective governments. In conferences from 1916 onwards consideration was given to the possibility of uniform returns, but this proved extremely difficult under the varying rates and scope of the taxes. In 1918, however, the taxation officers thought some scheme possible provided that a uniform income year and greater similarity in rates, deductions, etc., were adopted. It was proposed in 1919 to set up a single taxing authority, but opinion was divided on the question of control, some thinking that the rights of the States would be infringed. Later, in 1920, the Commonwealth Treasurer offered to collect the whole of the direct taxation at one-third of the cost at the time. Here again the States held back on the ground that their fiscal freedom would be restricted. The only real advance made in the matter was an agreement arrived at between the Commonwealth and West Australian governments whereby the former was to collect land, income and totalisator tax at one-third of the previous cost. Under the agreement the State Commissioner was to be responsible for the administration of the State laws, but all other officers were to be under Federal authority. The State Government was to be free to levy taxation as it pleased. Hence there would be two taxation acts though one collecting authority. Moreover, the arrangement undoubtedly strengthened the hands of the Commonwealth authorities. The Under-Treasurer of West Australia gave his opinion that the agreement was not ‘an amalgamation but an absorption, a surrender by the States of valuable rights and executive power’. This may be an exaggeration, but it sums up the attitude of those who stand by the rights of the States. They are to a large extent the property owners, business and commercial men and the opponents generally of the Labor Party, which works consistently for greater Federal authority. Everybody is agreed that there should be uniformity in taxation, one collecting authority for any one tax and a uniform return. But every proposal has broken down on the question of control. The Royal Commission rejected the West Australian agreement and passed over any form of joint collection as a permanent solution of the problem. ‘Only by a delimitation of spheres or allocation of subjects of taxation between the Commonwealth and the States can an ordered and satisfactory system of taxation be brought about in Australia’ (Sec. 240). Exclusive power of taxation by the States was objected to on the ground that ‘where any authority is receiving revenue it should be charged with the responsibility of determining the nature and
incidence of the taxation’ (Sec. 232). This is obviously sound, and federation would have been impossible without a recognition of this principle. But the Minority Commissioner on this point rather ignores this fundamental fact and proposes that the States should collect and levy direct taxation paying a per capita sum to the Commonwealth. Clearly the varying taxable capacity of the States renders such a scheme inequitable. Tasmania and West Australia would find it specially burdensome, and it would only serve to emphasise greatly the present diversity of taxes, rates, deductions, etc.

In favouring delimitation of spheres the Majority Commissioners were faced with a difficulty. Following Seligman and other authorities, they favoured income tax as the exclusive right of the Commonwealth. The soundness of this conclusion will become increasingly clear as the volume of inter-state trade increases. At present only 2 per cent of the taxpayers have incomes derived from more than one State. The proportion of tax paid by these taxpayers was about 25 per cent of the total for the years 1921-2 and 1922-3, and they would benefit greatly if income tax became the sole preserve of the States, their incomes being taxed in the State of earning. The problem is complicated by the inclusion of company tax, which must, more than personal income tax, be a Federal matter. Unfortunately, however, the States received £9,668,000 (1922-3) in income tax, while the total direct taxation other than income tax levied by the Commonwealth amounted to £4,108,000 only. Thus the States would lose some 5½ millions. They would be deprived of one of the most fruitful sources of revenue and their fiscal powers seriously impaired. Probate and succession duties, land taxes, amusement taxes and various licences being imposed for social as well as fiscal purposes should rightly be the province of the States. The States are responsible for land legislation, education, industrial legislation to a large extent, and general social control, and they should be able to use their fiscal powers in support of their general policy. But there will be some surrender of State rights in the proposal. The Commission suggests the above division of direct taxation as the ultimate solution. For the immediate future it recommends (i) that all direct taxation but income tax be surrendered by the Commonwealth, (ii) that income tax be levied by both State and federal authority on the basis of a uniform Act, (iii) that the Commonwealth be the collecting and administrative authority for income tax, (iv) that the Commonwealth retain the whole of the revenue from customs and excise, ceasing to pay the per capita sum of 25s. per head to each State, and (v) that during the early years of the scheme the Commonwealth should make such contributions to any State as may be necessary to adjust the finances of the State to the new conditions.
To anyone viewing the growth of federal power during the war some such scheme seemed inevitable. The present federal government, however, has worked more or less in the opposite direction. Early in 1923 it proposed to cease taxation of incomes of under £2000, giving over this field exclusively to the States. At the same time the per capita payments would cease and the States were to surrender their right to interest on properties transferred to the Commonwealth at the time of federation. It was pointed out that the burden of war charges prevented for the time being an entire abandonment of the field of direct taxation by the Commonwealth, but at some future time such a course might be possible. To this the States replied that the Commonwealth should retire from the field of income taxation and receive from the States, which would forgo their per capita payments, such a sum as might be required to meet any deficiency in the federal revenue. After much debate the Commonwealth modified its original scheme by agreeing to abandon all income tax except that upon companies at a flat rate of 12.5 per cent provided that the States would evacuate the field of company taxation to the extent necessary to enable the Commonwealth tax to be put on without increasing the total tax payable by companies. Each State was to be at least £100,000 to the good on this proposal, even if the Commonwealth had to make special contributions. This appeared a very good proposition from the point of view of the States, but certain obstacles prevented its immediate adoption: (i) the statistics of the amount of federal income tax collected in the States proved to be incorrect; (ii) there was no means of estimating the loss to revenue caused by taxing individuals separately on their earnings in each State; (iii) there was the probability of an increase in rates because of this loss and the fear that recipients of large incomes might escape; and (iv) some of the States were unwilling to meet the Commonwealth on the question of company taxation. New South Wales in particular stood out, though other States were generally sympathetic. Finally, the whole question was dropped until the figures for 1922-3 should become available. It is difficult to see how this can prove a satisfactory solution. It is opposed to the declared policy of the Labor Party, whose leader has intimated that he would not necessarily retain it, should Labor come into office. It will certainly weaken the powers of the federal government, which has generally taxed the wealthy at greater rates than have the States. There is no real solution of the problem of uniformity; both authorities continue to levy land, probate and succession duties, and the income taxes will differ greatly in the States. A revision of the federal Constitution is long overdue, and if it should result in strengthening the hands of the federal government, this surrender of taxing authority will almost certainly be revoked eventually.
Having failed for 1923 in its attempt at a reconstruction of the taxation system, the federal government turned to the question of income tax collection. It has now entered into an agreement with the State governments whereby they will collect the federal income tax, and a uniform return has been issued. Both assessments will be issued at the one time and the taxpayer will be relieved of the expense of the double returns and payments. Each government is free to make its own taxation laws, but the hope is expressed that there will be a tendency towards uniformity. The most likely way of achieving this is by the States agreeing to the provisions of the federal Act, but as administration is in the hands of the States there will be a tendency for the individual States to press the federal government to modify its law in their favour. It is generally admitted that the federal taxation department was efficiently organised and that it offered more protection to the revenue than the State departments. In view of this and of the inevitable centripetal developments of federal government, this agreement would appear to be a step backward. The federal taxation department still collects company, land and amusement taxes and probate duties, and it would be a comparatively simple matter for any government favouring the collection of income tax by federal authority to restore the powers of the department in this respect.

Notes

1 Throughout this article ‘State’ refers to the six members of the Commonwealth of Australia, originally independent colonies.

2 It may be argued that the land tax is not strictly a direct tax in that the whole incidence does not fall upon the landowner. In general it is very difficult to classify taxes into two well-defined groups, and the widespread assumption that State taxation is wholly direct is not quite correct. For example, a State entertainments tax is clearly indirect. But in general the State taxes are largely direct, while the main forms of indirect taxation levied by the Commonwealth are customs and excise duties. All other taxes will be regarded as direct, and the words ‘direct’ and ‘indirect’ are used throughout this article in this sense.

3 It is not suggested that the Labor Party when in opposition did not repeatedly censure the government; its criticism with respect to loans and taxes was relevant, but the government was merely following the policy inaugurated by the Labor Party when in office.

4 Taxation per head increased as follows:

<table>
<thead>
<tr>
<th>Year ending 30 June</th>
<th>Commonwealth</th>
<th>State</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£  s. d.</td>
<td>£  s. d.</td>
<td>£  s. d.</td>
</tr>
<tr>
<td>1911</td>
<td>3 4 10</td>
<td>0 19 0</td>
<td>4 3 10</td>
</tr>
<tr>
<td>1921</td>
<td>9 13 9</td>
<td>3 7 3</td>
<td>13 1 0</td>
</tr>
<tr>
<td>1923</td>
<td>8 19 1</td>
<td>3 4 7</td>
<td>12 3 8</td>
</tr>
</tbody>
</table>
5 In Queensland both are levied, in South Australia succession duties only, and in all other States probate duties.

6 Tasmania taxes a licensed lottery, most of the investments in which come from outside of Tasmania. It is computed that 18s. per head is derived in this way, and hence the Tasmanian taxation per head should be £2 8s. 6d. This is the lowest of the States, but increases in taxation in Tasmania estimated at 13s. 4d. per head have been imposed recently.

7 Pamphlet on 'The Taxable Capacity of Australian States'.

8 Excluding lottery tax, the burden of which is distributed over all Australia. The recent increases in taxation make this figure approximately 61s. 10d. and the corresponding figure in the last column would then be 105s. 2d. (Pamphlet, pp. 12, 15). The difference between the figures in Column A and those in the last column of Table IV are due to taking the mean population for the former and the population at 31 December for the latter. For the purpose of estimating taxable capacity, mean population is necessary for Tasmania, which has a large tourist immigration in December.

9 Report of Royal Commission on Taxation, p. 74.

10 An interesting constitutional point arises in connection with this proposal for a per capita contribution by the States. The Constitution provides that there shall be no discrimination in taxation between States and parts of a State (Art. 51). Surely a tax per head would in effect be discrimination, and for Tasmania very drastic discrimination. That State would pay almost double the amount now paid in federal income tax. Conversely the per capita contribution is in effect discrimination in favour of Tasmania. This consideration is a serious argument against a proposal for per capita contributions by the States, though it would doubtless be regarded as permissible under the Constitution.


12 Assuming that the collection of income tax by the Central Federal Office is confined to such taxpayers.

13 Proceedings of Conference of Commonwealth and State Ministers, 1923, p. 4.

14 Proceedings of Conference (Statement by Prime Minister), pp. 25-6.
Federation and Finance*

L. F. Giblin

Financial Provisions of the Australian Constitution

The financial relations between the component States and a federal government may not take up many of the pages of a federal constitution, but they are the chief determinant of the character of the federation. The conferring of large powers upon the central government may be of little avail, if no means of revenue are provided sufficient to put them into action. On the other hand, if wide financial resources are in the hands of the central government, a way will be always found to extend its powers, even without a formal amendment of the constitution. ‘The necessities of a nation, in every stage of its existence, will be found at least equal to its resources.’

The financial difficulties of a loose confederacy led to the Convention of Annapolis, from which sprang, at one remove, the United States of America. Financial relations gave most trouble in the federating of Canada and of Australia. In Australia the problem has remained the subject of acute controversy for 25 years and still awaits a satisfactory solution. It may be profitable, then, to attempt a brief inquiry into the proper financial relations of States to a federal Commonwealth. Such general principles as may help to a judgment in the matter will be most easily brought out by considering the familiar

*Reproduced from The Economic Record, November 1926, pp. 145-60 (originally presented as Presidential Address to Section G, Australasian Association for the Advancement of Science, Perth, August 1926).
structure of our own Federation, and comparing it with that of other federations under roughly similar conditions.

The essential features of Australian federation are given in the simple statement that the central government has exclusive power of customs and excise taxation, but for all other taxation Commonwealth and States have concurrent powers. To this must be added the proviso against preference being given to one State over others in any matter of taxation, trade or commerce. It is true that the central government has other exclusive sources of possible revenue, currency and coinage and the post office. These, however, are relatively unimportant, and practically, in normal times, incapable of expansion. The control of currency does indeed give to the Commonwealth in emergency the enormous reserve power of inflation, by which what is in effect a capital levy can be made in a form, easy and effective, and thoroughly pernicious. But in this, as in many other matters, it is unprofitable to dwell on the theoretical possibilities of the abuse of its powers by a central government. I may remind you of Alexander Hamilton’s classical statement of the argument (Federalist No. xxxi.):

I repeat here . . . that all observations founded upon the danger of usurpation ought to be referred to the composition and structure of the Government and not to the nature and extent of its powers. The State Governments by their original constitutions are invested with complete sovereignty. In what does our security consist against usurpation from that quarter? Doubtless in the manner of their formation and in a due dependence of those who are to administer them upon the people. If the proposed construction of the Federal Government be found upon an impartial examination of it, to be such as to afford, to a proper extent, the same species of security, all apprehensions on the side of usurpation ought to be discarded.

Practically, then, the important provisions of the Constitution are the exclusive power of customs and excise, and the concurrent powers of other taxation. Control over customs and excise revenue was indeed to some extent qualified and limited. But these qualifications and limitations were all strictly temporary, and due largely to the necessary difficulty in launching on the moment a fully equipped government. It was clearly wise that the central government should not attempt to carry out at once all the functions assigned to it by the Constitution in the 39 articles of Section 51 (some of which, in fact, are still dormant); and this principle was enforced by restricting its expenditure for the first ten years to one-quarter, at the outside, of the net income from customs and excise.
But after the first ten years, the control of the revenue from customs and excise was left absolutely in the hands of the federal Parliament. No doubt but it seemed probable to the people of 1900 that a considerable though decreasing share of customs and excise would be returned to the States for many years after 1910. A vision of the world war of 1914-1918 might have modified substantially that expectation. But whatever were their speculations as to the future, there is no doubt that by the agreement made in 1900, the States were deliberately exposed after 1910 to the working of the simple scheme, exclusive power over customs and excise for the central government, and concurrent powers for other taxation. This principle was confirmed in 1909 when the people of Australia, by a referendum, refused to make it a constitutional obligation on the Australian government to pay to the States annually 25s. per head of their populations.

A point to be particularly noted in the financial scheme, with the proviso against discrimination between States, is the assumption that the States in the long run would be, in proportion to population, of equal financial strength. The Constitution does not contemplate the possibility that any State should be (except temporarily) less able than its neighbours to take its full share, on a population basis, of federal responsibilities, whether from natural inferiority of material resources or from the federal scheme working to its disadvantage. Great anxiety was certainly felt over the difficulty of adjusting State finances to the new conditions, and the Constitution reflects this feeling. For 10 years, the States were guaranteed a large share in customs and excise revenue. Western Australia was allowed for five years to impose her own tariff, with certain limitations and on a diminishing scale, upon goods imported from other States. The ‘book-keeping’ clause provided that for five years (extended by Parliament to nearly nine) the States should receive the surplus revenue from customs and excise in proportion as they contributed it. All these provisions show a clear expectation that the need for them would be temporary; and their tendency is to safeguard the position of the more prosperous States rather than to give help to those less fortunately situated.

The sole provision for possible inequality in the financial strength of States is contained in Section 96, which provides for special assistance to States at the discretion of the Australian Parliament. Though the power to give such assistance is not limited in any way, the curious wording of the Section suggests strongly the expectation that special assistance was most likely to be required only in the early years of federation, before full adjustment had been made to federal conditions. The Section reads as follows:

During a period of ten years after the establishment of the
Commonwealth and thereafter until the Parliament otherwise provides, the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.

Strictly interpreted, the words down to ‘until the Parliament otherwise provides’ appear to give to Parliament after ten years the power to terminate its own power to give special assistance; and as Parliament is never likely to diminish its powers by its own act, these words are in practice inoperative. This is the view of Quick and Garran. But it cannot have been the intention of the clause. The words referred to were prefixed to the rest of the Section (which had previously been rejected by the Melbourne Convention), presumably with some intention of limiting its operation. We may guess that the intention was to empower the Commonwealth to give special assistance during the first ten years in the shape of an annual grant, which would continue when the ten years were ended, until it was terminated by Parliament. In any case, the expectation that special assistance would be required pre-eminently in the early years is indicated with reasonable certainty.¹

This assumption of the temporary nature of any comparative financial weakness in a State, which runs through the original Constitution, has persisted in all subsequent parliamentary action. The special grant made to Western Australia at the close of the “bookkeeping” period was made to diminish annually until it ceased. A similar provision attached to the special grant now being made to Tasmania. The new special grants proposed for these States are for two years, unqualified by the words ‘and thereafter until Parliament otherwise provides’. The recent proposals for terminating the per capita payments offered temporary assistance to certain States to give time for ‘adjusting’ their financial arrangements to the new conditions, but contained no acknowledgment of the permanent nature of the financial loss they would suffer.

This assumption of equal financial strength in the federating States is not confined to the makers of the Australian Constitution. Whenever federation is in question, circumstances seem to force the chief actors to a similar assumption. Federation is never easily achieved. There is a natural dislike to losing independence, and sinking individuality, which must make any closer union difficult, even among States of the most similar characteristics, and with the most friendly mutual relations. No amalgamation of clubs or schools is popular, however convincing the benefits that will follow. Battalions of the A.I.F., when seriously reduced in numbers in 1918, reached the point of actual mutiny rather than join up with a familiar battalion of the same Brigade. With States, mutual knowledge is
wanting; trade rivalries and jealousies reinforce the workings of the primitive ego; and in general only some external danger can break down, and that with difficulty, the natural barriers to union.

Difficulties Imposed by Inequality of State Resources

The prospects of federation are certainly brighter when the States are of an approximate equality in material resources, absolutely, if possible, but at least in proportion to population. The first attempt at federation in America, the New England Confederation of 1643, owed its inefficiency and final collapse very largely to the preponderating importance of Massachusetts, with resources greater than those of the three other members combined. There is therefore at the outset amongst the zealots for federation a willingness to forget as much as possible any disparity in the federating States. As discussion proceeds and difficulties multiply, consideration for the best possible scheme has to give place to what is practicable. Financial difficulties are likely to be the worst. The settlement of financial relations almost broke up the negotiations for Canadian federation, though failure might have meant the separation of Eastern Canada from the Pacific by an intrusive wedge of the United States. Under such circumstances, it is impossible to attempt any fully thought-out plan for permanent automatic regulation of the financial relations of central and State governments. The very possibility of federation is in the balance. The paramount necessity is to soothe the fears of the separate States as to the immediate effect of federation on their finances. The future must be left for the federation itself to provide for. The essential thing is that the Constitution should leave the road open, or at least that amendment of the Constitution should not be made impracticably difficult.

In the federating of the United States, the winning card was the population basis. 'Per capita' became almost a talisman. Honour and proper pride forbade the representative of any State to demur at this guiding principle. In the end it was imposed on the federation as a very rigid bond. Taxation could be levied only in proportion to the population as measured by the Census, and the United States was unable to face the financial problem of the European war without an amendment of the Constitution. So in Australia, the per capita basis for distribution of surplus revenue was adopted in 1909 — not as the best but as the one rousing least hostility from the States. In making the South African Union, though the circumstances of union rather than federation made it less important, the financial problem may almost be said to have been evaded; and the Union is now engaged in finding a satisfactory solution. The experience of Canada will be considered in more detail below.
In 1910 the working out of the financial scheme had resulted in the following position. The Commonwealth had only to an unimportant extent exercised its powers of taxation other than customs and excise taxation. The bulk of its revenue was derived from this source, and the contribution was assumed to be approximately equal per head of population throughout the Commonwealth. Western Australia had been considerably higher than the average, but was rapidly coming to the common level. Tasmania was somewhat below the average, but there was some ground to think that she was coming up to it. Taxation was therefore roughly in proportion to population, and the distribution to the States of surplus revenue was on the same basis, except for special grants for a limited number of years to Western Australia and Tasmania. The States were therefore sharing the financial burden of federation in proportion to population. The dogma of equal financial strength in proportion to population was in full force with only very minor qualifications.

Obviously this dogma had no basis in fact. Countries of the same race and civilisation are not of necessity equal in wealth or material resources, and if they contribute in proportion to population to a common cause, the burden will be very unequally felt. No such basis would ever be assumed for contributions to international organisations, such as the League of Nations. When Ireland received Home Rule, not even the bitterest opponent of Irish Self-Government proposed that she should be asked to carry any but a very small fraction of her per capita liability for the public debt of the United Kingdom. No agricultural portion of England or any other highly civilised country could possibly pay its share of the expenses of government on a population basis. The Report of the New State Commission for New South Wales shows the same financial difficulty in planning the organisation of an agricultural district into a new State.²

Even if States are equally well endowed naturally, they may be at very different stages of development, so that equal contributions would not be equitable. To a still greater degree may inequities come about because federal policy suits some States more than others. Particularly is this the effect of a high protective tariff. We have seen the growth of the Atlantic States in America at the expense of South and West; and of Ontario and (in part) Quebec at the expense of the Maritime Provinces and (in part) the West. So in Australia it was only to be expected that a protective tariff would be of the greatest value to Victoria but would be a burden, with hardly any compensation, to Western Australia.

In the case of a State with less than average advantages in material resources, federation may bring difficulties beyond those imposed
directly by federal policy. A poor State, while independent, has more liberty to cut its coat according to its cloth. Faced with adverse conditions, it may ‘forswear sack and live cleanly.’ It may practice economy in government and other expenses with perhaps no serious lowering in essentials of the basic standard of living. All this becomes more difficult under federation. In a hundred ways, directly and indirectly, the standard of expenditure is forced up. In many respects, though not in all, the changes may be for the better. But they all cost money, and a State which managed in the old days to live within its income, in peace if not altogether in comfort, may under federation go about in fear of the bailiff. Probably such rise in standard was inevitable. It would have come gradually in any case from geographical propinquity, and the war would have given impetus to the upward movement. But federation would have anticipated the natural process and so will appear the sole agent and get the whole blame for a disquieting and persistent failure of receipts to balance expenditure.

With States differing so widely as the Australian States in area, climate, development and natural resources, fairly wide divergencies in wealth might be expected in any case. Twenty-five years of federation will in general, on the preceding argument, have accentuated these inequalities, but in some cases may have levelled them down. The actual position can be tested with sufficient thoroughness by statistics.

The most searching test would be a comparison of income per head in the different States. The absence of information as to interstate trade for four of the States forbids any comparison of consumption or private expenditure in general, but there are a number of items — Savings Bank deposits, Bank clearings, consumption of alcohol, use of motor-cars — for which comparable information is available, and these may be used to check the comparisons of income. Total value of production is also available, but this figure must be used with caution.

Without going into detailed explanation, I may put before you the bare results of these tests.

Fig. 1 gives in graphical form a comparison of the amount of federal income tax assessed per head in the different States from 1914-15 to the present time. Very similar results are obtained from the less important land tax and estate duty. So that these income tax results may be taken as a measure of comparative taxable capacity for all direct taxes of the graduated type which are commonly used in Australia, both for federal and State purposes. In the graph, so as to get comparable results with a varying severity of taxation, the amounts of income tax assessed per head in each State for each year are expressed as a percentage of the average amount assessed per head.
for all the States together, and these percentages are plotted as indexes of taxable capacity. So that the index 80 indicates assessments per head 20 per cent below the average, and 120 indicates 20 per cent above the average.\(^3\)

The table below gives a number of other tests which may be used to check that given by income tax assessments. The value of production per head would give the most searching comparison, but the figures for this are computed independently by each State, and complete harmony in their methods of computation has not yet been achieved. The other tests are to a less degree pure tests of material prosperity and are affected by irrelevant factors. On the whole, however, they confirm in a striking degree the differences indicated by income tax assessments. The average amount or number per head for all States is in each case taken as 100, and the figures for individual States expressed as a percentage of it.

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**Fig. 1** Movement of Index of Relative Tax-paying Capacity, 1915-23. For each year, the Index shown graphically is the mean for the year in question, the year before, and the year after.
Prosperity Comparisons Per Head of Population

<table>
<thead>
<tr>
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<th></th>
<th></th>
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<td>N.S.W.</td>
<td>98</td>
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<td>122</td>
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<td>—</td>
<td>82</td>
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<td>W.A.</td>
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<td>109</td>
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<tr>
<td>Tas.</td>
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<td>35</td>
<td>74</td>
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<tr>
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<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Where gaps occur in this table, the information is not available. The value-of-production index must be used with reserve. Five States make independent estimates for themselves, and these do not appear to harmonise with the Commonwealth Statistician’s estimate for Australia, on account of variations in method. The base 100, therefore, refers in this case to the mean of the five States. It is expected that reasonably uniform figures will be available next year for all States. This index, of course, takes no account of activities in commerce and finance, nor of accumulated wealth, and therefore understates the position of Victoria and New South Wales in comparison with more purely producing States. In the case of alcohol, also, there are only independent estimates for four States, but the base 100 here refers to the Commonwealth Statistician’s estimate for Australia. The index is based on quantity of absolute alcohol, rather than on values, so as to eliminate possible variations in the method of valuing.

The Per Capita Principle of Distribution

It is quite clear that a *per capita* system of taxation and distribution could not be equitable with such variations of wealth as these comparisons indicate. Before, however, tracing the Australian development further, it will be of interest to consider now Canada dealt with a similar problem.

The difficulty in Canada was less acute — partly because the needs of the Provinces, with their limited functions, were much smaller than those of the Australian States, and partly because all provincial debts were taken over from the outset by the Dominion.

By the British North America Act of 1867, the provinces were given powers of direct taxation, though it was expected that they would not need them and would pay their way from the public domain and a subsidy from the central government. But this subsidy was never on a strict *per capita* basis. Discrimination by a sliding scale in favour of the less populous provinces was the principle adopted. Two years later the scale was varied to give better terms to Nova Scotia, and during the next four years the benefit was extended to other Provinces. In 1907, in a new British North America Act, the system was revised on
the same principle, with additional provision for British Columbia, which was somewhat in the position of Western Australia in our own Federation. In 1912, further variation was made in favour of Manitoba and Prince Edward Island.

It is of importance to remark that although the Canadian subsidies are small compared with per capita payments here, they form much the same proportion of provincial revenues as per capita payments do of our State revenues. The subsidies are about 12 per cent of the revenues of Quebec and Ontario, and 25 to 30 per cent for all the others, except Prince Edward Island, for which the percentage is very much higher.4

The figures for Australian States are, of course, much nearer a level. Deducting the revenue from Public Works in order to get a fairer comparison with Canada, the per capita payments make the following proportions of the remaining revenue:

<table>
<thead>
<tr>
<th>State</th>
<th>Per Capita Payments as % of Revenue, 1924-25</th>
</tr>
</thead>
<tbody>
<tr>
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<td>14</td>
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<tr>
<td>Tasmania</td>
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<td>Victoria</td>
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</tbody>
</table>

It is of interest to note here that in English local government: about 15 per cent of the revenue now comes from the central government, a proportion very similar to those given in the above table. Even with the special grant added, the Tasmanian figure would come up only to 19 per cent. With the new proposed special grants to Western Australia and Tasmania the proportions would be in each case: about 30 per cent or approximately the figure for the majority of the Canadian provinces.

Further revision of the Canadian scale seems not unlikely. The provinces have long found their original sources of revenue inadequate and hitherto have supplemented them chiefly by taxation of companies, especially insurance and banking — taxation which has been often crude, sometimes extravagant and always irritating to commercial interests.5 The limit in this direction appears to have been reached, and the alternative is a straight-out income tax system or increased subsidies from the Dominion. The Maritime Provinces on the one hand, and British Columbia on the other, are putting forward claims for special consideration, which also require a revision of the existing scale.
Canada, then though with less at stake, has deliberately avoided the strict *per capita* principle and adopted a method of subsidy which systematically, though a little crudely, helps out those provinces which are financially backward — whether temporarily or permanently, whether from defect of natural resources or by the workings of federation.

We left Australia in 1910 committed to the *per capita* principle — assumed to be holding approximately in taxation through customs and excise, and carried out exactly in distribution, with temporary alleviations in the cases of Western Australia and Tasmania. Then came the war, with a steeply-graded federal income tax, increasing in severity from year to year; and a similar tax on estates passing at death and on war-time profits. Logically, on principle, the *per capita* payments should have stopped first, because there was no surplus revenue to return. But logic and principle had few friends by the second year of the war, and the easier course politically was to retain them and impose sufficient new direct taxation to cover the cost. So at the end of the war we were left with the direct federal taxes and the *per capita* payments. But the *per capita principle* had disappeared. The income tax (and the other taxes very similarly) were collecting revenue on the basis of taxable capacity and the *per capita* payments were returning in proportion to population. The graph in Fig. 1 shows what was happening. One State was contributing twice as much per head as another State, but all were receiving back the same. It may be said throughout the last ten years that Tasmania has been paying 15s. per head and receiving back 25s. per head; which is equivalent to a subsidy of over £100,000 per annum. Queensland and Western Australia were in the earlier years paying as much as 30s. per head for the 25s. returned to them; but in the last two or three years have been paying only about 20s. for the same benefit and so have been receiving subsidies of roughly £200,000 and £100,000 per annum respectively. In these same years it has been Victoria and South Australia in particular that have furnished the necessary surplus for the purpose. It is clear, then, that the combination of federal direct taxation with *per capita* distributions to the States makes an adjusting factor of the greatest nicety. So long as the federal tax is uniform and uniformly administered in all the States, it cannot go wrong. The State which is flourishing at the time (or more precisely in the previous year) will pay more than the average, and the State which has had a bad year will pay less. The adjustment is automatic. It has the great additional advantage that it does not force itself upon our consciousness. No one is aware of the beneficent process which is going on. The right hand of the richer State does not even know what itself is giving. You may recognise almost the same unconscious poral bountifulness which was
affirmed by Sir Willoughby Patterne. Commonsense, of course, would expect some such general effect, but it is only by digging into the somewhat forbidding tables which the Commissioner of Taxation publishes from time to time that the full measure of this automatic adjustment can be appreciated.6

In manner and quality this method of adjustment between States is beyond criticism. But clearly it does not at present go far enough. Discrimination to the extent of £100,000 or £200,000 is not enough to adjust the financial inequalities of States. Collections by the federal government on a taxable capacity basis should be larger — both absolutely and relatively to customs and excise; and distributions to States on a per capita basis should be larger also. The extent to which these two movements could be carried with due regard to other principles of taxation is a difficult and complicated problem, which cannot be attempted here. But indications can be given sufficient for a first step in these directions.

In Australia, customs and excise taxation, which is very roughly on a per capita basis, makes 50 per cent of total federal and State taxation. Judging from general practice, this proportion is excessive from the point of view of equitable taxation. Probably 30 per cent would be a fair figure — 40 per cent at the outside. The inference from this is that when federal taxation is lightened, it is not the income tax which should be cut down but customs and excise duties. The protective part of the customs duties must, of course, stand or fall on other considerations. But a large proportion of customs and excise comes from purely revenue duties, which can be reduced without interfering with the protective tariff.

More important is the question of 'direct' taxation, meaning here taxation like the income tax, which varies with ability to pay as opposed to customs and excise taxation. Of this direct taxation in 1924-25 more than half — 58 per cent — was collected by the States. When local government taxation is brought into account, most of which is roughly on a taxable capacity basis, it appears that far too much is collected on the basis of local ability to pay and too little on the general ability to pay of the whole Commonwealth. Judging from the practice of other countries, a very considerable transfer of income tax collection could safely be made from States to Commonwealth, accompanied, of course, by a corresponding increase of per capita payments from Commonwealth to States.

A convenient limit to the extent of this transfer is set by the State with the lowest income tax. Victoria collected a little over two millions in income tax in 1924-25, an amount almost exactly equal to the per capita payments. The per capita payments could therefore be doubled (50s. per head) and the federal income tax increased by the
corresponding amount, about £7.5m. This would leave Victoria with the same revenue, and no income tax to collect. In the other States, the income tax could be reduced to about one-half without loss of revenue. The net Commonwealth revenue would not be affected, and the range of automatic adjustment between States would be doubled; so that where a State gets an advantage of £100,000 under present conditions, it would get an advantage of £200,000 after this transfer of income tax collection to the Commonwealth.

Even this additional range of automatic adjustment would not be enough for all the necessities of the situation, as disclosed by comparison of taxable capacities. Alternatively to, or concurrently with, the general increase of per capita payments, there might be a variation from one State to another in their amount. This is, in effect, the Canadian method. It has not the great advantage of being automatic and practically unperceived, and so is more apt to become the subject of political controversy. But it is probably the most convenient form in which to give special grants under Section 96 of the Constitution. Revision of the scale of payments would be required every ten years or perhaps every five years; and it might lift the matter somewhat from political controversy, if the scale and its revisions could be made by Parliament only on the advice of an Economic Committee, with powers and duties corresponding roughly to those of the Tariff Board.

Conclusion
We have seen how Australia set out on her federal career with no thought-out plan for equitable financial relations of the States to one another and to the Commonwealth; and how, under the exigencies of the war, a method has grown up, unplanned, unsought for, by which these relations are adjusted, to a considerable degree, automatically and entirely without friction. We have seen further how this automatic adjustment may be strengthened, and how it may be supplemented in cases of great and lasting inequality.

It is nothing to the point that such a scheme is not contemplated in the Constitution. It happens that it can be carried out without amendment of the Constitution, but that circumstance adds little to the reasons in favour of it, except the reason of practical political convenience. I hope enough has been said to make it clear that no far-reaching scheme of federal finance can be expected to find a place in an original federal constitution, so that there is little practical force in an appeal to the intentions of those who made the first federal compact.

Federation is not a definite form of government but a compromise between the two principles of independence and nationality. Like all
compromises, it is subject to continual adjustment in view of changing circumstances. Financial circumstances change most rapidly, and the war may be said to have put every federal constitution into the melting pot. A good federal constitution is one that can be easily amended.

History shows us how far federations depart from the intention of the founders. The functions of the federal government of the United States were intended to be rigidly limited to what was 'truly national in object and scope;' but they now include the instruction of the housewife in the pickling of onions. The idea of national scope is continually changing. In England, just as in America, roads have passed from being a matter of private enterprise through every grade of local government until they have become an important object of national expenditure. The police in England have had an experience similar to that of roads. The national interest continually grows, and though administration may be left to local authority, some form of national supervision and control is imposed. The bonds of the Constitution are powerless to stop this movement. A federal government will continually find a way to extend its activities beyond the province assigned to it. Sometimes it is done by using taxation and other powers for quite alien purposes, as when the Commonwealth tried to promote closer settlement by means of the land tax or suppress lotteries through Post Office regulations. Sometimes it is done simply by offering services which every one is glad to accept, and so indirectly establishing a certain control. The U.S. activities in Trade and Commerce, Agriculture and Health are salient examples of this method. Sometimes the new powers are bought outright by conditional grants of money. Roads and education and mining development have by this means come under a considerable measure of federal control in America, and our own federal government appears to be following the same path.

I have digressed somewhat from my proper subject in order to enforce the conception of federation as a growing organism, adjusting itself in every direction to changing circumstances, regardless of the strict provision of the Constitution or the intentions of its founders. This is particularly true in all that concerns the financial relations of the central government and the component States. The problem of financial relations is a difficult one and the need for a satisfactory solution is urgent. I think we are more likely to find that solution if we enter on the task unhampered by the tentative solutions of the past and free to concentrate on the actual needs of the present and the immediate future; but conscious that the best possible arrangement now made must be similarly liable to adjustment sooner or later to changing circumstances.
Notes

1 Quick and Garran (Annotated Constitution, pp. 868-71) think that the unfulfilled intention was to limit the operation of the Section to the time when the Braddon clause was in operation. A. I. Clark (Australian Constitutional Law, pp. 212-14) discerns rather a wish to make it clear that the Section was to operate even when the Braddon clause was operating. Harrison Moore (Commonwealth of Australia, 2nd ed., p. 533) appears to take the supposed will for the deed, and notes that Section 96 met ‘the possibility of exceptional conditions in any State in the early years of the Commonwealth.’ (The italics are mine).

2 [See Reading VI below.]

3 For further details on the computation of this index, see my pamphlet, Taxable Capacity of Australian States, Hobart, 1924. [See Reading XIII.]


5 Ibid., pp. 65-89, passim.

6 It may be argued that any such adjustment is over-stepping the bounds of federation, and savours rather of union. But there is no distinct boundary between the two. Perhaps the only strict federation is one in which the States are units for every purpose, regardless of area or population; so that, e.g., federal revenue would be made up by equal contributions from the States. From this impracticable and useless ideal you may have every grade of union up to the most highly centralized State with no local government at all; an ideal equally impracticable and useless. In practice, one might say that the Commonwealth is perhaps 62 per cent federal; and no principle is violated by altering 62 to 58 or 66.


‘The financial relations between the component States and a federal government,’ said my predecessor in this office, ‘are the chief determinant of the character of the federation.’

When previously independent political entities unite to create a separate federal unit one of their vital problems is the adjustment of financial means to political ends. The nature of the federation determines how political powers and responsibilities are to be divided between the new and the old, and the ultimate success of this division will depend on how far a corresponding division of financial powers is made. In particular, the problem of the financial relations in federation covers the allocation of sources of revenue, of borrowing powers, and powers of expenditure, and the question of the provision for necessary adjustments arising out of these. To quote Mr Giblin once more, ‘No far-reaching scheme of federal finance can be expected to find a place in an original federal constitution.’ Indeed, it is not desirable that it should. True political wisdom in these matters lies in the direction of a tentative solution of the problems, coupled with the necessary provisions to bridge over a period of transition, so that the experience of later years may, when required, furnish another tentative solution suitable for its day and generation. In the Common-
wealth Constitution, as is well known, the division of political powers followed the model of the United States of America, in that the Commonwealth was given specific powers and all others belonged to the States. Powers of expenditure corresponded with these political powers, whilst no limitation was put upon the power to borrow, either of the Commonwealth or of the States. Sources of revenue, or particularly fields of taxation, were allocated in such a way as to put the Commonwealth in a dominating financial position, since it has exclusive power to impose customs and excise duties, and concurrent power to impose all other forms of taxation, provided it does not ‘discriminate between States and parts of States.’

Since the Commonwealth was to take from the States their chief source of revenue, customs and excise, temporary provision was made for ten years for a return to the States of not less than three-quarters of the revenue derived from these sources. Apart from this a provision for readjustment was made that, at the end of the ten years, the Commonwealth Parliament might decide, in its own discretion, what provision, if any, should in this way be made for the States. Again, Section 96 of the Constitution allowed the Commonwealth to grant financial assistance to States. When the end of the ten-year period came, in 1910, the Commonwealth Parliament passed the Surplus Revenue Act of that year, which provided for a payment to the States of 25s. per head of population in lieu of the three-quarters of the revenue from customs and excise. These payments were to be made for ten years ‘and thereafter until Parliament otherwise provides,’ and actually continued until their abolition by the States Grants Act of 1927.

The revenue thus provided to the States was, per head of population, less than they had obtained under the preceding arrangement, but this was to be expected, since the Commonwealth had not at once exercised all the functions allowed it under the Constitution. This Act also contained a section which provided that ‘The Treasurer shall pay to the several States, in proportion to the number of their people, all surplus revenue (if any) in his hands at the close of each financial year.’ But, if this were intended as a practical method of adjusting revenue relations between the Commonwealth and the States, it was ineffective, for the federal Treasurer has been in the habit of transferring any surplus to trust funds, so that, although federal revenue has often exceeded expenditure, there has never been technically a surplus which the States could legally demand. This general solution was only practicable because the Commonwealth until the war left to the States the whole field of direct taxation with the exception of the land tax of 1910, which was, however, aimed not only at providing revenue, but at enforcing a particular land policy. With the war a new
significance was given to the problem of financial relations, demanding a new solution, which was fortunately possible under the Constitution. The Commonwealth, which was solely responsible for war expenditure, was forced to enter the field of direct taxation in competition with the States. Two important new federal taxes — estate duties (1914) and income tax (1915) — introduced into Australian public finance the problem of double taxation.4

The per capita payments were retained, and, since the revenue for customs and excise no longer sufficed to meet the needs of the Commonwealth, the federal government was, in effect, raising revenue by direct taxation and transferring some of it to the States. There had thus grown up almost unnoticed an eminently satisfactory solution for the problem of financial relations, and, indeed, one of the most satisfactory features of war-time finance in Australia. In the first place, the distribution of the total burden of taxation in Australia was fairly in accord with modern economic principles. If we look to writers on public finance for guidance in such a problem, we are confronted with an almost bewildering number of ‘principles.’ The best known examples are Adam Smith’s maxims, but they cannot give us much guidance today, for, as Dr Dalton says,5 Adam Smith, though a great economist in his day, wrote nearly 150 years ago, and before the discovery of the law of diminishing marginal utility. To say that Adam Smith said the last word in economics is on a par with saying that physics ended with Newton. The principle most widely accepted today is that of ‘minimum aggregate sacrifice.’ According to Edgeworth this means that the aggregate sacrifice will be least when that portion of income is taken in taxation which can be best spared, or whose absence is least felt. ‘The reasoning from the principle of “minimum sacrifice,”’ he says ‘assumes no exact relation between utility and means; it assumes only what is universally admitted, that utility does not increase proportionately to means, the Jevonian law of diminishing utility’.6 Another similar principle is ‘like sacrifice,’ i.e., that the sacrifice involved in taxation should be equal for each one, or in proportion to each one’s material welfare. Theoretically minimum aggregate sacrifice is preferable, especially as it affords a true justification for the exemption of a minimum, but in practice to follow either principle will lead to not dissimilar results. Professor Cannan calls ‘minimum aggregate sacrifice’ a ‘glorified common sense and eminently practical principle,’7 and states it popularly thus:8 ‘The object of every good legislature . . . is to raise the money required for Government purposes . . . with as little aggregate suffering as possible.’ In practice the principle points to progressive taxation, which takes the least useful parts of income, by taxing incomes more than proportionately. As Professor Pigou9 writes, ‘The general
principle that large incomes should contribute to income tax in larger proportions than small incomes is not now disputed by anyone, for progressive taxation is now almost universal. The practical conclusion, then, from the general principle is that ‘considerably the heaviest burdens should be placed on the broadest backs.’

In applying this principle to Australia it has to be always remembered that the policy of the Commonwealth, which has exclusive control over customs and excise, is to impose these duties partly for revenue and partly as a means of directing the economic development of the country. But the net effect of these taxes is regressive — they bear more heavily upon smaller incomes. In order, then, to distribute the burden of taxation in accordance with the principle of minimum aggregate sacrifice it is essential to supplement this form of taxation by a progressive tax, and experience shows that the best form is an income tax. So in practice the ideal economic solution, granted the presence of customs duties, is a general progressive income tax with proper deductions, and this is practically what the end of the war found established in Australia.

In the second place, the distribution of the proceeds, as Mr Giblin has shown, was economic, since the revenue was raised on the basis of taxable capacity and distributed on the basis of population. The more wealthy States contributed to the needs of the less wealthy. ‘The combination of federal direct taxation, with *per capita* distribution to the States, makes an adjusting factor of the greatest nicety.’

In the third place, the scheme was flexible and could be easily adjusted to changed circumstances.

What was needed, indeed, was not its abolition but its logical extension. For instance, there was much to be said for leaving the field of income tax entirely to the Commonwealth, provided that there were a corresponding increase in *per capita* payments to the States. In two respects the federal tax was better able to place the burden on the ‘broadest backs.’ In the first place, the Commonwealth authorities can most easily ‘aggregate’ incomes so that those arising in more than one State shall pay on the total instead of on the separate amounts, which makes a difference when the tax is progressive. The States have the power to ‘aggregate,’ but, as they usually follow the principle of ‘origin’ rather than that of ‘residence,’ it would be a distinct change in their practice to exercise that power. In the second place, the States may not levy tax upon interest arising from Commonwealth loans, whilst the Commonwealth may levy income tax upon interest paid on State loans. To have any public interest exempt from income tax is to offend against the principle of minimum aggregate sacrifice, since when the rates are progressive it offers more advantage to the large investor than to the small. From an economic point of view, then,
such a change would appear desirable, whilst if the equities of the case be considered there is much to be said in favour of allowing that authority, which enjoys the kudos attaching in Australia to a policy of protective import duties, to suffer as well the odium which attaches to heavy income taxes. The practice, too, of special grants to those States whose financial strength was less, either because of differences in resources or because federal policy had more adversely affected them, falls logically into its place under such a system. There was no particular virtue in the sum of 25s. per head. This was less than the States had got before 1910, because the Commonwealth proposed to assume responsibilities for old age and invalid pensions. If new circumstances arose which showed that the respective financial resources and political responsibilities of Commonwealth and States were somewhat out of accord, an alteration in the amount of per capita payments would be the easiest form of adjustment. Again, under such a system it would not have been difficult to incorporate a scheme whereby the Commonwealth took over the public debt of the States, allocating to this service part of the per capita payments, and used its dominant financial position to co-ordinate and to curb public borrowing.

Between 1918 and 1926, however, various alternative proposals were made, no one of which possessed the satisfactory features of the system which it was intended to supersede.

In the beginning of 1919, when the financial situation was causing anxiety, the then federal Treasurer, Mr Watt, proposed to reduce the per capita payments to 22s. 6d. in 1920-1, and thereafter by 2s. 6d. a year until they amounted to 10s., when the matter was to come up once more for revision. In 1923 the Commonwealth proposed to abandon taxation of incomes under £2000 a year and to abolish per capita payments if the States would surrender their right to interest on properties transferred by them to the Commonwealth at federation. The States made a counter proposal for a ten-year agreement that the Commonwealth should retire altogether from the field of income taxation, that the States should abandon any claim on customs and excise revenue, and, if necessary recoup the Commonwealth for any loss of revenue. The Commonwealth then offered to abandon income taxation, except on companies at a flat rate of 12.5 per cent, on condition that per capita payments and interest on transferred properties should cease. All the States except New South Wales were inclined to accept this proposal, but nothing further was done until 1926, when still another proposal was made by the Commonwealth to the States that the principle of reserving indirect taxation for the Commonwealth and direct taxation for the States should be normally recognised, and that as a first step the Commonwealth should
abandon the income taxation of individuals, discontinue the *per capita* payments, and grant, if necessary, temporary assistance to the States.

The most significant feature disclosed by these negotiations, and one which ultimately became all important, was the evident determination of the Commonwealth government to abolish *per capita* payments. As Dr Earle Page said:13 ‘Every Commonwealth Government since the war has recognised, and quite definitely asserted, that the capitation system must go. It is impossible for us to continue it.’ To oppose this determination the States, having no legal right to the capitation grants, and being definitely in a constitutional position of financial inferiority, put forward the claim that they had a ‘moral right’ to some share in the Commonwealth revenue. They were obviously more satisfied with the *status quo* than with any proposal made to them, and they saw no necessity for a change. But the federal government brought in a Bill in June, 1926, to abolish *per capita* payments. In moving the second reading14 Dr Earle Page proposed a new scheme, and also revealed a new principle which, he held, vitiated the system which had existed for so long. His new proposal was that the Commonwealth should abandon land tax, estate duties, entertainments tax, and 40 per cent of income taxation on companies and individuals. The new principle, in his own words, was ‘the vicious principle of one authority raising taxation for another authority to spend.’15

The Bill was not considered further until March 1927, when the Prime Minister proposed that the abolition of *per capita* payments should take place as from 30 June 1928, and that the States should be invited to a conference, where the problem of financial relations might be considered at large, apart from any previously suggested solutions. Mr Bruce advanced three reasons for the change proposed by the Bill.16 The first was ‘the financial insecurity of the States under the present system . . . it is possible for the Commonwealth Government at any time to cut off all the payments now being made to the States and to give them no compensation of any kind.’ The second was ‘the bad principle of one authority spending the revenue raised by another authority . . . that has always been recognized as a wrong principle.’ The third was

the inequity of payments upon a population basis . . . the *per capita* system means that the State which has the largest population, is most advanced in its development, and has therefore fewest problems to solve, will progressively receive more and more from the Commonwealth, while States like Western Australia, with small populations and great developmental problems, will fare the worst. In other words, the State
which is best able to provide for its own needs will continue for ever to receive the greatest share of Commonwealth money. That inequity is aggravated by the policy of tariff protection. The tendency is for secondary industries to develop in the most populous centres, and unquestionably the more populous Eastern States are deriving the maximum of benefit from the protectionist policy of the country. Thus the States that benefit most through the tariff receive also the largest payments from the Commonwealth.

The argument as to the financial insecurity of the States is not convincing. Under a system of *per capita* payments, which might in any year be abolished by the Commonwealth Parliament, the States were financially insecure. But the insecurity arose out of their constitutional position, and is, indeed, inherent in it. While the respective powers of the Commonwealth and of the States under the Constitution remain as they are, financial security cannot be guaranteed to the States. The most that they can hope for is that the federal government or the Commonwealth Parliament, either with or without agreement with the States, will voluntarily and temporarily refrain from such financial action as will make the position of the States insecure. This happened in 1910 when the Commonwealth Parliament passed the Surplus Revenue Act. It happened again in June 1927, when a tentative agreement was reached between the Commonwealth and States. But the Commonwealth cannot be definitely bound to refrain for all time from such action as will render the position of the States insecure. If it were thought proper by the Commonwealth Parliament, for whatever reason, to exercise fully its power of taxation without regard for the interests of the States, it could completely cripple State finances by entering into every field of taxation occupied by the States, and omitting to hand over any revenue to the States. It is not, of course, likely that this will happen, but it illustrates the meaning of financial insecurity. The capitation system, then, did not make the financial position of the States insecure, nor did its abolition make that position more secure — it only evidenced the insecurity.

The second argument concerns the so-called ‘vicious principle’ that one authority should spend the revenue raised by another. This was contrasted by Mr Bruce, in his policy speech at the elections of 1926, with the ‘basic principle of national finance that every government shall have the responsibility of raising the revenue which it is expending.’¹⁷ This latter principle, however, is obviously not recognised as basic in all systems of national finance. In the relations between central and local governments, for example, it is a common practice for the former to raise revenue for the latter to spend. If
comparison be made with the federal system of Canada and of the United States of America, it will be found that the 'vicious' principle is accepted and its extension advocated. In Canada, as Mr Giblin has shown, payments to the Provinces of revenue raised by the Dominion Parliament have always been a characteristic feature of the system of national finance. In the United States, writes Professor Seligman, 'as far back as 1837 the Federal Government distributed its surplus revenue among the States, and ... for some years it has been making annual grants to the States ... during the Civil War the Federal Government collected a direct tax, which was subsequently distributed among the States.' In the same article Professor Seligman strongly advocated, in place of the present duplication of State and federal inheritance taxes in the United States, 'a comprehensive federal inheritance tax, with a division of the yield between the nation and the State.' In effect, he sees nothing wrong in a system where one authority collects revenue which another spends. Coming nearer home, it is to be remembered that this 'vicious' principle has been followed in Australian financial practice for 27 years, and that the States, who might be supposed to suffer, have not only not protested, but have been entirely satisfied with its operation. Moreover, as Mr Bruce admitted, the grants in aid made by the Commonwealth government 'to the States whose needs and developmental obligations exceed the capacity of their people and finances,' are a clear violation of this basic principle. Even the grants to States under the Federal Aid Roads Act might without much difficulty be brought within the same category. Finally, the latest agreement of June 1927, between the Commonwealth and the States, once more accepts the 'vicious' principle in so far at least as the Commonwealth is to raise revenue and use it to contribute to a sinking fund on new debt incurred by the States. In fact, whether one or the other principle should be followed depends entirely upon circumstances. Neither principle itself is 'vicious' or 'virtuous', and it is very unfortunate that the chief reason advanced by the government for the abolition of per capita payments should be one of such doubtful validity.

The third reason was that payments upon a population basis were inequitable. This view entirely ignores what Mr Giblin pointed out in 1926, 'that the combination of Federal direct taxation with per capita distributions to the States makes an adjusting factor of the greatest nicety,' because the revenue is raised according to taxable capacity, so that the wealthier States pay more, while the revenue is divided according to population. Moreover, if equity demanded a distribution more in favour of the financially weaker States, that was a problem easy of solution by special grants (as, indeed, have long been made),
and did not involve the abolition of the whole system of *per capita* payments.

Notwithstanding some vigorous protests the Bill became law in April 1927. There followed in June and in July conferences between Commonwealth and State Ministers to consider the new proposals made by the Commonwealth government as a substitute for the *per capita* payments. Some modifications were made, but in the main the proposals were accepted. The scheme needs ratification by the Parliaments of the Commonwealth and of the States, and requires for its working an amendment of the Constitution, but in the meantime it is to be put into force by agreement. The two outstanding features of the scheme are the provision for dealing with existing and future public debt, and that for controlling public borrowing, but incidentally the question of 'transferred properties' is settled. The Commonwealth is to take over the existing public debt of the States on 1 July 1929, and will contribute towards the annual interest charge the sum of £7,584,912 — the amount of the *per capita* payments for 1926-7 — the States being responsible for the rest. For State debt existing on 30 June 1927, a sinking fund of 0.375 per cent per annum is to be established, estimated to extinguish it in 58 years, to which the States contribute 0.25 per cent and the Commonwealth 0.125. New Public Debt incurred by the States after 30 June 1927, is to be provided with a sinking fund of 0.50 per cent, estimated to extinguish it in 53 years, to which the Commonwealth and States contribute equally.

Public borrowing is to be controlled by making the Loan Council an integral part of the machinery of Australian public finance. The Council is to consist of a representative of the Commonwealth and of each State, and it is to exercise its powers under an amendment of the Constitution. To the Council each year the proposed loan programmes of the Commonwealth and of each State are to be submitted. The Council may then determine whether the total demands could be met at reasonable rates and conditions, or if not, what proportion could be so met. If it decides that the whole sum may be raised, there will be, of course, no difficulty in allocation. If, however, it decides that less than the total may be borrowed, the procedure in case of disagreement is that 'of the amount to be borrowed the Commonwealth shall be entitled to an allotment of one-fifth and the States to allotments of four-fifths, in the proportion which the net loan expenditure of each State in the preceding five years bears to the net loan expenditure of all the States during the preceding five years.' In either case, the Commonwealth is to carry out the decisions of the Loan Council and to arrange for all borrowings, including conversions, redemptions, and the consolidation of debt.
Considered as a scheme for dealing with the pressing problems of public debt and the control of public borrowing in Australia, the new agreement is an advance on any previous public proposal. The coordination of public borrowing which should result from the activities of the Loan Council will be an eminently desirable feature of Australian public finance. At the worst the saving which should arise from the disappearance of separate and competitive borrowing will be worth the while. At the best the Council may be able to act as a curb upon unnecessary borrowing. Possibly the method of allocation may induce States to interpret their needs liberally, in order to be sure of securing a fair allotment, but the inducement will be less than exists under a system of competitive borrowing. Permanent and regular sinking funds for new and old debt should also improve Australia’s financial position, for a sinking fund may be a positive aid in floating a loan. But there is a danger that the provision of a sinking fund may prove a delusion and a snare, by generating in the borrower a vague but comforting feeling of financial well-doing. Its effectiveness in reducing debt depends upon whether it operates to reduce borrowing or to justify an increase, and there is some reason to fear that the States may feel greater security in borrowing because the Commonwealth contributes to the sinking fund on all new debt.

By contrast with the system of per capita payments it will be noted that the present scheme is much less elastic. The federal income tax is retained so that income is still collected according to ability and distributed roughly according to needs, but instead of payments to the States automatically increasing with the growth of population they are now fixed, although in amount interest payments and contributions to sinking funds by the Commonwealth will for some time exceed what would have been received from the per capita payments. Again, whereas the former revenue might be used by the States for any purposes, the present contribution from the Commonwealth is limited to specified purposes. The payment by the Commonwealth of part of the interest on existing State debt will relieve State revenue, but the payment by the States of 0.25 per cent on existing and on future debt will in many cases involve additional demands on State revenues.

There remains the important feature that the previously untramelled power of borrowing possessed by each State and by the Commonwealth is definitely limited by the control exercised by the Loan Council. The limitation does not press quite so heavily upon the Commonwealth, for defence loans are excluded from the purview of the Loan Council, and, in the case of allocation of loans, the Commonwealth gets one-fifth whilst the six States share the remaining four-fifths. But this restriction on State autonomy enables the Commonwealth to share in controlling the developmental policy of
The Financial Relations

each State, and affords another instance of the way in which financial relations determine the character of a federal union, for the Commonwealth forced the issue upon the States, and, by the virtue of its superior financial power, compelled their agreement.

It would be difficult, however, to maintain that the problem of the financial relations of Commonwealth and States has been completely solved. The problem of double taxation is hardly touched by the new financial agreement. We still have the irritating anomaly of three of the principal taxes — Land, Inheritance, and Income — being collected both by the States and by the Commonwealth. Some of the unnecessary duplication, indeed, disappeared with the amalgamation of State and Commonwealth machinery for collecting the income tax. But we still suffer from the great lack of uniformity of direct taxation. It is true that the demand for the abolition of double taxation comes in the main from those who wish to see the total burden of taxation reduced, since they believe that, if the Commonwealth reverted to the status quo ante bellum, it would be impossible for the States to impose, for example, rates of income tax which would mean a burden equivalent to the present. But whilst each authority competes within these fields of taxation a pressing problem of financial relations still remains for solution.

Further, arising from this problem and from recent developments in State and federal finance, there appears to be now a certain maladjustment of financial means to political ends. The States find it increasingly more difficult to meet their political responsibilities from the fields of taxation which they now share with the Commonwealth, whilst the Commonwealth finds it necessary to explore new fields of expenditure in order to dispose of a superabundant revenue. For the most part deficits have for some time been characteristic of State finance, and surpluses of Commonwealth finance. To ascribe this feature wholly to State extravagance and Commonwealth parsimony is not convincing. The most striking example of the successful search for new fields of expenditure is found in the Federal Aid Roads Act of 1926, whereby the Commonwealth contributes revenue to the States to be spent, under supervision, upon roads which have hitherto been regarded as a sphere of activity belonging solely to the States. Another sign of this maladjustment is that, whilst the Federal Treasurer has frequently in the past few years announced reductions in the rate of income tax, State Treasurers have been forced to increase rates of taxation, and have even explored new and unconstitutional avenues, such as the petrol tax of South Australia and the newspaper tax of New South Wales. At first sight the solution of these two problems would appear to lie in one of two alternatives. Either the Commonwealth should revert to the status quo ante bellum, and so give the
States more scope for revenue production, or the States should hand over to the Commonwealth enough of their powers to adjust revenue and responsibilities in each case. The former solution involves, inter alia, the retirement of the Commonwealth from income tax, and I have said enough earlier in this paper to show that this is most undesirable. Even to reduce the rates of federal income tax, as has been done of late years, seems uneconomical, in view of our increasing public debt, for it is obviously much easier to continue a tax at a given rate than to increase it after a reduction. The latter solution takes us on to the thorny path of politics. For the States to hand over any powers to the Commonwealth means, or may be made to mean, the beginning of unification, which in the eyes of many is enough to condemn it. Complete unification would, of course, mean the disappearance of these two problems, but it is possible to suggest a transfer of powers from States to Commonwealth which would fall short of complete unification. If this solution were adopted I would suggest that the States hand over to the Commonwealth powers over communications such as roads and railways. These would then be managed as national undertakings, as the Post Office and allied services have been since Federation. Both roads and railways would be a source of net expenditure to the Commonwealth, the former much more than the latter, which would relieve State revenue and make possible a better balance between revenue and responsibilities.

A better solution, however, which would cover both the problems of maladjustment and of lack of uniformity, would be to have recourse to an extended form of the flexible and eminently satisfactory system existing before the abolition of per capita payments. This could best be done by handing over entirely to the Commonwealth the two chief direct taxes, income and inheritance, on the understanding that payments should be made to the States to compensate for the resulting loss of revenue. Instead of seven separate income taxes and seven separate inheritance taxes, with different rates and exemptions, we should have two uniform taxes, raising with more ease the same or even a greater revenue. Any maladjustment could easily be cured by varying the amount transferred by the Commonwealth to the States. This proposal has been objected to on the ground that it may mean placing the States in a position of political inferiority, but it is to be remembered that, by the Constitution, financial inferiority is the lot of the States, and that after all we are Australians first and members of a State afterwards. What Professor Seligman says of the United States today may well apply to us:

We need in the . . . domain of fiscal and economic life the disappearance of the feeling of opposition between State and
Nation, and the growth of a feeling of co-operation. Instead of thinking in terms of sovereign States and Federal encroachments, we must learn, in finance as in economics, to speak more and more in terms of a co-operative effort which will preserve all that is best in local and sectional vigour, and yet at the same time bring our institutions in line with the fundamentally changed conditions of a national life. Uniformity of taxation as among all our citizens is one of the imperative needs resulting from this change of conditions: let us not lightly turn away from the possibility of its achievement by utilizing the joint endeavours of State and nation alike.21

**Notes**

1 Giblin, *The Economic Record*, November 1926. [Reading IV, p. 47.]

2 [Ibid., p. 59]

3 Section 6.

4 There was also the entertainment tax, 1916, but its yield was never in any year as much as £1,000,000, and it may be ignored for our purposes.

5 Dalton, *Public Finance*, p. 79.


10 Dalton, p. 79.

11 Giblin, op. cit., November 1926, p. 156. [Reading IV, p. 57.]

12 [W. A. Watt, 1871-1946. Premier of Victoria 1912-14; Federal Treasurer 1918; Acting Prime Minister 1918-19; Speaker, House of Representatives 1923-26.]


14 *Hansard*, 4 June 1926, pp. 2677, et seq.

15 *Hansard*, 4 June 1926, pp. 2682.

Fiscal Federalism

17 Quoted by Mr. Latham, *Hansard*, 9 March 1927, p. 241. [See Reading VII, note 4 on (Sir) John Latham.]


20 *Hansard*, 2 March 1927, p. 38.

21 *Studies in Public Finance*, p. 179.
The recent rise of political democracy has resulted in a steady stream of social legislation which flows in ever increasing volume and diversity from the Halls of Parliaments. The effective execution of these enactments repeatedly challenges the resourcefulness of administrative officials. Are existing administrative agencies suitable for the task? Does a centralised administration provide efficiency, economy and popular control in government, or is a measure of devolution inevitable? Is a 'common rule' and a uniform interpretation desirable, or do local susceptibilities require a more intimate appreciation and a more sympathetic treatment by officials? What is the most appropriate political unit, and will that be an equally effective administrative area? These and allied questions are agitating the minds of political philosophers and many plain people throughout the world, and there is a growing consciousness of the urgency for making a systematic survey of the whole field of governmental activity with a view to delimiting the areas over which, and the agencies by whom, enactments shall be administered.

The post-war demand for self-determination assailed the suitability of many political units. Added to this much modern legislation has a most intimate bearing upon the lives of individuals, and therefore

requires more considerate administration if official regulation is not to become intolerably irksome.

In Australia the New State Movement gathered a new momentum from the world-wide speculation on these problems, although essentially different from agitations which developed elsewhere. With her sparsely populated continent, Australia definitely depends upon governmental action for exploiting her resources. Local government, generally so robust in older countries, is here as yet only rudimentary. Instead, government is highly centralised alike in the State and federal spheres. True it is that officials of the central governments are distributed throughout the country, but they obey the dictates of the centre rather than the behests of the locality. In consequence, it is asserted that the far-removed country interests have been sacrificed or neglected in favour of those more contiguous to the seats of government. In particular, roads, railways, water conservation projects, hydro electric schemes and other developmental works have been withheld or tardily undertaken. Given autonomous control by new States, these disabilities would be removed, and the resources of the country more expeditiously exploited; above all, government would be cheapened.

There was sufficient appeal in these assertions to fan widely-supported agitations after the war for a division of the existing States, the most vigorous being that in the north of N.S.W., led by the federal Treasurer, Dr Earle Page. The Federal Constitution Act of 1901 envisaged the possibility of new States being created, and it contained the necessary machinery clauses, one of which required that the Parliament of a State affected should agree to any subdivision. As a result of a resolution unanimously adopted by the N.S.W. Legislature in the closing days of 1923, the State Ministry appointed a Royal Commission in April 1924, to inquire into the practicability or desirability of creating new States. Paragraph 5 of the instrument directed the Commission to inquire ‘whether, in order to secure reasonable powers of self-government and efficiency of administration for any portion or portions of the State of N.S.W., which it is proposed should be erected into a new State or States, it is necessary to establish a new State or States, or whether such ends can be adequately secured by the creation of some form of local governing authority under the present State.’

The Commission consisted of a District Court Judge as Chairman, a leading Sydney accountant, and a representative from each of the three areas claiming severance from the parent State. The report submitted in April 1925 exhaustively reviews the whole question. The Commission unanimously answers the specific question that it is not
desirable to create a new State or States, and four members agree that the proposal is impracticable.

It would appear from the report that the financial aspect was a primary factor in this decision. The most attractive part of the New State programme was that under separate management, the cost of government would be less, even allowing for increased amenities. The figures submitted by the federal Treasurer in support of this contention were rigorously analysed by the Commission with the assistance of local Treasury experts and their reliability rejected.

It is unnecessary to follow the Commission through their survey of the grievances which were presented by the many witnesses on behalf of the new State. The validity of each complaint was tested by calling the responsible officials from the central government departments, and, in the light of their evidence, to review both sides of the question. As a consequence, students of administration in this State have now a wealth of material from which to judge whether centralised government has been efficient, economical or bureaucratic.

The Commission’s conclusion on the matter is expressed in the following sentence: ‘We are of opinion that the time has arrived when a revision of the existing system and the granting of much larger powers of local government are desirable’ (p. 131).

Urban local government has been in operation in N.S.W. for three-quarters of a century, but rural local government is not yet twenty years old, and the greater part of the Western Division is still unincorporated, because of the sparseness of its population. Furthermore, the powers and function of local bodies are much more circumscribed than in England or Europe, even with respect to those matters which are usually classified as specifically local. There has been no development whatever of the principle of committing to local authorities the administration of services of a national character, a practice which has been almost universally adopted in older countries. We have preferred to act through central departments or through specially constituted ad hoc bodies.

The Commission’s proposals would bring N.S.W. partly into line with old world methods, although it does not wholly adopt the hierarchical arrangement of areas and authorities. Over and above the existing shires and municipalities it would place District Councils, whose members would be elected by the existing bodies. They would commit to these new Councils many functions in regard to Health, Land Settlement, Education, Public Works, and the like, which are now administered from the centre, but suggest that the chief officer of the central government resident locally should be attached as official adviser to the Council. For its more important duties the Council is to constitute a Statutory Committee, the personnel of which is to include
a proportion of co-opted members chosen for their special experience and qualifications. In addition, the District Councils are to exercise in respect of the existing local authorities certain powers of supervision now committed to the Minister for Local Government.

The financial arrangements of these new bodies are to be determined by a Board of Experts, but the Commission suggest that their revenues will be obtained partly from rates and partly from government subventions. Rates for the new and the existing local authorities are to be collected by the proposed District Councils, to avoid repeated demands upon the ratepayer by different authorities. Districts are to be classified with a view to fixing the proportion of government subsidy to be paid, but the ‘percentage of subsidy should be fixed for a definite term of years, the longer the better;’ and ‘the amount should vary only with the amount which the district itself raises’ (p. 135). The subsidy is to be paid annually, and the local bodies are to prepare their estimates for a period of two years ahead to assist the central government in its own budgeting arrangements.

While the Commission’s recommendations represent a considerable advance upon our existing local government arrangements, they fall short of what might have been attempted. This was probably inevitable when the personnel of the Commission is considered. In the scheme as proposed the three principal weaknesses appear to be (1) A misapprehension of the capacity of parts of the State to undertake the duties proposed. Many parts contain large stretches sparsely populated and possess small resources. It is doubtful whether in these cases it would be desirable to disturb the present arrangements. Much more important is the relation which these District Councils would have to the large conurbations round Sydney and Newcastle. Would Greater Sydney and Greater Newcastle be excluded from the general scheme? (2) The proposal to give the existing councils of shires and municipalities the right to elect the members of the new District Councils is of doubtful wisdom, besides presenting technical difficulties regarding the proportionate representation to be accorded to rural and urban areas. (3) Lastly is the ever-present difficulty of finance. The Commission has avoided the disturbances associated with assigning specific revenues to the local authorities, but they seem inadequately to appreciate the fact that need may be in inverse proportion to local resources. The recent experiences of local authorities in England stricken by the Geddes axe, and of the South African provinces, is serious reminder that local authorities may be left to shift for themselves when the chests of the central Treasury are depleted.

Nevertheless, it is earnestly to be hoped that the government in this State will soon appoint the expert Board suggested by the Commission for the purpose of exploring the areas that are ripe for this measure of
extended local government. If Australia is to be expeditiously developed we must modify our existing excessive centralisation, and enlist in every locality the energies of those citizens who have any contribution to make.
VII
The Report of the Royal Commission on the Constitution of the Commonwealth*

K. H. Bailey

This Commission had a formidable task. It was to inquire into and report upon the powers of the Commonwealth under the Constitution and the working of the Constitution since federation, and to recommend such constitutional changes as it thought desirable. In particular, it was to report upon a number of specific subjects, including company law, industrial powers, new States, health, navigation, and trade and commerce. The Commission took evidence in all the States, and from 339 representative witnesses; the printed evidence fills 1700 foolscap pages; the Commission’s labours occupied two years. The Report itself is quite in keeping — some 300 pages of detailed and exacting material, with a further 60 pages of documentary appendices. It falls into two clearly-defined sections, which may be considered separately: a historical and analytical description of the Constitution and of its working, and a series of recommendations as to constitutional changes.

The scope of the descriptive part is wide, embracing not only the legal but the political, financial, and economic aspects of the Constitution. It is remarkable to have reduced to such a compendious and authoritative statement the amount of material available and necessary. But the Report does suffer a little from the defects of its

merits: it sometimes secures brevity at the expense of precision. One or two matters of constitutional law may perhaps be instanced. Thus, to say (p. 70) that 'any legislation passed by the Commonwealth Parliament may be repealed at any time by an Act of the British Parliament,' is perhaps a mere slip. Again, in discussing the Governor-General's power to refuse a dissolution to a Prime Minister defeated in the House (p. 50) the effect of the Imperial Conference of 1926 seems not to have been considered. The sections of the 'Balfour Memorandum' dealing with the constitutional relations of Great Britain and the Dominions have been unaccountably omitted from the Memorandum as printed in the appendix. The legal incidents of Australia's membership in the International Labour Organisation are wrongly stated (pp. 117, 185).

The problem raised for the Commonwealth by the draft conventions of this Organisation is not a new one. Many of the non-political treaties in which Australia has been concerned have required implementing legislation which is within the competence of the States only, and ever since federation this has made it difficult for Australia to ratify such engagements. How can the Commonwealth undertake obligations whose performance she cannot guarantee? Some federations give the federal government special powers in order to avert this difficulty, and it is just possible that the Commonwealth might be able to rely on its power to make laws with respect to external affairs. But in the International Labour Organisation special provision has been made. Labour Conferences may frame their conclusions either as 'draft conventions' or as 'recommendations.' A member State is under no obligation whatever as to a 'recommendation,' save to bring it under the notice of the competent authorities and to inform the League [of Nations] of action taken or not taken. A draft convention, however, must be submitted to the competent authorities for approval, and if approved must be ratified within a reasonable period. A draft convention will fall within either federal or State competence. If the former, the Commonwealth has exactly the same obligations with respect to it as has a unitary State. But if (and only if) the draft convention falls within State competence, the Commonwealth may treat it as a 'recommendation' merely. (Art. 405.) There have been some thirty draft conventions to date, of which eight fall in whole or in part within federal competence. Australia's obligations have not been very satisfactorily performed. One draft convention has, however, been ratified. At the Premiers' Conference in May 1929, the Commonwealth put forward a positive policy with respect to the draft conventions within State competence. The Commonwealth promised that if the States would approve any such convention, make the necessary legislative arrangements, and
undertake not to disturb them during the currency of the convention, the Commonwealth would ratify it. The Commission's account of these matters is necessarily brief: but it is definitely misleading.

The concluding 60 pages of the Report are devoted to the recommendations of the Commissioners. Modern government has owed much to Royal Commissions. The introduction of responsible government in British colonies is one illustration, the transformation of the English judicial system is another. This Commission had a great opportunity, and wisely permitted evidence pertaining to every kind of constitutional change, from merely verbal clarifications on the one hand to the adoption of a radically different type of Constitution on the other. The Commissioners did not reach unanimity. On the greatest issue before them — whether a federal type of Constitution should be retained or whether a unitary type should be adopted — they were divided, four for federalism, three for unitarism. This fundamental cleavage is expressed in two admirably concise general statements. In describing a 'federal' system, the majority of Commissioners abandoned precise definition, and explained that they meant a system, like that of the United States and Canada, in which 'not only are the powers of the local and central legislatures defined by a charter, but the powers of the local legislatures and executive governments are substantial and significant.' The minority Commissioners adopted Seeley's view, that all government represents a division of powers and functions between central and local authorities, and that there is no difference in kind, but only in degree, between a federal and a unitary government. They urged that the most suitable form of government for Australia is a unitary but decentralised system, 'one that provides for all major national questions being dealt with by the central Parliament, and that leaves matters of minor importance, as well as the administration of federal laws to a considerable extent, to local bodies.'

The way in which the Commission divided is interesting. In favour of 'federalism' were the three lawyers and the Western Australian member, Sir Hal Colebatch, the only Commissioner whose experience has been principally in an outlying State. In the minority were Mr T. R. Ashworth, President of the Victorian Employers' Federation, with Mr M. B. Duffy and Mr D. L. McNamara, whose views may be taken as representing the industrial and political wings respectively of the Labor movement. It does not appear that employers generally share — as yet — the views of Mr Ashworth. But his association with the two Labor men in a series of far-reaching proposals not only has obvious value as a piece of constructive cooperation between leaders too often ranged in opposition, but may also be fruitful of consequences in Australian history.
It is not easy to follow the Commission's specific recommendations, unless one first traces the position of the minority Commissioners. They proposed, in the first instance, merely to simplify the present method of amending the Constitution, so as to enable the Commonwealth Parliament to amend it — as State Parliaments can amend State constitutions — by an Act passed by an absolute majority in both Houses. Such a plan would, they claimed, 'enable the transfer of powers from States to Commonwealth to be accomplished gradually, as and when necessary and desirable,' and would avert all danger of chaos. They recommended that if, as a result of the Report, amendments of the Constitution were placed before the people, the general amendment they had suggested should be included as an alternative. They did not, however, stop at that point. They recommended, or concurred with the majority in a number of specific proposals for amendment, either as a guide to the federal Parliament, if their own original proposal were accepted, or as an alternative (faute de mieux) if it were rejected. The forty-odd specific recommendations as a whole are bewildering enough on a first reading, even with the aid of the good (but not quite complete) system of cross-references. But they fall on analysis into six classes. First come a few changes unanimously recommended. Some of these amount only to a clarification of the existing constitutional position, but most of them propose extended (though not greatly extended) Commonwealth powers. This group includes cinematograph films, adoption and legitimation, probate and letters of administration.

The second group comprises a few proposals for extended federal powers, from which Sir Hal Colebatch alone dissented: the registration of doctors, dentists and nurses; drugs; food standards; and aviation. Sir Hal Colebatch was opposed to the further centralisation of powers (save in the few cases already noted), and contributed a powerful and clear-eyed statement, from the point of view of an outlying State. His view was that the 'public finances and the commercial and industrial development of outlying States have been prejudiced to an extent incompatible with the requirements of a federal union and dangerous to the well-being and progress of the Commonwealth as a whole.' He supported this view by reference to the findings of the three Royal Commissions which have recently reported into the disabilities of Western Australia, Tasmania and South Australia. He held that 'central finance and central control have always meant largely-increased expenditure in proportion to the services rendered.' In general, he favoured the restriction rather than the aggrandisement of Commonwealth powers.

In a third group of recommendations (including those on health and company law), there was a curious tripartite division among the Com-
missioners. Sir H. Colebatch desired no change. The three lawyers proposed a limited, the three laymen an unqualified, extension of federal powers. With respect to navigation and shipping, Mr Bowden changed sides, and turned the minority into a majority in favour of full federal powers.

The fourth group of recommendations were those on which the Commissioners were divided, four against three. One or two are positive majority proposals, opposed by the minority — as that the term of Parliament should be extended to four years. But this group is principally made up of the minority recommendations proper — a formidable list (p. 302). Full powers were proposed for the Commonwealth with regard not only to railways, aborigines, fauna and flora, fisheries, and forestry, but also with regard to trade and commerce and to industrial matters. Railways in Australia are so intimately connected with development, and trade, commerce and industrial matters form so large a part of the subject matter of legislation in a modern community, that to transfer these powers to the Commonwealth would certainly make the Constitution unitary in character, even if not in form.

The minority Commissioners were not entirely unanimous among themselves, and the additional recommendations of the two Labour Commissioners form the fifth group. It includes a proposal to put certain matters beyond the reach of amendment or repeal by the federal Parliament; provisions securing adult suffrage and prohibiting conscription for naval, military or industrial service were to be inserted in the Constitution, and made changeable only by referendum. Mr Ashworth, while expressing no opinion on these matters, contributed an independent supplement with some important recommendations (the sixth group). From the standpoint of the political scientist he subjected Australian parliamentary and electoral machinery to critical and constructive analysis. He discussed responsible as opposed to presidential governments; the danger of parties divided on class lines; the philosophic basis of the party system. He adumbrated new electoral machinery. 3

In these pages it is possible only to draw attention to two aspects of Mr Ashworth’s report. Firstly, having regard to the breadth of the Commission’s tasks, one must feel, even if one disagreed with every word that Mr Ashworth has written, that it has been of service to the Australian people to raise and discuss such questions and ideas. Secondly, Mr Ashworth was the only member of the Commission to grapple with the position of the Senate, ‘the disappointment of the Constitution.’ It is a commonplace that Second Chambers in a federation are expected to perform the dual function of revising body and of State House, and that the Senate in Australia has not
performed either function satisfactorily. In the new federal constitutions of Europe a serious attempt has been made to construct satisfactory Second Chambers, associating the governments of the States in the working of the federal institutions. Evidence of these attempts was before the Commission. It is perhaps surprising that the majority Commissioners did not put forward some suggestion along these lines, in the hope of making the political machinery of the Constitution more truly federal. It is, however, only fair to remember that a revolution had preceded the establishment of the new Constitutions in Europe.

Mr. Ashworth himself, while not favouring a federal system, adopted the view of Bryce and Marriott that a revisory Chamber has a useful place in any Constitution, and, since much modern legislation is of a very technical kind, he proposed to reconstitute the Senate on a vocational instead of a territorial basis. He would include representatives of every important interest, economic and otherwise. The whole section deserves careful study.

We may now consider how the divergent principles already indicated worked out as applied to two important powers — to legislate on industrial matters and to create new States. The majority Commissioners held that industrial powers ought not, firstly, to be severed from the ‘general power to deal with health, trade and commerce ... and the development of a State,’ or, secondly, to be divided between two authorities. Once they had reached that point their conclusion was inevitable. If they vested in the Commonwealth all the powers which they thought inseparable from industrial powers, they would destroy the federal character of the Constitution. (There were other disadvantages, but that consideration was clearly paramount.) Accordingly, the majority advocated the deletion of Section 51 (xxv.) of the Constitution, so as to leave conciliation and arbitration (the chief industrial power that the Commonwealth has) entirely to the States. This, it will be noted, would put into permanent form the proposal which has, since the publication of the Report, caused the downfall of the Bruce-Page government.

The minority Commissioners met the majority on their own ground. They agreed that industrial powers should not be severed from the general power to deal with health or trade and commerce, and that industrial powers ought not to be divided. But in their view it is just as unsatisfactory to attempt a division of powers such as health or trade and commerce, as it is to attempt a division of industrial powers. All these matters in their view have come to present, and in the future will present more clearly, nation-wide problems. For the minority, too, therefore, the conclusion was ineluctable. The Commonwealth should have full powers to deal with all these matters.
The establishment of new States is a matter of great importance for the development of the Constitution, as the minority Commissioners point out. Powers which would be appropriate for six large States with a history behind them might not be at all suitable for 12 smaller States. The majority Commissioners show clearly that geographical conditions in Australia set definite limits to the creation of new States. But the creation even of a few new States would seriously threaten the continuance of a federal system in Australia. American experience will not offer us reliable analogies. For one thing, Australian populations are so much smaller. For another, the American theory of government leaves to governments very much less extensive functions than Australian governments have to perform. What we have to face in Australia is the possibility of small communities wielding large powers. It is therefore remarkable that a majority of the Commissioners were willing to extend the facilities for establishing new States. At present the Commonwealth Parliament may create a new State out of an existing State, but only with the consent of the Parliament thereof and of a majority of the electors therein. The Commissioners substantially adopted the proposals of the Northern New State Movement, as drafted by Mr Latham. Their recommendations would allow the Commonwealth Parliament to create a new State (having an area not less than the present area of Tasmania), even without the assent of the majority of the electors in the State concerned, provided that the change was supported (i.) by a three-fifths majority in the area proposed for the new State, and (ii.) by two-fifths of the electors of the existing State concerned. Sir H. Colebatch and the Chairman dissented, holding that the consent of a majority in the existing State should be required.

The significance of a Royal Commission's report depends chiefly upon its prophetic value — its value as a guide for future action. This report, as we have seen, points in different directions. Piquancy is added to the situation by the fact that the electors have since decisively rejected what is perhaps the most important individual recommendation of the majority Commissioners (the transfer of industrial powers to the States), and by the fact that a new federal government has come into office, presumably cherishing the objective proposed by the minority. Whither, therefore, is Australia tending? The majority Commissioners, whilst making certain adjustments, would keep the Constitution 'federal,' as at present. But a persistent question obstres itself: Are there not presently existing tendencies which, if not checked, will gradually undermine that power and independence of the States which makes and keeps Australia federal? The crux of the situation, as Sir Hal Colebatch said, lies in the financial relations between the Commonwealth and the States. If those relations are on a
permanently stable and satisfactory footing, ‘federalism’ may well continue: but there seem to be destructive forces at work. The New States Movements constitute one of them. Another is the establishment of the Australian Loan Council, as a result of which developmental policies are already ceasing to be a purely State matter, and are coming to be matters of common concern, dealt with on the financial side at any rate by an Australian body. Again, in various ways the States are becoming more and more dependent financially upon the Commonwealth. The federal government has interpreted its power under section 81 to appropriate revenue ‘for the purposes of the Commonwealth,’ as enabling the Commonwealth to endow purposes outside its ordinary legislative competence, such, for example, as scientific and industrial research. But it is at least possible that if the matter were to come before the High Court, a narrower view of the section would be taken. The section has not hitherto been responsible for serious inroads upon the sphere of the States. A more important matter is the power of the Commonwealth (section 96) to give financial assistance to any State ‘on such terms and conditions as the Parliament thinks fit.’ This has been extensively used during the last few years. The obvious cases are the annual special grants to Tasmania, Western Australia and South Australia. It is understood that here the Commonwealth has not gone so far as to impose any definite conditions, though it has expressed its wishes quite clearly. In some less striking cases, however, definite conditions have been laid down as the price of federal assistance. Loans on specially easy terms, for the construction of main roads and for housing, and grants for soldier settlement, are cases in point. The administration of the ‘£34,000,000 migration agreement’ has brought strong and direct federal influence to bear upon State developmental policies.

These matters are as yet small enough. But they are big with potentialities, as students of the ‘provincial experiment’ in South Africa will recognise. Sir Hal Colebatch realised it, and — alone among the Commissioners — urged that the new financial agreement between the Commonwealth and the States cannot be regarded as a permanently satisfactory adjustment of the position. He urged that the States should receive a fixed proportion of customs and excise revenue, say, one-third. It may, perhaps, be doubted whether this change would suffice to check the growing financial dependence of the States, but the remaining majority Commissioners were fain simply to describe these tendencies, and to put them aside, without attempting to arrest them. It may not be possible to arrest them. But, if so, can federalism endure in anything but a purely formal sense?
These considerations lend further weight to the conclusion put forward by Mr Owen Dixon (as he then was) in evidence on behalf of the Committee of Counsel for Victoria.

A federal form of government, [he said] represents a compromise, and the theory upon which it rests as a political device includes the supposition that it will serve during a period of transition, while people separately governed may find it possible to unite more closely under a less rigid constitution. It may be doubted whether the purpose for which the instrument was designed is best served by attempts to improve it from time to time merely for improvement's sake. The power of amendment seems rather to be a means for effecting important alterations which new conditions clearly require than for removing blemishes merely because they are discovered. Looked at as a whole, the constitution seems to have worked well enough as a federal instrument. (Evidence, p. 790.)

'Federalism is only an interim solution at best,' he seems to say to the majority. 'It isn't worth bothering about minor amendments. Leave the constitution alone until Australia is ready for a unitary system.'

But there is one further question which must be faced. The minority Commissioners urge us now 'to unite more closely under a less rigid constitution.' But is Australia really ready for it? The sparseness of her population, the greatness of her area, the divergence of physical environment and of local outlook, are very real things, as the majority insist. A closer form of union would admittedly be unsatisfactory if it were to be merely a gigantic centralisation. The minority Commissioners say, perhaps a little lightly, 'unify but decentralise'; 'leave a good deal of administration to local units.' The fact is that the Australian, as revealed in his history, is a confirmed centraliser. Decentralisation is yet his to learn. If this be true, the view of the majority may in the long run be in Australia's best interests. Federalism may well be impermanent, forces may already be at work to destroy it. But the majority Commissioners would retain it as long as possible, and meanwhile Australia may have time to learn the method of decentralisation piecemeal and indirectly, through the federal aid road system, the elaboration of soldier settlement policies, and so forth. Perhaps we are too young in the science of government, and a unitary system would at present be perilous for us. But, as Lord Macnaghton once put it, 'the negation of dangerous principles does not as a rule rouse enthusiasm.' A wise saying, which comes to mind as one lays down this report.
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Notes


2  [Sir Hal Colebatch, 1872-1953. Premier of Western Australia 1919; Senator for Western Australia 1923-27; Western Australian Agent-General in London 1933-39.]


4  [(Sir) John Latham, 1877-1964. Attorney-General 1925-29; Leader of Nationalist Party 1929-34; Deputy Prime Minister and Attorney-General 1931-34; Minister to Japan 1940-41; Chief Justice of High Court 1935-52.]

5  [(Sir) Owen Dixon, 1886-1972. Justice of High Court 1929; Minister to Washington 1942-44; Chief Justice of High Court 1952-63; Order of Merit 1963.]

6  The division among the Commissioners represents a real division of Australian sentiment and opinion, and it seems improbable that an attempt to carry out the proposals of the minority could at present be successful.
PART TWO

THE AUSTRALIAN LOAN COUNCIL
The readings in this part deal with the replacement of the per capita payments system by federal grants to the States in aid of their debt charges, and with the other changes in borrowing and debt arrangements which were associated with the establishment of the Australian Loan Council and the Financial Agreement of 1927. Because the per capita payments were made for general revenue purposes, like the original State share of customs and excise duties, it had always been possible to argue that they differed from the latter only in their basis of allocation and that they should be financed solely from indirect taxation, leaving direct taxation to the States. In 1927 this supposed link with the original arrangement for sharing indirect taxes was finally removed without any implied limitation on the Commonwealth’s right to levy direct taxes concurrently with the States.

Reading VIII by Professor D. B. Copland, which deals with the developments in Commonwealth-State financial relations that led to the Financial Agreement, is in effect a continuation of his 1924 article (Reading III). It gives a contemporary summary of events in the intervening years and shows how a solution of the fiscal allocation problem became linked with a settlement of the State debt problem that had been left unresolved at federation. The Reading seems to indicate that in the years before the Great Depression academic opinion — wrongly as it transpired — regarded popular concern about the debt burden as exaggerated. In the absence of any official national accounts, however, there was no recognised measure of the debt burden and economists had to invent their own by reference to ‘production’ — a forerunner of gross national product. It may also be noted that academic opinion at the time seems to have welcomed the
Financial Agreement because it did not entail the abolition or reduction of Commonwealth income tax, direct taxation being regarded as too low relative to indirect taxation — a far cry from the situation as it appeared to the Asprey Committee nearly fifty years later.

Reading IX by Mr (later Sir) Norman Cowper considers the effects of the Financial Agreement on Commonwealth-State financial relations as perceived in 1932. It was thus written in the depths of the Depression and records the view of a close observer of political and constitutional developments, particularly in New South Wales which was the storm centre of the Depression as Victoria had been in the 1890s. It is perhaps ironical that the full implications of the Financial Agreement did not become apparent until long-term public borrowing had become impracticable both in Australia and overseas. The only remaining source for public borrowing was the banking system. For the time being the Loan Council became the channel for negotiation between the Commonwealth and State governments on the one hand and the Commonwealth Bank and the private banks on the other. This alignment was disturbed by the failure of New South Wales to meet its interest obligations under the Financial Agreement and the resultant Commonwealth action, and by the first tentative moves to curtail the independence of the Commonwealth Bank Board. The dismissal of the New South Wales Premier (Mr J. T. Lang) in 1932 probably had an even more traumatic effect than that of Mr Whitlam over 40 years later, but the circumstances were similar in that both were connected with overseas borrowing.

Writing in North America at the end of the decade, Professor J. A. Maxwell was able to take a somewhat more detached view of the events of the early 1930s. In describing the recent history of the Australian Loan Council in Reading X, he pays particular attention to the technicalities of short-term Treasury bill finance and notes that without the Loan Council a co-ordinated fiscal policy would have been almost impossible during the Depression. By the mid-1930s new problems had begun to emerge. The dispute between the expansionists and the anti-inflationists which followed the resumption of long-term internal borrowing has a curiously modern ring. The apportionment of limited loan funds among the States also became a matter of dispute and brought into prominence, although never into actual operation, the apportionment formula that had originally been inserted as a concession to Lang. Some of the States also sought to avoid the constraints of the Loan Council by increasing the borrowing powers of their semi-governmental and local authorities. Maxwell was perhaps unduly sceptical of the effectiveness of the so-called ‘Gentlemen’s Agreement’ of 1936 to control such borrowing. He also
seems to attach undue importance to the need for a permanent secretariat.

Considerations of space have precluded the inclusion in full, in Reading XI, of Mr (later Professor) S. R. Davis's 1952 paper on 'A Unique Federal Institution' — a title borrowed from Professor Maxwell. The sections reproduced relate mainly to matters dealt with only incidentally by other writers, or to war-time and post-war developments affecting the Loan Council. Commonwealth borrowing for defence was not subject to the terms of the Financial Agreement, but Maxwell's expectation that such borrowing would be mainly from overseas was not fulfilled in World War II. However, the war-time demand on internal funds was so great that recourse was again necessary to large Treasury bill issues between 1941 and 1944, part of the proceeds being used to make monthly advances to the States for their drastically reduced Loan Council programs for civil works. The outstanding war-time Treasury bills were redeemed or funded by the Commonwealth after the war, and in 1944 a final settlement was also reached with the States concerning the funding of the Treasury bills which had been outstanding since 1931-33. This settlement was incorporated in a redrafted version of the Financial Agreement, and the opportunity was also taken to omit obsolete sections and to make various technical changes.

A second change resulting from the war was the appointment of a Co-ordinator General of Works to assess the defence priorities attaching to all public works programs, including those of the Loan Council. Originally agreed to in 1940, this arrangement was continued after the war as a means of increasing the information available to the Council. However, it did not involve anything in the nature of an elaborate secretariat, for reasons mentioned in the Reading.

The third and most important war-time change concerned the position of the Commonwealth Bank. Under the National Security War-time Banking Control Regulations 1941, the Bank acquired the full central banking controls over the trading banks which it had lacked in the 1930s. These controls were perpetuated under the Banking Act 1945 which was accompanied by another Act that reconstructed the Commonwealth Bank, combining the offices of Chairman and Governor, replacing the Board of Directors with an advisory body and establishing the right of the Commonwealth government to intervene in matters of policy. The effect of these changes was perhaps greater than Davis allows. The Bank's independence was greatly reduced and the Commonwealth government's power correspondingly increased. In future the Bank was to be aligned with the Commonwealth government against the trading banks on the one hand and the States on the other.
Despite these changes in the conditions under which the Loan Council operated, it was not long before some old problems reappeared. Inflation, which had been a largely imaginary bogey in the 1930s, suddenly became a reality in the early 1950s. In the ensuing scarcity of funds for long-term investment, the twin problems of determining a prudent maximum level of public borrowing and of its apportionment among the States again raised their heads.

Mr C. G. Headford's 1954 paper (Reading XII) takes up the story at this point, after giving a concise summary of the developments described in earlier Readings. At the 1951 meetings of the Loan Council, the Commonwealth government in effect took over the Commonwealth Bank's traditional underwriting role and agreed to make monthly advances towards a loan program which was less than the States had requested but still substantially above estimated loan raisings; the shortfall was to be made up by 'special loans' financed from the Commonwealth's revenue and other resources. At the 1952 Loan Council meeting, the States out-voted the Commonwealth and approved a borrowing program in excess of that which the Commonwealth was prepared to underwrite. However, their victory was a hollow one, because public loan raisings fell far short of the States' program and they had no means of inducing the Commonwealth to increase its support. Thereafter Loan Council programs were held virtually stable throughout most of the 1950s at levels determined by the Commonwealth. Commonwealth support continued to be necessary except for two years in the early 1960s.

In recent years the States have increasingly criticised Loan Council borrowing programs as being too inflexible to meet any upsurge in the capital works required for development purposes. Western Australia, in particular, has claimed that funds to finance the infrastructure associated with large-scale mining projects could be raised on better terms by the State than by the companies involved, and also on better terms overseas than in Australia. Provision for the States themselves to borrow overseas had been inserted in the 1927 Financial Agreement at the insistence of Mr Lang, as noted in the second section of Reading XI. However, the requirement of a unanimous Loan Council decision before a State can borrow under this provision seems to have been an effective impediment to its use.

During discussions of these issues among the States and the Commonwealth since 1976, attention seems to have shifted from the possibility of overseas borrowing by the States themselves to that of extending the 1936 Gentlemen's Agreement to provide for overseas borrowing by the larger semi-government authorities, both State and Commonwealth. The matter was discussed at the July 1977 Loan Council following a report by an expert committee. In March 1978 the
Prime Minister circulated a set of guidelines to which proposals for so-called 'special additions' to the loan program would have to conform, including provision for approval by a simple majority of the Loan Council members including the Commonwealth. The latter requirement was objected to in some quarters as still leaving the Commonwealth with an effective veto, but was finally accepted by the States for a three-year period. At the June 1978 Loan Council meeting, various proposals for 'special additions' were referred to an expert committee for assessment. On 6 November 1978, a special meeting of the Loan Council approved a special semi-government borrowing program of $1,767 million over an eight-year period, involving twelve projects in all six States. Applications for overseas borrowing in connection with the approved projects will require separate Loan Council consideration at the time. The program will be a continuing one but the Commonwealth indicated that it would not favour any additional projects for the next three years.

Note

1 Described as 'a queer clause' by Professor L. F. Giblin in his evidence before the Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois Commission), Ottawa, 1938 (p. 49 in the mimeograph copy in the National Library, Canberra).
Further Reading

In addition to the following, see Further Reading Part Five (pp. 425-8 below).

**Articles**

**Books of Readings and Symposia**
Portus, G. V. (ed.), *Studies in the Australian Constitution*, Angus and Robertson, Sydney, 1933.

**Monographs and Books**

**Official Documents**
In September 1924 I outlined in the *Economic Journal* the main features of the financial relations of the States and the Commonwealth since the establishment of federation, and discussed the abortive conference of 1923 at which the Commonwealth sought to commit the States to a proposal under which the *per capita* payments of 25s. to the States would be terminated and the Commonwealth would give up a portion of its income tax. The subject has been a major political issue in Australia in the past four years, further conferences have been held and proposals for its solution have been made by students of the problem. At an important conference of the States and the Commonwealth held in Melbourne in June 1927, a basis of agreement was reached upon which legislation in the several Parliaments is pending. This is a convenient moment for bringing the former article up to date, and briefly outlining the nature of the settlement now arranged.

In the period from 1923 to 1927 the chief facts relating to the problem may be stated as follows:

(i) The customs and excise revenue has steadily expanded, due partly to the increase in the tariff and partly to the growth of imports stimulated by prosperity at home and borrowing abroad. Thus the percentage of indirect taxation to total Commonwealth taxation
increased from 66 per cent in 1923 to 72 per cent in 1926, while the proportion of indirect taxation to total taxation of the Commonwealth and the States increased from 48 per cent to 50 per cent only in this period. Whilst the yield of direct taxes levied by the Commonwealth has been stationary in the past three years and the rates steadily declining, the States have found it necessary to increase taxation, the total return having risen from £18,740,000 in 1923 to £23,452,000 in 1926. The Commonwealth in this period abandoned the land tax on leasehold properties, but retained the tax on freehold.

(ii) Slight changes had been brought about in the financial relations of the States and the Commonwealth on account of the special difficulties of Western Australia and Tasmania. After investigations by the Commonwealth, both States received special grants amounting in the case of the former to £450,000 per annum for five years, and in the latter to £378,000 per annum for two years.

(iii) At a conference convened in May 1926 the Commonwealth proposed that the delimitation of spheres of taxation should be made on the principle that the Commonwealth should levy indirect taxes and the States direct taxes. As a first step in this direction the Commonwealth suggested that it should retire from the field of income tax on individuals, that the per capita payments should cease and that temporary assistance should be given to the States to prevent dislocation in their finances in the transition period. This scheme was quite unacceptable to the States, which insisted on their moral rights to some portion of the revenue from customs and excise. The attitude of the States was expressed at a special conference of the State Premiers held in June 1926, when it was declared ‘that there should be no departure from the basis upon which the financial relations of the States and the Commonwealth have rested without the fullest consideration at a constitutional session and the approval of the people at a referendum.’

(iv) Meanwhile, on 4 June, the Federal Treasurer had introduced a Bill for the cessation of the per capita payments. On this occasion he submitted an amended scheme under which the Commonwealth would surrender land tax, estate duties, entertainments tax, and 40 per cent of the income tax on both individuals and companies. As in all other Commonwealth proposals, the Treasurer was able to show that the total amount of taxation surrendered by the Commonwealth was greater than the per capita payments which would be terminated.

It is not necessary to repeat the objections against these schemes for adjusting financial relations. They are fully set out in the previous article. Acute differences between the States and the Commonwealth arose out of the situation brought on by the latter in using its legislative powers to terminate the per capita payments. The Bill was
not passed until March 1927, and the general opposition to the measure and to the policy of the Commonwealth government was largely responsible for the new proposals that were put before the conference in June [1927].

The rapid growth of the public debt and the increasing need of some measure of control over borrowing and a specific scheme of debt repayment were also factors leading to a more satisfactory settlement of financial relations. Towards this end a Loan Council had been set up in 1923 for the purpose of securing co-ordination in borrowing. All States except New South Wales joined the Commonwealth in this Council, which arranged the programme of borrowing each year, though not exercising any rigorous control over the amount each authority would borrow. Another measure designed to promote a better borrowing policy arose out of the migration agreement with Great Britain. During the next ten years an amount not exceeding £34,000,000 is to be made available by the British government at low rates of interest. These funds are to be used for the settlement of immigrants, and it is expected that a total of 450,000 will be absorbed in this period. Schemes for the expenditure of these funds are to be arranged by the Development and Migration Commission set up in 1926 for this special purpose. An important feature of the Act setting up this Commission is the provision that the Commission must approve of all schemes for the expenditure of the loan money stipulated in the agreement. This has the effect of taking some part of loan expenditure out of the hands of governments, though the funds must be expended with the approval of governments, who will ultimately be responsible for repaying the loans.

Another factor bringing the debt question into the discussion of financial relations was undoubtedly the criticism both at home and abroad concerning the growth of the debt and the unsatisfactory provision for repayment. Statistics of the growth of the debt have been used with great effect by critics, and whilst the discerning student can point to many errors in the popular interpretation of the position, the discussion has had good results in forcing governments to make greater provision for repayment. The total debt of the States and the Commonwealth increased from £828,000,000 at 30 June 1921, to £1,014,000,000 at the corresponding date in 1926. Of the increase, £138,000,000, or approximately 75 per cent, was raised abroad. The annual interest burden on the overseas debt rose from £17.4m in 1921 to £25.4m in 1926. Many misleading statements are made concerning this burden, which is in no way beyond the capacity of the country. The following table is of interest on this point.
Figures for production include only certain industries and should not be confused with national income, which is probably half as large again on the average. For purposes of comparison the proportion of the interest to production shows the real burden over the period. But when allowance has been made for the ratio of debt burden to production it must still be recognised that the debt has been increasing at a very rapid rate, and there is no likelihood in the immediate future that the rate of increase will decline. Moreover, with the exception of the Commonwealth debt and the debt of Western Australia, little provision has been made for redemption. While there is a tendency to attach undue importance to sinking funds, or other measures for dealing with the debt, it has been found necessary to meet the wishes of investors abroad by arranging for a definite scheme of repayment in connection with each loan.

It was in these circumstances that the Commonwealth brought forward fresh proposals at the [June 1927] Conference. As these were agreed to with slight modifications of detail by the States, they may be quoted as follows according to the Commonwealth memorandum placed before the Conference:

(i) The Commonwealth is to take over the whole of the public debts of the States.
(ii) The Commonwealth [is] to apply £7,584,912 annually from its revenues towards payment of the interest charges; the States [are] to contribute the balance.
(iii) Properly safeguarded Sinking Funds [are] to be established in respect of existing State debts and new borrowings, and the Commonwealth [is] to make substantial contributions to those Sinking Funds.
(iv) The management of debt and future borrowing on behalf of the Commonwealth and the States [is] to be vested in an Australian Loan Council consisting of a representative of the
Commonwealth and a representative of each State, such Council to be given powers under a constitutional amendment.

(v) A final settlement in respect of 'Transferred Properties' [is to be] based on the Commonwealth assuming the liability for interest and principal of equivalent amounts of States debts.

The advantages of this arrangement are obvious. In the first place, there is no disturbance to the present system of taxes. In particular, no effort is made to make the States wholly responsible for the income tax, or to cause undue dislocation of their finances through the abolition of the per capita payments. The Commonwealth cannot now become solely dependent upon customs and excise, and this is a most satisfactory feature of the scheme. Secondly, the moral right of the States to some proportion of the customs revenue is maintained, for the Commonwealth not only assumes liability for interest on the State debts to an amount of £7,585,000, but it proposes to contribute towards a sinking fund for the extinction of the existing debts at the rate of 0.125 per cent per annum. This will amount to £808,000 per annum for 58 years. In addition, all new debts created by the States are to be paid off through a sinking fund of 0.50 per cent per annum, of which the Commonwealth will contribute 0.25 per cent. Assuming that the present rate of borrowing is sustained, the annual increase in the liability of the Commonwealth on this account would be approximately £90,000, whereas under the per capita payments with a population increasing at the rate of 2 per cent per annum the annual increase at present would be £150,000. The obligation of the Commonwealth is increased by a rise in the rate of interest on transferred properties (buildings and equipment taken over at the time of federation) from 3.5 per cent to 5 per cent. If the scheme were applied to the year 1927-8, the following would be the effect upon the Commonwealth Treasury:

<table>
<thead>
<tr>
<th>Commonwealth Payments</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution towards interest on State debt</td>
<td>7,585,000</td>
</tr>
<tr>
<td>Sinking fund of £0.125 per cent on State debts</td>
<td>808,000</td>
</tr>
<tr>
<td>Increased interest on transferred properties</td>
<td>165,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,558,000</strong></td>
</tr>
</tbody>
</table>

Payments under *per capita* system                         | 7,735,000  |
Increase in Commonwealth payments to the States            | 823,000    |

(There would also be an obligation of some £90,000 on account of sinking fund on new State debt.)

Obviously the States stand to gain in the immediate future. Under the old arrangement they would be entitled to receive increased *per
capita payments of some £150,000, but in the first year of the new scheme they will receive over £900,000. If borrowing increases at a rate of £36,000,000 per annum, an unenviable prospect, the contribution of the Commonwealth will increase at a rate of £90,000 per annum, and it will be fifteen years before the contribution of the Commonwealth would be less than it would have been under the old per capita scheme.

A third advantage lies in the settlement of the debts. Clause 105 of the Constitution gives Parliament the right to ‘take over from the States their public debts’ and to apply the surplus revenue of the Commonwealth payable to the States, as defined in Clause 87, to payment of interest on the debts taken over. In 1910 a referendum had sanctioned an alteration in this clause, which originally restricted the debts that could be assumed by the Commonwealth to those ‘existing at the establishment of the Commonwealth’; but as another proposal designed to make the per capita system a permanent feature of the Constitution was rejected, no action was taken concerning the debts. Under the present agreement the Constitution is to be again amended in the direction of giving Parliament power to make laws with respect to the State debts ‘for carrying out or giving effect to any agreement made or to be made between the Commonwealth and the States.’ There is every prospect that this amendment will be carried. If so, it is only the second substantial alteration of the Constitution despite several attempts.

Both changes will refer to the one section dealing with State debts and will fasten on the Commonwealth a definite obligation in return for any increased powers granted. Though the provision of sinking funds will bulk largely in popular discussions and will appease the investor abroad, by far the most important feature of the debt settlement is the allotment of a portion of the customs revenue to the payment of interest on the State debts. Amendments to the Act providing for the Loan Council will also have beneficial effects in promoting a common discussion of the effects of heavy borrowing, and in securing uniformity of conditions for new issues and conversions of existing debts. The sinking funds will raise the value of the stocks of some States and secure a slightly better rate of interest, while the obligation to set aside 5s. per cent [0.25 per cent] on all new issues will serve as a slight check upon borrowing. As these sinking funds will be administered by the National Debt Commission, which controls the present Commonwealth sinking fund, there is some guarantee that the funds will not be raided by needy States, or used to justify a heavy and growing deficit, as has been the case in some States, notably Western Australia. A special feature of the proposals
concerning sinking funds is the stipulation that [long-term] loans to cover deficits must bear sinking funds of 4 per cent.

Against these gains from the sinking funds must be set the increased taxation required. Where the loans are for really sound development works they should furnish soon after their expenditure the increase in production allowing heavier taxation. Whilst the rate of borrowing overseas continues as at present, the sinking funds should make the transfer problem a little less difficult. By providing funds in Australia which may be used to purchase securities in London or New York, the amount of capital flowing in will not be equal to the full amount of the loans raised abroad. From this point of view a sinking fund has the merit that it will assist in preparing for the time when the loans abroad decline in importance and the full burden of interest and debt repayments fall on the export trade. But clearly this result could be obtained by reducing the loans raised abroad by the amount of the sinking fund now stipulated.

One further comment may be made. The agreement now reached implies a complete reversal of policy on the part of the Commonwealth government. For the past six years it has been animated with the desire to reduce direct taxation as much as possible in the mistaken belief that it should return to the pre-war policy of complete dependence upon customs and excise. It is not necessary to repeat that this policy was objectionable in both theory and practice. But what amazes the student of the problem is that a government which had consistently made such bad proposals should now be responsible for a scheme which is perhaps the most satisfactory readjustment of the relations of the States and the Commonwealth since federation.

Notes


2 Commonwealth Parliamentary Debates, 1926, No. 25, pp. 2677-91. [The Commonwealth Treasurer was Dr Earle Page.] [See Reading V note 13.]

3 [Copland, Wickens and Exley, 'Papers on the Public Debt', The Economic Record, May 1926, pp. 74-86. Between 1923 and 1927 the Loan Council existed only on a voluntary and informal basis. From December 1925 until June 1927, New South Wales was not represented but it seems to have observed Loan Council interest rate decisions while making its own borrowing arrangements. It may also be noted that during the 1914-18 War the Commonwealth had borrowed in London on behalf of the States. See Headford, Reading XII below.]

4 See especially the pamphlet by Messrs. Cooke and Davenport, Australian Finance, published in London just prior to the Imperial Conference of October 1926.
Fiscal Federalism

5 [The 'slight modifications of detail' here referred to were made principally to secure the adherence of New South Wales. In the event, some of them proved not to have been so 'slight', as will be evident from the list in the second section of Reading XI below.]

6 [The Commonwealth's contribution amounted to 23 per cent of total interest charges on State debt at 30 June 1927 and was equal to its total per capita payments to the States in 1926-27.]

7 It should be noted that the proposal requires the States to contribute to a sinking fund on existing debts at the rate of 5s. (£0.25) per cent per annum [making a total contribution of 0.375 per cent].

8 [After being agreed to in principle at the June 1927 Conference, the Financial Agreement was formally signed in December 1927 and was passed into law by each of the seven Parliaments in 1927-28. Legislation to amend the Constitution by the insertion of a new Section 105A was approved by referendum on 17 November 1928 and assented to in February 1929. The Financial Agreement was then validated in March 1929 and its permanent provisions (Part III) replaced the temporary provisions (Part II) which had operated from 1927 until 30 June 1929.]

9 [As a result of the new Section 105A, the Loan Council constituted under Part I of the Financial Agreement acquired a permanent constitutional status. As will be apparent from the next reading, no government henceforth could repudiate the Agreement establishing the Council, and power to enforce its decisions was conferred on the Commonwealth government.]
The First Financial Agreement: Its Effect Upon the Relations Between the Commonwealth and the States*

Norman Cowper

The Constitution and the Agreement
The union which was effected by the Commonwealth Constitution Act was essentially a federal one. The uniting parties, the six States, gave up to the national Parliament only certain specified powers which were deemed to be of a national character, and strove jealously to preserve and safeguard their independence and sovereign rights in other respects.

The first bench of the High Court, consisting of judges who had themselves been mainly responsible for the drafting of the Constitution, leaned strongly towards upholding the rights of the States. Indeed, by importing into the interpretation of the Constitution the doctrine of 'implied prohibition' against interference by the Commonwealth law with an 'instrumentality' of the States (and, vice versa, against interference by a State with a federal instrumentality) these judges ensured for the time being that the working of the Constitution would involve the least possible impediment to the free exercise by the States of their sovereign rights.

Since the war, however, a great change has come over the scene. Leaving apart the war period, when the defence power was invoked so successfully that Australia was, for the time being, a unified State so far as legislation was concerned, the first great inroad into the rights

*Reproduced from The Economic Record, December 1932, pp. 173-90.
of the States was made by the High Court in the Engineers’ Case and the cases which followed it. These decisions of a differently-constituted bench swept away the doctrine of ‘instrumentalities’ and ‘implied prohibitions’, and substituted the principles that Common­wealth law, made upon a subject within the competence of the Commonwealth Parliament, is supreme, no matter how crippling may be its effect upon a State government, and that when the Common­wealth Parliament has ‘occupied the field’ of legislation upon a subject allotted to it the power of the States to legislate on that subject is excluded.

But a more deep-thrusting invasion of the large extent of independence left to the States has resulted from the making of the first Financial Agreement and the introduction into the Constitution of the new Section 105A. One may be permitted to wonder whether the lawyers who drafted, or the statesmen who adopted, this new section, and this first Agreement, had anything like a full perception of what was implicit in their provisions.¹

Probably the chief objectives which were in mind when the Agreement was made were:

1. to end the competition between the Commonwealth and the six States on the loan markets, especially those of London and New York;
2. to stop the orgy of borrowing which had been occurring since the war, and ensure that future borrowings should be confined to such amounts as might be available at reasonable rates; and
3. to bolster up the weakening confidence of investors in Australian securities by throwing the weight of the whole of Australia behind all governmental borrowings, both past and future.

The accomplishment of even these objectives meant a considerable sacrifice of independence on the part of the States and of the Commonwealth as well. They gave up rights to borrow as much as they liked, when they liked, where they liked, and on such terms as they liked. They created a new unit of government, the Loan Council, and handed over to it the power to regulate their own borrowings; and, as a consequence of its possession of such power, the Loan Council was, in effect, endowed with the function of regulating the speed at which the capital development of the whole country should proceed.

But the last three years have shown that a far greater surrender of sovereign powers is implicit in the Agreement. Recent events have proved that, in certain circumstances, the Loan Council may be made the instrument of forcing upon the Commonwealth and the States a common policy involving the very details of their internal
administration; and that, through the exercise of the powers contained in the Agreement and Section 105A, it is possible to achieve a unified Australian effort to meet a world depression, comparable in some degree to the unified effort which, through the exercise of the defence power inherent in the Commonwealth Parliament, the nation was able to put forth in time of war.

The Genesis of the Premiers' Plan

Let us trace so much of the story of the Premiers' Plan as shows how the banks, using the provisions of the Financial Agreement, and aided by the existence of a conservative majority in the federal Senate, virtually forced the adoption of a plan of reconstruction of which they approved. The starting point is a letter from Sir Robert Gibson, as Chairman of the Commonwealth Bank, to Mr Lyons, as Chairman of the Loan Council, on 13 December 1930.2 This was written on behalf of the Commonwealth Bank and the trading banks, setting forth their views 'in connection with the difficulties of finance and the necessity of a closer control of the position as between the Loan Council and the banks'. It stated that

... all advances made to Governments should be approved by the Loan Council and arranged for by that body as the central authority . . . the banks propose that financial assistance to be given to any Government shall be covered by Treasury bills, issued under the authority of the Loan Council, to which body the banks will look for the discharge of the obligations created by the issue of these bills.

These announcements seem to have been accepted by the governments without demur. The distinction made by the 1927 Agreement between borrowing 'solely for temporary purposes' and other classes of governmental borrowing was thus obliterated in practice, and all classes of governmental borrowing from banks were placed on the same footing;3 and it was established that financial assistance to governments would be available only from the Commonwealth Bank and only through the Loan Council and on the security of Treasury bills issued under its authority. The great importance of these developments will be appreciated from what follows.

The letter concluded with a plain hint — foreshadowing the Premiers’ Plan — as to the conditions on which the Governments could expect to receive assistance:

... the banks throw out the suggestion ... that a sound, constructive scheme, covering a period, should be evolved, spreading the load of readjustment in such a manner as will enable all the component parts of the Commonwealth to cope
with the situation, and so eventually enable the country to return to an era of competence and prosperity.

In January 1931, a Committee of Under-Treasurers made a survey of the financial position of Australia, which they presented to the February Conference of Premiers. A supplementary report by four of the Under-Treasurers stressed the need for economy as the keynote of the position, and made some rather vague recommendations as to the ways in which economies could be effected. Sir Robert Gibson on 13 February informed Mr Theodore (who had now become Federal Treasurer) of the following resolution of the Bank Board:

Subject to adequate and equitable reduction in all wages, salaries and allowances, pensions, social benefits of all kinds, interest and other factors which affect the cost of living, the Commonwealth Bank Board will actively co-operate with the trading banks and the Governments of Australia in sustaining industry and restoring employment.

He added:

My Board realizes that this resolution in itself can be taken as only a comprehensive objective which it is desirable to aim for, and necessitates practical co-operation and effort in its attainment. This necessitates some definite movement and the creation of constructive plans for accomplishment.

This letter only made plainer the plain hint previously given, and after consideration of it the Conference adopted resolutions covering a three-year plan. This plan was rejected by the banks, apparently because the proposals for economies were not sufficiently drastic or specific, and because a proposal for a special tax of [17.5 per cent on government bond interest] was viewed with strong disfavour. Probably, however, the banks also distrusted this plan because they believed that it masked the inflationary designs of Mr Theodore.

Such designs were strongly prosecuted during the immediately succeeding months. But the rejection by the Senate of the Fiduciary Notes Bill on 17 April and the Commonwealth Bank Amendment Bill on 14 May brought the federal government up against a brick wall, which they could not hope to surmount except by the tedious and very risky process of a double dissolution.

Meanwhile, on 2 April 1931, Sir Robert Gibson had written another letter — and this was quite a momentous one. He complained of 'the continuous drift of Government finances', and advised the Loan Council that a point was being reached beyond which it would be impossible for the banks to provide the governments with financial assistance.
Mr Theodore gave an indignant and defiant reply, in which he charged the Commonwealth Bank Board with attempting 'to arrogate to itself a supremacy over the Government in the determination of the financial policy of the Commonwealth', and declared his government’s intention to proceed on the course it had chosen.8

But with Sir Robert’s ultimatum before them a majority of the Loan Council on 25 April appointed a sub-committee to survey the position with regard to budgets and economies with a view to obtaining balanced budgets by the end of June 1934.9 This sub-committee co-opted certain economists and Under-Treasurers, who produced the report which formed the basis of the Premiers’ Plan.10 It differed from all previous proposals:

(a) in the greater precision of its recommendations; and
(b) in providing for a greater internal conversion loan.

While Mr Theodore and Mr Scullin, like incompetent schoolmasters, had been arguing with their board of trustees as to the proper way of conducting the establishment, Mr Lang had been playing up very badly. He had made some tentative essays in default. Mr Scullin and Mr Theodore fingered nervously the formidable weapons of correction and compulsion which the Financial Agreement and Section 105A had placed in their hands. After some hesitation, they brought themselves on 13 April to issue a writ against the State of New South Wales, claiming payment of the interest and other moneys which the State had omitted to provide in accordance with the Financial Agreement. No doubt, the pendency of these proceedings, to which apparently New South Wales could find no valid defence, had a great deal to do with bringing Mr Lang into line with the other Premiers at the Conference which began at the end of May, and on 10 June 1931, adopted the Premiers’ Plan.11

The Influence of the Agreement upon the Adoption of the Plan

It will be convenient at this stage to speculate as to what would have happened if there had been no Financial Agreement and no Section 105A. Would the Premiers’ Plan, or any similar plan, have been evolved and adopted? No doubt, the banks would, sooner or later, have taken a united stand against unlimited governmental borrowing. The existence of the Financial Agreement, and the fact that borrowings otherwise than in accordance with its terms were rendered invalid, certainly ensured that the united stand was taken at a fairly early date, before the drift had gone too far. So much for the action of the banks. As far as the governments were concerned, Sir Edward Mitchell12 (to whose booklet *What Every Australian Ought to Know*, I am naturally very greatly indebted) is of opinion that Mr Theodore’s credit-expansion schemes could have been prevented by virtue of the
provisions of the Financial Agreement, notwithstanding that they should have passed both Houses of the Commonwealth Parliament. This is because he considers that they necessarily involved a ‘borrowing’ by the Commonwealth government, and therefore could have been restrained at the suit of any State, unless they had been approved by the Loan Council. With great respect, it seems to me that this view is clearly erroneous. With a favourable majority in the Senate, Mr Theodore would have amended the Commonwealth Bank Act to enable unlimited issues of currency and credit by the Bank Board — nothing unconstitutional or contrary to the Financial Agreement in that. Then he would have replaced the present Board with a more amenable one — nothing illegal in that. Then he would have procured the new Board to put more notes and credit into circulation, not by advancing them to governments, but ‘through the usual channels’, i.e., by advances to other financial institutions, to business enterprises and industries, even to trade unions, benevolent institutions, and individuals. This process could not by any straining of words be interpreted as a ‘borrowing’ by the Commonwealth or any other government, and consequently it could not have been affected by the Financial Agreement. I come, therefore, to the conclusions that the Commonwealth Government would not have been corralled into support of the Premiers’ Plan, or any other scheme of reconstruction involving drastic economies, if it had not found its escape blocked by the hostile majority in the Senate, and that the Financial Agreement had no decisive influence upon its attitude.

It was otherwise with regard to the recalcitrant State of New South Wales. It could not fall back on any scheme of currency or credit inflation, for the exclusive power of legislating with regard to currency and coinage rested with the Commonwealth. The fact that governmental borrowings not in accordance with the Financial Agreement would be invalid rendered futile any endeavours at this time to borrow money except from the Australian banks through the Commonwealth Bank and the Loan Council. Default in payment of the interest on its public debt was no remedy for its troubles unless the other governments were prepared to default, for under the Financial Agreement that interest was to be paid by the Commonwealth, which could be compelled to pay at the suit of any party to the Agreement, and the Commonwealth had a right to be indemnified by the State against such interest. It was hardly likely that the non-defaulting States would sit by and let New South Wales ‘get away with it’, and it was inevitable that, if New South Wales defaulted, sooner or later the Commonwealth would be forced into action to compel it to pay. Right from the beginning, therefore, the Financial Agreement, Section 105A, and the stand taken by the banks, together constituted a net encircling Mr
Lang's government, and gradually closing in on it — a net from which it had no hope of escaping except the faint hope afforded by the desperate expedient of the capital levy. If Mr Lang would not put his house in order, he must either borrow or confiscate. If he wanted to borrow, he must do it through the Loan Council, and comply with such conditions as it laid down. His actual decision to adhere to the Premiers' Plan was no doubt dictated by four things, namely:

(a) the necessity he was under of borrowing in order to carry on;
(b) the face-saving opportunity afforded by the conversion loan proposal;
(c) some dim conception of the futility of defying the rest of the Loan Council; and
(d) the immediate threat of the High Court action instituted by the Commonwealth Government.

I conclude, therefore, that the Financial Agreement was the main cause of Mr Lang's acceptance of the Premiers' Plan, and that if it had not been in existence he might have held up the adoption of a common policy until he had brought the whole of Australia toppling about his ears. He could have defaulted with impunity, and (prior, of course, to defaulting) might have been able to borrow, and thereby keep going for much longer than he did.

Implementing the Plan
Let us now turn to the story of the carrying out of the Plan. Here we cannot fail to be struck with the vital importance of the provisions of Section 105A, and of the machinery of the Loan Council and the Financial Agreement. Nor can we help noticing the extent to which the independence of the States is invaded.

The first essential step in the performance of the Plan was that the Conversion Loan should be put through successfully. If this had failed, the whole Plan might have gone for the time being. Actually, of course, it was almost entirely successful. This result was due largely to the fact that the conversion was made under the Financial Agreement and Section 105A. The bondholders were thereby given an indubitable assurance that the terms of their new contracts with the governments could not be altered in the future, and in particular, that no alteration in rates of interest, or in the tax exemption provisions, could possibly be made, without the assent of all the parties to the Debt Conversion Agreement. Nothing could have been better calculated to evoke confidence in the 'Australian Consols' on the part of investors and ensure the success of the conversion.

As to the other features of the Plan, the aim of the Commonwealth Bank, and of the majority of the Loan Council, was to enforce compliance with them by a careful and periodical scrutiny of the
accounts of the governments and a refusal to make funds available unless the Plan had been complied with. Thus, when the Loan Council met in August 1931, there was a discussion regarding the cash requirements of New South Wales for July. The following resolution was passed:

The Government of New South Wales, having given an undertaking to accept responsibility for payment of interest on New South Wales Public Debt, and having rejoined the Loan Council, and the representative of New South Wales on the Loan Council having advised that the State has effected a reduction of 20 per cent in its adjustable expenditure in accordance with the Premiers' Plan, the Loan Council approves the issue of Treasury Bills to the amount of £500,000 to cover the cash requirements of New South Wales for the month of July, 1931.

The question of the cash requirements of each of the Governments for August and subsequent months will be further considered, when an examination will be made with a view to seeing whether the economies agreed upon at the Premiers' Conference have been effected by the various Governments.14

The bank apparently demanded, and was certainly given, the most explicit assurances as to what the various governments were doing in the way of shaping their internal policy in accordance with the Plan.15 There seems no room for doubt that all the governments, with the exception of that of New South Wales, submitted readily to the supervision and direction of the Loan Council, and indirectly of the Bank, in matters which, a few years before, would have been regarded as peculiarly and exclusively the concern of the State governments. In other words, for the purpose of policing the Plan, the Loan Council became a kind of super-government, directing the States and the Commonwealth itself when they should prepare and present their budgets, what lines those budgets should follow, and even (it is scarcely too much to say) where and how economies should be made.

**Enforcing the Agreement in New South Wales**

Long before Mr Scullin's government was defeated it had become clear that New South Wales would not conform to the Plan. In the [federal] general elections in December [1931], Messrs Lyons and Latham repeatedly expressed their determination that one government 'should not be permitted to flout the will of the whole of Australia', and that the Plan should be loyally and strictly adhered to by every government. At the end of January [1932] the Loan Council was called together, and received a report setting out the position of Commonwealth and State finance under the Plan. This showed that
New South Wales had failed to perform its undertakings, and that it would exceed the amount of financial assistance to which it was entitled under the Plan by at least $3,500,000. An examination of the whole position 'forced the Commonwealth Government to the definite conclusion that Mr Lang has made no serious endeavour to honour the solemn undertaking he gave in respect of meeting his future interest obligations and to conform to the proposals embodied in the Premiers' Plan.'

Mr Lang informed the Loan Council

that he was unable to meet in full the overseas interest obligations of the State of New South Wales falling due in London and New York between the 1st and 4th of February, amounting to £958,763. He stated that his Government was in a position to find £458,763, and that this amount was being paid to the Commonwealth Bank. He asked the Loan Council to approve of an application being made to the Commonwealth Bank to advance to the State of New South Wales the balance of £500,000 to enable the obligations to be met.

With the Loan Council constituted as it now was, it was not likely that the request would meet with a very enthusiastic reception. It was declined, and further action was left to the Commonwealth government.

The legislation which it introduced was of a drastic character. Under Section 105A the Commonwealth was authorised to make agreements with the States relating to their public debts, including their taking over by the Commonwealth and the indemnification of the Commonwealth by the States, and the Financial Agreement did, in effect, make provision for (amongst other things) these two matters ... Sub-section (3) of Section 105A also empowered the Commonwealth to make laws for the carrying out of such agreements by the parties thereto, and ... sub-section (5) declared that every such agreement should be binding upon the Commonwealth and the States parties thereto, notwithstanding anything contained in the Commonwealth Constitution or the Constitutions of the States or in any law of the Commonwealth or a State. Mr Latham’s Financial Agreements Enforcement Acts provided that on the Commonwealth Auditor-General certifying that any sum was due under the Financial Agreement by a State to the Commonwealth, the Commonwealth Government, either before or after obtaining a declaration from the High Court, might issue a proclamation directing that

(a) specified classes of the revenue of that State should be paid to the Commonwealth instead of to the State; and

(b) moneys standing to the credit of that State with any bank should be attached and become payable to the Commonwealth.
This legislation undoubtedly came as a shock to constitutional lawyers who had not mastered the Financial Agreement and Section 105A, and had been nurtured in the traditions of the first High Court. It was such an extensive invasion of the sovereign rights of the States. Yet it was held valid by the High Court, and it now seems difficult to imagine how that Court could have decided otherwise...18

The decision of the High Court upholding the validity of the Financial Agreements Enforcement Acts meant that the net was closing round Mr Lang. Between 12 March, when the first Act became law, and 13 May, there was a tense and rather dramatic struggle. Mr Lang partially forestalled the attachment of his funds in the banks by withdrawing about £1,000,000 in cash and placing it in the vaults of his Treasury before the federal proclamation was issued. However, the stoppage of banking facilities involved difficulties in administration, which became more formidable every day. The federal government at first required income tax and some other classes of revenue to be paid by the taxpayers direct to the Commonwealth. The money came in slowly. Then further proclamations were issued, requiring State officers to pay over to the Commonwealth certain revenues coming to their hands. Mr Lang ordered that these proclamations should be disobeyed, and was dismissed by the Governor on 13 May for refusing to govern in accordance with the law. The result of his resistance had been that the whole machinery of government within the State had become disorganised.

His end had been almost inevitable after the High Court’s decision. There was then only one possible means left to him, by which he might hope to escape, for a time, at any rate, from the enmeshing toils of the Financial Agreement. This was the capital levy. But before this very doubtful expedient could be tested, he was dismissed from office. Since the State elections of June 1932, there has never been any doubt but that all the governments of Australia are united in their determination to carry out the Premiers’ Plan.

The Agreement and Commonwealth and State Powers
I think this cursory examination of the recent history of the Financial Agreement and Section 105A enables us to state several propositions with some confidence:

1. That the Agreement is an effectual instrument for ensuring that the obligations of all the governments with respect to the service of their public debts will be carried out.

This is subject to the qualification that, as the machinery for enforcement is placed in the hands of the federal government, enforcement will be difficult if that government is unwilling to use it.

2. That a State may be compelled to carry out any agreement made
under Section 105A, and that in the process of compulsion the 'sovereign rights' of the States may be ruthlessly swept aside.

3. That, in the course of enforcing such an agreement, the control of the servants and of the revenues of the State may be taken out of the hands, not only of the government, but even of the Parliament, of the State; and, indeed, that the people of the State may be prevented from having the government they want.

If Mr Lang had been returned to power in June 1932, and had then persisted in his refusal to obey the Financial Agreements Enforcement Acts, could the Governor have retained him in office? The dilemma is not so startling as it appears. It is probably an inherent though unlikely possibility wherever you have a federal system. For instance, if Sir Joseph Carruthers had continued to defy the Commonwealth, in spite of the High Court's decision in the Wire-netting Case, and had then been dismissed from office, and had then been re-elected at the head of a clear majority in Parliament, and had adhered to his policy of defiance, what would have been the position? I submit that there would have been only three alternatives:

(a) the breaking up of the federation; or
(b) civil war; or
(c) that some other person, not commanding the majority in the State Parliament, should have been called on to govern.

I submit that precisely the same alternatives existed so long as Mr Lang continued his defiance of federal law.

The truth, of course, is that we have never before had a statesman who was prepared to go to extremes. When you get a gentleman like Mr Lang, all sorts of extraordinary things may happen.

4. That the Financial Agreement can be used as a lever to secure the adoption and carrying out by all the governments of national policies which may encroach very considerably upon the independence of the States and Commonwealth. If a government needs to borrow, it must do so on terms approved by the Loan Council, and must conform to the conditions which the Loan Council imposes.

This proposition should be qualified and supplemented by the following observations:

(a) That the legal power of the Loan Council to impose conditions is limited . . .
(b) That a federal government which has a majority in both Houses can, by virtue of its control of currency and of the central bank, evade for the time being the pressure of the banks and of the majority of the Loan Council towards the adoption of such a national policy, if it is prepared to put in force inflationary measures.
(c) That a State government can only resist such pressure (at any
rate, when borrowing is difficult) if it does not need to borrow and can live within its means.

5. That, given a strong conservative government in the Commonwealth, the Financial Agreement is an effective though slow-acting curb upon a radical government of one of the States.

6. That the banks, especially the Commonwealth Bank, can by no means be acquitted on Mr Theodore's soft impeachment that they attempted to dictate the financial policy of the Australian governments. No doubt, the attempt was more or less forced on them, and, no doubt, it was a good thing anyway; but we may as well face the facts and admit that the Premiers' Plan was largely a policy forced upon the governments, through the Loan Council, and by means of the provisions of the Financial Agreement, by the banks.

If the above propositions are valid, may we not assume that the future historian of Australia will look back upon the passing of the first Financial Agreement as an immensely important point in our constitutional development?

Appendix

Sub-section (1) of Section 105A empowers the Commonwealth to make agreements with the States with respect to the public debts of the States, including:

(a) The taking over of such debts by the Commonwealth;
(b) Their management;
(c) The payment of interest and the provision and management of sinking funds in respect of them;
(d) Their consolidation, renewal, conversion and redemption;
(e) The indemnification of the Commonwealth by the States in respect of debts taken over by the Commonwealth; and
(f) Borrowing by governments.

Sub-section (3) authorises the Commonwealth Parliament to make laws for the carrying out of any such agreement; sub-section (4) provides that such an agreement may be varied or rescinded by the parties thereto (which apparently means that it is irrevocable and unalterable except with the consent of all the governments who made it); and sub-section (5) makes such an agreement binding on the Commonwealth and the States who are parties to it, notwithstanding anything in the Commonwealth Constitution or any State Constitution or in any law of the Commonwealth or any State.

The first Financial Agreement, which was made on 12 December 1927, and ratified in pursuance of Section 105A by the Financial Agreement Validation Act of 1929, provides, briefly, as follows:
(a) That there shall be a Loan Council, consisting of one representative of the Commonwealth government and one representative of each State, the Commonwealth representative having two votes and a casting vote and each State representative one vote.

(b) That the Commonwealth and each State is to submit to the Loan Council from time to time a loan programme for each financial year; and that the Loan Council is to decide how much of the total amount can be borrowed at reasonable rates and conditions, and may, by unanimous decision, allocate that sum amongst the various governments, or, in default of such a unanimous decision, the sum available is to be apportioned between the governments according to the formula prescribed in the agreement.

(c) That the Commonwealth takes over the gross public debts of the States existing on 30 June 1927, and the amounts borrowed since then; and undertakes as between itself and the States the liabilities of the States to the bondholders.

(d) That the Commonwealth will continue to allow to each State the amounts of the *per capita* contributions which were being made in 1927 towards State revenues, and that such contributions will be credited against the interest payable on the State debts taken over by the Commonwealth; that the Commonwealth will make certain contributions towards the sinking funds in respect of those State debts; and that the States will pay to the Commonwealth the balance of interest and sinking fund payments required after crediting the Commonwealth contributions.

(e) That, as a general rule, all future borrowings (i.e., made after 1 July 1927), whether for the Commonwealth or the States, are to be arranged by the Commonwealth under the direction of the Loan Council, are to be covered by the issue of Commonwealth securities, are to be subject to maximum limits as to interest, brokerage, discounts and other charges fixed by the Loan Council, and are to be restricted in amount in each year to the amounts which the Loan Council determines to be available at reasonable rates. [See (b) above.]

The partial exceptions to this general rule are:

(i) That a State may by *unanimous decision* of the Loan Council be allowed to borrow *abroad* in its own name and issue its own securities for such borrowing. Such borrowing, however, is to be guaranteed by the Commonwealth.

(ii) That the Commonwealth or a State may borrow in its own name *within* Australia or the State as the case may
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be, but such borrowing will be otherwise subject to the conditions of the general rule (e.g., the quota fixed by the loan programme adopted for the year must not be exceeded [see (b) above], the Loan Council must approve the rate of interest, etc.).

(iii) That the Commonwealth or a State may borrow in its own name within Australia or the State, as the case may be, beyond the amount fixed by the Loan Council [see (b) above], if the borrowing is solely for temporary purposes, but such borrowing must conform to limits fixed by the Loan Council as regards interest and other charges.

(f) That moneys are not to be borrowed by governments except in accordance with the Agreement.

Notes

1 The principal provisions of Section 105A and the Financial Agreement are shortly described below in the Appendix.

2 Shann and Copland: The Crisis in Australian Finance, p. 83. [In December 1930 J. A. Lyons (1879-1939) was Acting Treasurer in the Commonwealth Labor government. In January 1931 E. J. Theodore (1884-1959) was reappointed Treasurer, following the return from overseas of the Prime Minister, J. H. Scullin (1876-1953). Shortly afterwards Mr Lyons resigned from the Australian Labor Party, and became Leader of the new United Australia Party and Prime Minister following the election of December 1931. Sir Robert Gibson (1864-1934) was a Melbourne businessman and Chairman of the Commonwealth Bank Board from 1926 to 1934.]

3 [State borrowing for temporary purposes outside the Loan Council program (Appendix, sub-paragraph (e)(iii)) could be either from their own resources and institutions or on bank overdraft. In the Depression years, however, the States’ own resources were soon exhausted and they found it increasingly difficult to raise overdrafts. Recurrent State deficits meant that their overdrafts had to be continually renewed and such borrowing thus became, in reality, permanent rather than temporary. It was in these circumstances that the banks decided in December 1930 not to grant overdrafts to the States except on the security of Treasury bills. From the State point of view, however, Treasury bill finance still had the advantage of not being subject to the penal 4 per cent sinking fund that applied to long-term securities used to finance revenue deficits. See Maxwell, Reading X.]

4 It was at this Conference that Mr Lang scandalised the Premiers by his proposals for withholding oversea interest, for compulsorily scaling down interest on all Government borrowings within Australia to 3 per cent, and for setting up a ‘goods standard’ of currency. [Mr J. T. Lang (1876-1975) was Premier of New South Wales from 1925 to 1927 and again from 1930 to 1932, but from November 1930 until May 1931 he absented himself from meetings of the Loan Council. New South Wales was also unrepresented on the Committee of Under-Treasurers here referred to.]
5 Shann and Copland, op. cit., p. 182.

6 Shann and Copland, ibid, p. 185.

7 Shann and Copland; The Battle of the Plans, p. 44. It was to this letter that an official statement published in the Press on the 8th August, 1931, referred when it said: The plan of financial rehabilitation adopted by the Premiers' Conference in June last was rendered immediately necessary by a notification from the Commonwealth Bank that the Governments of Australia had reached the limits of their credit with the Commonwealth Bank and the trading banks.

8 Ibid., pp. 47-56.

9 Ibid., p. 57. [The Sub-Committee comprised the Premiers of South Australia and Western Australia, with a Victorian government representative as chairman.]

10 For an account of the Plan, see article by Bland and Mills in The Economic Record of November 1931. [The co-opted economists were Sir Douglas Copland (Chairman), Professor L. F. Giblin, Sir Leslie Melville and Professor E. O. G. Shann. See also Giblin, The Growth of a Central Bank, Melbourne University Press, 1951, pp. 101-7.]

11 [The Commonwealth dropped its proceedings against New South Wales when Mr Lang returned to the Loan Council and the State resumed interest payments.]

12 [Sir Edward Mitchell (1855-1941) was an eminent member of the Victorian Bar. He was closely involved in drafting the Debt Conversion Agreement of 1931 and probably the Financial Agreements Enforcement Acts of 1932. He also appeared as Commonwealth counsel in the Garnishee Case.]


14 Sydney Morning Herald, 10 August 1931.

15 See Sydney Morning Herald, 15 August 1932: 'It is believed that members of the Bank Board informed Mr Scullin of their determination to hold the Governments strictly to the conditions of the Premiers' Plan, and that the Board would require a full periodical disclosure of the various Governments' accounts before further advances would be made. Mr Scullin assured the Bank Board that the Loan Council, as the representatives of the Governments, was prepared to do its utmost to see that these conditions were observed. The Council had, in fact, already appointed a special sub-committee, whose duties it would be to police the plan.' It is understood that the minutes of the Loan Council fully bear out this report from a well-informed newspaper.


18 [The validity of the Financial Agreements Enforcement Acts was un成功elly challenged by New South Wales in the celebrated Garnishee Case (New South Wales v. Commonwealth 1932). The High Court found the legislation valid by a 44-2 majority.]
19  [Sir Joseph Carruthers (1857-1932) was Premier of New South Wales in 1904-7 when the State disputed the Commonwealth's exclusive right to levy customs duties on goods imported for the State's own use. New South Wales v. Commonwealth 1907 (the Wire-Netting Case).]

The Australian Loan Council is a unique body. Established in 1928-29 as a part of the Financial Agreement, after the opinion had become widespread that the credit of the whole of Australia, under existing conditions, could never be much higher than that of its weakest state, the Loan Council was given full legislative and constitutional status as the body which was to handle all borrowing by Commonwealth and State governments, except borrowing for temporary purposes or by the Commonwealth for purposes of defence. Against its decisions there is no appeal because the Council is not directly responsible to any one Parliament or electorate. 'If,' as Mr Forgan Smith of Queensland has complained, 'any Premier agrees (at a meeting of the Loan Council) to a line of policy from which his State Parliament dissents, all that this Parliament can do is, by means of a vote of no confidence, to remove him from office. Nevertheless the decision of the Loan Council would stand.' It is more than probable that nobody foresaw the extent to which, in the Depression, the Loan Council might 'be made the instrument of forcing upon the Commonwealth and the States a common policy involving the very details of their internal administration.'

*Reproduced from The Canadian Journal of Economics and Political Science, VI, 1, University of Toronto Press, February 1940, pp. 22-38.
Reduction of Deficits

The first evidence of the powers of the Loan Council came in April, 1931, when Australia was fumbling for a proper policy to stem depression. On the initiative of the Council the so-called Copland Committee was appointed and on the basis of the report of this Committee the ‘Premiers’ Plan’ was drawn up, which aimed, through a variety of measures, at a prompt balancing of budgets. These were long steps forward, but the question as to what could be done to keep governments in line still had to be answered, and here again the Loan Council had an important role. Early in 1932 New South Wales defaulted on its debt, and then approached the Loan Council for additional authority to borrow. This was bluntly refused, and the Commonwealth government took action against New South Wales for violation of the Financial Agreement. In this it was completely successful. The public was convinced that order had been restored in the field of public finance, and the Loan Council, encouraged by the Commonwealth Bank, policed observance of the Premiers’ Plan.

The Premiers’ Plan looked toward a balancing of budgets and at each meeting of the Loan Council figures of expenditure and revenue were scrutinized in detail. The ‘agreed’ deficit, at which a State had promised to aim, was compared with the actual deficit for the year, and, looking ahead, a comparison was also made between the ‘agreed’ deficit for the next fiscal period and the probable deficit. For the Commonwealth establishment of fiscal equilibrium proved to be relatively easy, but the States had greater difficulty and, besides, some of them were unsympathetic toward literal fulfilment of the Premiers’ Plan. As the States began to weary of well-doing, the Commonwealth took specific steps to encourage reduction of deficits. At the Loan Council meeting of June, 1934, it announced that for the next year it would distribute a (non-recurring) grant of £2,000,000 to the States, according to population, and although there was no stipulation as to how the grant was to be employed, the effect was to win over to a reduction of deficits those States which were most vocal about the difficulties of their fiscal position. When in 1935 and 1936 the same debate arose, grants of £500,000 were distributed as before. In all three cases the grants were, in effect, a device for reduction of State deficits.

By 1936-37 the State governments as a whole had eliminated their deficits, and for this the Loan Council can claim some of the credit. But one caution is necessary. In Australia the two-budget system is used and this has allowed considerable variation among the States in compilation of their public accounts. At various times the criticism has been voiced that deficits on current account were being concealed
by charging improper items to the capital budget. In so far as this is the case, the reduction of deficits is fictitious.

The pressure exerted by the Commonwealth toward reduction of deficits was supplemented by pressure from the Commonwealth Bank. The Bank did not, of course, make any direct attempt to influence governmental fiscal policy; its influence arose particularly out of its attitude toward Treasury bills.

During the early years of Depression, when the long-term market for capital had dried up, the only method by which the States (and the Commonwealth) could finance both their deficits and their expenditure for public works was through Treasury bills issued under the authority of the Loan Council through the Commonwealth Bank. The amount outstanding rose from £2,300,000 in June, 1930, to £48,875,000 in June, 1933, and before this time the Commonwealth Bank had become alarmed. In February 1933, it persuaded the Loan Council to agree that in the future Treasury bills should not be issued for loan expenditure, as distinct from deficits; and in June 1934, it announced that it would finance the deficits for 1934-35 by Treasury bills only 'on the understanding that bills of an equivalent amount would be retired during the year.' By this policy, which was maintained in later years, the Bank put an end to an increase in the amount of Treasury bills, but it wished, in addition, to bring about a substantial reduction through funding.

On the question of funding a sharp debate was waged of which the essential features can be understood by noticing the dual character of the Treasury bill. On the one hand, it represented short-term government debt, bearing a rate of interest much lower than that for long-term issues. The State governments objected to funding because this would put heavier charges for interest and sinking funds upon their budgets. Instead of an interest rate of, for example, 2¼ per cent on Treasury bills, the rate on a long-term loan would be 3½ per cent; and while under the Financial Agreement, the sinking fund on Treasury bills was ½ per cent, provided equally by the Commonwealth and the States, that on a funding loan to meet a State revenue deficit was to be 4 per cent, provided entirely by the State. On the other hand, the Treasury bill was an instrument of great importance for the control of credit. The bills held by the trading banks were liquid assets, discountable at the Commonwealth Bank, and funding would make the banks less liquid. The possibility of conflict between the two sets of considerations is obvious and the obstacles to funding as the Commonwealth Bank desired are clear. Funding would put larger debt charges upon State budgets and it would tend to harden interest rates by decreasing the secondary reserves of the trading banks. Yet the Commonwealth Bank might feel both that the governmental
short-term debt in the form of Treasury bills was too large for fiscal safety and that it made the trading banks too liquid. Despite persistent efforts, the Commonwealth Bank has been unable to secure any substantial reduction in the amount of Treasury bills. Reductions by funding have been offset by the issue of new bills for revenue deficits.

The existence of Treasury bills has, besides, induced the Loan Council to infringe the spirit of one provision of the Financial Agreement with respect to sinking funds. While the establishment and regularization of sinking fund payments through the Agreement have been a source of pride to the States, regret has also been caused because of the heavy burden placed upon current budgets. And long before budgets were balanced Treasurers pointed out that, if payments to the sinking fund were excluded, their published deficits would be eliminated. This was correct, but it was equally true that, so long as budgets were unbalanced, some part of the sinking fund was being provided by borrowing. Against this latter contingency the provision of the Financial Agreement which calls for a 4 per cent contribution should apply. In fact it has not. During the Depression the deficits were heavy and after establishment of budgetary equilibrium the Loan Council passed over the clause of the Agreement which provides that it shall arrange for the borrowing of money to fund revenue deficits.

The Formula for the Apportionment of Loan Money
As economic conditions in Australia improved and as a starvation policy toward public works became less imperative, the Loan Council had to face the problem of how much loan money should be raised and how it should be apportioned. Beginning in November 1932, loans were floated semi-annually in the Australian market, a part of which went to the States for public works. The amounts are shown in Table I. It will be noticed that when, after November 1934, interest rates hardened the amount of loans was curtailed. Against this there was a sharp protest from those who insisted that maintenance and even increase of loan expenditure were necessary to strengthen and consolidate economic recovery.

Passing over for the present the question of the amount of loan money to be raised, let us consider the problem of apportionment. Since the loan programmes submitted to the Council always had to be curtailed, this raised obvious difficulties. According to the Financial Agreement the Council may, ‘by unanimous consent,’ make whatever distribution it sees fit. But in the event that unanimous consent is not reached, the ‘formula’ is to be applied and by it the Commonwealth shall be entitled to have one-fifth of the total, and each State a sum
Table I
Loans Raised under the Authority of the Australian Loan Council

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount (£)</th>
<th>Yield (£)</th>
<th>Date</th>
<th>Amount (£)</th>
<th>Yield (£)</th>
</tr>
</thead>
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<td>8,000,000</td>
<td>3/15/0</td>
<td>Nov., 1935</td>
<td>7,964,000</td>
<td>3/15/6</td>
</tr>
<tr>
<td>May, 1933</td>
<td>8,462,000</td>
<td>3/15/0</td>
<td>June, 1936</td>
<td>9,018,000</td>
<td>3/17/6</td>
</tr>
<tr>
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<td>10,316,000</td>
<td>3/12/5</td>
<td>Nov., 1936</td>
<td>7,500,000</td>
<td>3/19/4</td>
</tr>
<tr>
<td>June, 1934</td>
<td>12,234,000</td>
<td>3/7/8</td>
<td>April, 1937</td>
<td>7,500,000</td>
<td>3/19/1</td>
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<td>Nov., 1934</td>
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<td>3/0/5</td>
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<tr>
<td>June, 1935</td>
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<td>3/8/5</td>
<td>May, 1938</td>
<td>10,250,000</td>
<td>3/15/10</td>
</tr>
</tbody>
</table>

'bearing to the balance of such amount the same proportion which the net loan expenditure of that State in the preceding five years bears to the net loan expenditure of all the States during the same period.'

The defects of this formula did not escape attention when the Agreement was being framed, but the demand for action was so insistent that the participants decided to take a chance upon future developments.

The most obvious charge to levy against the formula is that it puts a heavy penalty upon prudence and a premium upon extravagance in borrowing, and this charge had peculiar force when, as during the Depression, a large part of the loan expenditure was to cover deficits rather than public works. New South Wales, always a heavy borrower, had very large deficits in 1930-34, and application of the formula would have operated to give it, because of these deficits, a disproportionate share of the loan money.

At the Loan Council meeting of May 1935, the formula was very much in the limelight. Victoria had been a light borrower, but at this time the newly elected Dunstan government came to the Council with requests for loan funds for 1935-36 which were more than double those requested in 1934-35. The total requests of all the governments amounted to more than £39,000,000 and the Council agreed that this should be cut to £31,000,000. How were the cuts to be made? Application of the formula would have given Victoria less than it requested and much less than it would have received on such a basis as population, because, while the population of New South Wales was less than one and one-half times that of Victoria, its net loan expenditure in the past five years had been over three times that of Victoria. Indeed the formula would actually have allotted to New South Wales more than it was requesting for 1935-36. To Premier Dunstan this seemed outrageous. Application of the formula would have wrecked his programme, yet he threatened, unless his demands
were met, to force application in order to drive home the need for a change. But finally a compromise allotment was arranged — New South Wales and the Commonwealth took less than the formula assigned them, while Victoria took more than this, although less than its request — and the storm subsided.

Despite difficulties in later years, the formula has never been applied. Its very badness has made the members of the Loan Council show restraint. Those who would gain from its application dare not use their power because this would stimulate a movement for amendment which could hardly be checked; those who would suffer from its application have been content to force a compromise through parley and threats. What objection is there to a formula which is never invoked? Principally that it gives a large power to New South Wales, a State which, by virtue of its population and resources, is already strong; and that on some future occasion its indefensible basis may involve the Loan Council in a serious dispute.

The real problem is not how to devise, but how to secure the adoption of a better formula, since a change in the Financial Agreement requires consent by all parties. It should, moreover, be recognized that any formula would be inflexible and that it might, therefore, tie the hands of the Loan Council. Yet to abolish any formula and to leave the apportionment of loan money to the majority vote of the Council would be a further step toward a unified control of borrowing, and it is not practical politics. Even if the present formula is retained, it might be desirable to consider an amendment which, in place of unanimity of decision about apportionment, would require, for example, a two-thirds vote.

The Amount of Borrowing
The amount of loan money that can be raised ‘at reasonable rates and conditions’ is determined by a majority vote of the Council and at its deliberations Premier Stevens of New South Wales has usually been the leader of the expansionist group, while on the other side have been the Commonwealth government and the Commonwealth Bank. The position of the Commonwealth government on the Loan Council is strong. (1) It has the right to borrow for purposes of defence outside the Financial Agreement and this right might cover a wide range although so far it has been used with great caution. (2) The Commonwealth has two votes and a casting vote on the Loan Council. (3) It is entitled under the formula to one-fifth of the loan money for any year, and this is a larger share than it has ordinarily required. At most Loan Council meetings the Commonwealth Treasurer has used this strong position to bring about a compromise solution of the disputes which have arisen.
The Commonwealth Bank has no representation on the Loan Council, but its influence on the deliberations is great. It has been accused of usurping the function of determining the amount of loan money to be raised, leaving the Council only the job of dividing a given total among the claimants." Such charges the Bank denies. The Bank has always been the principal underwriter of government loans (no other arrangement would at present be acceptable in Australia) and as a central bank it can exercise a considerable influence over the terms at which the market will take a loan. Its advice is indispensable to the Loan Council and when requested it indicates the amount of loan money that can, in its opinion, be raised on given terms, and it specifies the amount which it is prepared to underwrite. But the Bank insists that the Loan Council is at liberty to disregard its advice as to terms and to float loans not underwritten by it. It points out also that in no case has its advice about the terms of a loan not subsequently been verified by the market.

Yet the defence of the Bank is somewhat naïve. The condition of the Australian money market is not a self-determining fact: the level of interest rates and the amount of loan money which can be raised depend to some extent upon the action of the Bank; and its judgment as to the amount of, and the terms at which, loan money can be raised are inevitably tied up with its judgment as to the whole monetary and economic position of the Australian economy. As a central bank it has a responsibility far beyond that of being a fiscal agent for the various governments and this it is which lies at the bottom of its squabbles with certain States." "

In examining the argument between the expansionists and their opponents it must be remembered that in Australia governments have a sphere of activity larger than in most countries and that governmental loan expenditure is an important part of developmental expenditure. The curtailment of public works during the Depression left a backlog of projects and as recovery proceeded there was an earnest demand that these be taken up. Failure by government to provide certain public works would, it was urged, not only deprive the people of amenities of community life — water supply, electricity, railways, roads — which they had a right to expect, but might also hinder economic development because public works were needed contemporaneously with, or even in advance of, investment of private capital as an area was being opened up. If, for example, private capital was delayed in developing a coal mine because of lack of transport facilities, a parsimonious loan policy would be injurious to the community.

This sort of argument raises immediately a question of great significance. If specific deficiencies of this sort exist, how are they to
be appraised? Some people doubt that Australia has suffered in recent years from a deficiency of public works expenditure; they insist that before the Depression expansion was so rapid as to get ahead of needs and that even yet public equipment is under-employed. Instead of futile debate, what is needed is investigation of the facts and a weighing of alternatives. It would seem, indeed, that any State which complains that it is being deprived of its proper share of loan expenditure ought to be ready to submit its projects for scrutiny upon their merits.

The Loan Council has, of course, made no such scrutiny. Both the amount of loan money to be raised and its allotment are arranged by dickering and haggling. No State submits any details of its projects and it is emphatically clear that any attempt to uncover this information would be repulsed. State rights sentiment is strong and each government is fearful lest a project endorsed by it be vetoed by the Council. 19

It is clear also that the Loan Council as now constituted is not qualified to investigate the details of State projects. It is a body composed entirely of political officers with no permanent staff and with little continuity of procedure. Its meetings are like the instalments of a serial, fragmentary yet complete, inconclusive yet final. The programme of each government is prepared independently and at the meetings each member seems to fear a coup by the others. The secrecy with which the meetings are sedulously shrouded seems to produce a furtive and conspiratorial atmosphere, although it has not been successful in suppressing those members who desire to give statements to the press. During the period of a meeting the press is full of unofficial and inaccurate ‘news’ about what the Loan Council is doing.

If timidity about State sovereignty could be allayed, it would not be difficult for the Loan Council to provide itself with information which would enable it to resolve difficulties of the sort mentioned above. As a first step some sort of expert secretariat should be attached to the Council. 20 The precise duties of such a body could only be settled by experience, but it would provide liaison between the Commonwealth, the States, and the Commonwealth Bank, and in time it might be permitted to look into loan programmes with a view to deciding upon the relative importance of different projects. Claims of a State that certain schemes would be fiscally self-supporting, or that they would pave the way for private investment could be appraised without much difficulty.

But there are larger questions about which appraisal of facts, past and current, is more difficult. Thus before the Depression Australian governments were borrowing over £41,000,000 a year; in 1935-36 the
net figure was less than £15,000,000. The anti-expansionists see in this contraction no presumption that the latter figure is too small. In their opinion pre-Depression borrowing was so reckless as to bring Australia to the verge of bankruptcy. Instead of looking at the evidence of a profligate past, the tests could be contemporary conditions of employment, interest rates, foreign exchange; and examination of these after 1935 seemed to them to warn against an expansionary programme. Trade-union unemployment fell from 15.1 per cent in 1933 to 12.2 per cent in 1936, and to 9.3 per cent in 1937 — the last figure being better than that of 1929.21 If public works spending was to be used as an anti-cyclical device to stabilize employment, it seemed time to taper off. The London balances of the banks were shrinking and increased spending might have an adverse effect upon the foreign exchanges. The tendency of interest rates to harden after 1935 indicated that there was a growing demand for private capital, and to add to this a greater governmental demand would be to destroy the foundations of prosperity.

The expansionists were not, however, convinced by these arguments. Before 1935 they argued for a larger loan programme in order to hasten recovery; after 1935 they insisted that a cut would endanger economic development. While disclaiming any intention of returning to the bad old pre-Depression days, they endorsed the Keynesian dictum that: 'The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom.'22 The expansionists were prepared even to resume overseas borrowing. Such a policy would, they argued, be consistent with a vigorous immigration policy; it might be used to promote business stability in Australia, and stability in sterling exchange rates by restoring Australian balances in London when these were depleted by temporary reductions in the balance of payments.23

Even this brief presentation of the conflicting views of the disputants must indicate that, besides a difference in premises, a difference in opinion as to what is a desirable state of affairs is involved which no amount of intellectual argument will settle. Of all the expansionist arguments the least defensible was the proposal to finance public works by overseas borrowing. Even if Australia needed the sort of equipment, railways, electricity, etc., which governments provide, the funds should be found in the home market.24 Private overseas investment of capital in Australian industry, particularly of the equity type, is desirable. This would not bring a burden of fixed charges and it would bring an improvement in the balance of payments by leading to production of goods which would serve to diminish imports or to increase exports with a permanent increase in
Fiscal Federalism

home employment. Australia is clearly a dependent and open economy, and an expansionist public works policy, financed by external borrowing, might lead to pressure on the exchange rate, higher interest rates, and unemployment. And it is to be noticed that an expansionist policy, even when financed at home, has similar, if less immediate, dangers. One can conclude that the anti-expansionist policy has at least the quality of being safer than its rival. When a country has achieved the degree of recovery enjoyed by Australia in recent years, with unemployment reduced to a low figure and with private investment on the increase, and when that country is a debtor, with a large part of its economy dependent upon an export market, then the virtues of a safe policy are significant.

It would be wrong to give the impression that the drive behind the expansionist policy should be explained only in terms of monetary and cyclical policy. The State governments are confronted with all the immediate pressure from electors for developmental expenditure and for relief. They are naturally less appreciative of the long-run problems which concern the Commonwealth government and the Commonwealth Bank. And even though certain State Premiers may not wish to spend as freely as they avow, they do desire that the onus for curtailment of a spending programme shall be placed upon the Bank and the Commonwealth.

Local and Semi-governmental Bodies
The most serious loophole in Loan Council control has been the rapid growth of borrowing by local and semi-governmental bodies. At the time the Council was established, the question of including the borrowing of these bodies under its control was discussed, but inclusion would have raised many difficulties and objections, and the problem did not seem very important. There were some forebodings about the omission and as a result a ‘gentleman’s agreement’ was made to the effect that issues by local and semi-governmental bodies, when they exceeded £100,000, were to be voluntarily submitted to the Loan Council for concurrence. The time of borrowing and the rates offered were also to be discussed with the Commonwealth Treasurer. For some years there was no complaint, but since 1935 the charge has been bandied about that Premier Stevens of New South Wales has used this loophole to escape the control of the Loan Council and to secure an advantage for his State. Table II indicates that the charges have some foundation.

It should, however, be recognized that there are ‘natural’ reasons both for the growth and for the lop-sided distribution of the borrowing among the States. Municipalization in Australia is growing and should grow, and the creation of public statutory bodies —
Table II

<table>
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<th>Semi-governmental (000's omitted)</th>
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<td>£2,905</td>
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<td>1,341</td>
<td>1,692</td>
<td>3,033</td>
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<td>1932-3</td>
<td>1,654</td>
<td>2,923</td>
<td>4,577</td>
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<tr>
<td>1933-4</td>
<td>1,866</td>
<td>3,248</td>
<td>5,114</td>
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<tr>
<td>1934-5</td>
<td>2,987</td>
<td>3,321</td>
<td>6,308</td>
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<tr>
<td>1935-6</td>
<td>2,720</td>
<td>4,260</td>
<td>6,980</td>
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<td>1936-7</td>
<td>4,712</td>
<td>6,880</td>
<td>11,592</td>
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Distribution in 1936-7

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<td>Victoria</td>
<td>518</td>
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<td>Queensland</td>
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<td>South Australia</td>
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<tr>
<td>Western Australia</td>
<td>125</td>
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<td>Tasmania</td>
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|                | £4,712   | £6,880   | £11,592  | 100.0 |

*These figures have been prepared by the Commonwealth Bureau of Census and Statistics, but they are subject to many qualifications and are not to be taken as precisely accurate.

sewerage boards, water boards, etc. — is a concomitant of municipalization which, within limits, it would be wrong to cripple by a rigid system of centralized financial control. As urban centres develop they should be given a measure of fiscal power to meet their local needs, and rigid supervision by the Loan Council, and even by the States, would be inflexible and unsatisfactory.

Yet it is clear also than an unwise extension of local borrowing has dangers for the Loan Council because this borrowing is outside the ambit of its control. If local bodies drew heavily upon the capital market, interest rates might be raised even though the Loan Council held down Commonwealth and State borrowing. It is, indeed, pretended that, through the 'gentleman's agreement,' the Loan Council has control over local borrowing. But surely this control is so precarious that it cannot easily be exercised, else something would have been done to curtail the growth of local borrowing in the past four years. A clear majority of the members of the Loan Council have
repeatedly expressed opinions adverse to the rapid extension of such borrowing, and yet nothing has been done. And if it be supposed that, in an extremity, the Loan Council refused to acquiesce in a programme of local borrowing that was submitted to it by a State, could not the State successfully defy the Loan Council? It is argued that local securities in this case would not be taken up by investors. But surely it is unlikely that investors would boycott an issue with a satisfactory yield, good security, and against which there was no legal impediment.

Some advocates of local borrowing minimize its possible effects upon the capital market by denying that there is competition between local issues and an issue of consolidated stock of Australia by the Loan Council. Money which might be attracted by the former would not, they say, be attracted by the latter. The capital market is, of course, not perfectly homogeneous, but the diverse demands of investors can readily be supplied, without the creation of local issues, by the great variety of private issues which are available; and it is disingenuous to argue that borrowing by local bodies has no effect upon the capital market as a whole.

There is no disguising the apprehension which the increase in local borrowing has aroused in many quarters. Some States, viz. South Australia, Western Australia, Tasmania, are very slightly municipalized and they have few local governments and semi-governmental bodies with borrowing power. Premier Butler of South Australia has explained his position as follows: 'So far as South Australia is concerned, we (the State government) borrow not only for Government departments and Government works but for such authorities as the State Bank, Municipal Tramways Trust, Metropolitan Abattoirs Board, etc. This means that a State such as ours does not receive its share in the total monies that can be borrowed for all purposes in Australia.' The premise behind this reasoning is that, for example, New South Wales has shifted some of its State works programme upon local bodies and yet, at the same time, obtained its full share of loan money from the Loan Council. The creation of new statutory bodies with borrowing powers by Premier Stevens is regarded merely as a subterfuge, and the cry is raised that the Financial Agreement is being endangered. Disgruntled Premiers aver that they also will create bodies with borrowing powers, and in several cases this has been done. It has been argued above that there is a case for devolution in Australia, but action for competitive purposes alone would be most unfortunate, because in that event the local bodies would be unable to support their own borrowing and the burden would fall upon the State. Since an Australian State has now no individual credit of its own, all borrowing being done by the Loan Council in the name of
Australia, the collapse of the credit of a local body would have an
effect beyond the boundaries of the State. Doubts have been raised
also concerning the constitutionality of independent borrowing by
local bodies created after the Financial Agreement, because the power
of States as such to borrow or to guarantee is now without meaning.27

It would be alarmist to see in the present situation a serious threat to
the Loan Council, because the amount of the borrowing is not large,
because some of the growth of autonomous bodies is ‘natural,’ and
because, under the terms of the ‘gentleman’s agreement,’ this
borrowing is submitted to the Loan Council. But disquiet has been
aroused primarily because of fears as to the intentions of New South
Wales. That State can present logical and plausible grounds for its
recent moves, yet it cannot be doubted that a further motive has been
the desire of avoiding Loan Council discipline.

No satisfactory remedy has yet been advanced. The extreme view
that local borrowing should be brought completely under Loan
Council control and treated as a part of State borrowing is imprac­
ticable, and it is impossible to believe that it would work. The present
job of the Loan Council is difficult enough, and this job probably
cannot be done well unless the Council has the right to look into the
individual projects of the States. A similar extension of control over
local projects would make the task unwieldy. Flexibility of action and
opportunity for adaptation of local needs to local demands is very
desirable. Perhaps this could be secured, and yet the present threat to
the usefulness of the Loan Council could be averted, if local bodies
were permitted a wide borrowing power, but were subjected to strict
and uniform rules over the whole Commonwealth with respect to
provision of sinking funds, the term during which loans should run,
and the rate of interest.

Conclusion
The Loan Council was set up in 1928-29 at a time when governmental
borrowing in Australia verged on fiscal anarchy. Borrowing was so
heavy as to be reckless, and in timing their issues governments
schemed to get ahead of each other. Many people in Australia worked
earnestly for reform, and the Commonwealth government took the
lead in persuading and even coercing the States to sign the Financial
Agreement. If in its terms the States saw threats to their sovereign
rights, they saw also a safeguard to their financial reputations.

It was a piece of great good fortune that the Loan Council (and the
whole Financial Agreement) was created at this time. Without it a co­
ordinated fiscal policy during the Depression would have been much
more difficult to frame and almost impossible to administer. With it
both the Commonwealth and the States were pushed toward a
national plan and budgetary equilibrium. All of this must have been somewhat surprising even to the framers of the Financial Agreement, because it represented a radical departure from the principles of federalism as expounded in Australia or elsewhere. Yet in a real sense the Loan Council as an institution is in accord with the spirit of federalism because it fosters and even demands the development of co-operation between Commonwealth and States.

At every Loan Council meeting — there are usually two meetings a year — representatives of the Commonwealth and the States have to debate and solve by compromise their borrowing problems. Since 1932 the Commonwealth, favouring cautious finance, has tended to prevail. Yet there is little likelihood that a cautious policy will be over-done, because the Loan Council is a political body and State pressure for loans is continuous. The tendency is always toward compromise. And if it happened that the Commonwealth took the lead in an expansive loan policy, there is no great likelihood that the States would apply the brakes. The influence of the Commonwealth Bank might, however, be important. Its opinion as to how much money is available for governmental borrowing is generally accepted as fair, and its assumption has always been that the rate to be paid on new borrowing should be closely related to what had been paid on the last loan. So long as this continuity is premised, an expansive loan policy would depend upon lower rates of interest.

In making the allocation of any given amount of loan money the Loan Council always works in the shadow of the formula. That this is unsatisfactory nobody would deny, since the formula is based upon the borrowing of the past five years; a large allotment of current funds may rest upon a previous record of improvidence. This is of some consequence inasmuch as establishment of the Council has removed one of the ordinary penalties of improvidence from the individual States. A State still has to pay interest (and sinking fund) upon its borrowing, but this rate of interest is governed by the credit rating of Australia as a whole, rather than by its own credit position. For this reason it would seem that the Loan Council ought to have the right to examine the loan programmes of the States and the Commonwealth. Moreover, the rate of economic development and the need for public works in the States will not be uniform. As things stand, a State is tempted to take its stereotyped share in order to hold its position under the formula. A secretariat attached to the Loan Council could appraise loan projects and put its findings before the Council. The weight to be given these findings would depend upon experience, but at very least the Council would have better evidence upon which to make decisions. The objection that all of this would be a further invasion of sovereignty seems irrational. The Loan Council represents
a pooling of rights: each State gives up certain unrestricted powers over its borrowing, while it receives restricted powers over the borrowing of its neighbours.  

The Royal Commission on Banking has called attention to another reason why the Loan Council should have a secretariat. 'Since,' it said, 'the successful working of monetary policy in Australia involves co-operation between the Governments and the Commonwealth Bank, we think there should be some permanent machinery for the Loan Council which would enable the Loan Council, the Commonwealth, and the State Treasurers, and the Commonwealth Bank, to establish and maintain close contact with one another.' In the past the co-operation has been slight, and the States have complained that the Commonwealth Bank has co-operated with the Commonwealth government rather than with the Loan Council. This criticism may be passed over as irresponsible so long as the Loan Council exists in its present form and meets only for a few days each year. But a secretariat would provide the Loan Council with a means of keeping in touch with the Bank, and through it the Bank might explain and justify its opinions as to the amount of government borrowing which could and should be raised in given circumstances.

A permanent staff would supply the Loan Council with better statistics. For certain tasks the lack of satisfactory statistics has long been recognized as a handicap. The public accounts of the States are not compiled on a comparable basis, and expenditure which is charged to loan account by one State may be charged to revenue by another. Obviously this difference in practice has an effect upon deficits and upon requests for loan money, and therefore upon many features of the Financial Agreement. Until financial statistics are provided which are reasonably comparable, the Loan Council will fumble at many of its tasks.

Finally, the Loan Council gives Australia a better opportunity than any federal nation, perhaps than any democratic country, to use public works spending as a counter-cyclical device. The very essence of this scheme is co-ordination of governmental loan expenditure, and the Loan Council has this power. But there is need also of long-range planning, and to handle this the Loan Council requires an expert permanent secretariat which would examine and classify projects with respect to their postponability.

In the past year and a half Australia has belatedly begun to rearm, and this new problem has cut across the agenda of the Loan Council. Borrowing for defence is, of course, excluded from Loan Council control, but somehow State loan programmes have to be adjusted to this extraordinary expenditure. A good deal of the defence works
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consist, not of armaments, but of highway, railway, and harbour improvements, airport construction, etc., which might be regarded as State projects, or certainly as substitutes for them. The Commonwealth has been afraid to let control out of its hands; the States, worried by the recession and the fall in export prices, have pressed for an increase in their borrowing. Somehow effective co-operation should be secured. Defence is at present the supreme necessity and the States should show restraint in their demands for public works which do not fit into a defence programme.

Notes

1 The material for this article was collected while I was Research Fellow at the University of Melbourne, a position I was able to take because of a grant from the Carnegie Corporation in 1938.


3 Quoted by D. B. Copland and C. V. Janes, Cross Currents of Australian Finance: A Book of Documents (Sydney, 1936), pp. 9-10. [W. Forgan Smith (1887-1953) was Leader of the Labor Party and Premier of Queensland 1932-42.]

4 It should be realized that a meeting of the Loan Council and a conference of Commonwealth and State ministers are often indistinguishable, except that in the former rules about membership and voting are precise. [Loan Council proceedings are also closed to the press and the public.]

5 Budget Speech, 1934-35 (Canberra, 1934), p. 10.

6 There was some discussion of distribution according to the amount of the current deficits, but this did not prove acceptable.

7 See Copland and Janes, Cross Currents of Australian Finance, pp. 32-4. Comment by Premier Ogilvie of Tasmania on ‘The Nature of Budget Deficits.’ [In his reference to ‘the two budget system’, Professor Maxwell possibly had in mind the separation of current account and capital account items, which was widely advocated in the 1930s as a desirable budgetary reform. However, it should be noted that this distinction is not quite the same as that between the Consolidated Revenue Fund and the Loan Fund, which had long been used by Australian States and which, as noted in Reading XII below, was adopted by the Commonwealth in 1911.]

8 ‘Treasury bills are three-month promissory notes issued through the Commonwealth Bank by the Commonwealth Government on account of itself and State Governments’ (Report of the Royal Commission to Inquire into the Monetary and Banking Systems in Australia, Canberra, 1937, p. 54).

9 Ibid., p. 57.
History of the Australian Loan Council

10 Ibid., p. 232. [The arrangement whereby the Commonwealth and the States contributed equally to a 0.50 per cent sinking fund on Treasury bills was an informal one, which may be contrasted with the formal requirement which applied under the Financial Agreement in respect of new securities for non-temporary purposes. See Giblin, *The Growth of a Central Bank*, pp. 157-8 and 311-12. This informal arrangement continued until 1944, when outstanding Treasury bills issued for State purposes still amounted to about £50m as in 1938. The States then agreed to the cash redemption of £7m and the conversion of the remainder into 1 per cent debentures known as ‘special deposit loans’, with a 1 per cent sinking fund to redeem them over 39 years, i.e. by 1983. This arrangement was written into the 1944 revision of the Financial Agreement (see Reading XI, Section 3, below).]

11 Unless this was done through so-called ‘private’ funding by which the Commonwealth Bank itself took the whole issue. [In the 1930s an increase in Treasury bills was popularly regarded as highly inflationary because it added to the money supply. In recent years, Treasury bills have been issued only to the Reserve Bank, similar securities known as Treasury notes being available to other institutions.]

12 Ibid., p. 233. In March, 1936, the Commonwealth Bank tried an experiment. It had been accustomed to use its discretion as to the amount of an issue of Treasury bills it held for itself, and the portion it sold to the trading banks. There had, however, been talk about broadening the market for Treasury bills, and now the Commonwealth Bank decided to issue to the public £1,000,000 of the £25,000,000 which it held. But the Bank of New South Wales, the largest of the trading banks, promptly raised the interest rate which it paid on deposits, bringing the rate for three-months deposits above the rate at which the Treasury bills were being offered. The effect was to make the purchase of Treasury bills unattractive to those institutions which might have purchased, and only a small portion of the offering was taken up. This in itself was of slight consequence. But the other trading banks raised their interest rates and at once a commotion was raised by those who held as an article of faith that maintenance of low rates was essential for full recovery in Australia. It was charged that the Commonwealth Bank, unable to induce the Loan Council to retire Treasury bills, had taken a deflationary step. This was an exaggeration. Undoubtedly the Commonwealth Bank was not averse to some contraction, but the only conclusion worth drawing is that the largest trading bank showed no disposition to co-operate with the Commonwealth Bank (ibid., p. 213).

13 For the provisions see H. A. Pitt, *Sinking Funds and Depreciation Funds of Governments and Public Bodies* (Melbourne, 1935).

14 Financial Agreement, part I, section 3 (i) (ii). [The corresponding section in the revised 1944 Agreement is 3(10)(b). The operation of the apportionment formula is further discussed in Readings XI and XII.]

15 [Sir Albert Dunstan (1882-1950) was Leader of the Country Party and Premier of Victoria, 1935-45.]

16 [Sir Bertram Stevens (1889-1973) was Leader of the National (later United Australia) Party 1930-39 and Premier of New South Wales, 1932-39.]

17 Premier Ogilvie of Tasmania once levelled the accusation as follows: ‘The Loan Council is purely a farce. This is what happens. State Ministers are dragged from the corners of Australia with our officers. For two days we talk together and put our genuine requirements into shape. It is time and trouble wasted. At the end of all our
moulding and adjusting the Commonwealth Treasurer (Mr Casey) telephones the chairman of the Bank Board. Telephones, mind you!

'We move a resolution that Mr Casey should at least write to the Bank Board that we might see its reasons in black and white. This is defeated on the casting vote of Mr. Casey' (reported in the Melbourne Herald, Jan. 5, 1937). [A. G. Ogilvie, (1891-1939), was Leader of the Labor Party and Premier of Tasmania, 1934-39.]

18 [The Commonwealth Bank in these years combined the roles of a central bank and a major trading bank. The Bank Board and its Chairman were appointed by the Commonwealth Government but exercised a considerable degree of independence and aligned themselves with the other banks rather than with governments. It was not until 1945 that the Bank Board was replaced by a new advisory council to the Governor, who combined the offices of Chairman and Chief Executive (see Giblin, The Growth of a Central Bank, Chapter XII). In 1959 the central bank functions were transferred to the Reserve Bank of Australia, leaving the Commonwealth Bank to operate as an ordinary trading bank.]

19 Premier Butler of South Australia declared: 'We will never delegate to the Loan Council the right to say how our loan money shall be spent. Each State submits not the details of its loan expenditure, but the gross and net loan expenditure' (South Australia, Parliamentary Debates, 1937, p. 588). [Sir Richard L. Butler, (1885-1966), was leader of the Liberal Party and Premier of South Australia, 1927-30 and 1933-38.]

20 The Development and Migration Commission, set up in 1926 and later discontinued, investigated public works projects with some success. [The question of a Loan Council Secretariat is further discussed in the conclusion to this Reading and in Reading XI].

21 [Trade union statistics of unemployment were generally recognised as unsatisfactory, but were the only ones available at the time.]


23 See Assisted Migration: Correspondence relating to, between the Prime Minister of the Commonwealth of Australia and the Premier of New South Wales (Sydney, 1936), p. 16.

24 The recent defence programme of the Commonwealth is of an extraordinary nature and some overseas borrowing to finance it seems inevitable and expedient.

25 South Australia, Parliamentary Debates, speech of 22 July 1938.

26 New South Wales has aroused suspicion that it intends to circumvent Loan Council control in another way. The State government, especially during the Depression, made loans to local governments. Recently it has begun to induce them to pay these back by offering attractive terms. This might, on its face, be simply a move to encourage local bodies to reassume responsibilities which they had dropped during the Depression. But the effect was also to give the State government extra funds and to increase local borrowing.

27 See Copland and Janes, Cross Currents of Australian Finance, pp. 18-20.
28 The share of loan money to which the Commonwealth is entitled does not, however, vary according to its past borrowing.

29 The objection sometimes raised that the Loan Council makes necessary hand-to-mouth loan programmes (see statement of Premier Forgan Smith, *Melbourne Herald*, 20 April 1938), might also be met by use of a secretariat. If a project was examined and endorsed by the secretariat and the Loan Council it would be as a long-run scheme.

XI
A Unique Federal Institution*

S. R. Davis

Introduction
No federal institution in Australia has attracted quite the same degree
of attention abroad as the Loan Council. The Rowell-Sirois
Commission, the Groves Committee on Federal-State Fiscal Relations
in the United States, the Rance (Caribbean Federation) Committee,
the Central African Federation Conference, the Hicks-Phillipson
Commission on Revenue Allocation in Nigeria, and the Indian
Constituent Assembly have each in turn drawn on the experience of
this body. And justly; for if Australia has made a unique contribution
to federal finance it lies in its harmonisation of public borrowing by
an institutional device which offers a solution for a host of related
federal problems — the co-ordination of public investment, economic
planning, tax conflicts, and so on. In Australia, the full implications
of this body are still in doubt. What is clear, however, is that in the
Council’s two primary elements of co-operation and compulsion
Australian federalism finds its most symbolic expression. For in its
origin and practice, the Council reflects the co-operative impetus of
inter-governmental relations in Australia since the very conception of
the federal movement. And in its compulsive force, it typifies the most
direct consequences of political and fiscal centralisation in the

350-404, omitting sections on enforcement and implications.
Commonwealth. How far these two facets of the Council are compatible or incompatible in a federal system, however, is not to be answered by reference to some doctrinal notion of 'federalism.' It is not in the nature of political institutions to grow according to some archetypal pattern of development. Their growth is organic and their interpretation must take place in the context of their own special historical experience. In this article we hope to make some slight contribution to the understanding of this 'unique institution' by an examination of its (a) origin; (b) structure; (c) procedure; (d) powers; and (e) implications.

The Origin of the Council

... From the outset the negotiations which culminated in the Financial Agreement were conducted in an atmosphere of great tension and bitterness. Commonwealth pressure was unremitting; and there is probably little doubt that the States were brought to the Financial Agreement 'at the point of a gun.' In all this episode, however, two things are often overlooked. In the first place, no matter how acrimonious this period or how strong the resistance to this financial scheme, the proposal to establish a permanent Loan Council provoked the least controversy. Indeed, in contrast with their former deep-rooted hostility to permanent regulation, each State, with the temporary exception of Western Australia and New South Wales, accepted the control of borrowing as an essential corollary to the consolidation of their public debts. And the reasons for this transformation? Of the large number the principal reason lies in the States' experience of the voluntary Loan Council.¹

The second reason ... is ... that if the broad terms of the financial settlement were 'dictated' by the Commonwealth the final structure of the Loan Council emerged only after considerable discussion and agreement with the States on many of its vital terms. For example, the original draft of the Council submitted by the Commonwealth underwent at least three important amendments; first, the crucial 'formula' clause which provided for the allocation of the loans in the event of disagreement between the governments was altered to meet the objections of Mr J. T. Lang of New South Wales;² secondly, provision was made to continue the States' practice of raising small loans within their own territory from such sources as local banks, public trust funds, and so on; and finally, provision was made to enable a State — with the unanimous approval of the Council — to borrow overseas on its own account.³

The Structure, Functions and Scope of the Australian Loan Council

The Australian Loan Council was formally established in 1929 as a
statutory and constitutional body in pursuance of an amendment to the Constitution, sec. 105A, and legislative ratification of the Financial Agreement of 1927 by each of the seven parliaments. Its structure, functions, and powers are derived in the first instance from the terms of the Financial Agreement itself; and its constitutional sanction through sec. 105A, which gives pre-eminent binding force to the terms of the Financial Agreement.

It has been suggested — and not without some undue alarm — that the effect of sec. 105A is to set any Financial Agreement ‘beyond the reach’ of the normal process of constitutional amendment. The proposition is a little startling and the arguments are somewhat slender. However, if this view is correct, it is extremely important not to confuse this presumed difficulty with the clear right of the parties to vary or rescind the agreement at will (sec. 105A (4)). Of course, the task of securing unanimity in the Council and concerted action among the seven parliaments may well import an element of ‘rigidity’ into this mode of amendment. But by comparison with the normal process of constitutional amendment, this method has proved almost the acme of flexibility. [From 1929 to 1952,] the Financial Agreement has been formally amended on four occasions, while at least two of the most important changes effected in the Loan Council — the ‘gentlemen’s agreement’ to control the borrowing of local and semi-governmental authorities (1936), and the appointment of a Co-ordinator General of Works to the Council (1941) — were introduced informally.

The structure of the Loan Council is relatively simple. In broad outline it corresponds to the general pattern of inter-governmental consultative machinery in Australia. Like its political counterparts, the Premiers’ Conference for example, it is a ministerial council representative of the Commonwealth and each State. Similarly, it resembles the procedure of the Conference in that its decisions are mainly formulated by discussion ‘around the table’ between the Commonwealth and State representatives. But here its resemblance ends. Unlike the common pattern of consultative machinery it is distinguished by at least three *formal* characteristics; first, its composition is specifically defined; secondly, its decisions are final and binding on its members; thirdly, where the consultative councils must rely on compromise to settle their disputes, the Loan Council, failing compromise, may generally apply special voting arrangements, or resolve one major decision — the apportionment of loan funds — by an automatic formula.

The Loan Council is composed of seven members, normally the Treasurers of the seven governments. The Financial Agreement specifically designates the Commonwealth Prime Minister and the Premier of each State as members of the Council. But since the chief
political executives in Australia generally combine the dual office of Premier and Treasurer, the formal requirements of the Agreement are satisfied. Where the Premier attends, he attends as of right; and his tenure on the Council is coincident with his position as the chief political executive. Where the two offices are separate, however, the Premier is empowered to nominate an ‘appointee’ who is almost invariably the Treasurer. The power of appointment is carefully defined to preserve the ministerial character of the Council. Departure from this rule is only permissible in ‘special circumstances’ when the Premier may accredit ‘some other person’ of non-ministerial rank to the Council. Presumably, under this exception, the Premier may appoint any member of Parliament or of the public service, or for that matter a private citizen. In all cases of appointment, however, there is no fixed tenure on the Council; office is held only ‘during the pleasure’ of the chief political executive of the Commonwealth or State governments.

The permanent chairman of the Council is the Commonwealth Prime Minister. This follows the practice of the Premiers’ Conference, but is in contrast with the rotation of the office of chairman in such consultative bodies as the Australian Agricultural Council. The justification for the Prime Minister’s role of primus inter pares is, of course, the predominant federal interest in the fiscal commitments of the Council. And on this ground, the explanation is probably decisive. Nevertheless, it is tempting to reflect how far personal relations in the Council might be improved — not to speak of gratifying the fiction of constitutional equality — if the practice of rotation were introduced into the Council. The loss of some administrative convenience would be negligible in comparison with the psychological gain.

The Loan Council is not obliged to meet at fixed intervals. The Financial Agreement vests the Council with complete discretion in regard to the ‘places, times, and notices of meetings.’ The Commonwealth is responsible for convening the Council. It may exercise this right ‘at any time’; but at the ‘request’ of at least three States it must convene the Council. In this respect, therefore, it appears that the States enjoy a considerably stronger position as legal members of the Loan Council than as conventional members of the Premiers’ Conference. In the current practice of the Premiers’ Conference, for example, the Commonwealth is responsible for its organisation, and if it refuses to summon a conference the States cannot compel it to do so. At best, the States can organise a meeting independently with all the limitations which the absence of the Commonwealth implies. In regard to the Loan Council, however, the ‘request’ of at least three States is sufficient to activate its machinery. The spectacle of April
1948, when a Federal Prime Minister rejected the request of three States to call a Premiers’ Conference, is inconceivable in the Loan Council.

A meeting of the Loan Council is not impaired either by the absence of any member, or by any ‘vacancy’ in its membership. A simple majority of the Council is sufficient to exercise its powers, though an absent member is entitled to appoint a deputy or to vote on any matter by letter or telegram. If a State, however, refuses to attend a meeting of the Council, or if a State ‘walks out’ on its proceedings, or if a State is seized with the desire to reverse ‘traditional’ fiscal practice by living on revenue alone, then, providing there is a quorum of four members, ‘a decision in which all the members for the time being . . . concur is a “unanimous decision” for all the purposes in which unanimity is necessary to the operation of the Loan Council.’ In short, a ‘Lang withdrawal’ cannot abort the Council’s activity.

The administrative machinery of the Council is remarkably small. It centres in two officers: the Secretary of the Council and the Co-ordinator-General of Public Works. The normal administrative routine — minutes, correspondence, organisation of meetings, and so on — is the responsibility of the Secretary of the Council, an officer specially appointed by and accountable to the Council. The Council is free to select anyone for this post; but so far, for reasons of convenience, it has invariably appointed a Commonwealth Treasury Official. He remains a member of the Commonwealth Public Service, and the administrative cost of his office — together with secretarial assistance — is provided by the Commonwealth. The Co-ordinator-General of Public Works is a recent accession to the Council. Shortly after the outbreak of war, in the primacy of Commonwealth defence needs, and the importance of reducing ordinary civil works to a minimum, the Loan Council agreed to appoint a Co-ordinator-General of Public Works to review the composition of the individual works programmes of each State, to report on their economic and military significance, and to recommend the borrowing to be made by the Council. Originally, the Co-ordinator-General’s Office was intended solely as a war-time measure. In 1946, however, the appointment was tacitly continued — surprisingly without protest from any member of the Council.

The Co-ordinator-General is a Commonwealth officer, and works in collaboration with the relevant officials of each State to present the Loan Council with a detailed statement of works proposed by every important governmental unit and department for each year. In this collaboration of Commonwealth and State officials, it is tempting to see the outlines of an informal ‘secretariat’ to the Loan Council. The short answer is that there is no secretariat attached to the Council, and
the activities of the Co-ordinator-General’s Office form no more than the barest semblance to the real functions of such an organisation. Periodic efforts to create a Loan Council secretariat have been made at various times, but without success. The reasons are not altogether clear. It appears that the Commonwealth has been its warmest protagonist, while most of the States have been generally suspicious of its implications. It was suggested to the writer by a federal official — perhaps in jest — that State disapproval sprang from the fear that the weight of expertise might prove embarrassing to a State Premier determined to carry out a project more in the thought of electoral ‘bread and games’ than sound public finance. ‘Log-rolling’, however, is not endemic to the States alone; nor is expertise a Commonwealth monopoly. In justice to the States it is important to note that the principle of a secretariat has not been in great dispute. The value of such an organisation could hardly be questioned. What has probably deterred the States more than any single factor is the concern that the Secretariat might become an informal adjunct of the Commonwealth Treasury. This certainly was their dominant thought during the pre-war discussions.

Until 1940, the chief function of the Loan Council was generally implicit in the purpose of its creation — namely, to control and coordinate the public borrowing of the Commonwealth and State governments. To this end it was mainly concerned with the total loan demands of the Commonwealth and State governments; the maximum amount which could be borrowed at reasonable rates and conditions; and the allocation of the agreed sum between the various governments. The Council was not directly concerned with the merits of any proposed loan expenditure. Its control of public investment was purely quantitative. Within the limits of its [funds] each State was free to pursue an independent spending policy.

Today [1952] it remains substantially correct to say that the Loan Council’s function is primarily to control the volume, not the quality, of public investment. But with the creation and continuance of the Co-ordinator-General’s office, a subtle change has taken place in the Council’s original conception. Evaluation of this change is difficult. From all accounts it appears that some degree of qualitative control (or what is in effect the co-ordination of spending) has now become an element of the Loan Council’s activity. But to what degree it is hard to determine from the available material. Certainly, during the war, the Council, through the Co-ordinator-General, exercised a fairly rigorous control over public investment. Since 1946, however, there has been little sign of anything like the same degree of scrutiny or regulation. The rationale of the Co-ordinator-General’s original appointment has changed; and the continuation of his office is
probably due, first to the success of the war-time practice, and secondly to the implicit understanding that his role is essentially advisory. Officials have been at great pains to emphasise that anything more, any pretence by the Council to exercise real control would wreck even the mild scrutiny given at present to the Commonwealth and State works programmes. The Co-ordinator-General's role, therefore, must not be exaggerated. Clearly he must tread with great caution. The sensitivity of State Premiers to direction is notorious. They are more inclined — as one official put it — 'to tell 'X' what they propose to do than wait for his advice.' If the Co-ordinator-General ever succeeds in deflecting or postponing a particular project it is entirely by persuasion, no more. For one thing is eminently clear — that if fiscal centralisation in Australia is well advanced it is still far from the point where the Commonwealth or any other body can direct the specific use to which a State should apply its loan funds.

The jurisdiction of the Loan Council may be briefly stated. Strictly, according to the terms of the Financial Agreement, its jurisdiction does not embrace all classes of public borrowing. The exceptions in order of importance are (a) Commonwealth loans for defence purposes; (b) borrowing by local and semi-governmental authorities; and (c) borrowing for 'temporary' purposes. In practice, however, the first two classes of loans have been brought within the purview of the Council. The omission of local and semi-governmental borrowing proved a serious defect. It gave the States an opportunity to circumvent the Council's control by placing a number of important State activities — for example, water, sewerage, and tramway boards — outside the budget. And this, together with the enormous growth of borrowing by these bodies immediately prior to the war, rendered any comprehensive control and co-ordination extremely difficult. To meet this situation, therefore, a 'gentlemen's agreement' was concluded in 1936 to bring all estimated borrowing by semi-governmental bodies (whether for new money or for conversion purposes) into account. The exclusion of Commonwealth defence loans was more justifiable. By their very nature they enjoy a special priority over every other class of borrowing. From the States' viewpoint, however, this exclusion could prejudice their interests. In the existing connotation of 'defence', for example, it empowers the Commonwealth to borrow for almost any purpose without Loan Council scrutiny; and in this way the Commonwealth could easily manoeuvre its demands to 'dampen' State loan programmes. For this reason it appears that a second [informal agreement] was concluded in August 1951 whereby the Commonwealth undertook to submit its total loan requirements to the Council. In regard to the third class of borrowing, the position is somewhat obscure. The specific character of borrowing 'solely for
temporary purposes’ is not defined in the Financial Agreement. Originally it was probably intended to free every form of short-term accommodation from the Council’s control. And even now this power is sufficiently alive in law to invalidate any Commonwealth legislation which might impair this governmental right to short-term credit. In practice, however, since bank overdrafts to bridge revenue deficits were brought within the control of the Loan Council during the 1930s, the residuary privileges of the States in regard to ‘temporary borrowing’ are now virtually negligible.\(^{12}\)

To this brief review of the apparatus and scope of the Loan Council, one final note. The executive agency of the Council for the purpose of borrowing is the Commonwealth. Once the Loan Council has decided on a particular course of action, loan operations are conducted solely by the Commonwealth. The securities issued are Commonwealth securities, signed by the Commonwealth Treasurer as Chairman of the Loan Council, and are redeemable at the Commonwealth Bank. The principal operative exceptions to this rule are, first, the right of a State — subject to the Council’s decision regarding the rate of interest and other charges — to borrow from any ‘authorities, bodies, funds or institutions’ within its territory, and from the ‘public by counter sales of securities.’ In this class of . . . borrowing, however, the Commonwealth remains the guarantor, and Commonwealth securities are issued on all moneys raised independently by the State. Secondly, local and semi-governmental authorities — though subject to the Loan Council’s scrutiny — make their own loan arrangements, and borrow on their own security.

**The Operation of the Loan Council**

To speak of the Loan Council’s procedure at once creates a vision of some regular and ordered mode of conducting the business of public borrowing. If there is a detailed pattern in this sense, the Financial Agreement itself gives only the slenderest indication of it. The Agreement simply requires that the ‘Commonwealth and each State will, from time to time, submit to the Loan Council a programme setting forth the amount it desires to raise by loans during each financial year.’ It specifies the broad nature of the statement; and it vests the Loan Council with the complete discretion — except in such matters as voting — to frame its own rules for the conduct of business at its meetings. Whether the Council has formulated a set of rules in these matters or whether there is simply a conventional pattern of procedure is not easy to determine. The exact proceedings of the Loan Council, no less than the activity of the Cabinet, are particularly an enigma. Its meetings are shrouded with considerable secrecy. The Council generally meets in the House of Representatives in Canberra
behind locked doors. Its minutes are confidential. Beyond a brief press 'hand-out’, press ‘imagination’, and the occasional ‘indiscretions’ of some of its members, little is known of its actual proceedings. We have made an attempt to reconstruct some elements of its operations from a number of secondary sources and chance conversations with public officials. What follows, however, pretends to be no more than a skeletal and diffident outline of the Council’s activity.

The Loan Council usually meets on the average twice a year for periods varying from two to three days. Its longest meeting was in May 1952, when it sat for three days and the session lasted 35 hours. The principal meetings generally take place in Canberra before the end of each financial year on a date mutually convenient to the Commonwealth and the States. But further meetings are frequently convened for purposes of supplementary borrowing or, for example, if the Council finds that owing to the conditions of the loan market it cannot raise the required sum in one transaction, it will generally agree to meet at a later stage to reconsider the position. On occasion, also, where policy has been settled at the principal meeting, the Commonwealth may secure State approval to specific operations by correspondence instead of convening a further meeting of the Council.

The formal information submitted to the Council before each meeting is partly defined by the Financial Agreement and partly by practice. Prior to 1940 each member sent the Secretary of the Council a statement of its loan requirements which mainly contained the information required by the Financial Agreement. These statements broadly listed the estimated loan expenditure under two principal headings: public works, and budgetary deficits (if any). The specific nature of the public works was not disclosed, except under such general heads as railways, bridges, and so on. If some piece of detailed information was volunteered it emerged only indirectly in the course of discussion in the Council to reinforce the particular claims of a State; for example, ‘we are committed this year to the construction of “X” reservoir . . .’ or ‘we cannot delay the construction of a railway from “A” to “B” any longer’.

Since 1940 three changes have been introduced, two of which have radically expanded the body of information available to the Council. In the first place the provision requiring each State to submit a statement of its loan requirements ‘for each financial year’ has been slightly amended to bring the formal requirements of the Agreement into line with practice. The Commonwealth Prime Minister explained this purely technical amendment in these terms:
The Financial Agreement prescribes that the Commonwealth and each State will from time to time submit to the Loan Council a programme setting forth the amount it desires to raise by loans for each year. It has not been practicable to relate the borrowings during a year to the actual loan expenditure during that year. Public loan raisings must be arranged at convenient intervals, and it has been customary for moneys to be borrowed towards the end of each financial year sufficient to meet the requirements during the early part of the new financial year until a further loan raising becomes practicable. This procedure is not strictly in accordance with the Financial Agreement, and it is now proposed in the amending agreement that the loan programmes to be submitted by the various governments shall be the programmes of amounts desired to be raised during each year and not loans raised for each financial year. This involves no alteration of procedure, but merely brings the provisions of the agreement into line with the present practice.

In the second place we have already noted the important practice initiated early in the war of submitting detailed public works programmes to the Council through the office of the Co-ordinator-General. Thirdly we also noted the submission of details of local and semi-governmental borrowing to the Council. The present position, therefore, appears to be this: each of the seven governments prepares three main statements — (a) a statement of estimated loan expenditure in accordance with the Financial Agreement as amended in 1944; (b) a statement of estimated loan expenditure of all semi-governmental and local authorities in accordance with the ‘gentlemen’s agreement’ . . .; and (c) a detailed programme of public works corresponding to the total estimated loan expenditure of (a) and (b) in accordance with the practice initiated in 1941. The first two statements are sent directly to the Secretary of the Loan Council, and the detailed works programme is sent to the Co-ordinator-General of Works for examination and report to the Council. 17

The uniqueness of the Loan Council, and the aura of secrecy which surrounds its meetings, tend to create an impression that its proceedings too may partake of the unusual. On closer examination of the available material, however, the anticipation of the unorthodox is dispelled. The opening stages of a Loan Council meeting conform to the normal ‘committee’ procedure of almost any executive body. The Council is opened by reading the formal notice convening the meeting. The minutes are read and confirmed. The Secretary circulates a number of financial statements which set out the budgetary position of each government, the tentative figures of the Commonwealth and State loan programmes, the estimated funds available, the consolidated works programme of each State, the Co-ordinator-
General’s report, and any memorandums prepared by the Commonwealth and States. The Chairman may give a brief report of any administrative action taken by him in relation to matters arising out of the Council’s previous meeting. And then, following this routine preamble, the Council turns to its main business — the settlement of the Commonwealth and State loan programmes for the year.

In this task, again, the procedure of the Loan Council is distinguished by little from the general conference technique of any ministerial council. There is first, as in every case, a statement of Commonwealth policy, its appreciation of the loan market, the conditions of the national economy, and sometimes at this stage its judgment of the total loan demands; then following the Commonwealth each other member of the Council presents his State’s case. This preliminary stage is, in effect, no more than the elaboration of seven individual ‘briefs’ in which the fiscal position of each member, its revenue and loan finance, etc. — already outlined to the Council in the formal information submitted by each member — is now fully developed. It has been usual at this stage also for the Co-ordinator-General — who attends each meeting of the Council — to give a brief analysis of the total programme of works in relation to the availability of labour, material resources, and any other factors which may affect the estimated programme. Then, once the fiscal position of each government has been fully presented to the meeting, the Council moves to the determination of its two major problems — (a) the amount to be raised, in what portions, and at what periods, and (b) the mode of distribution.

If the Loan Council’s operation has tempted the view that this institution is something more than its title suggests — that it should be renamed the ‘Australian Finance Council’ — it is due, almost entirely, to the range of the discussions which, each time, precede its first decision — whether the combined loan programmes can be met, and if not, then the maximum sum which can be raised at ‘reasonable rates and conditions.’ It is clear that before it makes this decision, the problem of capital demand and capital supply is discussed against the whole background of the prevailing monetary and economic condition of the Commonwealth and each State. It was certainly not intended in 1927 that this body should evolve into a national finance council. Yet, in the very nature of the first decision it must make, it is difficult to see how the Council could hope to discharge its function without engaging — however briefly — in a general debate on these matters. It is here, moreover, at this inflammable stage of its proceedings (as much as, and frequently more than, in the apportionment of the agreed total loans) that a violent controversy may often ensue in which conflicting policies of public investment, fiscal management, personal
enmities, party politics, and the inevitable relations of Commonwealth-State finance are thrown to the surface.

To decide the total loan programme, the Council is free to draw upon any information — beside Treasury opinion — and consult any institution. During the Depression, for example, the Loan Council relied extensively on the advice of a number of prominent economists — notably Professors Giblin, Copland, and Melville. And even now, according to one source, 'Professor “X” is generally to be found on the fringe of the Council.’ The one institution, however, which (until at least 1940) exercised a formidable influence at this stage of the discussions was the Commonwealth Bank. Its highly controversial activity in the formulation of the Premiers’ Plan is now a matter of history, and we do not propose to resurrect it. Some indication of its immediate pre-war role, however, is provided by Professor Giblin’s evidence to the Rowell-Sirois Commission on the working of the Loan Council. ‘Nominally’, he said, ‘the Loan Council is supposed to make up its own mind . . . and decide whether the total loan programmes can be raised or not. In practice, however, the Council does not like risking a loan unless it is underwritten’, and the ‘only body in a position to underwrite it is the Commonwealth Bank.’ Hence, it was common for the Chairman or an ad hoc committee to enter into negotiations with the Bank. How far this practice may disclose the realities of pre-war borrowing in Australia is again illumined in the outburst of [the Premier of Tasmania, quoted by Maxwell . . .] This incident may or may not be typical of pre-war Council meetings. To this picture, however, two brief notes must be added. In the first place, it is quite clear that constitutionally the approach to the Commonwealth Bank, as Giblin hastened to point out to the Rowell-Sirois Commission, was an ‘accidental side issue.’ The Loan Council has complete authority to determine the maximum which can be borrowed and proceed to raise it. Thus, for example, if the Commonwealth Bank had refused to underwrite the total sum required by the Council, the Council could have floated its own estimated total loan, and taken their chances on the market. Secondly, the present influence of the Commonwealth Bank on the Council is slight. It underwrites the Council’s operations and remains its most influential source of advice on the state of the loan market. But since the reconstitution of its governing board and the centralisation of credit policy in 1945, it has lost, for the time at least, the power to command the Council’s investment policy.

Once the total sum to be raised is settled, the Council turns to its allocation among the members — a stage stigmatised by one irreverent official as the dog-fight. Clearly, the problem of allocation does not arise where the total loan requirements of the Commonwealth and the
States can be satisfied. But where the Council decides that the total cannot be raised on reasonable terms — and this has been almost invariably the case — the meeting then determines the sum which can be raised, and proceeds to scale down the original loan demands. Here, the provisions of the Financial Agreement are simple enough. If there is *unanimity*, the Council is free to make whatever allocation it desires. In the absence of unanimity, however, the allocation is automatically determined in accordance with a statutory formula. The economic critiques of the formula need not concern us. The formula has never been applied. Invariably, after intensive ‘horse-trading’, agreement has been reached. On one occasion at least (1935) it appears that the Council, prior to discussing the apportionment of loan funds, instructed the Under-Treasurers to examine and report on the application of the formula to the agreed total. In this instance their report showed the results of applying the formula and alternative methods of distribution. The instructions of the Under-Treasurers in this case, however, must not be confused with a final application of the formula to settle an irreconcilable situation. On this occasion it probably served to define the area of dispute more closely, and thereby tied the negotiations to a concrete basis. In general practice, the weakness of the formula — despite some recent amendments — is recognised. The needs of the Loan Council are variable, and the formula is rigid and artificial. Yet it cannot be dismissed altogether. Paradoxically, from its very weakness springs its main strength, for in the threat of its application lies a constant inducement to compromise.

With the resolution of these two problems — the amount to be raised, and its allocation — the business of the Loan Council is virtually at an end. The Commonwealth is then formally authorised to raise the necessary funds and settle the details of underwriting with the Commonwealth Bank. All that remains is to consider the requirements of the various local and semi-governmental authorities (normally a brief matter) and other business which may require the Council’s attention — for example, to arrange for any ‘conversions, renewals, or redemptions’ of existing loans, to improve the conditions of any local borrowing by a State, and so on.

To complete this short sketch of the Council’s operation one other factor must be noted, namely, the nature and significance of the Council’s voting arrangements. In essence the Financial Agreement provides that in all matters, except (a) the apportionment of loan funds, and (b) consent to independent borrowing by a State outside Australia, disputes are to be resolved by a *majority* vote; for this purpose the Commonwealth has two votes and a casting vote by virtue of its special position under the Agreement, while each State is given
one vote only.\textsuperscript{27} Thus, for example, in such matters as the total sum of money to be raised, the rate of interest, the conditions of the loan, the source of borrowing, questions of procedure, the nature of the information to be submitted to the Council, and so on, decisions may be made by a simple majority. In the case of the two principal exceptions (a) and (b), however, \textit{unanimity} is essential.

This arrangement has generally raised two main questions; the extent to which voting is used in the Council, and the extent to which voting — if and when used — corresponds to party affiliations. A precise answer, of course, could only be given if the Council’s minutes were thrown open to examination. But, short of this, some rough approximation to the position may be made through a number of scattered references. In the first place, it is quite clear that voting has taken place, and that it has only been used — notably in May 1952 — for matters of major policy.\textsuperscript{28} On the question of frequency however, Professor Giblin’s evidence to the Rowell-Sirois Commission in 1939, Professor Maxwell’s paper, \textit{The Recent History of the Australian Loan Council}, and the opinions of a random number of senior officials clearly suggest that the dominant tendency in the Loan Council is to resolve conflicts by compromise rather than voting. On occasions there has been an unofficial counting of heads; but for the most part, there is a general desire to avoid pushing any important question through on the basis of majority voting. The Council prefers to talk around a subject until agreement is reached. If voting is applied or threatened in the case of some fundamental divergence, however, does the Council divide on party lines? The bulk of opinion we sought is agreed that voting alignments are rarely, if ever, related to the political complexion of the Council. This view is generally consistent with the character of the States’ behaviour in the consultative councils, and certainly it is exemplified in the whole conflict over federal-State financial relations. Indeed, it is too simple to presume that the individual self-interest of each State is so tenuous that party allegiance alone is sufficient to dictate its alignment in the Council. If voting in the Council does not correspond to party affiliation, are there any significant alignments on the Council at all? Are the only alignments, as one cynic remarked, ‘along parallels of latitude?’ Whatever the occasional groupings of States, one clear division in the Council is persistent — notably the cleavage between the Commonwealth and the States. The whole tenor of pre-war Council discussions accentuated this division, and the post-war meetings have contributed further evidence of it. True, it may vary in its intensity from one period to another, but its presence is unmistakable.\textsuperscript{29} We need scarcely elaborate the reasons, for the drama of federal-State financial relations is continually re-enacted on the stage and in the wings of the
Loan Council. There the Commonwealth enjoys a position of strength under the Agreement, and to this it adds the full bargaining force it derives from its present control of central bank credit policy, its aggrandisement of income taxation, and its partial influence over the three ‘mendicant’ States. With few exceptions this power has normally enabled the Commonwealth to ‘bring about a compromise solution’ of most disputes which have arisen in the Council...

Notes

1 See (1944) 180 Commonwealth Parliamentary Debates, 2516 (Sir Earle Page).

2 Cf. original clause (f) in Premiers’ Conference (June 1927), at 5 and amended clause (i) in Premiers’ Conference (July 1927) at 29.

3 See Premiers’ Conference (July 1927), 55-6, and sec. 4, clauses (a) and (b). The clauses were inserted at the insistence of New South Wales. It is interesting to note, however, that on no occasion did this State, or for that matter any other State, avail itself of this opportunity to borrow independently abroad after the establishment of the Loan Council. Indeed, the possibility of securing the Council’s unanimous approval to such a request seems sufficiently slender to make this ‘privilege’ illusory... The present consolidated Financial Agreement (1944) consists of two parts. The first part constitutes the Australian Loan Council, defining its structure, functions, and powers, and deals with the future borrowing of the Commonwealth and States. The second deals with the transfer of State debts, the payment of interest, sinking fund arrangements, the expenses of loan flotation, indemnification of the Commonwealth against all liabilities assumed on behalf of the States, and the maintenance of separate accounts by the Commonwealth for each State in regard to their debts, interest, etc. The Agreement is fixed for 58 years. Technically, therefore, the Loan Council’s authority ends in 1987. [See R. S. Gilbert, Future of the Australian Loan Council, distributed by ANU Press, Canberra, 1974.]


5 The four amendments are (1) the Debt Conversion Agreement Act of 1931; (2) the second Debt Conversion Agreement Act of 1931; (3) the Financial Agreement relating to Soldier Settlement Loans of 1935; and (4) the Amending Agreement of 1944... [The first two of the above amendments affected the circumstances in which the Financial Agreement operated but did not require any formal change in its terms. To the same category may be added the Tasmanian Sinking Fund Agreement Act of 1928 and the Financial Agreement (Commonwealth Liability) Act of 1932. The third of the above amendments required only a change of figures in the clause defining the amount of State public debt taken over by the Commonwealth, following the writing down of soldier settlement loans to the States. But opportunity was also taken in 1934 to amend the clause governing membership of the Loan Council to make it clear that the Prime Minister and the State Premiers were members as of right and did not need to appoint themselves to represent their governments.

The first general revision of the Financial Agreement thus did not occur until 1944. Lapsed provisions such as the temporary Part II were then omitted, the remaining
sections were renumbered and new sections were inserted, including those to provide for the funding of Treasury bills outstanding from the years 1927 to 1935 (Reading X).

Since 1944 there have been two further amendments to the Financial Agreement, a relatively minor one in 1966 and a major revision in 1976, retrospective to 1974. The former provided for the introduction of decimal currency and the latter for the take-over of an additional $1,000m of State debt, the introduction of new (and interminable) sinking fund arrangements and a general revision of the whole agreement. See A. R. G. Prowse and E. A. Morey, *The Financial Agreement and the Future of the Loan Council*, Centre for Research on Federal Financial Relations, Canberra, 1976.]

6 So far it appears that no appointee of non-ministerial rank has ever been accredited to the Council as a representative of any government. Clearly the emphasis on ministerial rank is understandable in view of the Council's function. Furthermore, the power to vote presumes that if a government is to be bound by the Council's decisions it will at least be represented by a member of its ministry . . .

7 Note that prior to 1944, the Council formally elected the Commonwealth Prime Minister to the chair; but since then [the] amendment of the Financial Agreement has given permanent status to the Prime Minister as Chairman of the Council . . .

8 For the circumstances of his appointment see *Premiers' Conference* (October 1938): *Premiers' Conference* (March 1939); (1939) 162 *Commonwealth Parliamentary Debates*, 2343; and E. R. Walker, *The Australian Economy in War and Reconstruction* (1947), 47, 95.

9 See Maxwell, Reading X.

10 See Walker, loc cit.

11 The terms of the 'informal' agreement [as amended to July 1939] are as follows:—

*Each Government represented on the Loan Council agrees:*

1. That in future all loan moneys which are required by (a) that Government or (b) any municipal, local or other public authority of the Commonwealth or State, as the case may be (in this resolution referred to as a semi-governmental authority), shall be obtained only from moneys raised in accordance with clauses 4, 5 or 6 of part 1 of the Financial Agreement, or from moneys raised by a semi-governmental authority with the consent of the Loan Council.

2. That it will not, without the prior approval of the Loan Council, guarantee any loan raised or to be raised by any semi-governmental authority (not being a guarantee of an overdraft to a body established under the law of a State for the organised marketing of produce).

3. That it will from time to time furnish to the Secretary of the Loan Council particulars of all guarantees given by it to bodies other than semi-governmental authorities.

4. That nothing in the foregoing provisions of this resolution shall prevent (a) any semi-governmental authority from raising in any financial year for its own purposes (other than for the purpose of repayment to a Government) a sum or sums totalling less than £100,000, provided that where the amount exceeds £50,000 particulars thereof are communicated to the Secretary of the Loan Council immediately upon approval of the loan being given; or (b) the Commonwealth or a State from guaranteeing the indebtedness of any semi-governmental authority to an amount or amounts not exceeding in the aggregate £100,000 in any one financial year.'
12 See *The Case of the People of Western Australia* (1934, Government Printer of Western Australia), 84-6; N. Cowper, Reading IX, 111; Mitchell, op. cit., 56-61 and Supplement, vi; and *Melbourne Corporation v. The Commonwealth*, (1947) 74 C.L.R. 31, at 63-66.

13 See Mitchell, op. cit., 55. In his view it was 'almost essential that if the Loan Council did not sit in public, it must at least, after each sitting, publish minutes of what it has decided, so that intending lenders may see that the Commonwealth or State is borrowing within the amount fixed by the Loan Council, and in accordance with the maximum limits as to interest, etc. (if any), fixed by it.'

14 See Maxwell, Reading X above, and Giblin, Evidence Before the Rowell-Sirois Commission, [as referred to on p. 99 above].

15 See L. F. Giblin, Evidence Before the Rowell-Sirois Commission, Ottawa, 1938, 39: 'Each State indicates what its needs are. The Loan Council takes no cognizance of that. One State says it wants £3,000,000, and that is accepted; it is not examined in any way, nor is any question asked as to the way in which the money is to be spent . . . It simply says it wants £3,000,000.'

16 J. B. Chifley, in (1944) 180 *Commonwealth Parliamentary Debates*, 1897.

17 The programme of works is prepared in the following way: Each State department and each semi-governmental and local authority make a detailed statement of their proposed public works for the ensuing year on standard forms and submit this information to the State Co-ordinator of Works; at the same time a copy is sent to the Co-ordinator-General of Works in Canberra. The State Co-ordinator consolidates the individual requirements of the various administering authorities (semi-governmental and local authorities are collated separately) and submits the whole as the State programme of works to the Co-ordinator-General. The latter then, in turn, with the assistance of a small staff, supplemented by frequent consultations with the State Co-ordinators, and (if necessary) the State Premiers, examines and collates the States' programmes into a consolidated national programme of works for submission to the Council with his report and recommendations.

18 See, for example, Forgan Smith's suggestion that the Loan Council should be renamed the 'Australian Finance Council', referred to by D. G. Copland and C. V. Janes in *Cross Currents in Australian Finance*, 15-16.

19 Mitchell, op. cit., 51.

20 Giblin, op. cit., 39.

21 Maxwell, Reading X, note 7.

22 Giblin, op. cit., 42.

23 Broadly, the apportionment is made as follows: First, the Commonwealth is entitled to one-fifth of the agreed total; secondly, each State is entitled to the same proportion of the total sum available to the States (after meeting the Commonwealth needs) as 'the net loan expenditure of that State in the preceding five years bears to the net loan expenditure of all the States during the same period.' In either case, however, the Commonwealth or any State may accept less than its allotted share. Furthermore, in
the event of the formula being applied, the term 'net loan expenditure' does not include expenditure for the funding of revenue deficits, or to meet revenue deficits, or 'any specified class of expenditure which the Loan Council by unanimous decision declares shall not be included . . .'.

24 Maxwell, Reading X, 128-30.

25 See J. B. Chifley (1944), 180 Commonwealth Parliamentary Debates, 1898.

26 See Giblin, op. cit., 44-5:— 'Always in fact some compromise has been reached, but it is only because there is the automatic agreement behind it . . . Generally, there is a good deal of give and take and adjustments . . . have fairly solved the problem.'

27 Financial Agreement 1944, clauses 3 (m) and 4 (b).

28 See an oblique reference, for example, in (1944) 114 Western Australian Parliamentary Debates, 2144; and note E. R. Walker, op. cit., 95 [cf. Headford, Reading XII, 173].

29 See, for example, the remark of the then Premier of New South Wales, Mr J. McGirr, at the August 1951 meeting of the Loan Council (as reported in Sydney Morning Herald of 18 August 1951, on page 4): 'The Commonwealth side-stepped every State request put to it. On some occasions the Commonwealth's secretive attitude made discussion pointless and time-wasting. I refer particularly to our two days of Loan Council discussion. The Commonwealth refused repeatedly to reveal what cut it wanted until the last minute. Discussion became farcical under those circumstances . . . .'
The Australian Loan Council — Its Origin, Operation and Significance in the Federal Structure*

C. G. Headford

It has been claimed that the 'financial relations between the component States and a federal government ... are the chief determinant of the character of the federation.' The claim is wide, but it is not surprising, as the power of the purse is the main means of power: the main means of gaining control over men and materials; of translating ideas and desires into action; of promoting and realising interests.

In Australia, public borrowing has played an unusually prominent part in federal finance and has led to a notable experiment in the creation of a constitutional hybrid — the Loan Council. This significant role of governmental borrowing is largely due to the fact that the economic exploitation of undeveloped natural resources, including the provision of adequate communications, has been undertaken more than in any other federation by public rather than by private enterprise.

There are three major questions to be decided, and each gives rise to the likelihood of conflict. Firstly, which of the various public projects competing for the expenditure of loan money should be selected? Secondly, what total amount should be borrowed? Thirdly, what share should each government receive of the total? The full significance of the second of these questions has only recently emerged.

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with the assumption by the Commonwealth government of responsibility for regulating the level of economic activity in Australia, and, specifically, for maintaining 'full employment.' This shift in emphasis has made it more necessary than ever to investigate the role of the Loan Council — to see why it was created, how successful it has been, and whether it still aids governments in meeting the 'felt needs of the time.'

This unique institution — the model of innovation in the sphere of public borrowing — has many unusual features, not the least of them being the secrecy of its operations. Her Majesty's Opposition meets a consistent refusal in attempts to obtain information; yet it is possible to attempt to piece together its story from a variety of sources.

Because of the close interrelation between revenue resources and the need to borrow, the general financial framework established by the Constitution in 1901 is important. The framers of the Constitution 'left the settlement of the financial scheme very largely to the future. They admitted that it was quite an impossible task for them to lay down the whole financial basis of the Commonwealth. They made provisional arrangements for temporary periods, and . . . left the rest almost entirely, if not quite entirely, to the discretion of the Parliament.' The crux of their problem was that customs and excise duties were necessarily granted exclusively to the federal government, yet these had been the chief sources of State revenues prior to federation. The States' annual interest liability was alone greater than the revenue they were accustomed to raise, or were likely to raise, by direct taxes. This inherent pattern of financial power was not fully realised by either the Commonwealth or the States at the time and has only gradually unfolded. Yet it has profoundly affected the character of the federation, and has been of basic importance in determining the power structure of the Australian Loan Council.

By section 105 of the Constitution, the Commonwealth was empowered to take over the States' debts existing at federation, and in 1910 the electors approved an alteration to that section which permitted the taking over of all State debts, whether incurred before or after federation. In fact, no attempt was made to use this power until the Constitution was again amended in 1928. Until 1911 the Commonwealth met capital expenditure out of revenue. In that year a Loan Fund was created, but it was not until 1914 that the Commonwealth entered the public loan market. The first world war wrought a big change in the financial positions of the Commonwealth and the States. The former entered new (concurrent) fields of taxation to finance war expenditure and incurred a large war debt. The problem of repayment of this debt, superimposed upon State borrowings, was basically the cause of the creation of the Loan
Council. During the war the Commonwealth government entered into an agreement with the States other than New South Wales under which all loans in London were to be raised by the Commonwealth.\(^7\) This continued from 1915 till 1919, when the parties reverted to independent arrangement of their loans. After 1920, the States were competing with one another on the loan market in London, and co-ordination of borrowing was badly needed.\(^8\)

By 1923 the first of the internal war loans raised by the Commonwealth became due.\(^9\) When arranging for the large conversion required, ‘Commonwealth Ministers could not get the States wholly off the market while the operation was in progress. In the long run, such a state of affairs could not fail to bring disaster.’\(^10\) As early as March 1923, the Prime Minister had pointed out that because of the loans and conversions required up to 1930, the credit of Australia should be placed upon the very best possible basis. In the interests of Australia as a whole, the ‘best policy . . . would be to have one borrowing authority.’ Further points requiring united action (he claimed) were the needs for uniform sinking funds and for some uniform basis of taxation on loans — the States exempted, but the Commonwealth did not exempt government loans from taxes.\(^11\)

As a result of a conference called by the Commonwealth, the States agreed to constitute the Australian Loan Council in May 1923, to act in an advisory capacity to co-ordinate internal borrowing and to stop competition for loans. At meetings of the Council in June and July, 1924 ‘a unanimous desire was expressed to limit borrowing. The Treasurers placed the Loan Council’s proposals-before their respective Cabinets, and all the governments accepted the Council’s recommendation for a reduction of their contemplated loan programmes.’\(^12\)

The following year the Council decided to extend this arrangement to all overseas borrowing.\(^13\) With the advent of Mr Lang as Premier of New South Wales, that State withdrew from the Council. He gave two reasons. Firstly, because they were underwritten, one large concerted loan would be dearer than small raisings by individual States, and secondly, because New South Wales had not experienced any difficulty in arranging conversions or new loans.\(^14\) A more fundamental reason, and one that coloured his whole approach to the Loan Council, was the fear that it would be an instrument of federal domination.\(^15\)

About this time, overseas borrowing became more difficult. Britain’s return to gold in 1925 meant that obstacles were placed in the way of lending abroad, and it also meant higher interest rates and dearer money for Australia. In addition, because of the privileged position held by Australian government bonds as trust securities in the
British market, a great deal of criticism was directed against Australian loan policies.16

During 1925 a loan of £20 million was placed in New York by the Commonwealth because London could not raise the amount required immediately and a sinking fund was insisted on as being part of the contract for loans raised there.17 The weakening of Australian credit was shown by the fact that loans raised by the Commonwealth as well as the States were ‘rated lower than those of other British dominions with less natural resources and potential wealth.’18 At this time the whole question of loan policy was arousing considerable interest in Australia and there existed ‘a very general feeling that the increase in the debt has been out of proportion to the growth of development’.19

The operation of the Council over this period had been along non-party lines and was smoothly co-operative apart from the withdrawal of New South Wales because of the personal convictions of Mr Lang.20 Nevertheless circumstances were assisting or perhaps engendering a feeling that the Council needed more authority.

It remains to be shown how the Loan Council became part of the Financial Agreement of 1927. In 1926 the question of control of public borrowing and the taking over of State debts was linked with the more general question of the financial relations of the Commonwealth and the States, and the suggestion was seized as a possible compromise solution of an intractable problem.

Negotiations had taken place intermittently over the whole of the period subsequent to federation in attempts to arrive at some basis for regulating future financial relations.21 A stumbling block in various attempts to reallocate tax fields was the States’ insistence that they were morally entitled to a share of customs and excise revenues, and that this was a condition of their consent to federation in 1901. A more compelling reason for the States’ resistance is clearly brought out in a statement by a Premier rejecting a scheme proposed by the Commonwealth. Under the scheme it was claimed that ‘the States would be in the position of an Aunt Sally, for every income taxpayer to have a shot at,’ and that the States would have to impose ‘all the odious direct taxation while the Commonwealth will be freed from such an obligation.’22

Several important points were made in a debate in the House of Representatives of July 1926, which had a direct bearing on the Financial Agreement of 1927 and on the place of the Loan Council in that Agreement. It was argued that the right to a share of customs revenue was a condition of federation, ‘the alternative being that their (the States’) debts would be taken over by the Commonwealth.’ This subject had not been mentioned at either of the 1923 or 1926 conferences. The suggestion was made that the per capita proposals be
linked with a constitutional amendment to gain Commonwealth control of State debts. The Treasurer argued that it would be 'impossible without constitutional alterations, for the Commonwealth to control State borrowing, and unless some binding agreement on that is arrived at, how could we deal satisfactorily with the transfer of State debts?'

These suggestions were incorporated by the Commonwealth in a scheme submitted to a conference in June, 1927. The proposal was to take over existing State debts; to establish the Loan Council as a statutory body with defined powers to determine the amount and terms for future governmental borrowing; to pay interest on State debts equivalent to the per capita payment for 1926-27; to establish sinking funds to redeem existing debts within fifty-eight years and future debts within fifty-three years, the Commonwealth making a contribution to these sinking funds; and to pay interest at 5 per cent per annum on the value of properties transferred to the Commonwealth under section 85 of the Constitution.

The Premiers' reactions to the scheme were generally favourable, although Mr Lang of New South Wales and Mr Collier of Western Australia were dubious about surrendering their power to borrow to the Loan Council. However, Mr Lyons (Tasmania) pointed out that 'it is my experience . . . on the Loan Council . . . that there has been no antagonism between the States, or between the Commonwealth and the State representatives.' Mr Collier agreed that if 'I were sure that the proposed Council would work as smoothly as the one now in existence, I would have no objection to offer.' Conflicts, it was claimed, could only arise when the amount of money said to be available for the Commonwealth and the States, was less than was considered necessary, and a formula for resolving such conflicts was set out. The Prime Minister insisted that there would be no interference with sovereign rights by the Council. 'All it could do would be to lay down the rate at which money is to be obtained by a first-class borrower.' After a number of modifications the scheme was accepted subject to ratification by the various Parliaments. Ultimately it was, in effect, written into the Constitution by the approval at the subsequent referendum of the insertion of S.105A in the Constitution.

The origin of the Australian Loan Council can, then, be attributed mainly to the peculiar historical circumstances of Australian conditions, particularly the tradition of government action. Difficulties in raising and converting internal loans and the desire for cheaper rates led to the creation of a voluntary council which worked smoothly. Criticism of Australian loans abroad and the insistence on sinking funds led to the extension of its operations to cover overseas
loans. Some years of experience, the absence of New South Wales, and the need (voiced by many) for some restriction of borrowing, all led to a desire to make the Council a permanent, fully representative body. The opportunity to realise this desire arose as part of a compromise solution of the perennial wrangle over the financial problem at Premiers' Conferences.

As a result, a new unit of government was created by the Financial Agreement of 1927 to co-ordinate public borrowings of the Commonwealth and the States. A brief description of its formal structure may be useful. It consists of the Prime Minister of the Commonwealth as Chairman and the Premier of each State, or his nominee. Each government submits annually a loan programme for the following year, including any revenue deficit to be funded. Loans for defence purposes are not subject to Council supervision. If the Council decides that the total of the loan programmes cannot be raised at reasonable rates of interest and conditions (the latter being determined by the Council), it then decides the amount which shall be borrowed. Each of these decisions is by majority vote in which the Commonwealth has two votes and a casting vote, and each State one vote. It may then, by unanimous decision, allocate that amount between the members. Failing a unanimous decision, the Commonwealth is entitled to one-fifth of the total, and each State to a proportion of the remainder. The Commonwealth acts as the executive agency for the Council for the purpose of borrowing and enforcing its decisions.

Although the Commonwealth does not appear to have considered that it could use the Loan Council as a means to ensure that 'injudicious' borrowing did not take place, the formula for resolving conflicts was designed to act as a deterrent to any State that might seek in any one year to make unduly large increases in its loan programme. One by-product of this has been to promote conflicts between States as to their relative shares of the total loan funds.

Events of the Depression years stretched the passions and the ingenuity of men, and under these conditions the Loan Council assumed an increasing importance. At its first meeting as constituted under the Financial Agreement, the Council was faced with the problem of the drying up of loan funds, and the members 'had the advantage of a discussion with the Chairman of the Commonwealth Bank Board (Sir Robert Gibson) and the Governor of the Commonwealth Bank (Mr E. C. Riddle) regarding the financial position.' This change in emphasis of the function of the Council gradually grew more marked. From the time of the visit of Sir Otto Niemeyer the real centre of political interest was in the Premiers' Conference and the Loan Council rather than in any of the Parliaments. The Council decided to reduce loan works, to mobilise London
exchange, and to adopt the principle of balancing budgets. A sub-
committee co-opted economists and Under-Treasurers who produced
a report which was the basis of the Premiers’ Plan. In this manner the
Council afforded the means by which common problems could be
aired and a national approach considered and even enforced — as the
Premier of New South Wales was to learn to his cost. Mr Lang
attempted to pursue an independent financial policy, but after a rather
dramatic struggle he found that his independence had been severely
restricted by the Financial Agreement and his failure to meet interest
payments led to the passing of the Financial Agreements Enforcement
Acts which finally led to his dismissal.36

Attitudes of the various governments towards loan expenditure
gradually changed. Up to 1935 Victoria and South Australia showed a
strong deflationary bent, while New South Wales and Queensland
showed an opposite tendency. Labor governments gained power in
Western Australia and Tasmania and this favoured a move for
expansion in government finance. More important was the feeling of
the Commonwealth government that, faced with a general election
and with 20 per cent of unemployment, there was a need for positive
action, and in the 1934 federal elections Mr Lyons finally turned to the
course of increased loan expenditure.37

The experiences of the depression years and the slow recovery
during the 1930s illustrate the importance for public borrowing of the
superior financial position of the Commonwealth under the
Constitution. From 1931-32 till the second world war, the Common-
wealth was in surplus and the States in deficit on their budgets for all
years but one. The Commonwealth was able to use its revenue surplus
for capital works, whereas the States were obliged to go to the Loan
Council to borrow for public works, unemployment relief, and
revenue deficits. The market was usually unable to satisfy the
demands made on it, and whether sufficient funds were raised to meet
the amount agreed upon by the Council, was to a significant extent,
dependent upon action by the central bank.38 The events of the post-
war years are even more striking as illustrations of the effects of the
division of powers and resources, and the issues arising will be con-
sidered later.

Firstly, the effect of the formula on different States will be con-
sidered. At the May 1935 meeting, the possibility of applying the
formula arose for the first time, and showed that New South Wales
would have received more than it wanted, while Victoria would have
received very much less than she claimed. The Premier of Victoria in
June 1935, claimed that a new formula was required as his govern-
ment wanted to apply a new approach to loan spending. Because
Victoria’s loan expenditure in the past five years had been
‘exceedingly moderate,’ its formula allocation was low.\textsuperscript{39} His need was urgent as he depended for his continuation in office on the amount he obtained from the Loan Council. If he did not obtain sufficient to carry out relief works at award rates the Labor party keeping him in office would withdraw its support.\textsuperscript{40} In 1939 and 1951 Victoria and New South Wales again clashed, and it is clear that a State may be restricted in its works programme for a particular year and over a period because of previous low yearly expenditure from loan funds.

Another source of inter-state conflict and at the same time an illustration of gradual co-operation under the pressure of events, is provided by the problem of semi-governmental borrowing. As early as 1925 the voluntary Council agreed to the principle that as far as practicable the requirements of semi-governmental bodies should be arranged so as not to interfere with the loan raisings of the Commonwealth and the States. The Treasurers agreed to exercise supervision in accordance with this decision.\textsuperscript{41} In 1929 they agreed to advise the Council from time to time of the programme of all such bodies under their control for each financial year in order to stop competition for loan moneys and to prevent issues clashing.\textsuperscript{42} In 1934 a borrowing board was created by New South Wales for the relief of unemployment and, although not legally necessary, the Premier obtained Council approval for its loan raising.\textsuperscript{43} In 1936 a ‘Gentlemen’s Agreement’ provided for ‘the submission of annual loan programmes in respect of semi-governmental authorities proposing to raise £100,000 or more in a year, for the consideration of such programmes in conjunction with the loan programme of the Government concerned, and for the fixing of the terms of individual semi-governmental loans coming within the scope of the annual programme.’\textsuperscript{44}

At various times protests were raised, by the smaller States particularly, against the relatively large semi-governmental spending of New South Wales and Victoria. In 1938 one Premier declared that he had now learned that the manner in which to finance State public works was by the establishment of semi-governmental authorities.\textsuperscript{45} When he went back to his State he intended to profit by the lesson and establish more of those authorities. The following year the Prime Minister announced that it had been decided ‘for the first time in the history of the Loan Council, that semi-governmental borrowings should be determined in advance and in conjunction with other borrowing plans. This made for a much greater degree of co-ordination in public borrowing than could otherwise be possible’.\textsuperscript{46} Though not legally binding, this arrangement would tend to offset the rise in creation of semi-governmental bodies as a means of avoiding Loan Council control.
During the period of preparation for the second World War and during the war, the Loan Council provided a convenient instrument in meeting the needs of the time. As Sir Bertram Stevens recognised, 'We are faced with ... problems which no single Government can deal with alone. Co-operation and decisive action through a developed Loan Council may be a solution.'

Following the outbreak of war, a Works Co-ordinator was appointed to examine and report upon the works projects embodied in the works programmes submitted by each government. By this means, through the Council, the necessary co-operation of the States was achieved — first, to mobilise the resources of the country for full employment in the war effort, and later to limit the inflationary effects of loan spending by restricting the amounts to be borrowed and also to concentrate resources on defence works. At its shortest meeting on record, the Loan Council in 1943 gave effect in entirety to recommendations by the Co-ordinator-General of Public Works.

At the Premiers' Conference on 14 July 1943, a further important step was taken. A National Works Council (consisting of the State Premiers and the Prime Minister) was formed on the initiative of the Commonwealth government. As part of its plan for post-war reconstruction and for continued full employment, it suggested that there 'should be a national "public works" policy directed to improving the welfare of the community and timed to correct deficiencies in private spending. When private enterprise fails to employ all available workers, the Government must step in and ensure their employment.' In consultation with the States and based on plans for works prepared by them, the Co-ordinator-General of Public Works prepared a programme of urgent and immediately required post-war works. From this list the Loan Council each year approves funds for immediate works, while new plans are added to the reserve and others brought up to date each year.

In this way a new flexibility was attempted as a foil to the rigidities of the system in this field. It appeared possible that, as Hancock expressed it in 1928, the 'needs of the Australian people may, perhaps, find satisfaction, without any radical amendment of the Constitution, merely by a shifting of political gravity and emphasis, by indirect pressure of the central authority, by co-operation and inter-penetration and the creation of intermediate organisations between the various centres of activity.' But signs were not wanting that this way was fraught with frustration, and the events of the post-war years may be interpreted as indicating that this way may not stand up to the forces at work in the modern world in times when a war no longer provides a focus for all interests into one predominant aim.
In 1944 the Co-ordinator stated that there had been 'some difficulty in ensuring a uniform approach in allocation of priorities.'\textsuperscript{52} He noted a tendency for governments to concentrate an unduly large proportion of work in the highest priority classification,\textsuperscript{53} and feared that it was hard to maintain a just balance. Having no power to see that his scale of values is adhered to by the States, the function of the Co-ordinator has, since the end of the war, become merely that of collating the programmes forwarded by the various State Co-ordinators of Works for presentation to the Loan Council. The Commonwealth, therefore, again has no direct influence on the particular projects on which a State's loan funds are spent. The amount of its indirect influence may be gauged from subsequent events.

Until 1950 the post-war boom provided plenty of cheap money and loan requirements were satisfied by the market, with the federal government mainly financing its works out of revenue. In the subsequent period of marked inflation, however, people and institutions shied clear of low-yielding Commonwealth bonds with the attendant risk of capital loss, and at the meeting of the Council in August 1950, the States were warned that their works programmes were tending to outrun the loan market. A special meeting was called in June 1951, and the position put to the States that their works would have to be cut, as loan money was not available in previous quantities.\textsuperscript{54} In August 1951, the States put forward loan programmes totalling £293 million plus semi-governmental works of £82 million.\textsuperscript{55} As they were aware, the most that could be expected from the market in that year was about £125 million.\textsuperscript{56}

The Commonwealth government was in a dilemma. It was anxious in its 1951-52 budget to counter inflationary forces and to reduce public works spending,\textsuperscript{57} but if the States were left to carry out works programmes with the small amount that would be raised on the market, it was apparent that there would be serious dislocations, especially as rising costs reduced the effective use of such loans. The Commonwealth, which alone controls other flexible sources of money, bowed to the pressure of circumstances and the Premiers, and agreed, for the first time, to underwrite State government loan programmes to a total of £225 million. 'We did so after the Premiers had earnestly assured us that to reduce loan programmes below £225 million would create great difficulties for their States and prevent them from meeting important actual commitments falling due.'\textsuperscript{58} Although the figure of £225 million was agreed to by the Loan Council, the States publicly complained that the refusal of the Commonwealth to provide sufficient money would slow down works and mean dismissals of workers. As the Federal Treasurer said: 'Politically we made the worst of both worlds: for our increased taxes,
levied, as it turned out, exclusively on behalf of the States, earned us much criticism. But some of the larger States, so far from acknowledging the value of our immense and timely aid, have done little but complain that we did not do more.\textsuperscript{59}

The same situation arose at the May 1952 meeting. The States' programmes for 1953 (not including semi-governmental borrowing) totalled £351 million, whereas the market at reasonable rates and conditions was expected to yield £55 million. The Commonwealth proposed a total of £180 million and agreed to underwrite that figure. The States refused to budge below £247½ million and finally outvoted the Commonwealth to pass this figure as the borrowing programme for 1953.\textsuperscript{60}

From this survey it is apparent that, as in other fields, there has been a shift in power in the direction of the Commonwealth. Its financial resources and control of currency enable it to exert a large amount of control on the total volume of public investment. Over a cycle covering depression, war and inflation, the institution of the Loan Council has undergone a profound change. It has recently been claimed that 'the Council exercises an influence far beyond its original scope and functions and now virtually embraces not merely the co-ordination of public investment in Australia, but also the general fiscal policy of the Commonwealth and the States.' There is evidence for this view, but it does not reflect a complete picture.\textsuperscript{61}

The assumption by the Commonwealth of responsibility for economic security, and the changed climate of economic thought, have forced it to take a lively interest in the volume of public investment, and the Loan Council is one of the avenues for its pressure. Yet, paradoxically, its political power to carry out its policies is weakened because of the checks of the federal structure, again operating largely through the Loan Council. The latter has emerged as 'a new States House'\textsuperscript{62} where each Premier, independently of party,\textsuperscript{63} battles for works for his own State, and where together the States have, in 1953, refused to accept the Commonwealth's decision on the total volume of loan spending. Too much should not, perhaps, be made of this point, as the Commonwealth possesses the fiscal power to ensure that in the short run its decision is followed. However, the blame for unemployment and lagging State works appears to have been successfully laid by the States at the door of the Commonwealth and in the long run their non-co-operation may prove vital to a government.

It is further argued by many that it is not possible to secure full employment without a high degree of economic planning extending over to individual works. Certainly the federal government has of recent years been trying to direct investment to more basic industries, because of its internal policies and external commitments. The Loan
Council does not provide the Commonwealth with legal power for this task, and the serious conflicts of recent years have shown the inability of indirect influence to fill the breach.

It is tempting to conclude that although the Loan Council has aided a shift in power which helps the Commonwealth government or the various governments to meet the needs of depression or war, it is not sufficient to preserve full employment without inflation. This problem, however, is common to all democratic communities and is not peculiar to federal states. On balance, the Loan Council appears as an institution which modifies the tendency of federal government to be conservative and weak, and is a significant aid to governments in meeting ‘the felt needs of the time.’

In the proposals for the creation of a statutory council in 1927, Mr Collier made a prophecy which to-day seems more likely to be fulfilled. He claimed that the greater flexibility of Commonwealth resources, combined with a lack of sufficient moneys from the loan market, would force the States to hand over many of their functions to the Commonwealth. It seems that the Commonwealth may eventually supply loan money for works from central bank credit or its other sources of funds subject to conditions which the States will gradually be forced to accept. In this way a gradual control over the direction of spending of public works money could be achieved by the central government.

Notes

1  R. C. Mills [Reading V.]


4  A. Deakin [Reading 1.]

5  Royal Commission on the Constitution of the Commonwealth, Report, 1929, p. 192. [Compare Copland, Reading VIII.]

6  Commonwealth of Australia Year Book No. 37, p. 640.


8  Giblin, ibid.
In September 1923 a loan of £38,750,000 matured. Conversions and subscriptions fell short by £6,500,000. *Round Table*, V.14, 1923-24.

10 *Commonwealth Parliamentary Debates*, 26 July 1923, p. 1662.

11 Ibid., 1/3/1923, pp. 84-85.

12 *Commonwealth Parliamentary Debates*, 31 July 1924, p. 2727.


14 *Sydney Morning Herald*, 4 December 1925, p. 12.

15 'It would be madness for us to permit an outside Federal authority to regulate our public works policy by deciding how much we should be permitted to borrow, and when and where we should borrow it.' *Sydney Morning Herald*, 11 February 1927, p. 14.


17 *Round Table*, V.17, p. 182 and *Sydney Morning Herald*, 17 June 1927, p. 10.


19 *Round Table*, V.17, p. 184.

20 Labor Treasurers ‘expressed amazement’ at New South Wales not rejoining. *Sydney Morning Herald*, 5 December 1925, p. 14. On 15 August 1925, the Council passed a resolution expressing regret at the decision of the N.S.W. government to withdraw and urged it to rejoin. The resolution stated: 'The Council emphasizes the fact that it is a non-party body, with advisory functions, but without executive authority; also that no decision of the loan council can bind any Government, unless it endorses the decision'. *Sydney Morning Herald*, 17 August 1925, p. 11.


25 Ibid., pp. 23, 24. [P. Collier (1873-1948) was Leader of the Labor Party and Premier of Western Australia 1924-30 and 1933-36.]
The Commonwealth was to get one-fifth — its proportion over the last five years — and the balance was to be split up among the States on the basis of each State's borrowings over the past five years. Population and production bases were rejected because 'a grave injustice would be done to the large undeveloped States if they were adopted.' Ibid. p. 13.


In the light of subsequent events, it is interesting to note that clauses reading 'the Loan Council shall control all future borrowings' were altered to 'arrange' such matters: 'In order to remove any feelings of misapprehension that too much power might be claimed by the Council.' Sydney Morning Herald, 21 June 1927, p. 11.

Of the Premiers who accepted the agreement proposed by a non-Labor Commonwealth government, five were members of the Labor Party.

Each State receives a proportion of the remainder equal to the ratio of its net loan expenditure in the preceding five years to the net loan expenditure of all States during the same period . . .


Sydney Morning Herald, 11 January 1920, p. 12.

Round Table, V. 23, p. 76.

For a full description of events, see particularly (a) N. Cowper, 'The Financial Agreement', Studies in the Australian Constitution, ed. G. V. Portus, Angus & Robertson, Sydney, 1932, pp. 130 ff; (b) Round Table V. 23 (1931-32), pp. 878-85; (c) L. F. Giblin, The Growth of a Central Bank, Ch. III.


Which, during those years, pursued a policy largely independent of the Commonwealth government. L. F. Giblin, op. cit. passim.

Copland and Janes, op. cit., pp. 11, 14.


Ibid., 18 June 1925, p. 8.

Australian Loan Council — Its Origin

43 Copland and Janes, op. cit., p. 16.

44 Commonwealth Year Book No. 38, 1951, p. 818.


46 Ibid., 23 June 1939, p. 11.


48 N.S.W. Year Book, 1941-42 and 1942-43, p. 422.

49 Sydney Morning Herald, 16 July 1943, p. 4.


52 Sydney Morning Herald, 25 August 1944, p. 4.

53 Ibid., 26 August 1944, p. 2.


56 In fact, only £63,810,000 was raised from the market. Commonwealth Parliamentary Debates, 6 August 1952, p. 81.

57 Ibid.


59 Commonwealth Parliamentary Debates, 6 August 1952, p. 68.

60 Ibid., p. 96. [In fact, the market only yielded £58.5m and the Commonwealth subscribed £131.5m as a Special Loan, bringing the actual loan programme of the States to £190m.]


62 A description given it by the present Prime Minister, Mr R. G. Menzies, many years ago—See R. V. Hawker, Australian Quarterly, Vol. 9, No. 3, September 1937, p. 62.

63 Davis, op. cit., p. 229.

PART THREE  THE COMMONWEALTH
GRANTS COMMISSION
The Financial Agreement went a long way towards solving, for the time being at least, the problem of vertical or 'general' fiscal imbalance in the Australian federation. From 1927 to 1942 there were no general purpose grants payable from the Commonwealth to all the States. On the other hand it left unresolved the problem of horizontal or 'special' fiscal imbalance affecting the financially weaker States in the federation. To deal with this problem, the Commonwealth had paid so-called 'special grants' to Western Australia since 1910-11 (as noted in Part One, that State had initially been allowed to levy its own tariff under section 95 of the Constitution) and to Tasmania since 1911-12. With the onset of the Depression, South Australia applied for and received special grants from 1929-30 onwards. These grants had all been determined on the basis of recommendations by various committees or ad hoc inquiries and seem to have been regarded as temporary expedients, but the problem refused to go away.

Reading XIII contains two extracts from the August 1930 report on 'The General Question of Tasmania's Disabilities' by the Commonwealth Joint Committee of Public Accounts, which included among its members a future Prime Minister (Mr J. B. Chifley). The first extract records the Committee’s recommendation for the appointment of a permanent body of three part-time members to make a continuous study of the financial relations between the Commonwealth and the States. The adoption of this recommendation two years later resulted in the establishment of the Commonwealth Grants Commission in June 1933, but as an independent non-official body rather than in the form proposed by the Committee. The Committee’s report also included an appendix on 'Taxable Capacity and Severity of
Taxation’ and the second section of the Reading includes an extract from a memorandum by Professor L. F. Giblin which was included in that appendix. In Professor Maxwell’s words, the memorandum ‘contains in miniature most of the principles and techniques adopted later by the Grants Commission. It is a remarkable instance of original and constructive analysis’. Attention may be directed particularly to the four conditions which Giblin said should be satisfied by any State seeking Commonwealth assistance, and to his insistence that he was not proposing anything in the nature of complete equalisation among the States.

In 1931, the Public Accounts Committee was requested to review its report so as to ensure that the claimant States were treated on a common basis. Its subsequent reports on the finances of Tasmania and South Australia are referred to at the beginning of Reading XV. The fiscal difficulties of the smaller States continued to grow and the resulting resentment reached its climax in the secession movement in Western Australia. At a State referendum in April 1933, a two-thirds majority of electors voted in favour of that State’s secession. In March 1934 a volume setting out the case for secession was published by the Western Australian government, and the British Parliament was later petitioned to amend the Commonwealth Constitution Act of 1900 so as to permit Western Australia to secede. Early in 1935 a Select Committee of that Parliament wisely resolved that the petition ‘was not proper to be received’ without the consent of the Commonwealth Parliament. In Reading XIV, Mr E. L. Piesse reviews The Case of the People of Western Australia...1 His paper conveys some impression of the emotions surrounding the issue, both in Western Australia and elsewhere.

In mid-1934, the Commonwealth Grants Commission published its first Report, which is reviewed by Professor J. B. Brigden in Reading XV. The special grants recommended by the Commission helped to remove the sense of grievance that underlay the secessionist movement.2 This was despite the fact that the Commission rejected the States’ claims that their financial difficulties were occasioned by the ‘disabilities’ of Federation and in particular by the Commonwealth tariff. The Commission found that any disabilities of Federation were probably offset by its benefits. Following the earlier suggestions of Professor Giblin, who was one of its founding members, the Commission therefore based its recommendations on relative ‘fiscal need’, as measured by the difference between a claimant State’s per capita deficit and that of the standard States,3 after ‘corrections’ (known as ‘modifications’ after 1966) to ensure reasonable comparability between State budgets, and after ‘adjustments’ to a claimant State’s budget result to allow for any relative lack of effort in
Commentary and Further Reading

raising revenue or relative lack of economy in spending it. This contrasts with the Commission's procedure since 1974, which in effect measures a claimant State's fiscal need directly by reference to differences in revenue-raising capacity and costs of providing services as between the claimant State and the standard States. Provided the same data, standards and assumptions are used, the two methods give the same result, thereby indicating the generality of the principles developed by Giblin.

Reading XVI gives the Commission's definitive statement of its principle of 'fiscal need', as set out in Chapter 6 of its Third Report and in its essentials as still applied by the Commission. Three points are especially worthy of note. The first is the Commission's emphasis that 'special grants are continuous in principle with other transfers of Commonwealth revenue to the States'. This point was no doubt made in order to secure greater acceptability for the principle of special grants and it is certainly true that differential elements have been, and still are, included in other general purpose and specific purpose grants to all States. Indeed, it could be argued that an increase in such differential elements has been a necessary condition for the cessation of special grants to South Australia (1959 and 1975), Western Australia (1968) and Tasmania (1974). There is, however, a danger of such differential payments becoming disguised special grants given on a more or less arbitrary basis, with no regular assessment of the need for their continuation. There is also the risk of confusing the problem of vertical imbalance with that of horizontal imbalance, an example of which is provided in the concluding section of Reading XV.

The second point is that the Commission, having rejected in a previous chapter the State claims that special grants should be based on 'disabilities' arising from the defective working of the Constitution, or from federal policy (including the tariff), or again from natural resource deficiencies, also rejected any supplementary grants on account of 'community losses' arising from these factors. The assessment of such losses would have involved the Commission in many of the complexities of welfare economics. However, it avoided this pitfall and confined itself to State Treasury needs on the ground that, insofar as 'community losses' were not already reflected therein, they should remain as long-term incentives to industrial mobility and migration, and that any short-term assistance should be given on an industry basis rather than on a State basis.

Thirdly, the Commission's recommendations for special grants were at that time clearly not intended to 'equalise' the budgetary position of the States, lest this undermine the financial responsibility of the claimant States. Consequently, under the Commission's original procedures each claimant State was required to make a
‘reasonable effort’ to help itself, and with this end in view the grant to which it might have been entitled on a complete equalisation basis was reduced by two additional ‘adjustments’.

These adjustments, or ‘penalties’ as they came to be called, are discussed by Professor J. A. Maxwell in Reading XVII. One of the adjustments, known as the penalty for claimancy, was expressed for statistical convenience as a percentage deduction from the allowable standard of expenditure on social services (defined as education, health services and the maintenance of law and order). The other adjustment was made in respect of past loan losses for which the claimant State itself could be held partly responsible and was expressed, again for convenience, as a percentage increase in the required standard of tax effort. Maxwell was critical of the Commission for an alleged lack of vigour in imposing these penalties, with the implication that the Commission took too lightly the dangers of financial irresponsibility.

However, the Commission’s view on this issue was not based on a cursory judgment and it subsequently moved even further from the position represented by Maxwell. This was partly under pressure from the claimant States, which as he observed already showed some hardening in their attitude towards the Commission, and nothing attracted their hostility more than the hated penalties. But the main reason was the changed circumstances resulting from World War II. Any opportunity for greater effort — or greater extravagance — on the part of a claimant State was effectively curtailed by the uniform income tax system, the effect of war-time controls on other State taxes (such as motor and racing taxation) and the restrictions imposed on public service salaries and employment by manpower controls. In its Tenth Report 1943, the Commission attempted to remove some of the misunderstanding surrounding the penalties by expressing them as separate items instead of as percentages of its social services and tax effort adjustments. In its Eleventh Report 1944, it decided to suspend the penalty in respect of past loan losses and to reduce that in respect of claimancy. In its Twelfth Report 1945, the latter was also suspended.

The suspension of the penalties still did not give the claimant States full equalisation, because the grants recommended by the Commission remained insufficient to enable them to more than balance their budgets, even in periods such as 1941-46, 1950-55 and 1961-63 when there were average (corrected) budget surpluses in the standard States. At the time of Maxwell’s article (1938), an overall average budget surplus for the standard States was still only a matter for speculation. When it became an actuality, the Commission nevertheless adhered to a balanced budget standard for the claimant States as explained in
Reading XVIII by Professor W. Prest. Despite some relaxation of the Commission’s approach in the 1950s and 1960s, it was not until the 1970s that a claimant State was unambiguously allowed a surplus budget standard, and only then did full equalisation become a possibility.

In Reading XVIII, Professor Prest describes developments during the years 1945-60 when Mr A. A. (later Professor Sir Alexander) Fitzgerald was Chairman of the Commission. Prest also refers to other important changes during or shortly after World War II. In 1945, the Commission suspended not only the penalties for claimancy but also the pre-war adjustments for relative economy in administrative costs and in maintenance expenditure on public works, although the latter was partially absorbed in a new adjustment for State business undertakings that was introduced in 1949.

The only two pre-war adjustments that remained after the war were those for relative economy in social service expenditure and for relative tax effort. There was little immediate change in the former, but the allowances for ‘special difficulties’ which Maxwell had criticised in 1938 were expanded — amid some controversy — in the 1950s. The statistical basis of the adjustment was changed in the 1960s. On the other hand, the adjustment for tax effort had to be revised substantially even before the end of the war. The Commission had in effect previously based the adjustment on a comparison of capacity to pay income tax but after the introduction of the uniform income tax system such a comparison no longer seemed strictly appropriate. It was therefore replaced in 1944 by a detailed comparison of capacity to pay State non-income taxes. However, local government taxation was excluded from the comparison, primarily because of statistical difficulties which had become even greater than at the time of Maxwell’s comments. Local government thus virtually disappeared from the purview of the Commission for thirty years, until new responsibilities in that field were conferred on it by the Whitlam government in 1973.

The problem of obtaining inter-State comparability of data, in particular comparability of the public accounts of the States, had always been a matter of concern to the Commission, and had attracted the attention of many commentators, including the Public Accounts Committee in 1930-31 and Professors Brigden and Maxwell (Readings XIII, XV and XVII). Official concern over the problem probably played a part in the appointment in 1945 of Sir Alexander Fitzgerald, a leading accountant, as Chairman of the Commission. However, the problem was much more intractable than some commentators supposed. State accounting systems certainly could not be reorganised overnight. Many of the differences between them were of long
standing and had their origin in differences in the historical and legal
development of the States. Nevertheless, during Fitzgerald’s chairmanship distinct progress was made in clarifying the public accounts and in compiling more comparable statistics along the lines indicated in Reading XVIII.

In these years, also, the post-war inflation necessitated an important change in the method of paying special grants. Originally the Commission had recommended final grants for the coming financial year on the basis of the latest audited accounts, which related to a period ended twelve months earlier. As explained in Reading XVIII, this system became increasingly difficult to implement with continuing inflation. In 1949, therefore, the Commission introduced its two-part system under which the grant to be paid in a particular financial year was divided into an advance grant for that year, originally known as the second part and subject to review two years later, and a completion grant, originally known as the first part and assessed on the basis of audited financial statements and other data which by then had become available for the year of review two years earlier.

Notes

1 The Case of the People of Western Australia in support of their desire to withdraw from the Commonwealth of Australia established under the Commonwealth of Australia Constitution Act (Imperial), and that Western Australia be restored to its former status as a separate self-governing colony in the British Empire, Government Printer, Perth, Western Australia, 1934.

2 Professor L. F. Giblin’s view was that the secessionist agitation in Western Australia was allayed largely by other causes (Evidence to Rowell-Sirois Commission, op. cit., p. 56).

3 The standard States were initially Victoria and Queensland, to which New South Wales was added in the Commission’s Fourth Report. Professor Giblin in his evidence to the Rowell-Sirois Commission said that the reason for the omission of New South Wales was the difficulty which the Commission experienced in interpreting that State’s budget figures (op. cit., pp. 12-14).

4 This is not to say that there was any marked deterioration in the good working relations which the Commission had established with the representatives of the claimant States and to which Professor Giblin twice referred in his evidence to the Rowell-Sirois Commission (op. cit., pp. 15, 54).

5 This matter was also referred to by Professor Giblin in his evidence to the Rowell-Sirois Commission. He there stated that the Commission at an early date had circulated a questionnaire on accounting procedures to all States and had been instrumental in effecting considerable improvements in the accounts of the claimant States (op. cit., p. 57).
Further Reading

In addition to the following, see Further Reading Part Five (pp. 425-8 below).

**Articles**


Giblin, L. F., 'A Note on Taxable Capacity', *The Economic Record*, Annual from 1928 to 1933.


**Books of Readings and Symposia**

Monographs and Books
May, R. J., Financing the Small States in Australian Federalism, Oxford University Press, Melbourne, 1971.

Official Documents
Commonwealth Grants Commission, Annual Reports, Government Printer, Canberra and Melbourne, Annual since 1934.
Commonwealth of Australia, Report of the Royal Commission on the Finances of Western Australia as Affected by Federation, Commonwealth Government Printer, Canberra, 1925.
Giblin, L. F., Evidence Before the Royal Commission on Dominion-Provincial Relations (Rowell-Sirois Commission), Ottawa, 1938 (mimeograph copy in National Library, Canberra).
Joint Committee of Public Accounts, Report on the Finances of South Australia as Affected by Federation, Commonwealth Government Printer, Canberra, 1931.
1. Appointment of Permanent Body to Study the Financial Relations of the Commonwealth and the States
The Committee is strongly of opinion that the time has arrived when a permanent body should be appointed to make a continuous study of the financial relations of the Commonwealth and the States. Of recent years the task of investigating the finances of three of the States — Western Australia, South Australia and Tasmania — has been assigned to different bodies, involving the expenditure of a considerable amount of public money. The reports submitted to Parliament indicate that the investigations were conducted with efficiency and thoroughness, and that a considerable amount of research was involved in their preparation. With the growing complexity of the finances of the Commonwealth and the States, however, the Committee holds the view that the financial relations of the Commonwealth and the States should be the subject of a continuous and intensive study by a permanent body. In fairness to the Commonwealth and the States uniform methods and procedure in relation to financial assistance to the States should be evolved. The essential requirement is that all questions of State grants should be referred to the same body for investigation. Uniformity cannot be achieved in any

other way. The Committee fully recognizes that the principles of determining grants cannot be developed and clarified in a day; but the importance of the matter to the Commonwealth, the States and the taxpayers demands that there should be no further delay in setting up a body capable of evolving definite basic principles under which the claims of any State may be measured or assessed from time to time without the necessity for protracted investigation.

The Committee is of opinion that the permanent body suggested should be composed of a representative of the Commonwealth Treasury with a close knowledge of Commonwealth and State finance, the Director of Development, and a qualified economist who should be attached to the office of the Commonwealth Statistician. The Committee also holds a strong view that in the investigation of any State's claim for financial assistance a Treasury officer from the State concerned should be temporarily attached to the proposed permanent body during the course of the inquiry.

During its investigations the Committee found it necessary to examine the financial statements of the various State governments. A noticeable feature of these statements was the lack of uniformity in the methods of setting out the financial position of important governmental activities. Researches were, on this account, rendered very difficult. The Committee is of opinion that early steps should be taken with a view to establishing, as far as possible, uniform methods in connexion with the preparation of Commonwealth and State financial statements. If the States could be induced to co-operate in the direction suggested, a study of Commonwealth and State accounts would be greatly facilitated. The establishment of uniform principles would be particularly helpful to any permanent body created to make a continuous study of the financial relations of the Commonwealth and the States. Moreover, researches of members of Parliament and others interested in public finance would be appreciably simplified if similar methods of presenting public accounts were generally adopted.

2. Taxable Capacity and Severity of Taxation\textsuperscript{1} L. F. Giblin

In considering a State's case for a special grant the crucial question is: What are its means? What is its prosperity; what are its wealth and income in comparison with the Australian average? If they are substantially less, it does not greatly matter to determine exactly how much the difference is due to Federation and to federal action, and how much to other more general causes. It is impossible, as we have seen, to separate out the causes, and it is unnecessary. If the fact of a steady lower level of material prosperity is established, the fact must be faced, and allowance made for it in the financial relations of the Commonwealth and that State.
We ought, then, to estimate as nearly as possible the difference in material prosperity between Tasmania and the average of the Commonwealth, and, if it is substantial, proceed to consider to what extent the handicap can be met by a grant from Treasury to Treasury, and what the amount of that grant should be.

**Taxable Capacity**

The best test of material prosperity is income in relation to the purchasing power of the money unit. There has been no very great difference in purchasing power in different States, and, as it happens, purchasing power in Tasmania, or, conversely, the level of prices, has been for many years very close to the Australian average, so that we can simply compare income (or taxation or expenditure) in Tasmania with the Australian average, without making any allowance for difference in purchasing power.

The income about which there is most accurate information, and which is the most important for our purpose, is the income assessed to income tax. For State income tax there are no comparable figures of income available, and the assessments and rates of tax, &c., are so different in different States that the amount of tax assessed or collected is no guide. But the federal income tax is a uniform tax, administered uniformly in all States, and the results give us most valuable information. It is true that the actual figures for income in States have not been published regularly in a form suitable for comparison in different years. But the figures for tax assessed in any year are available since the beginning of the tax in 1915, and these, divided by the populations, give us the amount of the uniform tax paid per head of population in each State. So we get an exact measure of the relative capacity of the States to pay Federal income tax, or any graduated income tax of the same type, such as are the State income taxes of Australia.

The last available figures are for the assessments made in the year 1928-29 of the incomes of the year 1927-28. Below is set out the amount of federal tax assessed per head of population in each State for that year, and in the last column numbers proportional to these amounts when the average of the whole Commonwealth is taken as 100.

The outstanding feature is that for Tasmania the uniform tax uniformly administered produces less than half as much revenue in proportion to population as in Victoria or New South Wales, and only just over half as much as the average for the whole Commonwealth. In other words, if the States had all to raise a certain revenue from taxation, say £4 per head of population, Tasmania would have to impose rates twice as high as the average of the six States — 5 per
Fiscal Federalism

Federal Income Tax Assessments Per Head on Income of the Year 1927-28 (Excluding Central Office Assessments)

<table>
<thead>
<tr>
<th>State</th>
<th>Tax Per Head</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>22 10</td>
<td>115</td>
</tr>
<tr>
<td>Victoria</td>
<td>22 0</td>
<td>110</td>
</tr>
<tr>
<td>Queensland</td>
<td>14 0</td>
<td>70</td>
</tr>
<tr>
<td>South Australia</td>
<td>16 10</td>
<td>84</td>
</tr>
<tr>
<td>Western Australia</td>
<td>16 3</td>
<td>81</td>
</tr>
<tr>
<td>Tasmania</td>
<td>10 9</td>
<td>54</td>
</tr>
<tr>
<td>Six States</td>
<td>19 11</td>
<td>100</td>
</tr>
</tbody>
</table>

1 cent instead of 2.5 per cent, 10 per cent instead of 5 per cent and so on. Three other States have some of the same handicaps compared with Victoria and New South Wales, but in a much smaller degree.

The figures for any one year are liable to fluctuation on account of bad seasons affecting one State more than another; and also because assessments of income are not always completed in the financial year, and the balance is then included in the next year's total, diminishing the one below the correct figure and swelling the other by the same amount. For this reason it is advisable to take the average of three or four years as a basis for practical conclusions. As the actual amounts of tax per head vary greatly in different years from alterations of rates, exemptions, and methods of assessment, they must be reduced to some common measure before averaging, and this is done by reckoning the average for Australia in every year as 100, and calculating the proportionate number for each State. These numbers, given in the last column of the above table, may be called the Index of Relative Taxable Capacity. The number 54 against Tasmania means, therefore, that the tax produces in Tasmania only 54 per cent of the average, or 46 per cent below the average, while in Victoria it produces 110, or 10 per cent above the average.

These indexes can then be added, and averaged for different years. I will give here the average for the last four years and for the fourteen years since the tax began, and repeat for comparison the index for the last year available.

It will be seen that, taken over the whole period, none of the States departs seriously from the general level except Tasmania, which has averaged little over half the taxable capacity of the Commonwealth. The other States have had ups and downs relative to the prosperity of Australia as a whole, and the figures for the last four years show that
Relative Taxable Capacity

<table>
<thead>
<tr>
<th></th>
<th>Income Year 1927-28</th>
<th>Last Four Years</th>
<th>Last 14 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>115</td>
<td>114</td>
<td>106</td>
</tr>
<tr>
<td>Victoria</td>
<td>110</td>
<td>110</td>
<td>108</td>
</tr>
<tr>
<td>Queensland</td>
<td>70</td>
<td>76</td>
<td>88</td>
</tr>
<tr>
<td>South Australia</td>
<td>84</td>
<td>85</td>
<td>92</td>
</tr>
<tr>
<td>Western Australia</td>
<td>81</td>
<td>74</td>
<td>93</td>
</tr>
<tr>
<td>Tasmania</td>
<td>54</td>
<td>47</td>
<td>56</td>
</tr>
<tr>
<td>Six States</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Western Australia, South Australia, and Queensland have all had a relative setback in prosperity. But only in the case of Tasmania is there evidence of a steady and persistent deficiency of income.

A persistent deficiency in taxable income is in itself the most valid and convincing evidence of the need for federal assistance, and between States is a fair measure of the relative need for it. This is not an academic theory; it is an old-established principle which has been the basis of many practical measures. Taxable capacity was the chief determinant in the financial settlement between Great Britain and Northern Ireland. It plays a great part in the British basis of local government grants as settled by the Local Government Act 1929. British Local Government, with its responsibility for education, roads, poor relief, and police, has functions not very different from those of Australian State Governments. The new system of government grants is not in proportion to population, but takes account of rateable capacity and other factors. These other factors — unemployment and proportion of young children — would be fairly uniform in Australian States, and the chief determinant in the British system applied to Australia would be rateable capacity — which is, in effect, taxable capacity. The effect in England is to give a county in financial difficulties, like Durham, more than four times the grant it would receive on a population basis, though there is no suggestion that the financial difficulties of Durham are in any respect due to the policy of the Central Government.³

Taxable capacity, then, gives a reasonable measure of comparative assistance required, but not of the absolute amount. A shortage of taxable income can be only approximately turned into a measure of shortage of total national income, and of the economic state of the community . . . I have attempted a rough measure of income based on taxable capacity and the official average wage-index in the different States.⁴ The result gives Tasmania an income per head 15 per cent
below the average, whereas the greatest deficiency for any other State
is 6 per cent for Western Australia . . .

I conclude, therefore, that there is unassailable evidence that the
State, from a combination of all causes, has a deficiency of
prosperity, as measured by income, manifest steadily over a long
period of years under federal conditions; and that this permanent
deficiency of income is so great that it is impossible for the State to
keep up to the Australian standard of material civilization without
substantial help.

There is, of course, no question of bringing Tasmania up to the
Australian level of prosperity by direct help from the Commonwealth.
Even if the deficiency was entirely due to Federation and federal
policy, it could not be directly remedied without destroying
Federation or reversing federal policy, which must be presumed to
have been deliberately adopted by Parliament in the interests of
Australia as a whole. Tasmania, in any case, must continue to put up
with a lower income and a lower standard of consumption, and
therefore of comfort. Wages cannot depart much from the Australian
standard, and most salaries cannot lag much behind. Therefore it is
the returns from land production and the profits from industry and
commerce of all kinds that will show worst in comparison with other
States, and it is the earners of these incomes who will have most
markedly a lower standard of comfort. The wage-earner will feel the
position, however, indirectly in greater uncertainty of employment,
and therefore a lower effective wage.

There is, then, no question of remedying the disabilities of the
State. For the most part they must continue to be borne. It is a
question only of supplying the urgent necessities of the State Treasury,
and the amount may be ascertained with due precautions from an
examination of the Treasury position. Any State requiring help from
the Commonwealth should show its good faith by satisfying the
following conditions:

(1) It should be taxing its people with considerably greater severity
than the Australian average.
(2) It should not be attempting social provision on a more generous
scale than the average.
(3) Its costs of administration should be below the average.
(4) It should for some years at least have shown moderation and
caution in loan expenditure.

If these conditions are satisfied, I submit that the responsibility is
on the Commonwealth to make up what is required to enable revenue
to balance expenditure. It is not a question of making a contribution
towards it. If the above conditions are fairly satisfied, the obligation is
on the Commonwealth to make up the deficiency in full as a vital condition for the effective working of Federation.

A statement has been prepared by a committee under the chairmanship of the Premier, setting out in full the needs of the Treasury, and giving the information which will enable the tests set out above to be applied to Tasmania.

**Severity of Taxation**

Severity of State taxation cannot be measured by the rates imposed, because there are several kinds of tax, of which income tax, estate duty, and land tax are the chief, and we need a measure of the combined effect. Further, each of these taxes is graded on different scales in each State, with different methods of assessment and different exemptions and abatements, so that comparison of rates is little help. We must, therefore, take the total proceeds of all State taxes per head of population, and consider them in comparison with the taxable capacity of each State, which the uniform federal income tax allows us to measure accurately. The same effective rate of tax will clearly produce twice as much revenue per head where the taxable capacity is twice as great. If, then, we take the total tax revenue per head in a State and divide it by the taxable capacity, we get a proper measure of severity of taxation. It will be convenient to make this equal to 100 for all States combined, and compute the measure for each State in proportion. This has been done in the following table, taken from *The Economic Record* (November 1929, p. 345):

**Severity of State Taxation (Omitting Lottery and Motor Taxation)**

<table>
<thead>
<tr>
<th>State</th>
<th>Taxation Per Head 1928-29</th>
<th>Taxable Capacity 1925-28</th>
<th>Severity of Taxation 1928-29</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>5.9 d.</td>
<td>93</td>
<td>2</td>
</tr>
<tr>
<td>Victoria</td>
<td>65 d.</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Queensland</td>
<td>100 d.</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>South Australia</td>
<td>106 d.</td>
<td>100</td>
<td>5</td>
</tr>
<tr>
<td>Western Australia</td>
<td>65 d.</td>
<td>100</td>
<td>2</td>
</tr>
<tr>
<td>Tasmania</td>
<td>59 d.</td>
<td>100</td>
<td>7</td>
</tr>
<tr>
<td>Six States</td>
<td>84 d.</td>
<td>100</td>
<td>8</td>
</tr>
</tbody>
</table>

The taxation here given is not the whole of State taxation. Lottery taxation is omitted because the tax is drawn in almost equal degree from the inhabitants of other States. The inclusion of lottery taxation would increase the Tasmanian figures very greatly and the Queensland
figures appreciably. Further, motor taxation is omitted because, though all States have it, in some it is not paid into the Consolidated Revenue, the figures are not readily available, and an uncertain amount is in payment for services and not strictly taxation. The figures ordinarily given for State taxation are misleading on this account. The taxable capacity is taken for the last three years available, as figures for a single year are sometimes abnormal.

It will be observed from the above table that the severity of Tasmanian State taxation in 1928-29 was 153, or 53 per cent above the Australian average. Queensland and South Australia have a similar high severity.

Not only in 1928-29, but consistently for many years, Tasmanian taxation has been much above the average in severity. I give the figures for the last five years, taking in each case the nearest three years average of taxable capacity as a basis of calculation.

**Severity of State Taxation**

<table>
<thead>
<tr>
<th></th>
<th>1924-25</th>
<th>1925-26</th>
<th>1926-27</th>
<th>1927-28</th>
<th>1928-29</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>91</td>
<td>88</td>
<td>99</td>
<td>89</td>
<td>96</td>
<td>93</td>
</tr>
<tr>
<td>Victoria</td>
<td>71</td>
<td>74</td>
<td>69</td>
<td>75</td>
<td>69</td>
<td>72</td>
</tr>
<tr>
<td>Queensland</td>
<td>180</td>
<td>161</td>
<td>167</td>
<td>178</td>
<td>164</td>
<td>170</td>
</tr>
<tr>
<td>South Australia</td>
<td>113</td>
<td>136</td>
<td>123</td>
<td>153</td>
<td>150</td>
<td>135</td>
</tr>
<tr>
<td>Western Australia</td>
<td>125</td>
<td>140</td>
<td>104</td>
<td>106</td>
<td>109</td>
<td>117</td>
</tr>
<tr>
<td>Tasmania</td>
<td>230</td>
<td>232</td>
<td>174</td>
<td>149</td>
<td>153</td>
<td>188</td>
</tr>
<tr>
<td>Six States</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

It will be seen that throughout the last five years Tasmania has very amply satisfied the condition of taxing herself with considerably greater severity than the average for Australia. The average Tasmanian severity for the last five years has been nearly double the Australian average, and more than double that of Victoria and New South Wales. For 1928-29 it was more than 50 per cent greater than the average.

It will be noticed that the severity was still higher in 1924-25. It was then that the financial position was becoming acute, and the State imposed very heavy income and other taxation. On small and moderate incomes the tax was considerably heavier than in any other State, and the consequent severity was more than twice the Australian average. It appeared in the event that taxation had overstepped the economic limit; the depression grew worse, and the exodus of population to the mainland reached unprecedented figures. It was accordingly proposed by the State, and approved by the
Commonwealth, that some part of the increased federal grant in 1926-27 should go to relieve to some extent this excessive taxation. This was done, but the severity of taxation is still 50 per cent above the average.

In the memorandum submitted to the Committee I have laid great stress on the relative taxable capacity of Australian States, both as a general measure of net economic disability and as a test of comparative severity of taxation. It is very important to get a true conviction that the measure proposed is satisfactory, because, when it is once established that the State has had continuously a substantially lower taxable capacity, and therefore, a lower level of income than any other State, it is perfectly clear that it cannot maintain the same efficiency of government and the same general standard of civilization without special help, which must be, like the deficiency in income, both substantial and continuous.

Notes

1 Memorandum published in Appendix F of the Committee's Report.

2 The Victorian tax is a partial exception, but the difference is not great, and is being reduced at every revision.


4 See Economic Record, November 1929, p. 344.
XIV
Federation and Western Australia*

E. L. Piesse

The high enthusiasms and fervent hopes, the consciousness of aspirations and needs of a national community, the extent and sincerity of the feeling for union, that were displayed in the campaigns for federation and at the establishment of the Commonwealth are within the memory of many of us. Inaugurated, as its first historians proudly recorded, 'on the first day of the twentieth century', federation was to bring about a new era of national life, for the first time in history 'a nation for a continent and a continent for a nation', 'an indestructible union of indestructible states', 'one people one destiny'. Tired of 'thinking parochially', of 'provincial selfishness and jealousy and suspicion', the federal leaders called on Australia to enter 'a larger national life'; 'united for high purposes to take her station among the free nations of the world', and so to achieve 'increased national honour and added national dignity'. Asquith in the House of Commons hailed the Commonwealth as 'a whole which we believe is destined to be greater than the sum of its component parts, and which, without draining them of any of their life, will give to them in their corporate unity, a freedom of development, a scale of interests, a dignity of stature, which, alone and separated, they could never command'.

*Reproduced from The Economic Record, June 1934, pp. 7-15.
A national parliament was to provide the forum for questions arising from the growth of elements of the national life which a united Australia alone could deal with adequately. Federation was to provide also for the effective defence of Australia, then first coming to be thought of as a matter of importance; for action, on behalf of Australia as a whole, in respect of the restriction of coloured immigrants and of Australian interests in the Pacific; and . . . it was to promote trade and increase wealth, by removing the customs barriers between the colonies.

Until the outbreak of the [first] World War, the Federation may be said to have been on trial by a jury of States very much biased in its favour; and their verdict was on the whole favourable, as to trade, defence and external relations, with perhaps less to be said of its aid to the growth of national life and national sentiment and cultural enrichment, and much against its course in Government finance. During the war the Federation made good; although money was lavished with the recklessness of inexperience, Australia's part in the war was well managed by the federal government, and federation, there was no question, justified itself in its material ends. There was no doubt also that in the stress of war some of the other ends which the Founding Fathers foresaw were accomplished; Australia's union served a high purpose, she took her station among the nations of the world, achieved increased national honour and added national dignity, and she seemed to have entered a larger national life.

The 1920s, however, brought disappointments and disillusionments to the States, which the 1930s have continued. In part these have resulted from the economic upsets brought about by the war, but in part also from the policy of governments. The strength of federal sentiment was not strong enough to keep us to a wise course amid post-war difficulties. The Navigation Act came into force soon after the war, with embarrassing consequences for the smaller States, and indeed for all inter-state trade; in 1920 the High Court, reversing its policy of half a generation, took away from State Parliaments the control of wages in State instrumentalities; federal revenues were greater than federal needs and gross extravagance prevailed, while many of the States were in difficulties; higher and yet higher customs tariffs served the interests of the industries of the larger States but tended to impoverish the people of the smaller; the federal Parliament levied new and higher taxes in spheres from which the States might have derived revenues; an arrogant administration from Melbourne and now from Canberra, estranged the State governments; the establishment of Canberra increased the misgivings of the more distant States; and five years ago the economic crisis brought anxieties to State governments which the more sympathetic policy and closer
touch maintained in recent years by the federal government have been unable to alleviate.

The result is general dissatisfaction with the federal union, a dissatisfaction that is evident in every State, and especially in the three of smallest population, Tasmania, South Australia and Western Australia. But the extent to which that dissatisfaction has gone in Western Australia, and its substantial grounds, are scarcely realized in ‘Eastern Australia’, as the other States of Australia are called by the writers of ‘The Case of the People of Western Australia in support of their desire to withdraw from the Commonwealth of Australia’.¹

This statement of nearly 500 pages, ably and persuasively written — albeit, a less rhetorical choice of adjectives and epithets in some of its more emotional passages would not have made it less persuasive — is a stern denunciation of the course of federal policy, which all Australians would do well to study and ponder.

The writers, it is true, ascribe the present predicament of Western Australia in large part to conditions which no policy could alleviate. Describing Australia’s physical features, they assert that there are two economic units in Australia, namely Western Australia and Eastern Australia (Chapter 16). The idea may be unfamiliar to many in Eastern Australia; it seems to have been a discovery of Professor Shann, of the University of Western Australia. In his evidence in 1927 before the Royal Commission on the Commonwealth Constitution he said that,

geographically, the Australian communities consist of (a) a continental mass in the east and south-east, containing a very wide range of resources and perhaps capable in the near future of a degree of self-sufficiency comparable to that attained by France or the United States; and (b) two insular areas, in Tasmania and Western Australia, unlikely, for various reasons, to develop the status of supplementary economies

and that ‘Western Australia is like New Zealand in its insular detachment and its concentration upon primary production — only more so’. The separation of the two areas, by distance and by the intervening arid region, is undoubted; but few facts are given in the Case, or in the passages cited from Professor Shann’s evidence (App. 59), to make good the view that the two areas are economically unsuited for union. The writers of the Case, however, regard the clash between the economic necessities of Eastern and Western Australia as the reason for Western Australia’s main disabilities; and it is an essential feature of their statement that the economic clash is so serious that no remedial measures within federation are possible, and therefore that
Secession is the only remedy for the threatened 'dislocation of the whole economic structure and social fabric of the State' (p. 320).

There is no escape from the irresistible conclusion that it is a practical impossibility to give Western Australia a satisfactory place in any system having for its object the centralized government, either wholly or in part, of the continent of Australia. From the very nature of things, the government of Western Australia from Canberra is ruinous to Western Australia, and is, therefore, not in the best interests of Australia (p. 341).

The main counts against the Commonwealth are the customs union that gives the manufacturers of Eastern Australia free entry to the markets of Western Australia, and the high level of the tariff. Western Australia, it is pointed out, is predominantly a country of primary production; approximately 80 per cent of total production is primary (the average for Australia is about 66 per cent); two-thirds of the total production, and 90 per cent of the wheat, is exported. To primary producers, as elsewhere in Australia, the high tariff has been a grievous burden, and there has been no compensation, as in the larger States of Eastern Australia, through the growth of a local market among factory operatives. The growth of such a market, even to the extent which the comparatively small population of Western Australia would justify, has been impeded, the Case asserts, by 'the relentless competition of the powerful manufacturers of the Eastern States' who, it is alleged (although only one instance is given), 'resort to the sporadic dumping of their products into Western Australia' (p. 283). (Adequate weight does not seem to be given, however, to the consideration that if manufacturing in Western Australia costs more owing to its small scale, and lower-priced products are imported, this is all to the advantage of the primary producer whose interests are claimed to be the main concern of the State.) After a survey of the effects of protection, the writers of the Case venture on the generalization that 'It is very doubtful whether this extraordinary and intolerable position, in which Western Australia thus finds herself, has any parallel in any other part of the world' (p. 286). But the Case against the tariff seems to be put too high. There is no recognition, for instance, of the general lowering of costs of Australian manufactures in the last year or two, as in the iron and steel industry, whose prices are now lower than the landed cost, duty free, of imports from Britain.

For the double evils of restricted opportunity of manufacturing and increased cost of primary production, tariff autonomy for Western Australia may seem a likely remedy. This indeed was the recommendation of the majority of the Royal Commission on the
Disabilities of Western Australia under Federation in 1925. But the Case rejects tariff autonomy (Chap. 17). Reasons given are that there are other interdependent factors resulting from federation that gravely affect the State. One is the danger that its budget may be dislocated by an award of the Commonwealth Arbitration Court in respect of employees of the State; another that action by the Commonwealth in respect of such matters as finance, exchange, bounties, State grants, navigation, quarantine, taxation, export control, might nullify the advantages of tariff autonomy. 'The people of Western Australia have learned from actual experience under Federation that "the means to do ill deeds, makes ill deeds done"' (p. 355). But the more important of these matters — such as the sphere of the Commonwealth Arbitration Court and control of navigation — are susceptible to reform, and Western Australia would not be alone in wishing to see a contraction of federal powers. The Case assumes too that tariff autonomy would be refused by the Commonwealth; but this is to under-estimate the effect of its own very persuasive statements. Tariff autonomy, with other reforms, seems a not improbable alternative to Secession.

But even if Western Australia does get tariff autonomy, either as a part of the Commonwealth or as a separate community, the conjecture may be ventured that it will be far from an end of its troubles. A community that exports two-thirds of its primary production, and 90 per cent of its wheat, has no easy role in the world to-day. Primary production may have to be restricted; in any case the demand of the primary producer for lower costs will continue. As in the larger States of Eastern Australia, half of its population is in the capital city; that population is sure to insist on more factories, and that will mean a high tariff; the production of those factories, being on a small scale, is certain to be much dearer than the present importations from Eastern Australia; and conflict of interest between farmer and factory operative will be intensified.

The economic conditions that result from geographical situation and federal policy and their effects on private prosperity and State finances are stated as the main grounds for claiming Secession. But there are others, of no less interest to Eastern Australians. It is claimed that the Commonwealth Constitution

instead of assuring unto the States their corporate life and separate existence, contains the machinery with which the Commonwealth can destroy the States; and it is the improper and unreasonable use of this machinery which the people of Western Australia allege is gradually not only crippling, but will ultimately destroy, Western Australia as a separate corporate community (p. 38).
There is a long and cogent statement of moral and legal breaches of the agreement by which federation was achieved; the Engineers’ Case of 1920, by which the Commonwealth Arbitration Court obtained control of the wages and conditions of work of State employees; the powers obtained by the Commonwealth under s. 105A of the Constitution (financial agreements with the States) and their ‘unexpected interpretation’ by the High Court which ‘has given the Commonwealth a power which definitely attacks and undermines the sovereign and independent rights of the States as self-governing communities’ (p. 91); the evasion, by the Surplus Revenue Act 1910 and the creation of trust funds, of the obligation to pay surplus revenue to the States; the imposition of duties on goods imported by the State governments; the appropriation of surplus revenues, while the States were in financial distress, for purposes unauthorized by the Constitution.

The States are saddled with responsibilities. The Commonwealth has the power. Power without responsibility has ever been dangerous; it sets too hard a strain on the virtue of ordinary men. The States still have their pressing and important obligations, but they have been deprived of their legitimate sources of revenue. Gone are the financial security and independence of the States, the guarantee of which alone enabled Federation to become an accomplished fact; and with it has gone the financial stability of Australia as a whole. Federation is a financial sham (p. 81).

The Case complains not only of ‘the numberless breaches of the Federal compact’ but of the ‘cavalier attitude’ of the Commonwealth (p. 380). An instance is found in the correspondence between the Premier of Western Australia and the Bruce-Page government in 1924, as to the charging of customs duty on locomotives imported by the State (pp. 98-100). Tenders had been invited in both Great Britain and Australia; only one Australian tender was received, and that proved to be not available as the Commonwealth government had placed a prior order. The Premier sent to the Prime Minister a full account of the facts and a carefully-reasoned request for exemption from duty, pointing out that the locomotives were required for a wheat harvest that would have to be moved long before the Australian tenderer could make them. Mr Bruce’s reply was a curt refusal, the sole ground — and this was quite irrelevant in the circumstances — stated for which was that the Minister for Customs was ‘not inclined to modify the Tariff conditions imposed for the protection of an established Australian industry’. Accordingly Western Australia had to borrow an additional £32,000 to pay duties on these engines. It is to be feared that brusqueness and lack of courtesy and consideration has
been too common a feature in federal intercourse with the States. Federal administration rides roughshod over State institutions, and excessive and wholly unnecessary powers are assumed and exercised in derogation of State laws.

In Chapter 7 the effect of federation upon the public finances of Western Australia is discussed. It is said that Western Australia has had fewer surpluses since federation than any other State. There does not seem, however, to be any comparison of amounts. The writers seem to take for granted that Western Australia is in worse case than other States; and they claim that 'the deficits of the State are not due to extravagance in the public administration, or to an inadequate scale of taxation' (p. 167). For a judgment on these matters of public finance as well as for some estimate of the relative economic position of Western Australia, we must await the report of the Commonwealth Grants Commission. But it may not be inappropriate to point out that, tested by the growth of population, Western Australia does not seem to have done so badly under federation. From 1901 to 1933 the population grew by 138 per cent, from 1921 to 1933 (the period in which disabilities are claimed to have been at their worst) by 32 per cent. The figures for the State that is commonly thought to have the greatest prospects of development, and has received great benefits from federal fiscal policy, Queensland, are 90 per cent and 25 per cent; for the Commonwealth as a whole 76 per cent and 22 per cent. Attention may also be drawn to the doubtful validity of the assertion (p. 321) that the 'calamitous condition' of the primary industries is definitely due to federation and federal policy and 'cannot be attributed to any material extent to the world trade depression'. The Case itself states that the price of wheat, which averaged 5s. 7½d. a bushel from 1917-18 to 1929-30, averaged 2s. 9¼d. for the last four seasons, a drop of 2s. 10d.; but elsewhere (p. 294) an estimate (which does not look as if it would bear close scrutiny) is given of the total cost of protection, in land clearing, farm machinery, shipping freight and cost of living, amounting to 1s. 1d. a bushel; and it is obviously not possible that other items of increased cost attributable to federation or federal policy could amount to more than a tiny fraction of the difference between 1s. 1d. (even assuming that figure could be established), and 2s. 10d. a bushel.

The days of high enthusiasm and great expectations from federation did not last long; it was only during the [first] World War and under Mr Hughes that Australia had an intensity of national feeling and national aspiration comparable with those of 1900. Mr Hughes' successors of the last ten years have all had a drabness of speech and idea; and the events of late years have scarcely given occasion for thoughts of the larger national life, the dignity of stature, the cultural
achievements, that federation was to bring. But it may be doubted whether any State of Eastern Australia would put forth a full and reasoned discussion of federation and its results so devoid of any feeling for national unity and any appreciation of what federation has done for national thought in all the States, as is this Case of the People of Western Australia. The writers say — as none will doubt — that Western Australians will remain good Australians after withdrawal, as they were before and have been in federation. ‘The withdrawal of Western Australia does not involve the severance of a race’ (p. 430). But nothing is said of any cultural loss, or any loss in ideas or opportunity for achievement, that might result. We must conclude that in the view of the writers federation has failed in these as in its material ends. Rather than stressing what Western Australians have in common with other Australians the writers claim distinctive qualities for Western Australians — a ‘rugged individuality of their own’ (p. 374); ‘that distinctive individuality of which they are so proud, and which has earned and enjoyed respect and admiration far beyond the boundaries of this State’ (p. 372). The emotional appeal in one passage is in such phrases as ‘a British community’, ‘British freedom’, ‘British justice’, ‘sincere loyalty to the British Crown and Throne’; in another ‘the not necessarily unmixed blessing of listening to an Australian-wide broadcasting programme’ is contrasted with ‘the pleasure and pride with which the people of Western Australia listened to the King’s message on Christmas day’ (broadcast though it was through a Commonwealth station); and one of the objects of Secession is to ‘afford greater opportunities for co-operation between the people of Great Britain and the people of Western Australia’ (p. 482).

Indeed it is to the United Kingdom, and not to Western Australia’s co-partners in the ‘one indissoluble Federal Commonwealth’ — a phrase that seems to have escaped the notice of the writers of the Case — established in 1901 that this appeal is addressed. But Western Australia can scarcely be so remote from the general stock of information as to believe — even although the Statute of Westminster is not yet proclaimed in Australia — that any British government would legislate or even actively concern itself in what is an internal and domestic question for the people of the Commonwealth. It is by the people of the other States and their leaders that this Case will have to be considered. What the outcome will be we need not now attempt to predict. But even if it falls far short of the separate Dominion status for which Western Australia asks, a Case so well and cogently stated, of the effects of unwise policies that affect Eastern Australia too, may yet lead to much needed contraction of federal powers, amendment of
federal laws and restraint both in using the powers and applying the laws, for the benefit of all the States.

Note

1 The Case of the People of Western Australia in support of their desire to withdraw from the Commonwealth of Australia established under the Commonwealth of Australia Constitution Act (Imperial), and that Western Australia be restored to its former status as a separate self-governing colony in the British Empire, Government Printer, Perth, Western Australia, 1934.
XV
Grants to States: The Report of the Commonwealth Grants Commission and Some of its Implications*

J. B. Brigden

Progress and the Next Step
The last record of the evolution of this problem appeared in The Economic Record in November 1931. The Commonwealth Joint Committee of Public Accounts had reported on the grants to be made to the States of South Australia and Tasmania. It had noted the criteria of relative State expenditures and severity of taxation suggested to it in 1930 by Professor Giblin, but had made its report in the shadow of the largest Commonwealth deficit ever known. The grant to South Australia had been increased from the first grant of £360,000 in 1929-30 to £1,170,000 in 1930-31, but a recommended increase in the Tasmanian grant had not been given. The South Australian grant was reduced to £1,000,000. The record of recent grants is as follows, including the present grants as recommended by the Commission [see table on p. 210].

Tasmania had received £378,000 in 1926-27 and 1927-28, and Western Australia £450,000 in 1925-26.

Per capita, these special grants for 1934-35 are approximately as follows: South Australia £2 7s. 9d. (£2.39), Western Australia £1 7s. 0d. (£1.35), and Tasmania £1 14s. 3d. (£1.71). Expressed in ratios with the average for the three States as 100, the respective proportions are 132, 74, and 94.

*Reproduced from The Economic Record, December 1934, pp. 230-42.
These special grants now amount to 7s. 2d. (£0.36) per head of Australian population, and will absorb about 5½ per cent of Commonwealth tax revenue in 1934-35, exclusive of Financial Agreement and Road Fund transfers of revenue collected for the States. Having regard to the expenses of war and defence and to all federal expenses that would have to be borne by the taxpayers whether there was a federal system or not, the special grants are now a very large element in that system.

The chief contribution of the Commonwealth Joint Public Accounts Committee was its recommendation that a permanent body should ‘make a continuous study of the financial relations of the Commonwealth and the States,’ and evolve ‘definite basic principles.’1 To this end a uniform system of public accounts was said to be essential.

The recommendation for the appointment of a special body was adopted by the federal Parliament two years later, by *The Commonwealth Grants Commission Act 1933*, but many members of that Parliament were still reluctant to admit any necessity for specialized and continuous study or any judgment other than they themselves would at all times be ready to give out of their own general knowledge. It is devoutly to be hoped that they will actually read the present report.2

The Commission was appointed for three years as from July 1933, and presented its report a year later. The federal government is to be congratulated on securing the services of its three members. The Chairman, the Hon. F. W. Eggleston,3 is a former Minister of the Crown in Victoria, and represents the States that have yet to be convinced that a permanent problem exists. Professor L. F. Giblin was indispensable as the experienced research specialist. Mr. J. W. Sandford represents both the ‘claimant States’ and critical business opinion.4

What the Commission has done in its first Report is to set the problem, to recommend grants which are generous to and protect the
interests of the claimant States until further progress can be made (and to hold the possibility of conditional grants in abeyance), to inform the States generally of the principles which the Commission expects to follow in the future, and to invite comment and discussion from all States (both recipients and contributors) on the principles so formulated. The Commission discouraged the customary 'forensic' procedure and used the method of informal conference as much as possible.

The actual grants recommended for 1934-35 were adopted by the federal Parliament (in its dying hours) and are now law. But apart from the precedent established by the magnitude of the grants, these recommendations are the least important part of the report. The Commission has much more than justified itself, if only by the fact of achieving agreement on so many vital and controversial principles. It has advanced the subject almost to the limits of practicability with the information and co-operation so far available to it. And if (as seems inevitable) future grants must be based on the principle of relative financial conditions, it is high time that facilities were provided for measuring those conditions in sufficient detail.

This involves a new procedure of accounting for each State, and it means expense. A uniform system cannot be substituted for the present systems. They conform to the requirements of State laws and of departmental administration, and they cannot be changed to meet the needs of the Commonwealth. Nor can the Commission continue to do 'with the aid of a Secretary, a clerk, and the temporary assistance of typists'.

If the Commission is willing to go ahead with the work of standardizing State accounts it should be encouraged to do so for reasons quite apart from the problem of special grants. Our public economy cries out for it. It also happens to be the next step towards safeguarding the federal system.

The following suggestions are offered:

(a) The Commission should be more adequately equipped for the research required. Having regard to the desirability of establishing a standard practice for the public accounts of each State, the Commission itself should be the authority.

(b) If the Commission itself is not to do this necessary work the State Auditors-General should be directed to commence it forthwith after consultation with the Commission.

(c) The Commission should visit each State, if possible, to discuss the principles it has evolved in the same way as it has done in the claimant States.

(d) Such suggestions should be submitted by the Commonwealth government to a Premiers' Conference for its approval and effective co-operation.
The Economic Background
As a contribution to the permanent problem the report is important firstly because of its concise and lucid exposition of the geographical and historical background, and secondly because of the tentative suggestions for measuring the relative economic positions of the States one to another. The latter will be discussed [below]. The 'background' will probably stand. A notable summary of the financial history of the Commonwealth and of the States is given in Chapter II. Three periods are used, namely, 1901-2 to 1909-10, 1910-11 to 1919-20, and 1920-21 to 1926-27, prior to the Financial Agreement of 1927. The financial supremacy of the Commonwealth is traced to its causes, the chief being (a) the incidental revenue-producing effects of tariff protection under Australian conditions;5 (b) the extension of Commonwealth direct taxation caused by the war; (c) the rise in prices which reduced the effective benefit of per capita payments of fixed sums; and (d) the burden on the States of their large development expenditures.

The Commission remarks that had the old per capita payments been made in 1909 to vary with the value of the £ (an 'academic' idea), the results would have placed the Commonwealth on the defensive in recent years instead of the States.

In the three periods given above, and without the Special Grants, the net aggregates of the States' finances showed surpluses of £5,155,500 from 1901-2 to 1909-10, deficits of £11,479,000 from 1910-11 to 1919-20 (including the war years), and deficits of £9,108,000 in the post-war years, 1920-21 to 1926-27. The relative position became much worse during the Depression years.

Chapter IV deals with the interaction of development policies, and summarizes the economic geography of Australia. It points out that the policy of protection was in every sense a development policy, and that its cost 'must be regarded in the same light as running railways or supplying irrigation water below cost'. 'The States were, within the limits of their powers, carrying out a policy of protection for primary industry parallel to the Commonwealth policy of protection for secondary industry'. But 'there is almost a competition between the two factors of development'. There is friction rather than co-ordination. While the tariff is credited with having tended 'to produce a larger population and a better balanced economy,' its extension has 'no doubt led to the failure of some marginal settlement' developed at the cost of the States. And the effects have been particularly unfortunate in the claimant States because they are 'marginal States.' 'Each contains a large area on the fringe of the rather exiguous portion of the continent which is cultivatable'.
Grants to States

The Commission makes the interesting remark that 'Australia probably produces more wealth from its arid and semi-arid areas than is produced from any similar area in the world'. The cost is borne by the community. The States have all been 'lacking in a real insight into the problem of marginal settlement'. But so has the Commonwealth in its development of marginal manufactures.

The Commission has many significant things to say about the tariff. The cost of protection to manufactures has fallen temporarily because of depression conditions, and 'it appears not improbable that the adverse effect of the tariff at present is due more to the protection of primary products than of manufactures'. It may be added that State protection of primary products is parallel to federal protection, and the two costs must now be very substantial indeed.

Another 'Australian Plan' is called for by these facts, and a much more far-reaching one than the financial plan of 1931.

Financial Principles

Having surveyed the economic field, estimated the direct financial contributions from and expenditures in and for each individual State, analysed the 'grounds of claim,' and stated the countervailing benefits of federation in the claimant States, the Commission fell back on the financial necessities of those States. As was to be expected it found it impossible to measure the effects of federal policy, even upon the finances of the State governments, and equally impossible to discriminate between disabilities due to such policy and geographical disabilities natural to themselves. The Commission does not say so, but these inevitable difficulties are on the whole an advantage to the claimant States. They are compensated for the accidents of marginal production, or for geographical aptitudes for which Australia and the world have less use than for those in other States.

The Commission has definitely and no doubt finally adopted the principle that the net results of all disabilities and benefits are summed up in the conditions of the finances of each State government. As an economic 'assumption' this principle may be bad. As a practical working rule it appears to be inevitable.

The consequential principles and procedure tentatively adopted and upon which comment is invited may be set out summarily as follows:

1. Ascertain the true budgetary position of each State according to a common standard of accounting.
2. Determine a standard accordingly. (The average of the non-claimant States is used by the Commission).
3. The difference between this standard and the position in each claimant State, less the special grant received, gives the crude amount required as a special grant for that year.

Note: There appears to be an inevitable lag of two years.
Fiscal Federalism

(4) Add any expenditure required to maintain capital equipment at the standard of other States.

(5) Add any amount estimated to represent the moral responsibility of the Commonwealth for any particular State expenditure.

(6) Deduct so much as represents expenditures due to any mistakes in policy (developmental or otherwise) in excess of a standard to be determined.

(7) Deduct so much as represents expenditures on administration or social services in excess of a standard to be determined, or add for subnormal expenditures.

(8) Deduct so much as represents taxation below a standard of severity to be determined, or add for excess severity.

Note: A State receiving a grant so determined has the option of varying its expenditures and its taxation as it thinks fit. For example, it may choose to reduce taxation and keep its services subnormal, or have both abnormal services and taxation.

Here are the 'basic principles' which were asked for. Now consider the standards required. There are eight of them also:

(1) true and comprehensive budgetary standards, based not only on correct accountancy, but on sound economic interpretation and allocations of liability in each year;

(2) an Australian average standard (whether the average — and what average — of any particular States or not) and for each year;

(3) one for the maintenance of capital equipment. (Presumably depreciation is included in (1));

(4) one for the moral responsibility of the Commonwealth in local matters;

(5) one for administrative expenditure;

(6) one for expenditure on social welfare;

(7) one for mistakes; and

(8) one for severity of taxation.

It looks like a playground for economic accountants. Yet the principles are simple and compare well with the complexity of income tax, or with any engineering formula.

The suspicion will intrude that in determining the grants for this year the desire of the Commission was not to vary existing grants downwards until its principles had been more completely thought out and offered for criticism. It was avowedly liberal and lenient, giving the benefit of its doubts to the weaker brethren, especially concerning Commonwealth moral responsibility and local mistakes, but not to
anything like the extent of the claims made, which are cited below. The recommendations can be stated thus:

South Australia: Crude amount £1,350,000, less £110,000 for excess mistakes, less £90,000 for excess social services, plus £110,000 for abnormal severity of taxation = £1,260,000.

plus a special addition of £140,000 in consideration of a long period of acute depression and high taxation. Actual grant, £1,400,000.
(An increase of £250,000. Claim £2,000,000.)

Western Australia: Crude amount £1,090,000 (including £220,000 for items properly chargeable in the budget according to practice elsewhere), less £130,000 for excess social services, less £400,000 for subnormal severity of taxation$^6$ = £560,000,

plus £40,000. Actual grant, £600,000.
(The same as for two previous years. Claim £1,500,000.)

Tasmania: Crude amount £170,000 (including £50,000 for items properly chargeable, as for Western Australia), plus £80,000 towards standard maintenance of capital, plus £80,000 for subnormal social services, less £40,000 for subnormal severity of taxation = £290,000,

plus a special addition of £110,000 in consideration of depression since 1922, former heavy taxation and meagre social services. Actual grant, £400,000.
(An increase of £20,000. Claim £1,099,536.)

Presumably the special additions for the year (£290,000) are non-recurring. The grants should diminish as prosperity returns to Australia and to the assisted States, and the Commission should be able to apply its principles more accurately as the grants are reduced.

It would be absurd to criticize any one of the figures quoted above. They are all so rough that even the base budgetary figures used to determine the crude amounts might have been substantially different without altering the final results. There is a good deal of looseness about the 'standards' and time periods, and a sometimes startling arbitrariness in their applications. Refinements must come later when the Commission is able to give adequate attention to the finances of the non-claimant States. If and when this can be done the Commission may establish an effective auditorship over the whole of the State accounts. This potential service is scarcely less important than the function of determining grants to particular States. It remains to be seen whether the Commission will in fact succeed in establishing the standards it needs. Its task is a task of judicial interpretation, similar
in effect to the interpretation of law by the High Court and the interpretation of monetary needs by a Central Bank.

**Differences between States**
Chapter VII of the report is in a sense a supplementary contribution, dealing in detail with that most difficult principle, the measurement of the severity of taxation in each State. It cannot be discussed within the space of this review, and as with its other principles the Commission will no doubt have to rely on its own further thought and experiment, and on such comment as it may provoke. The subject is highly technical, and it is not yet certain that relative severity of taxation can be expressed in any good measure. The Commission has advanced the idea very far (possibly too far), but it is still tentative. One's impression is that the present adjustments to Professor Giblin’s crude indexes of Taxable Capacity (as published in the *Record*, e.g., in December, 1933) have been made for the time being to fit a ‘common sense’ or general idea of relative conditions as between the States. Several corrections are made to the crude index based on federal income tax assessments, and a real wage index is used to represent the taxable capacity of lower incomes. The corrected income tax index is then combined with the real wage index, with the weight of 3 to 1. Later in the chapter there is a series of ‘measures of prosperity,’ which support the conclusions.

The effect of the adjustments are shown in the following table, wherein the first line gives the original crude indexes and the second line the corrected and combined indexes used by the Commission. The year is 1932-33.

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**Severity** of taxation is measured (for the claimant States only) by dividing an adjusted figure of taxation per head with the adopted index, and modifying the result by reference to differences in their local government taxation. This gave severity of taxation as 108 per cent of the Australian average for South Australia, 75 per cent for Western Australia, and 94 per cent for Tasmania. A survey of tax rates confirmed this conclusion.

The amount of work that has gone into this chapter is prodigious, and it savours almost of impertinence to raise minor points of criticism. One is indeed tempted to be facetious about the ‘harmony’ achieved among so many elements of possible discord. The confirming measures include production, population and factory employees in relation thereto, building activity, migration, and motor vehicles. The Commission found it ‘a little surprising’ that the
proportions of urban population and of factory employees in the ‘primary producing’ States should be so little below that in the ‘industrial States.’ The implication is that factory production which is competitive interstate is not so concentrated as would otherwise appear. What proportions did the members expect? The great bulk of factory workers is employed in work which must be done locally, such as the preparation of perishable foodstuffs, repair work, or the processing of primary products. Geographical conditions and mineral production are important elements in determining the proportions, but there is some minimum. Probably this minimum for any State would be between 50 and 60 per cent of the average for Australia. The margins over this minimum are the criteria and the differences are substantial. Using 50 as a standard, the range of excess in 1932-33 was from 11 to 93.

The Commission also assessed the (nearly) net value of production per head in each State on figures ‘accepted by the claimant States as satisfactory.’ Queensland appears as enjoying a net value per head 19 per cent greater than in any other State. This is certainly ‘in harmony’ with the result of adjustments to taxable capacity (cited above). The respective adjustments lift these measures of Queensland’s relative prosperity by 17 per cent and by 22 per cent.7

These measures of relative prosperity may be gratifying to all the States. They please the claimant States because they justify the special grants, and they flatter the States which contribute. But they will be used for all sorts of purposes. There is, therefore, all the more need for each one of them to be scrutinized critically and constructively, and from the points of view of each one of the States.

The Changing Federation

There have been times when it has seemed that federalism might everywhere become a casualty of the Depression. Not much is left of it in Europe. There is a rapid change in Canada. No one can say yet whether in the U.S.A. the federal system will survive the New Deal or vice versa. It may be that the federalism of the nineteenth century has gone for good. It belonged in spirit to the eighteenth century reaction against governmental authority, and while in form these limitations merely divided power, the divisions effectively limited the use of power. This characteristic of federalism proved to be no great defect when the peoples concerned did not want to use their legal powers as they do to-day. But now that there is an ‘end of Laissez-faire,’ federalism, too, is threatened with obsolescence. If the idea is to survive it must pass from the legal to the economic plane.

The trend was already advanced in Australia before the Depression, and much more than elsewhere because of the extent to which the
functions of governments had been extended. The Constitution as conceived by its founders was already becoming unworkable. And it was in fact incompatible with the permanent and characteristic policy of the Australian people. It belonged to a different age.

The Depression has intensified the situation. The federal Parliament shows no signs of limiting its own field of action. It meets continual demands from its electorates for further 'invasions' of the functions of the States. It is able to do so because of the incidental revenue derived from its protection policy. This policy in its ultimate effects is likely to change the whole character of the federal system.

The question is not whether the change will take place, but whether it can maintain the essentials of federalism. At present there is nothing but confusion, and no prospect ahead but an unwilling progress towards unification.

Australia will have to face this problem as it did the problem of financial readjustments in 1931, without precedents or assistance from experience in other countries. There is an escape from the dilemma, but it needs the same political sense as has characterized the development of the British Constitution, and that of the Empire. It needs the same elasticity and adaptation to changing needs. It needs above all an emancipation from the legalism that has hitherto confined the idea of federation.

Fortunately it is not true that federalism is as rigid as was once thought. Experience is proving that it can be elastic under the pressure of necessity. Not only can it be varied by legal interpretation; it can be changed by economic policy. And both of these processes have been and are going on rapidly in Australia. The Grants Commission found no vital defect in the machinery of the Constitution, and its makers seem to have builded better than they knew (e.g., in Section 96). What is now required is a wider sense of the federal idea; an economic as well as a legal compromise between the extremes of separation and unification. For this the ground has been prepared in Australia.

The Commission has shown how the incidence of federal taxation is an advantage to the States which have failed to get net benefits from federal tariff policy. There are natural elements of compensation. Income is transferred in substantial amounts through the expenditures of the federal government. In 1932-33, under the influence of the wheat bounty, nearly two-thirds of the actual help given to the claimant States was provided incidentally and apart from Special Grants. The total transfers to these States for the present year may exceed £5 millions, and £1 per head for the contributing States. The Commission has demonstrated beyond all doubt the pooling and compensating effects of federal direct taxation.
It has for long been recognized that in a federal system (as elsewhere) financial power is greater than legal power, and that the only effective way of maintaining a federal system at all is to limit the financial power of the federal government. The fact of financial power was seen only to be resented, and naturally enough the first ideas were to curb its powers of taxation. But this has not been practicable because of possible needs in time of war. Readers of the Commission’s report may be convinced that it is not even desirable to curb these powers, and for strictly federal reasons. What is the alternative? It is not to limit federal powers for the sake of such limitation. It is to restore a balance as between the federation and its parts. And this can best be done by adjusting handicaps, just as for a race. Australia can restore an effective economic balance of power by adjustment of financial liability as between the federation and the States. Such readjustments can be made more easily than readjustments of legal powers, and they can continue to be more elastic.

Moreover, this is a way of adjustment peculiarly appropriate to Australian conditions. The federation gets an incidental revenue from its constitutional share in development policy (i.e., the tariff). It is an accident of constitutional and other procedure that, for the respective Treasuries, the federal part brings money in while the States’ part takes money out. The result is that some of the revenue incidental to one kind of development is in fact spent on another kind (i.e., rural). But the federation knows less about this other kind, and in effect it competes with what is properly the function of the States. It would be a sensible adaptation if the revenue so used by the federation were used instead to share the national cost of past settlement now borne by the States. The principles of the road grants and the data of the Grants Commission will be available as bases for determining the proportions of each State’s debt that should be transferred. The special grants could be reduced and a true federal system could be restored appropriate to the times.

Adjustment could well go further. In consideration of this ‘concession’ on an adequate scale, the States might be willing to forgo their separate income tax and estate tax systems. If they could be content to use the one tax system, the States could each levy whatever additional taxation they required by way of a super-tax. The amounts so raised and the revenue itself would be entirely within their control. By some such proposal a greater degree of simplicity could be achieved, and equity could be restored both as between the federation and the States and between the States themselves. The remedy is not to embroider words into the Constitution, even if the people would consent to do it, but to use that economic sense which (it may be hoped) will eventually become a common sense.
Notes

1 [See Reading XIII, 1.]

2 Government Printer, Canberra, [July 1934]. 182 octavo pages, including 45 pages of Appendixes; chiefly Statistical Tables containing a great deal of important new matter.

3 [Sir Frederick Eggleston (1875-1954) was Victorian Attorney-General 1924-27, Chairman Commonwealth Grants Commission 1933-41, Minister to China 1941-44 and Minister to the U.S.A. 1944-46.]

4 [Sir Wallace Sandford (1879-1959) was an Adelaide businessman and a member of the Commonwealth Grants Commission 1933-36.]

5 Normally over 60 per cent of customs and excise revenue is the result of protection policy.

6 A Western Australian comment in the Senate was: 'What! Fine us for not burdening our people more.'

7 It is difficult (in Queensland) to understand why gross values of primary production should 'exaggerate the value for wheat-producing States in comparison with the sugar-producing State of Queensland', or why so much weight should be given to Real Wages as an index of taxable capacity. Sugar may cover a multitude of adjustments acceptable to the claimant States. The Commonwealth Statistician's figures for unsheltered production are seriously open to criticism, and so are his aggregates of 'Local and/or Net Values of Production' as indicators of relative conditions as between the States.
We have now given our opinion on the main grounds of claim advanced by the States except that of financial needs. In our first report this was eventually adopted as the basis of our recommendations. Special grants were recommended in accordance with the financial position of a claimant State relative to the other States. They were determined (subject to minor final adjustments) by the amount of help found necessary to make it possible for the State, by a reasonable effort, to function at a standard not appreciably below that of the other States. This was the operative principle, but it was adopted tentatively, and with some reluctance, for immediate practical purposes. The general discussion on the principles of grants was not summed up into final conclusions, but left with loose and somewhat contradictory ends. This was due partly to a pressure of time, but more to a desire to leave the whole question open. It was hoped that further investigation and discussion might lead to the discovery of some more fundamental principle to guide our recommendations.

In our second report we developed the tentative principles of the first, and concluded that the relative financial position of the States, when analyzed with sufficient care and understanding, was the only

basis on which special grants should be made. Further consideration and another year’s experience have led us to the following conclusion:

Special grants are justified when a State through financial stress from any cause is unable efficiently to discharge its functions as a member of the federation and should be determined by the amount of help found necessary to make it possible for that State by reasonable effort to function at a standard not appreciably below that of other States.

The difficulties of making a sufficiently thorough and convincing comparison are discussed [elsewhere in this report]. Here we are concerned to set out the reason why we have arrived at the above conclusion as to principle.

[In an earlier chapter] we examined the financial powers of Central and State governments, and found that it would not have been possible to give the Central government powers appreciably less than those it has now, i.e., an exclusive power of customs and excise taxation and concurrent powers in direct taxation. This distribution of financial powers in relation to functions has been on the whole, but not always, to leave the Central government in an easier financial position. The Commonwealth was in such a position in the years before 1928, and again in the last four years.

Such a condition of financial ease makes extravagance possible, but the same possibility lies ‘in a due dependence of those who administer them upon the people.’ We have not found more extravagance in Commonwealth than in State governments. There is however at the present time, and at most times, a superior power of raising revenue by the Central government and consequently an easier standard of expenditure.

A problem raised by this inequality in financial powers is the extent to which it is wise and useful for the Central government to raise revenue for transfer to State governments. The Constitution does not concern itself with this problem. At the outset the Commonwealth was in a position of being obliged, for other than financial reasons, to raise much more money than it needed, and the Constitution was concerned only with the disposal of the surplus. This state of affairs came to a sudden end in 1914, when the war imposed heavy burdens on the Commonwealth and reversed the financial balance. Thereafter no surplus was to be expected except that due to errors of estimation.

The logical course would have been to cease all payments to the States. This course was not adopted, but the Commonwealth continued to raise the money and pay it to the States in the form of grants per head. The case for using the superior taxing power of the
The Principles of Special Grants

Commonwealth in this way was apparently so strong in practice that
the alternative was not even considered. In effect, the income tax of
the Commonwealth was levied in order to continue payments to the
States at the rate of 25s. [£1.25] per head of population. These
payments in 1927 amounted to more than £7,000,000. The Financial
Agreement of that year resulted in a constitutional obligation on the
Commonwealth to continue these payments.

For several reasons revenue can be more easily raised by the Central
government than by the States. Moreover, the practice had the
additional merit of giving some measure of help to the poorer States,
because money was raised in proportion to taxable capacity and
distributed in proportion to population. Tasmania has benefited by
about £100,000 a year on this account.

The amounts of these grants were fixed upon no definite principle.
If they roughly corresponded with the requirements of the States at
the time they were fixed, the situation has changed now. The exact
amount was an historical accident. In fact, whilst remaining at 25s.
per head, the payments decreased between 1911 and 1927 from 15 per
cent to 7 per cent of the States' revenue. There is obviously no
particular validity about the present total of £7,585,000; the sum
which can be wisely raised by the Central government and distributed
to the States may be greater or less than this amount. Nor is there any
special validity in the method of distribution to the States of the
amount transferred from Commonwealth revenue. The population
basis has no outstanding claim except that it is simple and along the
line of least resistance. It does, in fact, give some help to States where
incomes are lower, and consequently public finance more difficult.
There is no reason why transfers, if they are to be made, should not be
adjusted so as to give more weight to the relative financial position of
the States.

The Central government itself has frequently, and apparently on its
own initiative, increased the transfers. In some of these, such as the
Federal Aid Roads Grant, the proportions were revised so as to give
still more help to the States in need than the simpler per capita
distribution. Others, such as the subsidies to wheat, were specifically
in relief of a distressed industry, and distributed among the States
accordingly. In 1934-35 the Commonwealth found £2,000,000 for an
additional per capita distribution, though this was a means of
disposing of an accidental surplus rather than the outcome of policy
deliberately provided for in the budget.

We have then an accepted practice of transferring large and
increasing sums from Commonwealth to State governments, primarily
because the Commonwealth can raise the money more easily. All these
transfers have had some effect in helping the weaker States, and this
has been, in part at least, the avowed purpose of some of the transfers. The weaker position of some of the States has been therefore recognized, and contributions have in effect been made, some regularly, some occasionally, to lessen the inequality, but without attempting a measure of how far such remedies are required to redress the balance. Special grants are then continuous in principle with other transfers of Commonwealth revenue to the States. They should be the amount required to complete the work begun by other transfers, and to reduce the financial inequality of the States sufficiently for the harmonious and effective working of federal government. That is the obvious and natural approach to the question of special grants.

We would determine special grants, therefore, by a strict measure of financial needs. The necessity of special grants arises from two different considerations. The financial scheme of the Commonwealth coupled with certain economic causes tends to produce inequalities as between the States, and where these are sufficiently severe some States find it impossible by their own efforts to discharge their functions with reasonable efficiency. In such circumstances there is a case for rectifying the inequalities. States may also become so embarrassed financially by various causes, apart from the operation of federation, and sometimes by their own faulty policy, that they are unable properly to discharge their functions to their citizens or the Commonwealth. Whenever they are in this position we say that special grants should be made, and should be determined by the amount of help found necessary to make it possible for the State by a reasonable effort to function at a standard not appreciably below that of other States. Thus we base special grants on needs.

It can hardly be disputed that needs, when interpreted with due austerity, are one sufficient cause for grants, though there may be others. The law of self-preservation is fundamental. A federation lives only while all its constituent governments live. If one of the governments becomes, or threatens to become, unable for financial reasons to discharge its proper functions adequately, it is a first necessity for the federation to give such help as will make it possible.

Consider a State in financial extremity. Suppose that it is making every possible effort to retrieve its position, is economical in administration, sparing in social services, severe in taxation, high in its charge for business services — all up to practicable limits — and still it cannot pay its way. Then the federation as a whole must come to its assistance with a special grant which will enable it to balance its budget, or more exactly to come as near a balance as other States.

Without such help the State must default. The Commonwealth is ultimately responsible for State debts, and is bound to meet all interest under pain of itself defaulting. The interest charges of the three
claimant States are over £10m annually, and the 'needs' of these States in the midst of an extreme depression have been estimated at under £3m. Even from the narrow view of expense, it is obviously much cheaper for Australia as a whole to keep a State solvent than to allow it to default.

We have said that there is no other course for the Commonwealth but to come to the assistance of a State when a strict examination of financial position shows no hope of its continued solvency except by special assistance. This is not strictly true, and there are two alternatives. One is to exclude the State from the federation by an amendment of the Constitution; but, as that would leave the Commonwealth responsible for the State's debts, it could hardly be chosen as a practical alternative to a special grant. The other alternative is for the Commonwealth to take over the government of the State in risk of default and administer it as a territory. The possibilities of this seem at present remote, but are not to be disregarded.

The financial difficulties of a State may be due to many causes which have been discussed in earlier chapters. The financial provisions of the Constitution may work adversely to it. The policies adopted by the Commonwealth Parliament may bear heavily on the industry of some particular State. Loan expenditure incurred in the past may now be unprofitable, whether from original errors of judgment or from the effect of price-changes in the world at large. Extravagances in administration or social services may have added to the dead-weight debt. Natural resources may become depleted or perhaps be relatively inferior to those of other States. Through a changed world demand resources once valuable may have become for the time useless. In practice, most of these causes will be found to have contributed to some extent to the financial difficulties of the States. Whatever the cause we must recognize the necessity of grants for States really in need. The fundamental criterion is that the State with all reasonable effort in the present is unable to achieve financial stability. If that is so, a grant must be made sufficient to make it possible for the State to function efficiently.

The general thesis cannot be questioned. Differences of opinion will arise in the interpretation of the terms in which it is stated. What are the 'practicable limits' in severity of taxation or in economy of social services? What is the 'reasonable effort' that can be expected of a State in financial difficulties? These are difficult questions of practical judgment...

The cause of financial difficulties, though immaterial to the general thesis, may have important effects on its application. For a State whose difficulties are due largely to its own mistakes or extravagance
in the past, it would be reasonable to expect a higher degree of effort than for a State whose position was due largely to the effects of federal policy. If the difficulty were due to relative poverty of natural resources, an intermediate standard might be expected.

For the present, however, we are concerned only with the general proposition that a grant must be made to a State in financial difficulties to enable it by a 'reasonable effort' to retrieve its position. It is objected that such a principle may encourage bad finance, perpetuate inferiority, and lead to a decay of the independence and sense of responsibility of the States. We do not think that the first part of this charge has any substance... Our procedure involves an annual review of State finances and a close comparison of their various activities and costs. Governments are thus in a position to know far more of the comparative costs of State functions than they did before. This knowledge and the publication of the details should stimulate better financial practice and a better system of accounting. To this end a uniform method of presenting accounts would also contribute, and some progress has already been made in this direction. The Commission by its searching comparisons can detect substantial differences of standards where they occur, and take them into account.

Nor is it true that the system impairs the responsibility of the States if it is grasped that the resources of the Commonwealth and States cannot be finely divided in relation to function by the Constitution, and must be adjusted in some other way. Our method aims at a fairer apportionment of the financial resources of the Commonwealth. Responsibility is impaired if a government has too much or too little for its essential needs. One leads to extravagance, the other to inefficiency and drift.

It should always be remembered that all financial adjustment within a federation is a means of distributing in a rational way the total financial resources of the group. It should not be regarded merely as a means of assisting States in difficulty. Extra assistance to them is simply a part of the general process. A fair application of the total resources is the true method of obtaining responsibility in each government.

Other Possible Grounds
In view of certain contentions put before us it is necessary to consider whether a grant according to needs as defined by us should be the only special grant, or whether, for any other reason, any additional grant should be made.

Other grounds that have been put forward by claimant States are:
   i. The financial relations of States and Commonwealth.
ii. Federal policy under various heads.

iii. Poverty of natural resources.

The first of these affects directly the finances of a State. The other two have their direct effect on the industry of a State, and indirectly on finance. These two then involve the question of grants on account of what have been called 'community losses', i.e., compensation for the lower prosperity of private citizens.

Financial Relations

The effect of 'financial relations' is directly on the budget position. There are no other effects to consider. Consequently, they cannot be the grounds for any grant additional to that based on a comparison of the financial positions of the States. Financial relations might conceivably be the cause of an inferior financial position, but that question has been sufficiently discussed [elsewhere in this report]. We found that the net effect of the system of finance was to give substantial help to the weaker States — a benefit which must be weighed against any burden which may be imposed by federal policy.

The Effects of Federal Policy

The effects on the budget will be first considered and then the effects on the community. The tariff policy of the Commonwealth undoubtedly has a very different effect in different States, and imposes a severe burden on claimant States. Other items of federal policy also discriminate, though not always against the same States.

The general effect of financial relations is beneficial to the claimant States. These States get a very large and measurable benefit from the allocation of Commonwealth revenue. They also enjoy advantages which are not measurable — such as those of a united foreign policy and common defence — and these are shared by all States.

All these matters have to be taken into consideration in estimating the total net effect of federation on the financial position of a State. We have pointed out the impossibility of measuring this net effect with any accuracy. There is, however, convincing evidence that at present, even with omission of imponderable benefits, the total net adverse effects on each of the claimant States is very considerably less than the needs of the State, measured from the relative financial position. We cannot see any possibility in the immediate future of this position being reversed. It follows that, under present circumstances, there is nothing to add to the measured 'needs' on account of federation and federal policy, so far as these affect the financial position of the States. Needs at present include the net effect of federation and a good deal more besides.
We have, however, to consider the theoretical possibility of the adverse effects of federation being greater than the measured ‘needs’. It is possible, for example, that Western Australia might have a great expansion of gold-mining which would bring her financial position up to the level of the other States. A great rise in wheat prices and a world demand for wine might put South Australia in the same position. At the same time, the burden of the tariff on export industries might continue undiminished or even increase, so that the net adverse effects of federation might be appreciable, although the ‘needs’ were nil. Should a grant be recommended for a State in this position?

We are strongly of opinion that no State in such a position of prosperity should receive a special grant. States federating expose themselves to certain hazards, and must stand by their decision. It cannot be expected that federation will have precisely the same effect on the prosperity of all States. It would be absurd, even if it were possible, to attempt a strict debit and credit account for each State for all the effects of federation. On the contrary, there is in general some more or less automatic arrangement, like the _per capita_ payments in Australia, by which the financially stronger States help the weaker. We have taken the position that grants should be given to States in financial difficulties sufficient to make it possible for them with reasonable effort to maintain Australian standards of government, whether the financial inferiority is due to the effects of federation or any other cause. We cannot see any valid grounds for recommending a grant to a State whose financial position is inherently as favourable as that of the other States which have to find the money for the grant.

The case would be still stronger if a State now accepting a grant based on ‘needs’ should in the future, when ‘needs’ have vanished, make a claim on account of net disabilities. ‘Needs’ are the defects below a certain standard and the total ‘needs’ of all the States measures the amount of inequality in the system. But ‘disabilities’ for one State are generally advantages or negative ‘disabilities’ for another, so that the net total for all States of all disabilities, positive and negative, is nil. If now, to take an extreme case, a State with disabilities nil, receives £1m on account of needs, that £1m is _ipso facto_ a disability of the other States; and if the doctrine of compensation for disabilities is valid, then this £1m should immediately be refunded by the claimant State for distribution among the other States. A State then accepting a grant on the ground of ‘needs’ implicitly rejects the principle of compensation for disabilities. A State cannot have it both ways.

We come now to the more difficult question of the effects of disabilities on the people of a State. We have so far considered only the effects as they were reflected in the budget. It is clear, however,
that the effects on the national income of the State may be much greater than the effects on the budget. Does any further claim lie on these grounds? The claimant states have expressly refrained from claiming for 'community losses', but the question requires consideration.

In our second report we have taken the ground that no claim was valid for community losses because:

When economic conditions are changed by legislation people must adapt their activities to the new conditions as they would to the effect of changes in the price-structure from any other cause. Population must be left free to move from occupations now become less profitable, and compensation would hinder the necessary movement. [para. 67]

This is a sound enough principle which must be allowed to prevail in the long run, but it cannot be expected to operate quickly on any considerable scale. For six years a good deal of wheat-growing has been unprofitable, but, if the farmers had left their farms and sought employment in the more profitable fields of sheltered and protected production, the result would have been to increase the number of unemployed by the number of men who left their farms. Purchasing power would be reduced and the sheltered and protected industries would in their turn suffer. The citation of this excellent principle does not then altogether dispose of community losses.

Let us consider the nature of these losses, which are chiefly due to the tariff. The burden of the tariff falls on industries and not on the States as such. Under Australian wage-fixing conditions, it falls predominantly and very quickly on unsheltered industry. It bears heavily on the claimant States, because they have a large proportion of unsheltered industry. If compensation or relief is to be given for the effects of the tariff on individuals, then it must be given by industries and not by States. It would be wholly unjust to give relief to the wheat-growers of Western Australia and refuse it to those of Victoria. Just as with special grants to the States, there is no need to make grants to industry on account of tariff costs so long as the industry is prosperous in spite of them. This applied to wool and wheat in the pre-Depression years. When, however, they become unprofitable on account of the fall in world prices, relief may fitly be given, and has, in fact, been given now for five years to the wheat industry by the Commonwealth government. The relief given during these years has been almost certainly greater than the tariff costs on the wheat industry.

No relief is given by the Commonwealth to some export industries (such as wool) and insufficient relief may be given to others. The relief
given must be regarded as what, in the judgment of the federal government and Parliament, is the amount which in the general interest, may wisely be given. This may well leave many cases of individual distress unrelieved. These will be found in all States, and those affected must equally look to their State governments for relief. If one State government is flourishing financially and another is impoverished, the export producer in the latter has little hope of relief. But if by means of special grants the impoverished States are brought near to the average of the others, then export producers in all States will be on an equal footing, receiving perhaps some uniform relief from the federal government, and looking for the remainder from State governments which should be within moderate limits equally able to give it. We conclude then that redressing the inequalities of the financial position of the States by special grants affords all the special relief necessary for the differential effects of federal policy on the people of different States.

If the amount required is relatively greater in a claimant State because of the relatively greater amount of unsheltered industry, the additional expense will be reflected in the budget, and consequently in the recommendation of an increased grant. Such relief must not, of course, amount to full compensation, which would take away the incentive to change to more profitable forms of production.

**Poverty of Natural Resources**

The natural resources in question are those of soil and climate, minerals and timber, fur and fish, and the like. ‘Poverty’ is meant to convey briefly that they are relatively unprofitable at present world demand for their products at to-day’s stage of production technique. They may be exhausted or not now worth development. Changes in price, improvements in transport, the progress of invention may at any time make them of value. At present they are unprofitable relatively to Australian standards. ‘Poverty’ of resources in this sense may be wholly or partly the cause of the inferior financial position of the State. Its effect on the budget will be adequately and properly met by a grant according to ‘needs’.

Poor resources will have also, of course, a depressing effect on general welfare in comparison with other States. Insofar as resources become poor through exhaustion or through price changes, there may be a case for relief to individuals as with those affected by federal policy. Here, however, the provision of relief will be the direct obligation of the State government, with the same caution as before — that it must not take away the incentive to move to better natural resources. As before, the necessary expense to the State will be taken into account in assessing needs, and will be reflected in the special
grant. As with disabilities due to federation, there can be no direct compensation for the lower income of the community resulting from relative poverty of natural resources.

Summary
We have found that special grants will in general be necessary to supplement the other transfers of revenue from Commonwealth to States, and that these grants should be determined from a strict comparison of the financial position of a claimant State with that of other States. If a State is in financial difficulties it must be made possible for it by a 'reasonable' effort to get as good financial results as other States. The payment that will make it possible will be the special grant, and, if this can be estimated in a satisfactory way, the grant so determined will fully and adequately meet all claims that can properly be made for special grants for any cause whatsoever.

The estimation of grants will be a matter of some difficulty. It will require a comparison of the inherent financial position — that is, of its actual budget position taken in relation to variations between States of accounting practice, of economy in expenditure and of severity of taxation and other charges. When this comparison has been made, a standard must be fixed based on the experience of non-claimant States. Next a judgment must be made as to the 'reasonable' effort which should be made by a State in difficulties whether by additional severity in taxation or economy of expenditure. The amount of effort judged 'reasonable' may be expected to vary with the cause of the financial difficulty, and be greatest when the difficulties arise from the State's own past mistakes. In every case, however, it must be great enough to leave the State with ample incentive to improve its financial position . . .

Note
Problems of the Commonwealth
Grants Commission*

J. A. Maxwell

The Grounds for Special Grants
The work of the Commonwealth Grants Commission has attracted wide attention outside Australia, most of all in Canada. There a Royal Commission has been appointed to survey the whole field of Dominion-Provincial relations, and during its hearings the provincial governments have made many suggestions based upon Australian experience. It is not unlikely that the Royal Commission will recommend that the Dominion should set up a body comparable to the Grants Commission. In any case, students of federalism everywhere must be grateful to the Commission for the lucid exposition of problems of federal-State finance presented in the Third Report, and for the ingenious technique which it developed as the basis of special grants.¹

In what follows an attempt is made to examine critically the work and the problems of the Grants Commission. There are, I believe, two reasons why an examination may now be useful. For one thing, the Commonwealth government has proposed that the Commission be superseded by a new Inter-State Commission, and this body, while it would doubtless continue along the lines laid down by the Grants Commission, might make any revision in method which seems to be desirable. For another, the Grants Commission has been long enough

*Reproduced from The Economic Record, December 1938, pp. 176-90.
in existence to disclose weaknesses in its methods which were not at first appreciated. The claimant States were slow to grasp the connotations of its methods, and they were, besides, pleasantly surprised at the size of the grants which those methods secured for them. As the following table shows, the special grants recommended by the Commission, 1935-37, in its first three Reports, were greater by 37.5 per cent than those given in the three years, 1932-34, before the Commission was created, although these latter were much larger than in any similar period in the past. One need not question the correctness of the increase to argue that the claimant States (especially Tasmania) were bound at the outset to be kindly disposed towards a Commission which produced such results. But this uncritical attitude cannot be expected to continue, and indeed, in the past two years, some hardening in the attitude of the claimant States is apparent. This is, of course, both inevitable and desirable, but it means that the methods of the Commission will, in the future, be subjected to more severe scrutiny. In short, the honeymoon period of the Commission is over.

Special Grants to South Australia, Western Australia, and Tasmania, 1932-34 and 1935-37

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<tr>
<th></th>
<th>1932-34</th>
<th>1935-37</th>
<th>% Increase</th>
</tr>
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<tbody>
<tr>
<td>S.A.</td>
<td>£3,150,000</td>
<td>£4,230,000</td>
<td>34.2</td>
</tr>
<tr>
<td>W.A.</td>
<td>1,400,000</td>
<td>1,900,000</td>
<td>36.0</td>
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<tr>
<td>Tas.</td>
<td>960,000</td>
<td>1,450,000</td>
<td>51.0</td>
</tr>
<tr>
<td></td>
<td>£5,510,000</td>
<td>£7,580,000</td>
<td>37.5</td>
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During the long years of controversy over special grants, the claimant States had based their claims upon disabilities, especially the effects of the Commonwealth tariff; and the decision of the Commission to reject this basis, and to adopt instead the basis of fiscal need, occasioned some surprise. Looking back through the earlier documents, it is possible to detect a vague appreciation of the 'needs' basis, but it remained for the Grants Commission to make the argument explicit, to give it a logical foundation, and to sweep away irrelevancies. In effect it asked: Who suffer from, and who should be compensated for, the disabilities which may arise from Commonwealth policy? Surely the burden falls immediately upon some individuals in a community, e.g. persons engaged in export industries, and the Commonwealth government cannot be expected to compensate them. 'When,' said the Commission, 'economic conditions are changed by legislation people must adapt their activities to the new
conditions, as they would to the effect of changes in the price-structure from any other cause. Population must be left free to move from occupations now become less profitable, and compensation would hinder the necessary movement. The obligation is on the government not to make changes that require an impossibly rapid rate of transfer, just as it is to slow down the rate of transfer made necessary from other causes, such as the fall in recent years of the price of wheat. But compensation in the full sense of a complete balancing of disadvantage would be a short-sighted and foolish policy.'3

But, the Commission continued, a State government is in a different position. Disabilities which, in the first instance, strike individuals, will be reflected with a time-lag in the State budget. Yet the natural remedies — curtailment of expenditure and higher taxation — will be peculiarly difficult to apply, since the capacity of citizens to pay taxes has been diminished, and since fresh demands for expenditure will be inevitable. The State government, thus reduced to a condition of fiscal need, might reasonably ask for a special grant, and the grant would serve to soften the impact of a Commonwealth policy, injurious to the particular State. State fiscal need may, however, arise out of other circumstances. Events over which the Commonwealth had no control and for which it had no responsibility — a fall in wheat prices, or exhaustion of gold mining — might reduce a State government to a condition of fiscal need. And finally, a State government might get into difficulties through mistakes in its own policies. In all of these circumstances there might be ground for special grants. As the Commission put it, ‘The determining condition of finance is independent of the cause. The necessity to keep a State solvent is paramount, whatever the cause may be.’4

The Commission does not rest its rejection of the disabilities basis merely upon abstract argument. In the first three Reports it marshals evidence which indicates that, even if the basis of disabilities is accepted, no compensation is due the three claimant States. It points out that the pertinent issue is net disabilities: that against the injuries inflicted upon a State by adverse Commonwealth policies must be set the benefits which accrue from other Commonwealth policies. Admittedly no complete calculation is possible, but even if imponderables are left out of account, it appears that, on the ground of net disabilities, South Australia, Western Australia, and Tasmania would not be entitled to special grants of appreciable size.

Neither the Commonwealth, nor South Australia and Western Australia have been entirely satisfied with the ‘needs’ basis. South Australia and Western Australia still plead disabilities, and they profess to believe that a grant calculated on this basis would be more
satisfactory. The Commonwealth Treasury has acquiesced in the 'needs' basis with reservations. While prepared to assist the Commission in applying its principles, the Treasury has expressed a fear that these may remove the incentive to State economy. Tasmania, however, has accepted the 'needs' basis, and this acceptance is understandable, since its grant will certainly be larger when founded on 'needs,' and since it has been treated generously by the Commission.

Problems of Comparison
The basis of fiscal need requires, for its application, a complete examination of governmental expenditures and revenues in the States. Such an examination presents many difficulties which the Commission has faced with ingenuity and judgment, and it assumes that there is sufficient homogeneity in governmental activities in the different States to make a comparison valid. This assumption is not entirely satisfactory. The differences between the Australian States in population, area, resources, and economic maturity are marked. The very fact that some States in the federation are claimant is in itself not quite consistent with the assumption of homogeneity in governmental finance. There can be no doubt that the totality of functions performed by government (not only the State government, but local governments as well) is not the same from State to State. In Victoria one would surmise that certain functions are rendered to the people by government, which in Western Australia are not rendered at all. The Commission is aware of these facts, and its conclusion that, nevertheless, comparison is justifiable, may be accepted.

But even if it be granted that the totality of governmental functions, as expressed in expenditure and revenue, is approximately the same, and therefore broadly comparable from State to State, serious practical difficulties arise in making the comparison, because the division of functions between governmental bodies within a State is not uniform. A direct comparison of the budgets of State governments alone would not yield accurate conclusions, since in State A local governments might be handling functions which in State B fall upon the State government. Yet any attempt to bring figures of local finance into the calculations encounters the obstacle that the statistics are extremely inadequate. Here also, the Commission has been alive to the problem and it has cautiously brought figures of local government taxation into the calculation of its indices of severity of taxation. But South Australia and Western Australia have sharply attacked the computation, and they have no difficulty in exposing the precarious foundation upon which the Commission has built, and the questionable nature of the results. This attitude is unfair, because the Commission knows that its calculation is a makeshift; but it knows also
that complete omission of figures of local finance would be unjustifiable. The only remedy lies in better statistics of local government.

There is another difficulty in making State comparisons which is still more serious. Statistics of State finance are abundant, but no two States compile their accounts on the same basis. Items are handled differently from State to State because of historical reasons, because of accounting technique, and because Treasurers sometimes wish to make the financial position look better or worse than it is. The published deficits (or surpluses) of State governments may, therefore, be quite misleading for comparative purposes. Yet it is from these figures that the Commission starts its measurement of 'relative financial position.' As a next step 'corrections' are, indeed, added or subtracted from the published deficits in an attempt 'to make the real financial positions comparable,' and these 'corrections' have forced the Commission into 'protracted enquiry.' If the protracted enquiry secured results which could be trusted, if it made progress towards the goal of comparability in State accounts for the future, the Commission could be content. But nothing of the sort happens. Although the Commission makes the 'corrections' with fairness and common-sense, the claimant States attack them with growing acerbity; and the work of one year is no foundation for the next, because any State may change the form of its accounts. Thus much of the work of the Commission in examining State accounts, while unavoidable, is essentially futile and repetitive. The goal of real comparability is, under present conditions, a will of the wisp.

It would be wrong to leave the impression that no progress has been made. Through the efforts of the Commission the public accounts of the claimant States have been greatly improved. But the accounts of the non-claimant States have not been influenced by the Commission, and yet they are vital to its computations, since they provide the 'standard' by which fiscal need is measured. If, for example, these States in a certain year charge items against loan account which they had previously charged to revenue, the grants to the claimant States will tend to be increased; while, if reversing this procedure, they shift items from loan account to revenue, grants will tend to decrease. The task of ferreting out all the possible divergencies in State practice is endless, and the Commission has made 'corrections' only along general lines. But it may be doubted that this will serve. The possibility of actual manipulation of accounts by the claimant States can, perhaps, be neglected, although under pressure of adverse circumstances the temptation would be great.

Here again the Commission is fully aware of the problem and in its First Report (p. 136) it said:
We desire to repeat, therefore, our representation to the Right Honourable the Prime Minister that immediate steps be taken to bring about a greater uniformity in the presentation of public accounts and statistics. In the absence of such uniformity the task of any body investigating the problems of Australian finance is unnecessarily complex and its decisions cannot have the certainty, and therefore the authority, they should. We are prepared to assist in this work. The difficulties of the Commission are only part of the evil caused by the present situation. Uniformity of public accounts would save the time of public officials; it would lead to a more general and intelligent appreciation in the public mind of the issues involved; it would ensure more efficient control of expenditure, and, in the long run, would enhance the credit of the Commonwealth.

Unfortunately, this recommendation was not heeded, and the Commission has been forced to continue its improvisation. It is emphatically my opinion that this is wasteful and that it will lead to serious difficulties in the future.

And one further point should receive attention. The Grants Commission is a quasi-judicial body. Its function is broader than that of a Court, since recommendations are based not merely upon evidence submitted to it, but upon investigations of its own designed to bring out all the facts. Yet the judicial function should be prominent, because the Commission stands as an umpire between the Commonwealth and the claimant States. It follows that, so far as possible, the Commission ought not to be forced to prepare statistics, and then to defend them against the attacks of the States, because this may bring it into undesirable controversy. The bearing of these generalizations upon what has been written above is obvious. If figures of State and local finance were gathered by some agency outside the Commission — perhaps through the Commonwealth Bureau of Census and Statistics — the task of the Commission could be better performed, and the field in which it has to exercise, not judgment, but guesswork, would be narrowed.

Penalties
The most obvious criticism which might, at first blush, be made of fiscal need as a basis for special grants, is that it will tend to break down the financial responsibility of the claimant States. But the Commission has endeavoured to insure against this possibility by providing ‘penalties.’ ‘It is axiomatic,’ said the Commission, ‘that a State requiring assistance should first have made a determined attempt to solve its financial troubles by reducing expenditure and increasing revenue.’ How great an effort should be required from the claimant
State is a matter of broad judgment, and the Commission, after a survey, concluded that a penalty equal, as a maximum, to 10 per cent of social service expenditure, and a further penalty equal, as a maximum, to 10 per cent in severity of taxation were the most that should be reckoned. Whether the whole, or only a portion, of the penalties should be assessed against a particular State was to be determined principally by considering how far it was responsible for its own misfortunes.

(a) The Penalty in Terms of Severity of Taxation

The problems involved in comparing the tax systems of the States are handled with remarkable ingenuity by the Commission, and the technique which has been devised is, I believe substantially sound. Suffice to say that through it the Commission derives comparative indices of severity of taxation in the States for a given year. Upon these a penalty calculation is based and here the Commission is less happy.

The principle that some taxation penalty should be assessed upon a claimant State is entirely reasonable. A claimant State ought, because of its claimancy, to make an effort in taxation somewhat greater than the ordinary. The Commission does not, however, proceed upon this principle. The penalty is aimed by it only against 'past extravagance and mistakes judged generally according to the record of a State,' and also 'its previous history of adversity and its prospects of coming prosperity.' Upon these criteria South Australia and Western Australia are assessed for a penalty, while Tasmania is not, although, as the two former States have complained, the loan losses of Tasmania are equally heavy. This is, I suggest, somewhat confusing. A penalty should certainly be lighter when conditions external to a State are responsible for its difficulties, and heavier when the cause of the difficulties has been mistaken State policy. But some penalty would seem to be inherent in a position of claimancy.

The Commission in its Third and Fourth Reports introduced a modification of the taxation penalty, which is of questionable logic, by reducing the penalty for Western Australia because the burdens of the tariff 'fall with substantially greater weight' upon it than upon any other State. But if, as the Commission had argued, 'whatever disabilities the people of a State may suffer, the effect of them on the Government will be reflected in Government finance,' then the burdens of the tariff should already have found expression in the State budget. And there is a further point. Why should this one disability be singled out for special consideration? The Commission had argued with great cogency that, if disabilities were to be adduced, the issue was net disabilities. It would seem to follow that if the Commission is to vary its penalty according to disabilities, the variation ought to
depend upon a judgment of relative net disabilities as a whole, and not upon the incidence of a single disability.

(b) The Penalty in Terms of Social Service Expenditure

The second penalty of the Commission is expressed as a percentage of State expenditure on social services, but it should be understood that there is no logical connection between this group of items and the penalty. The penalty is assessed in this way merely because of convenience in measurement — because here 'the data for comparison were most satisfactory.' The claimant States have persistently refused to appreciate this point. They — and especially South Australia — have argued as if the penalty required a reduction in social service expenditure. This is to misunderstand the position of the Commission. The penalty is imposed because of claimancy, and the manner in which it is calculated is entirely one of administrative convenience.

It must, however, be admitted that the complaints of South Australia have this very practical basis: if a claimant State is relatively economical in social service expenditure, it can reduce its penalty, even though it may be extravagant in other fields of expenditure. And this would tend to increase the grant in two ways: the penalty would be reduced because of low expenditure on social services, and the deficit would be larger because of extravagance elsewhere. So far as this happened, the purpose of the penalty would be defeated, and against this possibility, or the related possibility that a State might juggle its classification of expenditure, the Commission could guard by assessing the penalty upon a larger field of expenditure.

The present method of assessing the penalty has misled not only the States, but the Commission itself. In the Fourth Report a modification of the penalty was introduced by which account was taken of the fact that the cost of providing social services is not the same from State to State. The Commission made a rough calculation of the area of each State in which social services were provided, of population density in this area, and of cost per head. It concluded that 'the cost per head of social services is in some sort of inverse ratio to the density of population in the social service area,' and it 'decided to allow an addition to the standard expenditure' of 3 per cent for South Australia, 7 per cent for Western Australia, and 3 per cent for Tasmania. That is, if the average expenditure per head in the non-claimant States for social services was 66s. (£3.30), and if the penalty was 10 per cent, the standard would be 60s. (£3.00); and Western Australia, with a population of 448,000, would be entitled not merely to an expenditure of £1,344,000, but to 7 per cent in addition.

Against this modification at least two criticisms can be made. The claimant States are sparsely settled, but so also are Queensland and
New South Wales. For this reason the factors which tend to increase the costs of social services in the claimant States have already been allowed for in the figure of standard expenditure. A second criticism is that, in making this refinement, the Commission has forgotten that the cost of social services in itself has no special significance. The Commission calculated a penalty upon social service expenditure merely for purposes of convenience, and to modify the form of this penalty is to forget that the pertinent issue is not the relative cost of social services, but relative cost of all functions of government. One may, of course, argue that the relative cost of social services is a good indication of the relative cost of all governmental services. But the Commission has not so argued, and it has adduced no evidence to support this view.

It appears that the penalties of the Commission are wrong in emphasis. Penalties are justified because of the fact of claimancy, and variation in the amount of penalties is justified by consideration of the responsibility of a claimant State for its own misfortunes. It is doubtful if the factor of State responsibility has been sufficiently emphasized by the methods of the Commission. Its penalty on social service expenditure takes no account of it, and the actual technique creates the impression that the penalty is on this expenditure. The taxation penalty has been varied in its incidence on the individual States so as to punish extravagant loan expenditures. But this penalty has not been applied to Tasmania, although its dead-weight debt was, in 1935-36, above that of South Australia and Western Australia, and was growing. It might be advisable to broaden the base of the expenditure penalty so as to include a larger group of items, and to assess some taxation penalty upon every claimant State. The modifications of both penalties made by the Commission are, I believe, unsatisfactory, and they should be revised or dropped.

The item in the State budgets which reflects most obviously the mistakes in State policy is dead-weight debt losses. Such losses may, of course, be the result of forces external to a State as well as of mistakes in State policy; they may or may not be self-inflicted. And the Commission has felt that the debt losses of Tasmania, as compared with those of South Australia and Western Australia, were attributable to world events and adverse Commonwealth policy, although it recognized that the Commonwealth has responsibility for some of the developmental projects of South Australia and Western Australia.

But while it must be admitted that some of the debt losses were not self-inflicted, the importance of these losses in explaining the fiscal need of the claimant States is clear. If South Australia, Western Australia and Tasmania had debt losses which were merely equal to those of the non-claimant States, they would not at present be in fiscal
need. The following table shows the differences between the average net loss per head for the non-claimant States and the actual loss per head of the claimant States, and these differences, multiplied by population, produce amounts which would nearly balance the special grants.22

<table>
<thead>
<tr>
<th></th>
<th>Difference</th>
<th>Per head</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>N.S.W.</td>
<td>£2.41</td>
<td></td>
<td>£1,107,000</td>
</tr>
<tr>
<td>Victoria</td>
<td>£4.30</td>
<td>£1.89</td>
<td>£866,000</td>
</tr>
<tr>
<td>W.A.</td>
<td>£4.33</td>
<td>£1.92</td>
<td>£449,000</td>
</tr>
<tr>
<td>Q’land Average</td>
<td>£4.36</td>
<td>£1.95</td>
<td></td>
</tr>
</tbody>
</table>

Loan losses incurred in the past cannot now be helped, but they ought, perhaps, to suggest caution in the future. And if it be said that a State cannot protect itself against injurious Commonwealth policy or adverse world trends, one may answer that, in the immediate future, no new Commonwealth policies injurious to the claimant States are likely to be imposed, and that a State which is peculiarly exposed to adverse world events ought to take account of that fact in its borrowing. The Commonwealth government, through the Grants Commission, might reasonably ask that a special attempt should be made to curb the repetition of mistakes in loan policy so long as a State is a claimant for special grants.

How might this be done? I have already pointed out that the Commission takes some notice of past loan extravagance by assessing a penalty in terms of severity of taxation upon South Australia and Western Australia, and I have suggested that this penalty needs modification. If this were done, the Commission might assess a new penalty, designed so as to encourage the reduction of past loan losses and to discourage the increase of dead-weight debt. The precise form of the penalty is not important. But at present the net debt losses per head of the three claimant States are nearly equal. If in the future the Commission announced that it intended to scrutinize these figures so as to discover what each claimant State had done in relation to the other claimant States, and to the average of the non-claimant States, and that as a result of this examination some penalty would be assessed, then the effect might be salutary.23

**The Relative Standard**

When the Commission began its work, the fiscal position of the claimant States was serious, and in its early Reports the Commission
stressed this fact. It repeatedly pointed out that, in the event of default, the Commonwealth was responsible for State debt, and that special grants might, therefore, be justified to maintain State solvency. The Commission also assumed, without making a detailed argument, that as times improved the need for grants would diminish. Times have improved. The prospect of default need not be feared, even if special grants were reduced; and governmental services are now being provided on a higher level and on a more extensive scale than before the Depression. The Commonwealth Treasury has each year expressed the hope and expectation that special grants would diminish as prosperity returned, on the obvious ground that fiscal need was no longer as great as in the black years of the immediate past.

But the ingenious technique of the Commission will not automatically bring about a diminution in grants, because, in the main, it is based on relative standards which do not vary in time. The 'normal' expenditure and taxation are those of the non-claimant States in the year for which comparison is being made. If, for example, social service expenditure of the non-claimant States goes up from 55s. (£2.75) per head in 1936 to 65s. (£3.25) in 1937, the standard for 1937 (neglecting a possible change in penalty) goes up proportionately for the claimant States. The same is true of calculations of severity of taxation. Increased yields from taxation in, for example, 1937 as compared with 1934, due to a uniform increase in prosperity and without any change in rates, would not affect the indices. The Commission can, of course, modify its techniques in details, and it has always been careful to state that the results derived from its formulae were only guides to judgment. Insofar as the fiscal position of a claimant State deviated from that of the average of the non-claimant States, its grant would tend to diminish or to grow. If, for example, a claimant State was especially susceptible to cyclical swings, its grant would tend to go up in depression and down in prosperity. If, as another possibility, the effect of the business cycle on its fiscal position was less than the average, its grant would tend to go down in depression and up in prosperity. But if prosperity and depression struck it neither more nor less than the average of the non-claimant States, its grants would tend to remain about the same. I do not know which of these possibilities is appropriate to the claimant States, but it seems likely that, without substantial modification, the present technique of the Commission will not operate so as greatly to reduce the grants in prosperity, or conversely so as to increase them in time of depression.

It may be that the relative basis should be modified, because the fiscal need of a State is subject to variation in time as well as in relation to the financial position of the other States in a given year. I
am unable to say whether or not this should be done, but it is a question which the Commission might examine.25

Another aspect of the concept of a relative standard, which has recently been brought to the attention of the Commission, concerns the so-called 'surplus' standard. So far the 'normal' standard, from which all calculations have started, has been a 'deficit' standard, and the crude grants for the claimant States have been the difference between their (adjusted) deficits per head and the normal deficit. But what if, in the future, the non-claimant States produced a surplus? Should the grants be so calculated as to give the claimant States also a 'normal surplus', or should the 'normal' never be in excess of a balanced budget? . . . At present only Victoria of the [non-]claimant States has a surplus, and this surplus has not been large enough to offset the deficits of New South Wales and Queensland. Yet it may be argued that, since one surplus has been included, so also should all surpluses if and when they accrue. The Commonwealth Treasury, however, has declared that this would be unjustifiable.

Are Special Grants Permanent?
Given the premises of the Grants Commission, are special grants to be accepted as permanent? Fiscal need of a State may, as the Commission points out, arise through: (i) mistakes in policy; (ii) events external to the State, such as (a) injurious Commonwealth policy, or (b) adverse world trends. It would seem that the first of these would not justify permanent grants, because mistakes would be liquidated or rectified, and as this was done the fiscal need which grew out of them would disappear. But fiscal need which arose out of external events is less easily corrected, because it may lead to a permanent loss of labour and capital. In some circumstances, indeed, a prompt readjustment might be made and the grants might be regarded as transitional. A State in which mining had been important might turn to wheat, or a State which had been agricultural or pastoral might turn to secondary industry. For a time the shift would occasion grave difficulties, and the government might be in fiscal need. But this fiscal need would disappear as population and capital became adjusted to the new occupations. The outcome would, however, be less happy if there were no alternative occupations for the displaced capital and labour. In this case there would be a permanent loss in economic resources by transfer out of the State. In time the economic adjustment might be completed, and the population might become proportionate to the resources, but if, as has been assumed, the State is poor, the State government might be unable, through taxation, to carry on the functions of government at an Australian standard. In short, grants to such a government would be based upon poverty of resources which
caused fiscal need, and no discontinuance of the grants could be anticipated. The grants which would be necessary to enable such a government to provide governmental functions on a minimum Australian standard would not, perhaps, serve to hinder the operation of economic forces, but they would operate to keep the State government alive. This State government might, in such circumstances, be called an uneconomic unit of government, since, devoid of grants, it could not live. But the only remedy (except for special grants) would be loss of Statehood, and absorption by other States through redrawing of boundaries — a remedy which, in a federal country, is so difficult as to be nearly impossible.

Notes

1 My discussion does not take account of the Fifth Report of the Commission, although I have seen a portion of this Report in unrevised form, and I have made a few references to it. [The Canadian Royal Commission to which Professor Maxwell refers was the Rowell-Sirois Commission before which Professor Giblin gave evidence in 1938.]

2 See e.g., Report of Royal Commission on the Finances of South Australia as Affected by Federation (1929), No. 44, paras. 55-56; and particularly The Case for Tasmania (1930). Statements submitted as evidence before the Commonwealth Parliament Joint Committee of Public Accounts in reply to Questions by that Committee and the Commonwealth Treasury. The statement presented to the Committee by Professor Giblin contains in miniature most of the principles and techniques adopted later by the Grants Commission. It is a remarkable instance of original and constructive analysis. [See Reading XIII, 2 above.]

3 Second Report, p. 35.

4 Ibid., p. 37. See also Fourth Report, p. 9. As we shall see later, the Commission does consider the responsibility of a State government for its own misfortunes when calculating the grant.


6 ‘Our procedure involves the assumption that it is valid to compare the finances of one State as an organic whole with those of another.’ Third Report, p. 96.

7 The method has produced a curious result. To the (modified) figures of State taxation, the Commission adds half local government taxation, thus obtaining figures of total taxation collections for each State. These are converted into indices of collections per head which are, in turn, divided by indices of taxable capacity so as to secure indices of the severity of taxation. The effect of this was in, e.g., 1937, to give Tasmania, which has a low taxable capacity as well as a slight development of local government, a larger grant than if local taxation was entirely left out of account. This anomalous result seems to indicate that application of the indices of taxable capacity to figures of local government taxation is inappropriate. The differences between the States in local government taxation should be utilized in some other way.
Fiscal Federalism

8 Third Report, pp. 100 and 101. [Since 1966 the 'corrections' have been known as 'modifications'.]

9 I make no suggestion as to how this might be arranged, because if the decision to do the job is taken, a method can be found.

10 First Report, p. 96.

11 Actually these maximum penalties have not been assessed.

12 The Commission devised a measure of taxable capacity based principally upon actual assessments of Commonwealth income tax in the different States, but supplemented so as to cover small incomes by indices of real wages. An index of actual taxes collected by the States per head (plus one-half the collections of local government taxation) is next found. The index of collections divided by the index of capacity gives the severity index.

The most serious complexities arise because of the necessity for making adjustments to the basic figures of Commonwealth income tax assessments. Thus Central Office assessments have to be apportioned between the States, and adjustments have to be made because payments of State taxes are allowable deductions from the Commonwealth assessments. The Commission hopes to be able to discard this technique and to construct a more direct measure of taxable capacity by securing figures of the actual distribution of income in each State and then deducing what taxation would be paid under an assumed scale of rates. This assumed scale would be an average of the existing scales of State income taxation.

The Commission might give further consideration to two questions: (1) Do not the assessments of Commonwealth income tax give indices of taxable capacity which are too low for the poorer States? The indices measure the capacity of the States to collect revenue through income tax at a given scale of progression, rather than the capacity to pay taxes in general, especially commodity taxes; (2) How far is the assumption correct that the ownership of Commonwealth bonds, which are not open to State income tax, increases the taxable capacity of the citizens of a State? The position of the Commission is as follows: 'Income tax makes only about half of the field of State taxation, and to all other taxation, including probate duty, bond income is as open as any other income.' (Fourth Report, p. 107). The pertinent question would seem to be: How far can the taxable capacity represented by this bond income be tapped by a State government in view of the fact that the taxes (other than income and probate) open to use are levied, not in relation to income, but to some aspect of consumption?

13 Third Report, p. 94.

14 In assessing its other penalty this is the position taken by the Commission.

15 Third Report, p. 96.

16 Second Report, p. 36.

17 The penalty is calculated as follows: Average per head costs of social services in New South Wales, Victoria, and Queensland are found, a percentage deduction is made from this average to get a minimum standard, and the difference between actual per head expenditure of a claimant State and the minimum standard, multiplied by population, is the penalty.

19 An obstacle is that as the field is expanded, State figures become less comparable.

20 Fourth Report, p. 78.

21 This criticism has been made by the Commonwealth Treasury and the Commission, in answer, has declared that ‘in arriving at the differential allowances for the claimant States, the conditions of area and population of the standard States were carefully examined.’ (Fifth Report.) But no satisfactory evidence of this examination has been presented, and it would seem that many factors which make for differences in social service expenditure have not been examined.

22 The special grants recommended for 1936-37 were as follows: South Australia £1,330,000, Western Australia, £500,000, Tasmania, £600,000.

23 The penalty could not be automatically applied. Circumstances which curtailed the ability of a State government to make collections from its debtors should be considered by the Commission.

In its Fifth Report the Commission has, in effect, introduced a new penalty which indicates that it means to impress upon the claimant States a sense of their financial responsibilities. The failure of South Australia to collect debts due to the Crown, and the growth in unproductive loan expenditure in Western Australia and Tasmania are criticized, and a nominal deduction is made from the grant of each State. To me this appears to be a step in the right direction, and it may be a satisfactory way to meet the problems which I have raised.

An alternative method of dealing with the disproportionate loan losses of the claimant States will be suggested. The Commonwealth might assume enough of their debt to bring them, with respect to dead-weight debt, nearer the position of the non-claimant States. If this were done, the amount of the special grant might be reduced by the annual sum necessary to service the assumed debt, and the step would, therefore, not put any extra cost upon the Commonwealth Treasury. The claimant States would be relieved of special liabilities arising out of previous policies, and they would start tabula rasa. It may, however, be objected that, if this were done, the Commonwealth would have no safeguard against State repetition of mistakes in borrowing.

24 Third Report, p. 97.

25 If modification seems desirable, it might, perhaps, be introduced by relating the grants which emerge under the existing technique of the Commission to some fiscal indices which vary in time, i.e., which have time as the independent variable. Possibly the present indices of taxable capacity, calculated on an appropriate base, e.g., 1935-36, would be suitable. In a year in which the index for a claimant State was high, compared with the base year, the grant would be cut; while in the opposite case, the grant would be raised.
Introduction
The Commonwealth Grants Commission was originally constituted in July 1933, for the purpose of enquiring into and reporting upon applications by the States for special grants under Section 96 of the Constitution. Previously the Commonwealth government had made special grants to the three States of South Australia, Western Australia and Tasmania, under various limited agreements or after ad hoc investigations. Mounting dissatisfaction with this system had culminated in a movement for secession in Western Australia, and the Commission was established with the objective of evolving some principles that would take the determination of special grants out of the arena of political controversy.

In the twelve years prior to A.A.F.'s appointment the Commission had had two Chairmen, Sir Frederick Eggleston and Professor R. C. Mills. Sir Frederick Eggleston, in conjunction particularly with Professor L. F. Giblin, another of the original members of the Commission, formulated the basic principle of financial need on which the Commission has since relied. As stated in the famous Third Report (1936), this principle required the assessment of the financial need of a 'claimant' State, and the recommendation of an appropriate

grant for the coming financial year, on the basis of a comparison between its latest audited budget result and the average budget results of the non-claimant or ‘standard’ States (New South Wales, Victoria and Queensland), due allowance being made for economy in expenditure and effort in raising revenue.

During the war years the Commission, under the chairmanship of Professor Mills, was confronted with the task of applying its principle and adjusting its methods to the situation created by the introduction of the uniform tax system in 1942. Under this system the States ceased to levy their own income taxes in return for tax reimbursement grants from the Commonwealth. Large general purpose grants thus became payable to all States, in addition to the special grants paid to the claimant States. Moreover, the ability of the States to help themselves by their own tax effort was seriously circumscribed. For the time being the immediate pressure on State budgets was reduced by the cutting back of various State services and the increased earnings of the State railways, particularly in the standard States. By the end of the war this situation was reversed and the budgetary difficulties of the States began to mount.

A.A.F. became Chairman of the Commission on 8 November 1945, and his appointment was renewed for five three-yearly terms until he finally retired on 30 September 1960. In addition to the Chairman, the Commission consists of two other members. For approximately the first half of A.A.F.’s chairmanship his two colleagues were Professor Gordon Wood of Melbourne and the Hon. J. J. Kenneally of Perth. Professor Wood had been a member of the Commission since 1936. Having himself lived in two of the claimant States he had an intimate knowledge of their problems and his genial manner smoothed over many difficult situations. Mr Kenneally was a relative newcomer to the Commission, but he had wide political and trade union experience and was a former Western Australian Minister for Transport. Unfortunately, in 1953 Professor Wood died unexpectedly, and a year later Mr Kenneally retired. Their places on the Commission were filled by the appointment of the present writer and Sir Alexander Reid, a former Under-Treasurer of Western Australia. Thereafter the membership of the Commission remained unchanged until A.A.F.’s retirement.

Since all members of the Commission are part-time, including the chairman, considerable responsibility devolves on the full-time secretary and his small staff of research officers. In the first years of A.A.F.’s Chairmanship, the Secretary was Mr Martin Richardson, who had held that position continuously from the date of the Commission’s inception. He had a long and unrivalled knowledge of federal-State relations and his early death in May 1948 was a great loss
to the Commission. After some delay he was succeeded in June 1949 by Mr K. J. McKenzie, who had also been an original member of the Commission’s staff and who now returned after a period of service in Canberra. Despite several periods of ill-health he gave devoted service to the Commission until his death in January 1963.

It was an established part of the Commission’s procedure (and one which it still follows) to make an annual visit to each claimant State for about ten days during the period November to March, by which time the audited accounts for the previous financial year were generally available. The first three or four days of the Commission’s visit would be occupied by public hearings at which it would examine on oath witnesses for the State, including the Premier, treasury officers and departmental heads. The remainder of the visit would be devoted to an inspection of State services, public works and development projects. These tours . . . did much both to enlighten the Commission and to foster good relations with the State representatives. Later, a hearing would be held in Canberra, attended by representatives of the Commonwealth Treasury and the claimant States, to examine a statement by the Commonwealth on the States’ claims. Early in the new financial year, the Commission’s recommendations would be communicated to the governments concerned and its full report submitted to the Governor-General about September each year.

The Public Accounts

As Chairman of the Commission, A.A.F.’s most important achievement was probably the improvement which he inspired in the form and presentation of the Australian public accounts. This was done partly by direct discussions with State officers (both privately and at the Commission’s public hearings); partly by admonitions in the Commission’s annual reports; partly by public addresses calling attention to recent advances in accounting and urging their adoption by governments as well as by private businesses; and partly by the influence of his teaching, as students trained by him rose to positions of seniority in the Commonwealth and State public services.

By the end of the war, improvement in the public accounts was long overdue. As early as its First Report (1934) the Commission had urged the need for greater uniformity in State accounts as an essential prerequisite to its task of comparing State budgets. In its Tenth Report (1943) the Commission again called attention to the matter and a letter was addressed to the Treasurer suggesting that the Commonwealth initiate the collection of more comparable financial statistics. The need became more urgent after the war because of the increased scale of the special grants, the increased importance of technical accounting
problems (such as depreciation and sinking fund provisions) in the estimation of the grants, and the increased interest in social accounting. The latter required, if not greater uniformity in the public accounts, at least a more consistent and meaningful use of terms as an essential preliminary to the preparation of national income and expenditure estimates for the public sector.

Within a year of A.A.F.'s appointment the Commission submitted a memorandum to the Prime Minister, in August 1946, setting out the major difficulties it encountered in comparing and analysing the State accounts. It was suggested that the States might produce supplementary statements on standard lines, and also that a conference of Commonwealth and State treasury officers be convened to examine the problem. The latter suggestion was acted upon, and was followed by a meeting of under-treasurers at which all the States expressed their willingness to help.

A year later a special chapter on 'Uniformity in Accounting and Financial Practice' (Chap. VII) was included in the Commission's Fourteenth Report (1947). After recording progress to date specific suggestions were made for improvements in the accounts of State business undertakings, with particular reference to (a) the need for simple forms, (b) avoidance of ambiguous terminology, (c) logical and informative classification, and (d) clear recognition of the distinction between accounting and financial policy.

These points were further elaborated by A.A.F. in a paper on the Form of Public Accounts presented at the Commonwealth Institute of Accountants Diamond Jubilee Convention, Melbourne, October 1947. This paper filled in some of the background by pointing to recent improvements in private accounting and comparing the problems of public accounting with those of private accounting. It also added a number of suggestions for improvements in ordinary departmental accounts as distinct from those of State business undertakings.

A more definitive treatment of the differences between public and private financial statements was given about the same time in the book entitled The Form and Contents of Published Financial Statements written jointly by A. A. and G. E. Fitzgerald. In this volume the purpose and form of public financial statements were surveyed and detailed comments were offered on thirteen examples extracted from the published accounts of the Commonwealth and the various States.

Particular attention was directed to unravelling the tangled skein of accounting for depreciation, sinking fund contributions, the writing-down of assets and interest payments on the public debt attaching to State-owned business undertakings. The wide variety of accounting practices adopted by the States was commented upon in the
Eighteenth Report (1951), and the Commission stated its conviction that 'greater uniformity and clarity is possible and is desirable to the point of urgency'. In the Twenty-first Report (1954) it was pointed out that sinking fund contributions over the 53-year period required for public debt redemption could be regarded as a substitute for depreciation on publicly-owned assets only on the assumption that the assets had an average service life of 53 years. If new assets then had to be acquired it would presumably be from the proceeds of new loans. A few months earlier these problems had been exhaustively examined in a paper by A.A.F. at a symposium on Accounting and the Public Accounts held during the Adelaide Convention of the Australian Society of Accountants, in May/June 1954. The proceedings also included contributions by the Auditor-General of South Australia and officers of the State treasury.

In his paper at the Adelaide Convention, A.A.F. also called attention to the modifications necessary in the public accounts in order to facilitate their use for social accounting purposes along the lines suggested in the United Nations' Report on Budgetary Structure and Classification of Government Accounts. In particular it was suggested that the distinction between the consolidated revenue fund and the loan fund should be replaced by one between current and capital transactions.

The result of this continued advocacy was a steady improvement over the years in the public accounts of all governments, including the Commonwealth, but particularly of the States and their business undertakings. South Australia led the way. In that State the Treasury was in an unusually strong position vis-à-vis the other departments and had a team of alert and well-trained officers. In January 1947, the State Auditor-General informed the Commission that a committee of his senior officers had been appointed to examine the standardization of accounting terminology and the simplification of accounting forms. In the short space of two years the accounts of all the State departments and business undertakings were overhauled. Vertical forms were introduced for most purposes, except for balance sheets where the traditional forms were retained to permit the inclusion of adequate historic detail. It was established practice in this State to provide sinking-fund contributions in lieu of depreciation, but the procedure was clarified and the consequential need to raise new loans to purchase new equipment was recognized.

Other States followed the lead set by South Australia, particularly as trained personnel became more readily available in the treasuries and audit offices. The matter was continually pursued by the Chairman at the annual hearings in the claimant States . . . One undertaking that came under particular scrutiny was the Tasmanian
Hydro-Electric Commission, partly because of the treatment of its sinking-fund contributions in the State accounts, and partly because of the State's subsidies for some activities of what appeared to be 'an inherently profitable undertaking'.

Nor was the improvement confined to the claimant States. In June 1948, a conference of railway accounting officers from all States agreed to consider adopting the same balance-sheet forms and terminology as South Australia. (Later the Commission was to give close attention to railway accounting practices in its comparisons of railways charges and costs.) A.A.F. also had opportunities of directly influencing Commonwealth accounting practices, e.g., as a result of consultations over the system of accounting for the cost of Snowy power, and as the chairman of a committee of enquiry into the Post Office finances.

One result of all this activity is to be found in the recent supplements to the Treasury Information Bulletin on *National Accounting Estimates of Public Authority Receipts and Expenditure*. Such detailed estimates would hardly have been possible had it not been for the work that had gone on over the previous twenty years in improving and clarifying the public accounts of the States and the Commonwealth.

**War-time Reserves and the Budget Standard**

The most immediate practical problem facing the Commission at the time of A.A.F.'s appointment was how it should apply its principle of 'financial need', according to which it attempted to place each claimant State in a relative budgetary position not appreciably below that of the standard States, subject to a comparable degree of effort in raising revenue and economy in spending it. Before the war the Commission had allowed only a 'deficit-budget standard', i.e., it had recommended special grants sufficient only to enable the claimant States to reduce their deficits to the average per capita level of the standard States. During the war it had allowed a 'balanced-budget standard', i.e., it had recommended grants sufficient, but not more than sufficient, to enable the claimant States to balance their budgets.

From 1940-41 to 1945-46 inclusive the standard States had budget surpluses, not deficits, and were able to transfer substantial sums to reserves for deferred maintenance and post-war rehabilitation. In these circumstances the Commission's decision to adopt a balanced-budget standard for the claimant States during the war meant that they were denied the chance to accumulate comparable reserves. Consequently, after the war they were faced with the prospect of having to finance the rehabilitation of their assets from current revenue instead of from reserves. The Commission had, however, given an under-
taking that the claimant States would not be placed in a worse position than if they had been allowed to accumulate war-time reserves and this assurance was repeated in the Thirteenth Report (1946), the first to be published after A.A.F.'s appointment.

There were three ways in which this undertaking might be honoured. Firstly, the claimant States continued to press for increases in the special grants sufficient to enable them to set aside reserves comparable to those of the standard States. The Commission had consistently rejected such requests and did so again in the Thirteenth Report. Basically its reason was that the principle of financial need could be taken to justify only the covering of current indispensable needs, and not the accumulation of reserves which could not be currently spent and the adequacy of which could not be accurately determined.

Secondly, the claimant States requested supplements to their annual special grants sufficient to reimburse them for actual expenditure on deferred maintenance in the year under examination. This claim had been admitted in principle and was again conceded in the Thirteenth Report. Accordingly, account was taken of items of deferred maintenance expenditure in the assessment of the special grants for Western Australia for each of the three years commencing 1947-48, and for the other two claimant States for each of the three years commencing 1948-49.

Thirdly, under the Commission's normal procedures, the claimant States stood to benefit automatically from a more favourable budget standard insofar as the standard States could avoid, or at least minimize, deficits by drawing on their war-time reserves. This possibility was pointed out by the Commonwealth Treasury at the time of the Thirteenth Report but the claimant States questioned whether the standard States actually would use their reserves to relieve their current budgets. The Commission therefore undertook to exclude from its calculation of budget standards any expenditure by a standard State on deferred maintenance and rehabilitation that was charged to revenue, while that State still held balances in its war-time reserves. Even with this correction to their budgets, however, the standard States proved to have been in deficit in 1946-47 when that year came under review in the Fifteenth Report (1948).

At this stage the question whether a balanced-budget standard was still appropriate became a practical issue. The claimant States argued that, having been restricted to balanced budgets when the standard States were in surplus, they were in fairness entitled to balanced budgets now that the standard States were in deficit. Indeed, they further claimed that they should be guaranteed a balanced-budget standard for a term of years.
The Commission’s solution was [to develop] a system of ‘notional reductions’ in the war-time reserves of the standard States, the amount of the reduction each year being that which would have been required to balance the budget of the State concerned. Thus, in respect of the year of review 1946-47 a balanced budget standard was adopted after making notional reductions of £1,586,000 in the war-time reserves of the standard States. The same procedure was adopted in each of the next three years. The standard States continued to be in deficit, but their war-time reserves were notionally reduced by a further £3,340,000 and balanced-budget standards were thus maintained for the claimant States.

Under this system the accumulated war-time reserves of the standard States were regarded as being available for general budgetary purposes, and not just for deferred maintenance and rehabilitation of assets. On the other hand no guarantee was given that a balanced-budget standard would continue for a predetermined number of years, although there was an implication that the system would continue until the war-time reserves were notionally exhausted. No indication was given of what might happen then, but that question did not arise for the time being. The Commission’s Nineteenth Report (1952) showed that the average budget result of the standard States for the year of review 1950-51 was again a surplus, and this continued to be the case for five years. Balanced-budget standards could thus be maintained without any further notional reductions in the war-time reserves of the standard States.

However, by the time of the Commission’s Twenty-fourth Report (1957) the standard States had again run into heavy deficits for the 1955-56 year of review. On this occasion the Commission brought into account not only such parts of the war-time reserves as were still notionally available, but also other revenue reserves of the standard States. The total sum thus available was £4,521,000, but because of the size of the New South Wales deficit the average result for the three standard States was still a deficit budget. A deficit-budget standard was therefore adopted for 1955-56 for the first time since the Eighth Report (1941).

Thereafter deficit-budget standards continued to be necessary from 1957 until A.A.F.’s retirement in 1960. This reflected the general deterioration in the financial position of the States, and particularly of Victoria, prior to the termination of the tax reimbursement grants system and the introduction of the present system of financial assistance payments in 1959-60.

The Two-part System
Another important practical problem that confronted the Com-
mission in the post-war years was the difficulty of assessing grants under inflationary conditions. Each year the Commission was required to recommend a grant for the next financial year (year of payment), on the basis of the audited accounts of the previous financial year (year of review). There was thus a two-year gap between the year of review and the year of payment, which might not matter greatly if prices and incomes were stable, but which did matter if they were unstable.

The Commission's original method of dealing with this problem was to recommend deferments or advances. If it appeared that the grant assessed on the basis of the year of review would be in excess of current needs in the year of payment, part of it would be deferred until the following year, and this procedure was followed in the early war years. On the other hand, if it appeared that the grant assessed would fall short of current needs then a supplementary advance would be recommended corresponding to the estimated deterioration in the State's needs between the year of review and the year of payment. Such advances became necessary from 1944-45 onwards.

This system presupposed that the excess or short-fall in the assessed grant arose from temporary circumstances, the intention being that deferments or advances in one year would be paid or recovered in the following year. During the war years, however, deferments had to be renewed from year to year, and subsequently advances had to be continued until in effect they were allowed as part of the grant when the year of payment became, in its turn, the year of review. The States naturally pressed to have the advances recognized as final payments not subject to review, but the Commission always resisted this claim on the ground that final assessment would then be based on preliminary budget estimates instead of on audited accounts.

The position was further complicated by the rapidity with which State finances deteriorated after 1944. For a time a safety valve existed in a provision of the uniform tax legislation, whereby any State could request the Commission to report on its need for an additional tax reimbursement grant, as distinct from a special grant. This provision was repealed in 1946 but it was still open to the claimant States to seek supplementary assistance by way of second applications for special grants. In March 1946, this was done by all three claimant States. The Commission had already recommended special grants for the year 1946-47, assessed upon budget results for 1944-45 plus additional payments to cover the intervening deterioration in State finances. The States’ applications for further assistance late in the financial year were strongly opposed by the Commonwealth Treasury on the grounds that such assistance would still need to be based on estimates instead of accurate assessments, that it would tend to undermine the
sense of financial responsibility in the States, and that it would create difficulties for the normal budgetary practice of the Commonwealth. The Treasury, however, accepted the Chairman’s assurance that a special emergency existed and the Commission then recommended additional payments, but only as advances subject to subsequent review. Similar action proved necessary again in 1948 and 1949, but the Commission nevertheless declared itself opposed in principle to supplementary grants.

In 1949 a new accounting procedure was evolved ‘in an attempt to overcome the cumbersome system of advances and deferments and to avoid the necessity for a State to make more than one application in a year’. This was the two-part system which had originally been proposed by Western Australia in the previous year and which had received general support from the other State treasuries. Under this system, the financial need assessed for the year of review, instead of becoming the basis for the grant in the year of payment, was used to measure the adequacy of payments actually made, and available in respect of the year of review itself. The first part was in effect a final adjustment for the year of review, being the amount by which the assessed need exceeded or fell short of the actual payments for that year. The second part was a new advance for the year of payment and was subject to review two years later. It was based on an examination of budget estimates and other data, less a sufficient ‘margin of safety’ to cover the possibility of any unexpected improvement in a claimant State’s finances.

The two-part system has continued to operate from 1949 [onwards]. The States generally welcomed it, and in 1955 South Australia stated that it was the ‘most suited to the problem before the Commission of any procedure yet adopted in the assessment of grants in Australia, or, as far as we are aware, in any Federation’. On the other hand the Commonwealth Treasury has been critical of the system on several occasions.

In response to criticism that the system was too complicated and entailed technical budgetary difficulties for the States, the Commission urged the claimant States to clarify their procedure in accounting for deficits or surpluses, and to take steps to conserve their cash resources so that deficits could be carried until they were either funded or provided for by a first part grant.

Another line of criticism was that in determining the second parts of the grants, the Commission accepted too uncritically the tentative and preliminary estimates submitted to it by each State treasury, before they had been approved by Parliament and sometimes before they had been approved by Cabinet. It was therefore agreed in 1957 to hold a special hearing each July, at which the Commonwealth Treasury
would be represented, to consider the budget estimates submitted by the claimant States and to hold confidential discussions with the States later in the month to consider any variations which they might wish to make.

The Commonwealth Treasury's main line of criticism, however, was that in order to promote a sense of financial responsibility on the part of the claimant States, the special grants payable each year should be final payments not subject to review. But the Commission rejected as impracticable the suggestion that final payments could be accurately assessed on the basis of the limited data available in the first month of the financial year. Such a system would involve 'a grave risk of overpayments or underpayments'. A further suggestion that final grants recommended on the basis of preliminary estimates could be modified by additions or subtractions, based on relative budgetary experience in the year of review, was rejected as in effect retaining a two-part system in disguise, and adding to its complexity rather than reducing it.

These issues were discussed at length, shortly before A.A.F.'s retirement, in the Twenty-fifth Report (1958) and the Twenty-sixth Report (1959). It was agreed that the attainment of 'comparatively stable economic conditions might have lessened the need for a two-part system', and that earlier and fuller budget estimates were desirable. However, the Commission reiterated its view that special grants should be based on a close measurement of financial needs, and this could only be done on an *ex post facto* review of results, as always had been done even before the establishment of the Commission.

**Budgetary Adjustments**

The remaining field in which A.A.F. made an important contribution to the work of the Commission was in the measurement of the effort made by a claimant State in raising revenue and of its economy in expenditure, relatively to the standard States. When assessing the grant payable to a claimant State, the Commission took account of relative effort or economy by making 'adjustments' which increased or reduced the budget deficit to be made good. If a claimant State's effort or economy was found to be relatively less than that of the standard States, its deficit was notionally reduced by 'unfavourable' adjustments and its grant correspondingly reduced. If its effort or economy was found to be relatively greater than that of the standard States, its deficit was notionally increased by 'favourable' adjustments, and its grant increased, provided, however, that this did not leave the State with a surplus. After the introduction of the two-part system, precise assessment of such adjustments was unnecessary in
determining the second part of a special grant, but it was a major step in determining the first part.

Before the war the Commission had made adjustments for (a) effort in raising tax revenue, (b) economy in social-services expenditure, (c) economy in administrative costs, and (d) economy in maintenance expenditure on public works. Of these four adjustments the two latter were abandoned during the war years, and the Commission refrained from restoring them after the war, despite continued pressure from Tasmania for the reintroduction of the administration adjustment. Before the war the Commission had also required the claimant States to show somewhat greater effort and economy than the standard States, but this so-called 'penalty for claimancy' had also been abandoned during the war.

The two adjustments remaining from the pre-war era were kept under constant review. The adjustment for tax effort was derived from Professor Giblin's pioneering studies of State taxable capacity, but after the introduction of uniform income tax it had been confined to a comparison of State non-income taxes. The method adopted was to compare a claimant State's actual tax revenue with the calculated tax revenue that would have been raised if taxes had been imposed at standard rates, based normally on the average rates and exemptions prevailing in the standard States. The excess (or deficiency) of actual revenue over calculated revenue, as modified by the Commission's judgment, became the favourable (or unfavourable) adjustment to be added to (or subtracted from) the State's deficit, and hence its special grant.

In 1955 a major change was made by excluding motor taxation from the calculation, on the ground that either revenue as well as expenditure in respect of roads should be excluded from the budget, or adjustments should be made for economy in road expenditure as well as for effort in raising motor taxation. The latter alternative would have involved the Commission in difficult technical comparisons which it was not equipped to handle, and was therefore rejected. The Commission did, however, take into account the net impact of road finance on the budget and still had regard to the relatively low level of motor taxation in Western Australia in assessing the adjustment for tax effort in that State.

The social-services adjustment also dated from before the war, but its significance was enhanced after the war because of the great increase in State responsibilities in respect of education, hospitals and other social services. The adjustment was calculated by comparing actual social-services expenditure in a claimant State with what its expenditure would have been if the State had spent the same average amount per head as the standard States, plus an overall allowance for
its ‘special difficulties’. The deficiency (or excess) of actual expenditure as compared with this standard expenditure became the favourable (or unfavourable) adjustment to be added to (or subtracted from) the State’s deficit, and hence its special grant.

Controversy here centred on the allowances for ‘special difficulties’. These allowances differed for each claimant State and were intended to cover extra costs arising from factors such as a higher proportion of school children, sparsity of population and higher administrative overheads. The claimant States, and particularly Tasmania, continually pressed for increases in the allowances. The first post-war increase was made as an interim measure in the Thirteenth Report (1946), but the major increases occurred in 1954 and 1955 after the submission of a series of detailed memoranda by the claimant States, and after an examination of the 1954 census data. A further increase was made in the case of Tasmania in 1959. However, the matter continued to be a subject of vigorous debate, and was by no means settled at the time of A.A.F.’s retirement.

In addition to the continual review of these two surviving pre-war adjustments in respect of tax effort and economy in social services, the Commission in the post-war years introduced a new adjustment for State business undertakings. In the first instance this was an adjustment for the relative level of charges, and particularly for that of railway fares and freight rates; an unfavourable adjustment being imposed if a claimant State’s charges were low relatively to those of the standard States, and a favourable adjustment being made if they were relatively high.

In 1947 the Commonwealth Treasury called the Commission’s attention to the fact that the war-time regulations pegging the charges of State business undertakings had been repealed and that the responsibility for determining these charges now rested with States. In the Sixteenth Report (1949) it was pointed out that railway fares and freight rates had been increased in the standard States in 1947 but not in South Australia or Western Australia. The Commission found that ‘the conclusion is inevitable that adherence to the principle of financial needs ... necessitates adjustments on this account’. From that time onwards adjustments were made each year in respect of business undertakings and their range was gradually extended to take account of relative costs as well as relative charges, and of undertakings other than railways. These adjustments were a direct outcome of the close attention given by the Commission to the accounts of State departments and business undertakings.

The need to take account of costs was recognized by the Commission from the outset. The imposition of charges similar to those in the standard States did not absolve a claimant State from the
obligation to control its costs and reduce the burden of losses falling on the budget. On several occasions the Commonwealth Treasury urged that the Commission should base its adjustments on a statistical estimate of the net impact of business undertakings on the budget, but the Commission found this approach impracticable, partly because of the incomparability of the accounting data and partly because of differences in the conditions under which undertakings operated in the various States. The Commission found that even a comparative analysis of charges was a difficult statistical exercise, but its procedure was to use this as a starting point and to allow for costs by the exercise of broad judgment instead of attempting a rigid analysis. From 1957 onwards, however, it did include in its adjustments an assessment of the impact of differences in State basic wage policies upon the relative costs of State business undertakings.

One of the problems in extending the adjustments beyond railways was that so many State business undertakings, and often the more profitable ones, were administered by semi-governmental authorities whose finances were outside the State budgets. However, the Commission did extend the field of its comparisons to cover Electricity, Harbours and Metropolitan Water Supply in 1951, Country Water Supply in 1952, Tramways and Buses in 1955 and Forestry and Housing in 1958. Many other undertakings became the subject of critical analysis at the State hearings and the Commonwealth Treasury was always anxious to see the field extended. However, the major problem was the difficulty of reducing the financial and accounting data to a comparable basis, and in the case of some undertakings (e.g. the Western Australian State Shipping Service) of finding undertakings in the other States with which they could be compared.

From time to time the claimant States pleaded that they should not be expected to impose a level of charges similar to that of the standard States, either because of certain natural advantages which entitled them to operate on the 'service at cost' principle (e.g. Tasmanian hydro resources), or because a policy of low charges stimulated economic development and conferred intangible benefits on the State and indeed on the Commonwealth (e.g. South Australian Railways). The Commission never accepted the first argument unreservedly, and it rejected the second as irrelevant to its task of recommending special grants to enable a claimant State by reasonable effort to function at a standard not appreciably below that of the standard States.

**Conclusion**

Attention has been concentrated above on the four major fields of thought and practice where A.A.F. left his mark on the work of the
Commonwealth Grants Commission. One can perhaps sum up his work in these fields by saying that under his leadership the Commission became a sort of public accounts committee for the claimant States. Yet it would be misleading to suggest that his contribution was confined to accounting in any narrow sense. In the difficult post-war years the economic well-being of the claimant States came to depend heavily on the recommendations of the Commission. The special grants rose from under £3 million in 1945-46 to nearly £21 million in 1958-59. The responsibility was therefore heavy. The original purpose of the Commission had been to facilitate the smoother working of the Federation, and A.A.F. made his contribution by building up good working relations with both the Commonwealth and the States. Even a cursory perusal of the Commission's reports prior to his appointment will indicate that this had not always been the case. Under his chairmanship difficult situations still arose from time to time, but they were always handled with tact, firmness and good humour.
PART FOUR   TAXATION
COMMENTARY

In Reading XIX, Mr W. F. Murphy outlines the history of income taxation in the Australian States and the Commonwealth up to 1928. Incidentally noting Giblin's earlier work on taxable capacity and tax severity (see Reading IV), Murphy analysed rate structures, concessional deductions and types of income subject to tax in some detail for each State and the Commonwealth. After noting the great differences in the form and severity of income taxation from State to State, Murphy proposed a scheme of uniform income taxation. 'Agreement was reached last year on the much more difficult and involved questions covered by the [Financial] Agreement between the States and the Commonwealth. Is it not time that an attempt was made by the same means to get a uniform income tax?'

It should be noted, however, that Murphy's proposal for a uniform income tax differed from the proposal by R. C. Mills in Reading V, and also from the scheme introduced by the Commonwealth in 1942. Instead of the Commonwealth determining tax rates, collecting all the revenue and making grants to the States, Murphy suggested that there should be a basic tax structure (for example the original 1915 federal tax with slight modifications for exemptions, abatements and concessional deductions), to which the Commonwealth would apply one percentage rate (e.g. 110 per cent in 1928) and each State another rate (e.g. 70 per cent for Victoria and 130 per cent for Queensland) depending on its own assessment of its needs. The amount collected in each State on the basis of a single return and one taxing authority would then be allocated between the Commonwealth and that State in accordance with the percentages fixed by each government. Murphy's scheme thus has more in common with the scheme which was sub-
sequently adopted in Canada, and to a lesser extent with the State surcharge proposals which have been introduced more recently in Australia under the Fraser government’s new federalism policy, than with the uniform tax scheme introduced in 1942. Unlike the latter, it would have left the States free to determine their own tax rates and revenue yields.

In Reading XX, Professor T. Hytten shows how the first steps were taken (in South Australia) towards the development of a system of pay-as-you-earn (PAYE) taxation in respect of wage and salary incomes. Hytten showed that some form of tax instalments or deductions at source became necessary as progressive income tax came to be imposed on relatively low levels of income. The system which developed in South Australia in 1931 and 1932 was not a true PAYE scheme because collections in one year were related to tax to be assessed in that year in respect of incomes earned in the previous year. In Reading XXVI Professor H. S. Carslaw shows that PAYE on a current year basis was first applied by the Commonwealth to income earned in the year ending 30 June 1945. In that transition year, in addition to being assessed on income earned in the previous year taxpayers were required to pay tax on income earned in the current year, subject to a rebate of 75 per cent in respect of tax payable in that year in recognition of the fact that liability for tax was being advanced (so that effectively one and one-quarter years’ tax became payable in the one year).

The Report of the Committee on Uniform Taxation, which was chaired by Professor R. C. Mills, is reproduced as Reading XXI. The recommended scheme of uniform taxation, which differed from Mills’s earlier proposals mainly in relation to the suggested arrangements for compensating the States, was the essence of simplicity. The Committee formulated a rate structure and a scale of allowances for Commonwealth income tax which would raise the same amount of revenue as was then being raised by the Commonwealth and States together. It suggested that the Commonwealth, in imposing this tax, should give it priority over any form of State income tax, while paying to each State which retired from the field of income taxation an amount of compensation calculated by reference to the average income tax collections by that State in 1939-40 and 1940-41, less the estimated saving in costs of administration and collection. By giving priority to its own income tax at the higher level recommended by the Committee, the Commonwealth would effectively make it impossible for a State to continue to impose income tax and force it to accept the Commonwealth grant offered by way of reimbursement.
The reasons for imposing uniform taxation under war-time conditions were indicated by the Committee in its report, but in Reading XXII Mr K. M. Laffer demonstrates, in the context of an historical discussion of attempts to achieve taxation uniformity, just how complicated income tax arrangements in Australia had become by 1942 (when there were 26 separate Commonwealth and State income taxes), how the Commonwealth's ability to raise taxes for purposes of war finance was constrained by the substantial differences in State rate structures and levels of taxation, and how the States had responded negatively to various Commonwealth proposals, including the recommendations of the Committee on Uniform Taxation, which would have involved a voluntary withdrawal by them from the income tax field for the duration of the war and one year after.

When the States rejected the uniform tax plan and four States unsuccessfully challenged the legislation which the Commonwealth enacted to give effect to the substance of the Committee's recommendations, the Commonwealth was no longer bound by its offer to limit the scheme to the period of the war and one year after (as the Committee had recommended) and in due course decided to retain the system indefinitely. In this way, Laffer's prophecy, that the Committee's report would rank as one of the most far-reaching documents in Australia's economic history in terms of its effects, was confirmed.

Reading XXIII by Professor K. H. (later Sir Kenneth) Bailey complements Laffer's analysis of the uniform tax plan by discussing constitutional as well as economic and political aspects of the plan. Among other things, Laffer had considered the impact of the uniform tax arrangements on Commonwealth-State financial relations with special reference to the work of the Commonwealth Grants Commission. Bailey's paper confirms Laffer's analysis of the reasons why the Commonwealth was forced into a position of having to impose uniform tax — the impossibility of reconciling the requirements of war finance with the 'maddening maze' of State taxes. Bailey also described the course of the negotiations which preceded the appointment of the Committee on Uniform Taxation and showed how the four Commonwealth Acts which gave effect to the plan interacted with each other in such a way as to comply with constitutional requirements.

In the last section of his paper, Bailey analysed the results of the uniform tax arrangements by reference to their effects on the States, the Commonwealth and the future of Commonwealth-State relations. The plan not only effectively stabilised State expenditures from income tax (State revenues still benefited from war-time surpluses on railway operations), but also operated unevenly to the extent that the
level of existing services was lower in States which had had a relatively low severity of taxation. From the Commonwealth’s point of view, its potential for revenue raising was substantially increased. However, as Bailey pointed out, there was surprisingly little increase in Commonwealth income tax revenue in 1942-43 — the crisis year of the war — while at least three-quarters of Australian taxpayers paid less tax under the uniform tax arrangements than they had in 1941-42.

After discussing the constitutional arguments about the validity of the legislation, Bailey observed that the Commonwealth’s grants power had become one of the most vital elements of the Constitution and provided a mechanism for Commonwealth supremacy. After quoting a statement from the judgment of the Chief Justice (Sir John Latham) to the effect that the Commonwealth could apply the same procedures to other taxes and ‘make the States almost completely dependent, financially and therefore generally, upon the Commonwealth’, Bailey concluded that in future the security of the States under the Constitution was not so much legal as political.

Reading XXIV is a composite paper which has been constructed from extracts of six *Economic Record* articles contributed by Professor H. S. Carslaw, a Sydney mathematician, between 1941 and 1947. It is of interest not only for its account of the historical development of the Australian federal income tax system from 1915 (the year of its introduction) to 1947, but also because of its systematic analysis of what was then a unique income tax rate structure and of changes in that rate structure and in the system of allowances. Whereas income tax schedules in other countries have almost invariably been based on a stepped rate structure, Carslaw showed that the system devised by Sir George Knibbs in 1915 and carried through to the 1940s was based on a continuously increasing marginal tax rate, so that each successive £ of income was subject to a slightly higher marginal tax rate. In other words, as income increased a taxpayer was subject continuously not only to a higher average tax rate but also to a higher marginal tax rate. The system described by Carslaw may be contrasted with the simplified rate structure adopted in the 1977 Commonwealth Budget, which made provision for only three steps in marginal rates of tax, a standard marginal rate of 32 per cent to apply to taxable incomes over $3,750, a marginal rate of 46 per cent to apply to the excess of incomes over $16,000 and up to $32,000, and a marginal rate of 60 per cent to apply to the excess of incomes over $32,000.

Although the original uniform tax legislation was to have expired in 1946, the Commonwealth in that year informed the States that it proposed to continue the system. New legislation was passed incorporating changes in the method of determining the total tax reimbursement grants and their distribution among the States, and
later it was decided to change the basis of distribution over a ten-year period so that it would eventually reflect population adjusted for differences in demographic structure and population density. While Mr R. G. (later Sir Robert) Menzies is quoted by Bailey to have said that uniform taxation marked the end of the federal era in Australia, after he became Prime Minister for the second time in 1949 he indicated that the Commonwealth was prepared to return income tax powers to the States.

Following a report by Treasury officers on Commonwealth-State financial relations in August 1951, a Premiers' Conference in July 1952 asked Commonwealth and State Treasury officers to examine the technical problems involved in the resumption of income tax by the States. Reading XXV is the report which was published in 1953 as the result of that conference. It will be seen that the Treasury officers addressed themselves mainly to administrative and technical problems, listing the following main issues for decision by Ministers: the division of the income tax field between the Commonwealth and the States (relative rates and whether States were to tax companies as well as individuals); the relationship between Commonwealth and State rates (whether Commonwealth and State rates should be co-ordinated with respect to form and timing, e.g. by determining State rates as percentages of Commonwealth rates and agreeing on consultation before rates were varied); the extent to which uniformity was to be retained in assessment laws; the basis of State taxes on interstate income (residence or origin of income); arrangements for assessment and collection of tax; and transitional problems.

Although the officers surprisingly did not include it in their summary of main issues for decision, one of the major issues discussed in the Report (and in an appendix — not reproduced in the Reading) was the effect of differences in State taxable capacities. According to their estimates for 1951-52, for individuals and companies combined these ranged from 73 per cent of the weighted average of all States for Tasmania and 76 per cent for Queensland to 113 per cent for Victoria. For individuals alone, the estimated taxable capacities ranged from 62 per cent for Tasmania to 113 per cent for South Australia and 128 per cent for Western Australia (the surprisingly high figures for South Australia and Western Australia no doubt reflected the effect on incomes of high farm commodity prices before the collapse of the Korean war boom). The officers estimated that if the Commonwealth were to reduce its income tax in 1952-53 by the equivalent of the tax reimbursement grants and each State was to levy income tax to the extent necessary to yield the amount of its tax reimbursement grant, State rates would range from 20 per cent below average in Victoria to 50 per cent above average in
Queensland. The officers made little reference to the possibility of easing this problem through equalisation grants, noting merely that claimant States (then South Australia, Western Australia and Tasmania) would be protected from the need to impose much heavier taxation.

However, this question of State relativities was obviously the issue which dominated the Premiers’ Conference which was convened in 1953 to consider the Report. New South Wales, Victoria and South Australia indicated their willingness to impose their own income tax if the Commonwealth made sufficient tax room, Queensland also agreed to impose its own income tax provided the Commonwealth gave assistance to offset its low taxable capacity (and the Prime Minister offered a special fixed annual grant for this purpose), but Western Australia and Tasmania opposed the resumption of State income tax. The Conference was therefore deadlocked and no action was taken.

Reading XXVI by K. J. Binns and L. V. Beilis (1956) proposes a scheme to retain the advantages of uniform taxation while giving the States limited access to income tax. After pointing out that the formula tax reimbursement grants had been supplemented each year since 1949-50 by special financial assistance provided entirely at the Commonwealth’s discretion, Binns and Bellis suggested that the Commonwealth should vacate the income tax field only to the extent of the supplementary grants. The formula tax reimbursement grants, which by 1957-58 were to be distributed wholly on an adjusted population basis, would be retained along with the uniform tax system. It was estimated that Commonwealth income tax would still account for 90 to 95 per cent of the total, and that individual States would impose their own rates on the basis of a uniform assessment act, a single assessment and collection by the Commonwealth. Binns and Bellis suggested that a simple and convenient way of doing this would be for each State to fix a rate equal to a given percentage of Commonwealth tax for a given taxable income.

Binns and Bellis suggested that the problems of differential taxable capacity could be dealt with, insofar as the three claimant States were concerned, through the normal Grants Commission arrangements, and that special provision could be made for Queensland by means of an adjustment to that State’s tax reimbursement grant along the lines suggested by the Prime Minister in 1953. Surprisingly, the possibility that Queensland might itself become a claimant State does not appear to have been considered.

The Binns-Bellis proposal is interesting not only as a constructive attempt to reconcile the advantages and disadvantages of uniform taxation but also because of its similarity to the scheme for State income tax surcharges and rebates which formed part of the Fraser
government's new federalism policy that was implemented between 1976 and 1978. But the Binns-Bellis proposals were logically superior to those of the new federalism policy, in that they involved a partial Commonwealth withdrawal from the income tax field and they explicitly provided for the equalisation of taxable capacity to be achieved by relating a standard tax rate to differences in the tax base. (Under the new federalism policy of the 1970s, the Commonwealth did not make tax room, while equalisation of surcharges for any of the four less populous States was to be based on the rate of surcharge imposed by that State, so that it could influence the amount of the equalisation grant through its own policy.)

The last two readings in this part extend the discussion on Commonwealth and State taxing arrangements to forms of taxation other than income tax. In Reading XXVII, Professor H. W. Arndt considers the possibility that the States might be able to impose indirect taxes to circumvent, partially at least, the financial domination which the Commonwealth had achieved through the uniform income tax arrangements. For this purpose, he examined the legal judgments which had extended the constitutional prohibition on State excise duties to other forms of indirect taxation and even to levies imposed to finance agricultural marketing schemes. Arndt suggested that the States might be able to gain relief from these restrictive judgments by such legislative devices as charging taxes directly and separately to consumers, or imposing levies on the basis of production or sales in some previous year. The imposition by some States of consumption taxes on tobacco and petrol during the 1970s was based on the development of these ideas.

In Reading XXVIII, which should be read in conjunction with Arndt's analysis of the constitutional problem, Professor R. L. Mathews considers five forms of business taxation — taxes on business profits or income, taxes on capital, taxes on outlays, taxes on production, and taxes on sales or turnovers — with special reference to the problem of their suitability as State taxes. Among other things, Mathews proposed: a new basis of company taxation, whereby the company tax proper would be restricted to a low-rate 'doing business' tax and the whole of company profits would be taxed in the hands of shareholders; and the introduction of a broad-based value-added tax or retail sales tax. Mathews suggested that the residual company tax and the broad-based value-added tax (or retail sales tax) would be appropriate subjects for State taxation in the sense that they would give the States a flexible source of revenue, encourage political responsibility at the State level, and provide a link between State taxes and the spending decisions which determined the level of services available to business enterprises.
Further Reading

In addition to the following, see Further Reading Part Five (pp. 425-8 below).

Articles

Books of Readings and Symposia

Monographs and Books

Official Documents
History of Income Taxation in Australia

In the latter part of the last century, the governments of the different Colonies of Australia were launching out in more or less expensive developmental schemes. The cost of some of these was made a charge on revenue; and as the disbursements for the upkeep of government, and the growing liabilities for interest were already straining the credit of the fund, the Treasuries soon began to show signs of distress. New fountains of revenue, or more copious supplies from existing ones, were needed to meet the financial situation. Existing sources — lands, licences, customs, excise and probate — were not considered capable, without undue strain, of providing the necessary amounts; so new sources had to be tapped. The income tax field evidently showed the brightest prospect, and operations were commenced therein.

The idea was taken from England, where income taxation was tried, at first with limited scope in 1435, then with wider range in 1798 as a war measure. It was imposed again in 1842 and gradually became a recognised means of meeting ordinary expenditure. The example was not much followed by English-speaking countries, though the United States imposed an income tax as a Civil War measure and continued it for some years. In this event it was the Australasian Colonies that

*Reproduced from The Economic Record, May 1928, pp. 71-84.
were to adopt the principles of income taxation with most conviction and carry them to the furthest development.

Tasmania was the first of the Australian Colonies to make a beginning, in 1880, by imposing a tax on the dividend of companies; and the enabling act in that case was the forerunner of one of wider scope, applying to all incomes, which came into operation in 1894. Queensland and Western Australia in like manner taxed dividends at the source some years before they levied [tax] on incomes generally. As the South Australian revenue of 1885 included taxation collected under ‘Land and Income,’ it would appear as if she was the first Colony to tax incomes in the hands of individuals.

The following table shows the chronological order in which a tax on incomes was first levied in the various Colonies and in the Commonwealth:

<table>
<thead>
<tr>
<th>Dividend Tax</th>
<th>Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>Year</td>
</tr>
<tr>
<td>Tasmania</td>
<td>1880</td>
</tr>
<tr>
<td>South Australia</td>
<td>—</td>
</tr>
<tr>
<td>Victoria</td>
<td>—</td>
</tr>
<tr>
<td>New South Wales</td>
<td>—</td>
</tr>
<tr>
<td>Queensland</td>
<td>1897</td>
</tr>
<tr>
<td>Western Australia</td>
<td>1899</td>
</tr>
<tr>
<td>Commonwealth</td>
<td>—</td>
</tr>
</tbody>
</table>

Australian legislation generally was moulded on British lines; and it was only fair to expect that taxation schemes would not be made an exception to the rule. The scheme in force in Great Britain in 1879 provided for a tax at the rate of 5d. in the £1 on incomes over £150, with an abatement of £120 on incomes under £400; and this was the design on which the earlier Colonial income tax acts were outlined. But, beyond the fact that the general principles of the parent act were maintained in each, there was no uniformity in the statutes; they were dissimilar in rates, exemptions and deductions. This might well be expected, since they were framed by different designers, who had primarily in view the needs of their respective Treasuries rather than uniformity of taxation burdens. Capacity to pay or equality of sacrifice was not then aimed at as a condition of an act. Some graduation for small incomes was provided by fixed abatement, as in the English model. When further graduation was attempted it was generally by sudden jumps in the rate of tax. There was no attempt at systematic graduation or continuity.

The federal income tax, which was imposed in 1915 as a war measure but promises to remain a permanent and important contributor to federal revenue, has had a very considerable effect on the State systems, both by example of method and by the limitations
it, of necessity, imposes on high taxation by States. The federal tax, though its expression is cumbersome and needlessly involved, does provide a scale which is graduated continuously, and with reasonable steepness from the smallest to the highest incomes. It appears to satisfy general opinion in respect to fairness in graduation, and there has been a strong tendency for the scales of the States to approximate to it in this respect, though they may be stated in very different language and imposed with varying severities. There are still, moreover, very serious discrepancies between the States in the abatements and exemptions, as well as in the concessional deductions allowed from net income.

Relative Severity of Income Taxes
Income tax was not a very heavy burden in the earlier stages of its career, but it has gathered weight with advancing years. The steadily diminishing share of customs and excise revenue which has come to the States since federation has been one main reason for increasing State income taxes, and the burden of post-war reconstruction has been another. A glance at the following summary will give some idea of its progress:

**Income and Dividend Tax — Crude Rate — Per Head of Population**

<table>
<thead>
<tr>
<th>Year</th>
<th>N.S.W.</th>
<th>Vic.</th>
<th>Q'land</th>
<th>S. Aust.</th>
<th>W. Aust.</th>
<th>Tas.*</th>
<th>Federal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
</tr>
<tr>
<td>1899</td>
<td>2 5</td>
<td>3 1</td>
<td>2 9</td>
<td>4 7</td>
<td>6 5</td>
<td>2 7</td>
<td>—</td>
</tr>
<tr>
<td>1913-14</td>
<td>14 1</td>
<td>7 6</td>
<td>14 4</td>
<td>10 11</td>
<td>10 11</td>
<td>16 2</td>
<td>—</td>
</tr>
<tr>
<td>1917-18</td>
<td>22 9</td>
<td>10 11</td>
<td>28 2</td>
<td>20 3</td>
<td>6 5</td>
<td>18 7</td>
<td>29 8</td>
</tr>
<tr>
<td>1924-25</td>
<td>41 4</td>
<td>25 1</td>
<td>60 1</td>
<td>47 1</td>
<td>39 4</td>
<td>52 4</td>
<td>37 1</td>
</tr>
<tr>
<td>1926-27</td>
<td>66 0</td>
<td>27 10</td>
<td>64 0</td>
<td>48 0</td>
<td>32 8</td>
<td>28 3</td>
<td>36 5</td>
</tr>
</tbody>
</table>

*NOTE — Excluding tax on Lottery Prizes.

The growth of the impost is not quite as formidable as appears above, because the purchasing power of money has declined since 1899, and it is necessary to weight the figure in order to make a better comparison. This I have done by reducing the foregoing table to the level of the purchasing power of money, as measured by retail prices in 1911, and the result is as follows:

**Income and Dividend Tax Per Head of Population 1911 Retail Prices**

<table>
<thead>
<tr>
<th>Year</th>
<th>N.S.W.</th>
<th>Vic.</th>
<th>Q'land</th>
<th>S. Aust.</th>
<th>W. Aust.</th>
<th>Tas.*</th>
<th>Federal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
</tr>
<tr>
<td>1899</td>
<td>2 9</td>
<td>3 4</td>
<td>3 3</td>
<td>5 7</td>
<td>7 0</td>
<td>2 10</td>
<td>—</td>
</tr>
<tr>
<td>1913-14</td>
<td>12 4</td>
<td>6 9</td>
<td>13 6</td>
<td>10 4</td>
<td>10 11</td>
<td>14 7</td>
<td>—</td>
</tr>
<tr>
<td>1917-18</td>
<td>16 8</td>
<td>8 9</td>
<td>21 10</td>
<td>17 3</td>
<td>5 10</td>
<td>13 8</td>
<td>22 6</td>
</tr>
<tr>
<td>1924-25</td>
<td>25 1</td>
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<td>36 6</td>
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<td>28 0</td>
<td>28 1</td>
<td>22 1</td>
</tr>
<tr>
<td>1926-27</td>
<td>38 7</td>
<td>15 2</td>
<td>38 2</td>
<td>29 5</td>
<td>22 9</td>
<td>15 6</td>
<td>21 2</td>
</tr>
</tbody>
</table>

*NOTE — Excluding tax on Lottery Prizes.
These figures indicate more clearly the exact increase of the tax burden within each State, but they do not reflect the progress of the burden on taxpayers of various income-grades; and they are not a true index of the severity of the tax as between States, because the proportion of taxpayers with corresponding grades of net income was not the same in all States at any one period. It probably did not remain constant even in one State between the periods — in 1899 they were all based on a flat rate, or nearly flat rate, outlined on the British Act; but since 1916 they have been gradually moulded to follow, in varying degrees, the federal design. Hence the value of the summary as a comparison is mainly confined to each State as a whole. No particulars are available for a full analysis of the position in earlier years.

In 1922 Mr L. F. Giblin devised a scheme, based on assessments under the Federal Income Tax Act, for getting a summary comparison of the severity of taxation between States, when taxable capacity has been taken into account; and this has generally been accepted as a fair indication of the position. The following table shows a comparison of the severity of State income taxation in 1917-18, 1922-23 and 1926-27, as measured by this gauge:

<table>
<thead>
<tr>
<th>Year</th>
<th>N.S.W.</th>
<th>Vic.</th>
<th>Q'land</th>
<th>S. Aust.</th>
<th>W. Aust.</th>
<th>Tas.</th>
<th>Average Six States</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
<td>s. d.</td>
</tr>
<tr>
<td>1917-18</td>
<td>22 0</td>
<td>12 0</td>
<td>20 0</td>
<td>26 0</td>
<td>5 0</td>
<td>32 0</td>
<td>19 0</td>
</tr>
<tr>
<td>1923-24</td>
<td>38 0</td>
<td>16 0</td>
<td>69 0</td>
<td>33 0</td>
<td>39 0</td>
<td>35 0</td>
<td>34 0</td>
</tr>
<tr>
<td>1924-25</td>
<td>42 0</td>
<td>20 0</td>
<td>84 0</td>
<td>44 0</td>
<td>47 0</td>
<td>84 0</td>
<td>41 0</td>
</tr>
<tr>
<td>1926-27</td>
<td>60 0</td>
<td>25 0</td>
<td>87 0</td>
<td>48 0</td>
<td>44 0</td>
<td>52 0</td>
<td>50 0</td>
</tr>
</tbody>
</table>

The taxable capacity is based on the average federal income tax assessments for the three years preceding the year specified (see *Economic Record* No. 3, page 152).

**Varying Rates of Taxation Upon Similar Incomes in the States and the Commonwealth**

The following tables clearly show how unequal is the burden imposed on corresponding incomes according to existing State schemes:
## Personal Exertion Incomes

### Amount of Tax Payable by an Unmarried Taxpayer, 1928

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<tbody>
<tr>
<td>200</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>4.1</td>
<td>1.5</td>
<td>2.5</td>
<td>1.4</td>
<td>—</td>
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<tr>
<td>250</td>
<td>—</td>
<td>0.9</td>
<td>—</td>
<td>5.7</td>
<td>2.1</td>
<td>3.6</td>
<td>2.1</td>
<td>—</td>
</tr>
<tr>
<td>300</td>
<td>—</td>
<td>1.9</td>
<td>1.8</td>
<td>7.5</td>
<td>2.8</td>
<td>4.8</td>
<td>3.1</td>
<td>—</td>
</tr>
<tr>
<td>400</td>
<td>3.7</td>
<td>3.7</td>
<td>6.0</td>
<td>11.4</td>
<td>4.6</td>
<td>7.5</td>
<td>6.2</td>
<td>2.1</td>
</tr>
<tr>
<td>500</td>
<td>7.5</td>
<td>5.6</td>
<td>12.2</td>
<td>15.8</td>
<td>6.7</td>
<td>10.2</td>
<td>9.7</td>
<td>4.8</td>
</tr>
<tr>
<td>600</td>
<td>11.5</td>
<td>14.2</td>
<td>19.5</td>
<td>20.8</td>
<td>9.2</td>
<td>13.1</td>
<td>14.7</td>
<td>8.1</td>
</tr>
<tr>
<td>800</td>
<td>19.8</td>
<td>19.6</td>
<td>37.5</td>
<td>32.2</td>
<td>15.3</td>
<td>20.0</td>
<td>24.1</td>
<td>16.5</td>
</tr>
<tr>
<td>1,000</td>
<td>29.0</td>
<td>27.5</td>
<td>60.0</td>
<td>45.8</td>
<td>23.1</td>
<td>28.1</td>
<td>35.6</td>
<td>27.3</td>
</tr>
<tr>
<td>1,200</td>
<td>38.7</td>
<td>35.2</td>
<td>79.2</td>
<td>61.4</td>
<td>32.3</td>
<td>37.5</td>
<td>47.4</td>
<td>40.5</td>
</tr>
<tr>
<td>1,500</td>
<td>54.6</td>
<td>46.7</td>
<td>112.5</td>
<td>88.7</td>
<td>49.2</td>
<td>53.9</td>
<td>67.6</td>
<td>58.2</td>
</tr>
<tr>
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<td>180.0</td>
<td>144.7</td>
<td>85.0</td>
<td>87.5</td>
<td>108.1</td>
<td>94.5</td>
</tr>
<tr>
<td>3,000</td>
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<td>112.5</td>
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<td>185.8</td>
<td>178.1</td>
<td>214.8</td>
<td>192.4</td>
</tr>
<tr>
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<td>245.2</td>
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<td>600.0</td>
<td>498.9</td>
<td>325.6</td>
<td>249.0</td>
<td>345.6</td>
<td>324.0</td>
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<tr>
<td>6,000</td>
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<td>1,061.2</td>
<td>427.1</td>
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<td>1,548.1</td>
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<tr>
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<td>3,110.6</td>
<td>2,666.7</td>
<td>1,507.3</td>
<td>2,365.9</td>
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<tr>
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<td>5,561.2</td>
<td>1,755.2</td>
<td>7,080.0</td>
<td>6,235.7</td>
<td>5,333.3</td>
<td>3,090.6</td>
<td>4,842.7</td>
<td>9,825.3</td>
</tr>
</tbody>
</table>

*Gross Income, less expenses strictly necessary in earning income.

†Includes Bachelor Tax of 25s. (£1.25) in each case.

The percentage of net Business Income absorbed in paying income tax is set out in the following table:

## Percentage of Business Income Paid in Tax — Unmarried Taxpayers, 1928, PERCENTAGE OF INCOME REQUIRED TO PAY TAX

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>200</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>2.1</td>
<td>0.7</td>
<td>1.3</td>
<td>0.7</td>
<td>—</td>
</tr>
<tr>
<td>250</td>
<td>—</td>
<td>0.4</td>
<td>—</td>
<td>2.3</td>
<td>0.8</td>
<td>1.4</td>
<td>0.8</td>
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</tr>
<tr>
<td>300</td>
<td>—</td>
<td>0.6</td>
<td>0.6</td>
<td>2.5</td>
<td>0.9</td>
<td>1.6</td>
<td>1.0</td>
<td>—</td>
</tr>
<tr>
<td>400</td>
<td>0.9</td>
<td>0.9</td>
<td>1.5</td>
<td>2.8</td>
<td>1.1</td>
<td>1.9</td>
<td>1.5</td>
<td>0.5</td>
</tr>
<tr>
<td>500</td>
<td>1.5</td>
<td>1.1</td>
<td>2.4</td>
<td>3.2</td>
<td>1.3</td>
<td>2.0</td>
<td>1.9</td>
<td>1.0</td>
</tr>
<tr>
<td>600</td>
<td>1.9</td>
<td>2.4</td>
<td>3.3</td>
<td>3.5</td>
<td>1.5</td>
<td>2.2</td>
<td>2.5</td>
<td>1.4</td>
</tr>
<tr>
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<td>2.5</td>
<td>4.7</td>
<td>4.0</td>
<td>1.9</td>
<td>2.5</td>
<td>3.0</td>
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</tr>
<tr>
<td>1,000</td>
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<td>2.8</td>
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<tr>
<td>1,200</td>
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<td>6.6</td>
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<td>3.1</td>
<td>3.9</td>
<td>3.4</td>
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<tr>
<td>1,500</td>
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<td>3.3</td>
<td>3.6</td>
<td>4.5</td>
<td>3.9</td>
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### PERCENTAGE OF INCOME REQUIRED TO PAY TAX (continued)

<table>
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<td>6.2</td>
<td>5.9</td>
<td>7.2</td>
<td>6.4</td>
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<td>4,000</td>
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<td>7.2</td>
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<td>7.7</td>
<td>12.1</td>
<td>24.6</td>
</tr>
</tbody>
</table>

#### A Uniform Basis for State Income Taxation

It appears from the preceding pages that the State income taxes differ very greatly from one another in almost every respect. The differences in the interpretation of the term 'income' are considerable, but these are largely a legal question which has not been touched on here. But even when net income is determined there is no uniform procedure in discrimination, both as to the source of income, and between married and single taxpayers, in allowance for dependants, in concessional deductions of many different kinds, as well as in the whole system of graduation, and very wide differences between the States have been exhibited.

It will readily be agreed that in the States of the Australian Commonwealth, with interstate free trade and practical uniformity in wages and industrial conditions, taxation also should be as uniform as possible. The differing conditions of the States — the past they have inherited, the future for which they are preparing — of necessity involves the raising of different amounts per head by taxation. Further even when the same revenue per head is required, the great difference in taxable capacity involves, of necessity, different rates of tax. That necessity, however regrettable, must be recognised. Changing conditions again require different revenues for the same State, and the income tax, as the most powerful and flexible fiscal instrument, must respond to the changing needs. But there seems no reason why this difference of need should not be expressed in terms of one single income tax scheme. The federal income [tax] has been varied up and down, between the limits of the original tax and one 70 per cent greater, to meet the changing needs of federal finance. Similarly, a single tax might serve all the States and the Commonwealth as well.

Let us suppose that the original federal income tax of 1915 be taken as the basis. It can be reckoned with fair accuracy how much revenue it will produce in each State and for the Commonwealth as a whole.
The only technical difficulty is the allotment of central office assessments to individual States. Allotment in proportion with State office assessments would not introduce any serious error, but if greater accuracy were desired there would be no difficulty and no prohibitive expense in making an analysis of central office collections for one year and using the resulting proportions as the basis for the next five or ten years. The federal government decides that it requires (say) 110 per cent of the whole basic tax for its own needs, Victoria requires 70 per cent of the Victorian basic tax, Queensland 130 per cent of the Queensland basic tax, and so on. Then from a single income tax return, on one assessment, by one taxing authority, 180 per cent of the basic tax would be collected in Victoria, 240 per cent in Queensland, and so on; and the proceeds would be allotted between the Commonwealth and the respective States in proportion to these stated requirements. The original federal tax is taken as the basic tax for the purpose of illustration. But it probably satisfies general opinion sufficiently well to form at least a basis of discussion for a uniform scheme. Probably the original federal tax, with slight modifications in the matter of exemptions, abatements, and concessional deductions, would be fairly acceptable to every State. Is voluntary agreement possible? Agreement was reached last year on the much more difficult and involved questions covered by the [Financial] Agreement between the States and the Commonwealth. Is it not time that an attempt was made by the same means to get a uniform income tax?
We always learn something from adversity. Times of national adversity seem particularly efficient in teaching us new methods in public finance, and no great war or crisis occurs without leaving behind it some new method of collecting revenue. The present crisis has given Australia the sales tax, the wages tax and a new method of collecting income taxation at the source, the latter as yet only tried by one State. The war made treasurers turn to the high incomes for further revenue; now that high incomes are dwindling, they are looking to the lower incomes for the additional support required to retain their precarious balance.

The superior taxing powers of the Commonwealth government have made it difficult for the Australian State governments to touch the lower incomes, which are naturally best taxed through commodity taxes; taxation of expenditure seems for the time being to have reached its limits. There remain to the State governments only such things as amusement duties and lottery taxes which are not very prolific in times of depression. The State governments therefore have to get what they can out of the income tax and the wages tax.

But it is generally recognised that the wages tax has little to recommend it apart from the fact that it brings in revenue. It is difficult to graduate, and can have none of the refinements in test of

‘ability’ so well known in the income tax. A man with six children to keep will pay the same as a single man earning the same income, and if the tax is crudely graduated, as it is in Victoria and Tasmania, a wharf labourer earning £9 in one week and nothing for the next two will pay more than a man earning £3 per week in regular employment.

The income tax is therefore much preferable, but there is always a difficulty in collecting it on small incomes. The process is expensive, and there is also the factor that the small power to carry-over possessed by the small income earner makes it difficult for him to pay.

The proposal to collect income tax in weekly or monthly instalments by way of stamps is not new, but nowhere has it been very satisfactory on account of the difficulty experienced in allowing for graduation and exemptions. South Australia seems, however, to have found a method whereby the tax can be collected in instalments, and allowance at the same time be made for all the factors taken into consideration in an ordinary income tax.

The system was forced upon the State by the extraordinarily high rates of taxation imposed in 1930. Many tax-payers found it impossible to pay in a lump sum, and the taxation department was forced to accept payments by instalments. Sufficient general authority for this was given in the Taxation Acts of 1927-30. To meet the situation the department authorised the formation of ‘group schemes’, through which employees in an establishment remitted periodically instalments of their income tax through a representative.

Impressed by the success of these group schemes, and by the advantages to the Treasury of being able to collect income tax evenly throughout the financial year, the government introduced a comprehensive scheme, worked out by the Commissioner of Taxation, by which income tax payable by employees could be collected at the source. The group schemes were retained, and are in operation in government offices and in a number of large private business houses. Where groups are not organized, the employer is required to deduct 5 per cent from the cash payment in excess of 10s. [£0.5] to the employee, and to issue to the employee tax stamps corresponding in value to the amount deducted. These tax stamps are held by the employee, until he obtains stamps of sufficient value to meet his income tax assessment for the previous year. The assessment is issued in the ordinary way, and provides for the usual concessional deductions enjoyed by other taxpayers.

If the employee, through previous unemployment or for some other reason, has not obtained sufficient stamps by 31 May to meet his tax, he is required to pay the balance in cash by 14 June, otherwise interest is chargeable. Where, on the other hand, the employee had no taxable income in the previous year, he may apply to the taxation depart-
Collecting Income Tax at the Source

ment for a certificate of exemption, which acts as an authority to the employer to pay him his wages or salary in full. Such an exemption is not given if the taxpayer owes any taxation for previous years. Further, if the taxpayer can at any time produce sufficient stamps to cover his assessment, he is given a certificate of exemption for the balance of the year.

In respect of employees in government offices or in establishments where group schemes are in operation, the deduction is made on the pay sheets, and a cheque equal to the aggregate deductions is sent monthly to the taxation department. These deductions cease when sufficient has been paid in to meet the tax assessed. In case of overpayments a refund is made.

Taxpayers deriving their incomes from other sources than salaries or wages may make arrangements with the department before 30 November to pay similarly in instalments up to 15 June; otherwise their tax becomes due 30 days after the issue of assessment. This also applies to Commonwealth employees, who cannot be brought under the provisions of the Act on account of the provisions of the Commonwealth Financial Emergency Act, 1931.

Experience so far seems to show that the scheme is an unqualified success. Its success in providing a more regular flow of revenue may be measured by the fact that on 30 April this year 85 per cent of the estimated total yield of the income tax had been collected, as compared with a collection of 67 per cent at the same date in 1931. The reason is that all employees and a great many other taxpayers commence their payments right at the beginning of the financial year, and will in many cases have paid their full tax by the time they get their assessments. There is a definite benefit to the Treasury in this early revenue, in that it helps to save interest on overdrafts, and it is particularly welcome at a time when bankers are viewing government overdrafts with growing disfavour.

The scheme has shown another rather unexpected advantage to the Treasury in that it has stopped a great deal of evasion. This arises from the necessity for employees to obtain a certificate of exemption from the taxation department as an alternative to the automatic deduction of 5 per cent of income. Whenever an employee seeks such a certificate the department carefully checks his past returns, and in numbers of cases it has been found that a person has failed to submit returns for years past. Some cases are known of taxpayers preferring to continue having deductions made the year round to an unpleasant interview with the taxation authorities. But if the scheme lasts, and there is every indication that it will, this procedure will only postpone the evil day, unless the taxpayer concerned is prepared to make a substantial sacrifice.
There is naturally some extra cost of collection, of which it has been impossible to get an estimate, but it is quite certain that the extra cost is trivial compared to the additional revenue collected.

The scheme is still in its infancy, but the general feeling in South Australia is one of satisfaction, on the part of both the government and the taxpayers. It suits the great majority of taxpayers, who find a difficulty in paying the heavy tax in one lump sum at 30 days' notice, which, owing to the frailty of human nature, always seems far too short. To put it briefly, the method has given our most important direct tax the feature that has always made indirect taxes so dear to the hearts of financiers: the feature of causing the minimum 'feeling of hurt' to the victim.
General

1. The Committee recommends that for the duration of the war and for one year afterwards, the Commonwealth should be the sole taxation authority in the field of income tax.

2. A scheme of uniform income taxation imposed by the Commonwealth should operate from 1st July, 1942, in respect of the income year 1941-2, and the States should be compensated on retiring from the field of income taxation.

3. The Commonwealth should, after 30th June, 1942, administer the income tax laws of the States for the completion of assessments and the collection of arrears in respect of income years prior to 1941-2.

4. The Committee is impressed with the urgency of this reform particularly under war conditions. The expeditious and effective raising of revenue assumes greater importance during a period of national crisis. Income tax is the main source of revenue from which the Commonwealth finances war expenditure and that source is limited. The Commonwealth, therefore, should not be hampered by State laws which prevent the fullest exercise of taxation powers essential to the nation at war. The presence in the field of six States imposing eleven taxes on income at widely differing rates restricts the

power of the Commonwealth in raising revenue from income taxation.

5. The varying rates and conflicting principles of taxation applied throughout the States create anomalies that operate to the detriment of Commonwealth revenue and to the confusion of taxpayers . . .

6. A striking example is that under the present system rates of taxation could rise above 20s. in the £1 for many taxpayers but for the fact that State taxes paid in the previous year are allowed as a deduction in determining federal taxable income.

7. Despite this provision total taxes payable can still rise above 20s. in the £1 [100 per cent] in the case where the State tax paid in the previous year is appreciably less than State tax payable, because the taxpayer's income or the effective rates of State taxation have increased. Some alleviation of high rates of taxation is given by the provision in the Federal Act that the combined rate of Commonwealth and State taxes shall not exceed 18s. in the £1 [90 per cent].

8. Even this provision is not fully effective, partly because it has not been adopted by the States, and partly because it only applies to the rate over the whole of the income, and not to the rate on the highest part of the income on which taxpayers may still pay more than 20s. in the £1.

9. This and other difficulties can best be overcome by a single uniform taxation system administered by the Commonwealth.

10. The Committee attaches importance to the growing need for simplification of income taxation throughout the Commonwealth. Despite past achievements in the direction of uniformity there is still overlapping and insufficient co-ordination between the Commonwealth and States and the Committee considers that a sole taxation authority opens the way to more simple and efficient machinery for the raising of revenue.

11. By these means the nation's war effort will benefit from substantial economies in manpower, money and materials. It is estimated that when a uniform scheme of income taxation is in full operation, a reduction in staffs of Taxation Departments of the order of 30 per cent — or 1,000 men — would be possible, and a salary saving to governments of £250,000 annually, apart from reductions in the other general costs of taxation administration. To the number of government officers released is to be added staff similarly released from their occupations in private enterprise. No reform in taxation administration short of the introduction of a uniform system would produce savings on such a scale. Manpower set free in this way is for the most part highly skilled and much of it could, with advantage, be absorbed in activities more directly concerned with the war.
Basis for Compensation

12. The Committee in selecting a basis for compensation which would be equitable as between the Commonwealth and the States, paid particular attention to the relative needs for revenue of the Commonwealth and the States in war-time and to the existing financial arrangements in the States.

13. One basis considered and rejected was the estimated collection of State taxes on income for the year 1941-2. The reasons for rejecting this basis are —

(1) The scheme is intended to operate in the year 1942-3 and will have no effect on State budgets for 1941-2, and, in any case, estimates of revenue are no safe guide to collections which may exceed or fall short of expectations.

(2) The general upward movement in State revenues from income taxation is due largely to war expenditure by the Commonwealth, while the need for State expenditure upon unemployment has been substantially reduced.

(3) To choose the estimates of 1941-2 as the basis would stereotype an unduly high figure of State revenue which might adversely affect the relative future needs of Commonwealth and States.

14. The basis finally adopted by the Committee for its recommendation is the average of State collections from taxes on income in the two war-time financial years 1939-40 and 1940-41. Although certain States were in deficit in these years the Committee considered that the rising trend of revenue and the reduction of State expenditure already indicated should avoid a repetition of deficits in 1942-3.

15. The apparent disproportion in the proposed compensation to different States arises from the extent to which States have used income taxation as a source of revenue and from the desire of the Committee to leave existing financial arrangements in the States substantially undisturbed.

Compensation

16. The Committee recommends that the compensation to be paid to each State in 1942-3 should be the amounts set out below less the saving to each State in costs of administration and collection brought about through the introduction of the scheme.

<table>
<thead>
<tr>
<th>State</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>£15,991,000</td>
</tr>
<tr>
<td>Victoria</td>
<td>£6,666,000</td>
</tr>
<tr>
<td>Queensland</td>
<td>£5,982,000</td>
</tr>
<tr>
<td>South Australia</td>
<td>£2,417,000</td>
</tr>
<tr>
<td>Western Australia</td>
<td>£2,576,000</td>
</tr>
<tr>
<td>Tasmania</td>
<td>£823,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£34,455,000</strong></td>
</tr>
</tbody>
</table>
17. The saving in costs of administration and collection should be determined by agreement with each State. The estimated cost to the States in 1941-2 is as follows:—

<table>
<thead>
<tr>
<th>State</th>
<th>Cost (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>208,000</td>
</tr>
<tr>
<td>Victoria</td>
<td>119,000</td>
</tr>
<tr>
<td>Queensland</td>
<td>161,000</td>
</tr>
<tr>
<td>South Australia</td>
<td>48,000</td>
</tr>
<tr>
<td>Western Australia</td>
<td>53,000</td>
</tr>
<tr>
<td>Tasmania</td>
<td>12,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>601,000</strong></td>
</tr>
</tbody>
</table>

18. The Committee considers that the compensation recommended should be adopted for 1942-3 and for subsequent financial years during the currency of the scheme. To preserve flexibility, however, the Committee recommends that the following formula should be adopted:—

1. A State may submit a claim to the Commonwealth that its financial circumstances are such as to warrant an increase in the amount of compensation for any financial year subsequent to 1942-3.

2. The Commonwealth may claim that the compensation to any State for any financial year should be reduced on the ground that the Commonwealth has relieved the State of responsibility for an existing service provided by that State.

3. Any such claim shall be referred by the Commonwealth to an independent authority for investigation and report, and the Commonwealth shall, after receiving the report, decide on any appropriate variation of the amount of compensation.

**Arrears of State Income Taxation**

19. The arrears of State income taxation outstanding at the commencement of uniform taxation as well as assessments of State income taxation made during its currency in respect of income years prior to 1941-2 should be collected by the Commonwealth on behalf of the States and, after deducting cost of collection, should be held as war loan until the cessation of the scheme.

**A Uniform System of Taxation**

20. The Committee felt that its recommendation for a uniform income tax would be incomplete without some reference to the principal considerations that should condition the new system.
21. It would be unrealistic to make proposals that entirely disregarded past financial history. At the same time, it is clear that if the new system is to be uniform it must be very different from the old. It must replace a range of present Commonwealth and State taxes on income.

22. The new system should be capable of raising the same total revenue as the old system under comparable conditions. Revenues that are lost as a result of the change must be replaced by revenues that are produced by the change.

23. If, during the currency of the scheme, the Government decides to increase or to reduce revenues from income taxation this can be done by a general adjustment of the rates.

24. The new system should apply only to those income groups at present within the field of federal income taxation. It is not proposed that all those at present liable to State income tax will necessarily become liable under the uniform system nor that those incomes or income receivers now exempt from State taxation will remain exempt. If, at a later stage, it were desired to include or to exclude any income group that would be a matter of Government policy.

25. No attempt should be made to follow the current practice of any State or any average practice. That would defeat the object of uniformity. The present lack of uniformity is one of the defects to be cured and to condemn the uniform tax system because it did not conform to the practice of any one State, or to the average of all, would be to defend the very state of affairs which it is proposed to remedy. Practice varies so greatly that any attempt to discover an average practice at different ranges of incomes would produce an entirely illusory result.

26. Nevertheless, to arrive at what is considered to be a fair and reasonable system, the Committee made constant reference to the amounts payable in different States by individuals with similar incomes. At times comparison has been made between the proposed new rate on a given income and the present combined rate of Commonwealth and State taxes in the highest and the lowest taxed State at that range.

27. The Committee emphatically rejects the view that the new system can be tested satisfactorily simply by comparing what a given individual will pay with the amount he would have to pay at present in any selected State. Such comparisons merely disclose the inequalities of the present system.

28. The Committee has not attempted to recommend more than the minimum change necessary to introduce a workable uniform system. This explains the recommendations on company taxation. The Committee examined various proposals for recasting the whole structure of
company taxation but refrained from reporting upon these especially as another committee is preparing a report upon certain relevant aspects.

29. The removal of complexities and anomalies, however, involves alterations to the income tax system in certain directions. It is not to be expected that these will operate to the immediate financial advantage of every taxpayer particularly under present conditions. Moreover, it is inevitable that the advantage of uniformity cannot at its initiation, be equally distributed amongst the taxpayers throughout Australia. This is but another proof that the present system is chaotic and anomalous and should, in the public interest, be superseded.

30. The Committee, in accordance with these considerations, recommends that the uniform income tax to be imposed under the scheme should incorporate the proposals set out below. The rates of tax proposed illustrate how uniform taxation can be applied to raise the same amount of revenue as is now raised by the Commonwealth and States. Where the Committee has made no contrary recommendation it is expected that the practice of the Federal Income Tax Assessment Act will apply.

**Deduction of State Income Taxes**

31. Under a uniform tax the provision for deduction of State income taxes paid in the year of income would disappear but that has been taken into consideration in determining the rates. If a taxpayer has not received a deduction from federal taxable income for State income taxes paid in respect of assessment years prior to 1941-2, the Committee recommends that, when the State taxes are paid, the federal assessment for the appropriate year should be amended to allow for the deduction.

**Income from Gold-mining**

32. The Committee recommends that the operation of the Commonwealth Gold Tax should be suspended for the duration of the scheme of uniform taxation. This tax and State taxes on income from gold-mining should be replaced by imposing ordinary income tax on profits and dividends from gold-mining. Companies should be assessed in a similar way to other metalliferous mining companies. As this will produce approximately the same amount of revenue as is now raised from this source by Commonwealth and State taxation, gold-mining companies should not be liable to War-time (Company) Tax, Super Tax or Undistributed Profits Tax.
Individuals

33. The proposals for a uniform income tax on individuals are set out in detail in Appendix 'B' [not reproduced].

34. It is assumed that the range and amount of concessional allowances under the present Federal Law will be continued for the uniform scheme, but in order to blend the varying provisions of the Commonwealth income tax and war tax and the State taxes on income, the Committee makes the following recommendations.

35. The allowance for dependants as defined in the Federal Income Tax Assessment Act should be —

<table>
<thead>
<tr>
<th>Allowance</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spouse or Female Relative</td>
<td>100</td>
</tr>
<tr>
<td>Mother</td>
<td>100</td>
</tr>
<tr>
<td>First Child</td>
<td>75</td>
</tr>
<tr>
<td>Children in excess of one</td>
<td>30</td>
</tr>
</tbody>
</table>

36. In regard to all dependants, however, the value of the allowance should not exceed the maximum amount that would be allowed under the existing law.

37. All concessional allowances should, in future, be made by means of a rebate of tax calculated on the allowance at the taxpayer's personal exertion rate instead of a deduction from his taxable income as at present.

38. The Committee recommends that, in order to provide a uniform tax on companies, which it is advised will yield the present Commonwealth and State revenue, the Federal War-time (Company) Tax, Super Tax and Undistributed Profits Tax be continued at present rates, and that the rate of ordinary Federal Income Tax be increased to 6s. in the £ [30 per cent]. By this means a uniform system of company taxation can be introduced with minimum change.

39. The Committee recommends that the present deduction of 4 per cent on calculated liabilities allowed to Life Assurance Companies under Section 115 of the Federal Income Tax Assessment Act should be repealed.

40. As this change will render taxable a large amount of income that is now exempt for federal taxation, the Committee proposes that the rate of tax for Life Assurance Companies be fixed at 1s. 6d. in the £1 [7½ per cent] on income from mutual business. Income from non-mutual business should be taxed at the same rates as those imposed on other companies. These rates are calculated to produce approximately the same amount of revenue as is now raised from this source by Commonwealth and State taxation.

Estimated Taxation Yield

41. The Committee has obtained estimates of the yield for a full
assessment of all Commonwealth and State income taxation at the rates now in force and estimates of the yield from the proposed taxation.

<table>
<thead>
<tr>
<th>Estimated Yield of Present Taxes</th>
<th>Estimated Yield of Proposed Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>£m.</td>
<td>£m.</td>
</tr>
<tr>
<td>Individuals —</td>
<td></td>
</tr>
<tr>
<td>Under £400</td>
<td>22.5</td>
</tr>
<tr>
<td>£401-£1,000</td>
<td>21.5</td>
</tr>
<tr>
<td>Over £1,000</td>
<td>40.5</td>
</tr>
<tr>
<td>Total</td>
<td>84.5</td>
</tr>
<tr>
<td>Companies (excluding gold-mining)</td>
<td></td>
</tr>
<tr>
<td>Commonwealth Gold Tax</td>
<td>1.3</td>
</tr>
<tr>
<td>Income from gold-mining</td>
<td>.4</td>
</tr>
<tr>
<td>Grand Total</td>
<td>130.7</td>
</tr>
</tbody>
</table>

Elimination of Pence

42. To reduce the work involved in the assessment of more than a million returns and to eliminate the handling of pence in the collection of income tax, it is recommended that, in future, the tax payable and the rebates be calculated in each case to the nearest shilling.

Method of Introducing the Change

43. The Committee has conferred with the Solicitor-General on constitutional aspects of the proposed change. It recommends that the Commonwealth should impose a uniform income tax which will raise approximately the same amount of revenue as the existing Commonwealth and State taxes upon income, giving this tax priority over any form of State taxation on income of every company and/or individual liable to the tax.

44. At the same time, the Commonwealth should pay to each State which retires from the field of income taxation for the duration of the war and one year after, the amount of compensation set out above.

45. The Committee recommends that the operation of the Australian Capital Territory Hospital Tax and the Northern Territory Income Tax and Medical Benefits Tax should be suspended for the duration of the scheme.
46. As from 1st July, 1942, such officers of the taxation administrations in the States as are required, during the currency of the scheme, should be seconded to the Commonwealth Public Service.

**Other Taxes and Social Services**

47. Although its terms of reference do not go beyond income taxation, the Committee wishes to offer some observations on two other matters:—

(1) If, during the war, the Commonwealth finds it necessary to enter a field of taxation at present occupied by the States, such, e.g., as entertainments tax, the Committee is of opinion that it would be desirable to adopt a scheme similar to that proposed for income taxation, viz., that the Commonwealth should be the sole taxing authority and that the States should be compensated for the resulting loss of income.

(2) If, during the war, the Commonwealth should decide to provide uniformly for the whole of Australia a social service provided at present by some or all of the States, such, e.g., as widows' pensions, the Commonwealth should use the machinery set out earlier in the report to effect a reasonable reduction from the income tax compensation paid to those States relieved from the cost of providing such a service.

**Conclusion**

48. The Committee desires to thank the Commissioner of Taxation and members of his staff for help given during the course of the inquiry, and to express its appreciation of the valuable and efficient assistance provided by Mr. H. P. Brown, B.A. (Hons) of the Bureau of Census and Statistics, who acted as Secretary to the Committee.

(Sgd.) R. C. MILLS, Chairman.
(Sgd.) J. H. SCULLIN.¹
(Sgd.) E. S. SPOONER.²

28th March, 1942.

**Notes**

1  [Scullin, J. H. (1876-1953), M.H.R.; formerly Leader of Australian Labor Party, and Prime Minister 1929-31.]

2  [Spooner, E. S. (1897-1952), M.H.R.; formerly Minister for War Organisation of Industry, and later Senator and Minister for Social Services and Natural Development.]
Uniform Taxation

Though one of the most 'austere' documents in Australian economic history in its sparing use of words and its avoidance of ethical criteria, the report made by the Committee on Uniform Taxation on 28 March may yet come to rank as one of the most far-reaching in its effects. The Committee's recommendation that 'for the duration of the war and one year afterwards, the Commonwealth should be the sole taxation authority in the field of income tax', together with its detailed proposals to this end, were given substantial effect when on 7 June the States Grants (Income Tax Reimbursement) Act, the Income Tax (War-time Arrangements) Act, the Income Tax Assessment Act, and the Income Tax Act became law. The Commonwealth is to collect in 1942-43 income taxation at rates equivalent to the combined Commonwealth and State rates in the latter half of 1941-42, taking approximately the same total amount as before from each of the three income groups, under £400, £401-£1,000, and over £1,000, plus a small additional sum due to an expected increase in the national income. Each State which voluntarily retires from the income tax field until one year after the war is to be given annual compensation equal to the average of its income tax collections for the years 1939-40 and 1940-41, while if any State retains its own income taxation, Common-
Fiscal Federalism

Wealth collections are to have priority over State collections. The Commonwealth cannot under the Constitution directly compel the States to withdraw from the income tax field, but this legislation indirectly compels them to do so. Provision is made whereby the Treasurer of any State which feels that its grant is 'insufficient to meet the revenue requirements of the State' may inform the Commonwealth Grants Commission which shall inquire into and report 'as to whether it is just that an additional amount of financial assistance should be payable to that State.' In addition, State taxation officers, office equipment and relevant records are to be taken over by the Commonwealth. Moreover, apart from the introduction of new taxation rates and the abolition of deductions for State tax paid, necessitated by the amalgamation of Commonwealth and State income taxes, some other alterations in the method of assessment have been made, the most important of these being the substitution of concessional rebates for concessional deductions.

Victoria, Queensland, South Australia and Western Australia challenged the constitutional validity of the legislation before the High Court of Australia, but judgment was given for the Commonwealth, though by majority decision only in the case of the States Grants Act and War-time Arrangements Act.

Simplification of the Tax System

The history of efforts to secure taxation uniformity is a long one. All the States had income taxes by 1907, and when the Commonwealth entered this field in 1915, Commonwealth and State offices, operating independently, collected income taxes from what were often the same people on the same incomes. The administrative duplication and the complications arising from the existence of very different Commonwealth and State Acts led to several conferences, a Board of Inquiry, and a Royal Commission, all of which sought to devise means of achieving uniformity and simplification. Much administrative duplication was eliminated by an agreement in 1920 which provided that the Commonwealth should collect both its own and Western Australian income taxes, and agreements with the other States in 1923, arranging for these States to collect both their own and Commonwealth taxes except when a taxpayer earned income in more than one State, when the Commonwealth would collect its own tax. This simplification of administration, when considered with the discussions which led to it, may be regarded as a first small step in the direction of uniformity.

However, even before the Commonwealth entered the income tax field, the State income taxes themselves were uneasy bedfellows.
Debtor States usually begin by taxing according to sources of income, and creditor States according to residence, and as debtors the States first taxed entirely according to source. But this meant that a taxpayer earning income in more than one State paid in each State only the rate of tax appropriate to his income in that State, instead of the higher rate appropriate to his total income, and that a taxpayer resident in a State paid no taxation within that State on income earned outside it. Reluctant to lose revenue in these ways, the States adopted an arbitrary basis of apportionment which frequently led to the sum of an individual’s or company’s taxable income in the States differing from the taxable income for Australia as a whole, and some States added the basis of residence to that of source by taxing some classes of taxpayer on incomes earned in other States, and allowing rebates for taxes paid in other States. In the latter case a series of alternate rebates and amended assessments might prevent a taxpayer being quit of the tax on his year’s income for three or four years.

The confusion was great enough when each State levied only one tax. But in the Depression not only did each State, except South Australia, levy at least one additional tax on income, but in some States liability for the special tax was on the basis of residence, while liability for the ordinary tax remained on the basis of source. And in some cases rebates of special tax could only be made against special tax, and the rebates of ordinary tax against ordinary tax.

When the Commonwealth entered the income tax field, it taxed on the basis of source under its own definition of taxable income, and allowed State tax as a deduction from Federal taxable income, some States reciprocating by allowing Federal tax as a deduction.

At the height of the confusion in 1935, some taxpayers were paying as many as fourteen different income taxes, and receiving as many as a dozen rebates in the following year. The number of separate taxes was even greater.

Before this, it had become evident that some effort to create order should be made. The first step was through reciprocal agreements, whereby residents of, say, New South Wales earning income in, say, Victoria would be treated in the same way as residents in Victoria earning income in New South Wales. But these agreements were entered into by States in pairs, and not all States participated, with the result that whereas formerly a resident of, say, Victoria was treated with reasonable conformity in respect to all dividends received from other States, his dividends from reciprocating States were now treated differently from those in other States. Thus, although the agreements removed some anomalies, they did not make for simplification.

While some of these reciprocal agreements were being made, the Commonwealth government appointed a Royal Commission on
Taxation to examine the existing Commonwealth and State income and other taxation, and report on how a more uniform basis of assessment might be achieved. The final report of this Commission was received in 1934 and on the basis of its recommendations a taxation Bill was drawn up which, if adopted, would mean that each State would have an identical assessment Act. The amount of taxable income would then have been determined under a similar Act in each State, and the income of taxpayers operating in more than one State would be distributed between the States on various arbitrary bases which would ensure that the sum of State taxable incomes would not exceed the total income.

The proposed Bill was thoroughly explored at a series of conferences and modified until it was reasonably acceptable to all States. As each amendment to a State Act involved some gain or loss of revenue, it was only by a great deal of patient discussion that a reasonable compromise could be achieved. Thus, under the proposed Bill, Western Australia lost practically all its revenue from interstate shipping, but gained greatly on the taxation of trading banks. However, agreement was ultimately reached, and after some amendment by the seven Parliaments the Bill, still substantially uniform, was passed and applied to the 1936-37 assessment. Great simplification and some reduction of anomalies was thereby achieved. But much more was needed, for the uniform tax Act applied only to the seven ordinary taxes and not to the special taxes. And as time went on amendments were made and some of the advantages gained disappeared.

The special taxes were the next object of attack in the struggle for uniformity, and Western Australia led the way by abolishing the Financial Emergency Tax in 1940-41, while in 1941-42 Tasmania abolished the Special Tax and New South Wales the Unemployment Relief and Social Service Tax. But some special taxes remained. Moreover, by imposing its War Tax in December, 1941, the Commonwealth added a new one, and so the net gain in simplification was not great.

When the Committee on Uniform Taxation presented its report in March, 1942, there were twenty-six separate Commonwealth and State income taxes, and as a result of the adoption of uniform taxation this number has now been reduced to five. The moderate simplification painfully achieved and precariously held by the States was thus small compared with the great simplification gained at one stroke by uniform taxation. Business and industry generally, as well as private individuals, will benefit greatly, and simplification must be accounted one of the major gains resulting from uniform taxation.
Should the old Commonwealth-State income tax system be reinstated after the war it is possible that the States might continue at an accelerated rate their old progress towards uniformity, and so the advantages of uniform taxation be partly retained. But many will doubt, and unless a strong move develops for retention of States' rights, there will be solid support for continuance of uniform taxation on the ground of simplification alone.

Aid to War Finance

The adoption of uniform taxation must be viewed against this background of a long struggle for reform. Nevertheless, it was not the need for reform as such but the more immediately pressing needs of war finance which actually brought about uniformity.

The growth of Australia's war expenditure is shown in the following table:

Table I

<table>
<thead>
<tr>
<th>Year</th>
<th>Defence and War Expenditure</th>
<th>Total Federal Income Tax Collections</th>
<th>War Expenditure from Revenue</th>
<th>Money National Income Produced</th>
<th>War Expenditure as Percentage of National Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a)</td>
<td>(b)</td>
<td>(a)</td>
<td>(c)</td>
<td>%</td>
</tr>
<tr>
<td>1938-39</td>
<td>14</td>
<td>12</td>
<td>9</td>
<td>788</td>
<td>2</td>
</tr>
<tr>
<td>1939-40</td>
<td>56</td>
<td>16</td>
<td>24</td>
<td>863</td>
<td>6</td>
</tr>
<tr>
<td>1940-41</td>
<td>171</td>
<td>43</td>
<td>65</td>
<td>925</td>
<td>18</td>
</tr>
<tr>
<td>1941-42</td>
<td>320</td>
<td>78</td>
<td>109</td>
<td>1,000(?)</td>
<td>32(?)</td>
</tr>
<tr>
<td>1942-43</td>
<td>441</td>
<td>106</td>
<td>140</td>
<td>1,000(?)</td>
<td>40(?)</td>
</tr>
</tbody>
</table>

(a) Source: Commonwealth Budget Papers.
(b) Source: Commonwealth Budget Papers. Includes collections for both civil and war purposes, but excludes for 1942-43 collection of £27m to pay uniform taxation compensation to the States.
(c) Source: 1938-39 to 1941-42 Commonwealth Budget speeches; 1942-43 my own estimate.

In its desire to use income taxation as one means of meeting this growing burden, the Commonwealth early felt hampered by State income taxation. Each State levied its own rates of tax on each income group, and thus for the 1940-41 assessment year the combined Commonwealth-State taxation on an income of £200 for a person without dependants was £7 8s. [£7.4] in Queensland and £18 2s. [£18.1] in South Australia; on £500 it was £76 7s. [£76.35] in Victoria and £105 3s. [£105.15] in South Australia; on £1,000 it was £244 9s. [£244.45] in Victoria and £282 2s. [£282.1] in Queensland; and on
Fiscal Federalism

£10,000 it was £7,660 in Victoria and £8,209 in Queensland. The imposition by the Commonwealth of higher rates which could reasonably be applied to the lower taxed States might cause severe hardship on individuals in higher taxed States, and the Commonwealth's power to increase taxation on any particular income group was therefore limited by the rates obtaining in the highest taxed State.

Further, high Commonwealth rates added to the State rates could mean taxation of over 20s. in the £ [100 per cent]. As State taxation paid was allowed as a deduction by the Commonwealth in assessing the taxable income of an individual or company this would not normally happen. But if either State taxation or the taxpayer's income increased from one year to another, the value of the deduction would be less than State taxation payable in the later year. Marginal tax on high incomes could then be above 20s. in the £, while if incomes or State taxes increased very greatly the average tax over the whole income might be over 20s. in the £. An attempt by the Commonwealth to meet the situation by offering to forgo its proportion of any excess over 18s. in the £ [90 per cent] only partly solved the problem because the States were unwilling to forgo their proportion, but the arrangement would have been unsatisfactory in any case because it applied only to the average tax and not to the marginal tax. With these anomalies even retention of the 1941-42 rates would have been difficult, and an increase in the rates probably politically or economically impossible.

Another consideration was that State income tax collections had increased from £29.8m in 1938-39 to £35.5m in 1940-41, because of the rise in national income. Railway revenue was also increasing, while unemployment obligations were declining, and it was felt that the States should not have the opportunity to increase expenditure merely because Commonwealth war expenditure had increased their taxable capacity.

The efforts of the Commonwealth government to effect some reform have taken the following course: In the first part of 1941 a 'scheme' was formulated under which the States would cease to levy income tax and would receive compensation of about 10 per cent less than their current collections. This compensation was to be distributed partly on a per capita basis and partly in such way as the States might agree. These broad proposals were submitted to a Premiers' Conference in the middle of the year, but were rejected by five States and accepted with reservations by one. They were consequently abandoned.

The next attempt sought to achieve no more than revenue freedom for the Commonwealth. The States were to be left free to levy what tax they chose, while the Commonwealth was to levy a 'national con-
distribution’ from which State taxes would be deducted; and the excess of the balance over the federal income tax was to be held as a post-war credit. Under this scheme the Commonwealth would have been less hampered in its raising of rates, but the complex taxation system would have remained. Parliament rejected the proposal, and a Labor government took office.

Leaders of the Labor Party had for some time been convinced that uniform taxation could be achieved more directly by means of legislation, and in February this year [1942] the Committee on Uniform Taxation was appointed to consider the question. The Committee reported in essence that the scheme proposed in outline in the previous year should be adopted, though the basis of compensation was altered. Once again the proposal was rejected by the State Premiers — this time unanimously — but despite this rejection the uniform taxation measures detailed above were passed by the Commonwealth Parliament, and the States had little choice but to surrender the right to levy income taxes until one year after the war.

In addition to increasing the Commonwealth’s power to raise income tax, uniform taxation is expected to release 1,000 men from taxation departments and to save some £250,000 in salaries annually. There should also be a substantial saving of manpower in private enterprise.

The new uniform tax rates apply throughout Australia, and if incomes were unchanged they would yield the same total revenue as the old Commonwealth-State rates. It follows that taxpayers in lower tax States would pay more on the same incomes than before, while taxpayers in the higher tax States would pay less. Thus it has been estimated that on unchanged incomes Victorian taxpayers would pay £3.08m more, Tasmania £0.77m more, South Australia £0.49m more, Western Australia £0.55m less, New South Wales £1.06m less, and Queensland £1.60m less. But each State’s compensation is equivalent to the revenue it formerly collected for itself, and therefore governments of low tax States would receive less than their taxpayers paid, while governments of high tax States would receive more. Some have therefore suggested that per capita compensation to the States would be more equitable. But because the States have different population densities, different age and sex composition, and are at different stages of development, needs are different, and per capita compensation would leave one State with revenue sufficient to do little more than meet its debt charges while another had surplus revenue.

Another criticism arises from the differences in expenditure on social services (excluding child endowment and widows’ pensions now taken over by the Commonwealth), which in 1940-41 varied from £2 10s. 3d. [£2.52] per head in Victoria to £3 6s. 3d. [£3.32] per head
in Western Australia.\textsuperscript{11} The States with lower expenditure on social services claim that it will be difficult for them to raise their services to the level of other States now that the power to impose tax has been taken away from them. However, there is little evidence that the States concerned had any immediate intention of improving social services.

A more valid criticism is that the basis of compensation, apart from the recent addition of entertainment tax to the uniform tax scheme, takes no account of other State taxes. Excluding lottery taxation, the proportion of income and entertainment taxation to total taxation in 1940-41 was: Western Australia 71 per cent, Queensland 70 per cent, New South Wales 70 per cent, South Australia 64 per cent, Tasmania 61 per cent, Victoria 58 per cent.\textsuperscript{12} Of two States with the same tax revenue that State which had relied more on income and entertainment taxes would receive greater compensation.

These criticisms are all based on some principle of equity. But in a total war it becomes increasingly necessary to maintain 'the health and efficiency of the people for the continuance of the war effort.'\textsuperscript{13} The old principles of equity may thus conflict with totality and have to be abandoned or modified. Thus it may be necessary in a total war that individuals in States which have exercised great economy in the past pay the same taxation as those similarly situated in less economical States, while even individuals on the same income may have to be taxed differently if they have different margins between income and essential civil expenditure.

It has been suggested that compulsory savings should have been incorporated in the uniform taxation scheme as a means of treating the low tax States more equitably, and as a means of increasing the contribution of the lower income groups. But compulsory savings have no particular virtue. Equity does not demand them in a total war. Taxation is preferable on higher incomes because it reduces inequality, while compulsory savings are only preferable to taxation on lower incomes if they contribute more to the maintenance of willingness to work — which is doubtful. And the paying back of post-war credits is not the most efficient way of maintaining employment and activity in the post-war period. Taxation is in general superior to borrowing because it leaves no debt to complicate post-war budgets, and does not increase rentier earnings. The Commonwealth government's decision to borrow £300m of the £583m expenditure planned in the 1942-43 budget is therefore to be regretted; but, having decided to borrow, it should be able to do so voluntarily. For though the £300m required this year is much greater than the £133m borrowed from the public last year, increased national income, rationing, and the austerity campaign should assist to make the larger amount available.
Nevertheless, it remains true that there is a strong case for increased taxation, firstly on the higher middle incomes, but moving down towards the lower incomes. Income tax rates were not increased at all in the 1942-43 budget, and thus uniform taxation has so far been used solely to maintain existing rates by the removal of anomalies, and not at all to increase rates. Uniform taxation is still largely a potential rather than an actual aid to war finance.

Federal-State Financial Relations
The appointment of the Commonwealth Grants Commission in 1933, and its development of principles for the making of grants to the financially weaker States, had by 1939 done much to solve the peacetime problem of federal-State financial relations in Australia.14

One of the principal difficulties still outstanding at the outbreak of war was that grants on the basis of budgetary needs did nothing to solve the long-term problem of a State whose relative economic strength was declining and which was losing population to the stronger States in consequence. There was urgent need for the Commonwealth to decide whether it wished this relative decline to continue on economic grounds, or whether it felt that there were cultural and defence advantages in maintaining the weaker States, and to formulate a policy appropriate to its decision. This long-term problem has probably been accentuated for Western Australia and Tasmania by the war.

Of more immediate significance, however, is the effect of the war on the ordinary standard of budgetary needs. In the first place the non-claimant States had in 1940-41 a surplus standard for the first time in the Commission’s history, but the claimant States were only allowed a balanced budget standard instead of the same standard as the non-claimant States.15 If the non-claimant states achieved their surplus standard because of increased taxation the claimant States would under this principle not only lose by having a balanced budget standard applied to them, but would also suffer an additional loss because of their lower relative severity of taxation.

Secondly, there is the effect of uniform taxation, which is likely to make the usual methods of assessing needs difficult to apply. For one of the most important of the indices used, that of taxation severity, will have a more doubtful meaning now that the States are unable to levy any income taxation. The Commission may, therefore, either have to revise its methods radically, or else rely more on broad judgments.

Furthermore, the Commission will have new methods to work out if and when any State, including those hitherto non-claimant, applies for increased compensation under the uniform tax scheme. The Com-
mission will have to decide whether to allow an increase in ordinary expenditure, for example, on social services, or whether such expenditure is to be regarded as pegged for the duration of the war. In view of the paramount needs of war, the Commission may be expected to be cautious in permitting increases in ordinary expenditure, even to reduce inequalities. Increase in needs due to, say, a fall in the value of money or an increase in population, or special needs due to, say, a drought, will doubtless have to be met by increased compensation, and the Commission will have to decide what principles it is to adopt in these cases.

Loss of the power to levy income tax necessarily weakens the financial independence of the States during the war. But though the States were concerned about this they were even more concerned at the possibility that the loss might be permanent, and this latter fear was the main reason why all the States opposed uniform taxation, while four of them challenged the constitutional validity of the legislation. Is the Commonwealth, then, likely to be able to continue uniform taxation in peace-time?

It would seem to follow from the High Court's unanimous declaration of the validity of the Income Tax Act and the Income Tax Assessment Act that even in peace-time the Commonwealth can levy what rates of income tax it likes and that its collections have priority over State collections. But as the Grants Act was declared valid only by a four to one majority there is a slight doubt whether the Commonwealth can, after the war, make a State's retirement from the income tax field a condition for receiving a grant. In the opinion of Professor K. H. Bailey, however, the Grants Act, Assessment Act, and Income Tax Act would all be valid in peace-time, but in any case the Income Tax Act, in conjunction with either the 'priority clause' of the Assessment Act or the Grants Act, would be sufficient to make possible the continuance of uniform taxation, so that even should the Grants Act be declared invalid, uniform taxation could remain in force. The Wartime Arrangements Act, which enables the Commonwealth to take over State taxation personnel, though only declared valid under the Commonwealth's special war-time powers, is not essential for the retention of uniform taxation. It therefore appears probable that it will be constitutional for the Commonwealth to continue uniform taxation in peace-time if it so desires.

Of course, whether Parliament and people will desire its continuance is another matter. If they do not they can always seek a remedy in the political sphere, whatever the constitutional position. But if uniform taxation is retained, the effect will be very far-reaching. At the very least the financial independence of the States
will be greatly impaired, while going further it is at least possible that a unitary system will be substituted for a federal one.

Conclusion
The immediate advantage of uniform taxation is that it aids war finance both by removing anomalies which might have prevented even the maintenance of the present rates of income tax, and by removing important obstacles to rate increases when these are considered necessary. Another gain is the great simplification of the taxation system, and this is an advantage which might well be carried over into peace-time. But in the long run the most important effects may be those associated with federal-State relations. For not only has the problem of federal-State financial relations once again become a live issue, but as we have seen, federation itself may be threatened if uniform taxation is continued permanently. Of course, whether unification is desirable or not is a question to be decided on grounds far wider than any raised in this paper. But that uniform taxation has brought the possibility nearer is certain, and this may prove to be one of its most far-reaching consequences.

Notes

1 The members of the Committee were Professor R. C. Mills, Chairman of the Commonwealth Grants Commission (Chairman); the Rt Hon. J. H. Scullin, M.P., a Labor member; and the Hon. E. S. Spooner, M.P., an Opposition member selected by the Government.


3 Nos. 20, 21, 22 and 23 of 1942.


6 See Report of Committee on Uniform Taxation [Reading XXI above], Appendix B, for further rate comparisons.

7 Marginal tax is the additional tax paid as a result of an increase in income. It is not the incremental rate levied on an additional £ of income, which is really an average rate on excess income.
If in 1939-40 a South Australian taxpayer without dependants earned £1,000, then in 1940-41 he would have paid £112 10s. in State taxation, plus Commonwealth tax. The following table shows what his 1941-42 taxation would have been if his income had increased.

<table>
<thead>
<tr>
<th>Income in 1940-41</th>
<th>State tax paid in 1941-42</th>
<th>State tax paid in 1940-41 as deduction by C'wealth in determining taxable income for ordinary income tax</th>
<th>C'wealth tax paid in 1941-42 on 1940-41 income</th>
<th>Total tax paid in 1941-42 on 1940-41 income</th>
<th>Income remaining after tax paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>1,000</td>
<td>112.5</td>
<td>112.5</td>
<td>153</td>
<td>265.5</td>
<td>734.5</td>
</tr>
<tr>
<td>2,000</td>
<td>275</td>
<td>112.5</td>
<td>629</td>
<td>904</td>
<td>1,096</td>
</tr>
<tr>
<td>2,900</td>
<td>474</td>
<td>112.5</td>
<td>1,321.7</td>
<td>1,795.7</td>
<td>1,104.3</td>
</tr>
<tr>
<td>3,000</td>
<td>487.5</td>
<td>112.5</td>
<td>1,405.5</td>
<td>1,893</td>
<td>1,107</td>
</tr>
<tr>
<td>3,100</td>
<td>511.5</td>
<td>112.5</td>
<td>1,489.2</td>
<td>2,000.7</td>
<td>1,099.3</td>
</tr>
<tr>
<td>4,000</td>
<td>750</td>
<td>112.5</td>
<td>2,243</td>
<td>2,993</td>
<td>1,007</td>
</tr>
<tr>
<td>11,000</td>
<td>2,887.5</td>
<td>112.5</td>
<td>8,105.5</td>
<td>10,993</td>
<td>7</td>
</tr>
<tr>
<td>12,000</td>
<td>3,150</td>
<td>112.5</td>
<td>8,943</td>
<td>12,093</td>
<td>-93</td>
</tr>
</tbody>
</table>

It is clear from the last column that if income increased to £3,100 in 1940-41 marginal tax would be over 20s. in the £, while before income increased to £12,000 average tax would be over 20s. in the £. Similar illustrations could be given for other States, for taxpayers with dependants, or for the case of an increase in State taxation.

9 Commonwealth Grants Commission Reports, Appendix 5.

10 See Walker and Beecroft, Economic Record, June, 1941, p. 18; Professor E. R. Walker, Economic Record, December 1941, p. 175; and J. S. G. Wilson, Economic Record, June 1942, p. 46, for further discussion.


13 Professor D. B. Copland, in an address to the Economic Society of Australia and New Zealand, Victorian Branch, on 28/8/42.

14 [See Readings XV and XVII.]


16 [See Reading XXIII.]
XXIII
The Uniform Income Tax Plan
(1942)*

K. H. Bailey

[In this paper I propose to adopt a simple threefold approach by reviewing the causes, course and results of the Uniform Tax Plan.]

Causes of the Plan
First, then, the causes of the Plan. Scarcely expecting to be believed, I affirm that in essentials it sprang from the requirements of war finance: that fundamentally it represented not an attempt by the Caucus to carry out a political programme of unification (though, of course, all unificationists welcomed it) but an attempt by the Treasury to grapple with a problem set by the Constitution. I say 'scarcely expecting to be believed' because we live in such a knowing age. Psychology has taught us that no man is moved by what he thinks moves him, still less by what he says moves him. In politics, we have swung from an abstract rationalism to a universal search for the 'low-down.' We are willing in fact to believe anything, as long as it is low enough down. This always makes the preparation of a public record difficult, because the 'low-down,' however convincing, is usually unprintable.

Despite these disturbing reflections, I still seriously maintain that nobody who sees the Plan as a mere party trick, or a mere attack on the States, has grasped its essential significance. Certainly, the

*Reproduced from The Economic Record, December 1944, pp. 170-88.
Treasury damsel was dressed in the most politically attractive manner. About this I shall have more to say later on. My point here is that almost for the last twenty years the problem of Commonwealth and State income tax has been receiving intermittent attention. Before and during the depression of the 1930s, economists — Professor Mills in particular — emphasized the importance of establishing a single income tax authority for Australia. Treasury discussions about it were resumed in the first weeks of the present war. Throughout the first half of 1941, Mr Fadden as Treasurer was discussing with the States alternative methods of achieving the same result. In June, 1941, he put before the Premiers a plan that in essentials (though by no means in all respects) was identical with the Plan of 1942. When I say ‘in essentials,’ I mean the imposition by the Commonwealth of the sole income tax in Australia, the States evacuating the income tax field and accepting grants from the Commonwealth by way of compensation. The method of assessing the grants, and the quantum of the grants, are not essential. Both can be varied from time to time without disturbing the scheme as a whole. The essentials of the present Plan have, I repeat, received the support of men of all parties and of no party.

The problem, let me remind you briefly, takes its rise in the taxing powers conferred or recognized by the Commonwealth Constitution. The States may levy any form of taxation, except customs and excise. The Commonwealth may levy any form of taxation at all. But no Commonwealth law with respect to taxation may discriminate between States. This prohibition is expressly laid down in par. (ii) of s. 51. Till 1915, the Commonwealth did not levy an income tax, but the last war brought it into that field, which it has cropped ever since.

Each State has hitherto levied its own income tax. Some uniformity was with difficulty introduced recently into the machinery of assessment, following the recommendations of a Royal Commission (1932-1934). But the States have differed widely in the severity of the taxation they imposed, in the extent to which they relied on income tax, and in the incidence of the tax imposed. Taking the Commonwealth Grants Commission’s figures for severity of taxation in the financial year 1940-41, with ‘all States’ as 100, the States varied from Victoria at the bottom of the scale with 68 to Queensland at the top with 121 — nearly eighty per cent greater. Nearest to Victoria comes Tasmania with 95. Nearest to Queensland is Western Australia with 113. The other two are South Australia with 104, and New South Wales with 99.

These figures are not quite transferable to income tax alone, since in the year quoted three States (Queensland, New South Wales and Western Australia) obtained nearly 70 per cent of their taxation.
revenue from income tax, while the other three (Victoria, South Australia and Tasmania) relied on income tax for only about half of their taxation receipts. But the differences in income tax alone are striking. In round figures, Queensland was collecting, in 1940-1941, £6/3/- per head of population, New South Wales £6, Western Australia £5/14/-, South Australia £4/3/-, Victoria £3/10/-, Tasmania £3/8/-.

Differences between States in the incidence of income tax were almost as striking, South Australia being especially severe in the lower income brackets (£400 and below) and Queensland in the higher.

In days of peace and prosperity, when (as we realize now) all taxes were relatively low, these variations mattered little. But as soon as the Commonwealth began to require huge sums for war purposes, the situation changed as quickly as the Melbourne weather. Thus in 1924-25, to take a year at random, the total Commonwealth revenue was £69m., of which £11m. came from income tax. In 1938-1939, the last year before the present war, total revenue had grown to £95m. But income tax receipts were still just under £12m. — about 12½ per cent of the whole. In 1939-1940, revenue went up to £112m., income tax to £16m. Then came the big increase. In 1940-1941, £43m. of a total revenue of £150m. was collected in income tax. In 1941-1942, the figures stood at £78m. out of £210m. For 1942-1943, the estimate is £133m., out of £277m., nearly £100m. of which is for the Commonwealth alone. Nor obviously will this be the end. The costs of the war mount hourly, and will mount. Those £43m. in 1940-1941, those £78m. in 1941-1942, those £100m. for 1942-1943 and the demands of the year ahead: these are the real cause of the Uniform Income Tax Plan.

The Commonwealth needed to raise rapidly increasing sums from the taxation of incomes, not only for direct budgetary purposes but also in order to transfer to the government an increasing control over the purchasing power of the community. But the Constitution required the Commonwealth tax to be uniform. There was the Treasurer’s dilemma. His tax had to be fitted into the ‘maddening maze’ of State taxing rates. If the Commonwealth rates disregarded State taxes altogether, they would hit unbearably hard the lower income ranges in some States, and the higher ranges in other States. In some States, again, there would be a very heavy burden at both ends. On the other hand if a necessarily non-discriminating Commonwealth tax was contrived so as to fit equitably in with the divergent State rates at each income level, it would leave a substantial amount of unused taxable capacity at some income levels in every State, and in Victoria at almost all income levels.
On the whole, the Commonwealth had tried to adopt the latter method. Even so, it was plain that no great general increases could take place without creating some extraordinary anomalies. In 1941-42 the point had already been reached at which a few exceptional incomes were being taxed at rates exceeding [100 per cent]. Given s. 51 (ii) of the Constitution, I doubt myself whether any system that permitted the continuance of divergent State rates would enable the Commonwealth to solve the budget problem that we have just been considering. You will, I think, be aware that a very similar problem has existed under the federal constitution of Canada. It was solved, as long ago as 1940, by agreement with the Provinces, exactly along the lines that Australia has now adopted.

The Course of the Plan

So much for the causes of the Plan. Next, its course. The discussions of 1941 I have in part already referred to. In February, Mr Fadden put forward for consideration by the States various possible methods of achieving greater uniformity of taxation. They were not acceptable. But it should be mentioned that Tasmania put forward several constructive alternative suggestions. In June Mr Fadden went further than before and — urging that immediate decision and action were necessary — proposed specifically that the States should retire from the income tax field during the war, and receive compensation by way of grant. Failing to secure agreement with the States, Mr Fadden fell back, in the budget of September 1941, on the 'post-war credits' plan. The divergent State taxes would remain, a uniform Commonwealth tax would be added, and the divergent totals would be brought up, if necessary, to a uniform over-all national contribution by way of compulsory loans. This was as far as Mr Fadden's government thought it could go — politically, if not constitutionally. Labor rejected the compulsory loan expedient. Later on, when Labor took office, Mr Chifley introduced a budget for 1941-42 which left the whole problem still unsolved.

The insistent demands of war finance soon forced the Treasury to attempt another solution — this time by means of one of the most effective legislative techniques of modern democracy — the advisory committee. Early in 1942, the government asked Professor Mills, Mr Scullin and Mr Spooner to 'consider the question of the Commonwealth being the sole taxing authority in the field of income tax for the duration of the war, and of payment of compensation to the States by way of grants.' Its report did four things. First, it advised that such a plan could constitutionally be put into operation. Secondly, it recommended that such a plan should be put into operation, not only as a means whereby the Commonwealth could exercise to the full the
taxing powers essential for the efficient conduct of the war but also as a means of achieving a much-needed simplification in the taxing system. Thirdly, the committee proposed a new basis for determining the compensation to be paid to the States, in lieu of the State taxes to be abandoned; the basis suggested was the average of State collections from income tax in the two previous war-time years, 1939-40 and 1940-41. Fourthly, it made detailed recommendations for the proposed new uniform tax. It included a schedule of rates, calculated to produce the same total revenue as the existing combined Commonwealth and State taxes.8

The government adopted these recommendations in toto. Unanimously, the States refused to co-operate in implementing them. Notwithstanding their opposition, Parliament thereupon put the whole plan into operation. The States of Victoria, Queensland, South Australia and Western Australia challenged in the High Court the validity of the legislation, but the actions were dismissed.

That, summarily stated, was the course of the Uniform Tax Plan. Before turning to its results, may I make an observation or two about the substance of the measures as they now stand. Mainly in order to comply with certain provisions in the Constitution regarding the form of taxation measures,9 the plan was put into four separate Acts: the Income Tax Act 1942, which I shall call the ‘Rates Act’; the Income Tax Assessment Act 1942; the States Grants (Income Tax Reimbursement) Act 1942; and the Income Tax (War-time Arrangements) Act 1942. The Rates Act imposed a progressive income tax on every taxpayer in Australia on a completely uniform basis, irrespective of his State. The Assessment Act made numerous important alterations in the basis of assessment, but its chief provision was a new section giving an effective priority, for the duration of the war and one year thereafter, to Commonwealth income tax. The Grants Act, likewise limited to the war period, granted to any State which abstained from imposing an income tax a specified annual sum, with power to grant further sums on the recommendation of the Commonwealth Grants Commission if these amounts proved insufficient to meet revenue needs. The War-time Arrangements Act authorized the compulsory transfer to the Commonwealth, for the war period, of staff, equipment and accommodation utilized by the States in the assessment and collection of income tax.

Two of these Acts may be regarded as major and essential elements in the Plan, the other two as mere machinery measures, not essential. But opinions may differ as to which are which. On any view, the War-time Arrangements Act was purely secondary. It gave the Commonwealth direct control over the anticipated savings in manpower, arising from the simplification of the income tax system. It would
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protect the Commonwealth from any possible lack of effective cooperation on the part of a recalcitrant State. In an extreme case, it could be used to hamper any attempt by a State to continue an independent income tax collection. It could thus be supported by real grounds of expediency, though scarcely of necessity. The already existing system of income tax collection could have dealt with the new tax.\textsuperscript{10}

As to the other three measures, the Rates Act together with either the Priority clause or the Grants Act would probably suffice to keep the Plan going. If the Rates Act and the Grants Act were both in effective operation, there would be no need of the Priority clause, which would thus become quite secondary in importance.\textsuperscript{11} On the other hand, if the Rates Act and the Priority clause were effective, the States would be driven, at last, to accept any grant the Commonwealth was willing to make — at any rate so long as the Commonwealth’s tax rates stood as at present, or higher. It was the general opinion that the new rates were already sufficiently high in the 1942 Act to make it practically — i.e., economically and politically — impossible for a State to impose any substantial independent income tax. On the other hand, the quantum of the grants could be modified at will by the Commonwealth, without any necessary dislocation of any of the other measures. In this view, the Rates Act and the Priority clause are the only essential measures. This must be kept in mind later, when we consider the possibilities of the Plan after the war.

\textbf{The Results of the Plan}

The \textit{results} of the Plan we may consider first of all in the economic and financial, and finally in the constitutional, field.

Perhaps the most outstanding economic effect of the Plan is to ‘peg’ State expenditure from income tax, for the duration of the war, at the 1939-41 level. Possible increases in the grants to meet exceptional conditions must be taken into account. There are also other State taxes, amounting as we have seen to something between thirty and fifty per cent of State revenue. But this source is unlikely to yield much of an increment. The political difficulties of increasing these taxes would be substantial. In any case there is plainly nothing to prevent the Commonwealth from applying to the other State taxes, one by one or all together, the principles it originally applied to income tax alone. Indeed the same principle has already been applied to the entertainment tax. We must therefore assume, I think, that expenditure on State services generally will be ‘pegged for the duration.’

Clearly, this has been the quite conscious and deliberate intention of the Commonwealth. At the close of a long discussion in the Premiers’
Conference on 22 April 1942, Mr McKell\(^1\) (N.S.W.) asked the Prime Minister whether, if the Commonwealth was interested only in the raising of additional revenue and uniformity of taxation, it would be prepared to consider an alternative proposal which would also preserve to the States their rights. Mr Curtin's\(^3\) answer was: 'We do not consider that under war conditions you have a right to tax in such a way as will give you a total tax exceeding £34m.'\(^4\) Amplifying this, he agreed, in reply to Mr Playford\(^5\) (S.A.), that the Commonwealth 'is seeking to control State expenditure and keep it to £34 m. for each year during the war period.'\(^6\)

This decision, in effect to stereotype the present State services, must rest for justification on two propositions: (i) that it is essential for the purposes of war finance to curtail every possible form of civilian expenditure, public and private, in order to devote the maximum of the nation's resources to war purposes; (ii) that the basis of compensation adopted in the Plan will enable the States to maintain their services at least on a reasonably good footing. The former proposition I would think needs now no demonstration. The validity of the latter I think can fairly be demonstrated. The financial burdens of the States have been substantially lessened because of the elimination of unemployment and the extraordinary increase in railway revenues, transforming the railways from a serious financial liability into a large revenue-producing asset. Railway surpluses should certainly be put to reserves for post-war replacement. But the absence of a railway deficit puts a very different complexion on a State budget.

The really awkward thing about preventing improvements in the status quo in State services is that in some States the level of services is much lower than in others. A universal standstill order thus operates very unevenly. Under war-time conditions, I do not myself think this is a very serious objection. The same thing happens in private life, and we recognize without question that such inequalities are unavoidable. To prohibit the sale of paint may be necessary — but it works very differently as between the house that was painted last year and the house that has not been touched for a decade. In any case, the level of services in each State represents its own deliberate estimate of what is necessary and desirable, established over quite a long term of years. To be restricted to that level for the next few years cannot entail serious hardship or injustice. Nevertheless a quite different situation is likely to arise in the year that will immediately follow the end of hostilities. The full flood of demobilisation may perhaps not come till later. But during that year there will plainly be a tremendous transfer problem from war industries. That is the time when the opportunity should be taken to begin the large-scale improvement of social services. Possibly the Commonwealth will make itself entirely
responsible. But if the States are to be expected to do anything, they will require much larger funds.

A period of rising costs will affect the States in much the same way as it does an individual on a fixed salary. But provision may be made to cover this through the Commonwealth Grants Commission. The language of the Act is certainly wide enough to permit it. The only serious element of insecurity in the position of a State is, as the Premiers pointed out, that the amount of compensation is wholly at the will and discretion of the Commonwealth. It can be increased — or for that matter reduced. True, the present Act will run on till after the war if it is not interfered with. But the only security of the States is political, and not legal at all.

In the second place, we should consider the Plan in the light of the budgetary position of the Commonwealth. It is an exaggeration to say that the Plan has made no contribution to the budget for 1942-43. It would be an even greater exaggeration to say that it has solved the budget problem of 1942-43. But there is some confusion about just what it does mean, from the revenue point of view. The Uniform Taxation Committee proposed a schedule which — under the conditions of 1941-42 — was calculated to bring in as much revenue as the existing Commonwealth and State taxes would have produced in that year. I say 'would have produced,' because the Special War Tax of the Commonwealth was imposed only for one half of that year. The Committee's comparison was based on a whole year of that tax. But the national income, in monetary terms, has been rising throughout the war. It was calculated at £788m. in 1938-39, £863m. in 1939-40, and £925m. in 1940-41; it was estimated at £1,000m. for 1941-42, and it is expected to rise still higher in 1942-43. The Treasurer's budget speech did not hazard even a guess. But the Prime Minister told the Premiers in April, 1942, that the new taxes would probably raise from £12m. to £15m. more in 1942-43 than the combined Commonwealth and State rates would have raised in a full year in 1941-42. The whole of this additional sum will of course go to the Commonwealth. Under the old system it would have been shared between Commonwealth and States. The Commonwealth is thus perhaps about £4m. better off as a result of the change. And — even in a budget of £550m. — every additional million pounds of tax gathered means one less million pounds of loan to be found.

On the other hand, with war expenditure growing from £320m. in 1941-42 to the budgeted £441m. in 1942-43, it does seem odd to find the Treasurer budgeting for so small an increase in income tax revenue. At a first glance, it tends to weaken materially the contention that the Uniform Tax Plan was vital to ensure the collection of a much larger revenue. When looked at in detail, too, the schedule contains an
even greater surprise. Probably at least three-quarters of the taxpayers in Australia will pay less under the new plan, in 1942-43, than they would have paid if the old system had been still operating.\textsuperscript{20} Not less, please, than they actually paid under the old system in 1941-42. Don’t forget that last year we paid only six months of that War Tax. But to have reduced the rates of tax for the great mass of taxpayers in the fourth year of the war must surely be a unique achievement.

In most cases, the difference will be scarcely noticeable, the more so since the Committee’s figures do not take into account the fact that the new system of allowances for medical expenses, gifts, etc., is less favourable to the taxpayer than the old. Among taxpayers deriving income from property, increases indeed are fairly general, in all States except Queensland and South Australia. But among the much greater class of taxpayers deriving income from personal exertion it is only more or less isolated groups that will pay more, except in Victoria. In this State, taxpayers who have no dependent children will not escape an increase unless their incomes are below \£350; taxpayers with a wife and one child will not pay more unless their income is \£1,000 or upwards. Taking Australia as a whole, the Committee’s report shows that the new rates are designed to raise \£1.5m. more from taxpayers whose income is above \£1,000.\textsuperscript{21} This made it possible to reduce slightly the total amount to be raised from taxpayers in the \£401-\£1,000 group and in the under \£400 group. The reduction proposed was roughly \£0.75m. for each group.

These figures sufficiently explain the strong political support which the Uniform Tax Plan obtained — even, in many quarters, in Victoria. The action of the four States that challenged the Plan, however clearly justified in principle, was certainly not popular. It is difficult to suppose that the Treasurer consented in effect to postpone for a year any attempt to reap the full benefit of the change, except on the footing that such a concession was necessary to secure the adoption of the Plan. The Prime Minister, indeed, went so far as to give an undertaking later that the new rates would not be increased by a supplementary Act during the current financial year. The decision to link the new taxing measures with the establishment of a new Commonwealth social service, in the form of a pension for widows, was again no doubt influenced by the political desire to enlarge the range of support for the Plan. These elements were what I had in mind earlier in saying that the Treasury damsel was dressed in the most politically attractive manner.

But the question is, of course, what will the damsel look like when she is a bit older? The demands of war finance are not likely to be less in the near future than they are in the current year. The merit of the Uniform Tax Plan, from the budgetary point of view, is that it has
removed all the legal and constitutional barriers to an even more exacting schedule of income tax rates. The shopping centres, the need for an 'Austerity Campaign,' show that the present rates do not go far enough, in some income ranges at any rate. The real contribution of the Plan to the budgetary problem of the Commonwealth is its future potential. To the Premiers in April last, the Prime Minister stated the whole case in a nutshell: 'It is essential that there should be no margins left which the Government cannot get at . . . I do not see how the schedules of taxes which we might ultimately have to increase if the war lasts three, four or five years can be soundly conceived in a competing field such as the present position discloses.'

In the future, the only difficulties will be political.

In the third place, we ought to notice the way in which the Plan spreads uniformly over the taxpayers of Australia the cost of the total State services. Irrespective of his State, each taxpayer contributes ratably to the consolidated fund, from which compensation is paid, of course in very unequal amounts, to the States. Plainly, the result is equal payments for very unequal services. To spread the cost of services without any possibility of spreading their direct advantages is not a new principle in Australian public finance. The Commonwealth may give a bounty on the production of a commodity which for climatic reasons can only be grown in one State. But everyone recognizes that as a perfectly legitimate spending of Commonwealth funds, from whatever State derived. Similarly the eastern States have entirely accepted the principle — formulated expressly by the Commonwealth Grants Commission — of grants from federal funds towards the general cost of State government in South Australia, Western Australia and Tasmania. This is only another case of spreading the costs. But in these cases the principle is accepted because the object of the grants is to enable weaker States to provide services at approximately 'an Australian standard' — i.e., to bring them up to something like equality with the more prosperous States. The operation of the Uniform Tax Plan is not to produce equality but to continue inequality — to enable the States with more costly services to maintain them by means, in effect, of a contribution from other States.

The exact amount of this contribution is exceedingly difficult to determine. On one calculation produced during the High Court proceedings, Victoria would pay £4m. more than her own tax would have brought in. Another officer made it a little over £3m. A different calculation again reduced it to about £2½m., which would be distributed among the other States, principally to New South Wales (£1.5m.) and Queensland (£1.25m.). Whether the rates are increased or not in future years, this contribution will still be made.
There is, to be sure, some unreality in much of the discussions about the different costs and levels of State services. Victorians sometimes pride themselves unduly on the smaller cost of government in this State — thinking that the differences are due exclusively to superior frugality or management. But there are other factors — e.g. the higher costs involved in governing a large area with a small population, compared with the possible economies in a small area with a relatively large population. Nevertheless there are some significant comparisons, when all allowances have been made. The new system will probably stimulate a further demand for equality in governmental services — this time in the other direction. It will be a demand to bring the Victorian standard up to that available in the other eastern States.

A great deal of the criticism of the Uniform Tax Plan was occasioned not by what I have described as its essentials but by the particular basis of compensation adopted. Once the decision was taken to 'peg' the claims of the States upon the total income tax fund, the decision to take an average of recent collections seems logical and defensible enough. It had the merit of simplicity, and of leaving the existing financial arrangements of the State broadly undisturbed. There were minor criticisms — for example, that New South Wales was especially favoured because, whereas it provided, during the base years, its own scheme of child endowment, the Commonwealth had since established an endowment scheme of its own, and made no claim to reduce the New South Wales grant by the amount that the State had saved. But the substantial criticism was the one we have been considering — that it involved a large contribution by Victoria to the services of other States.

Victoria pointed out that if the total grant were to be divided on a per capita basis, New South Wales would receive £13.8m. instead of the £16m. provided for. Victoria would get not £6.7m. but £9.3m. Queensland would get £4.9m. instead of £6m. But these figures plainly show the very great practical difficulty of applying the per capita principle. For on that basis Victoria would have got over £2.5m. more than she had been collecting in the base period, but New South Wales nearly £2.25m. and Queensland over £1m. less. There would thus be dislocation both ways: Victoria presented with the opportunity of expanding her services (or reducing other taxation) and New South Wales and Queensland forced to make drastic cuts.

In the abstract, Mr Fadden's proposal of June, 1941, might have been fairer than the scheme finally adopted in the Plan. It was based on the distribution, on a per capita basis, of a fixed sum of £24.5m., supplemented by a further £5.5m. to be apportioned by agreement. The distribution of the £24.5m. would have given Victoria practically the same amount as she had previously been collecting, but some cuts
would have been necessary in the States with more costly services. It is not known whether or not the States ever reached the point of discussing the allocation of the £5.5m. There would have been ample room for disagreement. It may perhaps be reckoned one of the merits of the 1942 Plan that it applied a single clear method to the whole sum available, and left no room for haggling.

I have often felt that in all the welter of discussion about the effects of the Plan on State finances one of the other real issues tended to become lost to view. I mean the validity of the initial hypothesis adopted by the Commonwealth — that 'in a total war any Australian income, say of £500, must be left the same amount, and no more, for necessary private spending, wherever and however it is derived.' The proposition has an instantaneous appeal; for 'equality of sacrifice,' 'equality of burdens,' are very potent slogans in any democracy, the Australian democracy perhaps most of all. You can of course point out that to take for government purposes (Commonwealth and State combined) an equal amount from all citizens, and give them larger returns in some States than in another, is to do lip service to equality but to produce inequality in practical effect. In logic, therefore, you cannot justify at all the Commonwealth's proposition. But you can certainly justify it in politics — which is the sphere of ethics as well as of arithmetic. You can justify it on the ground that, unless people are sure that their fellows all over Australia are carrying a comparable financial burden, there will inevitably be dissension and impaired morale. On that ground you and I, as Victorian taxpayers, may fairly be asked not only to bear our additional burdens, but to grin while we are doing it.

I have discussed the Uniform Tax Plan on the basis that the High Court litigation was a mere incident in an essentially fiscal process. That view is, I think, correct. The decision of the High Court that the Plan is constitutionally valid may, however, have important political and constitutional results. Accordingly, I may perhaps be permitted to make some observations about the litigation itself before proceeding to assess its results.

Of the four Acts that implemented the Plan, the two that could most easily be attacked were the Grants Act (by contending that the condition imposed was not a condition which section 96 authorized) and the War-time Arrangements Act (by contending that it had nothing really to do with considerations of defence). But to knock out those two and leave both the Rates Act and the Priority clause in operation, could scarcely be satisfactory to the plaintiff States. Accordingly, the main attack rested on an attempt to link the four Acts together, so that if the Grants Act fell the Rates Act would fall with it and the Commonwealth would have to begin all over again.
The plaintiffs’ argument was that you could not determine the true character of the Acts until you read them together as a single legislative plan or enactment. On that basis, the contention was that Parliament had in substance prohibited the States from exercising their power to levy an income tax. This, the argument ran, it had no power to do, because the taxation power related only to Commonwealth taxation: the raising of a revenue by the Commonwealth for Commonwealth purposes. If the Commonwealth were then to fall back on the defence power, the plaintiffs argued that even the defence power must be interpreted as subject to an unwritten restriction, viz. that it may not be used to impede the exercise of the essential functions of the State — of which taxation was certainly one. I only hope I have not distorted the plaintiff States’ main argument in an effort at conciseness.

There was also an important, but still secondary, argument about discrimination. Though the Rates Act on the face of it did impose a uniform tax, you must, said the four States, read the Grants Act into it. When that is done, they said, you can see that the Commonwealth is really collecting not one uniform tax but two distinct and unequal taxes — a differential tax for the Commonwealth itself, superimposed on another differential tax for the States, though adding up to a uniform total. On this view, the Commonwealth had done precisely what was forbidden by section 51(ii): imposed a tax that discriminated between States.

The High Court unanimously rejected all the main contentions of the plaintiff States — that the four Acts, when read together, amounted in substance to a legislative prohibition against the exercise by the States of their powers of taxation, which neither the taxation power nor the defence power enabled the Commonwealth to impose; that the Rates Act discriminated between States. The whole Court therefore held that the Rates Act and the Priority clause were valid. By four Justices to one, the Grants Act was upheld. By three Justices to two, the War-time Arrangements Act was also upheld. In the result, the entire legislative scheme was declared valid.

I hope I may be allowed to express the view that, fundamentally, the case for the States rested on an attractive but rather misleading proposition — that what you cannot do directly you cannot do indirectly. In one sense, this is legally correct. If you have a power to make a law regarding excise, and no power to make one regarding manufacturing conditions, you cannot by a merely colourable or pretended exercise of your power to levy an excise, validly regulate the conditions of manufacture. But as long as you use a means that the Constitution permits, the Constitution does not concern itself with the motives or ends or policies that you obey or seek or accomplish. If, for instance,
you have power to impose a land tax, and do it, your tax will be valid even if your object in imposing it is to break up large estates.27 So also, if you have two separate powers, you can readily use them in combination to accomplish a policy that would be impossible if either power stood alone. Thus by using a power to tax together with a power to make grants on conditions to the States you may raise the home consumption price of wheat and secure the transfer of wheat-growers from unproductive or marginal areas.28

From this point of view, section 96 is to-day one of the most vital elements in the Constitution. It empowers the Commonwealth Parliament to grant financial assistance to any State, on such terms and conditions as the Parliament itself thinks fit. Grants to the three less-populous primary-producing States, on the recommendation of the Commonwealth Grants Commission, have been made without conditions; or at any rate without formally expressed conditions. But various grants for specific purposes have been made subject to the most rigorously specified conditions — for the construction and maintenance of roads, for housing, for the assistance of the wheat industry, for the relief of unemployment. None of these are subject-matters on which the Commonwealth Parliament can pass direct legislation. But through the agency of section 96 it has been able to carry out its own policy indirectly.

The condition in the States Grants (Income Tax Reimbursement) Act 1942 was of a different character from those I have just mentioned. To get a grant, the State was required not to exercise its powers in a specified manner but to refrain from exercising its powers. Starke J. thought that section 96 did not permit the Commonwealth to impose a condition of this kind. The majority of the Court, however, thought that the words of section 96 ('on such terms and conditions as the Parliament thinks fit') were too broad and clear to admit of any such limitation. A Constitution that contains a section 96 contains within itself the mechanism of Commonwealth supremacy, to be used as and when the people of Australia desire it.

It was along these lines that the High Court upheld the Uniform Tax Plan. There are plain indications that in the Court's view the Commonwealth could not, even under the defence power, have directly forbidden the States to impose an income tax during the war. The Commonwealth had in no way concealed its desire and intention to accomplish the elimination of State income taxes. But it had sought to accomplish its purpose by using, in combination, three different constitutional powers — the taxation power, the grants power, and the defence power. What it could not do directly, it could nevertheless do indirectly.29
Fully aware of the very great public importance of the litigation, the Court was at pains to emphasize the fact that its concern was with questions of legal power, not of political or economic or social policy. I cite a passage from Sir John Latham’s judgment which was quoted in some quarters (quite unfairly as I thought) as implying a critical view of the bases of the Plan:

The controversy before the Court is a legal controversy, not a political controversy. It is not for this or any Court to prescribe policy or to seek to give effect to any views or opinions upon policy. We have nothing to do with the wisdom or expediency of legislation. Such questions are for parliaments and the people. It has been argued that the Acts now in question discriminate, in breach of section 51(ii) of the Constitution, between States. The Court must consider and deal with such a legal contention. But the Court is not authorized to consider whether the Acts are fair and just as between States — whether some States are being forced by a political combination against them, to pay an undue share of Commonwealth expenditure or to provide money which other States ought fairly to provide. These are arguments to be used in Parliament and before the people. They raise questions of policy which it is not for the Court to determine or even to consider.30

These observations may perhaps suggest too rigid a dichotomy between questions of power and questions of policy. But I do not want to enter upon a discussion of the theory and practice of judicial review.31 What the Chief Justice said is a useful corrective to loose views of the High Court as a sort of general political referee.

As already explained, the Court was unanimous in upholding the Rates Act and the Priority clause. It did so without resort to any special war-time powers. This, as I have already indicated, may be of the first importance when (and if) the question arises whether the Commonwealth could continue the Uniform Tax Plan in time of peace, without an amendment of the Constitution. These two measures might alone be sufficient — so long at least as the tax rates were high enough to deter a State from entering the field. In my own view, the Grants Act also was upheld on grounds that will be equally valid in time of peace, though that view is perhaps rather more subject to reservations. With these three Acts the Plan could plainly be continued after the war so far, of course, as the constitutional aspect of the matter is concerned. The War-time Arrangements Act was upheld on the defence power alone. But that Act would not be necessary for the successful operation of the Plan.

Estimates of the High Court’s decision on the Plan have varied widely. To Mr Forgan Smith, for instance, was attributed the view
that the decision was a limited verdict in favour of the Commonwealth, exclusively as a war measure. Mr Menzies, on the other hand, was reported as having said that it marked the end of the federal era in Australia. I do not myself think any narrow view of the decision can be sustained. I would regard it as being, on a long-term view, probably the most far-reaching judgment ever handed down by the High Court. For it brings the essential taxing functions of the States under potential Commonwealth control. From the outset of the Commonwealth’s history, keen observers have noted that the financial provisions of the Constitution left the States in a position of great weakness vis a vis the Commonwealth. Hence Alfred Deakin’s famous letter to the Morning Post in 1902, in which he spoke of the States as financially bound to the chariot-wheels of the Commonwealth.32 Until the Tax Plan was implemented, though, few, I think, had realized the full central significance of the Commonwealth’s power to make grants on conditions.

The public importance of the Court’s decision was explicitly underlined by the Chief Justice, who said:

It is perhaps not out of place to point out that the scheme which the Commonwealth has applied to income tax of imposing rates so high as practically to exclude State taxation could be applied to other taxes so as to make the States almost completely dependent, financially and therefore generally, upon the Commonwealth. If the Commonwealth Parliament, in a Grants Act, simply provided for the payment of moneys to States, without attaching any conditions whatever, none of the legislation could be challenged by any of the arguments submitted to the Court in these cases. The amount of the grants could be determined in fact by the satisfaction of the Commonwealth with the policies, legislative or other, of the respective States, no reference being made to such matters in any Commonwealth statute. Thus, if the Commonwealth Parliament were prepared to pass such legislation, all State powers would be controlled by the Commonwealth — a result of which would mean the end of the political independence of the States. Such a result cannot be prevented by any legal decision. The determination of the propriety of any such policy must rest with the Commonwealth Parliament and ultimately with the people. The remedy for alleged abuse of power or for the use of power to promote what are thought to be improper objects is to be found in the political arena and not in the Courts.33

In the result, I come back to the proposition I put to you earlier: that for the future the security of the States under the Constitution is not so much legal as political. It is for the people of Australia, through Parliament, to decide what use is to be made of the great powers that
the national Parliament is now seen to possess. If the people desire it, Parliament can provide fairly fully for State activities and fetter its grants with few conditions — in which case the federal era will go on, much as it now does despite the fact that three States are permanently dependent on federal grants. I think myself, however, that the logic of the Uniform Tax Plan is that the States should eventually move, with simplified political structure, into the position primarily of administrative agencies, the main lines of policy in all major matters being nationally determined. When the lessons of war government come to be reviewed, I feel confident that we shall ultimately be convinced of the wisdom of national control of economic and social policy generally. But I think we shall also be convinced of the importance of a reasonably decentralized administration. So thinking, I regard the Uniform Tax Plan as marking a definite stage in the movement towards constitutional reconstruction.

Notes

1 The article below was read as a paper to the Victorian Branch of the Economic Society on 23rd October, 1942.


3 See Mr Fadden's outline of the discussions to the House of Representatives: Commonwealth Parliamentary Debates, Vol. 167, pp. 902-6, 4th July, 1941.


5 The figures were: Queensland, 68.1 per cent; N.S.W., 67.8 per cent; W.A., 67.5 per cent; Victoria, 52.6 per cent; S.A., 56.0 per cent; Tasmania, 46.8 per cent.

6 See e.g. Report of the Committee on Uniform Taxation (1942), pars. 6-8. [p. 288 above].

7 Professor Mills, Chairman of the Commonwealth Grants Commission; Mr Scullin, Labor Prime Minister, 1929-31; Mr Spooner, U.A.P. member for Robertson, a former Assistant Treasurer (N.S.W.).

8 Report printed by Government Printer, Canberra. [See Reading XXI above.]

9 By virtue of s. 55 a law imposing taxation must deal only with the imposition of taxation. Machinery measures must therefore be passed as separate Acts.

10 By agreement, State officers collected both State and Federal income tax except in Western Australia, where the converse system operated. [See Reading III above.]

11 [In fact the Priority clause was subsequently invalidated by the High Court in the Second Uniform Tax Case 1957. See Reading XXXII below.]
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12 ([Sir) William McKell, 1891- . Leader of Labor Party NSW 1939-47; Premier and Treasurer NSW 1941-7; Governor-General 1947-53.]


14 Report of Proceedings, p. 27 (Government Printer, Canberra — 3113).


16 Report of Proceedings, p. 27.

17 The Plan thus imposes certain additional responsibilities upon the Commission. It also has repercussions on the basis of calculation hitherto adopted by the Commission. See Eleventh Report (1944).


19 Report, pars. 30, 41.

20 Ibid., Appendix B.

21 Ibid., par. 41.


23 The grants provided for by the Act were:

<table>
<thead>
<tr>
<th>State</th>
<th>Grant (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>15,356,000</td>
</tr>
<tr>
<td>Victoria</td>
<td>6,517,000</td>
</tr>
<tr>
<td>Queensland</td>
<td>5,821,000</td>
</tr>
<tr>
<td>South Australia</td>
<td>2,361,000</td>
</tr>
<tr>
<td>Western Australia</td>
<td>2,546,000</td>
</tr>
<tr>
<td>Tasmania</td>
<td>888,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33,489,000</strong></td>
</tr>
</tbody>
</table>

24 The figures here given are those for gross collections by the States concerned in the base years. The grants provided for by the Act represented net figures, after deductions for cost of collection.

25 See the statements by Mr Curtin and Mr Chifley at the Premiers’ Conference on 22 April 1942 — Report [supra n. 14.], pp. 5-7.

26 South Australia v. Commonwealth (1942), 65 C.L.R. 373.

27 Osborne v. Commonwealth (1911), 12 C.L.R. 321.

28 Moran v. Deputy Federal Commissioner of Taxation (N.S.W.) (1940), 63 C.L.R. 338.
29 See in particular the judgment of the Chief Justice, 65 C.L.R., pp. 411 et seq., 424 et seq.

30 Ibid., p. 409. [For Sir John Latham, see Reading VII, n. 4.]

31 For a realistic and careful recent study, see R. K. Carr, The Supreme Court and Judicial Review, N.Y., 1942.

32 [See Reading I above.]

33 65 C.L.R. at p. 429.
1 Introduction

The Income Tax Act (No. 2) 1940 must be regarded as a temporary measure to meet a financial position of urgency. In his taxation proposals the Treasurer had to take into account the taxes already imposed by the States. As these in the field of income tax are far from uniform, he was, and still is, unable to draw upon the full taxable capacity of Australia. The Premiers, on his invitation, met at Canberra, on 1 February 1941, as a preliminary to a further conference at a later date ‘to consider the practicability of introducing a scheme that will have regard to the financial needs of the states and at the same time overcome disabilities owing to lack of uniformity between the state and Commonwealth systems.’

In these circumstances it seems to me advisable to explain without any higher mathematics the principle on which the federal rates of income tax on individuals have depended and to show in what respects those of the States very seriously affect the freedom of the federal authorities.

*Extracts from The Economic Record, June 1941, pp. 19-30; December 1942, pp. 158-67; June 1943, pp. 1-10; June 1946, pp. 40-9; December 1946, pp. 219-27; December 1947, pp. 177-85.
Original Federal Income Tax Rates
The first Federal Income Tax Act was passed in 1915. Until then taxation of income had been left to the States. In the financial year 1915-16 their revenue from this source was about £3 3/4m. The taxes were of the familiar graduated type. For example, in New South Wales, net incomes not exceeding £300 were free from tax; from net incomes over £300 a deduction of that amount was allowed, and on so much of the taxable income as did not exceed £700 there was a flat rate of 6d. in the £; on so much as exceeded £700 but did not exceed £1,700, 7d.; from £1,700 to £2,700, 8d.; £2,700 to £4,700, 9d.; £4,700 to £6,700, 10d.; £6,700 to £9,700, 11d.; and above £9,700, 1s. in the £.

The first federal tax was also designed at its original level to produce only a moderate revenue. In 1916 it brought in about £4 3/4m. It taxed high incomes with what was then regarded as some severity, fell lightly on middle incomes, and hardly touched incomes at the wage-earning level of the time. The scale of taxation was devised by Sir George Knibbs, then Federal Statistician. It included two original features. Instead of the fixed statutory deduction, he introduced one on a sliding scale. In recent years this has been £250, diminishing by £1 for every £2 by which the net income exceeded £250, and thus vanishing at £750. But its chief feature was that instead of graduation by steps as above, at intervals, say, of £1,000 or £2,000, he made every successive £ pay just a little more than the preceding £, up to a certain stage. After that, every £ of the excess paid the same, or practically the same, as the last £ of the ascending range. For earned income his formula was simple: The 1st £ paid (3 + 3/800) pence; the 2nd £ paid (3 + 9/800) pence; the 3rd £ paid (3 + 15/800) pence; and so on, up to the 7,600th £, each successive £ paying 3/400ths of a penny more than the preceding. The 7,600th £ paid (60 — 3/800) pence. Every £ of the excess, if any, over £7,600 paid 60 pence [25 per cent].

This scheme can be expressed by a simple formula:

Let the amount of the tax on a taxable income of £x be T pence.

Then $T = x \left(3 + \frac{3x}{800}\right)$, when $x$ does not exceed 7600,

and $T = 31.5 \times 7600 + 60(x - 7600)$

$= 60x - 28.5 \times 7600$, when $x$ is greater than 7600.

It is usual to speak of the rate of tax (R) on every £ of an income of £x, meaning that $R = T/x$. In the above scheme, we have

$R = 3 + \frac{3x}{800}$, when $x$ does not exceed 7600,

and $R = 60 - \frac{28.5 \times 7600}{x}$, when $x$ is greater than 7600.
Property Tax and the Progressive Rate Structure
Unfortunately, in dealing with income from property Knibbs introduced complexities of a mathematical kind. His curves of the 2nd and 3rd degree were quite out of place. But the scales devised by him remained the basic rates until 1931, percentage changes, sometimes only over part of the income range, being made in different years, while for a time 'a special tax' on property income was added.

In 1931 these Schedules were revised; the rate of tax on property income was simplified and both rates now depended on the principle used for earned income in the earlier acts. This simple formula, in one form or another, was gradually adopted by all the States except Tasmania, but the rate of tax was different in each of them and anomalies were introduced, which in places destroyed the progression. The rates in Tasmania, even now, are based on Knibbs's original tables.

The discrimination between the two kinds of income has been made either by using separate formulae, or by making the rate for property income greater by a certain percentage than that for earned income; but in New South Wales, since 1936, the method in use in England has been followed. A certain proportion is deducted from the total of the earned income, up to a certain maximum amount, and thereafter both kinds of income are treated as one. It seems to me a pity that in the federal tax a similar method was not adopted either in 1931 or in 1940, when the rates of tax were again altered.

There can be little doubt that the progressive rate, in the linear form devised by Knibbs, has advantages over the steps and stairs system. By a suitable choice of the initial term, the constant difference in the arithmetical progression or progressions, and the range, it can be made faithfully to carry out the fundamental principle of ability to pay.

Lack of Uniformity of State Income Tax Rates
The demands of the States and Commonwealth did not long remain at the modest level of 1916. In the financial year 1938-39, the State taxes on income, including in that term the wages tax and other similar taxes, which have become almost as revenue producing as the ordinary income tax, brought in nearly £30m, while the federal tax produced nearly £12m. In the year 1939-40, which included a great part of the first year of the war, the revenue from federal income tax had increased to nearly £16½m, but the revenue from these State taxes had risen to nearly £33½m.

In the budget for 1940-41 the new federal parliament was faced in November 1940, with an immense increase of expenditure on the war.
Fiscal Federalism

The Income Tax Acts had been passed in May, anticipating the budget, but the huge increase in the amount actually required in the budget from income tax (about £37½ m) made it necessary to replace these Acts by others which would bring in greater revenue. The Treasurer (Mr Fadden) told Parliament that the rates imposed by the States had very considerably hampered Commonwealth taxation and that it was a matter for consideration whether under the increasing pressure of war the present position could continue. The difficulty arose at all points of the scale, but chiefly at the lower and higher ends.

The wages tax and other State taxes on income down to quite a low level differ in the different States. An even more pronounced lack of uniformity exists in the way the States treat high incomes. The Commonwealth cannot discriminate in its rates between the States. It follows that its tax must press more heavily under present conditions on wages and low incomes in some States than in others, and that the heavy taxation on large incomes in Queensland compels the Treasurer to let off too easily many large incomes, say, in Victoria.

To me it seems that the rates of tax of the Income Tax Act (No. 2) 1940 can only be defended, if indeed they can, by the limitation on the Treasurer’s freedom referred to above.

Incidence of Federal Income Tax 1940

We shall now look more closely at the federal tax on the income of individuals as it at present stands. The government originally proposed that the statutory deduction, which in the Acts passed in May was £250, vanishing at £500, should be £150, vanishing at £300. The Labor Party, now in Opposition in an almost equally divided House, objected to this reduction, in view of the demands made on wages and low incomes by the wages tax and other similar State taxes. Their opinions were shared by some members on the government side. A budget crisis followed and for a time the government was in danger. A compromise was effected; the deduction was made £200, vanishing at £400; but the amount of the tax on incomes above £400 after the compromise remained the same as in the bill before the House.

It is surprising that so little was said in the debate about the incidence of the tax . . .

. . . the relation between the amount of the tax (T pence) and the size of the taxable income (£x) can be put simply3 as follows:

\[
\begin{align*}
T &= 16x, \text{ when } x \text{ does not exceed } 400, \\
T &= \frac{x^2}{25}, \text{ when } x \text{ exceeds } 400 \text{ and does not exceed } 1500, \\
T &= 120x - 60 \times 1500, \text{ when } x \text{ exceeds } 1500.
\end{align*}
\]
Property Income.

\[ T = 20x, \text{ when } x \text{ does not exceed 400,} \]
\[ T = \frac{x^2}{20}, \text{ when } x \text{ exceeds 400 but does not exceed 1200,} \]
\[ T = 120x - 60 \times 1200, \text{ when } x \text{ exceeds 1200.} \]

Since the tax on the \(x\)th £ is equal to the difference of the tax on an income of \(£x\) and the tax on an income of \(£(x - 1)\), it is an easy exercise in arithmetic to show that in the case of earned income:

- Each £ up to and including the 400th £ pays 16 pence;
- the 401st £ pays 32.04 pence;
- the 402nd £ pays 32.12 pence;
- the 403rd £ pays 32.20 pence, and so on, each successive £ paying 2/25ths of a penny more than the preceding, up to the 1500th £;
- the 1500th £ pays (120 — .04) pence.

Each £ of the excess, if any, over £1500 pays 120 pence.

Again for property income;

- Each £ up to and including the 400th £ pays 20 pence;
- the 401st £ pays 40.05 pence;
- the 402nd £ pays 40.15 pence;
- the 403rd £ pays 40.25 pence, and so on, each successive £ paying 1/10th of a penny more than the preceding, up to the 1200th £;
- The 1200th £ pays (120 — .05) pence.

Each £ of the excess, if any, over £1200 pays 120 pence.

One could not expect the Treasurer to put the matter before the House in this way but, if he had done so, obvious objections to the scale would have been raised. Surely this does not conform to the principle of ability to pay! Why should the progression be so steep and extend over so small a range of income? Is it fair to begin the flat rate so early as £1,500 in the one and £1,200 in the other? What about the British surtax?

In the original federal formula for earned income, the progression was a very gentle one and the range extended up to £7,600; even in its modified form in the 1931 formula it went up to £6,900. For property income the range before 1931 was £6,500, and after 1931, £3,700. The principal feature of the federal tax scales has been practically abolished in the 1940 Act, and this was done almost without remark . . . .

It must, I think, be admitted that, when the State taxes on income are taken into consideration, the federal tax in 1940 presses hard on very many wage-earners and those with low incomes, that it weighs heavily on all middle incomes, and that, in the States which tax large incomes less severely, there will be many incomes which get off relatively lightly. The Treasurer said that he had pushed the taxation
Proposals for State Taxes

It is idle now to discuss whether further search could have discovered a better way out of the difficulty. The rates have been fixed for the year ending 30 June 1940. What is important is that without delay steps be taken to give the Commonwealth power to impose a just, equitable and progressive tax that will bring in the revenue required from income tax in the next financial year.

...at the meeting of the Premiers at Canberra on 1 February [1941] three possible courses of action by the States were outlined by Mr Fadden. Special emphasis was laid, we are told, on a plan involving the adoption by all the States of the Victorian scale, the lowest in Australia. It was explained that, if this were adopted, the Commonwealth would pay partial compensation to States for amounts under-collected but that the residue would be regarded as a contribution by the States to the war effort. If reduction to the Victorian scale covered incomes from £400 upwards, Mr Fadden is reported to have stated that £6m could be raised for war purposes without additional burdens on taxpayers in general. If the reduction affected incomes from £1,000 upwards, the amount raised would be about £3m. The alternative of taking the Queensland rates as the standard seems quite impossible, though it would appear that this may have been the second alternative. One may assume that the other would be to devise a just and suitable scale intermediate between those of Victoria and Queensland and then persuade all the States to adopt this scale for their income tax as a war-time measure. The special needs of some States would have to be met by Commonwealth grants. Such a scale would have to be drawn up most carefully. It is astonishing to what an extent the State formulae now in use for income tax on individuals depart from the fundamental principles of the progressive rate. Space does not permit me to deal with this topic. But it is surely strange that in all of them, where a formula of the type $R = a + bx$ is used, when the ascending progression terminates, the flat rate on the excess, instead of being taken as equal to, or practically the same as, the amount which the last £ of the progression pays, drops down quite considerably and the big incomes are thus asked to pay much less than they ought. In New South Wales there is a drop from 6s. 3d. to 5s., and in Queensland from 8s. 6d. to 5s. in the
standard formula, but in the latter State the 'additional taxes' raise these figures considerably. . . .

The conclusion to which I am brought is that the proper solution of the difficulties the federal Treasurer has indicated is carefully to devise a simple, graduated and progressive rate, intermediate between that of the highest and lowest taxing States, and to persuade all the States to adopt this as a war-time measure. The federal authorities should then just as carefully and reasonably revise the scales of the Income Tax Act (No. 2) 1940, so that for the next financial year the necessary revenue from income tax may be obtained in an equitable and fair fashion.

* * *

2 Uniform Income Tax
[Early in 1942 the Federal government decided] to adopt almost all the recommendations of the Uniform Tax Committee . . . and the four Bills which embodied that decision . . . passed both Houses of Parliament. Now that they have survived an appeal by some of the State governments as to their legality and that most happily the new system is in force, it seems well that the rates which have been enacted for income of individuals received in the year ending 30 June 1942 be examined more in detail.

The Schedules included in the Committee's report and adopted by the government were devised to produce, with as little change as practicable, substantially the same revenue as was received in the previous financial year from the combined federal and State taxes on income. As is well known, the taxes referred to were a combination of numerous rates based on widely different principles, and it is not surprising that a single scale of rates to replace the combination appears, and in fact is, somewhat complex. However, we must suppose the Uniform Tax Committee thought that, to secure acceptance of the principle, it would be advisable to make the change-over as gradual as possible, and the government evidently was of the same opinion.

It is to be hoped that, when the details of the tax on income received in the year ending 30 June 1943 are being considered, the rates now in force will be revised. They would have been subjected to more criticism if it had not been feared that this would affect injuriously the fortunes of the important proposals, which were to bring about, as a war measure, a single taxing authority in the Commonwealth on income for the duration of the war and one year thereafter. It is most unlikely that, when the new system has been in operation, a return to the old will be desired by taxpayers or taxation authorities.
Features of the 1942 Income Tax Act

Under the Income Tax Act 1942 . . . the statutory exemption or deduction is withdrawn, but no tax is levied on individual incomes not exceeding £156. Where the taxable income exceeds £156 and is less than £170, the amount of the tax is to be half the excess over £156, when this is less than the sum given by the formulae of the schedule, after allowing for all rebates.

The concessional reductions, which were formerly applied to the income itself, are now replaced by rebates.

The old arrangement is retained for determining the amount of the tax on individual incomes derived partly from personal exertion and partly from property. For every pound of taxable income derived from personal exertion the rate of tax is to be ascertained by dividing the total amount of the tax that would be payable under Division A, if the total taxable income were derived exclusively from personal exertion, by the amount of the total taxable income. And similarly for the income derived from property . . .

With a simple notation the [provisions of the 1942 Income Tax Act] can be made both clearer and shorter. Let the amount of the tax on a taxable income of £x be T pence. Then the relation between T and x is as follows:4

\[
\text{Taxpayer without Dependents — Income from Personal Exertion}
\]

When \(150 < x \leq 200\),
\[
T = 1,200 + (x - 150) \left[ 8 + \frac{12}{100}(x - 150) \right].
\]

When \(200 < x \leq 250\),
\[
T = 1,900 + (x - 200) \left[ 50 + \frac{8}{100}(x - 200) \right].
\]

When \(250 < x \leq 600\),
\[
T = 4,600 + (x - 250) \left[ 58 + \frac{2}{100}(x - 250) \right].
\]

When \(600 < x \leq 2,500\),
\[
T = 27,350 + (x - 600) \left[ 72 + \frac{33}{1,000}(x - 600) \right].
\]

When \(2,500 < x \leq 4,000\),
\[
T = 283,280 + (x - 2,500) \left[ 198 + \frac{6}{1,000}(x - 2,500) \right].
\]

When \(4,000 < x\),
\[
T = 593,780 + 216(x - 4,000).
\]

Incidence of the New Federal Tax

With the Commonwealth the sole taxing authority on income one might expect under present conditions a very severe, but simple and reasonable, graduated tax. That the Uniform Tax is very severe on
high incomes is evident, but that it is simple, and in every feature of its graduation reasonable, is far from clear. Its failure in these qualities is probably due to the fact that the Uniform Tax Committee considered its mandate was to present the government with a scale which would bring in for this financial year a revenue as nearly as practicable equivalent to that of the combined federal and State taxes on income for the previous year.

With the scale rising to 18s. in the £ [90 per cent] on the excess over £4,000 in earned income and £2,100 in property income, the tax is certainly severe on all incomes over £4,000 (or £2,100), but it does not obey the principle of ability to pay. It would be a fairer tax if the flat rate were reached at a much higher point . . .

* * *

3 Australian Income Tax Act 1943
In this paper I discuss the Income Tax Act 1943 so far as it deals with individual incomes. Everyone must now recognize the advantage of having only one authority for taxation of incomes in Australia, and it is well that the 1943 Act be understood and perhaps further improvements suggested for another year. One of the most remarkable features of the 1943 Act is that persons without dependants with an income of just over £104 per annum are made liable to tax. In the Income Tax Assessment Act 1942 taxable income which does not exceed £156, derived by a person who is not a company, is exempt from tax. In the 1943 Act £104 is substituted for £156 and, of course, in both Acts persons with dependants obtain rebates which make their exemption limit much higher. Further, the tax on low and moderate incomes is very much greater in the 1943 Act than in its predecessor.

It must be noted, however, that along with the Income Tax Bill 1943 there was submitted a National Welfare Fund Bill 1943, which secured compensation in part for the heavy tax now imposed. From 1 July 1943, there was to be paid into a National Welfare Fund out of Consolidated Revenue an annual sum of £30m or a sum equal to one-quarter of the total collections each year from income tax on individuals, whichever may be the less.

The close connection between the Bills will be seen from Clause 2 of the Income Tax Bill, as placed before the House of Representatives and passed by that House on 4 March. This clause reads as follows:

This Act shall come into operation on a date to be fixed by Proclamation, not being earlier than the date upon which the National Welfare Fund Act 1943 comes into operation.
When the Bill reached the Senate the majority of that House objected to this clause as ‘tacking’ and the Bill was returned to the House of Representatives with the request that all the words after ‘Proclamation’ be left out. It was only after a consultation on 16 March between representatives of both Houses that a compromise was reached. The House of Representatives agreed to delete the words in Clause 2 complained of, and the Senate undertook to consider the National Welfare Fund Bill 1943 immediately and to complete its consideration before the end of the sitting on the 18th. The Income Tax Bill 1943 then passed both Houses on the 16th, and the National Welfare Fund Bill 1943, having passed the House of Representatives on the 9th, finished its course in the Senate on the 18th. Both Acts were proclaimed without delay . . .

Rate Structure Under the 1943 Income Tax Act
Let the amount of the tax on a taxable income of £x be T pence. The [provisions of the 1943 Act] may . . . be [expressed] by the following formulae:

Taxpayer without Dependants — Income from Personal Exertion

When $0 < x \leq 300$,
$$T = 600 + (x - 100) \left[ 30 + \frac{165}{1000} (x - 100) \right].$$

When $300 < x \leq 1,000$,
$$T = 13,200 + (x - 300) \left[ 96 + \frac{1}{100} (x - 300) \right].$$

When $1,000 < x \leq 2,000$,
$$T = 85,300 + (x - 1,000) \left[ 110 + \frac{33}{1000} (x - 1,000) \right].$$

When $2,000 < x \leq 3,000$,
$$T = 228,300 + (x - 2,000) \left[ 176 + \frac{15}{1000} (x - 2,000) \right].$$

When $3,000 < x \leq 5,000$,
$$T = 419,300 + (x - 3,000) \left[ 206 + \frac{4}{1000} (x - 3,000) \right].$$

When $5,000 < x$,
$$T = 222x - 262,700.$$

Concessional Rebates
Previous to the 1942 Act the concessions for dependants, medical expenses, etc., were given by deductions from the assessable income. With a graduated tax ascending so rapidly and reaching a flat rate of 18s. 6d. in the £ [92½ per cent] on the excess over £5,000 this method would make these concessions for persons with high incomes much greater than for those of low and moderate ones. To the 1942 Act, where the flat rate of 18s. in the £ [90 per cent] applied to the excess
over £4,000 in earned income and £2,100 in property income, the same remark applies. In 1942 these deductions were replaced by rebates of tax calculated at the personal exertion rate appropriate to the taxable income of the taxpayer on the amount of the allowance, with the proviso that the rebates shall not exceed defined limits.

For instance, for a dependent wife the allowance was half the taxable income, when this exceeds £200 but does not exceed £250; it was £100 plus half the amount by which the taxable income was less than £300, when this exceeds £250 and does not exceed £300; in all other cases it was £100. But the rebate of tax allowed in this respect was not to exceed £45.

Again, in respect of a dependent only child, or the elder or eldest of such children, the allowance was £75 and the amount of the rebate was calculated as explained above, with the proviso that it must not exceed £45.

In respect of a dependent child, who is not the only child or the elder or eldest of such children, the allowance was £30 and the amount of the rebate was not to exceed £5.

This treatment of the dependent children other than the first is due to the Family Endowment Grant for such children.

In the 1943 Act the same method is followed, but there are some additional cases where concessional rebates are granted, and in the case of children other than the first the maximum rebate is raised to £8.

This system of concessional rebates instead of deductions from the assessable income seems to me a sound one and it is quite a simple matter to calculate what each rebate will amount to in the case of any taxpayer affected. It is possible that on the low incomes a more liberal allowance might have been reasonable, but otherwise there seems no ground for the view expressed in some quarters that the rates of tax now favour the single taxpayer, while the man with family responsibilities is treated harshly.

* * *

4 Social Services Contribution 1945
The Income Tax Acts 1945 dealing with the assessment and rates of tax on income received during the year ending 30 June 1946 were passed in May 1945. With the system now in force it is necessary to fix the rates thus early so that employers may have the needed information in good time. The First and Second Schedules, giving the rates of tax on earned and property income, remained unchanged...
As-You-Earn system and ... the 1943 rates were then continued. The discussion above on — 'Australian Income Tax, 1943' — thus applies to the rates of the Income Tax Act (No. 1) 1945 . . .

Since 1943 the National Welfare Fund has been used as a means of financing the social services. Into this Fund has been paid annually from Consolidated Revenue the sum of £30m or a sum equal to one-quarter of the total collections each year from income tax on individual incomes, whichever has been the smaller. It was now proposed to add to the income of the National Welfare Fund so that it would meet all the social services, which were growing in number and importance. One of the methods of increasing the income which had been decided upon was to divide the present income tax into two separate levies, one of them to be a Social Services Contribution, the amount obtained from this levy to be used exclusively in financing the social services.

The government plan was embodied in four Bills introduced by the Treasurer subsequent to the budget and passed with little delay:

- The Social Services Contribution Assessment Act 1945,
- The Social Services Contribution Act 1945,
- The Income Tax Assessment Act (No. 2) 1945, and
- The Income Tax Act (No. 2) 1945.

The first two correspond to the usual annual Income Tax Acts, as the machinery for assessment and collection of the Social Services Contribution is to be the same as that for Income Tax. No duplication of returns or assessments will be required.

The rate of the Social Services Contribution (i.e., the amount of the contribution divided by the amount of the contributing income) is given in the Social Services Contribution Act. This rate is to be the rate of income tax the taxpayer would have been liable to be assessed under the Income Tax Act (No. 1) 1945 with the rebates in force up to the introduction of the Income Tax Acts 1945, less 12½ per cent, or 18d. in the £ [7½ per cent], whichever may be the smaller; but for the year ending 30 June 1946 the rate is to be half of that applicable for a full year.

The Social Services Contribution is made only by individuals, but will not be paid unless the income exceeds in the case of a taxpayer without dependants £104, with dependent wife £156, with dependent wife and one child £175, with dependent wife and two children £211, with dependent wife and three children £257, with dependent wife and four children £277, since under the first Income Tax Acts 1945 the tax vanishes up to these limits . . .

* * *


5 Social Services Contribution Rates 1946

The scale chosen for the Social Services Contribution proved so difficult to apply that, when the financial proposals for the year ending 30 June 1947 were laid before Parliament in July 1946, a new scale was devised and made applicable to the last six months of the previous financial year. This simpler scale reduced the amount of contribution from contributors on the lower ranges of income but the maximum of 18d. in the £ [7½ per cent] remained unchanged.

The new schedule of rates prescribed a separate basic rate commencing at 3d. in the £ and increasing by one-eighth of a penny for every £1 of income in excess of £100. This basic rate applies to the case of a person without dependants, who is not entitled to rebates for life insurance, medical expenses, etc. The basic rate is varied so as to preserve the concessions allowed previously to contributors for dependants, life insurance, medical expenses, etc. The rate so varied is called the concessional rate . . .

Schedules of the Income Tax Act 1946

We turn now to the Schedules of the Income Tax Act 1946, which deal with the tax on individual incomes received in the year ending 30 June 1947. The weekly deductions from wages and salaries from 1 July 1946 to 30 June 1947 are determined by these schedules, as well as the Provisional Tax which will have to be paid with the Income Tax on income received in the year ending 30 June 1946 . . .

Let the amount of tax on a taxable income of £x be T pence. The [Schedules of the Act] may then be replaced by the following formulae:

\[ T = \begin{cases} 0 & \text{when } x \leq 200 \\ 6x^2/100 + 12x - 4,800 & \text{when } 200 < x \leq 300 \\ 4,200 + (x - 300)(48 + 2/100(x - 300)) & \text{when } 300 < x \leq 1,000 \\ 47,600 + (x - 1,000)(76 + 25/1,000(x - 1,000)) & \text{when } 1,000 < x \leq 2,000 \end{cases} \]
When $2,000 < x \leq 3,000,$

$$T = 148,600 + (x - 2,000) \left[ 126 + \frac{14}{1,000}(x - 2,000) \right]$$

$$= \frac{14x^2}{1,000} + 70x - 47,400.$$ 

When $3,000 < x \leq 5,000,$

$$T = 288,600 + (x - 3,000) \left[ 154 + \frac{5}{1,000}(x - 3,000) \right]$$

$$= \frac{5x^2}{1,000} + 124x - 128,400.$$ 

When $5,000 < x,$

$$T = 616,600 + 174(x - 5,000).$$

The new rates of Income Tax have the effect of raising the limits of income which may be received by persons with dependants before incurring any liability for Income Tax. These persons will, however, be liable for the Social Services Contribution.

It will be remembered that the amount of the rebates is determined by applying to the rebatable amount the rate of tax on the taxable income, as from personal exertion, but to that rate is to be added 18 pence in the £ for the Social Services Contribution.

In the case of income derived wholly from personal exertion the amounts which will be free of Income Tax under the new scale will be as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Person with dependent wife</td>
<td>280</td>
</tr>
<tr>
<td>Person with dependent wife and 1 child</td>
<td>345</td>
</tr>
<tr>
<td>Person with dependent wife and 2 children</td>
<td>378</td>
</tr>
<tr>
<td>Person with dependent wife and 3 children</td>
<td>412</td>
</tr>
<tr>
<td>Person with dependent wife and 4 children</td>
<td>447</td>
</tr>
</tbody>
</table>

The Social Services Contribution and Income Tax Acts 1947

In [preceding sections] I have examined the graduation of the Australian tax on individual incomes. The scale of the 1942 Act was devised so that the tax on income received in the year ending 30 June 1942 would be approximately equal to the sum of the federal and State taxes of the previous year. But in 1943 the Treasurer felt himself free to impose a tax heavy enough to meet the existing circumstances, a true war-time tax. This is to be found in the Income Tax Act 1943.

In 1944 it was decided to adopt the Pay-As-You-Go [Earn] system, modified so that both earned and property income might be included. This was applied for the first time income received in the year ending 30 June 1945. The scale of the 1943 Act was still adhered to as had also
been the case for income received in the year ending 30 June 1944, but for that ‘transition year’ a rebate of 75 per cent of the tax was granted. It had been intended also to use the 1943 Act scale in the year ending 30 June 1946, but, in September 1945, after the surrender of the Japanese in August, a new scale, giving a slight reduction, was adopted for the second half of the financial year. This scale was also used for income received in the year ending 30 June 1947. The combined Social Services Contribution and Income Tax amounted to something like the 1943 tax less 12½ per cent.

Finally in March 1947, the Treasurer in his financial statement promised for the next year a much greater reduction. This was given in the Social Services Contribution and Income Tax Acts 1947, which deal with income received in the year ending 30 June 1948.

It is with these Acts, so far as they are concerned with individual incomes, that this concluding section deals.

It is easy to construct a graph which will show the amount paid by each £ of income received in the year ending 30 June 1948 from the sum of the Social Services Contribution and Income Tax, when there are no rebates.

![Figure 1](image)

It is interesting to have on one diagram the corresponding graphs for the total levy in the 1943 Act and the Acts of 1946 and 1947, Earned and Property Income. These are given in Fig. 1 and Fig. 2.
The graphs give at once the amount paid by the xth £ in the different stages. Also, if a taxpayer's income is raised from £x₀ to £x₁, where x₀ and x₁ lie in the same segment, the rate of tax on the additional income in pence per £ is given by the ordinate at \( \frac{1}{2}(x₀ + x₁) \). If we look at the value attributed on the axis to the ordinate, we have the result. When x₀ and x₁ are not in the same segment a slight alteration of this process gives the figure wanted.

It is too often stated that the tax on the wage earner is still so high that he has little incentive for increased production. The graphs in Fig. 1 show that, while this may have been true to some extent in the wartime scale, it is true no longer in the 1947 scale.

The 1946 graphs show irregularity from £200 to £220. This arises from the form given to the basic rate of Social Services Contribution. The expression \( 3 + \frac{1}{8}(x - 100) \) rises to 18 at \( x = 220 \), but income tax starts in that scale at £200.

**Concessional Rebates**

With the rebate system in force in Australia the graphs of Figs. 1 and 2 do not give more than a slight indication of the present tax burden as compared with that of previous years. They take no account of the relief given to persons with dependants or entitled for other reasons to reductions in their tax.
In this section we deal as briefly as possible with this matter. The amount of the rebate which a taxpayer with an income of £x obtains in respect of a rebatable amount £A is
\[(R + 18)A\] pence,
where R is the rate of tax \((T/x)\) on an earned income of £x, and 18 is added, the maximum Social Services Contribution being 18 pence in the £. For instance, a taxpayer with an earned income of £1,000 and a dependent wife would receive on her account a rebate of 
\[(36.75 + 18)150\] pence, or £34/2/-.

I give below details of the earned incomes that were free of income tax under the 1946 Act and are now free under the 1947 Act.

<table>
<thead>
<tr>
<th></th>
<th>1946</th>
<th>1947</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Taxpayer</td>
<td>£200</td>
<td>£250</td>
</tr>
<tr>
<td>Taxpayer with dependent wife</td>
<td>£289</td>
<td>£396</td>
</tr>
<tr>
<td>Taxpayer with dependent wife and one child</td>
<td>£345</td>
<td>£513</td>
</tr>
<tr>
<td>Taxpayer with dependent wife and two children</td>
<td>£378</td>
<td>£572</td>
</tr>
<tr>
<td>Taxpayer with dependent wife and three children</td>
<td>£412</td>
<td>£632</td>
</tr>
<tr>
<td>Widow or widower with one child</td>
<td>£245</td>
<td>£344</td>
</tr>
<tr>
<td>Widow or widower with two children</td>
<td>£275</td>
<td>£396</td>
</tr>
<tr>
<td>Widow or widower with three children</td>
<td>£304</td>
<td>£454</td>
</tr>
</tbody>
</table>

Notes

1  [Sir George Knibbs, 1858-1929. First Commonwealth Statistician, 1906-21.]

2  Victoria changed over from its steps and stairs system only in 1938, much later than the other States.

3  These formulae are simple but that does not make them good.

4  On incomes not exceeding £2,100, these formulae give for the tax on property income an amount greater by one-quarter than that on the same earned income. When the income from property exceeds £2,100, the amount of the tax on the first £2,100 is greater by one-quarter than that on an earned income of £2,100, and on the excess over £2,100 there is a flat rate of 18s. in the £, while in earned income this flat rate of 18s. in the £ applies to the excess over £4,000.

5  The Social Services Contribution was introduced in the 1945 Acts.
XXV
Resumption of Income Tax by the States*

Commonwealth and State Treasury Officers 1953

I. Terms of Reference
At a conference of Commonwealth and State Ministers held in Canberra in July, 1952, it was decided that Commonwealth and State Treasury officers should examine the technical problems involved in the resumption of income tax by the States. The terms of that decision are contained in the concluding statement made by the Prime Minister at the conference. . .

2. The following report has been prepared in accordance with that decision. . .

II. Technical Material Prepared by Treasury Officers
4. The technical problems involved in the resumption of income tax by the States have been discussed at a number of meetings of Commonwealth and State Treasury officers and data on the following subjects have been prepared for consideration by Ministers:—
   (a) Commonwealth Rates of Income Tax
   (b) Implications of Differences in Taxable Capacities of the States
   (c) Relationship between Commonwealth and State Rates
   (d) Problems of Establishing and Maintaining a Standard Assessment Law

*Government Printer, Canberra, 1953, L3009 (Appendices omitted).
(e) Implications of a ‘Residence’ Basis as compared with an ‘Origin of Income’ Basis of State Income Tax
(f) Arrears of State Income Taxation

5. The Commonwealth Solicitor-General was asked to prepare, in collaboration with the Crown Solicitor for New South Wales and the Solicitor-General of Victoria, a report on the legal problems connected with the establishment and maintenance of a uniform assessment law . . .

6. The Commissioner of Taxation has also prepared a report on the effects on administration of the resumption of income tax by the States . . .

III. Main Issues for Decision

7. The proposal that the States re-enter the field of income tax and that the Commonwealth abandon the present system of tax reimbursement grants can be implemented in a number of ways.

8. The Treasury officers of the Commonwealth and States have not attempted to recommend any particular scheme for adoption because a choice between the various alternatives involves policy decisions which Ministers have not yet made.

9. In order to focus attention on the principal problems upon which decisions must be reached before a detailed scheme can be formulated, this report sets out the main policy issues which arise and discusses the implications of various alternative courses of action. The main policy issues requiring decision by Ministers are listed at the conclusion of the report in paragraph 101 and the technical problems are discussed more fully in the appendices [Not reproduced] . . .

1. Division of Income Tax Field between Commonwealth and States

11. One of the first and most important questions to decide is the manner in which the income tax field is to be shared by the Commonwealth and the States. The main problem is to apportion the income tax field between governments in such a way as to secure as far as possible that income tax provides each government with a reasonable and flexible source of revenue, and that the combined imposts on the taxpayer are kept to a reasonable minimum. Before discussing specific proposals for the sharing of the income tax field among governments, it may be useful therefore to outline the main factors which will determine the scope and flexibility of income tax in any scheme under which the Commonwealth and States share this field.

12. In this connexion it should be recognized that, as compared with the pre-war position, there is greatly increased reliance upon income tax as a source of revenue. Income tax by the governments has increased from 4½ per cent of the gross National Income in 1938-39
(of which about two-thirds was raised by the States) to 14 per cent of the National Income in 1951-52. As the tax reimbursement grants to the States in 1951-52 bore much the same proportion to the gross National Income as the States' pre-war income tax and, as the Commonwealth contribution to the States' loan programmes out of revenue in 1951-52 was about 2½ per cent of gross National Income, the greatest proportion of the increase was used to meet Commonwealth commitments. Because of the increased reliance by governments on income tax it follows that, irrespective of the way in which income tax may be shared by the Commonwealth and the States, it is likely to be a much less flexible source of revenue for each government than in the pre-war period, unless there is some decline in the revenue requirements of governments. It follows also that the problem of devising an equitable apportionment of the income tax field among governments is necessarily much more difficult than in the pre-war years.

13. In determining an apportionment between Commonwealth and States, the main factors to take into account are —
   (a) the present and prospective level of Commonwealth income tax rates;
   (b) the prospective level of State income tax rates.

Present and Prospective Level of Commonwealth Rates

14. [The] Commonwealth income tax is now taking a much greater proportion than in 1938-39 of incomes of comparable purchasing power . . . [For] most grades of income the present severity of rates is of the order of two and a half times the severity of the combined State and Commonwealth income tax pre-war, when regard is had to comparable purchasing power. This conclusion is consistent with the calculation that income tax in 1951-52 took 14 per cent of the gross National Income as compared with 4½ per cent in 1938-39.

15. The possible scope and elasticity of State income taxes would depend both on the extent to which the Commonwealth proposed to withdraw from income tax in the first year of the new arrangements and upon the possible level of Commonwealth rates in subsequent years.

16. Commonwealth income tax collections in 1952-53 are estimated at £552,000,000. The main lines of estimated expenditure which are greatly expanded as compared with 1938-39, or which did not exist in 1938-39, are tax reimbursement grants £135,900,000, capital works and services £106,600,000, National Welfare Fund £164,200,000, war and repatriation £111,400,000, and defence £200,000,000. If the Commonwealth were to reduce its income tax to the extent of the tax reimbursement grants (£135,900,000), the reduction would be about 25 per cent. This would mean that if they found it necessary to raise
income tax revenue equal to their present tax reimbursement grants, some States would need to impose income tax heavier than the Commonwealth withdrawal. If the Commonwealth were to reduce its rates sufficiently to ensure that no State would have to impose rates more severe than the extent of Commonwealth withdrawal in order to get income tax revenue equal to its present tax reimbursement grant, the reduction would be about £200,000,000 or about 35 per cent.

Prospective Level of State Rates

17. The scope and flexibility of State income taxes would be influenced not only by the extent to which the Commonwealth withdraws from the income tax field, but also by the relative taxable capacities of the States.

18. [Estimates] have . . . been made of the relative taxable capacities of the States and certain calculations have been included to illustrate the effect on income tax rates as between States if the States were to raise certain amounts of revenue by way of income tax.

19. The estimates of the relative taxable capacities of the States reflect the amounts of revenue per head which each State would obtain if they all imposed the same rates of tax. The estimates . . . are based on the estimated yield per head of the Commonwealth income tax in each State in 1951-52. It must be emphasized, however, that these estimates should be used with caution in considering the possible position in 1953-54 or subsequent years. State income taxes might differ significantly in general structure and in rates of progression from the present Commonwealth tax. . . Furthermore, the taxable capacities of the States may vary significantly even from year to year as a result of changes in economic conditions.

20. Subject to these qualifications, the general picture which emerges is illustrated in the following indices of the taxable capacities of the States in 1951-52. These figures assume that income tax would be assessed by each State on the income derived within that State — i.e. on an ‘origin of income’ basis. (Figures compiled on a ‘residence’ basis are given . . . in paragraph 26 of this report. On a ‘residence’ basis interstate income would be taxed by the State in which the income recipient resides.)

21. These figures indicate that there are marked differences in the relative taxable capacities of the States. For the reasons set out in paragraph 19, the figures must not be used as a precise measure of the differences between States. There is, however, no doubt that, as the ability of the States to secure revenue from income tax would vary from State to State, some States would either have to apply higher rates of taxation than other States, accept lower standards of governmental services or rely to a greater extent on financial assistance from
Estimated Relative Taxable Capacities of the States in 1951-52

<table>
<thead>
<tr>
<th></th>
<th>Individuals</th>
<th>Companies</th>
<th>Individuals and Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>96</td>
<td>106</td>
<td>100</td>
</tr>
<tr>
<td>Victoria</td>
<td>112</td>
<td>115</td>
<td>113</td>
</tr>
<tr>
<td>Queensland</td>
<td>76</td>
<td>75</td>
<td>76</td>
</tr>
<tr>
<td>South Australia</td>
<td>113</td>
<td>89</td>
<td>105</td>
</tr>
<tr>
<td>Western Australia</td>
<td>128</td>
<td>70</td>
<td>110</td>
</tr>
<tr>
<td>Tasmania</td>
<td>62</td>
<td>97</td>
<td>73</td>
</tr>
<tr>
<td>Weighted average — All States</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

the Commonwealth. In this latter connexion the existing method of the Commonwealth Grants Commission in recommending supplementary financial assistance would protect claimant States against the necessity of imposing much heavier taxation.

22. [Certain] tentative calculations have been made of the position which might have arisen if the States had been in the income tax field in 1952-53. Thus it is estimated that if it had been desired to ensure that in 1952-53 all States collected amounts equivalent to their present tax reimbursement grants (£135,000,000) without imposing taxation heavier than the Commonwealth withdrawal, the reduction in Commonwealth income tax yield would have had to exceed the present tax reimbursement grants by as much as 50 per cent.

23. To quote another example, it is estimated that if the Commonwealth had reduced its income tax in 1952-53 by £135,000,000 and each State had levied income tax sufficient to yield its present tax reimbursement grant, the rates of State tax would have ranged from 20 per cent lower than the average of all States in Victoria to about 50 per cent higher than average in Queensland.

24. The combined Commonwealth-State rates in 1952-53 would, in that event, have ranged from 11 per cent higher than at present in Queensland to 5 per cent lower in the case of Victoria . . . These figures are illustrative only. The amounts which the States decide to raise by way of income tax may vary markedly from the present distribution of the tax reimbursement grants among the States. Moreover, the illustrations take no account of the possible effects upon the grants recommended by the Commonwealth Grants Commission. Nevertheless these calculations do give some indication of the nature and possible magnitude of the financial problems which arise in any attempt to provide all governments with reasonable scope and flexibility in the income tax field.
2. **Manner of Division of Income Tax Field**

25. There are many ways in which the Commonwealth could withdraw from portion of the income tax field to allow the States to participate. The main ones are —

   (a) The Commonwealth to reduce rates of income tax more or less proportionately over the whole present field thus restoring the pre-war position under which the States taxed both individuals and companies.

   (b) The Commonwealth to reduce rates more or less proportionately only in a selected field of income tax (e.g. on individuals only or companies only) and the States to enter that selected field.

   (c) The Commonwealth to reduce its taxation disproportionately in selected income ranges, e.g. to permit the States to concentrate their taxation mainly upon either the lower or higher income groups.

**Effects on State Rates**

26. [The] decision as to the actual subdivision of the tax field could have appreciably different effects on potential tax yields in the several States. Following is a selection of the estimates of taxable capacities:

<table>
<thead>
<tr>
<th>Individuals</th>
<th>Individuals and Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residence</td>
<td>Origin</td>
</tr>
<tr>
<td>Basis</td>
<td>Basis</td>
</tr>
<tr>
<td>Both Residence</td>
<td>Both Origin</td>
</tr>
<tr>
<td>Both</td>
<td>Companies</td>
</tr>
<tr>
<td></td>
<td>Origin</td>
</tr>
<tr>
<td></td>
<td>Residence</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>States</th>
<th>Residence Basis</th>
<th>Origin Basis</th>
<th>Both Residence</th>
<th>Both Origin</th>
<th>Companies — Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>96</td>
<td>96</td>
<td>100</td>
<td>100</td>
<td>99</td>
</tr>
<tr>
<td>Victoria</td>
<td>114</td>
<td>112</td>
<td>124</td>
<td>113</td>
<td>114</td>
</tr>
<tr>
<td>Queensland</td>
<td>74</td>
<td>76</td>
<td>64</td>
<td>76</td>
<td>75</td>
</tr>
<tr>
<td>South Australia</td>
<td>113</td>
<td>113</td>
<td>103</td>
<td>105</td>
<td>106</td>
</tr>
<tr>
<td>Western Australia</td>
<td>127</td>
<td>128</td>
<td>102</td>
<td>110</td>
<td>109</td>
</tr>
<tr>
<td>Tasmania</td>
<td>60</td>
<td>62</td>
<td>54</td>
<td>73</td>
<td>72</td>
</tr>
<tr>
<td>Weighted average — All States</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

27. The difference in taxable capacities as between States would depend in part on whether they decided to levy their taxes upon an 'origin of income' or a 'residence' basis. This latter question is dealt with in paragraphs 79-85 below . . . Broadly the pre-war position was that the States taxed individuals mainly on a 'residence' basis and
companies on an 'origin' basis. The relative taxable capacities of the States on this basis are shown in the last column of the table above. On this basis the disparity between State taxable capacities would be least.

28. If the States were to tax individuals only, this would increase the differences between States, reacting (from the point of view of yield) to the disadvantage of Tasmania and New South Wales and to the advantage of South Australia and Western Australia. Furthermore, it would restrict the choice of States in the range and incidence of their taxation.

29. Any proposal for the Commonwealth to withdraw by differing proportions from selected ranges of incomes would likewise have varying effects upon individual State yields. If, for instance, the Commonwealth decided to make its reductions mainly on the lower incomes, Queensland and Tasmania would probably be advantaged (so far as potential yield is concerned) and Victoria and Western Australia disadvantaged. If the emphasis were in the opposite direction the effects would be the reverse. Of course such withdrawal would have other, and probably more important, implications.

3. Relationship between Commonwealth and State Rates

36. . . . The main matters for decision are —

(i) Whether State rates should follow the same form as Commonwealth rates.

(ii) Whether Commonwealth and State rates should be coordinated in any way.

(iii) Whether the timing of variations in rates should be coordinated.

Form of State Rates

37. In considering whether State rates of income tax should follow the same form as Commonwealth rates, the alternatives are —

(a) State rates to be determined as a certain percentage of Commonwealth rates; or

(b) State rates not so related to Commonwealth rates.

38. State Rates as Percentage of Commonwealth Rates. — Under this proposal State rates would be determined at the same percentage of Commonwealth rates at all income levels. This would mean that, although the percentage might vary as between States, each State would maintain the same progression in its rates as the Commonwealth.

39. At first sight, this proposal would appear to have the advantage of simplicity for both the taxpayer and collecting authority. This would be so, however, only if taxable income for both Commonwealth and State purposes were identical . . . Commonwealth and
State taxable incomes would not be identical where the income included Commonwealth loan interest, whilst policy considerations may also result in other departures from a uniform assessment law. . .

Co-ordination of Commonwealth and State Rates

43. Under the Constitution, Commonwealth rates must be the same in all States. In view of the wide differences in the taxable capacities of the States, however, the possibility must be faced that State rates may vary as between States not only in their overall severity but also in their incidence on particular groups of taxpayers. In these circumstances the incidence of the combined Commonwealth-State rates may give rise to special problems.

44. It could transpire, for example, that the combined maximum incremental rates in a particular State or States might approach limits considered to be unduly high. Furthermore, the weight of the combined Commonwealth and State taxes could be unduly heavy at various income levels.

45. The question arises, therefore, as to whether Commonwealth and State rates should be co-ordinated in some way in order to avoid inequities or anomalies of this kind. If some degree of co-ordination is desired, the main alternatives appear to be —

(a) Agree on some specific method of limiting the combined rates; or

(b) Rely on periodical consultations as between governments.

46. Agreement on Limitation of Rates. — Limitation of the level of the combined Commonwealth-State rates could be achieved by —

(a) Allowing Commonwealth tax payable in respect of the income year as a deduction from taxable income for State tax purposes; or

(b) Allowing State tax payable in respect of the income year as a deduction from taxable income for Commonwealth tax purposes; or

(c) Placing a stated limit (or limits) on income tax rates.

47. Whichever government allowed the other government’s tax as a deduction would, of course, need to impose higher nominal rates of tax than would otherwise be necessary to raise the same amount of revenue.

48. Adoption of alternative (a) or (b) would minimize the possibility of the combined rates proving unduly high in the various income ranges.

49. On the other hand, adoption of either alternative would mean that the taxable income for Commonwealth and State purposes would never be identical. This would lead to complexity for the taxpayer and additional administrative work in the assessment and calculation of
tax. Problems of co-ordinating the timing of variations in rates by the Commonwealth and States would also be involved.

50. Under alternative (c) the Commonwealth and States might reach an agreement to place a ceiling for a stated period on the Commonwealth, State or combined Commonwealth-State rates. Such an arrangement might meet the problem of the maximum combined rates but, for practical reasons, it would probably be impossible to fix stated limits on the level of the combined rates throughout the tax scale. In any event, such an arrangement even if confined to the maximum combined rate, might hamper the Commonwealth or certain States in raising adequate revenues if circumstances changed during the currency of the agreement.

51. It appears that adherence to agreements of the kind described above could not be enforced without an amendment of the Constitution.

52. Consultation between Governments. — Problems connected with the incidence of the combined Commonwealth-State rates might be met to some extent if the Commonwealth and States were to consult each other before deciding on variations in income tax rates. Such consultations could be of mutual advantage in exploring the implications of proposed Commonwealth-State rates, and in avoiding unduly high combined rates and any anomalies. It is obvious, however, that difficulties could arise which would make detailed consultations impracticable. For one thing, proposed variations in income tax are closely related to a government’s budgetary policy. Consultation in income tax matters might therefore involve revelation of budget policies before introduction of the budget. In any event, a major timing problem would be involved if the seven governments concerned were to complete their budget plans in time to allow full consultation without delaying presentation of their budgets.

Timing of Variations in Rates

53. If some degree of co-ordination between Commonwealth and State rates were desired, it would be necessary for the seven governments to agree also on the timing of variations in rates, unless such variations were of a minor nature.

54. The timing of variations in rates would be important in relation to revenues and the convenience of taxpayers under a pay-as-you-earn system of taxation.

55. Particularly in the interests of the great bulk of taxpayers (who are wage and salary earners) rates of instalment deductions should be fixed as early as possible in the financial year so as to enable collections by instalments to proceed smoothly. To ensure this, close
co-ordination between Commonwealth and State administrations would be necessary.

56. If the revised instalment scales were not issued until late in the financial year, taxpayers would, if rates were increased, need to find additional cash and, if rates were reduced, need to await the full benefit of that reduction until the final assessment of tax was made in the following year. Late issues of instalment scales could also affect current revenues.

57. Similar considerations apply in the case of provisional tax. Delay in the issue of provisional tax assessments could also affect current revenues significantly.

58. The main matters for decision therefore appear to be the extent to which governments should consult each other before varying tax rates and the timetable arrangements which should be attempted, particularly in relation to pay-as-you-earn taxation.

4. Degree of Uniformity in Assessment Laws

59. The question arises as to the extent to which the assessment laws should be uniform as between the Commonwealth and each State. The problems involved in the establishment and maintenance of uniform assessment laws are . . . outlined below.

Technical Obstacles

60. One of the principal advantages of uniform assessment laws would be to ensure that the same taxable income could be adopted for purposes of assessing both Commonwealth and State taxes. Two technical obstacles which stand in the way of achieving this objective relate to taxation of interest on Commonwealth loans and taxation of interstate income.

61. Prior to the introduction of uniform taxation Commonwealth loans were exempt from State income tax. During the uniform tax period, this freedom from State tax has been continued, in effect, by means of a rebate of 2s. in each £1 [10 per cent] of interest. The Commonwealth could not now agree to the States taxing such interest as that would amount to breach of contract with subscribers. As Commonwealth loan interest is exempt from State taxation, those taxpayers deriving income from Commonwealth loan interest would have different taxable incomes for Commonwealth and State purposes. . . .

5. Basis of Taxing Interstate Income

79. The fact that a considerable amount of income which can be regarded as having been derived in some States flows to certain other States provokes an issue as to which State should tax such income.
80. The broad alternatives are —
   (a) To adopt a ‘residence’ basis of State taxation — in which case interstate income would be taxed by the States in which the income recipient resides; or
   (b) To adopt an ‘origin of income’ basis — in which case interstate income would be taxed by the State in which the income is derived.

81. Which of these alternatives should be sought or whether some composite basis should be adopted are essentially policy questions in which the main considerations are equity and revenue yield. A State which would benefit from the adoption of a ‘residence’ basis may claim, for example, that the capital used to finance enterprises in the State of origin was provided by its residents, and furthermore, that when spent on wages and materials the operation of such enterprises creates income in the State of origin on which tax is levied in that State. On the other hand a State in which interstate income is derived may claim to tax that income on the ground that it was produced by the labour and resources of that State or that the people in that State paid the profits on goods from elsewhere sold there.

82. The estimates . . . reproduced in paragraph 26 of this Report show that in the case of individuals, the relative taxable capacities of the States would not be affected significantly by the basis adopted for taxing interstate incomes. In the case of individuals, a ‘residence’ basis may be of some small advantage to Victoria and South Australia whilst an ‘origin’ basis would probably favour the other four States. In the field of company tax, on the other hand, adoption of a residence basis would be at present of substantial advantage to Victoria (and to some extent New South Wales), but would greatly accentuate the differences in taxable capacities as between the States.

83. . . . [Implications] of adopting a ‘residence’ or ‘origin’ basis (or some composite basis between these two) . . . may be outlined briefly as follows:

84. A ‘residence’ basis would be preferable in the interests of simplicity for taxpayers and ease of administration. Adoption of this basis, would, however, prevent the States from taxing Australian incomes of non-residents unless some special provisions were made to cover such incomes. As noted in paragraph 31 adoption of a ‘residence’ basis in the case of companies would be open to the objection that companies could in many instances readily change their State of residence to a lower taxing State.

85. An ‘origin’ basis would be much more complex for taxpayers with interstate incomes and would involve multiple returns and assessment notices for such taxpayers. Administrative work would also be increased. An ‘origin’ basis would prevent State taxation of ex-
Australian incomes unless a special provision were made to cover such incomes. There would also be some inducement for companies to prefer to trade in the lower rather than the higher taxing States.

6. Arrangements for Assessment and Collection of Tax

86. It is necessary to decide which government or governments should be responsible for assessing and collecting income tax. The alternatives are —

(a) Commonwealth to assess and collect income tax for both Commonwealth and States.

(b) States to assess and collect for both Commonwealth and States.

(c) Separate assessment and collection by Commonwealth and States.

Commonwealth to Assess and Collect

87. Resumption of State income taxation would probably be assisted considerably if the Commonwealth continued to be the sole assessing and collecting authority. The Commonwealth is the only government with staff and machinery already established for administering income tax and, whilst some expansion and modification of the existing organization would be necessary, this could probably be accomplished without major changes in the existing staff and organizational arrangements, particularly if the Commonwealth and State tax systems did not differ markedly in such matter as the basis of assessment of tax. If joint assessing and collecting arrangements are to be made there is also some logic in an arrangement under which the authority which receives the greater proportion of income tax revenue is responsible for administration.

7. Transitional Problems

94. The nature of the transitional problems which will arise when the States re-enter the income tax field will depend largely on the decisions made on the foregoing issues. Detailed consideration of such problems would, therefore, need to be left until these decisions are made.

95. Particular attention should be given to the fact that some arrangements would need to be made to ensure that the States receive adequate revenues in the transition period — particularly in the first year in which they imposed their own taxes on income.

IV. Summary of Main Issues for Decision

99. This report examines the technical problems involved in State resumption of income tax, and discusses the implications of the main issues which arise.
100. No attempt has been made to formulate a specific scheme. Before such a scheme can be prepared it will be necessary for decisions on issues of policy to be made by Ministers.

101. The main issues may be restated briefly as follows:—

1. *Division of Income Tax Field.*
   (a) The extent to which the Commonwealth will withdraw from the income tax field (paragraphs 10-24).
   (b) Whether the States will tax individuals only, individuals and companies or specific categories within these respective fields (paragraphs 25-35).

2. *Relationship between Commonwealth and State Rates.*
   Whether Commonwealth and State rates should be coordinated, particularly as regards form and timing (paragraphs 36-58).

   The extent to which uniformity is to be sought in assessment laws (paragraphs 59-78).

4. *Basis of Taxing Interstate Income.*
   Whether State taxation is to be levied on the basis of 'residence' or 'origin of income' or whether some composite basis should be adopted (paragraphs 79-85).

5. *Arrangements for Assessment and Collection of Tax.*
   (a) Whether the Commonwealth is to assess and collect for both Commonwealth and States, States to assess and collect for both, or each to assess and collect separately (paragraphs 86-90).
   (b) The extent to which Commonwealth priority in collection (section 221 of the Assessment Act) will require amendment (paragraphs 91-93).

6. *Transitional Problems*
   Until the foregoing issues are decided and a detailed scheme drawn up, it is impossible to present the detailed issues requiring decision in connexion with the transitional problems (paragraphs 94-98).

ROLAND WILSON, Commonwealth.
J. W. GOODSELL, New South Wales.
A. T. SMITHERS, Victoria.
R. L. MURRAY, Queensland.
F. C. DREW, South Australia.
ALEX. J. REID, Western Australia.
K. J. BINNS, Tasmania.

19th January, 1953.
Note

1 The signatories to this Report were respectively the Secretary of the Commonwealth Treasury and the Under-Treasurer or chief executive officer of each State Treasury. Commenting on their Report in 1966 Professor Maxwell wrote as follows:

'A thorough job was done. The Commonwealth Treasury exercised great ingenuity in raising difficulties, and feeding them backstage to Under-Treasurers of States which were opposed or lukewarm to resumption . . . Puzzling problems . . . were posed and not answered because answers could be advanced, so the Under-Treasurers averred, only after policy decisions had been made by the political people.

The effect on the Press and the public of this negative exposition was confusing. An extensive and unweighted presentation tended to exaggerate the difficulties. The politicians began to have doubts because they had not been aware of the problems and the report offered no positive remedies. And timing at the Commonwealth level conspired to hinder solid appraisal. The report (dated 19 January 1953) came up for cabinet consideration only a short time before the date of the Premiers' Conference of 20 February 1953. Accordingly the decision was taken not to offer a concrete Commonwealth proposal; instead the Premiers were to be invited, at the opening session, to offer proposals for their States. A political factor which may have influenced this decision was that five of the six Premiers were Labor.

No coherent or reasoned response should have been expected, and none was provided.'

XXVI
Uniform Taxation with States Taxing Incomes*

K. J. Binns and L. V. Bellis

Introduction
Up till 30 June 1942, each State and the Commonwealth imposed separate rates of income tax in accordance with its own different Income Tax assessment act. Various attempts had been made to achieve some degree of uniformity in State assessment acts, but with limited success. It was first suggested in 1940 that the States as a war emergency measure should vacate the income tax field in favour of the Commonwealth. Owing to differences in the relative severity of State taxation and the constitutional limitation that it shall not 'discriminate between States' in taxation, the Commonwealth was unable to use its income tax power to the full extent desired. In 1942, following an expert investigation, the Commonwealth offered to make the States annual tax reimbursement payments equal to their average income tax collections during 1939-40 and 1940-41 if they would cease to levy their own income taxation for the duration of the war. The proposal was rejected, but the Commonwealth nevertheless enacted the necessary legislation. Four States thereupon challenged the constitutional validity of the legislation, but the High Court of Australia upheld it.

The judgment had far-reaching constitutional implications because the Court ruled that the Commonwealth had priority in taxation. This

*Reproduced from The Economic Record, May 1956, pp. 50-63.
Fiscal Federalism

was the beginning of what is known in Australia to-day as uniform taxation, under which the Commonwealth is the sole income taxing authority.

The Commonwealth now enjoys a monopoly of income taxation by reason of its priority in taxing. No State is precluded from imposing its own income tax. However, if it does so, it automatically ceases to be entitled to a tax reimbursement payment. Furthermore, such taxation would be super-imposed on the existing Commonwealth income tax. In present circumstances, no State could hope to raise an amount equal to its reimbursement payment from its own income tax. Thus the States are dependent on the Commonwealth for a major portion of their revenue. Furthermore, they have lost what was their only flexible source of revenue.

The original uniform taxation legislation was due to expire on 30 June 1946. In 1945, the Commonwealth government informed the State governments of its intention to continue the system, but subject to a new scheme of reimbursement payment to the States. Following meetings of Commonwealth and State representatives, a formula was devised and incorporated in the legislation to determine the total reimbursement to the States each year and its distribution between the States.

Since the introduction of the formula in 1946, there have been two important developments. First, each year since 1949-50 Special Financial Assistance Grants have been made by the Commonwealth to supplement the reimbursements determined in accordance with the formula. These supplementary grants are made entirely at the discretion of the Commonwealth government. Secondly, in 1952 the Commonwealth government indicated that it favoured the restoration of income taxing powers to the States. A Committee of Commonwealth and State Treasury officers was instructed to prepare a report on the technical difficulties associated with such a move.

Following completion of this report, a Premiers' Conference was convened to consider the restoration of taxing powers to the States. However, the conference reached a deadlock. Two States, Western Australia and Tasmania, declared opposition to the abolition of uniform taxation. Queensland was prepared to resume income taxing responsibility if adequate provision were made to offset its relatively low taxable capacity. The remaining three States indicated willingness to impose their own income tax provided they were satisfied with the extent of Commonwealth retirement from the field.

Advantages of Uniform Taxation
There is no doubt that the present system of uniform taxation has considerable practical advantages over the former system under which the
Uniform Taxation with States Taxing Incomes

Commonwealth and each State government independently imposed its own income taxation. There are advantages both to taxpayers and governments.

So far as the taxpayer is concerned, he is faced with only one set of taxation laws, with one return to complete, and one tax demand to pay. Prior to 1942, all individual taxpayers deriving income from more than one State had to submit separate State taxation returns as well as a federal return. The six States between them imposed twenty-two separate taxes on incomes. The greatest complexity existed in the taxation of companies which had their head office in one State and branches in other States. The States had been unable to agree on a common basis for taxing such companies, although there was reciprocity between certain States. In such circumstances, there was considerable uncertainty concerning liability to taxation, and some double taxation was inevitable.

Under uniform taxation, State governments largely escape the political unpopularity attached to taxing incomes directly. From a fiscal viewpoint, the system operates to the advantage of the poorer States to the extent to which the revenue from which reimbursements are paid is raised in accordance with relative taxable capacity, whilst the grants are distributed in accordance with the formula which has some regard to relative financial need. The 1953 Report of the Treasury Officers showed that relative taxable capacity of the Australian States ranged from 73 per cent of the Australian average in Tasmania to 113 per cent in Victoria. Differences in the relative severity of State income taxes pre-war were in part due to differences in relative taxable capacity. The States with relatively low taxable capacity now receive revenue comparable with States of high taxable capacity without being obliged to impose higher rates of taxation.

The Commonwealth as the government primarily responsible for determining economic policy is now in a stronger position to implement its fiscal policy. For instance, it can give greater effect to anti-cyclical measures through its dominant control over private consumption and public expenditure. Again the Commonwealth’s strong revenue position has enabled it in recent years to dominate the proceedings of the Australian Loan Council through its support of borrowing programmes.

Disadvantages of Uniform Taxation
The major disadvantage of the present system of uniform taxation in Australia is that it has reduced all States to a condition of financial dependence on the Commonwealth. The ability of State governments to improve existing services or to provide new services for which they are constitutionally responsible depends on the amount of the supple-
mentary grant decided upon each year by the Commonwealth government. The State governments have recently been placed in a difficult financial position owing to continually rising prices and costs. They claim that they have been obliged to incur additional outlay on education and health services without having access to any sufficiently flexible source of revenue from which to finance such expenditure. If financial responsibility is defined to exist when any real increase in expenditure by a State must be met entirely by an increase in taxes levied by that State,10 the States have only limited responsibility at the present time. One measure of financial responsibility in this sense is the relationship between State taxation collections and Commonwealth grants to the States. The comparative position in 1939-40 and 1953-54 is shown in Table I.

Table I
Relative Importance of State Taxation and Commonwealth Grants to States

<table>
<thead>
<tr>
<th>Year</th>
<th>State Taxation</th>
<th>Commonwealth Grants</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1939-40</td>
<td>£54,387,000</td>
<td>£15,717,000</td>
<td>£70,104,000</td>
</tr>
<tr>
<td></td>
<td>77.58%</td>
<td>22.42%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>State Taxation</th>
<th>Commonwealth Grants</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953-54</td>
<td>£80,217,000</td>
<td>£207,360,000</td>
<td>£287,577,000</td>
</tr>
<tr>
<td></td>
<td>27.89%</td>
<td>72.11%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

However, the absence of financial responsibility in this sense must not be identified with financial irresponsibility connoting waste and extravagance. It has not been seriously suggested that Australian State governments have been increasingly wasteful in their expenditure as their dependence on Commonwealth grants has increased.11

From the Commonwealth’s viewpoint the major disadvantage of uniform taxation is the unreasonable demands that the States are tempted to make for supplementary grants. When all that they demand is not forthcoming, the Commonwealth is sometimes accused of infringing the spirit of federalism and is blamed for the inability of the States to expand services.

Requirements of an Alternative Scheme
Our purpose is to propose a scheme of Commonwealth-State income taxation which largely retains the major advantages of the existing uniform taxation system mentioned above and, at the same time, goes some way towards overcoming the disadvantages mentioned in the preceding section. If such a scheme is to have any worth, it should be
straightforward and capable of being adopted in the existing political and financial circumstances. The major objectives of such a scheme are:

(i) The simplicity achieved by the system of uniform taxation should be retained in the interests of the taxpayer.

(ii) The States if they so desire should be free to raise additional revenue by increasing rates of taxation to provide additional services.

(iii) There should be no large overall differences between States in the severity of the Commonwealth plus State taxation arising solely from the need of any State governments to maintain the revenue they previously received by way of tax reimbursement and supplementary grants.

A Scheme Envisaged

Previous discussions of the problems associated with the resumption of income taxing powers by the States have generally centred round the assumption that the Commonwealth will vacate the field to the extent of the present tax reimbursement and supplementary grants, and the States will enter the field to collect approximately the same amount through the exercise of their own taxing powers. On such a premise, the need for reimbursement grants as such would disappear.

There is a major difficulty associated with this approach. Because of their relatively low taxable capacity, some States would have to impose substantially heavier rates of State income tax than other States in order to raise the same amount of revenue as they now receive by way of grants. There would be substantial differences between States in combined Commonwealth-State taxation such as existed pre-war, thus infringing the third requirement mentioned above. A further shortcoming of this approach is that the adoption of uniform assessment laws would be purely voluntary on the part of the States. It is probable that, after a few years, some differences would be introduced and uniformity and simplicity would be lost.

It would seem that it is impossible to overcome difficulties such as these under any scheme in which reimbursement grants are dispensed with entirely. Reimbursement grants provide the means whereby inter-state differences in relative taxable capacity can be smoothed out. Furthermore, they can be made conditional upon the maintenance of uniformity in assessment laws.

It is possible to envisage a situation in which the States are obliged to impose State income taxes to maintain their existing revenue. If the Commonwealth retired from the income tax field to a limited extent, and reduced reimbursement payments/supplementary grants by the same amount, the States might find it necessary to enter the income
tax field to recover the revenue lost. The Commonwealth could reduce
the aggregate sum it would otherwise pay to the States by the amount
of its retirement from the income tax field. The distribution of the
reduced sum available to the States could be in such proportion that
each State, if it imposed the same (uniform) rates of State income tax,
would derive the same revenue from both sources, namely, a reduced
reimbursement payment plus State tax, as it formerly received by way
of reimbursement payment plus supplementary grant.

Under such a scheme of sharing the income tax field between the
Commonwealth and States, there would, as with any scheme where
the States independently impose income taxes, be no guaranteed
uniformity of taxation rates throughout Australia. A State would be
free to impose rates which, when taken in conjunction with Com­
monwealth rates, could be greater or less than previous Commonwealth
rates. However, any variation between States would result from
decisions affecting the levels of State services. Thus, if one State had
higher rates of income tax than others, then, ceteris paribus, it would
follow that standards of services in that State would be above those in
other States.

A Suggested Scheme
By way of illustrating the situation envisaged above, we have worked
out a scheme on the basis that the Commonwealth vacates the income
tax field to a limited extent, namely, to the extent of recent supple­
mentary grants, but continues to make the reimbursement payments
in accordance with the States Grants (Tax Reimbursement) Act 1946.
The scheme will differ slightly from that envisaged above insofar as it
permits small differences between States in relative taxable capacity
that are not offset by an appropriate adjustment to reimbursement
payments. In any event, it will later be shown that such differences in
the relative severity of State income tax can be offset by other means.
The reason for allowing this variation is to limit the need for sub­
stantial variation to the existing legislation governing tax
reimbursement payments.

This hypothetical scheme has been designed to commence from 1
July 1957. In 1957-58, the distribution of the present reimbursement
payments to the States will be entirely on an ‘adjusted population’
basis. For the purpose of exposition, it will be assumed in this hypo­
thetical example that by 1957-58, the aggregate reimbursement pay­
ment calculated in accordance with Section 6 of the States Grants (Tax
Reimbursement) Act 1946, has increased to £160m, and that, but
for the decision of the Commonwealth to permit the States to re-enter
the income tax field, it would have decided to pay a supplementary
grant of £20m, this being a reasonable assessment of the States' financial needs in excess of the reimbursement payment. In other words, we are merely assuming the amount of the supplementary grant in 1957-58, which must in any event be decided early in 1957-58. It is proposed that the Commonwealth should retire from the field of income tax to the extent of the supplementary grant that would otherwise have been paid. As will be seen later, it would make the suggested scheme much simpler if the Commonwealth retires from the income tax field to the required amount by reducing the tax payable in all ranges of income by a fixed percentage. It is further assumed that each State will decide to raise the same amount of revenue from State income tax as it would have received by way of supplementary grant.

It is proposed, for reasons that will be given later, that the States re-enter the field of individual income tax only, and further, that they tax individuals on a residence basis. Finally, the assumption will be made for the purpose of illustration that the relative taxable capacity of the six States in the field of personal incomes when taxing on a residence basis will be the same in 1957-58 as it was calculated by the Treasury Officers to be in 1951-52.

On the basis of these assumptions, it is possible to show the impact on State finances in the first year of its operation, 1957-58, of the adoption of the scheme outlined. Table II shows the tax reimbursement payment and supplementary grant which each State would receive in that year if the existing scheme of uniform taxation were continued, and the total amounts available for distribution were £160m and £20m respectively:

Table II
Assumed Distribution of Reimbursement Payments and Supplementary Grants, 1957-58.

<table>
<thead>
<tr>
<th>State</th>
<th>Reimbursement Payment £'000</th>
<th>Supplementary Grant £'000</th>
<th>Total Grant £'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>60,266</td>
<td>7,533</td>
<td>67,799</td>
</tr>
<tr>
<td>Victoria</td>
<td>41,883</td>
<td>5,235</td>
<td>47,118</td>
</tr>
<tr>
<td>Queensland</td>
<td>25,314</td>
<td>3,164</td>
<td>28,478</td>
</tr>
<tr>
<td>South Australia</td>
<td>14,307</td>
<td>1,789</td>
<td>16,096</td>
</tr>
<tr>
<td>Western Australia</td>
<td>12,533</td>
<td>1,567</td>
<td>14,100</td>
</tr>
<tr>
<td>Tasmania</td>
<td>5,697</td>
<td>712</td>
<td>6,409</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>160,000</strong></td>
<td><strong>20,000</strong></td>
<td><strong>180,000</strong></td>
</tr>
</tbody>
</table>

Under the scheme of State income tax which we suggest and have outlined above, the position in 1957-58 would be as shown in Table III.
Table III
Assumed State Revenue and Relative Severity of State Income Tax, 1957-58

<table>
<thead>
<tr>
<th>State</th>
<th>Reimbursement Payment £'000</th>
<th>Revenue to be Raised by State £'000</th>
<th>Index of Relative Taxable Capacity</th>
<th>Relative Severity of State Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>60,266</td>
<td>7,533</td>
<td>96.0</td>
<td>90.9</td>
</tr>
<tr>
<td>Victoria</td>
<td>41,883</td>
<td>5,235</td>
<td>113.5</td>
<td>74.3</td>
</tr>
<tr>
<td>Queensland</td>
<td>25,314</td>
<td>3,164</td>
<td>74.1</td>
<td>129.1</td>
</tr>
<tr>
<td>South Australia</td>
<td>14,307</td>
<td>1,789</td>
<td>113.3</td>
<td>78.4</td>
</tr>
<tr>
<td>Western Australia</td>
<td>12,533</td>
<td>1,567</td>
<td>127.3</td>
<td>76.1</td>
</tr>
<tr>
<td>Tasmania</td>
<td>5,697</td>
<td>712</td>
<td>60.3</td>
<td>151.2</td>
</tr>
<tr>
<td></td>
<td>160,000</td>
<td>20,000</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

In 1955-56, the Commonwealth expects to collect £577m in income tax of which it is estimated that £390m will be paid by individuals and £187m by companies. Of these collections it will pay to the States a total of £155m, of which it is estimated that £140.8m will be by way of reimbursement in accordance with the formula, and the remaining £14.2m will be a supplementary grant.21 If it is assumed that the same relationship exists between Commonwealth collections of individual and company taxes, and between tax collections and reimbursement grants in 1957-58 as in 1955-56, then the relative severity of combined Commonwealth and State rates of individual income tax in each State will be as shown in Table IV, compared with 100 in each State under uniform taxation.

Table IV
Index of Relative Severity of Commonwealth and State Income Tax, 1957-58

<table>
<thead>
<tr>
<th>State</th>
<th>Index of Relative Severity of Commonwealth and State Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>99.51</td>
</tr>
<tr>
<td>Victoria</td>
<td>98.69</td>
</tr>
<tr>
<td>Queensland</td>
<td>101.37</td>
</tr>
<tr>
<td>South Australia</td>
<td>98.87</td>
</tr>
<tr>
<td>Western Australia</td>
<td>98.77</td>
</tr>
<tr>
<td>Tasmania</td>
<td>102.79</td>
</tr>
<tr>
<td></td>
<td>100.00</td>
</tr>
</tbody>
</table>

Queensland and Tasmania, because of their relatively low taxable capacity, would both require to impose rates of State taxation substantially higher than in other States to raise revenue equal to that
formerly received by way of supplementary grant (see Table III). It will be explained later that, so far as Tasmania is concerned, the necessity to impose higher taxation is avoided because of the Special Grant it receives annually from the Commonwealth under Section 96 of the Constitution. However, Queensland does not receive Special Grants, and there are several reasons why it is not generally desired it should become a claimant State. The alternative is the payment of a fixed grant to Queensland to compensate for its reduction in revenue.

At the Premiers' Conference in February 1953, which considered proposals for the return of taxing powers to the States, the position of Queensland was referred to by the Prime Minister (Rt Hon. R. G. Menzies). He said that the Commonwealth was prepared to make a special fixed annual grant to Queensland to offset this difference in relative taxable capacity. He affirmed that it would be most undesirable if rates of taxation in Queensland needed to be so much higher than in New South Wales and Victoria in order to maintain existing revenue. If rates of taxation in Queensland were the same as those imposed in New South Wales and Victoria, Queensland would lose about £1,150,000.

Under the scheme outlined, it is proposed that the Commonwealth government should increase the reimbursement payment to Queensland by an amount sufficient to offset the low taxable capacity in that State. In the example given in the preceding paragraphs, the reimbursement payment to Queensland would require to be increased by £1,150,000 from £25,314,000 to £26,464,000 to give effect to this proposal. For Queensland, Table III would then read:

<table>
<thead>
<tr>
<th>State</th>
<th>Reimbursement</th>
<th>Special Grant</th>
<th>Tax Rate</th>
<th>Average Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Queensland</td>
<td>£26,464,000</td>
<td>£2,014,000</td>
<td>74.1</td>
<td>82.6</td>
</tr>
</tbody>
</table>

The three claimant States of South Australia, Western Australia and Tasmania, will, in accordance with the established principles of the Commonwealth Grants Commission in assessing Special Grants, only be expected to impose rates of tax equal to the average of the three larger States. This means, for example, that if Tasmania taxes with severity equal to the average in the three larger States after allowing for the special payment to Queensland, namely, 82.6, its revenue from State taxation and reimbursement payment would be reduced by £323,000 in the foregoing example, but the Special Grant would be increased by the same amount. For Tasmania, Table III would then read:

<table>
<thead>
<tr>
<th>State</th>
<th>Reimbursement</th>
<th>Special Grant</th>
<th>Tax Rate</th>
<th>Average Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tasmania</td>
<td>£5,697,000</td>
<td>£389,000</td>
<td>60.3</td>
<td>82.6</td>
</tr>
</tbody>
</table>

Thus, through an adjustment to the tax reimbursement payment to Queensland and through the operation of Special Grants, it would be a simple matter to reach a situation where the severity of State income taxation in all four smaller States would be the same as the average of New South Wales and Victoria. Those States would then be receiving
exactly the same revenue as they formerly received through the operation of uniform taxation. All States would, of course, still be free to vary rates of income tax to produce more or less revenue than they received under uniform taxation.

As already explained, we feel that the scheme suggested above could be introduced from the commencement of fiscal 1957-58. However, we believe it would be more satisfactory if 1957-58 were to be treated as a transition year. The reimbursement grant to be paid to each State in 1958-59 and thereafter would be more soundly based if it were determined from actual taxing experience of the States during 1957-58 and using indices of relative taxable capacity derived therefrom.

It is felt that the scheme outlined above would overcome the major difficulties arising from differences between States in relative taxable capacity. It remains to consider possible means of overcoming the disadvantages that would arise from the point of view of the taxpayer if the States were permitted to re-enter the field of income tax without restriction.

At the present time, tax reimbursement and supplementary grants are paid conditionally upon the States not imposing an income tax. Such a condition would no longer be necessary; instead it is proposed that the Commonwealth should make the payment of tax reimbursement grants conditional upon the States undertaking to adopt certain measures to ensure that the simplicity of uniform taxation is continued.

The first would be that the States should tax personal incomes only, and that the tax should be imposed by each State on residents only. Observance of this condition would avoid complexities which arise when States attempt to tax absentee income earners. Taxable capacity appears to be affected only slightly if calculated on a residence rather than an origin of income basis.23

A second condition should be that the States adopt the Commonwealth Income Tax Assessment Act. That is, they should adopt the same definition of earnings in determining gross income and allow the same concessional deductions from gross income in determining taxable income. Thus, taxable income for State taxation purposes would be identical with taxable income for Commonwealth purposes, except for the exemption of Commonwealth loan interest.24 The prospectuses of all Commonwealth loans have provided that the interest will be free from State taxation. However, no serious administrative difficulty need arise on this account because such interest must even now be shown separately on tax returns because of the tax rebate of 10 per cent which is allowed.

There would undoubtedly be political difficulties at the outset in requiring the States to adopt the Commonwealth Income Tax Assess-
ment Act in its entirety. However, such difficulties should not prove insurmountable. In any event there would be considerable scope for any State to make such adjustments as it desired for political reasons in the incidence of its income tax by appropriate variations in the rates of State tax applicable to given income grades.

Thirdly, a condition of payment of tax reimbursement grants should be that the Commonwealth should act as the agent of the States for the purpose of collecting the tax. This would ensure that the individual taxpayer would be required to complete only one taxation return and pay one (joint) demand.

Subject to these conditions, a State would be free to impose rates of taxation in any form it chose. The adoption of uniform assessment laws would do no more than ensure that taxable incomes would be the same for Commonwealth and State purposes. A State would be free when enacting its annual income tax rating act to fix such schedule of rates as it chose. It would be extremely simple and convenient if each State fixed a rate equal to a given percentage of the Commonwealth tax for a given taxable income. Such percentage should be constant throughout all ranges of taxable income, or increase or decrease if a more or less progressive scale were desired. Alternatively, a State could devise its own schedule regardless of the Commonwealth.

Appraisal of the Suggested Scheme
Under the scheme outlined above, each State would be required to accept responsibility for raising some income tax revenue, or forgo the equivalent revenue it would receive by way of supplementary grant. Each State would be free to decide whether it would impose State income tax of such severity as would yield more or less than it previously received by way of supplementary grant. It would balance the burden of additional taxation against the social advantages arising from expenditure of the additional taxation revenue. In this way the States would be given a flexible source of revenue. At the same time the States would be called upon to share with the Commonwealth the political responsibility associated with the imposition of income taxation. The States would be responsible at the margin for their own revenue.

The scheme as suggested would have advantages for both States and the Commonwealth. The States would be in a stronger financial position to the extent that they would once again have command of a flexible source of revenue. The revenue they formerly received from the Commonwealth as supplementary grants would no longer be subject to arbitrary determination by the Commonwealth. Some of the discontent expressed by the States at the present uniform taxation system has undoubtedly been due to the steady reduction by the
Commonwealth in recent years in the amount of the supplementary grants. The difficulties that arise at Premiers' Conferences in determining the amount and distribution of supplementary grants would be avoided. The Commonwealth has complained that in recent years there has been a tendency for State Premiers to make inordinate demands upon the Commonwealth for funds to finance new services. The Commonwealth has questioned whether the States would have been prepared to assume the political responsibility for raising the additional revenue if they had been obliged to impose their own income taxation. The Commonwealth would still collect 90-95 per cent of total Commonwealth-State income tax revenue, and thus would still be in a position to use income tax as an important instrument of fiscal policy.

As already stated, it would be desirable, and much simpler, if State income tax rates in each State were expressed as percentages of Commonwealth rates. This would involve the Commonwealth government in fixing its rates of income tax as early as possible to avoid undue delay in the preparation of State budgets. In any event the Commonwealth rating act would need to be determined not later than, say, April in any year.

The process of putting the scheme into operation would not involve any Constitutional amendment. The States would need to pass legislation adopting the Commonwealth Income Tax Assessment Act in force at the time. Each State would need annually to pass its own income tax rate act. The Commonwealth would need to pass certain machinery legislation to enable it to assess and collect State income tax. It would also be necessary for the Commonwealth to delete Section 5 of the States Grants (Tax Reimbursement) Act, 1946, which makes the payment of reimbursement grants to the States conditional upon their refraining from imposing an income tax. This section would be replaced by a provision that if a State imposed an income tax and wished to remain eligible for reimbursement grants, it must (a) adopt the Commonwealth Income Tax Assessment Act, so far as it relates to individuals, in its entirety; (b) impose an income tax on individuals only; (c) tax only individuals residing in the State; and (d) make an agreement with the Commonwealth for it to assess and collect such tax.

In practice, the Commonwealth would continue to collect individual income tax as at present. When both Commonwealth and State rates for a financial year had been decided, a schedule of weekly and fortnightly deductions would be calculated separately for each State, and issued to employers in order that the present system of 'pay-as-you-earn' might continue. At the end of the financial year the taxpayer would fill in a single return, providing for a single calculation
of taxable income, but two calculations of the amounts of tax payable. The taxpayer should be able to ascertain how much tax was payable to the Commonwealth, and how much to the State. Thus, the simplicity of uniform taxation would be maintained.

The remaining matter to be considered is the relationship between the operation of such a scheme and the payment of Special Grants by the Commonwealth under Section 96 of the Constitution. At present, the three smaller States, South Australia, Western Australia and Tasmania, receive Special Grants. Under the principles and methods adopted by the Commonwealth Grants Commission in assessing the amount it recommends should be paid to a claimant State by way of Special Grant, a claimant State would be required to impose a rate of income tax equal only to the average rate imposed in the three standard States of New South Wales, Victoria and Queensland. To the extent to which its taxable capacity was relatively low and as a result the standard rate yielded less revenue per head, the deficiency would be made good through the medium of the Special Grant. However, if a claimant State chose to impose higher than standard rates of taxation for the purpose of providing better than standard services, this would have no effect on the level of its Special Grant. Similarly, if a claimant State were to impose lower than standard rates of taxation and as a result provided lower than standard services, the Special Grant would still be unaffected. The taxpayers of claimant States would be protected against the liability of having to pay higher taxation than ruling in other States in order to obtain the same level of services.

Thus, through the agency of a special subvention to Queensland as already explained, and the principles and methods of the Commonwealth Grants Commission, one of the major drawbacks of the scheme outlined earlier could be overcome. Combined Commonwealth and State rates of income tax throughout Australia would be uniform except to the extent that different decisions were made concerning the standards of services in each State.

Conclusion
To sum up, we envisage a scheme under which the States would re-enter the income tax field to raise revenue to replace supplementary grants. The States would be restricted to the taxing of individuals, according to State of residence. They would continue to receive reimbursement grants subject to certain conditions, including the adoption of a uniform assessment act. Financial inequalities between States could be offset by a compensating reimbursement grant where necessary or by Special Grants under Section 96 of the Constitution.
A scheme based on these principles would be essentially a compromise designed to overcome the disadvantages while retaining the manifold advantages of uniform taxation. Insofar as it is a compromise, it has shortcomings; but any scheme will have shortcomings because there are no solutions as such to the financial problems inherent in a federal system.

It has been questioned whether there is a real will on the part of the governments concerned to alter the present pattern of federal-State financial relations in Australia. If they are satisfied with the present system, the trend towards financial unification will continue. If this trend is to be arrested, the States must assume greater financial responsibility. Although there has been much talk of the need for a complete revision of federal-State financial relations in Australia, there has been surprising hesitancy in suggesting alternative schemes to the present system of uniform taxation.

Notes

1 Royal Commissions on Taxation in 1921 and 1932-34 dealt with lack of uniformity between the assessment acts of the Commonwealth and States.

2 See Report of the Committee on Uniform Taxation, March 1942. [Reading XXI]

3 The Commonwealth passed four Acts, viz:
   (a) The Income Tax Act, imposing rates of tax for the year;
   (b) The Income Tax Assessment Act, which, inter alia, gave payment of the Commonwealth Income Tax priority over all other taxes;
   (c) The Income Tax (War-time Arrangements) Act, which provided for the transfer of State officers to the Commonwealth; and
   (d) The States Grants (Income Tax Reimbursement) Act, which provided for payments to the States.

4 South Australia v. The Commonwealth, 65 C.L.R. 373. The other States involved in the appeal were Queensland, Victoria and Western Australia.


6 States Grants (Tax Reimbursement) Act 1946. Details of the formulae are contained in Section 6 and the Schedules to the Act.

7 Report by Commonwealth and State Treasury Officers; Resumption of Income Tax by the States, Canberra, 19th January, 1953 [Reading XXV].

8 The term relative taxable capacity is used to denote income taxation yield per head in each State expressed as a percentage of income taxation yield per head in all States.
9 Op. cit. p. 32. The figures quoted are from an index of taxable capacity relating to individuals and companies when taxed on an origin of income basis [Reading XXV].


11 We certainly do not agree that unconditional grants infringe any principle of financial responsibility. Contrast our attitude with that of J. A. Maxwell [Reading XVII above].

12 See, for example, the Report of the Treasury Officers, op. cit. p. 5 [Reading XXV]. This was the basis of the discussion at the Premiers’ Conference in February 1953, which met to consider the restoration of taxing powers to the States.

13 See Report by Treasury Officers, op. cit. pp. 32-3 [Reading XXV].

14 So far as we are aware, the only occasion on which such an approach has been suggested was by Professor W. Prest, in the Joseph Fisher Lecture in Commerce at Adelaide, in September 1954 (p. 28) ['The Economics of Federal-State Finance', The Australian Economy, H. W. Arndt and W. M. Corden, eds., Cheshire, Melbourne, 1963, pp. 222-45]. He suggested that the States might obtain sufficient freedom of action if they were given power to raise something less than current reimbursement payments through State income tax. Presumably Professor Prest envisaged a continuation of reimbursement grants in a modified form.

15 Distribution on a population basis adjusted for differences in numbers aged 5 to 15, and density of population. See Second Schedule to States Grants (Tax Reimbursement) Act 1946.

16 Compared with £140.8m for 1955-56.

17 Compared with £14.2m for 1955-56, and an average of £23.3m per annum over the past five years.

18 See note 25 below.

19 It may be noted that the position would then be the reverse of that which existed in Canada when the Provinces of Ontario and Quebec re-entered the field of corporation tax in 1947.

20 See Report by Treasury Officers, 1953, op. cit. p. 32 [Reading XXV].

21 In fact, the Commonwealth will pay £16.2m in supplementary grants, but this will include a special non-recurring payment of £2m to New South Wales for flood relief.


23 See Report by Treasury Officers, op. cit. p. 32 [Reading XXV].
We do not favour allowing State taxation paid as a deduction for Commonwealth income tax purposes as was the case pre-war.

On the basis of the scheme worked out in this Section, the Commonwealth would retire from the field of personal income tax to the extent of 4.53 per cent of existing Commonwealth tax. The States would then have to impose rates equal to 4.73 per cent of the reduced Commonwealth rates to obtain the same revenue. It would be hoped that the Commonwealth might voluntarily retire from the field to a greater extent, say 5 per cent, on the above figures.

In 1951-52, the supplementary grant was £33.6m. It has been reduced progressively in subsequent years thus: 1952-53 — £27.1m; 1953-54 — £21.9m; 1954-55 — £19.9m; and 1955-56 — £14.2m.

Section 96 provides that ‘... the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit’. Under the Commonwealth Grants Commission Act 1933, any claims for assistance under this Section are referred to the Commonwealth Grants Commission for recommendation.
Section 90 of the Commonwealth Constitution states that 'on the imposition of uniform duties of customs the power of the [Commonwealth] Parliament to impose duties of customs and excise, and to grant bounties on the production or export of goods, shall become exclusive.' The object of this section, as the records of the Convention Debates show, was to assure to the Commonwealth government firm control of tariff policy; and in particular, to prevent State governments with free-trade inclinations from obstructing Commonwealth protection policies by the imposition of 'countervailing' excise duties. 'It was considered essential that the two correlative powers of customs and excise, properly so called' — conceived as instruments of commercial policy, rather than as sources of revenue — 'should run together.'

Like other sections of the Constitution, s. 90 has, in fifty years, undergone a process of interpretation by the High Court which has extended its scope far beyond its original purpose. The history of s. 90, like the more notorious history of s. 92, provides an instructive illustration of some of the general problems of judicial review. It is of special interest to the economist because, in the nature of the subject

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matter of s. 90, the difficulties with which the Court has had to deal have revolved around economic concepts.

This article is mainly an attempt to ascertain how far economic analysis could have aided the Court in its task of judicial interpretation of the Constitution. It will be suggested that, while the advantage which judges could derive from a full knowledge of economic theory would be limited, simply because they are, in the last resort, concerned with law, not with economic policy, that advantage would, at some points, not be negligible.

Summary of Cases
In the first fifty years of the Commonwealth Constitution, the validity of legislation under s. 90 has been tested in altogether eleven cases before the High Court. Apart from the two earliest, Peterswald v. Bartley in which the Court held that State legislation imposing licence fees (in this case, brewers' licences) were not invalid under s. 90, and Barger's Case in which the Court refused to allow the Deakin government to carry out its policy of New Protection under cover of the Commonwealth's excise power, the cases fall into two groups.

The first, and earlier, group consists of four cases in which State governments had attempted, by devious means, to get round the prohibition of s. 90 on State excise taxation. The second group concerned State marketing schemes which were challenged on the ground that levies imposed by these schemes violated s. 90.

Since our primary concern is to analyse, in logical rather than chronological order, the concepts and reasoning employed by members of the Court in their judgments, it may be well, at the outset, to give a brief resume of the course which judicial review has followed in these cases.

In Peterswald v. Bartley, the Court held that a brewer, charged with carrying on a brewing business without a licence under N.S.W. legislation, was validly convicted, since the licence fee could not be held to be an 'excise duty' and thus invalid under s. 90. Griffith, C.J., relying largely on the reference to duties of excise in s. 93, and on the explanation of the purpose of s. 90 given by Quick and Garran, defined 'excise' narrowly as including only taxes 'paid on goods produced or manufactured in a State' and measured by quantity or value. In Barger's Case two years later, it was Commonwealth legislation that was in question. The Act was an attempt to enforce labour standards by exempting employers who conformed to prescribed standards from excise duties specifically imposed for the purpose. A majority of the Justices, including Griffith, C.J., Barton and O'Connor, JJ., held the Act invalid, over the dissenting judgments of Isaacs and Higgins, JJ., on the ground that the legislation was 'in
substance' regulation of the conditions of labour which was outside the power of the Commonwealth.

The Petrol Case and John Fairfax & Sons Ltd. v. N.S.W. both arose from attempts by State governments to get around the prohibition of s. 90 on State excise taxes. In the Petrol Case, the Court was unimpressed by the fact that the Act called the petrol tax, imposed by the South Australian government largely as a means of putting pressure on the Commonwealth government to give a larger grant for State road maintenance, an 'income tax' on vendors of petrol. It held that the tax was a tax upon the sale of a commodity, assessed on the basis of the quantity of the commodity sold and intended to be passed on to the purchaser, and thus an 'excise tax' within the meaning of s. 90. The decision was followed in John Fairfax & Sons Ltd. v. N.S.W., where a tax on newspapers imposed by the State government of N.S.W. was held invalid on the same ground, the Court refusing to accept the arguments that this was a tax on 'information', not on a commodity, and on 'sale', not on production. The other two cases in this group, the Vacuum Oil Case and N.S.W. v. Homebush Flour Mills Ltd. were less straightforward. In both, the States' attempt to circumvent s. 90 had assumed more roundabout and ingenious forms. In the Vacuum Oil Case the Queensland government wanted to subsidise local producers of power alcohol. Since it could neither constitutionally grant a 'bounty', nor raise the money for it by an excise duty, it hit upon the expedient of a quota scheme. Importers of petrol were compelled to buy a certain quantity of power alcohol at a fixed price for every quantity of petrol they sold. The Court held that this scheme did not infringe s. 90, since neither a 'tax' nor a 'bounty' was involved (no money passing through the State Treasury) though it invalidated it under s. 92. Finally, in the Homebush Flour Mills Case, the N.S.W. government had tried to provide farm relief out of a tax on flour. So as to evade s. 90, the Act took the form of a purely notional scheme of compulsory acquisition of flour at a fixed price, with an option to millers to purchase back the flour at a higher fixed price, the arrangement actually ensuring that the flour would never leave the hands of the miller and that the only alternative open to millers would involve them in even greater loss. The Court held that this scheme in substance imposed a tax upon the production of flour, since the option to millers was unreal and the payment in effect compulsory, and invalidated it on that ground.

The first of the marketing board cases, Crothers v. Sheil arose under the Milk Act 1931 (N.S.W.) by which milk was compulsorily acquired and resold by the Milk Board, the administrative costs of the scheme being defrayed by way of deduction from the proceeds paid to producers. The Court, without much hesitation, held that, since 'no
actual levy of a sum of money was involved', the levy did not amount to a tax. This decision was followed three years later, in a case under the Dried Fruits Act 1928 (Vic.), Hartley v. Walsh, where all Justices unanimously and with little discussion held that the contributions under the scheme amounted to 'payments for services rendered' and were therefore not taxation, even though the contributions had to be paid in money to the Board and were assessed on the value of dried fruit sold. A year later, however, in Matthews v. Chicory Marketing Board, a majority of the Court, over the dissenting judgments of Latham, C.J. and McTiernan, J., in effect reversed the decision in Hartley v. Walsh, without reference to it, by holding that a levy payable to a Chicory Marketing Board set up under the Marketing of Primary Products Act 1935 (Vic.) was an 'excise tax' and thus invalid under s. 90. All Judges, including the dissenting minority, followed a Privy Council judgment in a Canadian appeal, and held without further ado that the levy was a tax, since it was 'a compulsory exaction of money by a public authority for public purposes, enforceable by law, and... not a payment for services rendered.' Disagreement arose merely on the question whether it was an 'excise' tax, the Chief Justice holding that it was not, because the levy, assessed on acreage planted, was not a tax on production of chicory, while the majority held that, since 'planting is an essential step in production', the particular method of assessment did 'not alter the nature of the tax.' In the next case, Hopper's Case, the levy was again paid by way of deduction from the proceeds of resale after compulsory acquisition, and the Court unanimously applied Crothers v. Sheil although the case was remarkable for obiter dicta by Evatt, J., which roundly questioned the soundness of the earlier decision in Matthews v. Chicory Marketing Board (in which his Honour had not been a member of the bench). No notice, however, was taken of these obiter dicta in the most recent case, Parton's Case, in which a majority, again over the dissenting judgments of Latham, C.J., and McTiernan, J., followed the ruling in Matthews v. Chicory Marketing Board. Again, all Justices treated the levy as a tax, and the majority as an 'excise' tax, the Chief Justice dissenting on this occasion on the ground that the levy was here imposed on distributors of milk, and thus not on 'the first sale after production'; while McTiernan, J., reverted still more intrepidly to the earliest interpretation of 'excise' under s. 90 as covering taxes on 'production', but not on 'sale' of commodities.

The task of the Court in all these cases has revolved around two problems of interpretation: (i) whether the payments in question amounted to taxes at all; and if so, (ii) whether they were 'duties of
excise' within the meaning of s. 90. In analysing the judgments, it will be convenient to deal separately with these two aspects.

**Taxation**

The first question arose in the marketing board cases, and also in the *Vacuum Oil Case*. It is perhaps the most surprising and unfortunate feature of the record of judicial review under s. 90 that any of the levies under the marketing schemes were regarded as taxes at all, though the fault here lay mainly with the Privy Council whose judgment in the *Crystal Dairy Case* may be thought to have tied the High Court's hands.

Most of these schemes were adopted by State governments during the depression years of the inter-war period. Their primary object, on which the legislation was usually silent and to which the Court never alluded, was to maintain minimum prices for certain primary products by regulating supplies. Incidentally, the schemes aimed at more efficient marketing arrangements and other activities, designed to reduce costs of production and distribution and improve the quality of the products. Such monopolistic arrangements for price maintenance and rationalisation were by no means uncommon in the depression years. In manufacturing industries, they were widely adopted in many countries by producer groups acting on their own initiative. In the nature of the case, every effort was made to bring all firms in the industry into the scheme and to devise the most effective means available to deal with recalcitrants and to prevent new firms from entering the industry outside the scheme. In most cases, the administrative and other expenses of such schemes were defrayed by levies upon the member firms. Depending on economic conditions, the charges were either added to the price of the product and paid for by the consumer or, as was more likely where price maintenance was a major objective, treated as a cost item to be debited against the monopoly profits (or avoidance of losses) yielded by the scheme.

The only difference between such voluntary schemes and those at issue in the cases under discussion was that, in the latter, governments took the initiative, because the producers concerned were usually large numbers of unorganised small farmers who had neither the initiative nor the administrative resources to form voluntary co-operative marketing and price maintenance schemes. In the circumstances, it might have seemed natural for the Courts to hold that these schemes differed from similar private schemes only in the method of organisation, and that the levies imposed under the schemes represented, in just the same way as in corresponding non-governmental schemes, payments for services rendered, whether the services were thought of as rendered to, and the payments as payments by, the producer
interests concerned, as would have been reasonable where the primary objective was price maintenance, or as costs of efficient production and distribution of commodities and, therefore, as embodied in the value of the product to the consumer and paid by him as part of the price.

The High Court did not adopt this course (though Evatt, J.'s obiter dicta in Hopper's Case suggest that he believed it should have done so). Following the Privy Council judgment in the Crystal Dairy Case, it treated these cases by a strict application of the accepted legal definition of a tax as 'a compulsory pecuniary payment to a public authority for a public purpose.' At first sight, no definition could be more reasonable. Yet the results of applying it rigidly in these cases can hardly be regarded as satisfactory. In the marketing board cases, it led the Court to treat the levies as taxes where they were payable in cash, but as 'payment for services rendered' where they were levied by way of deduction from the proceeds of resale after compulsory acquisition — with the incidental paradoxical result that State governments appear to have a free hand with such schemes if they virtually nationalise the intra-State distribution of a commodity by compulsory acquisition and resale but are stopped in their tracks if they content themselves with more modest forms of intervention and assistance.\textsuperscript{13} It is difficult to disagree with Evatt, J.'s view that this distinction, based on the presence or absence of a 'pecuniary payment', could not support the weight placed on it by his fellow Justices: 'The fact that the state exacts a contribution from a producer by way of deduction from moneys which are his rather than by a direct levy can make no difference.'\textsuperscript{14} But even if the form of payment had been regarded as irrelevant, the Court might still have considered itself bound by accepted rulings on the nature of 'taxation' to treat the levies under all the marketing schemes as 'taxes'. The question is whether a reasonable definition of 'taxation' would have enabled the Court to treat the marketing board levies as 'payments for services rendered' and thus, for this reason alone, as beyond the reach of s. 90.

Taking the community as a whole, there is, of course, a sense in which all taxation could be regarded as payment for services rendered. Governments and other public authorities satisfy some of the community's wants — defence, administration of justice, education, etc. — by providing public services and the community pays for them through taxation. In order to be able to distinguish 'taxes' from other types of payment for services rendered, therefore, we need some additional criterion. At first glance, it might seem that the distinguishing feature of 'taxes' lies in the mere element of compulsion, at any rate where compulsion is exercised by a public authority; where, in other words, the payment is 'enforceable by law'.
Not only is it difficult to think of any actual example of such a compulsory payment that could not reasonably be regarded as a tax, but it is probably true that we would generally consider that compulsion confers upon any payment something of the quality of a tax. Further consideration, however, suggests that it is not the element of compulsion in itself which is responsible, but rather the implication which it contains that the payments would not be made voluntarily, presumably because the payer does not consider that he is receiving adequate quid pro quo for his payment. Could it, then, be argued that whether or not a payment is a tax, depends not on how it is paid, and not merely on whether it is compulsory and enforceable by law or not, but also on whether the payer can be held to receive an inadequate quid pro quo?

It is never possible to be dogmatic on questions of definition. But such a definition of tax would seem to be in conformity with normal usage and economic significance, and it would certainly have led the Court to a more satisfactory treatment of the cases that have arisen under s. 90. True, such a definition would not be without difficulties. In the first place, it would confront the Court with the awkward task of evaluating the services rendered to payers; in most cases, this could be done only in a broad and rough fashion. But this is a task which the courts of law have in fact to perform in many other contexts and which they usually carry out with wisdom and commonsense. Secondly, where, as will usually be the case, the payers, as well as the beneficiaries of the services, are defined as broad classes, the individual members will generally not all benefit in the same degree from the services rendered, and not even precisely proportionately to the payments exacted from them. This is, indeed, another aspect of the point mentioned before that the mere fact of compulsion suggests that the persons concerned could not all be relied upon to purchase the services voluntarily. The difficulty is always liable to arise where a service is provided to a group, a minority of whose members does not, at any rate initially, appreciate the benefit they will obtain; and where the provision of the services is not practicable unless all members of the group join the scheme. A reasonable way out of the difficulty would be to ask whether all, or at least the great majority of, members could be expected to be willing to purchase the services, or join the scheme, voluntarily, once they had the opportunity over a period of assessing the benefit to themselves. Thirdly, quite a different difficulty arises from the fact that governments have frequently in the past attempted to make taxes more palatable to the victims by notionally 'earmarking' the proceeds for a particular purpose which could be claimed to represent a quid pro quo. An obvious illustration is the 'earmarking' of petrol tax revenue for road maintenance. It might be
argued that, on the basis of the distinction here suggested, such a petrol tax might have to be regarded as a 'payment for services rendered.' More generally, the example suggests that any such definition would invite evasion of constitutional prohibitions on taxes by the simple technique of earmarking the proceeds. The difficulty exists, but it is unlikely to prove serious in practice. Cases where governments can plausibly adjust tax incidence sufficiently closely to the benefits of services to be provided without defeating part of the object of their taxation or expenditure policies are rare. By excluding from the definition of payments for services rendered any taxes used to finance old and established services customarily and necessarily provided by public authorities, such as road maintenance, the difficulty could in practice be largely eliminated.

Further support for the definition of a tax, based on the presence or absence of an equivalent *quid pro quo*, is derived from the fact that this criterion did in fact play an important role in the decisions of one or two members of the Court in the marketing board cases. It entered into their reasoning through their interpretation of the apparently innocuous phrase 'for a public purpose' in the accepted legal definition of a tax. In principle, of course, any payment exacted by a government or other public authority may be held to be 'for a public purpose', solely by virtue of the fact that a Parliament has seen fit to make it the subject of general legislation. More specifically, it could be said that any legislation designed to benefit a particular group, for instance a marketing scheme in the interest of a group of primary producers, must be held to be 'for a public purpose' since the fact of legislation implies that to confer such benefits on this group is thought to be in the general 'public' or 'national' interest. This would seem to have been the view of Rich, J., in *Matthews v. Chicory Marketing Board*: 'As to the fact that [the levy] is to be applied to meet the expenses of a marketing scheme and for purposes connected with chicory growing, the statute treats these as public purposes to be undertaken by a public body in the public interest.'

But Dixon, J., in *Parton's Case*, interpreted the phrase 'for a public purpose' so as to yield much the same distinction as that suggested here: The levy on milk distributors is a tax because it is a compulsory exaction . . . by a government agency and the objects are governmental. It is not a charge for services. No doubt the administration of the Board is regarded as beneficial to what may loosely be described as the milk industry. But the Board performs no particular services for the dairymen or the owners of a milk depot for which his contribution may be considered as a fee or recompense . . . The purposes for which the money may be expended are extensive and cover not only all the
activities in which the Board may engage, but also [such matters as] subvention to measures . . . to improve the quality of milk.16

The principle applied here by Dixon, J., is the sound one of insisting that 'payment for services rendered' implies identity between contributors and beneficiaries, and equivalence of payment and benefit.17 Whether one agrees with his Honour’s application of the principle in this case is another matter. It is arguable that even the relatively wide functions of the Milk Board in this case could have been regarded as in the interests of the milk industry, since they did not go beyond activities, such as sales promotion or improvement in the quality of the produce, which producers in many industries voluntarily undertake from a profit motive. It is even arguable that the fact that the contributions were exacted from the distributors while the benefits would accrue to milk producers constituted no serious obstacle to treating the levy as a ‘payment for services rendered’, since the charge would ultimately be paid, neither by distributors nor by dairy farmers, but by consumers, and that, from the latter’s point of view, the extra charge represented a payment for services rendered no less than if the same marketing and research activities had been undertaken by producers or distributors on their own initiative and charged to consumers as part of the cost of production and distribution of milk. The latter argument, however, would have been much more difficult to uphold if the primary object of the scheme had been interpreted as price maintenance and monopoly profits to the producers. On this interpretation, Dixon, J.’s, objection that the contributors were not the primary beneficiaries, and the payment from their point of view a tax, would have been valid.

In any event, it is clear that some such definition of a tax as ‘a compulsory payment to a public authority, enforceable by law, for which no equivalent quid pro quo in the form of additional services is rendered’ would not exempt any type of levy whatever under such a scheme. It would exempt levies only if they were imposed with due regard to, and broadly in proportion to, the benefits which participants could be expected to derive from such schemes. It would certainly enable the Court to distinguish reasonably well between bona fide levies imposed purely to finance schemes of this sort, and subterfuges designed to raise revenue for other governmental purposes. But it would have nipped in the bud all attempts to deprive State governments of the power to organise intra-State marketing of primary products under a clause of the Constitution intended to protect Commonwealth tariff policy from State interference.

Before leaving this aspect of the problem, something should be said about the only other case in which the question of definition of a tax
arose, the *Vacuum Oil Case*. The Court here again applied the conven­tional legal definition and held that the compulsory pecuniary payment imposed on Queensland oil importers was not a tax because it was made, not to a public authority, but directly to the private producers of power alcohol whom it was intended to subsidise. Members of the Court freely admitted that the scheme was carefully designed to evade s. 90, that its effect was identical with a com­bination of tax and subsidy, neither of which were within the power of the State government. Yet, in *Dixon*, J.'s, words, 'There is imposed neither customs nor excise, for . . . the compulsory payment . . . does not answer for the description of taxation . . . The payment received by the sellers of power alcohol is not a bounty . . . but the price on a sale.'

At first sight, it would seem that the distinction between a compulsory payment directly to the beneficiaries of proposed government expenditure and a compulsory payment to a government for sub­sequent expenditure by the government is no more logically defensible than the distinction between a 'pecuniary payment' and one by way of deduction. On practical grounds, the Court's ruling in this case could also be questioned as opening a wide field for evasion of s. 90 by the simple procedure of camouflaging excise taxation in the form of com­pulsory payment by the intended group of taxpayers directly to the intended group of beneficiaries of government expenditure; the Act involved in the *Homebush Flour Mills Case*, for example, might have taken the form of compelling millers to buy some worthless by­product at fixed prices from necessitous farmers. It could, therefore, be argued that, for all practical purposes, the compulsory payment by the oil importers was, and should have been treated as, a tax. It would have followed, *a fortiori* that the margin between the fixed price of power alcohol and the price which its producers could have obtained in the free market would have had to be regarded as a subsidy; nor is there any doubt that that was its economic significance.

But it should be noted that such an interpretation might have had far-reaching consequences. By analogy, any fixation of minimum prices would have to be regarded as involving an element of subsidy to sellers, while fixation of maximum prices might be regarded as amounting to the payment of a subsidy to buyers. This would seem to be a case where one might be pardoned for shrinking from the rigorous pursuit of the logic of economic analysis. Where economic analysis is liable to lead to the conclusion that State governments might have to be considered debarred by s. 90 of the Constitution from fixing maximum or minimum prices, there is much to be said on pragmatic grounds for clinging to the accepted and not, on the face of
Duties of Excise
If the preliminary problem of defining a ‘tax’ proved troublesome, the central issue under s. 90 of determining the meaning of ‘duties of excise’, has been far more difficult still. While none of the decisions so far given by the High Court which have turned on this issue could be considered unsatisfactory, the problem of legal definition has been left in a state of confusion which is certain to cause further trouble in future.

The root cause of the difficulty has been that the term ‘excise’ which the framers of the Constitution put into s. 90 has never had a definite meaning, either in law or in economics. As Higgins, J., pointed out, ‘“excise” is not a technical term in the law; and the popular meaning is not rigid.’

The term had come into use in England from the seventeenth century onwards, but its meaning had sprawled over a large ill-defined field, including all kinds of licence fees, stamp duties, etc. In the very first case under s. 90, it was clear to the High Court that it could not base its interpretation on customary English usage, as the Supreme Court of N.S.W. had tried to do, if only because, on such an interpretation, ‘the power to impose licence fees on publicans for instance, [would pass] to the Commonwealth, as well as a large number of other fees, which, up to this time, have been thought to be within the power of the State to impose.’ The alternative might have been to consider the intention of the framers of the Constitution behind s. 90, which might have led to some definition of excise duties that confined them to State duties liable to interfere with Commonwealth tariff policy. But although the Court cast a few hesitant glances in that direction in the early cases, sometimes decently veiled by reference to the authority of Quick and Garran, any systematic effort of interpretation in the light of the intentions of the Founding Fathers was ruled out by the self-denying ordinance which dismissed the most obvious documentary evidence, the record of the Convention Debates, as improper. The Court, therefore, was thrown back on the ‘words’ of the Constitution; and initially it found help in a slight elaboration of the term ‘excise’ in s. 93, a transitional clause, which refers to ‘duties of excise paid on goods produced or manufactured in the State.’ In Peterswald v. Bartley the Court clung to this sheet anchor and held that a brewer’s licence was not an excise duty since it was not ‘imposed upon goods either in relation to quantity or value when produced or manufactured.’
The very next case, however (leaving aside Barger's Case in which the problem did not come up for discussion) showed that this was no solution. The petrol tax imposed by the government of South Australia was indistinguishable from Commonwealth excise duties even though, for the purpose of getting round s. 90, it was called an 'income tax'; but it was a duty on the sale of (mostly imported) petrol, not on goods 'produced or manufactured in the State.' Isaacs, J., in a somewhat obscure obiter dictum, tried to adhere to the narrow definition of 'excise duties' of Peterswald v. Bartley: 'Licences to sell liquors, etc., may well come within an excise duty law, if they are... so imposed as in effect to be a method of taxing the production of the article... But if in fact unconnected with production and imposed merely with respect to the sale of goods... a tax on the sale appears to fall... outside... “excise duties”.' But Rich, J., took the bull by the horns: 'Economists called the duties upon home manufactures duties of excise because such they were. But there is no authority which explicitly denies the correctness of the application of that term to duties upon goods collected in respect of use, consumption, or sale because the duty is not confined to goods of home manufacture'; and Higgins, J., agreed that 'it matters not whether the duty is imposed at the moment of actual sale or not, or sale and delivery, or consumption.' What made the extension of the meaning of 'excise duties' from duties on 'production' to duties on 'production, sale or consumption' easy for the Court was the very fact that the Act in question had called the petrol tax an 'income tax'. For it was obviously not that. From the discovery that it was, on the contrary, an 'indirect tax', it was a short step to the idea that 'excise duties' could be treated as synonymous (together with customs duties) with 'indirect taxes'. Henceforth, the problem of definition of 'excise duties' became inextricably tied up with the distinction between 'direct' and 'indirect' taxes.

The step was probably inevitable, if only because the Court's attention was from the beginning drawn to Canadian constitutional cases which arose under the provision of the British North America Act, precisely analogous to s. 90 in substance, but expressed with reference to 'indirect taxes', not 'duties of excise'. But it was unfortunate, not only because it prevented a more confined interpretation which the very vagueness of the term 'excise duties' might otherwise have made possible, but even more so because the distinction between 'direct' and 'indirect' taxes has itself been a source of endless confusion to lawyers and economists alike.

The classical statement of the distinction is in J. S. Mill's Principles of Political Economy. Mill defined a direct tax as 'one which is demanded from the very person who it is intended or desired should
pay it.' As illustrated, for example, by a direct income tax and an indirect duty on tea collected from traders but charged to consumers as part of the price, the distinction appeared straightforward enough. But its ambiguities were such as to lead public finance theorists into a century of confusion and wild-goose chases which have only recently been straightened out in an article by the English economist, Ursula Hicks.28

As an aid to judicial interpretation, the classical distinction had the great disadvantage that, in its nature its application demanded an inquiry by the Court into the 'intentions' or 'desires' of the taxing authority. Not only have the Australian Courts, in particular, always been chary of inquiring into such matters; but even when they were prepared to disregard that precept, they faced the difficulty that the legislature usually did nothing to reveal its intentions or desires for the simple reason that it was often indifferent as to who paid the tax. The inevitable next step for the Court was to try to gauge the 'intentions' of the legislature by trying to assess the probable economic effects of the tax, i.e., who would actually pay the tax; and with that step it plunged deep into purely economic analysis, and found itself floundering in the morass into which the classical distinction, and its implicit theory of the 'incidence' of taxation, had led public finance theorists.

As Mrs Hicks has pointed out, the classical distinction was originally developed by administrators, for administrative purposes. Although even for this purpose it was not free from ambiguities,29 it was serviceable. But it had no economic significance. An economic analysis of taxation requires a complete investigation of the economic effects of a tax, a (necessarily hypothetical) comparison of the conditions of the economy with and without the tax, and for this purpose, the classical distinction, and the conventional theory of the incidence of taxation which might or might not be 'shifted', was inadequate and misleading. Even if the object of analysis was solely the narrow one of determining 'the distribution of actual revenue collected',30 or what Mrs Hicks calls the 'formal' incidence, the traditional analysis of the 'shifting' of indirect taxes by the manufacturer or trader to the consumer was unsatisfactory. It did not allow, for instance, 'for the manufacturer preferring to vary quality rather than price, or the landlord increasing the repairs he is willing to do after a rise in rates, rather than conceding a lower net rent.'31 Nor did it concern itself with some of the most important effects of the imposition of indirect taxes — shifts in demand away from the taxed product in favour of saving or expenditure on, and consequent production of, other commodities. On the other hand, it misled theorists into abstruse attempts to apply the shifting mechanism to income tax to which it is clearly in-
appropriate. For purposes of economic analysis, as Mrs Hicks suggests, the significant distinction, to which the traditional classification approximated but with which it did not coincide, is between taxes on income and taxes on outlay. The former have to be paid regardless of the directions in which the taxpayer allocates his income, while the characteristic feature of the latter is that they have to be paid as a condition of being allowed to enjoy a particular commodity or service. On this definition, all taxes on outlay must be regarded as in the same class (whether we choose to call them ‘indirect’ or not), regardless of how they are collected or assessed; they would include not only all conventional customs and excise duties, sale and purchase taxes, but also such taxes as dog licences, stamp duties, local rates, or entertainment taxes. The economic importance of the distinction is that taxes on outlay may and usually do, while taxes on income do not, induce the taxpayer to allocate his income among various forms of expenditure differently from what he would have done in the absence of such taxes. They may thus have an effect on the economic welfare of the taxpayer (and incidentally also on the allocation of productive resources among different uses) in addition to the reduction of disposable money income through the payment of a sum of money to the tax gatherer which they share with income taxes. The distinction is also significant for the modern technique of national income analysis or social accounting, because when it is said that direct taxes are paid out of factor incomes, while ‘indirect’ taxes (minus price subsidies) make up the difference between ‘national income at factor cost’ and ‘national income at market prices’, the relevant distinction is, in fact, between ‘taxes on income’ and ‘taxes on outlay’. In analysis of the economic effects of taxes, Mrs Hicks suggests that we shall not go far wrong if we assume that the ‘formal’ incidence of indirect or outlay taxes is on the consumer of the product or service — thus by-passing all the elaborate analysis of ‘shifting’. If, however, we want a complete analysis, we must take into account all the major economic effects, not merely those treated in the traditional ‘shifting’ analysis.

Courts of law cannot necessarily accept those definitions which are economically the most meaningful; nor could the judges of the Australian High Court of the nineteen-twenties or thirties be criticised for following what was then accepted terminology among experts on public finance. But the problem of interpretation of s. 90 did, as we have seen, force the High Court into venturing on economic analysis, and it is instructive to observe the confusion which ensued.

The tendency to define ‘excise duties’ in terms of the conventional definition of ‘indirect taxes’ began with the judgment of the Chief Justice in the Petrol Case: ‘Such a tax is a duty of excise . . . In each
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case it is assumed or intended that the burden of the tax is to be passed on by the person paying it to his vendee and ultimately to the consumer — that is to say it is what is known as an indirect tax.' 32 It seemed merely an alternative formulation of the same definition to say, as Higgins, J., did in the same case, that 'customs and excise' are correlative words for indirect taxes, such taxes as enter at once into the price of the taxed commodity.33

The snags in these definitions were revealed in the marketing board cases. Who was intended to pay these levies 'ultimately'? Who would actually pay them? Did they enter at once into the price of the produce? Evatt, J., in Hartley v. Walsh, asserted flatly that 'the charge is not intended to be passed on to the consumer, but back to the grower.'34 In Matthews v. Chicory Marketing Board, Starke, J., did not venture to inquire into intentions and defined 'the leading characteristic of an indirect tax' as being 'that it is susceptible of being passed on.'35 But he noted at once that, in the circumstances under consideration, whether the charge would be passed on to the consumer of chicory would depend on the price charged by the marketing board: 'It may be that the board does not consider the tax or levy in disposing of the commodity. But that is because the “question whether it is to be borne by the purchaser or seller is determined by the bargain made”.' Abandoning the attempt to carry economic analysis further, his Honour concluded that it was still a tax on production for sale, 'normally susceptible of being passed on.'36

Once an indirect tax was defined as one 'susceptible' of being passed on, the fact that the same might be said of income tax threatened the whole distinction with collapse. Already the Court had heard it argued by counsel that 'the passing of the tax on to the consumer is incident to every tax levied upon a business properly regulated';37 and a definition of an indirect tax by the Privy Council in a Canadian case, quoted by Dixon, J., in Matthews v. Chicory Marketing Board as a tax which sellers 'would seek to recover . . . in the price charged to a purchaser'38 was almost identical with a perfectly sound statement about income tax made by Latham, C.J., in the same case: 'An income tax may lead dealers . . . who pay income tax to endeavour to raise their prices.'39

Latham, C.J., in his judgment just quoted, sought a way out of this impasse which came very close to the economic reasoning underlying the distinction between taxes on income and taxes on outlay:

Excise duties are . . . indirect taxes . . . additions of definite amounts to the prices . . . It is true that commercial competition or other factors may prevent the actual addition of the whole amount of the duty to the price of goods in particular cases, but,
even in such cases, a specific amount which has been paid as tax can be assigned to each and every article taxed . . . The effect of a direct tax is quite different . . . An income tax may lead dealers in chicory who pay income tax to endeavour to raise their prices . . . But in such cases it is not possible to attribute to each pound of chicory sold a specific amount of money.40

He concluded, therefore, that ‘a tax which has no relation to the quantity or value [however measured] of goods, . . . cannot be said to be an excise duty.’41 Although his object here was to distinguish the levy, which was assessed on acreage planted, from an excise duty, the emphasis on the basis of assessment led his Honour to the economically significant distinction. But by that very fact, it completely transcended the traditional administrative distinction between ‘direct’ and ‘indirect’ taxes. If an excise duty is any tax which represents an ‘addition of definite amounts to the [factor cost] prices’ of commodities, then it would include all outlay taxes, whether they are charged separately and directly to the consumer (‘consumption taxes’) or collected from the manufacturer or trader and charged in the price, and whether they are imposed at the point of production or sale or use. Those who were not impressed by the Chief Justice’s distinction in Matthews v. Chicory Marketing Board, widened the definition still further: an excise duty is any ‘tax directly affecting commodities.’42

Finally, the wheel turned full circle. In 1943, the Privy Council in a Canadian case (Atlantic Smoke Shops Ltd v. Conlon) held that a tobacco tax charged separately and directly to consumers was a ‘consumption tax’ and, therefore, on Mill’s definition, a direct, not an indirect tax.43 This was conclusive for Canada, where the constitutional provision referred to ‘indirect taxes’, but not necessarily to Australia where s. 90 refers to ‘duties of excise’. But although the Privy Council explicitly emphasised that a consumption tax, though a direct not an indirect tax, might be regarded as an ‘excise duty’,44 its judgment influenced at least one member of the High Court. Dixon, J., who had all along been inclined to favour Mill’s administrative distinction,45 pronounced in the first post-war case under s. 90, Parton’s Case, that ‘it is probably a safe inference from Atlantic Smoke Shops Ltd. v. Conlon . . . that a tax on consumers or upon consumption cannot be an excise.’46

What, after all this, is an ‘excise duty’ within the meaning of s. 90? It is not confined to taxes on ‘production or manufacture of goods produced in the State.’47 To be an excise duty, a tax may be a tax on the sale of goods, but it may have to be assessed in relation to the ‘quantity or value’ of the goods produced or sold in the current year: Dixon, J., in Parton’s Case, suggested in an obiter dictum that the levy in Hartley v. Walsh had been calculated on the goods passing
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through the contributor’s hands in the preceding twelve months, and that this appeared to him to place it ‘in the category of a licence fee in respect of a business calculated on past business done’ and could not be regarded as an excise. Finally, if Dixon, J., is to be followed, no tax on consumption, that is to say no tax charged separately and directly to the consumer, can be an excise under s. 90.

It can hardly be said that the process of judicial review has done much to clarify for State governments the spheres within which they may and may not constitutionally impose indirect taxes. The position appears to be that State governments can set up marketing boards with the power to impose levies on producers, provided they socialise distribution of the commodity by compulsory acquisition and re-sale. They may possibly be able to stop short of compulsory acquisition, and yet maintain some rough justice between large and small producers, if they calculate the levy on the quantity or value produced in some past year. For the rest, they may be able to impose outlay taxes of any kind provided they follow one of two courses: they must either ensure that the tax is charged separately and directly to the consumer, instead of being included in the price; alternatively, they can, where appropriate, camouflage the tax as a compulsory payment from the intended taxpayers to some group of intended beneficiaries of government expenditure. The fact that all the judicial definitions of ‘excise’ refer to ‘goods’ only, not to services, suggests that State governments have a free hand in indirect taxation of services, whatever the form or basis of assessment of the tax. But on none of these points can there be any certainty. On each, there is enough explicit or implicit judicial opinion in favour of the contrary view to make a challenge in the Courts a promising undertaking.

How could this unfortunate outcome have been avoided? We have suggested that the marketing board levies could, on the basis of a reasonable economic analysis, have been withdrawn from the purview of s. 90 by treating them as ‘payments for services rendered’ and not as taxes at all, though this must be treated as a comment on the Privy Council rather than on the High Court which was probably helpless in the matter. On the definition of ‘excise duties’ in those cases where the payments in question were undeniably taxes, purely economic analysis would not have helped the Court. The modern distinction between taxes on income and taxes on outlay, though the only logical and economically meaningful classification of taxes that seems possible, would have been quite out of the question for practical reasons, even had it been available at the time and justifiable as an interpretation of the historical term ‘excise’. For had the Court identified ‘excise’ with outlay taxes, State governments would have been deprived of a large number of sources of revenue that have always been considered open
to them, such as liquor and other licences, racing and betting taxes, stamp duties, etc. Local authorities would have had difficulty in defending their power to levy local rates. Some definition, not defensible on economic grounds, was therefore inevitable. Had it not been for the reluctance of the Court to take notice of the intentions of the founders of the Constitution, the Court might have been able to develop a narrow definition of taxes liable to interfere with Commonwealth tariff policy, for instance, 'taxes on goods currently subject to tariffs or other import restrictions.' Such a definition would, it seems, have been quite practicable. It would certainly have had the advantage of preventing the unforeseen restrictive effect of s. 90 on State taxing powers. Alternatively, as Professor Sawer has suggested, the Court might have tried at all cost to adhere to the narrow definition of Peterswald v. Bartley of 'taxes on production, measured by quantity or value'; this would have had the same practical advantage, but it would have been virtually impossible to maintain on economic, logical or historical grounds, as the history of the later cases indeed shows.

Notes

1 The author was stimulated to undertake this study by a seminar on federalism held at the Australian National University, Canberra, in September, 1951, and particularly by a paper read to the seminar by Professor G. Sawer, entitled 'The Record of Judicial Review'; he also wishes to acknowledge Professor Julius Stone's encouragement to trespass further on this field, and to express his thanks to both of them and to Dr J. G. Fleming for helpful comments.

2 Quick and Garran, Annotated Constitution of the Australian Commonwealth, 1901, p. 381.

3 Since an inter se question was involved, none of the cases has gone on appeal to the Privy Council.

4 (1904) 1 C.L.R. 497.

5 (1908) 6 C.L.R. 41.


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8 The legislation was subsequently re-enacted in such a way as not to offend against s. 92 and has been operated ever since. I owe information on this point to Professor Sawer.

9 Lower Mainland Dairy Products Sales Adjustment Committee v. Crystal Dairy Ltd. (1933) A.C. 168. The Privy Council here upheld a decision of the Supreme Court of British Columbia invalidating a milk quota scheme designed to subsidise the production of processed milk products out of levies on the more profitable production of milk for liquid consumption. Both the main levy, and a separate levy imposed to finance the administrative expenses of the scheme, were held to be taxes.


12 Starke, J., ibid. at p. 286.

13 Cf. G. Sawer, op. cit. p. 15.

14 Hopper's Case (1939) 61 C.L.R., p. 686.

15 (1938) 60 C.L.R., p. 281; cf. also McTiernan, J.'s statement in Parton's Case (1949) 80 C.L.R., at p. 268, that the levy is 'a tax because it is a forced contribution to the government for public purposes. The objects of the Act are directed to the general welfare rather than to the performance of services for the sellers and distributors who may be required to contribute.'

16 (1949) 80 C.L.R., p. 258.

17 There is a vague hint of a similar criterion in the Privy Council's judgment in the Crystal Dairy Case, (1933) A.C. p. 175 et seq.

18 (1934) 51 C.L.R., p. 125.

19 John Fairfax and Sons Ltd. v. New South Wales (1927) 39 C.L.R., p. 144.

20 Cf. Dixon, J.'s, detailed account of the history of the term in his judgment in Parton's Case (1949) 80 C.L.R., pp. 253-63.


22 Cf. Griffith, C.J. (ibid.): 'In construing a Constitution like this it is necessary ... to ascertain ... whether the power to deal with such matters was intended to be withdrawn from the states'; also Higgins, J., in Barger's Case (1906) 6 C.L.R., p. 113: The founders of the Constitution 'did not intend that the Federal Parliament should move in leading strings.'

23 E.g., Griffith, C.J., in Peterswald v. Bartley (supra), pp. 508 et seq.

24 (1926) 38 C.L.R., p. 426. Isaacs, J.'s obiter dictum had a curious history. When it was relied on by counsel for the State in the Homebush Flour Mills Case (supra) ('a sales tax, not an excise tax'), Latham, C.J., dismissed it by explaining that it 'was not essential to his judgment in that case' (1937) (56 C.L.R., p. 401). It was then ignored
until Latham, C.J., in Parton’s Case, himself revived the distinction by holding that the levy in this case was ‘a tax merely upon the sale and not upon production’ (1949) (80 C.L.R., p. 246), only to have his own dismissal of Isaacs, J.’s, dictum promptly quoted back at himself by Dixon, J. (ibid. p. 259). Finally, McTiernan, J., in the same case, again quoted the obiter dictum at length, and adding other instances of the distinction, found himself able to conclude that ‘the weight of judicial authority favours’ the distinction between an excise duty and a sales tax (ibid., pp. 263 et seq.). But the majority judgment in Parton’s Case has probably, for the time being, established the contrary proposition.

25 (1926) 38 C.L.R., at p. 437.
26 Ibid., p. 435.
27 By way of contrast between an excise duty and ‘a direct and personal tax’, the distinction had already been introduced into the discussion by Griffith, C. J., in Peterswald v. Bartley (1904) 1 C.L.R., at p. 504.
29 The word ‘demanded’ in Mill’s definition, for example, might be interpreted as ‘collected from’ or as ‘assessed on’; on the latter interpretation, income tax under the system of deduction at source would be a direct tax, but on the former more usual interpretation, it would have to be classified as an indirect tax.
30 U. K. Hicks, op. cit., p. 47.
31 Ibid.
33 Ibid., p. 435.
34 (1936) 57 C.L.R., p. 396.
35 (1938) 60 C.L.R., p. 285.
36 Ibid., p. 286.
37 Counsel for defence (Cleland) in Petrol Case (1926) 38 C.L.R., p. 416.
38 (1938) 60 C.L.R., p. 302.
39 Ibid., p. 276. The problem of applying the conventional analysis of tax incidence to the marketing board levies was indeed a singularly difficult one. As we have argued before, the most sensible way out would have been not to have treated them as taxes at all, but as payment for services rendered, either to producers (if the service was conceived to be price maintenance) or to consumers (if the service was considered as part of legitimate costs of production and distribution). On this line of reasoning, the levies could certainly not have been regarded as taxes on outlay, since, whatever view was taken of the nature of the services, the charges had to be regarded as part of the factor cost of the commodities, not as additions to factor cost which is the essential
characteristic of a tax on outlay. The conventional analysis could not answer the question at all without leading into the most esoteric speculation on economic facts and possibilities. For, as Starke, J., observed, since the re-sale prices were fixed by the marketing boards, the 'formal' incidence was entirely a matter of whether or not the boards, in fixing these prices, made a mental allowance for the charge.

40 Ibid., p. 278.

41 Ibid., p. 277.

42 Dixon, J., ibid., p. 303. Judges were frequently tempted to get round these difficulties of the definition of indirect taxes by following the example of contemporary economists and speaking simply of 'a tax upon the commodity' (e.g., Starke, J., in Petrol Case (1926) 38 C.L.R., p. 439); but as Mrs Hicks points out, 'since the commodity could not pay the tax itself, this was not very satisfactory' (op. cit., p. 40).

43 (1943) A.C., p. 550; it was arguable, as the Privy Council did indeed stress, that in interpreting the British North America Act, there was a special point in following Mill's definition, not relevant to Australian conditions, viz., that the British North America Act was drafted in 1867, when Mill was himself a member of Parliament and his recently published textbook was accepted as the standard authority, so that it could plausibly be assumed that, when the authors of the Act used the term 'indirect' taxes, they had Mill's definition in mind.

44 Ibid., p. 565, per Lord Simon; this point had been established in earlier Canadian decisions and had been relied upon by Starke, J., in Matthews v. Chicory Marketing Board [see note 35].

45 Compare his quotation, with apparent approval, in his judgment in Matthews v. Chicory Marketing Board, of a Canadian judgment that 'a dog tax . . . is clearly direct taxation' — a good example of the contrast between Mill's and Mrs Hicks' definitions.

46 (1949) 80 C.L.R., p. 261.

47 But see note 23.

48 See note 46.

XXVIII
Business Taxes in Relation to Problems of Australian State Finance*

Russell Mathews

The proposals for tax reform that were advanced by the four authors of *Taxation in Australia* were concerned especially with direct taxes on income and wealth and, although attention was directed to State governments as well as to the Commonwealth government, there was no attempt in that study to relate the problem of tax reform to the task of securing a viable system of Commonwealth-State finance. In this paper I propose to extend the scope of examination of the Australian tax system by looking especially at the taxes which are paid in one form or another by business enterprises, and from this study will emerge proposals for particular forms of business taxes which, it will be argued, can be logically, beneficially and, in my view, constitutionally levied by the States.

**Kinds of Business Taxes**
Conceptually it is possible to distinguish five main forms of business taxes, namely taxes on business profits or income, taxes on capital, taxes on business expenditures or outlays, taxes on production and taxes on business receipts or sales. A further distinction may be made according to whether the taxes are general or partial, and for the

purposes of this paper we shall also be interested in the division of business taxes between the Commonwealth and States.

*Taxes on Business Profits or Income*

Although income taxes are usually imposed on income generally, the tax base may be defined in such a way as to exclude important categories of income, such as capital gains or income arising from gold mining operations, while in calculating taxable income certain deductions may be allowed — such as deductions in respect of capital expenditures — which would not normally be regarded as relevant by economists and accountants in the determination of business profits or income. Again, taxes on company profits may be related to total profits, to that portion of profits which has been distributed as dividends, or to undistributed profits. In Australia, the profits of unincorporated businesses are included among the personal incomes of their proprietors and are thereby taxed in accordance with the progressive income tax rate structure. Dividends distributed by companies are likewise taxed as part of the personal incomes of recipient shareholders. In addition, however, Australian companies pay a separate company tax on their profits, as assessed for tax purposes, a distinction being made between private companies (defined as companies in which the public is not substantially interested) and non-private companies. There is a mild degree of progression in the rate of company tax, the first £5,000 of profits being taxed at a slightly lower rate than the remainder. Private companies, while subject to an undistributed profits tax if they do not satisfy specified requirements relating to the distribution of profits, pay somewhat lower rates of ordinary tax than non-private companies.

Since the introduction of uniform tax legislation during World War II all personal and company income taxes have been collected by the Commonwealth.

*Taxes on Capital*

Some forms of capital taxes are necessarily personal taxes, for example estate and succession duties, but Australian companies are subject to gift taxes with respect of gifts of property. Although neither business nor personal capital gains are subject to tax as such, taxable income is defined in Australia so as to include profit arising from the sale of property acquired for profit-making purposes. Some overseas countries impose capital gains taxes either by defining income to include capital gains or by making a separate assessment on capital gains as calculated for the purpose. Many European countries also impose an annual tax on personal wealth or net worth.

In Australia the main forms of capital taxes paid by business enterprises are land and real property taxes, that is partial taxes on
particular forms of capital ownership. Since the Commonwealth vacated the field in 1952 land taxes have been imposed only by the States, in the form of taxes on the unimproved capital value of land. Real property taxes in Australia are usually known as rates, and are imposed by local governments on the annual rental value, the improved capital value or the unimproved capital value.

**Taxes on Business Expenditures or Outlays**

The expenditures which Australian businesses incur in the course of purchasing raw materials, property, equipment, trading stocks and even services are likely to include various charges in respect of stamp duties, sales taxes, excise duties and customs tariffs, which have been passed on by suppliers or, in some cases, paid directly by the enterprises themselves. Registration and licence fees of various kinds are often payable by businesses and in addition there is a general tax on all business payrolls above a specified exemption level. These are partial outlay taxes or taxes on particular transactions, but it is also possible to conceive of a flat-rate tax on general business expenditures. Such a tax has indeed been strongly advocated in Sweden. Sales taxes, customs and excise duties, and payroll taxes are imposed by the Commonwealth, while all other taxes on business outlays are State taxes. Stamp duties and motor taxes are the main sources of State taxation revenue.

**Taxes on Production**

These also may be either partial (i.e. restricted to a few specified products) or general. In Australia State taxes are sometimes based on output (the best example is licensing charges imposed on breweries) but the most important taxes related to production are those imposed by the Commonwealth. These include excise duties, which are levied on the output of alcoholic beverages, tobacco, petroleum, and a few other commodities, plus certain taxes in the nature of benefit levies which are collected in particular industries for such purposes as financing research, publicity and marketing activities in the industries concerned (wool levy, wheat tax, dairy produce levy, canning fruit charge, tobacco industry charge and cattle slaughter levy), stabilizing prices or financing the operations of export boards (wheat, meat, dairy produce, eggs, canned fruits, dried fruits and wine export charges), financing long service leave for miners (coal excise) or improving conditions on the wharves (stevedoring industry charge).

A general tax on production is imposed in some countries, e.g. France, Sweden, in the form of a ‘value-added tax’. The base of the value-added tax is somewhat broader than that of the net profit tax and somewhat narrower than the general expenditure tax, since value added is defined as the net value of production, or the value of total
output less the value of material inputs purchased from other entities: value added is thus equal to the sum of surplus items (net profits, rent, interest), depreciation and labour costs. This definition may be varied to permit depreciation or the costs of capital equipment purchases to be deducted from the value of output along with the cost of material inputs. Value added may also be defined as either gross or net of other taxes.

*Taxes on Gross Receipts or Turnovers*

These include various State taxes such as those on receipts from lottery tickets and other gambling receipts, entertainment taxes, and *ad valorem* stamp duties, but in Australia the most important tax on sales transactions is the Commonwealth sales tax, which is an *ad valorem* tax applied to the wholesale selling value of a wide range of commodities and levied at the time when the commodities are sold to retailers by wholesalers, manufacturers or importers. In principle, sales taxes differ from excise duties by being based on sales rather than output and by being more general in their application. Because the Australian sales tax is subject to substantial exemptions and because different rates are applied to different classes of commodities, it is closer in concept to an excise tax than to a sales tax as usually defined by students of public finance.

In some countries ‘doing business’ or business activity taxes are imposed by applying very low rates to gross business receipts. While these are often justified as benefit levies charged for the privilege of being able to carry on business, their economic effects are similar to those of a general sales tax. There is also a close affinity between a sales tax based on the retail price of a product, and a value-added tax in respect of the same product, since the sum of the values added at each stage of the production and distribution process must necessarily equal the retail selling price.4 Sales taxes themselves may be imposed on gross turnovers at each stage of production, in which event the same commodity may attract tax several times depending on the degree of business integration; turnover taxes of this kind are levied in several European countries. Alternatively, sales taxes may be applied to only one point of sale, such as the sale by the manufacturer (as in Canada), the sale by the wholesaler (as in Australia or Great Britain, which however, calls its tax a purchase tax), or the sale by the retailer (as in most American states).5

*The Effects of Business Taxation*

The several kinds of business taxes which have been discussed are frequently further differentiated according to whether they are direct taxes, the effective incidence of which falls on the business enterprises.
which pay the taxes, or indirect taxes, which the taxpayers are able to shift to consumers or other groups. Taxes on business profits or incomes are usually classified as direct taxes, while the other forms of business taxation are usually regarded as indirect. In some countries certain forms of taxes on gross business transactions are apparently intended by legislators to be direct taxes on enterprises, but in practice these taxes are just as likely to be shifted as other taxes which are generally regarded as indirect.

For our purposes it is more useful to distinguish between personal and business taxes than between direct and indirect taxes. Taxes on business profits or income will then be classified as personal or business according to whether they are imposed on persons according to the income they receive from businesses (taxes on profits of unincorporated businesses or dividend income would fall within this category) or on business income itself (company taxes would fall within this category). Whether or not taxes on company profits are shifted, and if so the extent of the shifting, will depend on numerous factors. These include the extent to which companies, in planning investment and formulating their pricing policies, seek to achieve specified after-tax rates of return and the extent to which the competitive position of companies, and the shape of the demand curves for their products, enable them to shift the burden of the tax from themselves to their customers. Similar considerations apply to other business taxes, and it is probably more realistic for our purposes to assume that there is some shifting of all business taxes, including company taxes. The analysis of business taxes may then proceed on the usual basis, by reference to their effects on economic stabilization and the regulation of total spending, on equity and the distribution of spending power, on resource allocation and the pattern of spending. Any proposals for the reform of business taxes may then be considered in the light of the contribution which they are capable of making towards the achievement of Commonwealth or State economic policy objectives in these areas.

Company Income Tax
One of the major proposals made in *Taxation in Australia* was concerned with the reform of company taxation.

Arguments for and against the separate taxation of company income are usually based on the conflicting and irreconcilable claims (a) that companies are separate legal entities and are taxable as such, and (b) that the taxation of company profits once in the hands of companies and subsequently (when distributed as dividends) in the hands of the shareholders is inequitable because it involves double taxation.
Neither of these arguments is conclusive as a reason for taxing or not taxing company profits. The first does not resolve the question of equity. The second ignores the fact that the incidence of company tax is uncertain, and in any case the co-existence of personal income taxes and other taxes within the same fiscal system makes it impossible to argue that some taxes involve double taxation while others do not.

One of the main reasons advanced for taxing company profits is that this is necessary to prevent the undistributed portion of such profits from escaping tax altogether. On this argument it would seem that company tax should be restricted to undistributed profits, and this practice is in fact followed in some countries, which either tax undistributed profits per se or allow a rebate of tax in respect of dividends which are subsequently taxed in the hands of shareholders. But because undistributed profits taxes are usually levied at a flat rate, and because the incidence of such taxes is in any case uncertain, this practice cannot be regarded as providing a satisfactory solution to the equity problem.

But there are several reasons why the present Australian system of taxing total company profits must also be regarded as unsatisfactory from the point of view of its effects on equity, efficiency and growth.

(a) Because, as we have seen, many companies are in a position to shift the tax by charging higher prices for their products and achieving desired after-tax rates of return, company tax cannot be regarded as a satisfactory supplement to a tax on personal income.

(b) Even if the company tax were to be accepted as a substitute for a tax on undistributed profits, and even if it were not shifted forward to consumers, there would remain two reasons for regarding it as inequitable. In the first place, the effective rate of tax on undistributed profits will differ between companies according to the proportion of profits which each company distributes. In the second place, shareholders whose marginal rate of tax is less than the rate of company tax are taxed more heavily than is warranted by reference to the personal income tax system, while wealthy shareholders with relatively high rates of personal income tax are taxed more lightly.

(c) Companies are able to accumulate savings in the form of undistributed profits, and because these have attracted tax at substantially lower rates than those which apply to middle and higher income groups in the personal income tax schedule, they constitute an important source of untaxed capital gain. Attempts to prevent tax avoidance, by distinguishing between non-private and private companies and placing restrictions on the ability of the latter to retain profits, have added enorm-
ously to the complexity of the tax system but have generally failed dismally in their purpose. Recent legislation has provided new definitions of public and private companies and at the same time has limited the ability of the latter to avoid undistributed profits tax by passing dividends to associated private companies. But on past history one may expect the closing of one loophole in the wording of the tax laws to be soon followed by the opening up of another. In any case public companies will still be in a position to gain tax advantages in respect of their undistributed profits.

(d) The tax system, by differentiating between non-private companies, private companies and unincorporated businesses, plays a key role in determining the form of business organization, which should depend on other considerations (such as the desired capital structure or the desired relationships between the contributors of capital, creditors and management of the enterprises in question).

(e) To the extent that company taxes are not shifted, they reduce the funds available for investment from internal sources. When personal taxes are superimposed on company taxes new and growing companies are likely to be inhibited to a greater extent than large, old-established firms, which are in a stronger position to limit dividend distributions or obtain funds through new issues in the capital market.

(f) Company taxes discriminate in favour of debt financing relative to the provision of equity capital, by permitting deductibility of interest on borrowed funds but not dividends on share capital. This has been one of the main factors contributing to the lack of financial balance that was responsible for the failure of many Australian companies during recent years; the capital structure of a company should be determined not by tax considerations but by its profit prospects in relation to total funds employed, having regard especially to the riskiness of operations and the possibility of fluctuations in earning power. This lack of balance could be corrected by allowing deductibility of both interest and dividends, in effect restricting the company tax to a tax on undistributed profits, but this would have the disadvantages noted above. Alternatively, as will be suggested later, it could be corrected by allowing deductibility of neither interest nor dividends.

Proposal for Taxing Company Profits in the Hands of Shareholders
These disadvantages of company taxes are so considerable as to suggest the need for drastic changes in the basis of company taxation.
Leaving on one side for the moment the question of company tax itself, the most effective way of overcoming the defects that have been described would be to force companies to submit all their profits to taxation in the hands of shareholders. This could be done by imposing tax on the undistributed profits of all companies, both public and private, equal to the highest marginal rate paid by persons (at present 13s. 4d. in the £ [or 66.7 per cent]). Companies could still pre-empt funds for their own expansion, in the same way as they now do through undistributed profits, by paying some of their dividends in the form of bonus shares rather than cash, but these bonus shares would be taxable in the hands of shareholders along with the cash dividends they receive.

To ensure that shareholders could meet their enlarged tax liabilities, a system of tax deduction at the source could be introduced, whereby companies pay part of their dividends to shareholders in the form of tax certificates, calculated at the rate of 7s. 6d. in the £ [37.5 per cent] on total cash dividends and bonus shares, the face value of the certificates being paid by the companies to the Commissioner of Taxation in the same way as pay-as-you-earn deductions. The tax certificates would be forwarded by shareholders with their tax-returns, appropriate additional payments or refunds being made in accordance with the assessment of individual liability. With the introduction of this system provisional tax on dividends could be abolished.

Such a system would have many advantages. The equity of the tax system would be improved as between different classes of proprietors and different income groups. Undistributed company profits would disappear as a major source of untaxed capital gains. The distinction for tax purposes between private and public companies would become unnecessary and the administration of the tax system greatly simplified. Finally, the undesirable allocation effects of company taxation which have been noted would be eliminated.

The changes that have been proposed would pose certain difficulties of their own. Care would thus need to be taken to ensure that companies did not avoid undistributed profits tax merely by paying dividends to associated companies in the same group; this could be done by requiring the consolidated profit of a group to be distributed to persons or independent companies in the same year in which the profit was earned, and by insisting that all companies in the group have a common balancing date. Companies should be permitted to carry forward losses as a charge against future profits.

The basis of taxing non-resident shareholders would also need to be revised under the new arrangements. At present dividends paid to non-resident shareholders are subject to a withholding tax of 3s. in the
£ [15 per cent] in the case of countries subject to double taxation agreements and 6s. in the £ [30 per cent] in the case of other shareholders. These rates of withholding tax would need to be increased in order that non-resident shareholders should share the burden of higher personal taxes on an equitable basis with resident shareholders, who are generally subject to much higher marginal and average rates of tax.

The Company Tax Base

The changes that have been proposed in the basis of company taxation do not dispose of the problem of the company tax itself, since the company tax could not be abolished altogether without substantially reducing total income tax revenue and producing a corresponding increase in private spending power. To maintain the aggregate yield of personal and company tax under the proposed scheme of tax reform, it has been estimated on the basis of certain assumptions that a company tax of 4s. in the £ [20 per cent] would be necessary. In Taxation in Australia, a slightly higher rate of company tax was favoured, on the grounds that the effects of company taxation have already been largely embodied in product prices and share values. While it was unlikely that a reduction in company tax rates would be reflected in reduced product prices, it would almost certainly result in windfall capital gains to present shareholders. It was argued that the extra shilling in the pound on company profits would be a reasonable burden for shareholders to bear, since the company tax has never been a satisfactory substitute for a tax on the capital gains resulting from company profits. The new basis of taxation would, however, eliminate capital gains from this source in the future.6

The scheme that has been outlined would reduce but not eliminate the discrimination which the tax system currently makes in favour of debt-financing. The authors of Taxation in Australia argued that there is a strong case for equal tax treatment of that part of operating surplus which is distributed as interest on fixed-interest securities and that part which is distributed as dividends; they therefore recommended the extension of the company tax base from company profits (after charging interest) to operating surplus (before charging interest). Recognizing that this poses problems in relation to banks and financial enterprises (as the government discovered with its ill-fated legislation of November, 1960), it was suggested that banks should be permitted to continue to treat interest as a deductible expense, and that other financial enterprises should be allowed to qualify for this exemption by applying for authority to carry on banking business. This would incidentally bring the other financial institutions under the control of the Reserve Bank. The widening of
the tax base in this way could be accompanied by a compensating further reduction in the rate of company tax.

Proposal for Basing the Company Tax on Gross Business Transactions

As an alternative to a reduced company income or operating surplus tax, it would be worth while exploring the possibility of widening the base still further and introducing a tax on gross company outlays, or values added, or sales, and substituting one of these for the company profits tax at the time the other changes are made. This would give explicit recognition to the view that, if company profits are fully taxed in the hands of shareholders, any remaining tax on companies is in the nature of a 'doing business' tax on company transactions, or a charge which companies are required to pay in return for the privilege of incorporation and limited liability.

This immediately suggests the possibility of transferring the proceeds of such a tax to the States, which administer the company laws and which are generally responsible for the incorporation and regulation of companies (except in respect of Commonwealth territories). There would be many advantages, from the viewpoint of providing a viable system of federal-State finance, in having such a substantial and flexible source of revenue transferred to the States. But whereas a system of State taxes on company profits or operating surpluses would be very difficult to administer, because of the problem of allocating the profits of companies operating on a nationwide basis to individual States, it would be relatively easy to classify gross expenditures, values added, or sales on a State basis.

The transfer of taxing powers could be accompanied by an appropriate reduction in the level of Commonwealth financial assistance grants to the States. If, on the new basis of taxing company profits, the yield of company taxes was £150 million (and it would be of this order) this would represent the amount by which grants to the States could be reduced without affecting the net budgetary position of either the Commonwealth or the States in the aggregate. The transfer of taxing powers would be intended not so much to provide the States with additional revenue immediately, as to give them the power to raise additional revenue from a flexible source under their own control.

The Case for Gross Business Taxation

The case for basing business taxation on gross outlays, values added or turnovers rather than on net profits has been discussed at some length during recent years in Sweden. Although net profits taxes have traditionally been regarded as more equitable than the so-called
indirect taxes based on gross transactions, Swedish trade union economists have argued that firms, to the extent that they adopt full-cost methods of pricing, are not likely to distinguish between the two types of taxation in determining their pricing policies, so that one form of tax is not likely to be shifted to a greater extent than another. But a net profits tax imposes a relatively greater burden on efficient firms making high profits, with undesirable effects on the allocation of resources among firms and industries. Inefficient firms and industries, it is argued, are in effect being subsidized by the revenue authorities.

The substitution of a gross for a net profits tax would cause a redistribution of the tax burden among firms; companies whose profit rates are low in relation to the value of their gross transactions would pay relatively more tax than under the present system and vice versa. Profitability may be related to other factors besides efficiency, and it is debatable whether one form of tax is more equitable than the other, especially if the possibility of shifting is admitted. But if shifting takes place under both a gross and a net tax, the former may be expected to disturb the pattern of product prices to a lesser extent than the latter, and thus has the advantage of interfering less with patterns of production and consumer choice.

If applied to investment outlays or to export production a gross tax could have adverse effects on growth and the balance of payments, but these items could easily be exempted from a gross tax which might otherwise be expected to favour dynamic firms capable of providing an impetus to growth and export performance.8

In France, which pioneered the value-added tax, it has been argued that such a tax bears equally on all the factors of production, whereas a net profits tax tends to fall most heavily on capital with a consequent tendency to encourage the unjustified substitution of labour for capital (this would be counteracted if there exists, as in Australia, a payroll tax as well as a tax on net profits). To the extent that tax shifting does not take place, the substitution of a gross tax for a net tax might be expected to reverse this and encourage companies to undertake labour-saving investment.

The recent decision of the British Chancellor of the Exchequer to introduce a corporation tax and capital gains tax on the American pattern has led to a re-examination of business taxation in that country also. It has been suggested9 that a so-called turnover tax, based on value added, could with advantage be substituted for all other forms of company profits taxes. Thus a value-added tax, unlike a net profits tax, could be remitted on exports without infringing the General Agreement on Tariffs and Trade;10 it would be more easily administered than a company profits tax; and insofar as allocative
effects are concerned, a value-added tax would remove the encouragement to inefficiency which results from the fact that the company profits tax allows loss offsets not only between different companies (as a result of take-overs or mergers) but also between different products of a single firm. Investment subsidies could be incorporated into a system of gross taxation just as easily as into a system of net profits taxation.

Perhaps the main disadvantage of changing to a system of gross business taxation would be the large-scale economic disturbances which the change would generate, resulting in windfall gains for some firms and windfall losses for others. An associated problem is the difficulty of predicting the consequences which a change in the tax base would have in respect of price patterns and the distribution of incomes. Although, as we have seen, the advocates of gross business taxation have usually assumed or asserted that the effective incidence of gross taxes, as between businesses and consumers, is much the same as that of net taxes, this would only be true if the whole of net profits taxes were incorporated in the supply prices of firms in the same way as outlay or other taxes on transactions.

Nevertheless, if company profits can be effectively taxed as personal income in the hands of shareholders, and the role of company tax reduced to that of a ‘doing business’ tax, it may be conceded that there is substantial merit in the idea of widening the tax base to take account of gross transactions instead of restricting it to net profits. If such a tax were regarded by companies as being a clear substitute for the existing company profits tax (and this would depend largely on its manner of introduction) and if it were to apply only to companies (the taxation of unincorporated businesses remaining unchanged), there might be no significant shifting and the main effects of the change might be the allocative ones which are desired.

If a gross transactions tax were to be introduced into the Australian tax system, the payroll tax could be incorporated in the new tax with some benefit to the logic of the tax structure viewed as a whole. The main argument for retaining the payroll tax in Australia is that it is an old tax, the effects of which have been incorporated in the structure of prices and incomes; merely to eliminate the tax would be to give businesses windfall gains which are less likely to be passed to consumers than was the original tax, which was viewed generally as an increase in wage costs. The most satisfactory method of dealing with such a tax is to incorporate it in a tax having a wider base, making it clear that the latter is intended to subsume the former.

Unincorporated businesses have paid payroll taxes along with companies, and if it were desired to maintain revenue from this source it would be possible to have two rates of gross business taxation, one
for companies and one for unincorporated businesses. If, as has been argued, the gross tax should be regarded as a levy on companies for the privilege of limited liability, unincorporated businesses may well be exempted from the need to pay either a gross tax or a payroll tax. In any case, because of the wider base, the rates of tax could be substantially lower for a system of gross taxation than the effective rates of company profits and payroll taxes combined. If the Commonwealth were to withdraw from the payroll tax field and hand over the responsibility for gross business taxation to the States as has been suggested, a further adjustment could be made to the level of financial assistance grants.

Choice of Gross Business Tax
It remains to discuss which forms of gross business transactions, namely expenditures, values added or sales turnovers, has the best claim for consideration as an alternative to net profits as a base for company tax. The first can be disposed of quickly. If gross expenditures in the market place were to be taxed at each point of sale, there would be an inducement to business enterprises to integrate with a view to eliminating the number of taxable transactions. A country such as Australia, whose industries are already highly concentrated, could hardly afford to provide this further incentive to vertical integration, which, although it might bring greater technical efficiency in its wake, would undoubtedly weaken the forces of competition and leave consumers in a vulnerable position.

The choice between a value-added tax and a general tax on retail sales is less clear-cut. As we have seen, a value-added tax imposed on each manufacturing or marketing operation will yield the same revenue in respect of a particular product sold to consumers as a sales tax imposed on the retail price of the product (assuming also that output equals sales). A disadvantage of the value-added tax is that price pyramiding, involving mark-ups in excess of the amount of tax paid, may occur at each point of sale. The main advantage which the value-added tax has over the sales tax is that the former is spread over a larger number of firms, and can be more easily explained as a ‘doing business’ tax if that is the justification advanced for imposing a tax on gross business transactions.12

On the face of it the problem of administering a general sales tax would appear to be simpler than that of collecting a tax on values added at each stage of production and distribution. However, Swedish experience has been that the general sales tax fails to provide the cross-checks which are possible when different businesses are subject to tax and one firm’s taxable output becomes another’s deductible input,
and ease of administration has been one of the main arguments used to justify a switch from a general sales tax to a value-added tax in that country.\textsuperscript{13}

Since the Commonwealth government already imposes sales and excise taxes on a wide range of commodities, it would be difficult for it to introduce a general sales tax in lieu of the existing company tax without disturbing the structure of sales and excise taxation, so that if the Commonwealth were to continue to collect company taxes it would almost certainly need to impose them in the form of a value-added tax. This constraint would not operate with respect to State governments, which could impose a new general tax on company sales in addition to whatever selective sales or excise taxes the Commonwealth might continue to levy.

The choice between a value-added tax and a general tax on retail sales, if such a tax were to be imposed by the States, would also depend on constitutional considerations. I believe that a substantial weight of economic opinion would support the view that neither a value-added tax nor a general retail sales tax is an excise tax as normally defined, especially if the States were careful to justify the tax as a kind of licence fee imposed on companies for the privilege of incorporation, the amount of which was to be related to the gross value of company transactions in the year preceding the year in which the tax is levied. The High Court has permitted the States to levy liquor taxes related to quantities purchased, even though it has generally defined an excise as a tax upon goods at the manufacturing stage or before the goods reach the final consumer. Provided the value-added tax is a general tax on companies and not on the goods and services produced by companies, it would seem to be admissible by these tests, even if the amount of the tax is related to the value of production added as has been suggested. A general retail sales tax, on the other hand, could be justified as a tax on consumption, as opposed to a tax on production, and would seem to fall within the States' taxing powers.

I conclude by summarizing the reasons why I am attracted to the idea that the company tax should take the form of a value-added tax or retail sales tax rather than a profits tax.

(a) Such a tax helps to avoid the definitional problems that arise in connection with the use of profits or operating surplus as the tax base.

(b) Because a gross tax is imposed, in effect, on all factors of production at the same rate, it avoids distorting effects which the profits tax and the payroll tax have on (i) the choice of factors and (ii) the rewards that accrue to efficient relative to inefficient firms.
(c) There is logic in the idea of handing over the company tax to the States, but it is doubtful whether the States could effectively administer a company profits tax because of the difficulty of allocating profits earned by companies operating in more than one State. A tax on transactions would avoid these difficulties.

State Sales Taxation
If the Commonwealth cannot be induced to hand over the company tax to the States as has been suggested, there would seem to be good reasons why the States should examine again the possibility of obtaining a flexible source of revenue through the imposition of a general tax on sales transactions, say at the retail level and preferably applying to services as well as goods. The main argument against State sales taxation, as indeed against sales taxation in general, is that it would fall most heavily on lower income groups, but this effect could be mitigated by ensuring that the revenues which the States collect from such a tax are used to finance expenditures which will be of particular benefit to these groups, e.g. education, health services, low-cost housing and cost-reducing expenditures on transport and power. While it would be more equitable for increased expenditures in these areas to be financed through progressive taxation, this is not possible under the present division of taxing powers in Australia, and the alternative to higher indirect taxes imposed by the States seems to be a chronic deficiency in the provision of these public services. In addition to facilitating the transfer of resources from the private to the public sector, the moderate use of sales taxation, viewed as a supplement to the progressive income tax, has the further advantage that it is likely to retard enterprise, effort and growth to a lesser extent than increases in marginal income tax rates.

State Motor Taxation
It is unfortunate that the States, which have the major responsibility for roads, face constitutional difficulties in imposing sales or other taxes on motor cars, petrol or other items which relate to the consumption of services of private motor transport. When judged by reference either to the state of the roads or to the weight of motor taxes in other countries, there is considerable scope for higher taxes on motor transport, especially in urban areas. The Commonwealth government, instead of undertaking to reduce the price of petrol in rural areas, could have improved the relative position of these areas by imposing substantially higher petrol taxes in the cities and using the proceeds for higher Commonwealth-aid road grants. Both the effects of the increased tax itself, and the road-improvement expenditures which could be financed from the tax, would help to remedy the acute
problem of urban traffic congestion. In the face of constitutional difficulties the States must tackle the roads problem either by making funds available from their general revenues or by imposing benefit levies which are directly related to the use of the roads. There would seem to be no reason why the States could not tackle the problem of main inter-city highways by building toll expressways. The increased charges for the use of roads would, if accompanied by a reduction in congestion, almost certainly be more than recouped by businesses through lower operating costs.

Conclusion
In the matter of fiscal responsibility the Australian States are now at the crossroads, and the decisions they take during the next few years will determine whether they will continue to play an autonomous role in government or whether they will become mere spending agencies of the Commonwealth. The arrangements relating to financial assistance grants are being reviewed in 1965, and if the States continue to seek the answer to their financial problems solely in terms of increased Commonwealth grants Australia will soon cease to be a federation in anything but name.

Not even those who favour unitary government in Australia can be satisfied with the present system of Commonwealth-State financial relations, since it encourages political irresponsibility, economic waste and social neglect. State government expenditure decisions are divorced from the responsibility for raising revenues from taxpayers on whose votes the governments depend, and States are tending to take the easy way out by seeking additional Commonwealth assistance instead of exploiting sources of taxation subject to their own control. Commonwealth financial assistance grants are determined by an arbitrary formula that bears little relation to revenue collections in the various States, expenditure needs or standards of efficient performance in the exercise of State functions. The examination of State needs in relation to resources available at present goes by default. Most of us suspect that there are dual standards of expenditure as between the Commonwealth and States — that State expenditure must meet more stringent tests before being approved than are necessary in the case of Commonwealth expenditure. The existing basis of allocating financial assistance grants among the States also undoubtedly places some States in a stronger financial position, in relation to their needs, than others. However, the breaking of the nexus between expenditure decisions and the raising of finance makes it difficult to establish satisfactory criteria in respect of State expenditures. If present trends continue, and the States do become mere financial appendages or spending agencies of the Commonwealth, there would
seem to be a strong case for subjecting State needs to the same kind of scrutiny as is already applied to expenditure proposals in Commonwealth departments, and for relating financial assistance grants more directly to needs and standards of performance; such a task could presumably be carried out by enlarging the responsibilities of the Commonwealth Grants Commission.

However, the point I wish to emphasize in concluding this paper is that there is no need for the States to abdicate from their traditional position of political autonomy and fiscal responsibility. Because they still have important sources of revenue under their own control, they can still make a choice between financial independence and subservience to the Commonwealth. Even if they are unwilling or unable to reintroduce income taxes, they have other opportunities for exploiting personal taxes, particularly in the capital tax field. In view of the widespread use of the net worth or annual capital tax in other countries, it is surprising that none of the Australian States has ever considered the adoption of such a tax, especially since it has considerable advantages from the point of view of equity and does not have the deterrent effects on enterprise, risk-taking and effort which are usually associated with many other forms of taxation.

But it has been a major purpose of my paper to suggest that the States, irrespective of their position in relation to personal taxes, should be able to raise all the additional revenue they need by imposing taxes on gross business transactions, such as values added or retail sales. The notion that the States should rely on business taxation for a substantial proportion of their revenue makes sense in a federation such as Australia; although the Commonwealth has the main responsibility for policy decision relating to equity and economic stabilization, it is the States which have the major responsibility for setting the conditions under which business enterprises operate, and which play the major part in determining questions relating to resource allocation and economic growth. Because the prosperity of business enterprises depends so directly on State government decisions relating to transport, power, water supply, land utilization, housing and, in the longer run, education, there is a strong case for arguing that business transactions should be taxed in order to ensure that these services can be provided by the States on an adequate scale.

Notes


2 This is not to be confused with a progressive tax on personal expenditures which Mr N. Kaldor and others have advocated as a substitute for the personal income tax.

4 This assumes that output equals sales. The French value-added tax is in fact calculated by reference to sales, any tax previously paid by suppliers in respect of material inputs being deductible in assessing tax liability. See J. F. Due, *Sales Taxation* (Routledge and Kegan Paul, London, 1957), Ch. 7.

5 Ibid., Ch. I.

6 *Taxation in Australia: Agenda for Reform*, Ch. IX.

7 Since writing this paper, the author has read the report of a recent conference sponsored by the National Bureau of Economic Research and the Brookings Institution, in which some of the issues raised in the remaining sections of this paper, and particularly the case for substituting a value-added tax for a company profits tax, are subjected to more rigorous analysis. See *The Role of Direct and Indirect Taxes in the Federal Revenue System* (Princeton University Press, 1964), especially the paper on 'Allocation Aspects, Domestic and International', by R. A. Musgrave and P. B. Richman.


10 One of the main advantages claimed for the value-added tax is the opportunity it provides, if a rebate of tax is given in respect of export sales, for stimulating exports. The European Common Market countries, mindful of this advantage, have provisionally decided to adopt the French value-added tax as a major component of their fiscal system. This consideration might be expected to carry more weight with the Commonwealth government, which is responsible for maintaining equilibrium in the balance of payments, than with State governments. However, if the States were to impose value-added taxes it would be possible to devise a system whereby they could be reimbursed by the Commonwealth for the loss of revenue involved in granting exemptions in respect of export sales.

11 Two types of value-added taxes have themselves been distinguished in the literature, depending on whether fixed-capital investment outlays or depreciation are deducted from sales proceeds in calculating the tax base. If the tax is applied to sales proceeds minus material purchases and purchases of depreciable fixed-capital assets, it is said to be a value-added tax of the consumption type, while if the tax is applied to sales minus material purchases and depreciation it is said to be a value-added tax of the income type. The consumption-type tax is more regressive than the income-type tax but is also more favourable to growth. See C. S. Shoup, 'Theory and Background of the Value-Added Tax', *Proceedings of the National Tax Association for 1955*, pp. 6-19, and R. A. Musgrave and P. B. Richman, 'Allocation Aspects, Domestic and International', *The Role of Direct and Indirect Taxes in the Federal Revenue System* (op. cit.), pp. 89-90. Musgrave and Richman argue that if other indirect taxes are ignored, the total tax base with an income-type value-added tax is equal to net national income, while the total tax base with a consumption-type value-added tax is equal to consumption. But this seems to include in the tax base value added by the government sector.
12 See J. F. Due, *Sales Taxation*, op. cit. Ch. VII. Professor Due has shown that the business receipts levy imposed by the State of Michigan, while similar in its effects to the French value-added tax, is regarded as a charge for the privilege of doing business or a substitute for a corporation tax. It is calculated by subtracting the value of material inputs (including depreciation), interest, rent and taxes from a firm’s gross receipts, and applying the tax rate to the resulting figure. Under the French tax a firm calculates its tax liability on its total sales and subtracts the tax that has already been paid on its material inputs (including purchases of capital equipment).


14 This argument has been forcibly presented by J. K. Galbraith in *The Affluent Society* (Hamish Hamilton, London, 1958), Ch. XXII, as an argument for the extended use of the sales tax despite its regressive effects.
PART FIVE

POST-WAR DEVELOPMENTS
COMMENTARY

After World War II, Commonwealth-State financial relations continued to develop within the framework of the institutional arrangements discussed in the preceding groups of readings dealing respectively with the Loan Council, the Grants Commission and the uniform income tax system. The readings in this part consider the working of these arrangements in the post-war years to 1962.

Reading XXIX by Professor G. L. Wood accepts as inevitable the trend towards increased grants as a means of relating resources to responsibilities and smoothing intergovernmental relations. Himself a member of the Commonwealth Grants Commission for many years, Wood regarded the Commission's experience as providing a useful foundation for the development of a logical pattern of expanded grants, either directly to the States or indirectly in the form of farm relief or social security payments to their citizens. He envisaged a new central authority to take over the functions of the Commission and to extend its methods into new fields, incidentally promoting greater cooperation and co-ordination. Although he based his proposal partly on American developments, it was not in fact until over ten years later that the continued deterioration of federal-State relations in that country led to the establishment by the Eisenhower Administration of the Advisory Commission on Intergovernmental Relations. The Australian Advisory Council for Intergovernmental Relations, which has some of the advisory but not the executive functions of the body envisaged by Wood, was established in 1977.

Like Professor Wood, Mr H. P. Brown in Reading XXX accepts the financial predominance of the Commonwealth as inevitable — and indeed desirable. Brown also traces this development in some
detail. In 1942 he had been Secretary of the Committee which recommended the system of uniform income tax and reimbursement grants to the States (see Reading XXI). Nevertheless he recognised that the system had certain disadvantages, for which the most obvious short-term remedies were some sharing of personal income tax between the Commonwealth and the States and some scheme for reducing the deficits of State business undertakings (particularly State railways). In the longer term, however, he looked to the replacement of the States and their weak local authorities by a new system of regional decentralisation. This reading thus contains the germs of the ideas that eventually found expression in both the regionalism of the Whitlam government and the tax-sharing element in the Fraser government’s ‘new federalism’.

In Reading XXXI, Professor S. J. Butlin attempts to dispose of ‘The Problem of Federal Finance’ on the purely semantic ground that federalism as defined in 1900 no longer exists and cannot be restored. He agreed that the existing government structure, whatever it be called, gave rise to problems of financial relations, although unlike Brown he was not concerned with short-term solutions such as tax sharing. In the longer term, Butlin saw the States as developing into administrative agencies analogous to Commonwealth departments, but probably without any new regional structure as envisaged by Brown and certainly without any extension of Grants Commission procedures by a new administrative agency as had been envisaged by Wood.

Subsequent discussion was, however, naturally concerned less with such long-term possibilities than with the more urgent need for short-term solutions, such as increased taxation powers for the States, more satisfactory arrangements for federal grants, the introduction of new specific purpose grants and the possible transfer of functional powers from the States to the Commonwealth. State dissatisfaction with the system of uniform taxation and reimbursement grants led Victoria and New South Wales to challenge the validity of the legislation in the High Court in 1957. Although the crucial part of the legislation was upheld by the Court, the Commonwealth felt impelled to call a series of Premiers’ Conferences in 1959 to discuss intergovernmental financial relations. As a result, the original tax reimbursement grants were replaced by a new system of financial assistance grants, as explained in Reading XXXII by Professor W. Prest and Reading XXXIV by Dr (later Professor) G. S. Reid.

Both these Readings show how, in the course of the Conferences, a substantial differential element came to be included in the financial assistance payments thereby permitting the replacement not only of the previous tax reimbursement grants but also of a large part of the special grants. This provides a further illustration of the ‘continuity of
principle’ between special grants and other federal grants to which the Commonwealth Grants Commission had referred in its Third Report 1936 (Reading XIV). However, if this arrangement was intended as a step towards the abolition of special grants it can hardly be regarded as having been successful in the event. Although the special grants formerly recommended by the Grants Commission were reduced, the remainder continued in a disguised form, thereby obscuring the distinction between special grants to offset horizontal fiscal imbalance and general grants to offset vertical imbalance. Moreover, since 1971 Queensland has found it necessary to apply for special grants and even South Australia had to reapply during the years 1970-75.

Similarly, if the substitution of the term ‘financial assistance’ for ‘income tax reimbursement’ was intended to divert the attention of the States from the loss of their income taxes, this also can hardly be regarded as having been successful. So far from being ‘destined to oblivion’ as Reid anticipated (Reading XXXIV), State rights in the income tax field were eventually formally recognised in the tax sharing system introduced by the Fraser government in 1976.

Nor did the 1959 formula prove any more effective than the previous formula in ensuring that State revenues kept pace with inflation. In the ensuing years, the financial assistance grants had to be supplemented on numerous occasions and the formula itself had to be liberalised in 1965 and at subsequent quinquennial reviews. State complaints that the system virtually compelled them to borrow from the Commonwealth at high and increasing interest rates in order to finance their public works, as mentioned in Reading XXXII, also led eventually to the introduction of interest-free capital grants from the Commonwealth in 1970 and to the 1976 redrafting of the Financial Agreement to validate the take-over by the Commonwealth of $1,000 million of State debt.

Reading XXXIII by the anonymous author K.F. provides a good summary of the 1958-59 Reports of the Commonwealth Parliamentary Joint Committee on Constitutional Review. The reports are of interest as indicating the then current state of thinking among the Committee’s members, one of whom was Mr E. G. Whitlam. The Committee concerned itself primarily with the constitutional provisions relating to the Commonwealth Parliament, and with the concurrent legislative powers of the Commonwealth and the States, but virtually ignored the position of local authorities. On federal-State fiscal relations the Committee found itself unable to make any worthwhile constitutional recommendations that would be acceptable to all or most of the governments concerned. It did, however, recommend a series of new legislative powers for the Commonwealth, to ensure ‘a national approach on matters of national interest’. The Committee’s expectation that one of the major
matters to require Commonwealth regulation would be the development of a nuclear power industry 'during the remaining years of the present century' has not so far been fulfilled. In fact none of the Committee's recommendations have been implemented and the only new legislative powers acquired by the Commonwealth have been in respect of Aborigines, a matter which was not even mentioned by the Committee.

Nevertheless, the Commonwealth's effective power to promote 'the national interest' has been greatly expanded by the proliferation of specific purpose grants, sometimes called 'conditional' or 'tied' grants because they can only be spent on purposes designated by the Commonwealth, as distinct from general purpose grants which the States are free to spend as they wish.

Because the encouragement of national minimum standards in the provision of government services is a primary objective of specific purpose grants, their allocation amongst the States must necessarily be on a 'needs' basis, thus again providing an illustration of the Grants Commission's 'continuity of principle'. The allocation is made by formula in the case of some grants such as those for roads, which also required revision in 1959 as described in Reading XXXII. Many specific purpose grants, such as those for universities, other educational institutions and, after 1964, roads began to be allocated on the recommendation of expert committees or commissions following the precedent of the Commonwealth Grants Commission, supplementing its work but not replacing it by a super-commission as had been envisaged by Professor Wood in Reading XXIX.

In Reading XXXIV, Professor G. S. Reid notes that in the early 1960s specific purpose grants were generally only about one-fifth of all Commonwealth grants to the States, and he observes that the latter were still very far from being mere administrative agencies of the Commonwealth as Sir Kenneth Bailey had earlier predicted (Reading XXIII above). Some ten years later, however, specific purpose grants had risen to about two-fifths of all Commonwealth grants under the influence of an expansion in grants for education, health services, economic development, urban affairs and transport. Moreover in 1973 Mr Whitlam, as Prime Minister, informed the State Premiers that 'from now on we will expect to be involved in the planning of the function in which we are financially involved'. The Fraser government has attempted to reverse the trend towards greater Commonwealth involvement, but with what success remains to be seen. In any case the need for national standards of efficiency in the various public services, as advocated by Reid, remains as strong as it was in the early 1960s. The essential problem of Australian fiscal federalism continues to be one of reconciling the conflicting interests of unity and diversity.
Further Reading

In addition to many of the works published or reprinted by the Centre for Research on Federal Financial Relations (see below), the following may be consulted:

**Articles**

- May, R. J., 'Intergovernmental Finance', *Public Administration (Australia)*, Vol. 28, No. 1, March 1969.

**Books of Readings and Symposia**


**Monographs and Books**


**Official Documents**


**Publications of the Centre for Research on Federal Financial Relations**


Sawer, G., *Seventy Five Years of Australian Federalism*, Australian National University, Canberra, 1977.


Causes of Inequality of Financial Resources
The recent history of all federations reveals a search for methods of bringing about effective co-ordination of finances between the federal government and the governments of the member States. The difficulties of co-ordinating financial policy lie partly in the history of the States before the federation, partly in the rigidities of the federal Constitution, and partly in enlarged and enlarging international responsibilities which national governments are called upon to undertake, particularly in the emergencies of economic depression and war. The prevailing difficulties in federal-State relationships in Australia are not necessarily results of the urgencies of war, of an avowed pursuit of unification, or of an attempt to achieve socialism in our time. The facts are that:

(i) For more than a decade national emergencies have been forcing the federal government to initiate expenditures in conformity with policies aimed at economic stabilization, social betterment, or defence.

(ii) Only the superior financial resources of the Commonwealth could be made to match the enlarged expenditures. The resources of the States, while sufficient for some of them

*Reproduced from The Economic Record, December 1945, pp. 197-211.
during the war, will possibly become deficient for most of them in the post-war period.

(iii) Most federal constitutions, but particularly the Australian, contain no provision for speedy and authoritative action in emergency.

Under the economic conditions of the 20th century, much the same forces which prompted agreements among separate States to federate are now impelling federations towards unification. Dynamic forces which have compelled federal governments to extend their powers during depression or war, have been accompanied by expedients of various types which amount to acceptance by the States of everything short of unification. These forces may be broadly stated as:

(i) The enlargement of the social responsibilities of a central government caused by the pattern and technique of modern industry and trade.

(ii) Political pressures to limit and supervise the power of large nation-wide financial and industrial groups with, in many cases, strong international connections.

(iii) Social pressure to alleviate the economic insecurity of wage-earners and their families which is a result of the modern industrial and financial structure.

(iv) The administrative contraction of the modern State brought about by improvements in transport and communication.

(v) The overwhelming needs of war.

All the factors which make for enlarged federal responsibilities are, at the same time, powerful pressures operating in the direction of a unitary political structure. As a result, problems of public finance have assumed a new degree of political significance, if indeed they have not fundamentally altered the political structure itself.

Naturally enough, these pressures towards unification have provoked resistance by the governments of the member States owing largely to vested State interests which have grown up under the security of the residual powers provided for in the Constitution. Reluctance on the part of the States to surrender their inherited privileges, the 'proud traditions of the past,' and all the interstate suspicions and jealousies which mark federal relations everywhere have continued to mount a considerable opposition to the changes which central governments regard as unavoidable and necessary. In such circumstances the Constitution is invoked as the protector of State governments, individual rights, and free enterprise in general. For federations of the Australian type the Constitution tends to become a barrier rather than a highway to progress; the right to amend it by referendum is a slow and doubtful expedient. In clashes between federal and State governments a search has to be made for
legalistic and other devices which will enable the rigidity of the Constitution to be overcome and the frigidity of financial relations to be thawed somewhat.

The Method of Making 'Grants-in-Aid'

One of these devices has proved so useful that a new technique of financial federation is being forged. This device is the grant-in-aid, and, like all innovations, it tends to be viewed with suspicion and hostility despite advantages which are both administrative and economic. For their enjoyment an appreciable surrender of 'State rights' and sovereignty seems inevitable; and this necessity provokes vigorous resistance by the recipient governments. Despite this, grants by federal governments to State and local governments will, to an increasing extent, become accepted as a method of compromise in federal-State financial relations. In the interests of efficient administration, if for no other reason, the underlying theory and method of grants should be more widely understood — and more scientifically applied.

The method may be described as that of revenue matched with responsibilities, relief made available in conformity with rights, additional assistance based on State financial needs. Australia, perhaps, has gone farther than most other federations in putting the theory of federal aid into practice. Compared with the unhappy history of Dominion-Provincial financial relations in Canada, or with the chequered picture presented by the United States, the Australian development could not unfairly be regarded as logical, cooperative and progressive.

The Commonwealth Grants Commission, appointed in the throes of depression to restore budgetary equilibrium to embarrassed States, has survived to become a court of conciliation and arbitration in a fiscal sense. Its work for the first twelve years has been set in a background of economic change and political controversy. Adjustments accelerated by war-time conditions are emphasizing the extent to which federal-State financial relations are a national problem, and fiscal co-ordination rather than financial dependence the real issue. All States are likely to become increasingly dependent upon federal assistance in the future. The time may be arriving, in fact, when taunts about the mendicancy of some States may lose their meaning because all are likely to exercise their legal and moral rights to apply for financial compensation in a formal, year-by-year procedure. Special grants may become an ordinary process of blood transfusion. Federation, in other words, may be about to take on a new significance in financial terms. That is a consummation devoutly to be wished if it will leave the Commonwealth and States free, at Treasury
levels, to reach working agreements which can be tested in application before they have been ruined by premature controversy. When it is understood, and continuity of practice is assured, the federal grant will be recognized as the appropriate instrument for overcoming conservative and obstructive rigidity in financial relations, and for enabling States with unequal resources to function at something like equal standards in a flexible union.

**State Objections to Federal Aid**

Not the least interesting aspect of a system of ‘block grants’ is the implied repudiation of the revered canon that the authority which spends money should also have the responsibility of raising it. In a modern commonwealth such a theory is no longer applicable. The grants method has proved that the authority which is best fitted by place or competence to administer a public service is not necessarily the one which can find the money to finance services of national importance. It is not at all certain, for example, that the federal government is the best authority to administer education or hospitals merely because it has superior taxing powers. The State governments are, for many reasons, the authorities which can most effectively control certain services, even though their revenues may be inadequate to set up or maintain them. In every efficient federation, financial power at the centre must energize experience at the periphery.

In practice the federal grants have proved a useful device for solving this problem of function without funds. It ‘injects flexibility into a rigid constitutional system,’ indeed it may enable an obstructive constitution to be ‘by-passed’ in such a way that deficient State finances may be assisted and financial duplication avoided or minimized. Administratively, the device of making conditional or unconditional grants is an effective instrument both for ensuring an understanding of State difficulties by the federal government, and for improving State standards of administration. Special grants ‘with strings’ do not, however, commend themselves to State governments because of the stigma of federal charity, largesse, or patronage which accompanies them, and because of the financial tutelage which is a tacit assumption of the method. It is alleged that they complicate government and intergovernmental relations and undermine State rights and responsibilities. On the other hand, federal governments are traditionally reluctant to provide subsidies without provisos.

It is, in fact, becoming clear that ‘division of the powers’ has become a fiction, and shared functions a persistent reality. Sharp and simple distinctions between federal and State functions are difficult to maintain in practice. The complexity of social services, for example, and the need for a national approach to social and economic problems
make the search for simplicity unavailing. Even if it were otherwise, the desire for national standards, for equality of opportunity, and for equitable distribution of tax burdens would strengthen the federal government vis-à-vis the States. But, as Alvin Hansen shows, 'Federal aid, far from undermining the financial sovereignty and functions of the States, is an important instrument for preserving both State rights and the local government structure because it provides State governments with the finance necessary to provide the services State governments must supply.'

What would happen in Australian public finance if federal grants and subsidies ceased is quite plain. State governments would be forced to abandon or starve some services, to raise additional revenue by new and probably regressive forms of taxation, or to relinquish to the Commonwealth functions which the States are better able to perform. A State government at the present stage would have recourse to any of these measures only at considerable cost to its own prestige. The alternatives are, in fact, not all practicable, and it seems the federal grants must continue to form the bridge between State needs and financial resources. They seem certain to persist as an increasing element in the public finance of all federations.

The experience gained by the Commonwealth Grants Commission over a decade of pioneering work in this field suggests, however, that little more than a beginning has been made in applying the principles of grants-in-aid to the requirements of a federation. The methods to be applied in the measurement of the revenue needs of the States are becoming clear and are gaining wider acceptance; but much remains to be thought out before the full function of grants in a federal economy is understood, and the technique of 'gearing' federal, State and local government finance is perfected. The measurement of relative taxable capacity and severity of taxation for each of the States has revealed financial and economic practices which are incompatible with balanced national development. The apportionment of total financial resources among the States is still unco-ordinated and unscientific, as will be seen by even a casual survey of Loan Council procedure, the work of the Grants Commission, the assistance determined at the political level for various types of industry, the work of the Tariff Board and of bodies such as the Rural Industries and Secondary Industries Commissions, as well as by the ad hoc emergency grants of various kinds made every year by the federal Parliament. In the field of social service needs and in the problems arising from the administration by State governments of the variety of grants made to them, the need for a full and expert examination of the whole field of federal-State financial relations is obvious. The distortions of the national economy brought about by war, and the need for the wisest possible management of financial resources for the
purpose of reconstruction and the maintenance of high employment, provide ample justification for such a review at all levels of government. Federal assistance to the States does not at present conform to any sort of logical pattern, and the various types of financial aid should be brought into a system in which every application for assistance will receive adequate investigation prior to consideration by the federal Parliament. In this way conflicting national needs could be kept in balance, and justice done to areas which are still underdeveloped relative to others. The method of unco-ordinated grants had its dangers before the war; the dangers will be much greater and the scope for mistaken assistance much wider during the years of adjustment from war to peace.

The Extent of Federal Aid in Australia

An account of the financial assistance given to the States by the Commonwealth in 1943-44 is presented in the federal budget for 1944-45. This assistance is grouped under three categories of payment:

(i) Direct payments to the State governments, i.e., ‘budget-to-budget’ assistance.
(ii) Assistance for relief of primary producers.
(iii) Other payments.

In order to get a comprehensive picture of monetary transfers from the Commonwealth to the States, another type of payment should be added to these, viz.:

(iv) Social service payments made by the Commonwealth to citizens domiciled in each State.

Groups (i) and (iii) comprise payments which directly affect State budgets, and provide the basis for the kind of analysis here being attempted. Group (ii) sets out payments which are not direct federal aid to States. It is not dissected by States or concerned with budget resources or State sovereignties; but is rather an account of ad hoc assistance given to industries, or to certain rural producers whose income has been affected by Commonwealth policy. Group (iv), also, comprises assistance to certain persons viewed as citizens of the Commonwealth rather than as citizens of the States. Moreover, these payments, made on the basis of age, health, marital state, etc., are uniform within classes of recipient, and have no direct relevance to State financial needs as such, although they do relieve the States of social service expenditure.

Direct ‘budget-to-budget’ assistance as indicated by groups (i) and (iii) amounted in 1943-44 to a little more than £46m. It would be wrong, however, to exclude groups (ii) and (iv) as having no bearing upon State budgets. The more interesting group is (iv), social service payments. In 1944-45 the Commonwealth has appropriated £48.5m
for social services, which will be nearly 14 per cent of federal revenue approximating £360m, whilst the States will appropriate about £31m. Total expenditure, federal and State, on social services will be about £80m, or 5½ per cent of national income estimated at about £1,400m. If the cost of social services were to be brought up to the level of that of the highest State, several States would require further federal aid and the additional cost would be about £4,500,000 . . .

The relation of social service expenditure to community income in each State has some significance in this connection . . . For the Commonwealth as a whole, . . . [net] real income per head was £169 in 1942-43, and for 1943-44 was of the order of £180. Divergence from this average figure is important only in Victoria, £196, and in Tasmania, £157.

Questions prompted by this examination are whether increasing financial assistance to the States represents a growing sense of responsibility on the part of the Commonwealth government, or a sustained attempt to undermine the authority of State governments. Both views have been put forward; but there is little evidence to support either. Federal aid in Australia is too much the product of compromise and emergency to appear as deliberate and sustained policy, and too reluctantly provided to be evidence of any systematic plan to ensure that State financial resources are adequate for the part they must play in providing for national needs.

The Scope of Federal Aid

The method of federal aid is now beyond the experimental stage, and, as Alvin Hansen puts it, a programme of assistance to States ‘cannot achieve an effective balance, nor can it be properly integrated with other aspects of national policy unless every element of the programme is periodically reassessed and geared to the changing relative need for various public services.’ In the last decade alone, the changing emphasis upon unemployment relief, housing, education, roads and hospitals illustrates the need for constant review of the significance of the various services. The methods of the past — annual fixed payments, or payments per head on some agreed formula — failed because they did not achieve the objective of uniform conditions for all Australian citizens irrespective of the State in which they live. Grants of various kinds may be no more successful unless they are intelligently applied. Over a vast continent, however, absolute uniformity is a chimera. Climatic and economic differences will frustrate the attempt to achieve it. Some utilities essential in one region will not be required in another, some services in every area will necessarily be emphasised at the expense of others.
The great danger of unco-ordinated assistance is lack of balance. The result of giving preference to some national services only has been to depress the general level of even more necessary services, and to permit serious inequalities of opportunity to develop as among States and local areas. In view of the total needs of the nation, federal and State policies are too often unscientific and uneconomic. They fail to achieve the benefits which the expenditure should make possible. Education policy that is timid, health policy that is pseudo-curative rather than preventive, industrial assistance which tends to consolidate an existing pattern of agriculture when rapid adaptation is required, tariff policy which imposes burdens upon non-industrial States, all need review in the light of reconstruction needs; and for this purpose continuous research and investigation as a prelude to policy is the best instrument.

An extended and remodelled system of federal aid would, of course, require an enlightened attitude on the part of the States towards the total objective. State governments would need to be persuaded that federal aid was not a method of destroying State authority. If the necessary skill in administration is developed, the basis of federal aid will shift from the 'unbalanced stimulation of a few favoured services to the support of several broad categories of services in which there is a strong national interest'; and friction at administrative levels will need to be avoided by wise and timely political co-operation.

In this connection a method of co-operation is suggested by the work of the Commonwealth Grants Commission. Set up as a semi-judicial body to hear evidence from claimant States and to recommend grants which would enable them to function with balanced budgets, the Commission has evolved a set of principles and methods which form the basis, mainly statistical, upon which the financial needs of claimant States are determined. There is nothing remarkably original in this, but what is significant is the technique of co-operation and adaptation of resources to needs which Commonwealth and State agencies have worked out. Unfettered discussion at hearings between the Commission and the Economic Committees of each claimant State enables a two-way service of information and suggestion to precede a final session comprising the Commission, the State Economic Committees, and representatives of the Commonwealth Treasury, when all issues are open to discussion and all methods open to criticism. Behind this untrammelled consideration at the administrative level, however, is the vitally important scrutiny of methods and statistics at the staff level. Continuous discussion and information about difficulties of technique, and frank exchanges of opinions between Commission and State officers upon methods and equity prior to the 'claiming' and 'reporting' stages enable most of the
inequalities of relative financial need to be ‘ironed out’ in such a way that any serious margin of miscalculation or faulty estimate within the limits of more or less agreed principles can be adjusted. This technique is not perfect, but it is at least true that some efficiency has been developed in the application of a new form of federal aid, viz., calculated block grants for a limited field of State needs. What is also a matter for some satisfaction is that the public services of Commonwealth and States possess officers with the knowledge and expertise required for an extension of a continuously operating method of compromise.

The method is capable of wider and more useful application. Minimum standards for all important services over the whole of the Commonwealth could be provided by payments determined upon a broad basis of national policy. The basis of these payments would be needs compared with the financial resources of each State; but Professor K. S. Isles has advocated payments to weaker States of something more than indicated needs. The justification is broadly as follows:

1. A desirable regional redistribution of financial resources would correct the present concentration in the great manufacturing States. The general effect of equalizing grants would be to tax incomes concentrated in the wealthy States, but derived from operations in all States, a process that would seem to be inevitable if equality of economic opportunity is to be regarded as the method of enabling the smaller States to function at Australian standards.

2. This would promote economic expansion of financially deficient areas, relieve the pressure on the budgets of the smaller States, and tend to equalize income per head throughout the Commonwealth.

3. It would also tend to correct cumulative concentration by some dispersion of factory industry. Decentralization by States would help to arrest loss of population by enlarging opportunities for factory employment in the smaller States.

4. It would, further, tend to counteract sudden contraction of business activity in the smaller States by providing greater variety of industry and a larger range of occupations. This would seem to be a necessary concomitant to national plans for maintaining employment at high levels.

The economic nexus between regions which differ greatly in their industrial organization has received little study in Australia. It is the problem of fusing, within a federal economy, assisting and assisted States, or more correctly, debtor and creditor areas. Its effects on public finance in the United States have been discussed by the
Chairman of the Federal Reserve Board (Mr Marriner S. Eccles), and much of his thesis has a close application to Australian conditions. In those parts of the U.S.A. which were settled earliest, accumulated wealth has found an outlet for investment in the development of the frontier regions . . .

The maintenance of economic balance in the country as a whole requires that citizens of debtor areas have enough money income both to maintain payments on their obligations to investors and to maintain at a high level their purchases of the output of the factories of the creditor areas. They must maintain their standing both as good credit risks and as good customers. This healthy state of national economic balance is continually being upset by forces that are entirely outside the control of the States or of the individual business man and the individual worker . . .

It would be wrong to regard the American and Australian degree of inter-dependence as completely comparable in this respect; but, on a smaller scale, the relationship is broadly similar . . . [The] federal form of government in the United States does not adapt itself easily to a centralized and co-ordinated attack upon problems that must be dealt with on a national basis, and this touches the seat of the difficulty in Australia too. Basically the problem is one of maintaining the national income at ‘levels which represent the fullest possible utilization of the labour supply and other economic resources’ because debts become insupportable when a protracted and serious fall in income occurs.

[It is suggested] that the solution is to be found in a long-run plan for public investment adapted to the differing needs and conditions of different geographical areas. ‘This should take the form of productive public works and expenditures not only to improve the basic conditions which are responsible for keeping the standards of living in some States lower than others, but also to raise the standards of living, particularly in the lower income groups wherever they may be.’ This method of stabilization and national betterment has wide and deep implications for the theory and practice of federal aid. The Loan Council in Australia does, in a manner, provide on a competitive basis the loan funds which State governments require; but the Council has worked with little regard to the over-all pattern of federal aid and with little foresight or acumen as far as the long-term stabilization needs of the Commonwealth as a whole are concerned. Investment control of the type [here advocated] must be co-ordinated with the allocation of revenue resources of the Commonwealth as a whole. This is the true function of the Loan Council which should be exercised, not on any ad hoc or year-to-year basis, but according to a plan aimed at the
geared development of Commonwealth resources. The forward plannning of the Department of Post-War Reconstruction and the National Works Council bring Australia nearer to a balanced administration of public finance and more in line with a scientific method of federal aid. At an early stage, however, a much more comprehensive analysis and co-ordination of all forms of federal assistance to States will be needed.

Co-ordinating Public Finance in Australia

This survey of the implications of federal aid prompts two general conclusions of some importance. The first of these is the necessity for establishing a central authority which would be charged with the duty of integrating federal aid with broad national policy. Such a body with a reasonably permanent tenure could perform the more limited functions of the Grants Commission, as well as continuously examining the needs and resources of all the States. It would need powers and facilities which would enable it to study in advance the problems of financial adjustment, especially in the period of reconstruction.

Considerable interest attaches to such a development in the United States, where the President is responsible for the general management of the governmental organization just as the Prime Minister is in Australia. Until 1939 the President attempted to discharge this duty with the aid of a small secretariat, much as the Australian Prime Minister does to-day. In 1936, Congress commissioned The Brookings Institution of Washington to report upon governmental organization, and the President appointed a Committee on Administrative Management. The reports of both groups stressed the necessity for strengthening the 'top-management of the nation' by providing more assistance for the President in that task. As a result of these reports, the Executive Office of the President was formed in 1939 . . .

The office is so staffed that it can analyse and compare the work of each Department, thus revealing to the President and to Cabinet instances of overlapping and gaps in administration. Armed with this knowledge, it can also report upon the suitability to its task of the organization and staff of each Department, the appropriateness of legislation, regulations and orders proposed by each, and the necessity for the requests for financial appropriations. The office can also watch the trends of events and propose, sufficiently early to allow for proper consideration, measures necessary to meet conditions that are likely to become pressing in the future. The introduction of such an instrumentality in America was difficult because of its encroachment on the freedom of action and independence of Departments; it would be even more difficult in Australia because of the close relations
between Parliament and the Executive, which do not exist in the United States.

Apart from the general task of assessing grants of various kinds and making recommendations as to the relative urgency of each, a central agency of this kind could perform for the government and Parliament several functions which are of growing significance to public administration in Australia. It could, for example:

(i) standardize the statistics relating to federal and State public finance, or to economic conditions which bear upon finance;

(ii) promote the exchange of information upon a variety of matters which find focus in budgetary problems, but have an interest for other than government officials or parliamentarians;

(iii) provide technical information and certain research services for State and Commonwealth governments;

(iv) by maintaining contact with other Commonwealth agencies, provide an annual review of economic conditions in the States, and for the Commonwealth as a whole.

The second conclusion is that the growing complexity of financial relations in a federation urgently requires that an engine of compromise be set up. There is great need for much study to be done in the field of inter-governmental co-operation, and the mere collection and interpretation of statistics or the process of assessing needs prior to recommending grants scarcely touches the larger field. Even amongst public officials the federation is seldom viewed as a whole, and much energy and time are lost in fruitless strife about relatively unimportant matters. The Commonwealth Grants Commission is merely a cushion between the Commonwealth and certain States in their financial relations. What is wanted is a collision mat, and a means of using it in a timely and conciliatory way. In time this would promote a new kind of understanding of federal and State problems at every level of administration.

It is now necessary to think beyond the mere arbitrating function of the present Grants Commission towards the wider need for bringing all types of Commonwealth grants into some kind of systematic relation. This would involve for the new body certain responsibilities for co-ordinating inter-governmental financial policy, and this would necessitate providing it with powers and facilities in acquiring complete information concerning the financial projects, policies, and activities of both federal and State governments. It would be an extremely important instrumentality in breaking down the division between the financial planning of the Commonwealth and the States, and would permit this to be done at the discussion and conference level leading to recommendations which have previously been agreed upon by representatives of the different governments. There need be
no apprehension that the functions of the new body would collide with those of other authorities such as the Loan Council, the National Works Council, or the Tariff Board. It would have purely investigating and recommending functions which could be brought to finality only through the ordinary Treasury and legislative channels.

Finally, it would perform a very useful purpose in collecting and collating information from federal and State governments. At the present time very many separate enquiries upon federal-State financial relations are carried out for specific investigations or for routine administrative purposes. The information so collected is frequently not available to departments not directly connected with the investigating agency, and the data collected are in large part unknown to many Commonwealth agencies to whom they would be of both general and special use. This results in much duplication and inefficiency in collecting information, which when collected is not put to the maximum possible use.

Notes


2 [Hansen and Perloff, op. cit., p. 127.]

3 [Hansen and Perloff, op. cit., p. 129.]

4 [Keith S. Isles, 1902-76; Professor of Economics, University of Adelaide 1939-45 and Queen’s University, Belfast, 1945-57; Vice-Chancellor, University of Tasmania, 1957-67.]
Federal-State financial relations in Australia have moved very rapidly in the past ten years from the situation during the first forty years of federation. It was recognised from federation that the Commonwealth would have superior financial power and provision was made in the Constitution for distribution of surplus Commonwealth revenue among the States and for grants for any purpose from the Commonwealth to the States. This view, however, was based largely on the exclusive Commonwealth power over customs and excise and did not contemplate the dominating importance of income tax (which falls naturally to the Commonwealth) nor the growing deterioration of rail transport (a State activity).

Nevertheless, the financial superiority of the Commonwealth was not fully demonstrated until the 1939-45 war, although the relative ease with which the Commonwealth financed the 1914-18 war and the rapid recovery of Commonwealth finances in the Depression gave some indication of the true position. The States managed to fulfil their functions for the first forty years with little more transfer of revenue from the Commonwealth than immediately after federation — but only with constant restraint on the expansion of State activities and a rising total of borrowing for deficits. The relative transfer fell greatly. In 1938-39, total Commonwealth grants to the States were only about

10 per cent of total State revenue including business undertakings and about 15 per cent excluding business undertakings. Corresponding figures at federation were roughly 25 per cent and 50 per cent. By 1950-51 Commonwealth grants were 40 per cent and 65 per cent of State revenue respectively, and the bulk of the grants were at Commonwealth discretion rather than laid down under the Constitution.

This paper discusses certain aspects of the change in federal-State relations, some of the disadvantages of the present situation, some short-term measures to restore financial balance between Commonwealth and States and the possible directions in which current trends are leading.

The Story of Commonwealth Grants
Commonwealth grants to the States since federation have followed six main lines.

75 per cent of Customs and Excise, per Capita, Financial Agreement
The first line extends from the constitutional provision that the Commonwealth should pay to the States 75 per cent of its net revenue from customs and excise up to at least 1910. This amount was distributed between the States on the 'book keeping' method laid down in the Constitution. In addition the Commonwealth, in the period up to 1910, made small extra grants out of the 25 per cent of customs and excise revenue which it was permitted to retain. In each of the years up to 1910 the total of the grant was about £8m.

In 1910, the Commonwealth Parliament passed the Surplus Revenue Act providing for payments to the States for ten years of annual sums equal to 25s. (£1.25) per head of population. The immediate effect of the change-over was to reduce payments to the States to about £6m in 1910-11. (At the same time a special grant was made to Western Australia. This will be referred to later.)

The per capita payments continued until 1926-27 when the amount of per capita payments had reached £7.6m. At this stage, a Financial Agreement was proposed to and accepted by the States under which the Commonwealth agreed to contribute a flat sum of £7.6m towards interest on State debts together with a contribution towards sinking fund on past and future State debt. These sinking fund contributions now amount to about £2m. At the same time the Loan Council was established to co-ordinate the Commonwealth and State borrowing. The Financial Agreement has continued to operate until the present time.
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**Surplus Revenue**
The second line of development in Commonwealth grants has been distribution of surplus revenue to the States. Provision for the monthly payment to the several States of all surplus revenue of the Commonwealth on such basis as the Commonwealth deems fair, is made under Section 94 of the Constitution. Payments of this nature were made both before and during the period of per capita payments. Similar grants were also made in the three years 1934-35 to 1936-37, the basis of distribution being population. The amounts involved have not been large.

**Special Grants to Claimant States**
The third line of development has come from the special grant made to Western Australia in 1910-11, referred to above. These grants are made under Section 96 of the Constitution which provides that the Commonwealth may grant financial assistance to any State on such terms and conditions as it thinks fit. The grant to Western Australia was presumably made to preserve stability in Western Australian finance when grants were changed from 75 per cent of customs and excise to 25s. per head. Tasmania first received a special grant in 1912-13 and South Australia in 1929-30. These grants were determined entirely by the Commonwealth Treasurer and Government up till 1934-35. In that year, and in all subsequent years, the amount of the grants of these three claimant States has been recommended by the Commonwealth Grants Commission and the recommendation of the Commission has been accepted by the Commonwealth. The amount of these grants remained fairly constant at about £2m up to 1942-43. Thereafter the amount has risen rapidly to a total of about £12m in 1950-51.

Very briefly, the Commission has based its recommendations on the amount required to enable the three claimant States to function at a standard not appreciably below that of the other States. The Commission also recommended some additional payments in 1944-45 and 1945-46 to the claimant States under Section 6 of the main uniform tax Act (see below). These payments may conveniently be regarded as part of the special grant procedure since no applications were ever made under Section 6 by any of the non-claimant States.

These special grants, together with the £15m grant made this year (to be referred to later), are the only grants in which the Commonwealth has purported to make general purpose payments to the States in accordance with their individual needs rather than on some overall basis of apportionment agreed on with the States as a whole. The appointment of the Commonwealth Grants Commission in 1933 came after a period of growing dissatisfaction in the claimant States with the procedure for determining special grants and growing appreciation...
within the Commonwealth government of the difficulties of determining appropriate amounts. It may be noted that no attempt has been made to seek a recommendation from the Commission on any grant other than the special grants and the grant under Section 6 of the uniform tax legislation.

**Federal Aid Roads**
The fourth line of development of Commonwealth grants has been the Federal Aid Road grants which were commenced in 1922-23. Although these grants are specific purpose grants, they differ from other specific purpose grants in that they are continuing, their aggregate amount has been determined by various formulae and their distribution has been essentially on a formula basis. Federal Aid Road grants amounted to £4m by 1938-39 and, after declining during the war, have since risen to £12m.

**Specific Purpose Grants**
The fifth line of development of grants has been a group of miscellaneous specific purpose grants. These have been either of a relief nature such as fire, frost, flood and drought relief, and unemployment relief such as grants for local public works; of assistance in national problems such as tick control, national fitness, etc.; or because the necessary administrative machinery was in the hands of the States. This latter group consists of such grants as those under the hospital benefit scheme, assistance to State Universities, various bounties, price control, etc.

The general nature of these grants might best be illustrated by their range for 1950-51. In that year they consisted of price control reimbursement, Western Australian water works, encouragement to meat production, coal mining, long service leave and flood and bush fire relief. In no case did the amount exceed £1m. Although these grants have in total been quite considerable, they do not seem to be very important in a discussion of federal-State financial relations, since they consist essentially of relatively minor payments of a special adjusting nature and carry little long-term implication.

Apart from these types of specific purpose grants, there are two sorts of arrangement between Commonwealth and States which are of significance to financial relations. The first is the normal type of contract under which a State agrees to carry out certain work for the Commonwealth — in which the Commonwealth is in much the same position as a private customer of the State. The obvious example is rail carriage of Commonwealth goods. Another frequent example is the State using its construction equipment to carry out contract work for the Commonwealth. Usually, these contracts are on a purely com-
mmercial or cost-plus basis, but, particularly during the 1939-45 war, they occasionally operate to assist the general State financial situation. The sums involved currently are probably large, but they cannot readily be separated out from similar private contracts in either the Commonwealth or the State accounts.

The second type of arrangement is the formal agreement between the Commonwealth and a State or States for carrying out an activity. Recent examples are the Housing Agreement, War Service Land Settlement, Rail-Standardization, Joint Coal Board, Aluminium Production, etc. In this type of agreement, each party attempts to set out in legal form its rights and obligations, and the agreement becomes the formal document governing the manner in which the activity is to be carried out. The agreement attempts both to ensure the satisfactory co-operation of the parties in the activity and the supervision of the activity, and to overcome the constitutional limitations on either party carrying out the activity by itself. Agreements of this type have had a powerful influence in extending Commonwealth functions into the field of State powers, since the Commonwealth usually provides the major part of the finance.

**Uniform Income Tax**

The final line in Commonwealth grants is that arising out of the uniform tax legislation of 1942. These grants dominate the whole current situation and reflect the real problem of federal-State financial relations. Very briefly, the history of these grants is as follows. The limitations on the Commonwealth raising rates of income tax because of the widely differing rates of State income tax, became apparent early in the 1939-45 war and during 1941 the Commonwealth Treasurer made three separate moves to overcome this difficulty. In February 1942, a committee was appointed to report on the problem. Its report dated 28 March 1942, recommended a single Commonwealth income tax and compensation to the States equal to average income tax revenue in 1939-40 and 1940-41. The recommendations were given effect to in four Acts of the Commonwealth Parliament assented to on 7 June 1942, despite the rejection of the proposal by the State Premiers. In September 1942, a similar plan was adopted for entertainments tax. Both schemes were to operate for the duration of the war and one year thereafter and the amount of the grant was £34m.

At a Premiers' Conference in January 1946, the Commonwealth Government intimated that it was proposed to continue uniform income taxation indefinitely. After discussion with the Premiers, the new scheme provided for a basic grant of £40m to be varied with variations in the total population of the six States and with half the
percentage increase in average wages over 1946-47. The distribution of the basic amount of £40m was decided upon by the State Premiers who also provided that the basis of distribution would be progressively altered, until in 1957-58, the aggregate grant would be distributed in accordance with the adjusted populations of the States. Adjusted population was actual population varied to take account of relative sparsity of population and the number of children aged 5-15 in each State. It was hoped at this time, that the formulae would continue to operate for a considerable number of years (as the formula under the Financial Agreement had operated) although provision was made for a general review after five years.

In fact, however, the tax reimbursement grants have been varied in each year since 1946-47. Following representations by the Premiers at a Premiers’ Conference in 1947 that an aggregate grant of £40m would be insufficient to meet the States’ budgetary requirements in 1947-48, an aggregate grant of £45m was provided together with provision that an additional grant would be payable in future years to cover any deficiency between the formula grant and £45m. Following similar representations by the Premiers in 1948, the Commonwealth altered the reimbursement formula itself to provide for a basic amount of £45m, to vary the amount by the full percentage increase (instead of half) in average wages and to alter the base year for the average wages adjustment from 1946-47 to 1945-46. These amendments had the effect of raising the grant under the formula for 1948-49 from £43.2m to £53.7m.

In 1949-50, a special non-recurring coal strike emergency grant of £8m was made and distributed in the same proportions as the tax reimbursement grant; and following the Premiers’ Conference in September 1950, an amount of £5m was added to the formula grant for 1950-51. In each of these annual variations, the main considerations urged by the State Premiers were budgetary difficulties, and the distribution of the additional amounts between the States was determined by the distribution formula for the main grant.

Following requests by the States for further financial assistance, the Commonwealth announced in March 1951, that a further amount of £15m would also be payable in 1950-51 and legislation was passed in June 1951 to validate this payment. This decision differed from earlier practice with tax reimbursement grants in that the amount was substantially larger than in previous upward adjustments and, of more importance, the distribution of the amount was determined solely by the Commonwealth and the decision conveyed to the States as a statement of Commonwealth intentions.

Tax reimbursement and associated grants in 1950-51 will be slightly over £90m as compared with £34m up to 1945-46, and will be more
than twice State taxation collections and about £20m larger than the
total of State revenues other than revenue from business undertakings. All other Commonwealth grants in 1950-51 will amount to
about £45m.

The Balance of Functions
The functions of government in Australia are divided between the
Commonwealth, the States and local governments. There are also
various semi-governmental authorities whose functions are essentially
those of conducting business undertakings. Very broadly, the division
of functions between the three purely governmental authorities is as
follows. The Commonwealth has sole responsibility for and power
over a group of activities which may be described as international
relations. These include defence, external affairs, overseas trade, im-
migration and territories. The next broad group of activities may be
described as social. The Commonwealth has responsibility for cash
social service benefits, employment and repatriation. The States have
responsibility for education, health and hospitals, law and police,
liquor, gambling, sport, etc. Local authorities are responsible for
sanitation and garbage. The Commonwealth expenditure in this field
(mainly cash social service benefits) is about £120m, State expenditure
about two-thirds that amount and local expenditure less than one-
tenth of State expenditure.

In the general field of development of national resources, the
Commonwealth is directly responsible for civil aviation, aerodromes,
etc.; the States for roads, agriculture and forestry, and water works;
and the local authorities for streets and footpaths and parks, gardens,
etc. The bulk of the expenditure is a State government responsibility.

Business undertakings and capital expenditure thereon are divided
fairly widely between the different authorities, and a number of them
have been delegated to semi-governmental authorities set up by any
one of the three main types of governmental authority. The Common-
wealth is responsible for the Post Office, the trans-Australian
railways, civil airlines, and banking and has recently entered the field
of irrigation and electricity generation (Snowy Mountains Authority).
The States are responsible for railways, tramways and buses,
harbours, water supply and irrigation, electricity generation and
housing. Local authority business undertakings consist of gas and
electricity reticulation, tramways and buses, and water supply and
sewerage. Of these undertakings, airlines, electricity, water, sewerage
and drainage and harbours, are generally delegated to semi-
governmental authorities.

Some indication of the size of the respective spheres of
responsibility for national development and business undertakings is
given by the expenditure of the authorities on new works. The Commonwealth spends about £45m, States about £60m and local and semi-governmental authorities about £15m each.

The most striking features of this division of functions are the very limited field of local government activity, and the extent to which the States are responsible for those matters which most directly affect everyday life (education, liquor, roads). At the same time the Commonwealth has been entering more and more into the fields of State activity, generally by means of either new social service benefits (child endowment, hospital benefits), by specific purpose grants to the States (Federal Aid Roads, hospital benefits, University grants), or by direct agreements (Joint Coal Board, Housing Agreement). The Commonwealth has also been entering into some of the fields of State construction, particularly where the works are of national importance (Snowy Mountains Authority).

The States have done very little to develop local authorities who are, of course, creatures of the State government without any independent rights. The functions of local authorities in Australia are probably narrower than in any other English speaking country. One gets, therefore, a general impression of pressure from above, with each higher government authority entering into the functions of the lower authority. There is also an extremely centralized form of government, for it can hardly be said that the government of New South Wales, for example, with 40 per cent of the population is any more decentralized than the Commonwealth government itself. In fact, over recent years the Commonwealth has perhaps done more than the State government to decentralize administration. The Post Office provides a natural point in each town through which a number of Commonwealth services are administered (age pensions, savings banking). At the same time the national service areas for military training have been associated with the development of employment areas for the administration of unemployment benefit and of local social service areas. There has, however, been little attempt to set up a general Commonwealth office to handle all these matters in each of the regions of Australia which correspond roughly with national service areas. These regions are some 100 in number but at present, for administrative purposes, are little more than lines on the map.

On the other hand, it is not necessary to postulate any undue pressure from above the State governments to account for the weakness of local authorities in Australia. There are some 3½m people living outside the five main metropolitan regions and there are 750 local government authorities to cater for their needs. The average population of a non-metropolitan local government authority is about 4500, but 35 per cent of the authorities have populations under 2000
and 15 per cent under 1000. It could not be expected that these smaller local authorities would be capable of supporting any sort of administrative machine, while the number of authorities is so great that it would be extremely difficult for any State government to exercise effective control over its local authorities if it delegated substantial functions to them.

Equally it may be said, that one can hardly expect the Commonwealth government to delegate any functions which it has developed back to the States, since considerable difficulty has been experienced in persuading State governments, which have full sovereign power, to administer and control an Australia-wide function in a reasonably uniform manner. Finally, of course, it cannot be ignored that the written Constitution imposes very severe limitations upon the natural development of Commonwealth-State co-operation because of its rigid allocation of powers and functions.

The Financial Balance
The economy has developed in such a way since federation that the cost of the functions allocated to the Commonwealth has expanded very greatly in relation to the expansion of State functions. At the same time the recognised sources of revenue at federation (customs, excise, land tax, etc., and a little income tax) are now totally inadequate for combined governmental needs, and reliance has had to be placed primarily on income tax, together with new taxes such as sales and pay-roll tax. These major revenue sources have, for one reason or another, all become the exclusive property of the Commonwealth, with the result that Commonwealth taxation revenue in 1949-50 was some £500m, as against State collections of about £45m and local collections (rates) of half that amount.

The other important source of State revenue at federation was the receipts of business undertakings. These undertakings operated on a reasonably profitable basis up to 1930 (i.e., sufficient to cover both working expenses and interest and sinking fund) but since 1930, the main undertaking — railways — has shown a progressive deterioration despite some appreciable improvement during the 1939-45 war. At the present time most State business undertakings do not even cover working expenses and there has been a deterioration of about £20m since the end of the war.

If we exclude business undertaking revenues and working expenses from consideration, the States are left with some £70m of revenue from taxes, lands, interest and other governmental receipts to meet general expenditure and interest and sinking fund of some £200m. It follows that the Commonwealth contribution of about £130m to fill
the gap could only be eliminated with very substantial modifications to the existing division of financial powers and functions.

Local authorities derive their main revenue from rates — a very inflexible source of income — and they also have suffered from a deterioration in business undertaking proceeds. There has, however, been no major transfer of revenue from State governments to local authorities, and a large part of the adjustment has been achieved by extension of State responsibility for such matters as roads and hospitals.

Although the major Commonwealth grant — tax reimbursement — has an automatic variation clause in it which it was thought might provide for increasing State needs, this has not proved to be the case and the States have, therefore, like the local authorities, fallen into the position where they must either seek extra money from the Commonwealth government, or permit the Commonwealth government either to take over functions or to intervene in State functions through specific purpose grants and agreements.

**The Problem and its Approach**

The system of federal-State financial relations, which has been outlined above, has three main disadvantages. The most important of these is that the State financial position is now so hopeless, that State governments have little incentive to set their own house in order by such actions as raising railway rates and other charges, or by exercising a reasonable restriction on activities which are not essential. Each State is constrained to make an annual approach to the Commonwealth government for an *ex gratia* increased grant and there must be a growing feeling that this implies a Commonwealth responsibility for the ultimate solvency of the States. It would be expecting a great deal of State governments if they were not to recognise the political advantages of such a situation. As a result, the financial test of the desirability of particular expenditure is being considerably weakened and replaced by a test of political desirability. There is no readily acceptable criterion, other than the financial one, as to whether a particular development is worth while or not. Consequently, activities can be undertaken which are politically highly desirable but which imply a far greater use of resources than the present real product of Australia and the standard of living justify.

Some indication of the development of this attitude is given in the growth of special grants to the three claimant States from £2m to £12m within the last seven or eight years. Since these grants are intended to measure the relative deterioration in these three States as against the three major States, it might have been thought that considerable alarm would have been caused by their growth, and that
considerable efforts would have been made to discover the causes of and the remedies for this rapid deterioration. But the rise in special grants has passed virtually unnoticed.

The second main disadvantage of the present situation is that it encourages inefficiency in carrying out national objectives. The Commonwealth has the financial resources while the States have the constitutional powers and, as a result, it has happened that a number of devices of greater or lesser efficiency have had to be adopted to overcome both the constitutional limitations and the unwillingness of the Commonwealth to hand over to the States adequate resources without adequate supervision.

The third major disadvantage is the virtual lack of effective local administration in Australia. The development of such local administration will not be possible so long as the States are unable to make adequate resources available to local authorities, and at the same time are unwilling to see the development within their own States of an effective Commonwealth local administration.

The political attitudes which have led to the development of the present situation are, of course, extremely complex, but two general features of the political situation as between Commonwealth and States may be worth mentioning. The first is that the States appear to be far more popular electorally than the Commonwealth, and this would be a natural outcome of the fact that the States deal essentially with those matters which intimately affect the electors, while the Commonwealth deals with the remoter high policy matters and at the same time is responsible for raising the great bulk of taxation revenue. It is probable that the present situation will tend to enhance this relative popularity of the States, since the States are more and more becoming the spending authorities while the Commonwealth is becoming the revenue raising authority. Moreover, the States, since they have an alternative source of revenue in Commonwealth grants, are unwilling to raise revenue rates such as charges for business undertakings so long as they have their electoral popularity to back their requests for increased Commonwealth assistance.

The second aspect worth mentioning is that co-operation between the Commonwealth and the States has not, in recent years, been on party-political lines. The good will or lack of it existing between the Commonwealth and particular States, has come mainly from such matters as particular State interests and personal factors.

One gains a very strong impression that the problem of federal-State financial relations is not as yet recognised as being politically urgent. Although both the Commonwealth and the States deplore the present situation, there is very little indication that either of them would be prepared to sacrifice anything real to obtain a solution. Nor
for that matter, do the present disadvantages of the system appear particularly serious to an outside observer. The danger lies rather in the lines along which federal-State financial relations are drifting and the probable difficulties of the future. From the State point of view, the present arrangements have certain obvious advantages in that it is easier to ask the Commonwealth government for extra revenue than to impose increased taxation on one's own people, while the lack of financial resources provides a ready excuse for not doing things one does not want to do. From the Commonwealth point of view also, there are some advantages in that, in time of need, it is always possible to bring the States into line by the use of financial pressure and a solution of the problem might well leave the Commonwealth power appreciably weakened. These aspects are at least important enough to enable the Commonwealth and the States alike to look on any solution with rather mixed feelings.

One other matter which might be mentioned under this heading, is the varying attitude which has been adopted from time to time to a system of federal-State financial relations which implies that the Commonwealth has some responsibility for balancing the budget of each individual State. This approach first emerged in the special grant to Western Australia, made when the adoption of the _per capita_ formulae in 1910 left Western Australia in a difficult financial position. The subsequent special grants to Tasmania and South Australia and the determination of these grants by the Commonwealth Treasury, implied Commonwealth responsibility, and this was a powerful factor leading to the setting up of the Commonwealth Grants Commission. The Commission from the first set its face against giving grants which would merely enable the three claimant States to balance their budgets, although, for a period during the 1939-45 war, rapidly changing circumstances led the Commission into recommending amounts which would be substantially adequate for budget balance purposes. The Commission, however, moved away from this position in the grants for 1948-49 when it recommended payments in two parts. The second part is an estimate of relative needs for the current year, the first a correction of the estimate made two years earlier.

At the same time, the development of tax reimbursement and associated grants from 1946-47 to 1949-50, implied a general Commonwealth responsibility to give sufficient to balance the budgets of the States as a whole, while the decision, announced in March 1951, to give an additional £15m allocated at the Commonwealth discretion, implied a responsibility to balance the budgets of each individual State. This decision was, of course, the logical outcome of the decisions of the four previous years, but it has placed a very different
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complexion on the general problem of lack of financial balance and of substantial Commonwealth grants.

The Range of Short-term Solutions

Any short-term solution presumably lies in a restoration of the balance between flexible revenue and expenditure in the States, and in some separate solution of the business undertaking problem which is essentially related to the fact that the main State business undertaking — railways — is becoming obsolete.

Any consideration of the problem seems to fall naturally into three divisions:

(i) State taxing powers.
(ii) Allocation of flexible expenditure between Commonwealth and States.
(iii) Business undertakings.

Much of the difficulty in discussions between Commonwealth and States in recent years has arisen from the failure to keep business undertakings clearly separate from general government functions.

State Taxing Powers

Certain rearrangements of taxing powers to give the States a share in the most flexible taxes is the most obvious remedy for the shorter term problem. To some extent the problem arose because of the transfer of income tax to the Commonwealth, although this was only the immediate cause.

Income Tax

It would be impracticable to restore taxation of company income to the States, since even before the war the allocation of company income between States was arbitrary and gave rise to numerous anomalies.

There are, however, no insuperable problems to giving the States a share in taxation of individual income, provided that liability to tax is based entirely on residence, i.e., the whole income from any source of a resident of a State would be subject to taxation by that State.

Some Commonwealth control would be necessary to ensure that the basic principles of uniformity were maintained. The real pressure on the States to accept and maintain uniform tax lay in the power of the Treasurer to withhold the grant, unless he was satisfied that no income taxes were being levied by the State. A similar provision in one of the other grants by the Commonwealth to the States would achieve the same result. Preferably, however, the Commonwealth should supplement actual State collections by 10 per cent or 20 per cent if the
Treasurer is satisfied with the State taxing Act on all grounds other than the actual rates of tax imposed.

A 25 per cent reduction in Commonwealth rates would open a field of at least £60m to the States as a whole.

Entertainments Tax
Entertainments tax is essentially local in nature and could be returned to the States. As a semi-luxury tax it is flexible in revenue. Present rates yield about £5m.

State Probate Duties
Probate duties are inflexible and there is gross overlapping and lack of uniformity between Commonwealth and States. It would be preferable for the Commonwealth to take them over on the grounds of inflexibility and the difficulty of apportionment of an estate between States. Current State revenue is about £9m.

Retail Sales Taxes
The problem of local finance in U.S.A. and Canada has been met to an increasing extent in recent years by retail sales taxes. The two really flexible objects of tax assessment are either income or expenditure and the use of retail sales taxes would probably overcome present State difficulties. It appears, however, that such taxes (even in the form of a shop licence fee based on last year’s purchases) would be held to be an excise and hence invalid. A constitutional amendment on this matter would be most unlikely to be carried except perhaps as part of a comprehensive constitutional proposal.

Reallocation of Expenditure
Changes in this field could take one of three forms:

(i) Transfer of flexible expenditure to the Commonwealth;
(ii) Transfer of inflexible expenditure to the States;
(iii) Specific purpose grants to the States with flexible adjustment formulae.

There are very few State functions which could be taken over completely by the Commonwealth. The following might be possibilities:

(i) Mental hospitals £5m.
(ii) General hospitals £10m.
(iii) Technical schools £4m.
(iv) Main highways £20m.
(v) Civil service superannuation £5m.

All these functions have highly flexible expenditure and the first four already receive substantial specific purpose grants for assistance from the Commonwealth.

There is very little inflexible Commonwealth expenditure which
could be transferred to the States other than debt charges. It might be desirable to make a final adjusting transfer of this sort perhaps in the form of a modification of Financial Agreement payments. Abolition of Federal Aid Road payments in conjunction with taking over highways, could also be considered.

Flexible specific purpose grants could perhaps be made per child of school age for education or per bed occupied for hospitals. These could be varied for average wages as is done with the present reimbursement.

The main object of such specific purpose grants would be to eliminate any residual general grant of the nature of the reimbursement grant. This would help to avoid general appeals to the Commonwealth for financial assistance.

**Business Undertakings**

Although it seems reasonable that State business undertakings should be looked at as a separate problem, any practical approach to ensure that business undertakings either pay their way or meet a specified proportion of their costs, is made difficult by the impossibility of obtaining adequate data on actual or appropriate charges or working expenses.

Any flexible grant from the Commonwealth based on business undertaking revenue and expenditure would probably conflict with the general objective of making business undertakings efficient and self-supporting, while taking over of debt would conflict with the general objective of restoring flexibility. There is not even much to be said for a complete transfer of railways to the Commonwealth since their operations are essentially intra-state.

A possible solution might be that all changes from an agreed level of working surplus or deficit in each State be met or taken by the Commonwealth, and the Commonwealth pay to the States certain adjusting incentive grants. These incentive adjustments, the agreed level of working surplus or deficit, and debt charges would be the only amounts appearing in State budgets. On the revenue side, the incentive adjustment could be equal to the amount by which revenue in any State in each year was above (grant) or below (deduction) what revenue would have been if revenue per ton mile and per passenger mile in that State had moved from the agreed base in the same proportion as the average of the six States. On the working expenses side, the incentive adjustment could be equal to the amount by which working expenses in any State in each year was below (grant) or above (deduction) what working expenses would have been if working expenses per ton mile and per passenger mile (combined in agreed pro-
portions) in that State had moved from the agreed base in the same proportion as the average of the six States. There should also be provision for a revision of the agreed base if the adjustments for any State had exceeded or fallen below an agreed figure for more than say three years.

Such a solution would give each State an incentive to raise its rates to the economic maximum and to exercise reasonable economy in working expenses. At the same time loan expenditure, which would react favourably on net surplus, would be stimulated. The solution would, of course, be cumbrous and complex and would probably require a permanent Commission to operate it.

There is no doubt that innumerable other objections could be raised, but it must be emphasized that railway deficits are perhaps the greatest single cause of present State financial difficulties and, if it is correct that railways are becoming obsolete, will continue to be so for many years. At present the States have no strong incentive to reorganise the railway system to meet current requirements, since any action will merely slow down deterioration and the sums involved are too great in relation to other State revenue and expenditure. The railways, more than any other single factor, cast the States on the Commonwealth’s mercy and they should be treated as a separate problem and not as part of the general financial difficulties to the States.

**Long-term Trends**

A combination of these short-term measures which, on the face of it, restore full financial balance in the federation is, however, unlikely to be more than a palliative and further difficulties would almost certainly arise within a matter of 10 or 15 years even if there were no major upsets to the economy.

The fundamental problem in the federation is that the States are neither a central government nor a local government, but are a sort of central government with limited powers interposed between the national government and local governments. Because of the weakness of local governments, the pressure of the Commonwealth government from above, and the centralisation of lines of communication on a small number of cities placed around the coast, State governments naturally cling to what powers they have and at the same time administer them from a capital city point of view.

It is unavoidable that reserve financial power be with the Commonwealth since it has responsibility for dealing with major national emergencies such as war and depression. With this reserve financial power goes a growing attraction of functions. The Commonwealth feels itself unable to delegate these functions back to the States,
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because the States are not adequate local administration bodies and their sovereign power (made effective by political popularity) makes it difficult for delegated authority to be exercised satisfactorily.

It is clear that some effective form of local government must be developed in the future and this could come about in one of three ways. In the first place, the Commonwealth could develop its local administration offices into a unified system which would develop into true local government bodies by the election of advisory and, at a later stage, executive councils. In the second place, the States could be subdivided into smaller units which could be effective in local government. The difficulty here, however, lies in the fact that about half the population of each State is concentrated in one city. Finally, the States could develop local government by vigorous amalgamation of existing local government areas until they had reached a reasonable size and then by delegating real functions to them.

Each of these developments, however, implies a reduction in the power of the existing State governments and is almost certain to be resisted by them. Moreover, under the present division of functions between Commonwealth and States (the Commonwealth raises the revenue and the States make the expenditure which most closely concerns people) the political power of the States to resist is likely to be fostered. Perhaps, however, if the States become increasingly mendicant and are forced more and more to obtain specific purpose and general grants from the Commonwealth for carrying out their functions, there may be a weakening in their political influence, and it may happen that the Commonwealth will delegate increasing powers to them together with the funds necessary to exercise these powers. This in itself, however, would provide no solution unless an effective local government system were developed. In any case, a system of short-term palliatives such as outlined above, would prevent the development of this situation.

As has been pointed out, the disadvantages of the present system of federal-State financial relations are not as yet sufficiently obvious to bring pressure for any major change, and they would only become really serious if the States became irresponsible in their expenditure. Meanwhile, it is fairly clear that neither party is prepared to make any adjustment which would involve it in any major sacrifice of power or prestige.

It may be, therefore, that the present situation of continuing drift in federal-State financial relations is a necessary preliminary in the hammering out of an integrated system by the force of circumstances in the next few decades. Meanwhile, both the Commonwealth and the States should be making some effort to develop effective local government if they hope to come out best in the ultimate arrangement. The
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Commonwealth should be developing a real system of local administration on a unified basis rather than permitting each department to establish its own local offices, while the States should be consolidating their present local government areas into units of an effective size. Neither seems to be doing so.
When a problem is always with us, it can scarcely be said to be exhausted. Nevertheless, the theme of what I have to put to you is the suggestion that the reason why, after all the dust and noise, there is no solution to the problem of federal finance, is that the problem is not one of finance, nor even, except because of the historical institutional context, one of federalism. Our difficulty in dealing with the group of problems which, for purely historical reasons, we continue to label federal finance, lies, I suggest, precisely in that; a misleading label conditions our thinking so that we look for financial solutions, and presume that they must take a federal mould. There is certainly not likely to be much further advance in technical discussion within the strictly financial field of debate. The main issues have been analysed, the chief lines of possible change in financial relationships have been scrutinized, and over half a century most of them have been tried out. I do not propose to enter the lists with a new solution; within the accepted framework of debate there is nothing new to propose. My comments are rather directed towards expressing scepticism about the importance of the issues in that debate; doubts, as I said, whether the problems of Australian federalism are financial or are problems of federalism.

*Reproduced from The Economic Record, May 1954, pp. 7-18. (Presidential address to Section G of A.N.Z.A.A.S., Canberra, January 1954.)
All the issues come to sharp focus in uniform income taxation and a convenient way to break into the subject is to start with it. Uniform taxation has already gone through several clearly marked stages. From its introduction until the end of the war the system of compensation to the States originally adopted worked well enough, that is, the average of their two preceding years' tax collections being paid to the States with a right to any State to apply for increased amounts, the Grants Commission being the referee. The reason it worked was that the States were rolling in money, partly because the decline in unemployment and the shortages of manpower and materials imposed low spending. The second stage was the immediate post-war period in which the States made it clear that they would have no truck with the Grants Commission, not so much because of the inappropriateness of the Commission’s technique of relating the position of the claimant to that of the non-claimant States, as because no State could be expected to tolerate a Commission of three, appointed by the Commonwealth, passing judgment on its policies. In some small measure, that does, of course, happen with the claimant States, but the general standard of reference is the level of the better-off States, and the claimants have no occasion to quarrel with that. But uniform taxation grants are a very different matter. No such inter-State comparisons are available, and the amounts are a substantial part of State revenues.

The removal of war brakes on expenditure necessarily meant within a short time that all States would want to spend more, and any review of their claims must mean passing judgment on their policies in a much more directly political way than is involved in the ordinary work of the Grants Commission. It was only to be expected, therefore, that the end of the war should see a period of inter-governmental wrangling and wangling through and outside the Premiers’ Conference and the Loan Council, and the striking of impermanent and clumsy compromises. Thus we have had a series of compromise formulae serving no other purpose than to give the States some more while limiting Commonwealth commitments.

We now seem to be entering the latest stage, involving increasing use of the grant-in-aid and further transfer of functions to the Commonwealth. Unwelcome as these are to the States, they seem to be the only likely avenues for a solution — and they might, therefore, as well be consciously thought out in advance. The States are naturally reluctant to surrender functions; the Commonwealth is equally unwilling not to claim the power of the purse, so that the adoption of the grant-in-aid seems inevitable. But there are also other fields in which the Commonwealth can be relied upon to proceed with its own policy directly, not through the machinery of the States, and thus effectively to take over State functions. The enlargement of the
federal Parliament and the rewards of the Commonwealth service are both hastening the transition to a condition in which the States have no future except as administrative agents of a central government. For a while the old hands among both State politicians and State officers will in general prefer to remain with the States, but increasingly the able young men will regard State politics as a proving ground preparatory for the more open fields of Canberra, and State service as at best an apprenticeship for wider horizons and the greater power of the Commonwealth.

The trend was only underlined by the interlude of the Commonwealth proposal to return taxing powers to the States. Whether that was seriously meant, or was a momentary outburst of irritation at States which used federal monopoly of income tax as the never-failing political smoke-screen, or was intended to call their crude bluff, was never quite clear. Perhaps it was all three. What is clear is that it was merely a light interlude which did not interfere with the main performance. The point was made effectively, without attracting much notice, by two small examples of the tax-return policy in practice. Those States which reached out a tentative avaricious hand for the land tax which the Commonwealth cast aside did not go far, and at least one recoiled with singed fingers; when entertainment tax was dropped in their laps several of them ostentatiously looked the other way. Yet these two taxes have pre-eminently the characteristics of 'local' taxes, where divergences in rates and other conditions between States are, within broad limits, not matters of concern. Any State Treasurer who had really believed his own yarns about financial independence for the States would have moved smartly into these fields and demanded more of the same policy of re-allocation of sources of revenue on the only sort of basis that is workable in the twentieth century.

There is, you will rightly say, nothing new in all this, either in the facts, or in what I am saying about them. It is merely the latest phase of a trend which has been continuous since federation, and it is still the same because it is by and through financial relations that federalism is disappearing. But it is extremely difficult to get it admitted that federalism was a stage in Australian political development which must now be regarded as over, and that in most, but not quite all, functions of government we have effective unification within a nominal federalism.

That, as I see it, is central to the whole discussion. In current debate the terms of the problem have been dictated by those who oppose the trends of the last half-century, the diehard federalists who want to put the clock back. All the arguments about Commonwealth encroachment on State functions and tax fields, the claims for financial independence for the States, and the like, pre-suppose that the
objective to be sought is something like the distribution of political powers of 1901. To deplore the departures from what the Founding Fathers designed is perfectly legitimate; to see dangers of centralization and over-government in trends away from the weak government which characterizes federalism may be completely justified. But it is not sensible to believe that it is practical politics to secure in this country a reversion towards federalism and less of the near-unitary state we have reached. The clock will not go backwards. And if that is conceded, it calls in question at once any continued discussion of financial problems within the traditional framework of Commonwealth-State relationships. What becomes relevant is the design of financial machinery and financial policy without undue regard to the ‘rights’ of the ‘States’.

The basic weakness in the diehard federalist position is the refusal to recognize that, except momentarily half a century ago, Australians are not federalists. It is doubtful if, in any community, more than a tiny proportion of people are ever federalists on principle, believing that it is the best system of government. It is a platitude that it is a compromise system, for combining unity of action in some fields with diversity of interests in others. But that was a very short phase for Australia, and federalism would probably never have stood a chance but for the accident that the Australian colonies attained self-government at a time when they were effectively separated by wide, scarcely-settled, areas. It was the fifty years between self-government and federation which dictated that the first stage of the process of unification should start in what was almost an academic text-book application of the federal structure. In 1850 the Colonies were physically separate; in 1900 they had had half a century of conscious political separatism to prevent anything closer than federation — what is remarkable is that the unifying forces even then were strong enough to produce a Constitution which, especially in its financial clauses, foreshadowed the pre-eminence of the Commonwealth.

One argument for federalism — distance and difficulty of communication — has ceased to have much relevance. Of the two main conflicts of interest between the separate Colonies which had a geographical basis, one, the tariff, was settled in 1908. The other, closely related one, the disproportionate importance in some States of primary industry, has been resolved by the Country Party lamb lying down with the Liberal Party lion and fattening on a varied fare of subsidies, bounties, home consumption prices, stabilization schemes, tax exemptions and the like.

What uniform income tax has done has been to make patent and immediate the fact that the States depend henceforth for their security, and even their existence, not on the legal prescriptions of a
written Constitution, but on the shifting currents of politics. It is not because Australians are federalists that they so frequently have said ‘no’ on referenda, nor that on issues where there are sharp cleavages it has so often happened in recent years that judicial action has denied power to the Commonwealth. The processes of legal resistance to expanding federal power become increasingly easy to exploit, when the incentive to exploit them is strong, the further actual Commonwealth activity extends. But only the naïve would claim that the main body of those who have inveighed against recent Commonwealth attempts to exercise new powers were inspired by the desire to preserve federalism; they were opposed to the exercise of such powers by any authority, and the remnants of federalism provided the effective legal method of resistance. The verdicts in the two bank cases will appear, in twenty years’ time, not as great victories in the limitation of a voracious federal octopus, but as key decisions in the final rejection of federalism.

The existence of new-State movements is evidence not so much of active ‘federal’ thinking as of reaction against centralization. The centralization against which new-States profess to campaign is not, at least mainly, that of the Commonwealth; it is far more conspicuous in every State. In fact, what has made possible a high degree of centralization within State administrations is the existence of a nominal federalism. It is a paradox that the number of our States is far too few to make federalism work, but that in terms of population and the size of its governmental problems, even the largest of them is too small to be compelled to decentralize its administration. The conspicuous examples of decentralized administration are Commonwealth ones — the large federal department has its State offices; the post office being necessarily localized becomes the instrument of other departments’ administration, as in pensions. It is not that the Commonwealth is consciously following a political principle, merely that when the problem is big enough decentralization is the effective way of getting the job done.

Apart from the immense inertia created by a formal written Constitution, the forces that are actively concerned with restoring or maintaining the powers of the States are largely a matter of political organizations. State political parties exist by and for State politics and can be expected to take a lively interest in self-preservation, just as State public servants will be concerned about their own careers. Even ‘federal’ political parties are organized on a federal structure and cannot ride roughshod over the institutional vested interests of their component bodies. ‘State rights’ is, in the middle of the twentieth century, often merely a high phrase for such institutional and occupational interests which, in themselves, are of no great moment.
It is the measure of the decline of Australian federalism that this is so; the States are no longer vital political entities in any basic sense, but merely institutional structures whose justification depends on the function they fulfil.

The financial realities of Australian federation are now represented not by the written clauses of the Constitution but by uniform income tax, the Loan Council, the Grants Commission, and the miscellany of Commonwealth grants to States, and by the far-reaching monetary powers, even short of bank nationalization, which the federal government possesses. One can respond to dissatisfaction with this by clinging to the tatters of federation and seeking a new financial deal. That is what the diehards want, and at least they have achieved a victory in that, as I have suggested, even their opponents allow them to dictate the agenda for debate, to impose their view that restoration of effective State financial independence is the acknowledged objective. A reversion to a modified system of *per capita* payments, and ingenious devices for combining a single collection process with a dual income tax have been discussed; no one I suppose any longer takes seriously the Commonwealth returning to the States effective power to raise their own taxes. Those things have all been tried before, and experience has shown that they are solutions at best for a very few years. They would work no better in the future for the same basic reasons.

Those who cling to federalism in fact want weak government with few and limited powers. That is a coherent position but one somewhat out of fashion. The trend is obviously to strong centralized and extensive government, with public insistence on uniformity of policy throughout Australia. What I want to suggest is that it would be more sensible to accept the inevitable, even if one dislikes it, and think out the financial and other relations of the Commonwealth and States, on the basis that the Commonwealth is the primary policy-making body and the States primarily administrative agencies, instead of tinkering, with the intention of making a moribund federal system work, with financial arrangements which really register the collapse of that federal system. In short, as I have suggested, the problem of financial relations between Commonwealth and States is no longer, at least mainly, one of finance. It is that of designing our administration to fit a *de facto* unification achieved by financial trends — not, I hasten to add, that I would support anything so futile as a grand convention to rewrite the Constitution on these lines.

The difficulty with such a convention is that it could only function effectively if there were basic agreement on the type of government to be enshrined in a rewritten constitution. In the nineties the job of the final convention was to determine on what precise terms there should
be federation. To-day the accepted issue of the debate imposed by the diehards is whether there should be 'real' federalism, or the *status quo* with its implication of increasing Commonwealth authority. Election of delegates to a convention on any acceptable basis would mean a collection of delegates who would represent the divisions which constitute the problem. If it ever arrived at any substantial area of agreement, it would be on the basis of the *status quo* with improvement in details. And I am not sure that recasting, by such a convention, of troublesome clauses in the Constitution, such as section 92, would lead to happy results. Section 92 as it stands, we may remind ourselves, owes its delusive simplicity to the determination of the political leaders to say what they meant in plain straightforward language and to prevent the lawyers introducing complications; the banking clause owes its final form to a motion in the N.S.W. Parliament by W. M. Hughes, who demonstrated clearly enough that he had not the foggiest idea what it was about. Within the financial field, a convention which ultimately accepted the kind of so-called federalism at which we have arrived would be hard put to it to devise revolutionary changes in the financial arrangements which have grown out of the relatively simple, sweeping clauses of the Constitution. It might give exclusive rights to some 'local' taxes to the States — but they don't all want land or entertainments tax. It could hardly be so unrealistic as to propose denying the Commonwealth at least equal powers in all important taxes which have not a local basis. Uniform income tax has come to stay, despite the constitutional right of any State to re-enter the income tax field. Something might be done with regional (i.e. State) sales tax, but it is most improbable that the States would show any greater enthusiasm for this than for land tax. That the convention should place any limits on Commonwealth grants to States is unthinkable. In short, it is difficult to imagine, in the present circumstances, any very drastic rewriting of the formal financial clauses of the Constitution emerging from a convention. And if the constitutional clauses remained substantially unchanged, there is no reason to believe that the institutions, policies and procedures which have been built upon them would be vitally affected by a set debate about the state of federalism in Australia.

What all this means for my main subject is, in one respect, comforting. If one accepts as inevitable — whether unwelcome or not is immaterial — something like the present sort of political relationships between Commonwealth and States, then broadly the financial relationships which have grown up are reasonably appropriate ones. In short, as soon as one rejects the demand for restoration of financial independence to the States, 'the problem of federal finance' largely evaporates.
But it is not really as comforting as all that, because it is not so simple. The disappearance of the problem of federal finance, as I have just stated it, comes dangerously close to the tautology that if you decide, on any of various grounds, to reject the objective of restoring State financial independence, then you do not have to worry about the methods by which that independence might be re-established. It does not mean that the kind of governmental system into which our federalism has evolved does not create problems of financial relations.

Consideration of those, I suggest, must start from acceptance of Commonwealth pre-eminence in the raising of revenue and specifically of income tax. The evidence should by now be clear enough that no strong interest group really wants a reversion to separate income taxes, unless perhaps those who naively believe that it would mean lower taxes. That would be an impossible outcome unless Commonwealth defence and social service spending were seriously reduced. State governments are clearly not over-anxious, despite their posturings, to face the responsibility of politically earning their livings. Apart from the minor attractions to taxpayers of relative simplicity in returns and assessments, one income tax does mean the uniformity throughout Australia of rates, and that has attractions not only to business interests but also emotional appeal to our somewhat simpleminded ideas of fair play and equal treatment. Moreover, it has come to be accepted in modern thinking that taxation should be varied not merely to raise spending money, but to deprive taxpayers of spending power; that is, that taxation should be consciously employed as an instrument of economic policy. That is impossible to any significant degree for a State, whereas it is, at least theoretically, fully within the competence of the Commonwealth — although recent experience with a wool levy, or with efforts to incorporate income tax in a general anti-inflationary policy, should be warnings that effective use of taxation as an instrument of general economic policy still requires more governmental skill in the devising of policies and more political sophistication on the part of the taxpayer.

But the point is a valid one. Given the demand of the electorate for active governmental direction of the economy — whether enshrined in slogans of full employment, control of inflation, or whatever appears to be the problem of the moment — possession of over-riding taxing power is essential to the Commonwealth as is central banking or trade policy.

Nevertheless, most of the discussion of federal finance concentrates on the revenue side, as if surrender of Commonwealth power over the main taxes were a realistic issue. But the introduction of uniform income tax has transferred the emphasis to the expenditure side. Primarily that is expressed in the demands of State governments for
more money — more money, that is, without responsibility for raising it by taxation. But behind that very natural demand are the real problems, problems created, as I see it, by persistence with the forms of federal government in the face of permanently unified finance.

It is in the annual Premiers’ Conference wrangle that there is the nearest approach to any assessment of priorities between State and Commonwealth activities. It is only to the extent that specific forms of expenditure become incidental subjects of discussion that even that rough and ready evaluation of State against Commonwealth needs descends to the level that ought to be our real concern.

The total funds becoming available to a State are now determined by a rather remarkable process, in which the effective discretion rests with the Commonwealth, and even that is not in practice very free. A State has, of course, its receipts from various remaining taxes and from miscellaneous sources. On the whole the revenue under State control is not very flexible, or where it may be so, as in some particular taxes, the total amount involved is not large enough for variations in rates to affect in any great degree total revenue. Against State receipts are commitments the large items of which are not open to any drastic reduction. The theoretically flexible items in State finances which are important are loan raisings and receipts from the Commonwealth as tax reimbursement.

Politically tax reimbursement payments are not very flexible. Serious reduction on the last year’s figures is not conceivable. Really large increase is nearly as improbable. On the lowest level, the Commonwealth is bound to resist large increases because subsequent large reductions are sure to be difficult if not impossible. Equally, increases will be resisted because the Commonwealth has to raise the money, and in so doing to face the political consequences — which would include, for example, inability to win electoral favour by tax reductions.

On a higher level, the Commonwealth, being responsible for the main variable taxes, is primarily responsible for varying them in the light of economic conditions, just as it has to accept the main task of setting a limit to loan raisings. The gross total of Commonwealth and State spending is just as much a matter of broad economic policy to be formulated in the light of current economic conditions. At best, therefore, the Commonwealth must look at the total of its own and State spending in these broad terms and endeavour to control them as part of its overall responsibility for monetary and financial responsibility. Commonwealth policy makers would be less than human if they did not prefer to squeeze State spending rather than their own, quite apart from the more earthy pressures in the same direction to which I have referred. The tendency may be modified in
some degree by such political pressure as the States can muster, as well as by the activities of groups and organizations with special interests in particular forms of State expenditure.

Whether out of this process there emerges what, in the economic situation of the moment, are the desirable total of taxation and loan raisings, and the desirable total of spending by Commonwealth and State governments combined is a moot point. At least it is hardly the machinery for determining these levels which an economic planner presented with a clean slate would design; some of us, who are a little afraid of giving government planners real power to follow their forecasts boldly, may take comfort from the persistence of some inefficiency and untidiness in the process. But even we would have to recognize here a particular expression of one of the most potent of the forces which have undermined federalism and a major barrier to any restoration of independent flexibility in State finances. Governments and their advisers faithfully reflect the temper of the times, and the pursuit of policies designed to influence general economic conditions marches ill with the weakness and diffusion of power of federalism.

The other side of the medal is the unsatisfactory provision for assessing particular forms of State expenditure against particular forms of Commonwealth spending. For instance, it seems likely that the process of allocation of financial resources between States and Commonwealth has in the post-war years favoured government spending on consumption as against investment, taking particularly the form of enlargement of those Commonwealth social services which involve money payments or free (or subsidized) services. Two expensive State activities which have clearly suffered are transport and education. More generally it is obvious that functions the cost of which has risen steeply are at a serious disadvantage if they remain State functions and that extensions of State functions and improvements of their efficiency are at a serious disadvantage in competing for funds. Moreover, this is a situation which can be expected to deteriorate over time.

This view does not involve taking at face value the protestations of the States, which of course have nothing to lose either in clamouring for more or in belabouring the Commonwealth. Within the financial limits they have, they are fully responsible for the distribution of their resources, in which they have on occasion evidently chosen their economies with an eye to blackmailing the Commonwealth. I may, perhaps, be permitted the professional comment that nothing in the alleged niggardliness of the Commonwealth can excuse the miserable scale on which the States finance their Universities.

As between Commonwealth and State activities these broad questions of priority enter only incidentally into the annual squabble
over funds. They are used by State governments in a loose sort of way to beat the Commonwealth and especially in self-justification for their own deficiencies; while the Commonwealth in rebuttal is apt to make rhetorical reference to defence and social services. Federal authorities will not be anxious to push detailed comparisons too far, for they might prove embarrassing. The States themselves hesitate to submit reasoned cases for particular forms of expenditure, for that would be the final surrender. It would mean unambiguously transfer to the Commonwealth, with its power of financial veto, of policy-making in such fields, leaving the States in a position comparable with that of any Commonwealth department preparing estimates, even if the consideration of the proposals demanded more formal proceedings.

Yet that, in substance, seems to be the only line of advance open. If we are to have an assessment of the claims of, say, education against medical services or of the capital development needed to restore public transport against the plans of National Development, the holder of the purse-strings must be forced to face responsibility for the issues and to make the decisions explicitly. This does not mean a plea for summary abolition of the States; that would be as unrealistic as the pleas for giving them back financial sovereignty. The argument is rather that, in 1954, the practical problem of federal finance is to devise procedures for determining how far the Commonwealth should contribute to State spending, not in total, but on specific activities. (At least for a long time to come I would imagine this would mean specific arrangements in connection with a number of functions, side by side with a substantial general purpose grant.) The tidy short-cut to the end result would, of course, be outright unification, but even if it were not, practically, a remote objective, it is hardly likely to be the efficient solution and is not very attractive. Historically, gradual transfer of high-level policy to the centre from local and regional bodies, which have stubbornly clung to limited independence in matters of lesser importance, seems to have been the path both to efficient government and to political freedom. We have had held up to us the bogey of centralized government from Canberra, bogged down in an effort to govern Australia from West Block. It is a risk of any transfer of policy-making to the Commonwealth; Canberra is as prone to the disease as Sydney or Melbourne, but no more. But directing our planning to making the States primarily administrative agents is the best available safeguard. Much second-level policy-making will remain with the States; they will have some independent taxing powers for a long time to come; and they can be relied upon to surrender no more power than is the price of a more rational distribution of funds.
There is considerable scope for diversity of devices and experimentation with ways in which the Commonwealth may participate in the finance of specific State activities. We have already some examples of joint enterprises and a number of grants-in-aid. The arrangements we have already vary a great deal, and there is no reason why they should in future follow a standard pattern.

What is being contemplated here is little more than a continuation of past trends, which will undoubtedly continue. Either the States will, under financial pressure, take the initiative in seeking Commonwealth aid for specific purposes, or those who are denied by State poverty will press the Commonwealth directly sufficiently for it to move. One potent force will be the one which all through has favoured Commonwealth dominance — the Australian preference for Australia-wide uniformity of treatment.

In 1900 Australians wanted common provision for defence and trade policy and little else on a uniform basis. To-day they want much else on an Australian standard, not a diversity of State policies. Few of us are much concerned in principle with the allocation of a function between States and Commonwealth. We may make a judgment about relative competence and efficiency; financial realities are compelling us to look to the Commonwealth for new expenditures and for major advances in old ones; and we tend to favour it because it does produce uniformity of treatment. Those of us who perversely see virtue in diversity and untidiness are a small minority.

All this finally comes down then to just a little more than accepting the trends of the last fifty years, to the view that our ingenuity should be directed towards easing the transition, instead of resisting it or pretending that our problem is to reverse the trend by trying to re-establish effective federalism. In short, all I have to contribute is the modest suggestion that, federalism having broken down financially, the practical problem is to avoid an otherwise inevitable centralization by moving a little faster, more consciously and deliberately, along the established trends, as the only promising way of retaining, not federalism, but a healthy degree of decentralized government.
In every federation vital questions arise concerning the extent to which the member States have adequate tax revenues, the extent to which they are dependent on federal grants and the extent to which federal grants should be designed to assist the financially weaker States at the expense of the financially stronger. The underlying issue therefore is how far legal and political independence can be reconciled with financial dependence. Australians have had this problem with them in one form or another since the beginning of federation, but it has become increasingly acute in recent years.

Before the war each State levied its own income tax and received only a limited number of specific-purpose grants from the Commonwealth. However, the Commonwealth Grants Commission existed to recommend special grants, in aid of the general revenues of the three smaller States (South Australia, Western Australia and Tasmania), and the Loan Council existed to co-ordinate borrowing programmes by joint Commonwealth-State action. The situation is now radically changed. As a result of the introduction of uniform income tax during the war, the States have been deprived of their major source of tax revenue, and every State has now become dependent on Commonwealth grants for about two-thirds of its current ordinary revenue.

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(including net, but not gross, receipts of government business undertakings). The States have also had to depend largely on Commonwealth support for their large post-war borrowing programmes. Both the limited amount of Commonwealth assistance and its allocation among the States have come under increasingly heavy criticism.

In their policy speeches before the general election in November 1958, both the Prime Minister and the Leader of the Opposition referred to the question of federal-State finance, and the Prime Minister undertook to call a special Premiers’ Conference if the government were returned to office. In the event, a series of conferences has been held. In February 1959 the Commonwealth summoned a conference of State representatives and other interested parties to discuss the future of road finance. In March a special Premiers’ Conference was called, at which the Commonwealth submitted a new plan for road grants to the States and invited State Premiers to discuss the general problem of federal-State finance, including the uniform-tax system. In June a further Premiers’ Conference was held in the normal way in conjunction with the Loan Council meeting, and on this occasion the Commonwealth proposed and the Premiers accepted a new system of federal grants.

The Uniform Income Tax System

The major component in the Commonwealth payments to the States has hitherto been the income-tax reimbursement grant, which amounted to £175 million in 1958-59. This grant began with the introduction of the uniform income-tax system in 1942, and is payable to the States on condition that they do not levy their own income taxes. The total reimbursement grant has been determined each year by a formula under which a base figure is increased according to the increase in population and average wages throughout Australia.

In fact, the grant yielded by the formula has had to be added to each year by a supplementary reimbursement grant, which in 1958-59 amounted to an extra £30 million. The States have regularly claimed, probably with some justice, that the formula grant is too small for their needs. On the other hand, they appear to have found it easier, both politically and administratively, to demand and obtain extra financial assistance from the Commonwealth than to raise extra revenue from the limited and somewhat inflexible tax fields that are still open to them, such as stamp duties, land taxation and the like.

For the last few years both the reimbursement grant and the supplementary grant have been allocated among the States according to a second formula which measures their ‘adjusted population’, i.e. actual population adjusted for sparsity of settlement and proportion of school children. The effect of this formula has been to transfer sub-
stantial sums collected in the wealthier States to the poorer States. In particular, Victoria has ‘lost’ about £7 million per annum in this way and Queensland has ‘gained’ about £7 million. This has introduced an element of discord among the States, and on more than one occasion has enabled the Commonwealth to fob off demands for reform by blandly inviting the States to agree among themselves.

The uniform-tax system was introduced originally as a war-time measure, but its legality was upheld by the High Court and it was then continued after the war on a permanent basis. Soon after the present Liberal-Country Party coalition assumed office in 1949 serious consideration was given to the possibility of the Commonwealth’s withdrawing from the income-tax field to the extent necessary to permit the States to levy their own income taxes. A number of formidable technical difficulties were, however, encountered and there appeared to be a general reluctance to return to seven different assessment acts and seven different tax schedules, particularly for company tax. However, the major difficulty was political, and became obvious as soon as it was realized that the abandonment of the uniform-tax system would have serious financial consequences for Queensland. This could hardly fail to have electoral repercussions, particularly on the vital Senate vote. For a while consideration was given to the possibility of paying an annual compensation grant to Queensland, but this proposal did not find favour with the other States and was not proceeded with.

Resentment against the uniform-tax system, however, continued to grow in Victoria, particularly as that State found increasing difficulty in balancing its budgets. From being the State with the lowest per capita expenditure on social services ten years ago, Victoria has now become the State with next highest after Western Australia and Tasmania (where administrative costs are necessarily high because of small and sparse population). Since Victoria also has the highest per capita level of personal income, the State government has naturally cast longing eyes on the extra revenue that it might obtain if the Commonwealth were to withdraw from part of the income-tax field.

Agreement between the Commonwealth and the States being apparently incapable of attainment, Victoria, in conjunction with New South Wales, again challenged the validity of the uniform-tax system in the High Court. In August 1957 the Court held invalid a provision forbidding the collection of a State income tax while Commonwealth income tax was outstanding, but upheld the vital requirement that a State must refrain from imposing its own income tax as a condition for receiving a Commonwealth reimbursement grant. In the words of the Prime Minister this left the position ‘in substance exactly as it was before the litigation began’.
At the special Premiers’ Conference in March 1959 Victoria and New South Wales returned to the attack. Both proposed schemes under which each State should be allowed to levy and retain its own income tax within the framework of a common system of assessment and collection. These schemes were unacceptable to the other States, however, since they would have permitted the wealthier States to impose lower tax rates (or alternatively to raise a higher per capita tax revenue) than the poorer States. Attention was therefore diverted to the possibility of amending the system of tax reimbursement grants, and the Commonwealth was left to prepare proposals for submission to the Premiers at their next meeting in June.

Commonwealth Grants Commission
In addition to tax reimbursement and supplementary grants, the three States with the smallest populations (South Australia, Western Australia and Tasmania) have regularly received special grants on the recommendation of the Commonwealth Grants Commission. This was established as a body independent of the Commonwealth Treasury, to which the government of the day could refer applications for special grants under section 96 of the Constitution. The Commission can only consider applications thus referred to it and cannot, therefore, take the initiative in recommending grants. It reports direct to the Governor General, and its recommendations have always been accepted by the government. For 1958-59 the Commission recommended special grants amounting to £20,750,000.

The above three States have become known as ‘claimant States’ to distinguish them from New South Wales, Victoria and Queensland which, until last year, had never applied for special grants. In his 1958 Budget speech, however, the Queensland Treasurer announced that his State was submitting an application to the Commonwealth for a special grant, in the evident expectation that it would be referred to the Commonwealth Grants Commission. The Victorian government immediately submitted a similar claim. To have referred both applications to the Commonwealth Grants Commission would have left New South Wales as the only non-claimant State. Faced with this prospect, the Prime Minister refrained from any action on either application pending the outcome of the proposed conferences with the States.

It will clarify the position to explain briefly the Commission’s procedure. Its recommendations are based on a per capita comparison of the budget result of each claimant State with the average budget result of the non-claimant States. The whole basis of these comparisons would be upset if there were five claimant States and only one non-claimant State. But it was certainly never envisaged at the outset
that the same three States would continue year after year to be dependent on the recommendations of the Commission for a large proportion of their annual revenue. Both the Commonwealth Treasury and the Commission itself have indicated their uneasiness at this situation.

Victoria's budgetary position is serious enough, but its application for a special grant was probably a tactical move designed deliberately to bring the whole situation to a head. Queensland's difficulties are of a different order. Income per head is relatively low, and the State has not shared in the post-war expansion of population to the same extent as other States. Until last year, however, it was able to avoid any serious budgetary difficulties by drawing upon war-time surpluses accumulated largely from railway earnings when the State was a base for allied operations in the South-West Pacific. These accumulated surpluses are now practically exhausted and large budget deficits have begun to appear — an embarrassing position for any government, and particularly for the Liberal-Country Party coalition which came into office in 1957 for the first time in nearly thirty years.

Queensland's position in some respects compares unfavourably with that of South Australia, which received a special grant of £5 1/4 million in 1958-59, despite an era of rapid industrial development, a high rate of population growth and good prices for its agricultural products. South Australia's position as a claimant State has thus appeared somewhat anomalous, but it is easily forgotten that the State's population is still nearly 40 per cent less than Queensland's and that it is deficient in natural resources. Industrial development creates additional demands for State services, and does not necessarily and immediately strengthen a State's budgetary position, particularly when it is precluded from levying its own income tax.

Road Expenditure

In Australia, with its long distances and its rapidly expanding population, the need for increased expenditure on roads has become at least as urgent as in other parts of the world. The responsibility for road construction and maintenance rests with the States and their local authorities. The States are precluded from financing their road works by the imposition of sales taxes (which the Courts interpret as excise duties) on motor fuel, but they do levy registration fees on motor vehicles, drivers' licence fees and transport regulation fees. In recent years the Courts have declared invalid various forms of State taxation on inter-state road hauliers, and three States have therefore resorted to ton-mile taxes, levied on all road transport and designed ostensibly to cover damage to the roads by wear-and-tear.
Since 1923 State road expenditure out of motor-tax proceeds has been supplemented by annual Commonwealth grants for road works, and from 1931 until the present year [1959] these grants have been equivalent to the proceeds of specified rates of customs and excise duties on petroleum. From 1956 to 1959 the specified rate was 8d. per gallon on both imported and locally refined petrol. The grant yielded in this way in 1958-59 was £34 million, to which a further £3 million was added after the imposition of a duty of 1s. per gallon on diesel fuel. However, since the Commonwealth customs duty on imported petroleum was 13d. per gallon and the excise duty on locally refined petrol 11½d. per gallon, there was a persistent agitation for the payment of the whole proceeds of these taxes to the States for road purposes.2

Almost from the outset, the Commonwealth road grants were allocated among the States on the basis of two-fifths according to area and three-fifths according to population, with the exception that Tasmania received 5 per cent of the total. This formula naturally favoured the States with large areas such as Western Australia and Queensland, at the expense of the smaller and more populous States such as Victoria and New South Wales. Feeling against this method of allocation has been particularly strong in Victoria, which has claimed that its motorists are contributing about £19 million per annum in petrol taxes whereas it receives less than £7 million by way of the Commonwealth road grant.

The existing legislation being due to expire in June 1959, the Commonwealth, after preliminary discussions with interested parties at the February Conference, announced new proposals at the Premiers' Conference in March. Over the next five years, the Commonwealth will make available a basic sum of £250 million, rising from £40 million in 1959-60 to £48 million in 1963-64. However, this sum is no longer to be related directly to petrol tax collections. It is claimed that this will give greater certainty to the grants, but on the other hand the grants may well be less than they would have been if they had continued on the old basis and petrol consumption had continued to rise as in recent years. The Commonwealth's primary purpose in severing the link between road grants and petrol tax is no doubt to forestall further pressure to increase the grants until they absorb the whole proceeds of the tax.

A second important change is that the formula for allocating the annual grant among the States has been altered so that, except in the case of Tasmania, one-third will be allocated according to area, one-third according to population, and one-third according to motor vehicles registered. Motor registration has been introduced as a new factor, but in effect it does not differ greatly from the population
The increased total grant has made it possible to avoid reducing the actual payment to any State, and the Commonwealth has undertaken to ensure that even Western Australia does not receive less under the new formula than it did under the old. It will simply mark time, while increased payments are made to Victoria and New South Wales. Even so neither of these States expressed itself as satisfied.

A third and more dubious innovation in the new roads plan is the introduction of a matching provision. This does not apply to the basic grants, but to a supplementary grant of £30 million for the five-year period, rising from £2 million in the first year to £10 million in the fifth year. This supplementary grant will be available for allocation among the States on the same formula as the basic grant, but the actual payment to any State must be matched by an equal amount from the State’s own resources over and above the road expenditure which the State was thus meeting in 1958-59.

There has been an increasing tendency in recent years for the Commonwealth to attach matching conditions to its grants. Other examples are the grants for universities, and for capital expenditure on mental institutions. Matching grants are extensively used in the United States, but it may be doubted how far they are appropriate in Australia where the States derive such a very large proportion of their revenue from Commonwealth sources. The requirement that the States should increase their own expenditure on roads or any other service is likely to create a situation in which the Commonwealth has eventually to meet the State share of such increased expenditure as well as its own.

**Public Borrowing**

In Australia it was the general practice before the war to finance public works other than roads by borrowing. In 1927, following a constitutional amendment, the Loan Council was set up to co-ordinate the borrowing programmes of the State governments and that of the Commonwealth with respect to civil (but not defence) works. The members of the Council are the Premiers of the States and the Prime Minister of the Commonwealth, but the latter has two votes and a casting vote. Loan Council programmes are implemented by the issue of Commonwealth securities and the States are thereby enabled to borrow on the credit of the Commonwealth. State semi-governmental and local authorities continue to issue their own securities, but under the so-called ‘gentlemen’s agreement’ of 1936 their programmes are also submitted to the Loan Council for approval.

Although in theory the Commonwealth position on the Loan Council is that of primus inter pares, it has in fact become very much more. Since the end of the war, the Commonwealth’s budgetary
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position has been so strong that, unlike the States, it has had no need to borrow for civil purposes and has been able to finance its public works, including the Snowy River project, out of revenue to the tune of about £80 million per annum. Apart from Commonwealth borrowing to finance housing advances to the States, the Loan Council programmes have thus been confined to loans for State purposes.

Nor is this all. In each year since 1951-52, public subscriptions have been insufficient to fill the Loan Council's programme and the gap has been filled by the Commonwealth, again principally out of revenue. Some additional hard currency loans have been obtained from the International Bank and other overseas sources, but there has been practically no other public borrowing overseas in the post-war period, which contrasts markedly in this respect with earlier periods in Australian history, such as the 1920s.

The position of the Commonwealth government has thus changed from that of being one borrower among several to that of being the major lender. At the Premiers' Conference last March the Commonwealth was inclined to take much credit to itself for its generosity in thus supplementing State loan programmes and obviating the need to reduce them to the level set by public loan subscriptions. It is able to adopt this role only because it has monopolized the income-tax field, and the level of public loan subscriptions might well be higher if Commonwealth income-tax rates were lower.

Another complaint of the States is that from 1952-53 until 1957-58 inclusive the Commonwealth froze the Loan Council programme at under £200 million per annum, despite rising costs and the increasing demand for schools, hospitals and other State public works on account of population growth. On several occasions the States have outvoted the Commonwealth on the Loan Council and secured a nominal increase in the programme, but in the final outcome the Commonwealth has itself determined the rate at which it makes advances in support of the loan programme. It can also influence the loan market indirectly through its control of the Commonwealth Bank and other mechanisms.

A further complaint of the States is that they are required to pay interest on loan funds provided by the Commonwealth out of revenue, that is, from taxation levied on the people of Australia. It does not follow, however, that any real burden is imposed on the States since the Commonwealth ultimately has to provide them with the means to meet the interest charges by making higher annual grants than would otherwise be necessary. From the Commonwealth point of view, however, the system is not so absurd as it sounds, since those parts of its annual grants to the States which return to the Commonwealth in
the form of interest and sinking fund payments become available for the reduction of the Commonwealth debt.

This brings us to what is perhaps the major complaint of the States, which is that the Commonwealth has used its control of tax resources to reduce its indebtedness, while allowing that of the States to increase. The position has been aggravated for the States by the increase in interest rates in recent years, consequent largely upon the activities of hire-purchase companies. In the last ten years State debt charges have more than doubled, and are now approaching the formidable total of £100 million per annum. This is creating an increasingly serious budgetary problem for all State Treasurers.

None of these problems was resolved at the June meeting of the Loan Council except that the Commonwealth did finally agree to raise the State loan programme to £220 million for 1959-60, as compared with £210 million for the previous year. The Commonwealth's original proposal was for only £215 million whereas the States asked for £270 million. In addition, the Council approved a programme of £100 million for semi-governmental and local authority loans, but there is no Commonwealth support for this type of loan.

The New Financial Assistance Grants
At the Premiers' Conference in June the Commonwealth proposed radical changes in the system of Commonwealth grants, which after some skilful manoeuvring and some concessions it induced the States to accept. Both the Prime Minister and the Premier of Victoria were absent and were represented by their deputies, but it is impossible to say whether the outcome would have been any different if they had been present.

The main features of the new scheme are as follows:

1. Financial assistance grants will henceforth replace the old formula reimbursement grants, the supplementary reimbursement grants, and also (except for marginal amounts in Western Australia and Tasmania) the special grants. The careful avoidance of any reference to 'tax reimbursement' in the new proposals is significant as indicating a final denial by the Commonwealth of any State rights in the income-tax field.

2. Each State will have a basic financial assistance grant in 1959-60 derived from the amounts actually paid under the pre-existing grants in 1958-59. The 1958-59 amounts have, however, been adjusted upwards by over £7 million for New South Wales, by £6 million for Victoria, by £4½ million for Queensland and by £3½ million for South Australia, though these sums represent increases of only about £2 million each over what the four States would have been entitled to anyway under the old system. In the case of Western Australia and
Tasmania, the actual 1958-59 grants have been adjusted downwards by about £2 million and £1 million respectively, but these amounts will be more than made up by special grants to be recommended by the Grants Commission. The total cost of the new scheme to the Commonwealth, over and above what it would have had to provide under the old, may not be much more than £10 million.

3. Only Western Australia and Tasmania will now receive special grants regularly. The amount which South Australia received by way of special grant in 1958-59 is now included in its basic grant and the State has undertaken not to apply for special grants again except in circumstances which are variously described as ‘special’, ‘unexpected’ or ‘exceptional’. Queensland has given a similar undertaking. On the other hand, Victoria and New South Wales are now presumably precluded from applying for special grants under any circumstances.

By the above arrangements the Commonwealth has introduced into its own direct grants a large element of differential assistance to the smaller States. From the Commonwealth Treasury’s point of view this may have the advantage that such assistance is now ‘frozen’ and therefore predictable for budgetary purposes, and from the political point of view it has the advantage of removing the apparent standing invitation to the States to apply for special grants in an endeavour to break out of the financial straight-jacket into which, as it appears to many observers, the Commonwealth tries to fit them.

On the other hand these administrative and political advantages have been gained at the cost of paying South Australia as much, and more, than she received by way of special grant, and also paying it henceforth as a matter of right, with no questions asked and no public investigation into the State’s accounts. How long this will prove acceptable to the other States remains to be seen. On the one hand, Queensland is entitled to ask why she cannot receive as large a per capita grant as South Australia, and on similar terms. On the other hand, Western Australia and Tasmania are entitled to ask why they should be subject to Grants Commission investigations when South Australia is not. If differential per capita grants are to be paid to the States, there is a strong case for basing the differentials either on some objective formula, or on public investigations into State accounts and standards of administration.

4. In future years each State’s basic financial assistance grant will be increased by the same percentage as its growth of population, and by 1.1 times the percentage increase in average wages for Australia as a whole. The aggregate assistance provided by the Commonwealth will henceforth be simply the sum of the grants to each State, and will not, as hitherto, be determined before the allocation among the States.
The effectiveness of these adjustments in measuring changes in the needs of the States will depend, first, on the accuracy of the Commonwealth Statistician’s inter-censal estimates of the population of the various States. Unfortunately there is no adequate means of checking population movements by road, and Queensland maintains that its population is persistently under-estimated. Secondly, the effectiveness of the proposed wage adjustment in measuring increased costs is open to doubt. If wages increase by 5 per cent in a year, State grants will now increase by 5.5 per cent in the following year, but it is doubtful whether this will fully compensate for the lag of revenues behind costs which the States inevitably experience in any period of inflationary pressure. Moreover, since this adjustment is based on wage movements in Australia as a whole, its benefit will be greatest in the States where wages rise relatively slowly, and least in the States where wages rise most.

5. The new arrangements are to apply for six years. In view of past experience, it seems somewhat optimistic to expect any scheme of federal-State finance to last unchanged for so long a period, but the Commonwealth is clearly anxious to break away even for a few years from the system of annual bargaining sessions with the State Premiers. Whether it will succeed will obviously depend on the degree of stability achieved in wages and costs, and also on the absence of marked changes adversely affecting the finances of particular States. A major source of instability which is not covered by the new arrangements is the increasing burden of debt charges on the budgets of all the States.

Notes

1 This condition is imposed under section 96 of the Constitution, according to which ‘the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit’.

2 [The rates of pence per gallon quoted in the text would be approximately equivalent to 1.5 cents per litre for the allocation to the States as compared with 2.2 cents per litre for the duty on diesel fuel, 2.4 cents per litre for that on imported petroleum and 2.1 cents per litre for that on locally refined petroleum.]

3 On a per capita basis, the financial assistance grants are equivalent to £22.14 for New South Wales, £21.64 for Victoria, £25.11 for Queensland, £30.21 for South Australia, £35.33 for Western Australia and £31.85 for Tasmania.
The Report of the Joint Committee on Constitutional Review

K. F.

The first Report of the Committee was presented in October, 1958, and contained recommendations covering a wide range of subjects. The Committee had not enough time to include a full exposition in support of its recommendations in the first Report. A second Report, presented in November, 1959, supplies the reasons in support of the Committee's recommendations.

Parliamentary Reform
The Committee made recommendations of a major character affecting the composition and functioning of the Federal Parliament and the relationship of the Senate with the House of Representatives. For example, the number of members of the House of Representatives and the number of senators would, under the Committee's proposal, be no longer tied to each other. At present the number of members of the House of Representatives have to be as nearly as practicable twice the number of senators. This means that an increase in the size of the House of Representatives of any material order has to be accompanied by an increase in the size of the Senate. The former will have to occur because of Australia's expanding population but in the Committee's opinion, the number of senators is already adequate.

*Reproduced from Public Administration (Australia), December 1960, pp. 354-9.
It is proposed that the Parliament should be able to determine the size of the House of Representatives, subject to the qualification that there should be not more than one member for every 80,000 persons of a State. (At present there is an average of one member for about every 81,000 persons.) The number of senators for each State would be fixed at a maximum of ten, maintaining a Senate of sixty as at present.

Another proposal involves amending Section 57 of the Constitution. Where a deadlock arises between the Senate and the House of Representatives, at present the only action which a government can take to attempt to resolve the dispute is to obtain a double dissolution of the two Houses, which entails the holding of elections. The Committee proposes that the government should have the choice of alternative courses of action, including the convening of a joint sitting without a double dissolution.

The allotment of fixed terms of six years for senators has, in the past, made it necessary either to hold separate elections for senators and the House of Representatives, or else the House of Representatives has been prematurely dissolved to prevent the occurrence of separate elections. Accordingly, the Committee proposes that one-half the number of senators should retire at every dissolution of the House of Representatives.

The Committee was aware that its recommendations would provoke criticism in some quarters. The Senate was intended to function as a House of Review and as a States' Assembly, in which the States were accorded equal representation as partners in the federation. Nevertheless, historical changes in the twentieth century have prevented the Senate from properly expressing the Founders' intention. In the first place, there has been a growth in the number and importance of the subjects arousing national interest under the stimulus of an expanding and vigorous national life and the pressure of world events. By comparison, the number of State issues has tended to diminish or else matters which were once primarily the domain of the States have come to assume a national significance.

Secondly, the party political system has permeated proceedings in the Senate, just as in the House of Representatives. Senators are elected on the popular appeal of the platforms of their parties rather than because of their individual qualities. The loyalty of senators to their parties has characterised proceedings in the Senate just as it has in the House of Representatives.

These considerations have led the Committee to make recommendations which, if they become effective, would in its view achieve a realistic adjustment of the relationships between the two Houses consistent with the expression of federal principles. The Committee's
proposals leave undisturbed the Senate's constitutional powers
relating to the passage of legislation and equality of representation of
the States.

Commonwealth Powers
The Committee proposes that the Commonwealth Parliament should
be granted increased legislative powers on a wide range of subjects,
despite the fact that any contemplated increase in the legislative
powers of the Federal Parliament has usually provoked the criticism
that the Commonwealth already has enough, or too much, power.
The Committee points out that the constitutional powers of the States
are still far more extensive than those of the national Parliament. Very
few powers have been withdrawn from the States and vested
exclusively in the Commonwealth Parliament.

The additional powers which the Committee proposes are to be con­
current powers, that is to say, they would not be vested exclusively in
the Commonwealth Parliament and withdrawn from the States. Criticism of increased legislative power for the national Parliament
has, in the committee's view, frequently failed to acknowledge that
each House comprises members directly chosen by people. Funda­
mentally, the question of increased Commonwealth legislative power
resolves itself into whether the people wish to have their will expressed
through the national Parliament or whether they choose to have a
divided expression of will through the separate State Parliaments.

The Committee has proposed express or increased legislative powers
over such subjects as navigation and shipping, aviation, scientific and
industrial research, nuclear energy, broadcasting, television and other
telecommunication services, industrial relations, corporations,
restrictive trade practices, marketing of primary products and capital
issues, consumer credit and rates of interest charged for loans secured
by mortgage of land.

The Committee's recommendations are framed in the light of the
factors which have tended to bind the people of the Commonwealth
into a homogeneous community. Some of the considerations which
have influenced the Committee are the following:

(1) There have been two costly world wars in the first half of the
century and the people of Australia are aware of the dangers of
external aggression from powerful forces linked by common
philosophies or policies. The provision of adequate means of
defence requires the continuous expenditure of enormous sums
of money and other resources. The conception of world-wide
total war in which the whole of a nation's manpower, material
and financial resources are directed to common defensive
purposes hardly existed in 1900.
2) Internationally, the Commonwealth of Australia has become an independent country negotiating agreements in its own right and maintaining an active interest in the course of world events, in a way that could not have been foreseen in 1900. Australia's special position in relation to the affairs of South-east Asia and the Pacific area has become apparent only in recent years.

3) The Australian economy has developed a national character and can no longer be assessed in terms of six separate economies. The various components of the economy are interdependent and the condition of one affects others. For example, the level of prosperity in the community depends substantially on the state of Australia's overseas trade balances. External trade has become a national matter.

4) The Australian economy has become increasingly industrialized and the process has been accompanied by an intensive use of various Commonwealth powers. For example, in the determination of terms and conditions of industrial employment, Commonwealth awards and determinations cover directly almost one half of the total number of male employees in Australia. Federal determination of industrial conditions also has pronounced effects on State regulation of wages and other conditions of employment.

5) The growth in population, including a steady flow of migrants from other countries with no traditional State ties, and the movement towards a more diversified economy have made it necessary to undertake national works and promote development through the exercise of financial, economic, defence and other powers vested in the Commonwealth Parliament under the Constitution.

6) Rapid progress in transport and communication has broken down the isolation of States, led to an increase in the volume of interstate trade, commerce and intercourse and fostered an appreciation by residents of one State of the activities and problems of other States.

7) In common with many other countries, the Commonwealth has assumed direct responsibility for the provision of a wide range of social service benefits available to all persons in the community irrespective of their place of residence.

8) The Commonwealth has become the financially dominant member of the Federation with sources of revenue at its disposal far greater than those of the States.

9) Increasing Commonwealth commitments are reflected in the relative size of the Commonwealth and State budgets. Whereas in the early years of Federation total expenditure by the States
on their own services was several times greater than Commonwealth expenditure, total Commonwealth expenditure on its own services now exceeds that of the six States combined.

The Committee is concerned that there should be a national approach to matters of national interest. For example, in the remaining years of the present century, Australia stands to make considerable gains from the employment of nuclear power, particularly in the undeveloped regions. The major consideration would be to place a nuclear power industry on a sound economic footing. Unco-ordinated action by separate States could lead to situations as inimical to the national interest as the break of gauge in the Australian railways system. The Commonwealth must be in a position to promote the development of an integrated nuclear power programme, in which maximum use is made of the extremely costly capital facilities which would be needed.

Subjects such as aviation, broadcasting and television, and scientific and industrial research should be made express subjects of Commonwealth legislative power, if only for the reason that the Commonwealth is already committed to extensive programmes in these fields, under defence and other powers.

The Committee's recommendations on other subjects such as terms and conditions of employment in industry, restrictive trade practices, capital issues and consumer credit, and the marketing of primary products have been largely dictated by the need to take action on a national rather than a State basis. In some instances, effective State action is impossible simply because the problem has no reference to State boundaries. This, for example, is the case with restrictive trade practices which require the adoption of uniform national policies if the economy is to be safeguarded against abuse. Again, it is now accepted that the Commonwealth has a general responsibility for the health of the national economy and in this respect it is called upon to perform a function of government which did not even exist at federation. The Commonwealth at present has to tackle economic problems from a position of constitutional weakness.

Experience since Federation has, according to the Committee, also demonstrated that the division of constitutional powers on some subjects had created many undesirable divergencies of policy. One example is in the very important field of terms and conditions of employment in industry. Commonwealth arbitral authorities, the State Parliaments and the separate industrial machinery of the six States, all have had a hand in creating a complex fabric of industrial conditions not infrequently to the detriment of good employer-employee relations. Another example is the treatment of company law in Australia. There is, for example, no uniformity in the provisions of
the State company acts for the protection of the investing public and a company registered in one State has been treated as a foreign corporation for the purposes of the laws of each of the other States.

In the marketing of primary products, the Committee's recommendations represent a synthesis of the views of several major primary producing organizations. The Committee recommends that the proposed Commonwealth marketing power should be given immunity from Section 92 of the Constitution which guarantees the freedom of trade between the States. The Committee's recommendation provides that a proposed marketing plan will have first to be approved by three-fifths of the producers affected.

The States and Constitutional Amendment
The Committee has also made recommendations on three other subjects not involving any addition to the substantive legislative powers of the Commonwealth Parliament. One recommendation is that the States should have the power to impose fair and reasonable charges on interstate road transport for the cost of providing and maintaining highways without infringing Section 92 of the Constitution. The Committee contemplates the revival of the Inter-State Commission, for which the Constitution already made provision, for the purpose of determining whether a State charge is fair and reasonable having regard to the promotion of interstate trade and the public interest.

In addition, the Committee proposes the insertion of an alternative provision in the Constitution to enable new States to be formed from existing State territory if a majority of electors in the area of the proposed new State and a majority of the electors of the whole State affected express their approval. (At present, the consent of the State Parliament is required.) The history of Australia in the nineteenth century was largely one of the division of the continent into self-governing communities. Yet, although the Founders thought the position would be otherwise, no new State had been created since federation.

Finally, the Committee recommends that a proposal to alter the Constitution should need to be carried by majority vote of the electors of the Commonwealth plus separate majorities in at least one-half of the States instead of in a majority of States as at present. The proposal is not of a sweeping character. Of twenty proposed laws so far rejected by the electors, only two would have to be carried on this basis.

The Constitution has proved more difficult to change than the Founders perhaps realized. A major factor has been the inability of the federal government which sponsored a constitutional alteration to obtain support from the parties then in opposition. The committee
The Report of the Joint Committee

considers that the prospects of constitutional change would be considerably enhanced if there was agreement in the first instance between the parties in the Federal Parliament. The Committee’s Report carried the signatures of members from both sides of the two Houses. One member dissented from the recommendation to extend federal powers over employment relations. Another dissented from many of the other recommendations. [The dissenters were the Liberal members Mr A. R. Downer M.H.R., and Senator R. C. Wright.]
The trend in governmental relationships within the Australian Federation has by now become clearly defined. I propose to illustrate the trend by a study of the period 1957 to the present time [1962]. This period, although short, will be seen to be important. There is nothing in it in the nature of a national political crisis. Nor could the relations between governments be called turbulent. On the contrary, there has been a continuous non-Labor government at Canberra, dedicated to 'The maintenance of the federal system of government . . .', and changes in government, from one political party to another, have occurred only in Western Australia and Queensland. But during this period past trends have been extended, and the position of the Commonwealth government in the Federation greatly strengthened.

My chief concern in this paper will be to assess trends in public administration. But the study of administrative relations in a federation has little meaning unless set against the relevant political background. The first part of this paper, therefore, is devoted to political decisions, especially those since 1957, determining financial relations. This will, in large measure, explain the 'context, climate and atmosphere' (to use an expression of our last conference) in which the administrative trends and problems, the subject of the second part, have developed.

*Abridged from Public Administration (Australia), June 1962, pp. 101-21.
In both parts a common trend will be evident. Politicians, through a redistribution of finance, and through Commonwealth-State cooperation in policy making, are fostering Australia’s development on the premise that Australians, wherever they may live in the Federation, ought to enjoy governmental services at equal standards. This has important implications in public administration. It means that many administrators, within the several Public Services, are seeking to provide the services of government at equal standards of administrative efficiency. And it means that, at all levels of government, standards of administrative behaviour now have national as well as local significance.

Commonwealth-State Financial Relations

Financial Assistance Grants
Our starting point is the decision of the High Court in the second Uniform Tax Case in August, 1957. Inter alia the Court was unanimous in holding to be valid the condition attached by the Commonwealth Parliament in the legislation providing tax reimbursement grants to the States — requiring the States ‘to abstain from imposing income tax, as a condition of obtaining the grants which the Act provided’. The tax reimbursement grants were made under Section 96 of the Constitution, and this decision in the opinion of one reviewer of the case, ‘in a considerable measure worsened the position of the States, since it finally lays at rest most of the doctrines suggested from time to time for the purpose of avoiding the possible influence of Section 96 on State administration’. The decision of the Court left State governments increasingly subject to the influence of Commonwealth government policies, through conditional grants of finance.

In some political quarters these facts of Australian federal life were disturbing. The Commonwealth government was one of the governments to express its concern. The Prime Minister in his election policy speech in October, 1958, stated that if returned to office, his government would ‘convene a special Premiers’ Conference’ to discuss uniform taxation, ‘and indeed the whole tangled problem of Commonwealth-States financial relations’. A victorious government held the promised conference in Canberra in March, 1959.

The conference in March, 1959, may lay claim to two achievements. It agreed upon a new plan for Commonwealth help towards the cost of the development and maintenance of roads in the States (to be considered below) and it provided a forum for the airing of the views of the State Premiers about ‘Uniform Taxation’ and the possibility of returning income taxing powers to the States.
Prior to the conference the Premier of Victoria (The Hon. H. E. Bolte) had made known his views about uniform income taxation. In a series of articles published in the Melbourne Herald he claimed

The same story is apparent in every financial deal between the Commonwealth and the States. Victorians pay more than they ever get back. Our yearly loss can vary between £30 and £60 millions. Think what we could do with that amount of money. We could build four times as many schools — or twice as many roads — or more hospitals in one year than we have in the past ten. Or, better still, we could reduce taxation.6

Mr Bolte also requested that the item ‘Uniform Taxation’ be added to the March conference agenda.

The Prime Minister in introducing the topic reminded the Premiers, ‘We have had discussion on this before and I think that some of us, including myself — perhaps all of us — recognize the validity of the principle that the government that spends money ought to raise it . . .’.7 He called upon the Premiers to give their views. Mr Bolte was in complete agreement with the Prime Minister’s suggestion that the Uniform Tax laws might be repealed. That, he said, ‘would do me’.8 South Australia’s Premier (Sir Thomas Playford) was guarded. He said, ‘I can express the view to-day that I would like to come back into the taxing field’.9 The Hon. G. F. R. Nicklin, the third non-Labor Premier, expressed a cautious attitude on behalf of Queensland: ‘Although we are prepared to accept our responsibilities as a sovereign State, if taxing powers are returned to the States without a compensation grant to Queensland, we shall be placed at very great disadvantage’.10

The three Labor Premiers at the conference were opposed to the complete return of income taxing powers. The leaders of two claimant States did not hide their satisfaction with the existing scheme of things — Tasmania’s Premier (The Hon. E. E. Reece) was forthright, ‘I say most clearly that Tasmania, without equivocation, favours a continuance of the present system’,11 and The Hon. A. G. Hawke (Western Australia) warned that, ‘We should be exceedingly careful about any step that would disturb the existing uniform tax system and which would place in the hands of the wealthier States a very great advantage which I suggest they do not need’.12 The Premier of New South Wales (the late Hon. J. J. Cahill) presented an interesting case for a limited withdrawal from the income tax field by the Commonwealth into which the States could enter. He explained, ‘We are conscious of the fact that New South Wales is the most populous State, Victoria is the next, very close behind, and we are very conscious of the fact that a good deal of taxation raised in those two
States is used to subsidize the services of the less populous States. But we are Australians and we cannot object to that, and we do not object'.

This disparity in attitudes rendered difficult any solution based on the Prime Minister’s principle that ‘the government that spends the money ought to raise it . . . ’ and in fact the conference adjourned with the question undecided.

A further conference of Commonwealth and State Ministers assembled in Canberra on 23 June 1959. The Acting Prime Minister (the Rt Hon. J. McEwen) explained to the Premiers that the discussions in March about the States resuming income taxation ‘did not appear to take us any nearer to such a solution and we have had to look in other directions for ways and means of improving the present arrangements . . . ’ He continued, ‘It did appear, regrettably from our point of view, that a satisfactory basis for State taxing of income was beyond attainment’. The conference, therefore, was called to seek ‘firm, effective and equitable arrangements and a real and lasting improvement in the general field of Commonwealth-State financial relations’.

Undoubtedly the arrangements for tax reimbursements then existing were in urgent need of improvement. The formula for their calculation was patently inadequate. For ten years the amounts had fallen short of the needs of the States and the Commonwealth had acknowledged this by supplementing the formula grant with ‘Special Financial Assistance’ grants. The size of the latter was largely arbitrary, the result of ‘annual wrangles’ at the conferences with the Premiers.

The stability of the financial relations had also been threatened by the actions of the governments of Victoria and Queensland in lodging applications to be considered by the Grants Commission as claimant States. Their acceptance would have meant that only one of the six States — New South Wales — could then have boasted non-claimant status. This prospect alarmed the Commonwealth government as well as the Premier of New South Wales. The latter stated: ‘The States know their own business best, but if a State like Victoria is to become a claimant State, we might as well get rid of State governments altogether and hand over the whole business to the Commonwealth’.

The Commonwealth government responded with a new financial assistance plan. This had a number of purposes. It was aimed to render redundant the applications for special grants made by Queensland and Victoria. It was also aimed ‘to eliminate South Australia’s need to seek special assistance as a claimant State’; and thirdly, to ‘reduce the claimancy needs of Western Australia and Tasmania to more marginal dimensions’. The Acting Prime Minister emphasised
that the Commonwealth government was guided in its new plan by the desire ‘that no more than two States, Western Australia and Tasmania, should be regular applicants for special grants’.19

The plan provided for an increased grant, the new base grant, for each State for 1959-60. The gross financial assistance grant for all States in 1959-60 was the total calculated from the old reimbursement formula together with additional amounts added by the Commonwealth government. This was allocated to the States on a newly-determined percentage basis.20 The plan provided that each year, each State’s base allocation would be varied in accordance with fluctuations in the average of wages paid in Australia (plus 10 per cent ‘betterment’ factor) and changes in each State’s population. The new plan was to operate for a period of at least six years (that is, at least till the end of the financial year 1964-65).

Here, then, was an important milestone in the history of Commonwealth-State financial relations. The new plan made it abundantly clear that a grant to a State had no relation to the volume of income tax collected in that State. The Treasurer (Rt Hon. Harold Holt), in introducing the legislation to enact the plan, explained: ‘As these grants can no longer be regarded as being in the nature of tax reimbursements or a form of compensation to the States for their vacation of the income tax field, it is proposed in future to refer to these payments as financial assistance grants rather than tax-reimbursement grants’.21 The words ‘tax reimbursement’ have since been dropped from all States grants legislation.

The Commonwealth government also asserted that the new plan provided for the grants to be allocated to the States in accordance with the ‘needs’ principle — the principle adopted by the Grants Commission for calculations in its now famous Third Report (1936). At the June conference the Acting Prime Minister explained this: ‘We adhere to the principle, which is a long-established one, that those States which operate under basic financial difficulties should be extended a helping hand in order that the standards of services available to all citizens, regardless of whether they live in one State or another, should not be far out of line’.22 This, of course, was an important modification of the Prime Minister’s principle that ‘the government that spends money should also raise it’. But it is important to note that it has clearly been adopted as the basic principle for the distribution of Commonwealth financial assistance to the States.

All States, therefore, particularly New South Wales and Victoria, are now co-operating in a large-scale plan for the redistribution of national finance — the wealthier States helping to finance the development of the poorer States — through Commonwealth taxation. And the administrative machinery of the Commonwealth government is
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effecting this. In 1959-60, for example, the £244.5m grant to the States for financial assistance, made in accordance with the plan, provided grants, per capita, which varied from £21.64 for Victoria to £35.55 for Western Australia.23

The Commonwealth Parliament in enacting the plan included in the statute a significant appropriation provision of the earlier ‘tax reimbursement’ legislation. Section 9 of the States Grants Act 1959, provides that the Consolidated Revenue Fund ‘is appropriated accordingly’. Each year, therefore, the sums calculated under the plan will be granted the States without further parliamentary consideration. As far as these grants are concerned, governments at both levels are able to plan ahead with certainty. By this method States enjoy many administrative advantages which would not be available to them under the traditional and widely-used system of strictly annual parliamentary appropriation.

The States also enjoy autonomy in spending the sums granted. There are no conditions prescribed in the States Grants Act relating to expenditure policies. But there is one ominous limitation on revenue raising. The Treasurer commented on it in his second-reading speech. ‘The new grant arrangements proposed in this Bill’, he said, ‘are based on the assumption that the States and their authorities will continue to meet payroll tax and that the distribution of taxing powers as between the Commonwealth and the States will remain unaltered. In the event of any change or proposed change in respect of such matters as these, having a major effect on the finances of the States, the arrangements would be reviewed by the Commonwealth’.24 This suggested, therefore, that although there are no expressed limitations on expenditure there is the prospect of limitation on the amount available should any State impose its own income tax or exploit a hitherto unexploited revenue field. This might even limit the response of any State to a High Court judgment indicating a specific field of revenue open to it.25

It is significant that the Commonwealth government, being possessed of the power to attach conditions to all its grants, has refrained from doing so in respect of the financial assistance grants — the largest of its subventions to the States. It may be asked: How long may the States expect to enjoy this autonomy? One would clearly need a sensitive political barometer to answer such a question accurately. But in the light of the Second Uniform Tax Case it would seem that the only restraints upon the Commonwealth government in tagging conditions to these grants are political restraints. Possibly, such a course would be contrary to the political philosophy of the party in power, or the government may fear repercussions from the political forces within the electorate. One thing, however, seems probable.
Now that the words ‘tax reimbursement’ have been removed from the grants legislation, future generations of Australians will hold generally different views of the financial *status quo* from the views held by adult generations in the immediate post-war years. The issue of the return of taxing powers to the States would seem to be destined to oblivion.

**The Commonwealth Grants Commission**

The new plan of financial relationships with the States brings the role of the Commonwealth Grants Commission under review. The acceptance of the new financial assistance plan was dependent upon assurances being given at the June conference by the representatives of the governments of Queensland and South Australia that, except in ‘special’, ‘unexpected’ or ‘exceptional’ circumstances, they would not make an application to the Grants Commission for special assistance. (Apparently it was assumed that there was no possibility of Victoria making a further application.) The assurances were given (after Sir Thomas Playford had used the occasion to have South Australia’s basic grant increased by £1m) and, as a result, the grants to the claimant States as recommended by the Commission have been reduced from £20.7m (three States) in 1958-59 to £8.3m (two States) in 1959-60 and £8.6m in 1960-61.

An obvious question is provoked by this new state of affairs. What is the role of the Grants Commission to-day? It would seem that the extent of its work is determined by the Commonwealth government’s policy on financial assistance grants. Obviously, it is within the competence of the Commonwealth government to adjust its allocations to grant the Commission out of a job.

The Grants Commission, since the new plan, has admitted that ‘... the term claimant State has now become anomalous’. It has pointed out that ‘all States receive large Commonwealth payments in aid of their general revenues’. Would it now be appropriate, therefore, for the Commonwealth Treasury, with extensive statistical resources at its disposal, to perform the functions of the Commission? The Premier of New South Wales (Mr Cahill) at the March conference suggested that there was little difference between a Grants Commission enquiry and a Treasury enquiry. He suggested that if a State becomes a claimant State, ‘In effect, what you do is ask Commonwealth public servants to come in and examine your whole budgetary position and the whole of your accounts ... You give the public servants of the Commonwealth the right to tell how much you will get, and how much you will not get’.

Is this really the case? The Grants Commission would hold that Mr Cahill was wrong. In its 1959 report it endeavoured to make its current
role clear. It said that the distinctive position of the claimant States arises from the grant of ‘additional amounts determined after public enquiry, conducted by a Commission of three independent part-time members, into their accounts and their standards of revenue and expenditure’. In justification of their continued existence, in the light of the reduction in the number of claimant States, the Commissioners pointed out that ‘the amount of necessary investigation work will remain much the same in each of these two States irrespective of the size of the grant, and the Commission will also need to maintain its continuous review of the budgets of the non-claimant States, particularly South Australia and Queensland’. 29

A study of the Commission’s Reports for 1959 and 1960 reveals the firm stand it has taken in opposition to proposals made by the Commonwealth Treasury that it should amend some of its procedures. This is a healthy attitude from the viewpoint of State interest. It is, of course, State interest that is the principal reason for the Commission’s continued existence. It affords each State a continuing safeguard against deprivation of finance, and hence development, through causes beyond the control of the government of that State. State governments would oppose strongly any suggestion for its abolition; the political interpretation of ‘State interest’ will keep the Commission a feature of the federal scene for some years yet.

Grants in Aid
The Commonwealth government has long used the technique of granting money to the States for specific purposes and under specific conditions. Its motives have been varied. Generally its grants have fostered State government activity in fields in which the Commonwealth’s own constitutional power has been deficient or non-existent. Approximately one-fifth of the total of the grants made to the States by the Commonwealth is tied to particular expenditure projects. This proportion has changed very little during the five years under review. There have, however, been important changes in the size and the conditions imposed in the case of some grants. The grants made for expenditure on roads and on universities warrant particular attention.

The Commonwealth’s grant for roads is, by far, the largest of its tied grants to the States. The Premiers’ Conference in March 1959, in addition to its consideration of uniform taxation, adopted a new five-year plan for Commonwealth assistance to the States for the construction and maintenance of roads. The Commonwealth Parliament enacted the plan to take effect from 1 July 1959. 30

The plan provides for the States to receive five annual grants totalling up to £250m. There are conditions which provide that £30m of this sum will be dependent upon the States expending the same
amount from their own funds on roads; and that 40 per cent of the total must be spent on rural roads. For the grants, the Consolidated Revenue Fund has been ‘appropriated accordingly’. This is to say that no further grant by the Parliament is required within the life of the plan.

The roads grants to the States, like the main financial assistance grants are not deemed to be reimbursement of revenue. They are not related to the Commonwealth’s collections of taxes from petrol and other motor fuels. The Treasurer asserted that ‘no Commonwealth Government has ever accepted that claim’. The new plan provided for the distribution to the States of the Commonwealth’s annual grant on the basis of 5 per cent for Tasmania and the remainder to the other States, one third according to area, one third according to population and one third according to motor vehicles registered. The Treasurer pointed out that this new formula was based on a re-assessment of States’ needs. Under it the States received grants for 1959-60 ranging from £3 per capita in the case of Victoria to £10.6 per capita for Western Australia.

Commonwealth grants for universities, on the other hand, have received widespread publicity. The establishment by the Prime Minister in December 1956 of a ‘Committee on Australian Universities’ to enquire inter alia into ‘the financial needs of universities and appropriate means of providing for these needs’ was an important development. The Committee made an extensive enquiry, and its Report, dated September 1957, is a foundation document for Australia’s new universities expansion. The Committee claimed that there was an ‘irrefutable need for the development of a national policy for the Australian universities.’ It suggested ‘If the States’ financial resources have not enabled them to meet the universities’ needs up to the present, they will certainly be inadequate to put things right and get ready in time for the inevitable expansion that lies ahead’, and ‘that the day is past when planning of university development can be left entirely to individual institutions or confined within the boundaries of one State’. The Committee recommended the establishment of an Australian University Grants Committee similar to the committee established in the United Kingdom. It also made important recommendations on ‘The Immediate Financial Needs of the Universities’ and, in response, the Commonwealth Parliament enacted grants to the States ‘to remedy the urgent deficiencies of universities’ for the years 1958, 1959 and 1960.

In April 1959 the government introduced legislation for the establishment of the Australian Universities Commission. (The Prime Minister had specifically rejected the proposal to call the body a ‘Universities Grants Committee’. In his opinion ‘far more than money
is at stake." Section 3 of the *Australian Universities Commission Act* 1959 empowers the new Commission 'to furnish information and advice to the Minister on matters in connection with the grant by the Commonwealth of financial assistance to the States in relation to universities'.

The Commission presented its first report to the Prime Minister in October 1960. This made a comprehensive review of the development of Australian universities and it recommended grants to meet the 'financial needs' of State universities for the period 1961-63. In response the *States Grants (Universities) Act* 1960 was passed. It provides that the maximum Commonwealth contribution of £40.8m in the three years will be dependent upon the several State governments providing funds totalling £62.4m. And, like the grants for general financial assistance to the States and the grants for roads, it provides for an appropriation of revenue for the complete term of the grants plan. State governments and State universities, therefore, may plan university development with a definite knowledge of the amounts of Commonwealth assistance available to them up to the end of 1963.

*Trends and Problems*

In the grants we have examined, the Commonwealth government has adopted 'needs' as the criterion of its calculations and it has made it clear that its general objective is to ensure that 'the standards of services' in all States 'should not be far out of line'. But what are 'needs' and how are they calculated? In Commonwealth-State financial relations this word has been given more use than thought. For the two largest grants to the States — the financial assistance and the road grants — which together in 1960-61 totalled 87 per cent of all the Commonwealth's revenue payments to the States, States' 'needs' have been determined largely at the level of political conferences. Annual adjustments are made in accordance with accepted formulae but the only variables acknowledged in them are changes in population and wages in the financial assistance grant, and in population and motor vehicles in the roads grant. In this way many determinants of 'needs' would, in each case, seem to be excluded. Indeed short-comings in the formulae have been admitted publicly — the Commonwealth Treasurer has stated that the financial assistance formula 'in some respects' produces only 'a rough form of justice' and the present Chairman of the Public Accounts Committee has stated that the roads grant formula 'fell a long way short of perfection'.

It is paradoxical that for the grants for State universities and the grants for the claimant States, which together in 1960-61 totalled only 5 per cent of the total of the Commonwealth's grants to the States,
more precise methods for the assessment of 'needs' are used. Both of these grants are made on the recommendations of statutory Commissions, submitted to the Commonwealth government after extensive and systematic enquiries. The reports of both Commissions bear witness to the extent of their enquiries. It would seem that it is only in this method of assessment that there is any cause for satisfaction.

On the face of it, there is obvious scope for the extension of the fields of interest of organs of enquiry and advice for the assessment of States' 'needs'. Some people, however, would hold that this is politically impracticable. They would claim that no State government would submit itself to wider enquiries by Commonwealth bodies; that no State government would surrender its autonomy to that extent. This may be true while there is general satisfaction with the Commonwealth's monetary expression of 'needs'. But when this is disputed, the extension of the Commission technique would seem to be an obvious solution to problems of Commonwealth-State financial relations.

Common to all the grants mentioned above is a similarity in the appropriation provisions. The Commonwealth Parliament has departed from the traditional method of strictly annual appropriation in favour of grants for longer terms. We have seen how it has enacted a plan for at least six years for the main financial assistance grants, a five year plan for roads grants and a three year plan for universities grants. These have effected a substantial clarification of the financial relations between the Commonwealth and the States. Grants for long terms have other advantages. Above all they permit longer-range planning within the administrations concerned, and this is a considerable advance within a financial-administrative system which has been geared rather rigidly to a system of annual parliamentary appropriation. Gunnar Myrdal pointed out in a recent economic survey that 'The development towards economic planning, in all Western countries, has had its course demarcated by . . . intermittent attempts to bring more order and rationality to those measures of intervention which have already grown up in a particular field'. This has been Australia's achievement in Commonwealth-State financial relations in the last five years.

Attempts to provide services 'not far out of line' can be seen in spheres other than those related to the redistribution of finance. There is widespread support for national similarity or even uniformity in many social matters in Australia, and since 1957 action has been taken on both the federal and State levels.

Since 1957 we have seen the Commonwealth government use its constitutional powers to secure the enactment by Parliament of a uniform divorce law as well as a uniform marriage law — these would
be important achievements in any nation. At the present time negotiations are afoot between Commonwealth and State governments to secure a uniform company law. And on September 11th last the Commonwealth’s Attorney-General (Sir Garfield Barwick) was reported to have said in Sydney that ‘the Federal Government was progressing with legislation for uniform social welfare laws’ and that ‘the pooling of State and Federal resources ensured that they would be the best laws’. 47

At the same time State governments have been working for similar ends. They seek to have the problems of secondary education examined on a national scale. The Australian Education Council, comprised of the Ministers of Education from the six States, presented its findings to the conference of Commonwealth and State Ministers in Canberra, in June, 1961. 48 Inter alia the Council stated that ‘the size of the task’ and ‘the extent to which the efficiency of education has implications for so many aspects of the life of the nation as a whole’ make it ‘a national problem’. The statement was ‘taken into consideration’ by the Commonwealth government.

The quest for nation-wide standards of public service, therefore, motivates many of the relationships between Commonwealth and State governments in Australia today. Our interest is in the contribution that public administrators can make, and have made, to this political goal.

Commonwealth-State Administrative Relations

The attempts to provide public services at similar standards, and the political attitudes prompting them, obviously have a profound significance in administration. There is nothing new in the political aspiration but it is only in recent years that administrators have begun to show that they can contribute on a national scale to its realisation.

There are two important features of this growing contribution to be noted here. In the political-financial field discussed above, the equation of ‘standards of service’, as attempted through fiscal grants, is simply one between the six States of the Commonwealth. But in the purely administrative field, to be discussed below, in the development towards a similarity of administrative standards, the standard of efficiency of a seventh unit, the Commonwealth government’s administrative service, is increasingly influential.

The second feature to note is that the trend towards a nation-wide standard of administrative efficiency is not the result of overt acts; it is not the result of recommendations of commissions of enquiry or the calculations of quantitative formulae designed to achieve common standards. In this respect the politicians are ahead of the administrators. The development, yet in the primary stage, would appear to
be the result of an unpremeditated drift towards a position of equality. It has emerged as the consequence of the empirical solution of a multiplicity of organizational problems. There have been valuable conferences of many kinds to consider common problems; one notable example is the biennial conference of Public Service Chairmen and Commissioners, and there is a growing volume of communication between the several services. But, I submit, *laissez faire* prevails. Whether it will prevail in the future is a matter of high importance to public administrators, no less than it is to the recipients of the service they provide — the Australian people.

Before considering some of the details of this 'drift' we should first establish the role of State governments in the current political scene. It is within the framework of State units of governments that most public employees in Australia are at work. Their contribution in administration, therefore, has wide importance.

In spite of the Commonwealth government's ascendancy in matters of public finance, State governments, at the present time, still enjoy a large degree of autonomy in policy making; this means they enjoy a large degree of freedom in determining their own organizational framework. Indeed, they have a greater freedom than is popularly imagined. Professor (now Sir Kenneth) Bailey's prophecy of 1944 has not yet been fulfilled. He suggested that '... the logic of the Uniform Tax plan is that the States should eventually move, with a simplified political structure, into the position primarily of administrative agencies, the main lines of policy in all major matters being nationally determined'. An analysis of State Consolidated Revenue Funds indicates that the States are, as yet, a long way removed from 'agency' status.

...[In] 1959-60 the States relied upon the Commonwealth Government for 56.7 per cent of their consolidated revenue. For the States, this was a substantial degree of dependence upon an external authority. Without a formal constitutional right to this revenue the financial and political sovereignty of the States is undoubtedly jeopardized. But to assess the restrictions currently imposed by the Commonwealth upon the autonomy of the States in policy making, through financial grants, we have to look to that part of the revenue of State governments which is tied by conditions associated with grants, to specific expenditure projects. Excluding from States' revenue the receipts from business undertakings, tied grants to the States were in 1959-60 only 15 per cent of total States' revenues. The States, therefore, were, generally speaking, free to expend about 85 per cent of their total revenues in accordance with their own policies. It ought also to be appreciated that the expenditure of business undertakings takes place in accordance with policies made in the States. If
these are included in the comparison, the autonomy of the States in shaping their expenditure policies expands (for 1959-60) to more than 90 per cent of their total revenue expenditure.

Bearing this in mind and considering the range of the responsibilities borne by State governments and their administrators to-day — responsibilities, for example, for administration in education, public health, prisons, regulation of industry, conservation and development, agriculture, law and order, social welfare, aborigines, town planning, harbours’ control and transport, the importance of State administrative services is evident. I support Professor Miller’s thesis that while we must recognize the increase in the importance of Commonwealth administrative functions in recent years, we should be wrong to imagine that this has been achieved at the expense of the importance of State functions. State administrative services remain vital to the welfare of Australian citizens. They are deserving of due emphasis in the study of public administration.

Clearly, a Commonwealth official has opportunities to influence and to administer policy decisions of national significance, but his efforts to secure national progress and development will be impeded unless complementary governmental services within State regions are provided with similar efficiency. Might not the trade policy of the Commonwealth government be undermined by inefficient transport and harbour services in the States? Might not the national policies of the Department of Primary Industry and the Department of National Development be less effective if accompanied by inefficiency in State Agriculture, Conservation and Mines Departments? Examples of administrative interdependence are legion. Indeed, growing interdependence of this kind has accelerated the establishment of organs of Commonwealth and State co-operation in recent years. To the great credit of public administrators in Australia formal and informal co-operation takes place at almost every point of common interest.

**Administrative Co-operation**

Administrators do not co-operate successfully for long if they perform at markedly different degrees of efficiency. I would suggest that, with a continued increasing trend in Commonwealth-State and inter-State administrative co-operation, we shall get a growing similarity in the techniques and the tempo of public administration. Moreover, organs of co-operation are breeding grounds for ideas and it is to be expected that the more efficient public services will have the most infectious ideas. I suggest that administrative co-operation, if fostered, will spur on the less efficient public services to approximate the more efficient in techniques of organization and method . . .
Publications
The growing volume of published information on Australian public administration is also creating an understanding and a common interest between administrators within the several Australian governments. A great deal has been achieved in the five years under review. It is to be hoped that the rate of publication will increase... The Public Service's reputation as a profession will in many ways depend upon an expanding volume of published material on its functioning at every level. Jeremy Bentham once pointed out, '... of two governments, one of which should be conducted secretly and the other openly, the latter would possess a strength, a hardihood, and a reputation which would render it superior to all the dissimulations of the other'.

Representative government knows many dissimulations. To counteract these, objective enquiry and publication are needed and the responsibility falls on the practitioner as well as the academic student. There are large gaps in our knowledge of Australian public administration yet to be filled, especially our knowledge about administration in the States.

Arbitration
It is widely recognized that industrial arbitration in Australia, at the federal level, has for long promoted a similarity in industrial conditions. This has had, and is having, its effect upon conditions of employment within units of public administration. Possibly the most noticeable example, over the last five years, is to be found in the award of the Commonwealth Conciliation and Arbitration Commission known as the Engineers Award [1961], and in its implications... A conference of Commonwealth and State Public Service Chairmen and Commissioners has considered the problems involved. It would appear that in the short term there will be a growing uniformity in the salaries and conditions of employment within each of the professional groups in the several Public Services in Australia. And, in the longer term, this will have an influence upon the non-professional classifications when industrial tribunals look above, below and inter-State seeking 'fair comparisons' for the arbitral process.

A survey of the reports of the wage-fixing tribunals in the States, especially in the less-populous States, will indicate the wide degree of inter-service emulation embodied in the salary and wage claims submitted for arbitration...

All of this will have its effect upon the attitudes of employees in the several State services in their contributions, individually and collectively, in Australian public administration. The growing trend towards uniformity in conditions of employment ought to encourage...
the notion of a 'national' administrative purpose. At least it will weaken the strength of State boundaries as mental restraints upon the consideration of public administration in a national framework.

Training
It is probably in the sphere of training that most is being done, and will be done, towards increasing efficiency and the organizational similarity in public administration in Australia. The expansion of public service training facilities in post-war years has been marked, and it is yet unfinished. A recent question on notice in the House of Representatives sought details of the Commonwealth government's interest in the provision of educational facilities. The answer brought to light the most comprehensive documentation we have on this subject.53 If we exclude the details concerning the provisions made for formal education in the Commonwealth's several Territories, the Commonwealth Office of Education and the medical research facilities of the Department of Health, the balance of the Commonwealth's educational interests would appear to be in the field of Public Service training . . .

There is also an expansion of training within State administrations. Over the last five years the reports of the several Boards and Commissioners have paid increasing attention to its development. But no State provides a range of training to match the Commonwealth's. The State services, having Education Departments of their own, have, to a large degree used existing educational facilities. The School of Management, Department of Technical Education, New South Wales, the Royal Melbourne Technical College and the South Australian Institute of Technology are, for example, used widely . . .

From all this there will inevitably accrue a comparison of ideas, and there should emerge an increasing understanding of the administrative problems of the several services. This, in turn, will have a common influence on the organizational arrangements and the standards of service provided by all Australian governments . . .

It is evident, in view of the influence that training will have on the character of Australian public services, that the content of in-service training courses is of considerable administrative importance. The time has probably come when introspection is necessary. It might be asked whether trainees are being indoctrinated with existing service values only, or whether they are encouraged to question the assumptions of departmental organization, and to contribute new ideas?

University Studies
The final administrative trend I wish to mention is in the increasing attention being paid by all public services in Australia to education at
the university level. The reports of the Boards and Commissioners over the last five years disclose a growing interest in the participation of public servants in university studies. In the field of administration this would appear, at the present time, to be the chosen alternative to the adoption of policies designed to attract graduate recruits.

Public services are using a number of incentives to interest their employees in university studies. Cadetships and studentships are long established incentives to scientific, technical-type training. In recent years there has been a widening use of free place schemes, scholarships and fellowships, time off, living allowances and qualification allowances, to foster full-time and part-time studies. No personnel authority, however, has yet published a comprehensive review of the contributions it is making in the field. But the larger authorities (the Commonwealth, New South Wales and Victoria) are beginning to disclose greater detail... So far similarity is lacking, but it is on the way.

Administrative Trends and Problems

Many factors, therefore, are contributing to the increasing similarity in the standards of efficiency of Australian public administration. But the trend is in its primary stage. There still exists a wide area of discretion in policy making in the several State governments, and, in consequence, there is still the likelihood of the prescription of diverse administrative arrangements from State to State. Consider, for example, the variety of arrangements for the recruitment of administrative personnel in the several States, or the inadequate and dispersed city-office facilities mentioned in the reports of some Public Service Boards or Commissioners. Administrative arrangements, of course, are the product of their environment and will be peculiar to time and place. Nonetheless, the Commonwealth government has declared that the aim of its grants to the States is to provide "that the standards of service available to all citizens, regardless of whether they live in one State or another, should not be far out of line." There is, therefore, a political obligation upon individual State governments to meet this prescription, and, in doing so, to condition their administrative machinery accordingly.

But if the attainment of national standards in the provision of public services is a political condition for the receipt by the States of financial grants, then a failure by any State government to meet that condition is also a matter of politics. Any sanction for failure will be determined and imposed at the political level. It could be asserted, therefore, that the attainment of the prescribed standards is not a matter of administration; that the role of the public administrator is
merely to administer services at standards that are politically determined. That is to say, his role is the application, not the creation of policy. Is this the case? In reality, the situation is different. The administrator is influential in policy making; he can, and he does influence the political determination of standards in the provision of services; he gets opportunities to pursue the equalitarian thesis. But his influence upon policy-making varies in time, person and place. It is as fickle as the personal and political influences about him. In this respect, the administrator’s contribution is unpredictable.

The political goal of providing public services at equal standards has a wider significance for public administrators. The plans to achieve the goal will fail unless they are nurtured by administrative organizations of similar efficiency. The political goal, therefore, provides public administrators with a concept of administrative provision which has nation-wide professional significance. As such, it is suggestive of three responsibilities:—

First, it suggests that public administrators in Australia have national professional administrative standards to aspire to; their abilities to reach them, or their shortcomings, individually and collectively, influence a national professional reputation.

Secondly, it suggests that there is a need amongst public administrators in Australia to focus their interests upon administrative behaviour as a subject of academic enquiry. It is only in this way that necessarily subjective definitions of key-words in administration such as ‘efficiency’ and ‘standards’ will approach consistency.

And finally, it suggests that the Institute of Public Administration in Australia . . . has a role of high national importance to fill should it foster the attainment, and the advancement, of nation-wide standards of efficiency in public administration.

Notes


6 Melbourne Herald, 3 December, 1957, ‘Victoria always loses’.
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8 Ibid. p. 29.

9 Ibid. p. 25.

10 Ibid. p. 34.

11 Ibid. p. 38.

12 Ibid. p. 36-7.

13 Ibid. p. 32.


15 Ibid. p. 10.

16 Commonwealth Parliamentary Debates (C.P.D.), House of Representatives, 22 October, 1959, p. 2199.

17 March Conference, p. 31.

18 June Conference, p. 6.

19 C.P.D., House of Representatives, 22 October, 1959, p. 2200.

20 June Conference Report shows the percentage distribution as New South Wales 34.0, Victoria 25.0, Queensland 15.0, South Australia 11.0, Western Australia 10.5 and Tasmania 4.5.


22 June Conference, p. 6.


24 C.P.D., House of Representatives, 22 October, 1959, p. 2202. And see States Grants Act 1959, Section 7(2).

25 For example, the suggestion in Dennis Hotels Pty. Ltd. v. Victoria (1959-60) 33 A.L.J.R. 470 where the minority of the Court showed ‘a willingness . . . to retrace the path trodden in earlier decisions, which had suggested inter alia, that States could not impose sales tax.’ See ‘Judicial Decisions affecting Public Administration, 1958-1960’. Public Administration (Sydney), Vol. XIX, No. 3 (September, 1960), p. 230.


27 Ibid. p. 23.

28 March Conference, p. 31.
Fiscal Federalism


31 C.P.D., H.R., 28 April, 1959, p. 1623.

32 Ibid. p. 1626.

33 Ibid. p. 1625.

34 Ibid.


36 Ibid. p. 98.

37 Ibid.

38 Ibid.

39 Ibid. Chapter IX.

40 States Grants (Universities) Act 1958.

41 C.P.D., H.R., 21 April, 1959, p. 1371.


43 Act No. 106 of 1960.

44 June Conference, p. 11.

45 C.P.D., House of Representatives, 29 April, 1959, p. 1648.


47 Sydney Morning Herald, 12 September, 1961.

48 Conference of Commonwealth and State Ministers, Canberra, 15th June, 1961, p. 6.

49 At June, 1961, the number of Commonwealth government employees totalled 225.9 thousand and State government 497.5 thousand (including in each case employees of governmental instrumentalities). Local government employees totalled 84.1 thousand.

50 [See Reading XXIII above.]


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53  C.P.D., House of Representatives, 11 April, 1961, pp. 682-698.

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