Studies In Comparative Federalism: AUSTRALIA
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In the *State and Local Fiscal Assistance Amendments of 1976* (P.L. 488), Congress asked the Advisory Commission on Intergovernmental Relations to study and evaluate "the allocation and coordination of taxing and spending authority between levels of government, including a comparison of other federal government systems." The objective of this research is to determine how federal systems in other industrialized nations have dealt with some of the issues of fiscal federalism that are of current concern in the United States.

To carry out this assignment, four reports have been prepared: individual studies of Canada and West Germany, this selection of readings on the federal system of Australia, and a comparative analysis of the United States and the other three countries. The Commission chose to describe the Australian system of fiscal federalism by a series of readings because of the availability of a rich array of studies prepared in Australia under the aegis of Russell Mathews, the Director of the Australian National University's Centre for Research on Federal Financial Relations. The selection of readings covers the institutions and practices which are unique to Australia, as well as those which it shares with other federal systems. These readings pay particular attention to the ways in which Australia has coped with the fiscal imbalance between and, to a lesser extent, among governmental levels. While the powers assigned to the national government are quite limited, its fiscal resources considerably exceed those at the state-local level. As a result, the Australian federal system makes extensive use of equalizing grants from the federal to state governments. In addition, Australia relies upon an institution that is unique among the federal systems studied—the Australian Loan Council—which controls the borrowing of the entire public sector except for national defense and temporary needs.

Abraham D. Beame
Chairman
The Advisory Commission on Intergovernmental Relations (ACIR) wishes to thank the Centre for Research on Federal Financial Relations of the Australian National University, Publius, The Journal of Federalism of Temple University, and the Honorable Mr. Justice Else-Mitchell, C. M. G., for permission to reprint the articles which appear in this series of readings.

Russell Mathews, Director of the Centre for Research on Federal Financial Relations, assisted in the selection of the articles and also adapted the articles which he had written for presentation in this volume. At ACIR, the studies were edited by Susannah E. Calkins and L. Richard Gabler. Secretarial tasks were shared by Ruth Phillips and Shari Quick.

Wayne F. Anderson
Executive Director

John Shannon
Assistant Director for Taxation and Finance
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by The Hon. Mr. Justice Else-Mitchell, C.M.G., Chairman, Commonwealth Grants Commission of Australia

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by C.P. Harris, James Cook University of North Queensland

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10 Receipts and Financing Items, 1975–76 45
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Area: 2,967,741 Sq. Mi.
Regional Disparities in Australia

Russell Mathews

Centre for Research on Federal Financial Relations
The Australian National University

The island continent of Australia is about the same size as Europe (excluding Russia) and the U.S.A. (excluding Alaska and Hawaii), but it is inhabited by only 14 million people. It is a country of great climatic and physical diversity, ranging from the tropical and monsoonal north to temperate and Mediterranean climatic zones in the south; from great inland deserts to the small alpine region and the densely forested mountains of the southeast; and from the high rainfall areas of the northeast and the island State of Tasmania to the vast areas in which rain seldom falls. It is a land almost continuously subject to natural disasters—droughts, cyclones, floods, bushfires and even earthquakes—but it also has great mineral, pastoral and agricultural wealth. Distance is a factor which has great social and economic significance for all Australians, not only because of the problems it creates for internal transport and communications but also because of its effect in isolating Australia from the rest of the world.

Despite its small population, Australia is one of the most highly urbanised countries in the world with nearly six million people living in the two cities of Sydney and Melbourne and

some three million in seven other major urban centres.

Since World War II the predominantly Anglo-Saxon racial stock and the small Aboriginal population have been leavened by a great influx of immigrants from Europe, Asia and, to a lesser extent, South America. Of every five residents, one was born overseas (including the United Kingdom) and another has at least one parent who was born overseas.

The change to a multiracial society has been achieved with relatively little social or economic disturbance and has been accompanied by a major switch in Australia's economic relationships. The United Kingdom and Europe have been replaced by Japan, the U.S.A. and other Pacific and Asian countries as Australia's main trading partners.

**Regional Disparities in Australia**

As a federal parliamentary democracy, Australia is governed by a federal government with its seat in the only inland city of any size—Canberra—and by six autonomous state governments. The sparsely populated Northern Territory has also recently achieved self-government, but the Australian Capital Territory continues to be administered by the federal government. The state governments all have highly centralised administrations based on the capital cities; for all practical purposes regions in Australia may be regarded as synonymous with states or territories.

Local government is weak and, although regional movements exist in one or two of the major river valleys, such regional bodies as do exist are usually state agencies established to implement land-use planning legislation, provide water, sewerage and electricity services on a coordinated basis and, in some cases, administer social services. A recent attempt by a Federal Labor government to develop a framework of regional administrative and community services throughout Australia failed, largely because of opposition from the states.

Regional disparities in the Australian context are thus essentially disparities among the states. The great differences between the rural and the urban economies have not usually been reflected in great disparities in incomes and wealth between these areas, although the export-oriented rural industries have naturally been more susceptible to economic fluctuations than the heavily protected manufacturing industries and the service industries based in the cities. Rough balance between rural and urban interests tends to be achieved by the nature of the Australian political grouping, which is reflected in a division between the Australian Labor Party (a moderate socialist party which relies heavily on the support of the trade union movement) and two conservative parties—the Liberal Party and the rural-based National Country Party—which usually govern in coalition.

The principal disparities among the states have been caused only partly by differences in the pattern of economic activity or in the degree of economic development. By comparison with most other countries, living standards are high in all states and there have been no persistent economically depressed areas in Australia. Although income levels in the more populous and industrialised states of New South Wales and Victoria are somewhat higher than in the other four states, it will be seen from Table 1 that differences in per capita incomes and consumption expenditures among the states are small relative to regional differences in most other countries.

Even differences in the pattern of economic activity should not be exaggerated. Not only are New South Wales and Victoria important primary producing states, but with the exception of Western Australia (which has the highest value of production per head in cereal grains, wool, sheep and fishing) the less populous states all have at least one manufacturing industry in which they record the highest production per head of population of any state. Thus Queensland leads in food, beverages and tobacco; South Australia in transport equipment (motor cars); and Tasmania in paper and paper products.

All states and the Northern Territory have very large mineral and energy resources: petroleum or natural gas in Victoria, South Australia and Western Australia; coal in New South Wales, Queensland and Victoria; hydro power in Tasmania; and uranium in Queensland and the Northern Territory; lead, zinc and copper in New South Wales and Queensland; iron ore in South Australia and Western Australia;
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<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>Six States</th>
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<tr>
<td>Population As of 30 June 1977</td>
<td>36.0</td>
<td>27.5</td>
<td>15.5</td>
<td>9.3</td>
<td>8.7</td>
<td>3.0</td>
<td>100</td>
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<tr>
<td>Average Annual Increase(^a)</td>
<td>73.1</td>
<td>80.9</td>
<td>184.4</td>
<td>88.7</td>
<td>160.3</td>
<td>55.3</td>
<td>100.0</td>
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<td>Density</td>
<td>284.8</td>
<td>765.9</td>
<td>57.1</td>
<td>59.9</td>
<td>21.7</td>
<td>279.3</td>
<td>100</td>
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<td>Urbanization (major centres)</td>
<td>105.3</td>
<td>110.5</td>
<td>75.0</td>
<td>106.8</td>
<td>99.1</td>
<td>50.7</td>
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<tr>
<td>Age 5–18</td>
<td>95.4</td>
<td>101.2</td>
<td>102.3</td>
<td>100.6</td>
<td>103.6</td>
<td>107.7</td>
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<td>Age 65 and over</td>
<td>101.2</td>
<td>98.4</td>
<td>105.4</td>
<td>101.5</td>
<td>87.9</td>
<td>96.5</td>
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<td>Labour Force</td>
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<tr>
<td>As percentage of population</td>
<td>99.2</td>
<td>101.5</td>
<td>96.7</td>
<td>102.0</td>
<td>103.4</td>
<td>97.4</td>
<td>100</td>
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<tr>
<td>State government employees as percentage of labour force</td>
<td>91.2</td>
<td>93.2</td>
<td>103.0</td>
<td>120.9</td>
<td>120.6</td>
<td>129.2</td>
<td>100</td>
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<tr>
<td>Value of Production Per Capita(^b)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Primary industries (excluding mining)</td>
<td>81.3</td>
<td>76.9</td>
<td>135.2</td>
<td>125.3</td>
<td>180.5</td>
<td>109.4</td>
<td>100</td>
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<td>Mining</td>
<td>69.6</td>
<td>51.2</td>
<td>176.0</td>
<td>37.1</td>
<td>302.0</td>
<td>132.4</td>
<td>100</td>
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<tr>
<td>Manufacturing</td>
<td>108.3</td>
<td>126.7</td>
<td>67.9</td>
<td>94.8</td>
<td>62.4</td>
<td>90.3</td>
<td>100</td>
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<td>Income and Expenditure</td>
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<tr>
<td>Personal income per capita</td>
<td>102.5</td>
<td>104.5</td>
<td>91.4</td>
<td>97.3</td>
<td>95.4</td>
<td>94.0</td>
<td>100</td>
</tr>
<tr>
<td>Average weekly earnings per employed male</td>
<td>101.3</td>
<td>100.2</td>
<td>96.7</td>
<td>94.1</td>
<td>100.0</td>
<td>95.0</td>
<td>100</td>
</tr>
<tr>
<td>Cash social service benefits as percentage of personal income</td>
<td>103.5</td>
<td>91.4</td>
<td>110.6</td>
<td>97.2</td>
<td>95.4</td>
<td>110.8</td>
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<tr>
<td>Consumption expenditure per capita</td>
<td>104.3</td>
<td>102.5</td>
<td>90.7</td>
<td>95.1</td>
<td>98.2</td>
<td>92.8</td>
<td>100</td>
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<tr>
<td>Social Services</td>
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<tr>
<td>Government school enrollments as percentage of state population</td>
<td>97.0</td>
<td>98.8</td>
<td>95.8</td>
<td>108.9</td>
<td>105.4</td>
<td>117.3</td>
<td>100</td>
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<tr>
<td>Public hospital beds per 1000 of population</td>
<td>103.7</td>
<td>84.5</td>
<td>111.3</td>
<td>91.1</td>
<td>116.2</td>
<td>123.9</td>
<td>100</td>
</tr>
<tr>
<td>Indexes of State Development(^c)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage and salary earners in civilian employment</td>
<td>94.6</td>
<td>97.7</td>
<td>106.9</td>
<td>103.1</td>
<td>126.9</td>
<td>97.7</td>
<td>100</td>
</tr>
<tr>
<td>Area used for crops</td>
<td>105.7</td>
<td>68.9</td>
<td>118.9</td>
<td>83.0</td>
<td>124.5</td>
<td>38.7</td>
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<tr>
<td>Area used for pasture</td>
<td>89.0</td>
<td>72.6</td>
<td>171.9</td>
<td>101.4</td>
<td>125.3</td>
<td>97.3</td>
<td>100</td>
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<td>Value of mineral production</td>
<td>51.9</td>
<td>161.9</td>
<td>133.7</td>
<td>45.5</td>
<td>266.5</td>
<td>70.6</td>
<td>100</td>
</tr>
<tr>
<td>Manufacturing employment</td>
<td>95.7</td>
<td>100.0</td>
<td>106.3</td>
<td>101.1</td>
<td>121.1</td>
<td>95.8</td>
<td>100</td>
</tr>
<tr>
<td>Electricity generated</td>
<td>92.6</td>
<td>97.5</td>
<td>127.5</td>
<td>102.9</td>
<td>153.9</td>
<td>83.8</td>
<td>100</td>
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<tr>
<td>Dwellings completed</td>
<td>80.3</td>
<td>96.9</td>
<td>137.8</td>
<td>91.3</td>
<td>148.8</td>
<td>111.8</td>
<td>100</td>
</tr>
<tr>
<td>Railway freight traffic</td>
<td>71.7</td>
<td>53.0</td>
<td>206.6</td>
<td>77.1</td>
<td>187.3</td>
<td>88.0</td>
<td>100</td>
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</table>

Notes:  
(a) Five years ended June 30, 1976.  
(b) Average for three years ended June 30, 1977.  
(c) Three years ended 1976–77, as percentage of three years ended 1965–66, relative to six-state average.  

bauxite in Queensland, Western Australia and the Northern Territory; and other metallic minerals in all states. It is nevertheless true that the mineral and energy resources of Queensland and Western Australia are so large by world standards as to raise the present rates of population and economic growth of those states above those of the other four states.

While regional differences in the pattern and growth of economic activity have been relatively small by the standard of other countries, numerous factors have contributed to significant differences among the states in their capacity to provide comparable government services without imposing differential taxes or charges on their citizens. These include differences in the capacity of states to raise taxation and natural resource revenues, differences in population size, age structure and the dispersion or density of population, and differences in the physical and economic environment.

FOOTNOTE

The development of intergovernmental financial relations in Australia may be evaluated by reference to the concepts of vertical and horizontal fiscal balance. Vertical fiscal balance is defined as a situation in which each level of government commands the financial resources necessary for it to discharge its expenditure responsibilities and be held responsible for both spending and taxing decisions. Horizontal fiscal balance is defined as a situation in which each unit within a particular level of government (e.g., each state) has the capacity to provide services at a standard comparable to that of other units provided that it imposes taxes and charges at a comparable standard.

Constitutional Background

The Australian Constitution which came into effect on 1 January 1901, made provisions for three kinds of fiscal transfers from the Commonwealth (federal) government to the states. The first of these involved a pure tax sharing arrangement, whereby the federal government
was required to transfer to each state at least three-quarters of the net customs and excise revenues derived from consumption in that state for a minimum period of ten years after federation. Secondly, after a transition period the federal government was required to transfer all its so-called surplus revenue to the states on such basis as its parliament deemed fair. Thirdly, the federal government was empowered to grant financial assistance to any state on such terms and conditions as its parliament thought fit.

Under the Constitution, the federal government was also empowered to impose all forms of taxation "but so as not to discriminate between states or parts of states." The states were given concurrent powers with respect to taxation, except for being excluded from customs and excise duties. This exclusion was to have great importance in later years, when the High Court ruled in a series of confused judgments that virtually all forms of sales or other indirect taxes on goods were excise duties and were thereby not available to the states.

On the expenditure side, the Constitution gave the federal government responsibility for defence, external affairs, international and interstate trade and commerce, maritime activities, citizenship and matrimonial matters, postal and telecommunication services, and various other matters extending beyond the limits of individual states. At the time of the drafting of the Constitution, the stabilisation and distribution functions of government were not highly developed, but provision was expressly made for federal control over currency and banking and for federal powers with respect to the payment of invalid and old-age pensions. (In one of the few important constitutional amendments in 1946, the latter power was extended to cover virtually all forms of cash social welfare payments to individuals or families.)

The states retained responsibility for the provision of education, health and most other social services, the control of local government and the provision of most forms of community and economic services. The allocation function, that is to say, remained essentially a state responsibility.

The federal and state governments were given concurrent powers with respect to borrowing and the public debt, but another major constitutional amendment in 1928 validated the so-called Financial Agreement made in the previous year, whereby both the federal government and the states agreed to hand over responsibility for all borrowing arrangements (other than federal borrowing for defence purposes) to the Australian Loan Council. This was an intergovernmental body in which the federal government was given two votes and a casting vote and each state one vote.

Decisions relating to the size of the loan program, interest rates and other terms and conditions of loans were made subject to majority decision, but a unanimous decision was required for any changes in the distribution of the total amount borrowed among the seven governments. The Loan Council's jurisdiction was restricted to the raising of loans; the federal government and the states remained free to spend the proceeds in accordance with their own priorities and policies.

The fiscal transfers authorised by the Constitution were intended primarily to redress the vertical fiscal imbalance which resulted from the loss by the states of what until then had been their principal sources of revenue—customs and excise duties and, to a lesser extent, postal and telecommunication revenues —while they continued to be responsible for the provision of most of the costly services of government.

At the Federal Conventions of the 1890s during which the [Australian] Commonwealth Constitution was drafted, differences in population size and density and economic disparities among the [Australian] colonies gave rise to a number of other political and economic issues which had to be resolved before federation could become a reality. A further problem was created by differences in tariff policy, since New South Wales was a free trade colony while the others were in varying degrees protectionist.

The Conventions sought a political solution to these problems, the assumption being that demographic, political and economic disparities could be dealt with by political means through an appropriate parliamentary structure. The result was an uneasy compromise between the Westminster system of responsible government and the United States approach of a federal congress, whereby each [Australian] state regardless of size was to have the same representation in a Senate which, for all practi-
cal purposes, would have the same legislative powers as the House of Representatives.

The four less developed and financially weaker colonies were aware that their accession to the new common market would involve them in higher costs of manufactured goods and transport, to their disadvantage and the advantage of New South Wales and Victoria. But except for special transitional tariff arrangements for Western Australia, the only explicit constitutional provision dealing with economic disparities or horizontal fiscal imbalances among the states was the requirement that the states' share of federal customs and excise duties should be distributed on a derivation or consumption basis.

This was somewhat more favourable to the four less developed states than distribution on a collections basis, which would have reflected the greater trading and manufacturing strength of New South Wales and Victoria. There was some discussion about the possibility of adopting a population (or equal per capita) basis of distribution. No agreement could be reached on this, although it was believed that the federal government would eventually distribute its surplus revenues in accordance with this principle.

Ironically, the general grants power, whereby the federal government was enabled to provide financial assistance to any state on such terms and conditions as it thought fit, was not a part of the original draft Constitution. It was added in order to meet New South Wales objections to the financial arrangements after the first Constitutional Referendum in that state had failed to obtain the necessary majority.

It was this provision which was eventually to enable the federal government not only to achieve a position of financial domination in relation to the states generally but also to distribute general revenue grants, equalisation grants and specific purpose payments among the states on a basis which was much more favourable to the financially weaker states than a population basis would have been. Although the grants power was subsequently used to correct horizontal fiscal imbalances among the six states, it and the other financial provisions in the Constitution were included primarily in response to the problem of vertical fiscal imbalance as between the federal government and the states generally.

Developments in Fiscal Federalism After Federation

The constitutional provision whereby the federal government was required to pay its surplus revenue to the states was thwarted by that government in 1908, by the simple device of paying the surplus into a trust fund and thereby ceasing technically to record a surplus. The sharing of customs and excise revenues likewise did not extend beyond the compulsory period of ten years, being replaced in 1910 by a system of equal per capita general revenue grants ($2.50 per head of state population). The per capita grants continued until 1927, when they were withdrawn by a federal government which objected to what it called the vicious principle of one government raising taxes for others to spend. In their place, the states received debt charges assistance as part of the arrangements for debt management and the coordination of government borrowing which resulted from the Financial Agreement and the action taken to give constitutional authority to the Australian Loan Council.

Because the states had access to income taxes and, except for commodity taxes, most other forms of taxation, vertical fiscal imbalance was not a major issue during most of the period from federation to the beginning of World War II. The fiscal system was strained by the demands of war finance during World War I and by the budgetary problems of the Great Depression, but the federal government shared the difficulties and did not achieve any general financial superiority over the states.

Horizontal Fiscal Imbalance and Fiscal Equalisation Grants

The major problem which emerged during this period was one of horizontal fiscal imbalance. First Western Australia (from 1910-11), then Tasmania (from 1912-13) and later South Australia (from 1929-30) sought and obtained special grants from the federal government to assist them in overcoming budgetary difficulties, which they said were accentuated by the operation of the Constitution and by federal tariff, shipping and other economic policies. But these special grants were made on an unsystematic and ad hoc basis and on a scale which failed to satisfy the aspirations of the
governments and the people of the states concerned.

By the 1930s, discontent with economic and fiscal disparities had become so widespread that secession movements developed in all three states. Following a referendum in 1933 when two-thirds of Western Australian electors declared themselves in favour of secession, the government of that state presented a petition to the British Parliament seeking leave to withdraw from the Australian federation. This was unsuccessful, because the British Parliament decided that the consent of the Australian (Commonwealth) Parliament was necessary before the Commonwealth would be dissolved constitutionally.

Meanwhile, the Australian Parliament had responded to these developments by establishing the Commonwealth Grants Commission as an independent statutory authority, which was to be responsible for inquiring into and reporting on applications by any state for special financial assistance. The principles and methods developed by the Commission, (which are described in greater detail in Chapter 3) provided an innovative and acceptable solution to the problem of horizontal fiscal imbalance in Australia. The Commission's approach has been refined over the years, but from the beginning it has represented the most highly developed system of fiscal capacity equalisation in any federal country.

The recommendations of the Commission have always been accepted by federal governments. Because the financially weaker states are also the less populous states, the level of special (equalisation) grants recommended has always been low relative to the financial resources of the federal government, New South Wales and Victoria. No doubt this has contributed to the general acceptance of the equalisation arrangements by all Australian governments.

**Uniform Taxation and General Revenue Grants**

Although an acceptable solution was thus found to the problem of horizontal fiscal imbalance, it was not long before the problem of vertical fiscal imbalance re-emerged in an acute form, as disparities among the individual states came to be overshadowed by disparities between the federal government and the states collectively. During the early years of World War II, the financing of the war effort through federal taxes was severely constrained by differences in the income tax rate structures of the states. The federal government had asked the states to hand over their income tax powers for the duration of the war in return for fixed grants, but the states had refused.

In 1942, therefore, the federal government introduced uniform tax legislation which effectively excluded all states from income taxes, while giving each state a fixed tax reimbursement grant equal to its average collections in 1939–40 and 1940–41. The reimbursement grants were subject to the condition that the states would refrain from levying their own income taxes. The states remained legally free to raise income taxes but, because such taxes would have been superimposed on the high Commonwealth rates and would have disqualified them from receiving the reimbursement grants, it was politically impossible for them to do so. Any state could apply through the Grants Commission for additional financial assistance if its tax reimbursement grant was considered to be insufficient, and some grants were paid under this arrangement in 1945–46 and 1946–47.

The continuation of this system after the war, despite constitutional challenges by the states, changed the whole balance of the Australian federation and left the federal government in a position of financial superiority which it has retained to the present day.

After 1945–46, the amounts of the tax reimbursement grants were arbitrarily increased for two years and thereafter determined by means of a formula, under which the base amount was increased in accordance with changes in population and average wages. The formula was varied to the benefit of the states from 1948–49. From that year, also, the distribution among the states, which as noted above had previously reflected the states' own collections in 1939–40 and 1940–41, and was therefore unfair to states which had deliberately adopted policies of relatively low taxes and low standards of services, was gradually adjusted over a ten-year period. By 1957–58, the total tax reimbursement grants were distributed in proportion to the populations of the states adjusted for relative population densities and numbers of school-age children. In principle, the stage
had thus been reached where the vertical fiscal transfers from the federal government were being distributed on an adjusted population basis, while horizontal fiscal adjustments were made independently through the Grants Commission's procedures to the extent that the Commission could be satisfied that individual states had additional financial needs.

Even by 1957–58, however, this theoretically adequate system was breaking down because of the persistence of chronic vertical financial imbalance. Commonwealth grants to the states (including specific purpose grants, a growing proportion) maintained a level approximately twice that of state taxes, despite efforts by the states to exploit additional revenue sources. The inadequacy of the reimbursement grant growth formula was indicated by the fact that supplementary grants were made on an arbitrary basis every year after 1948–49, without noticeably alleviating the inadequacies that were apparent in the provision of state services. In 1959, five of the six states applied for special grants through the Grants Commission.

A new system of financial assistance grants and a new growth formula replaced the tax reimbursement grants in 1959. At the same time, adjustments were made to the distribution formula with the intention of reducing the number of so-called claimant states (states seeking special assistance through the Grants Commission) to two (Western Australia and Tasmania), it being understood that South Australia (which until then had been a claimant state) and Queensland would seek special grants only in exceptional circumstances. Despite these adjustments, intergovernmental financial arrangements in Australia continued to be characterised by bitter disputes and confrontations between the federal and state governments at annual Premiers' Conferences. Frequent adjustments were made on an arbitrary and ad hoc basis to the financial assistance formula as well as to the financial arrangements generally, which had the effect of increasing the total amount of financial assistance grants, improving the relative debt position of the states and, in 1971, giving the states access to a major form of taxation (payroll tax) which until then had been levied by the federal government. But the frequent adjustments failed to affect the inherent instability of the system, which arose from the arbitrary nature of the federal government's decisions and the failure at both federal and state levels to integrate responsibility for taxing and spending decisions.

Political decisions favouring particular states also replaced systematic analysis as the basis for dealing with fiscal disparities among the states, as the distribution of financial assistance grants shifted from an adjusted population basis to one which contained implicit but arbitrary equalisation elements. The four financially weaker states left or joined the Grants Commission arrangements depending on how well they fared under the distribution of financial assistance grants, and by 1975, none of the original claimant states was seeking special assistance. Only Queensland, which had first become a claimant state in 1971, continued to apply for a special grant through the Grants Commission.

**Government Borrowing**

As a consequent of the federal government's control over all major tax sources after World War II, it was also able to achieve a dominating position in the Australian Loan Council. From the early 1950s, it began to underwrite the loan programs of the states, by making special loans from its revenue surpluses to the extent that it was prepared to approve programs which could not be met from public subscriptions. As a result, by the late 1960s, the public debt of the federal government was more than covered by amounts owing to it by the states, so that overall it was a net creditor on loan account. This vertical imbalance on capital account was partly corrected during the 1970s, when the federal government assumed responsibility for $1,000 million of state debts and the associated charges and agreed to make general purpose capital grants to the extent of one-third of the total Loan Council programs it was prepared to approve.

The Commonwealth did little during this period to influence the distribution of loan monies among the six states. This continued to reflect past allocations rather than the relative needs of the states for public works expenditure. Although the loan programs of state semigovernment (i.e., business undertaking) and local authorities were also subject to Loan Council approval, some states were able to fi-
nance public works expenditure by indirect means.

Thus mining companies in Queensland and Western Australia were required to provide much of the capital needed to construct railways, port facilities and even townships for the purposes of some of the major mining developments in those states. In the case of Queensland's special mineral railway lines, for example, the mining companies were required to lodge special deposits with the government to finance the cost of constructing the lines and purchasing the rolling stock which the state railway authority needed to operate the system. The government's debt was then redeemed from mineral freights when operations on the lines commenced.

Loan Council borrowing constraints could also be circumvented by leasing equipment or by arranging for profitable state business undertakings (such as electricity authorities and insurance offices) to finance developmental and other public works from retained profits. In 1978, also, the Loan Council agreed to permit individual states to borrow overseas to finance approved infrastructure development.

Specific Purpose Payments

None of these arrangements provided a systematic solution to the problem of disparities among the states in their need for administrative, social and developmental capital. In any event, the principal instruments used to redress horizontal fiscal imbalance in relation to public works expenditure were specific purpose capital grants and advances from the Commonwealth to the states. The federal government had long been making grants to the states for particular development or other capital purposes—road and railway grants had commenced in the 1920s, and after World War II the list was extended to include shipping and harbours, water resources and power projects, agricultural development and housing.

Most of the early programs favoured the less industrialised states in general and rural areas in particular. But the rapid growth in specific purpose payments which occurred during the 1960s and 1970s, was centred to a much greater extent on the needs of people living in the cities. Some programs were especially designed to alleviate urban problems and were therefore of relatively greater benefit to New South Wales and Victoria. Urban programs supported by the federal government included: metropolitan and regional growth centres designed to relieve population pressure on Sydney and Melbourne and, to a lesser extent, some of the smaller state capital cities; land acquisition for residential and associated uses; the improvement of community facilities in urban areas; a national program to eliminate the backlog of sewerage works in the principal cities; urban water supply; and urban public transport.

In addition, however, there was an extension of Commonwealth specific purpose payments into the fields of education, health and other social and community services, not only through capital grants but also through grants for recurrent purposes.

Recurrent grants for universities had commenced in 1951-52, and during the next 25 years were extended to cover capital expenditures, other forms of tertiary education, nongovernment schools, government schools, preschools, technical education and research. Federal assistance for health services commenced with grants in the 1950s for specialised purposes such as control of tuberculosis, mental hospitals and nursing homes, followed in the 1970s, by grants of up to 50% of the net recurrent costs of state public hospitals, development grants for public hospitals and community health facilities. Assistance for social security and welfare commenced on a significant scale in the 1970s, and covered such activities as home care services, senior citizens' centres, pensioners' dwellings, employment grants and Aboriginal advancement.

Special provisions for housing finance operated from 1945-46, with the states or their housing authorities receiving interest concessions or, from 1971-72, grants for welfare housing. Grants to the states for cultural and recreational purposes and for legal aid commenced in 1973-74. In addition to providing grants on a $1 for $1 matching basis for natural disaster relief, the federal government in 1971, began to meet all approved state expenditures in respect of major disasters in excess of designated base amounts, which were determined roughly in proportion to state populations.

As noted above, all local government borrowing in Australia is controlled by the Australian Loan Council. After World War II, the fed-
eral government began to make direct payments to local governments for such purposes as domiciliary care, aged persons' homes, employment for handicapped persons, and local aerodromes. These were supplemented during the 1970s by grants for nursing homes, child care, Aboriginal advancement, community arts and regional employment. During the 1970s, the federal government also introduced a number of programs involving payments to local government through the states, the most important of which were: equalisation grants made on the recommendation of the Grants Commission in accordance with the principles and procedures it had developed for assessing the financial needs of claimant states; and so-called area improvement grants for the benefit of local governments in the underprivileged western regions of Sydney and Melbourne.

In addition, various grants were made by the federal government to encourage the development of regional organisations of local governments, assist local governments in the new regional growth centres and facilitate the establishment of regional councils for social development under the Australian Assistance Plan, which was then being implemented as part of a comprehensive program of community development and social welfare.

Although there had been a steady growth in the range and magnitude of specific purpose programs throughout the period after World War II, there was a dramatic increase in the three years during which a Federal Labor Government held office from December 1972 to November 1975. Total specific purpose payments increased from $901 million (or 2.1% of Gross Domestic Product) in 1972–73 to $4,216 million (or 5.8% of GDP) in 1975–76, reflecting the declared intention of the Australian Labor Party to use the federal government's grants power to take over the direction of the major functions of government for which the states had formal constitutional responsibility. It should be noted, however, that general revenue grants also increased substantially during this period (from $1,923 million to $3,112 million), despite an offsetting reduction when the federal government assumed full responsibility for financing tertiary education and for railway operations in some states.

The expansion of specific purpose programs was a direct consequence of the vertical financial imbalance which resulted from uniform income taxation and the other shifts in financial powers which have been noted above. Denied access to their own tax revenues and limited in the amounts they could borrow through the Loan Council, the states were forced to accept the specific purpose payments and with them the conditions which the federal government attached to the payments. These were mainly spending conditions involving acceptance of the federal government's priorities and policies, which were often formulated without adequate planning or consultation with the states.

To the extent that revenue conditions were imposed, these generally took the form of a requirement that the states maintain their existing revenue effort and seldom involved burdensome matching requirements. Even the grants for up to 50% of hospital operating costs did not impose onerous revenue conditions on the states, since they substantially relieved the states of existing expenditure responsibilities and enabled them to switch funds to other uses. Specific purpose payments for capital purposes usually took the form of advances rather than grants where the payments were to be used to acquire revenue-producing assets.

Although the specific purpose programs were primarily concerned with vertical shifts in power from the states to the federal government, during the 1960s and 1970s they increasingly incorporated elements of horizontal fiscal adjustment which were designed to alleviate or remove disparities in the provision of government services among the states. The first specific purpose grants, those for roads, had been distributed on the basis of two-fifths according to area and three-fifths according to population, and subsequent programs in this and some other fields incorporated distribution formulas which were intended to distribute funds in accordance with rough and arbitrary political judgments about relative needs.

However, compared with other federal countries, the formula approach has not been widely adopted in Australia as a method of determining the distribution of specific purpose grants. Federal governments have either made all kinds of ad hoc politically motivated decisions in response to state requests for assistance or, in implementing new programs on their own initiative, have established statutory
commissions to advise them on the level and pattern of expenditures and on the distribution of grants and other funding arrangements.

**Statutory Commissions and Specific Purpose Payments**

The significance of specific purpose payments in Australian federalism cannot be grasped without an understanding of the role of these statutory commissions which, although advisory and outside the formal structure of parliamentary and executive government, have played a major role in the development of government services. The prototype for such bodies was the Commonwealth Grants Commission, which since its establishment in 1933 has acquired a semijudicial status and has always had its recommendations for special financial assistance accepted by governments. But the Grants Commission has been concerned only with general revenue grants for purposes of equalising fiscal capacity among states or local governments.

The establishment of advisory bodies in the functional fields represented by the federal government’s specific purpose programs represented a new development, which involved the direct assessment of the expenditure needs of each state for the purposes of those programs, on the basis of what a former Prime Minister called “systematic, impartial and objective inquiry.” The forerunner of these bodies was the Australian Universities Commission, which was established in 1959 to advise on grants to the states for universities. Subsequently, the federal government established a Commonwealth Bureau of Roads, a Commission on Advanced Education, a Technical and Further Education Commission, a Schools Commission, a Children’s Commission, a Hospitals and Health Services Commission, a Social Welfare Commission, a Cities Commission and a National Heritage Commission.

One aspect of the work of these commissions, like that of the Commonwealth Grants Commission, was concerned with the assessment of relative financial needs for equalisation purposes. However, instead of recommending grants for general revenue or fiscal capacity equalisation, the specific purpose commissions made judgments about the levels of expenditure and financial support needed to ensure that standards of government services in functional fields were adequate and comparable not only between but also within states. They were therefore concerned with achieving equalisation in fiscal performance. Ideally, this presupposed equality in the outputs of educational, health, welfare, transport, urban and other services, but because of the difficulties of comparing outputs the commissions usually sought merely to equalise expenditure inputs.

Nevertheless, there were wide differences in the approaches of the various bodies. The Commonwealth Bureau of Roads based its recommendations on substantial empirical analysis undertaken for the purpose of formulating, by means of cost-benefit studies, road programs which would yield a designated rate of return. The Schools Commission attempted to move towards equality in recurrent expenditures per student in both government and nongovernment schools, while making special provision for migrant education, handicapped children, disadvantaged schools, teacher and community development and special building needs. Other commissions sought to fill functional, program, institutional or geographical gaps in the provision of services.

Not only did these approaches seldom take into account differences in state capacity to provide services or their relative revenue-raising and expenditure efforts, but the commissions frequently recommended grants which had the effect of compensating particular states for deficiencies arising from their own past priorities or policies. The more general problem of reconciling fiscal capacity and fiscal performance equalisation in Australia is examined in Chapter 3.

There were other weaknesses in the constitution and method of operation of the statutory commissions, associated with the problem of defining their relationships to Parliament and the executive government, a failure to fit their recommendations into the normal budgetary processes of priority determination and financial appropriation, and their tendency to operate as federal rather than intergovernmental agencies even though they were concerned with making recommendations for financial assistance in fields which were the constitutional responsibility of the states.

Some of these weaknesses have been dealt
with by abolishing commissions or by absorbing their functions in the public service departments. The specific purpose commissions which continue in existence (apart from the Grants Commission these are the Tertiary Education Commission, the Schools Commission and the National Heritage Commission) must operate within approved budgetary guidelines and are now primarily concerned with the distribution of funds among states and educational or other institutions. There has thus been a recognition that the specific purpose commissions, like the Grants Commission, are better equipped to advise on relative than on absolute financial needs.

The financial domination which the federal government achieved through uniform income taxation, control over Loan Council programs and the use of specific purpose payments resulted in increasingly acrimonious conflicts between federal and state governments, especially after the Australian Labor Party came to power in 1972, and began to adopt centralising policies that were expressly designed to reduce the power of the states. The states responded by mobilising political opposition to such policies, so successfully that they became a major issue in state and federal elections. The Federal Labor Government was defeated in a general election in December 1975 (after it had been dismissed by the Governor-General in highly controversial circumstances when the opposition-controlled Senate had refused to grant supply).

The massive growth in federal payments to the states between 1972–73 and 1975–76, had significantly improved their financial position, despite their complaints about the restrictive effects of specific purpose programs and their attempts to replace the growth formula for financial assistance (general revenue) grants by a percentage share of federal income tax collections.

Ironically, the large increase in specific purpose payments which had been so bitterly resented by the states was a major factor in shifting the financial balance of the Australian federal system in their favour, to the disadvantage of the federal government. Other factors contributing to the federal government's budgetary difficulties were a large growth in cash social welfare payments to individuals between 1973 and 1976, and the introduction of personal tax indexation in the latter year. By contrast with the position before 1974, when the federal government was using substantial revenue surpluses to make special loans to the states to finance their works programs, it now began to incur large budget deficits largely for the purpose of financing increased specific purpose and other grants to the states.

### The New Federalism Policy

The new Liberal-National Country Party Government which came to power in December 1975, had adopted and began to implement a new federalism policy which, after discussions with the states at a series of Premiers' Conferences, was based on the following major elements:

a) A system of personal income tax sharing was to replace the financial assistance grants arrangements, with the states being given a designated share of federal government personal income tax collections based on the relationship of financial assistance grants to such tax collections in 1975–76 (the ratio for a given year was eventually fixed at 39.87% of collections in the previous year).

b) The distribution of tax sharing entitlements among the six states was originally to be based on the distribution of financial assistance grants in 1975–76, but was to be reviewed by the Commonwealth Grants Commission in accordance with its fiscal capacity equalisation principles (after opposition from some states it was agreed that the three-member Commission would be augmented for this purpose by three members nominated by the states).

c) Although a system of uniform tax assessment and collection was to continue to operate, each state was to be permitted to impose a percentage surcharge or allow a percentage rebate on personal income tax collections in that state, to its own benefit or cost.

d) Special equalisation arrangements to be administered by the Grants Commission were to apply to the state tax surcharges, while the four less populous and financially weaker states were to continue to be eli-
gible to apply through the Commission for special (equalisation) grants.

e) The federal government would be able to introduce personal income tax surcharges or rebates without affecting state entitlements, but guarantee provisions were to operate for a number of years to prevent state entitlements from falling below the amounts they would have received as financial assistance grants (there was also to be a continuing guarantee that a state’s entitlement in one year would not fall below that of the previous year).

f) Specific purpose programs were to be restricted to areas of national need and grants to encourage innovation or to meet special situations, and as far as possible were to be reduced in size or absorbed into general revenue or block grants.

g) Local governments were also to receive a designated share of the previous year’s personal income tax collections (1.52%) instead of the equalisation grants paid on the recommendation of the Commonwealth Grants Commission, whose future role was to be restricted to advising on the inter-state distribution of the tax sharing funds.

h) State Grants Commissions were to be established to advise on the distribution of local government tax sharing entitlements among individual local authorities, but at least 30% of the total amount was to be distributed on a population basis and only the remainder in accordance with equalisation principles. And,

i) Measures were to be taken to improve intergovernmental consultation and cooperation, including the establishment of an Advisory Council for Inter-government Relations modelled on the U.S. Advisory Commission on Intergovernmental Relations (ACIR).

The new system is now in operation, but so far there has been little noticeable improvement in federal-state financial relations. Tax sharing entitlements flowing to the states have fallen well below expectations, partly because of the introduction of personal tax indexation and partly because of depressed economic activity and high unemployment, so that the financial assistance formula guarantee has had to operate for most states.

Except in the fields of education (where grants have been roughly maintained in real terms) and health and welfare (where there has been an increase in hospital grants and it seems likely that most other grants will be consolidated into block grants), most specific grant programs have been abolished or severely curtailed rather than absorbed into general revenue or block grants. This has been especially the case with grants for urban and regional purposes. The principal reason for this has been the federal government’s difficulty in holding down the size of its budget deficit, a problem which has also given rise to a significant reduction in the effective size of the capital works programs which the federal government is prepared to support through the Loan Council.

The states, which had previously been so critical of the federal government’s use of the financial assistance grants formula and of the restraints imposed by the conditions attached to specific purpose grants, now began to complain of the loss of revenue under the new arrangements, but so far no state has taken advantage of the opportunity to impose its own income tax surcharge. The federal government must share responsibility for this, because its steps towards a restoration of vertical fiscal balance did not include the making of tax room for the states by simultaneously reducing both its own rates of personal income tax and the level of the states’ tax sharing entitlements. This would have forced a measure of fiscal responsibility on the states instead of permitting them to continue to seek increased payments from the federal government.

The prospects for improved horizontal fiscal balance under the new arrangements are somewhat brighter, as the enlarged Commonwealth Grants Commission has now begun its review of the state relativities of the income tax sharing entitlements.

The amounts and the per capita distribution of the major forms of federal government payments to the states in 1977–78, are recorded in Table 2. It should also be noted that payments of $53 million or $484.73 per head of population were made in that year to the Northern Territory, which became a self-governing territory on 1 July 1978. The main functions of government were transferred progressively to the
## Table 2

### AUSTRALIAN GOVERNMENT PAYMENTS TO STATES, 1977–78

(in millions of Australian dollars)

<table>
<thead>
<tr>
<th>Form of Payment</th>
<th>Total Payments</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>Six States</th>
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<tr>
<td>Personal Income Tax Sharing Entitlements</td>
<td>$4,316.6</td>
<td>$264.89</td>
<td>$259.08</td>
<td>$357.87</td>
<td>$395.48</td>
<td>$429.38</td>
<td>$519.66</td>
<td>$313.63</td>
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<td>Special Grants</td>
<td>24.8</td>
<td>11.52</td>
<td>11.52</td>
<td>11.52</td>
<td>11.52</td>
<td>11.52</td>
<td>11.52</td>
<td>11.52</td>
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<tr>
<td>Total General Revenue Funds</td>
<td>4,341.4</td>
<td>264.89</td>
<td>259.08</td>
<td>369.39</td>
<td>395.48</td>
<td>429.38</td>
<td>519.66</td>
<td>313.63</td>
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<td>General Purpose Capital Funds(a)</td>
<td>1,433.8</td>
<td>93.03</td>
<td>94.78</td>
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<td>109.57</td>
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<td>Total Specific Purpose Payments</td>
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<td>302.31</td>
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<td>377.71</td>
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<td>State Taxation</td>
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<td>276.86</td>
<td>283.44</td>
<td>234.19</td>
<td>310.64</td>
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**Note:** (a) One-third capital grants, two-thirds Loan Council borrowings.


Northern Territory Assembly between 1 January 1977 and 30 June 1979. The financial arrangements between the federal and the Northern Territory were similar to those for the states, so that from 1 July 1979, the territory will receive a personal income tax sharing entitlement, relevant specific purpose payments, and general purpose capital funds on the same basis as State Loan Council programs. The Territory will also have access to the Commonwealth Grants Commission, and has in fact applied for a special grant through the Commission for 1979–80.

Table 2 also records per capita state taxation from own sources as a basis of comparison. Differences in the per capita amounts reflect differences in revenue-raising capacity as well as differences in tax effort. It will be seen that in 1977–78, state taxes as a percentage of total federal government payments ranged from a high of 52.8% in Victoria to a low of 20.1% in Tasmania, the six-state average being 42.1%.

Pending the imposition of uniform customs and excise duties and the development of a complicated bookkeeping system to enable revenues to be assigned to states according to place of consumption rather than place of importation or manufacture, each state was credited with the net revenues collected in that state.

Fiscal Equalisation in Australia

Russell Mathews

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The Australian fiscal response to regional disparities has not typically taken the form of development incentives but has rather been directed towards the equalisation of state government administrative, social and economic services. This has been achieved partly by a sophisticated system of general revenue equalisation grants from the federal government in support of the revenue budgets of the four financially weaker states, based on an assessment by a body established for the purpose—the Commonwealth Grants Commission—of differences in revenue-raising capacity among the states on the one hand and differences in costs of providing government services on the other.

Implicit fiscal capacity equalisation has also been undertaken through the distribution of general revenue grants or shared taxes among the states, but until now the distribution has reflected ad hoc political decisions rather than the systematic assessment of relative needs. However, in 1978 the Commonwealth Grants Commission was given the task of reviewing the distribution of tax sharing entitlements among the six states in accordance with its

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established principles of fiscal capacity equalisation.

The federal government has also made increasing use of specific purpose payments to the states, some of which have had the effect of equalising fiscal performance or of promoting economic development. Many of the specific purpose payments are distributed among the states in accordance with assessments of relative needs by specially constituted commissions or advisory bodies.

The different kinds of fiscal equalisation arrangements are examined in detail below.

The Assessment of Relative Financial Needs: The Methodology of the Grants Commission

Since its establishment in 1933, the Commonwealth Grants Commission has developed a comprehensive set of principles and methods for dealing with applications by so-called claimant states for special financial assistance. The Commission's early approach was based on pioneering work on the concepts and measurement of relative fiscal capacity and tax effort by one of the first members of the Commission, Professor L.F. Giblin.

In its first three reports, the Commission rejected arguments that special grants should compensate for economic disabilities resulting from the operation of the Commonwealth Constitution, the tariff and other policies of the federal government, or the poverty of a state's resources. It decided that it would be impossible to measure the economic disabilities associated with federation, that grants should not be provided in such a way as to encourage uneconomic development, and that it was not the Commission's responsibility to equalise the incomes and living standards of individual citizens in the several states.

However, to the extent that a state and its citizens suffered from economic disabilities of any kind, these would be reflected in the state's relative financial position. The Commission therefore decided to base its recommendation for a special grant on a comparison of the budgetary position of the claimant state with that of other states. In the Commission's Third Report (1936), the criterion adopted as a basis for special financial assistance for a claimant state was expressed as follows:

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.

There were several elements in the Commission's approach at this time which need to be emphasised. First, special grants were considered to be justified only to the extent that they were necessary to enable claimant states (at that time, South Australia, Western Australia and Tasmania) to provide government services at an appropriate standard. Secondly, the designated standard was not one of equality with nonclaimant states but was rather a minimum standard which would enable a claimant state to function with reasonable efficiency. In recommending a special grant, the Commission at this time was thus concerned with assessing a claimant state's minimum financial needs and not with bringing its fiscal capacity up to the level of the most prosperous states. Thirdly, a reasonable revenue-raising effort was required of the claimant states. Fourthly, the financial needs of claimant states were assessed indirectly rather than directly, by means of comparisons of the budget results of the claimant states with the results of other states being used as the standard. Finally, the comparisons were restricted to items in the so-called consolidated revenue fund budgets of the states.

Capital expenditures and financing transactions which were traditionally recorded in separate loan funds were excluded from the comparisons, as were the transactions of statutory corporations not subject to detailed parliamentary scrutiny, trust funds and other earmarked funds such as those used for road finance and expenditures.

In applying its principle of financial need and assessing a claimant state's special grant, the Commission adopted the following procedures:

a) So-called corrections or modifications were made to the published budget results of the claimant state and of the three nonclaimant states which were used as the
standard of comparison (at that time New South Wales, Victoria and Queensland), so as to eliminate the effects of differences in accounting practices and financial policies.

b) The modified budget results of the claimant state and the standard states were then converted to per capita amounts, and the difference between the per capita deficit of the claimant state and the simple average of the per capita budget results of the standard states was multiplied by the claimant state's population to calculate the first component of the recommended grant. This calculation was subject to an important constraint, which emphasised the fact that the Commission's principle was one of meeting minimum financial needs and not one of equalising fiscal capacity. If the average per capita budget result of the standard states was a surplus, then the grant recommended for the claimant state was merely sufficient for its budget result to be brought into balance.

c) The comparison of modified budget results for the purpose of calculating the per capita difference only provided an indication of financial need to the extent that the revenue-raising efforts and the range and quality of services were comparable between the claimant and the standard states. The Commission recognised that if the recommended grant was based solely on the differential budget results, it would be possible for the claimant state to influence the size of the grant merely by increasing its deficit, for example by reducing its own tax efforts or by adopting extravagant expenditure policies. To preclude such a possibility, the Commission made adjustments for differences in the claimant state's revenue and expenditure policies relative to those of the standard states.

d) There was thus an adjustment for each tax (or other revenue) source, calculated by reference to the difference between the claimant state's actual collections and the amount it would have raised if it had applied each of the standard state's tax schedules to its own tax base. If its own collections fell short of the simple average of the standard collections, a so-called unfavourable adjustment was made which, as part of a second component of the recommended grant, had the effect of diminishing the grant. In effect, the adjustment offset the higher deficit which resulted from the lower than standard tax effort. It should be noted that the tax effort adjustment did not itself operate as a constraint on the claimant state's tax policies, but was merely intended to ensure that the budget result comparison reflected differences in taxable capacity rather than differences in tax effort. However, the Commission at first adopted certain other procedures which had the effect of limiting the process of fiscal equalisation and influencing state policies. It thus initially required a claimant state's tax effort to be higher than that of the standard states (and its per capita expenditures to be lower); these additional effort requirements were described as penalties for claimancy. For many years, also, the Commission did not allow a claimant state the benefit of a net favourable adjustment if the combined effect of its revenue effort and expenditure levels was favourable relative to standard.

e) Adjustments were also made for departures by the claimant state from standard levels of expenditure. For each expenditure item, the difference between the claimant state's actual per capita expenditure (as modified) and the simple average of the standard states' modified per capita expenditure was multiplied by the claimant state's population. The resulting unfavourable or favourable adjustment formed part of a third component of the recommended grant. In addition to the penalties for claimancy and the limitations it imposed on the use of net favourable adjustments (noted in d above), the Commission adopted certain other procedures which made it possible for the recommended grant to reflect policy differences among the states as well as relative financial needs. During the first few years, no allowance was made for the fact that a claimant state might need to incur higher costs in providing services comparable to those of the standard states, because of a relatively larger number of units to be
served (e.g., for demographic reasons) or higher unit costs (e.g., because of diseconomies of small scale or difficulties in providing services for a dispersed population). This limitation was reversed when the Commission began to make what it called allowances for special difficulties. A more intractable problem arose in relation to items of expenditure (or revenue) for which it was difficult to separate the effects of differences in policy or efficiency from the effects of disabilities on the claimant state's financial position. Initially the Commission made no adjustment for most items of general administration expenditure and debt charges, so that a claimant state's implied need in relation to these items was simply the difference in per capita expenditures as between the claimant and the standard states.

f) To overcome the two-year time lag between the most recent year for which budget data were available and the year in which the special grant was paid, the Commission initially adopted a complicated system of advances and deferments in an attempt to make grants reflect current needs. After 1949, however, it introduced a two-part system, whereby the grant recommended for payment in a particular year was composed of two elements, an advance grant for that year (the year of payment) and a completion grant for the second last year, for which published and audited budget results had by then become available (the year of review). The completion grant represented an adjustment to the advance grant in the year of review and could be negative or positive.

g) In developing a framework for its inquiries, the Commission adopted the procedure not only of analysing relevant budgetary and statistical data but also of conducting inspections and public hearings. At the hearings, witnesses representing the claimant state and the Commonwealth Treasury were required to give sworn evidence and transcripts were taken of the proceedings. The Commission's reports gave detailed consideration to the submissions of the interested parties and from the beginning its recommendations were supported by reasoned argument. Although data limitations often made it necessary for the Commission to resort to broad judgment in its deliberations, wherever possible its decisions were based on verifiable data. During recent years, detailed work-sheets running into several volumes have been made available to the interested parties.

To conclude this summary of the original Australian response to fiscal disparities, the following further points may be noted. First, the recommended grant was paid by the federal government to the claimant state and, except to the extent that they cooperated in providing budgetary data, the nonclaimant states played no part in the proceedings which led to the assessment of the grant. The Australian arrangements were undoubtedly helped by the fact that special grants were relatively small by comparison with equalisation grants in other countries, not only because fiscal disparities were not as great but also because the financially weaker states were the less populous states.

Secondly, the special grant paid to claimant state was unconditional in the sense that, subject to the qualifications which have been noted, it left the recipient state free to determine its own revenue and expenditure policies. Although the Commission's original procedures fell short of full fiscal capacity equalisation and incorporated a revenue effort adjustment, the latter merely offset the effect of differences in revenue effort on the differential budget result. As noted above, the net effect was to eliminate the effect of differences in revenue effort from the assessment of the claimant state's financial needs by using the standard states' revenue effort as the basis of comparison.

Thirdly, and again subject to the qualifications which have been noted, the Grants Commission's procedures resulted in an assessment of a claimant state's relative expenditure needs as well as its relative revenue needs, and thus extended beyond the scope of fiscal capacity equalisation arrangements in most other countries. However, the comparison was restricted to recurrent expenditures and to the results of certain government business undertakings.

Finally, the Commission's recommendations in relation to special grants have always been accepted by federal governments.
The Shift to Fiscal Capacity
Equalisation and Direct Assessment

Over the years, the Grants Commission's original approach to the assessment of a claimant state's financial needs has been modified in two principal ways. The first has involved a shift from the criterion of minimum financial need to one of full fiscal capacity equalisation, defined as the financial assistance necessary to give a claimant state the capacity to provide services comparable to those of the standard states without having to impose higher taxes and charges. The second change has involved a shift from indirect assessment based on budget result comparisons to the direct assessment of revenue and expenditure needs. Thus the Commission ceased to impose additional effort requirements or penalties for claimancy during World War II; progressively relaxed its limitation on the inclusion of net favourable adjustments in the calculation of special grants; and eventually, in 1975, abandoned altogether its rule that the grant recommended should be limited to the amount necessary to achieve budget balance.

After a change in federal-state financial arrangements in 1959, which resulted among other things in South Australia ceasing to be a claimant state, the Commission adopted a two-state standard based on the average fiscal capacity of the two states with highest capacity, New South Wales and Victoria.

In 1974, also, the Commission adopted a new analytical framework and form of presentation. This involved, instead of the comparison of modified budget results adjusted for differences in revenue effort and service provision, the direct calculation of a claimant state's revenue and expenditure needs for purposes of fiscal equalisation.

Revenue needs were now assessed as the difference between (i) the revenue the claimant state would have raised if it had applied the average standard state revenue effort to its revenue base, and (ii) the revenue it would have raised, on the basis of the standard revenue effort, if its per capita revenue base had been the same as the average per capita revenue base of the standard states. Expenditure needs were assessed as the difference between (i) the expenditure which the claimant state would have incurred if it had provided the same average range and quality of services as the standard states and (ii) the expenditure it would have incurred if its per capita expenditure had been the same as the average of the standard states. Total assessed needs were then simply the sum of assessed revenue and expenditure needs, representing the claimant state's shortfall in revenue-raising capacity relative to the standard states and its additional costs of providing services comparable to those of the standard states.

The new approach is essentially a new form of presentation and does not of itself solve the data problems which have been noted, but the Commission has progressively extended its analysis so as to limit the extent to which it must exercise broad judgment in distinguishing between policy or efficiency differences and a claimant state's needs.

Under the new approach of the Commission, a claimant state's differential revenue-raising capacity or revenue need is measured by applying the average standard state revenue effort to the difference between the average standard state per capita revenue base and the per capita revenue base of the claimant state. A claimant state's differential revenue-raising capacity may be expressed in an alternative formulation as a variation from the standard per capita revenue collections. This variation depends on the ratio of the claimant state's per capita revenue base to the standard per capita revenue base.

The measurement of a claimant state's differential revenue-raising capacity is a relatively easy calculation for specific or ad valorem taxes. However, where the standard states have progressive or other complicated rate structures, the task is more difficult because the rate schedules of the standard states need to be applied to appropriate dissections of the claimant state's revenue base.

In some cases, the Grants Commission uses indirect means to determine the standard revenue effort or the respective revenue bases of the claimant and the standard states. If, for example, a claimant state obtains royalties from a mineral which is not available to either of the standard states, a national standard revenue effort needs to be determined. In the cases of taxes related to turnover, such as gambling taxes, the level of turnover in a state may reflect tax effort as well as taxable capacity. The Commission has responded to this problem by
using proxies to compare the revenue base, such as personal incomes per head of population in the relevant age groups, or by making adjustments to turnovers to allow for differences in the revenue efforts of the claimant and the standard states.

Finally, the Commission still uses differences in per capita revenue collections as a measure of a claimant state's need for some relevant items, when it is satisfied that the revenue effort is comparable as between the claimant and the standard states or that adjustments can be made to allow for differences in policy.

In all cases, a claimant state's revenue need will be assessed as a negative amount if it has above-standard, revenue-raising capacity. However, the use of standard state policies for the purpose of determining the standard revenue-raising capacity means that a claimant state may have a need assessed for a tax or charge imposed by the standard states which it does not levy itself. Conversely, if the claimant state taxes a revenue base which exists in the standard states but is not taxed by them, the resulting revenues are assumed to result from a policy difference and are not subject to equalisation.

A claimant state's expenditure need is represented by its differential cost of providing a standard range and quality of government services. This differential cost is measured by reference to (i) the differential number of units to be served relative to total population as between the claimant and the standard states, and (ii) the differential cost per unit.

The differential number of units to be served will reflect differences in the proportion of the population which is eligible for the government services, for example the number of school children relative to total population or the number of farm units relative to total population. The differential unit cost of providing services may be attributable to economies or diseconomies resulting from differences in scale, dispersion of population or environmental factors such as climate, terrain, and the pattern of economic activity.

The differential cost in relation to a particular expenditure item may be positive or negative, depending on whether the ratio of claimant state cost to standard state cost exceeds or falls short of unity.

In some cases, the Commission assesses a claimant state's expenditure need directly. In the case of education and most other social services, it thus attempts to measure the per capita cost which the claimant state would incur if it applied each of the standard state's education policies to the claimant state's school-age population, and compares this with the standard state's per capita cost. The two differences are then averaged and multiplied by the claimant state's population in order to calculate the expenditure need.

With the advent of other kinds of federal government general revenue grants to all states, in particular the income tax reimbursement grants which commenced in 1942 and the financial assistance grants and tax sharing entitlements which replaced them in turn, it was necessary for the Commission to allow for the fact that part of a claimant state's financial needs might be met by differential grants from these sources. The Commission has dealt with this problem by deducting, from the amount of a claimant state's assessed financial need calculated in accordance with the foregoing procedures, an amount equal to the additional per capita assistance received by the claimant state relative to the average of the standard states, multiplied by the claimant state's population. That is to say, the assessed special grant is equal to the total assessed revenue and expenditure needs of the claimant state less an amount representing the extent to which those needs have been met through other federal government general revenue grants.

A related problem has concerned the treatment of the growing number of specific purpose recurrent grants, many of which relate to fields of expenditure covered by the Grants Commission's comparisons. The Commission has adopted one of three approaches to the assessment needs in such cases:

a) What is called the exclusion approach, whereby it excludes from its comparisons all expenditures on the program which is the subject of the grant as well as all revenues identified with the financing of the program, including both the specific purpose grant and taxes or revenues from the states' own sources. This is the procedure which has been adopted in relation to road grants, which along with road taxes have traditionally been paid by Australian gov-
ernments into funds earmarked for the finance of road expenditures.

b) What is described as the deduction approach, whereby the specific purpose grant is deducted from total expenditure in respect of the program and the expenditure need is assessed by reference only to the net expenditure which is financed from the state’s own revenue sources.

c) What is described as the inclusion approach, whereby the Commission assesses the claimant state’s expenditure need in the usual way by reference to the total expenditure, and treats the specific purpose grant in the same way as a general revenue grant. That is to say, it deducts the additional per capita grant multiplied by the claimant state’s population from the state’s assessed need (or makes an addition to the assessed need if the claimant state receives a smaller per capita grant).

The problem arises because the need criterion adopted in assessing specific purpose grants, which is usually concerned with equalising the performance of the different governments in the assisted field, is at variance with the criterion of fiscal capacity equalisation which is adopted by the Grants Commission. If the exclusion or the deduction approach is adopted, the Commission in effect abdicates from the equalisation task to that extent; if the inclusion approach is adopted, the Commission overrides the process of fiscal performance equalisation. All three approaches have been adopted by the Commission in respect of different specific purpose grants.

As a general principle, the inclusion approach has been used where it has seemed to the Commission that this is necessary if it is to fulfill its general obligation to enable a claimant state to provide services comparable to those of the standard states without having to impose higher taxes and charges. Schools grants and the grants for hospital operating costs have thus been subject to the inclusion approach, even though relative needs under the former have been assessed by an independent Schools Commission. The Grants Commission has indicated that it is prepared to accept the Schools Commission’s assessment of school expenditure needs if it can be made as comprehensive in relation to fiscal capacity equalisation as the Grants Commission’s own assessment, but so far it has not been possible to reconcile the two approaches.

The Commission has continued to use the two-part approach to the assessment of grants which was described above, so that the special grant recommended for payment to a claimant state in a particular year is calculated as follows:

\[
\text{Assessed revenue needs for year of review} \quad \text{plus} \\
\text{Assessed expenditure needs} \quad \text{equals} \\
\text{Total assessed needs} \quad \text{minus} \\
\text{Assessed needs met from other federal government grants} \quad \text{equals} \\
\text{Assessed special grant for year of review} \quad \text{minus} \\
\text{Advance grant paid in year of review} \quad \text{equals} \\
\text{Assessed completion grant for year of review} \quad \text{plus} \\
\text{Advance grant for year of payment} \quad \text{equals} \\
\text{Special grant recommended for payment.}
\]

Evaluation of the Grants Commission’s Methodology

The Australian fiscal capacity equalisation arrangements, while subject to some exclusions, are more comprehensive than those in other federal countries. In Canada, for example, the equalisation is restricted to revenue-raising capacity. Differential costs of providing services among the provinces are implicitly assumed to be zero, that is per capita expenditures are assumed to be equal for all provinces. In the Federal Republic of Germany, likewise, attention is concentrated on the equalisation of revenue-raising capacity, although some provision is made for differential costs of services associated with differences in the degree of urbanisation among the states.

In Australia and Canada, the equalisation grants are paid by the federal governments and are open-ended up to the limits set by the
equalisation standards. This has been a matter of some concern to the government of Canada following the rapid growth of oil and gas revenues accruing to some provinces during recent years. In West Germany, on the other hand, the equalisation process is closed-ended because the states with above-standard fiscal capacity are, in effect, required to make transfers to states with below-standard fiscal capacity.

The equalisation standards in Australia are also different from those in the other two countries, since a claimant state in Australia is equalised to the average level of the two states with the highest fiscal capacity, whereas the average fiscal capacity of all provinces or states is adopted as the standard in the other two countries. Similarly, in Australia the weights attached to the different revenue and expenditure items, for the purpose of calculating standard per capita revenues and expenditures, depend on the budgetary performance of the two states with the highest fiscal capacity and are not based on an average or representative budget as in Canada and West Germany. At first sight, it may appear that the Australian use of a nonclaimant state standard is preferable to the use of an average equalisation standard, because an Australian state receiving the equalisation grant is not able to influence the size of the grant through its own policies. However, despite the Grants Commission's attempts to exclude the effects of policy differences from its assessment of a claimant state's financial need, it is possible for the Australian procedures to impart an inherent bias into the equalisation process in favour of the claimant state. This is because the standard states' taxation and other revenue policies which are used as the standard are likely to reflect areas of revenue raising in which those states have a comparative advantage. The claimant state will be assessed as having relatively high revenue needs for these items of revenue, without any offset for forms of taxation in which the claimant state has a comparative advantage. It will be apparent from the foregoing that the Australian procedures for the assessment of revenue and expenditure needs depend to a considerable extent on detailed analysis of budgetary data by the Commission and on subjective assessments of relative need, following written and oral arguments about principles and methods in adversary proceedings. By contrast, equalisation procedures in other countries are usually based on statistical or other disability indicators which may be more objective but which often involve the use of arbitrary criteria and weights. Australia has the advantage of having a relatively small number of states for which calculations need to be made, but it may be noted that the Commonwealth Grants Commission applied its usual principles and methods to the assessment of equalisation grants for nearly 900 local authorities until this responsibility was transferred to state grants commissions.

The Australian fiscal capacity equalisation arrangements, like those in Canada and West Germany, make no provision for revenue effort adjustments. This contrasts with the approach which is usually advocated in the U.S.A. where, to the extent that fiscal capacity equalisation is attempted at all (as in the crude Congressional formulas for the distribution of general revenue sharing payments), it usually incorporates a tax effort factor of some kind. The Australian position reflects a philosophical attachment to federalism which regards any fiscal effort requirement as incompatible with fiscal capacity equalisation and as an unwarranted restriction on the ability of state governments to determine their own levels and pattern of revenue raising and expenditure. It would be a relatively simple matter to expand the Australian general fiscal capacity equalisation model so that it includes a fiscal effort adjustment (although such a procedure is not likely to be adopted in Australia in the foreseeable future). The effect of the revenue effort adjustment would be to reduce (or increase) the equalisation grant received by a state by the amount of that state's below-standard (or above-standard) revenue effort.4

Review of State Relativities Under Tax Sharing Arrangements

Although the Australian equalisation grants arrangements are more comprehensive than those of other countries in their treatment of revenue and expenditure needs for an individual state, until now they have not been applied universally to all states. Political decisions rather than systematic analysis of relative revenue-raising capacity and costs of providing
services have determined whether or not the four financially weaker states have applied for special (equalisation) grants through the Grants Commission. This is because the very large vertical fiscal transfers which the federal government makes to the states—the tax reimbursement grants, financial assistance grants or tax sharing entitlements—have incorporated large per capita differences which have not been determined in accordance with equalisation principles.

The four financially weaker states are therefore not likely to apply for equalisation grants unless they believe that their differential per capita shares of the tax sharing entitlements are below the amounts which the Grants Commission is likely to assess as financial needs; at present only Queensland is a claimant state. Furthermore, although New South Wales and Victoria have been used as standard states they have never been able to play an active role in the equalisation grants arrangements.

This situation has now changed. An enlarged Grants Commission has been given the task of reviewing the tax sharing relativities among all states and reporting by 30 June 1981. The Commission is required to base its recommendations on fiscal equalisation principles. In effect, it will recommend a population adjustment factor for each state which will be applied to the state’s population for the purpose of determining its share of the states’ total tax sharing entitlements. The adjustment factors will reflect the differential per capita revenue-raising capacity of the states and their differential cost of providing standard services. An average six-state standard will be used as the basis of the relativities, so that the fiscal capacity adjustments to the standard entitlement will be positive for some states and negative for others. The proposed distribution formula will thus be similar in effect to that used in the Federal Republic of Germany and would integrate the processes of vertical fiscal adjustment and horizontal fiscal equalisation.

Fiscal Performance Equalisation Through Specific Purpose Grants

Distribution arrangements in respect of most specific purpose (conditional) grants programs in Australia have been based on arbitrary political decisions, crude distribution formulas or detailed assessments of relative needs by statutory commissions established for the purpose. However, a performance equalisation model incorporating revenue capacity equalisation may be developed when recipient governments are required to contribute to the programs from their own revenue sources according to their relative revenue-raising capacities.

To apply this model, the total expenditure program for all governments must be determined and its distribution among the individual governments decided in accordance with relative needs as assessed. The next step requires a decision about what proportion of the total program is to be financed by specific purpose payments and what proportion from the governments’ own sources. The latter amount will then be allocated among the recipient governments in accordance with their relative revenue-raising capacity, in order to establish their required revenue contributions. The grant to each recipient government will be calculated as the difference between its expenditure allocation and its required revenue contribution.

The effect of this approach is to allocate expenditures among the recipient governments in accordance with their relative assessed needs while requiring financing contributions (to match the specific purpose payments) in accordance with their relative revenue capacities. This is essentially the approach which has recently been used by the Commonwealth Bureau of Roads in Australia in making recommendations to the federal government on road grants to the six states.5

Conclusion

The elaborate system of fiscal equalisation which has been developed in Australia has been partly the product of political necessity, resulting from a need to reconcile the political strength of individual states with the financial domination of the federal government. The acceptability of the equalisation arrangements owes much to the fact that economic and financial disparities among the states are relatively small and that the richest states, whose citizens in the last resort finance the equalisation transfers, are also the most populous states.

However, there is also a general commitment
in Australia to the view that a system of fiscal capacity equalisation is an essential element of federalism, in that it makes it possible for individual states to provide services on a comparable basis if they are prepared to impose comparable taxes and charges, but leaves them free to develop their own taxing arrangements and expenditure programs. Fiscal capacity equalisation is thus a means of reconciling the two objectives of equality and diversity.

Footnotes


5 This approach is developed in R.L. Mathews and W.R.C. Jay, Measures of Fiscal Effort and Fiscal Capacity in Relation to Australian State Road Finance, Centre for Research on Federal Financial Relations, distributed by Australian National University Press, Canberra, 1974.
The federal Constitution of the Commonwealth of Australia was largely modelled on the United States Constitution, not only in the basic structure, which assigned specific powers to the central government and left the residue of powers to the states, but also in the text of a number of major provisions.¹

The Commonwealth (or federal) Parliament consists of a House of Representatives, elected on a universal franchise by all adult citizens of Australia on a basis of individual electoral areas of approximately equal populations, and a Senate, consisting principally of an equal number of senators from each state. Under the Constitution, which became effective in 1901, the Commonwealth Parliament was given basic financial powers similar to those of Congress: its power to levy taxes, but so as not to discriminate between states or parts of states, was similar to the power of Congress in Article 1, Section 8, "to lay and collect taxes, duties, imposts and excises..."; the limitation on discrimination was reinforced by a declaration, also similar to that of the United States Constitution, that "the Commonwealth shall not by any law or regulation of trade, commerce or revenue, give preference to one state or any

¹ Printed with permission of the author. This article was originally prepared as an address before the Sydney Sessions of the Law Council of Australia, August 13, 1980.
The Australian Constitution, like that of the United States, gave the central government the power of "borrowing money on the public credit of the Commonwealth" and provided a corresponding control over revenues and other federal funds by the following provisions:

81. All revenues or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund, to be appropriated for the purposes of the Commonwealth in the manner and subject to the charges and liabilities imposed by this Constitution.

83. No money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law.

There were, however, some important differences. First, the Australian Parliament's power to levy customs and excise duties was made exclusive, so that the states were deprived of the power to impose any such taxes or duties. This resulted in a substantial diminution of the capacity of the states to raise revenue from taxes on the production or sale of goods. Second, because it was thought that the Commonwealth would not be required to spend all of the customs and excise revenues it collected, the Constitution provided that, for the first ten years and thereafter until provision was made to the contrary, only one-fourth of the net revenue from those sources should be applied annually by the Commonwealth toward its own expenditure, and the balance should be paid to or applied for the benefit of the states. Third, while there is no power in the Commonwealth Parliament similar to that of Congress to "provide for the common defence and general welfare of the United States," section 96 of the Australian Constitution endowed the Parliament with express power to "grant financial assistance to any state on such terms and conditions as the Parliament thinks fit."

The development of a Commonwealth (or federal) grants policy in Australia was not possible until the High Court had clarified some aspects of the appropriation power (section 81) and the nature and extent of the power to grant financial assistance to a state (section 96). The founders and early commentators of the Constitution held differing views upon major aspects of these powers and the relevance to them of the constitutional requirements that taxes should not discriminate between states and that laws of trade, commerce, or revenue should not give preference to any one state over another.

It was accepted, however, that the power to appropriate funds for "the purposes of the Commonwealth" extended to the making of grants to the states because the Constitution expressly provided for the distribution of surplus revenue to the states under section 94, which provided that "after five years from the imposition of uniform duties or customs 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." Nevertheless there was—and, in spite of two major decisions of the High Court, still is—doubt as to whether the phrase "the purposes of the Commonwealth" is limited to those matters in respect of which the Commonwealth Parliament has legislative or executive power under the Constitution, or whether the phrase has a wider connotation.

A majority of the High Court in 1946 decided that the power given by section 81 to appropriate Commonwealth moneys did not authorise their expenditure for the provision of pharmaceutical benefits for members of the public otherwise than through the states. When a similar question arose in 1975 in relation to funds voted by Parliament to regional councils for social development not created under state law, the High Court was divided: three justices upheld the legislation authorising the expenditure and associated regulatory measures; two justices thought that both the expenditure and associated regulatory measures were invalid; one justice took the view that the expenditure was authorised but that the regulatory measures were ultra vires; the remaining justice said that the action was not justiciable because the plaintiff had no legal standing. In the result the challenge to the legislation failed, but the decision can hardly be taken as finally determining the scope of the power.

The limitations on the scope of the appropriation power illustrated or implied by these decisions have not in practice represented a major obstacle to the expansion of the
Commonwealth Parliament's grants and expenditure policies, mainly because of the amplitude of the grants power contained in section 96. But those limitations have entailed most grants being made through state governments rather than directly to the bodies, or for the purposes, envisaged by Commonwealth policies. In particular, grants of financial assistance to local government bodies were effected by payments being made to each state on condition that the moneys so paid were distributed in a prescribed manner to the numerous local authorities in that state.⁸

Early Resort to the Grants Power

It was generally agreed by the founders of the Constitution and early commentators that the power to grant financial assistance to a state was in the nature of a safety valve; it would enable financial assistance to be given to a state to preserve it from “financial shipwreck” or other circumstances of emergency. Its potential use as a means of furthering national policies devised by the Commonwealth Parliament was beyond the contemplation of all but an isolated minority of the founders of the Constitution.

It was upon this generally accepted basis from 1910 onward grants were made to one or more of the less populous and financially weaker states—Western Australia, Tasmania, and South Australia. Before federation these states had derived the major part of their revenue from the levy of customs and excise duties which subsequently came within the exclusive power of the Commonwealth Parliament. Those states also complained that the industrial and tariff policies of the Commonwealth government had affected their economies and made it difficult for them to maintain public services without financial assistance from the Commonwealth. These grants were made regularly on an ad hoc basis, but in 1933, largely as a result of state discontent, the Commonwealth Grants Commission was established to provide machinery for the consideration of applications for financial assistance from states in need and for the making of recommendations to the government.⁹

In 1923 the Commonwealth government took the first major step toward exploiting the grants power by passing two legislative measures authorising grants to the states upon conditions which had to be complied with by them. The first was the Main Roads Development Act, which provided for moneys being paid to the states for the purpose of building and maintaining main roads in accordance with a program approved by the relevant Commonwealth minister. The second was the Advances to Settlers Act, which appropriated funds to the states to enable them to purchase wire netting in bulk and to supply it to settlers in rural areas of the states at cost.

The latter measure was subjected to criticism in the House of Representatives by Mr. J. G. Latham (later to become attorney-general and chief justice of the High Court) on the ground that it intruded into fields of state legislative power and was unconstitutional. Latham took the view, which he developed in a later debate, that, while there was power in the Commonwealth Parliament to grant financial assistance to a state, such a grant could be made, in effect, only if the state required assistance. There was a prophetic element in his speech on the Advances to Settlers Bill when, in order to reinforce his claim that the legislation was ultra vires, he said: “If the mere voting of money is to bring a matter within the jurisdiction of the Commonwealth, any matter may be dealt with in this Parliament . . . . It is obvious . . . . that by a liberal grant of money the Commonwealth Government could obtain control of the whole education system of Australia.”¹⁰

Judicial Interpretation of This Grants Power

When legislation under the title of the Federal Aid Roads Act was passed by the Commonwealth Parliament in 1926 to make more permanent provision on a ten-year basis for grants to the states for road construction and maintenance, its validity was at once challenged by three states in the High Court. The grounds of the challenge were:

a) that the act related to road making, a matter which fell within the powers of the states, and was not, in substance, a grant of financial assistance;

b) that the Commonwealth could only impose conditions on a grant of financial assistance which were of a financial nature or were within its legislative power; and
c) that, if any one state did not take advantage of the grant, the legislation would represent a preference to one state over another in a matter of revenue in contravention of section 99 of the Constitution.

The High Court, consisting of all seven justices, dismissed the action without taking time to consider its reasons, and pronounced the following judgment: "The Court is of the opinion that the Federal Aid Roads Act No. 46 of 1926 is a valid enactment. It is plainly warranted by the provisions of sec. 96 of the Constitution, and not affected by those of sec. 99 or any other provisions of the Constitution, so that exposition is unnecessary."11

Few important decisions of a constitutional nature have ever been given in such brief terms. This prompted Professor Sawer, a leading Australian constitutional lawyer, to observe: "In view of the extensive debates which had taken place both within and without Parliament, and the number of opinions given by senior constitutional counsel that the legislation was at least of doubtful validity, this was very cavalier treatment of the problem, and left many problems concerning the application of sec. 96 unsolved, as to which a little more judicial reasoning could have been helpful."12

More than a decade was to elapse before any attempt was made to develop the potentialities of the grants power which this decision had revealed. During that period, which included the economic recession of the 1930s, grants were made to the states for assistance of primary industry and for the relief of unemployment as well as for the construction and maintenance of roads.

However, in 1938, in order to cope with some of the consequences of the depression in the wheat industry, a legislative scheme was devised based on the grants power. The scheme proposed to ensure a stable return to wheat growers through the imposition by the Commonwealth of a series of taxes on flour millers and merchants, the proceeds of which were to be paid to wheat growers through a Wheat Stabilisation Fund as a supplement to the market price which the growers received from millers. A substantial obstacle to the scheme lay in the fact that there was practically no wheat grown in the state of Tasmania. To meet this situation it was proposed that the flour tax raised in that state should be returned to the millers from whom it had been collected. The practical consequence was that the tax operated differentially in the state of Tasmania from the other states.

The attack on this scheme, based on its involving discrimination between states in the levy of taxes contrary to section 51(ii) of the Constitution, failed.13 The major contention in support of invalidity was that the acts imposing the tax and making the grant to the state of Tasmania should be read together as a single legislative scheme so as to produce the result of a differential taxing scheme in breach of the requirements of the Constitution. In dismissing this claim, Chief Justice Latham expounded a view of the Commonwealth grants power which later gained general acceptance. He said:

Section 96 is a means provided by the Constitution which enables the Commonwealth Parliament, when it thinks proper, to adjust inequalities between states which may arise from the application of uniform nondiscriminating federal laws to states which vary in development and wealth . . . . A uniform law may confer benefits upon some states, but it may so operate as to amount to what is called "a federal disability" in other states . . . . A wise differentiation based upon relevant circumstances is a necessary element in national policy. The remedy for any abuse of the power conferred by sec. 96 is political and not legal in character.14

The Uniform Tax Scheme

When the Second World War was at its height, the Commonwealth took advantage of the decision in the Flour Tax Case to devise a uniform tax plan which would enable it to levy an income tax at a uniform rate throughout Australia and to reimburse the states by grants under section 96 of the Constitution of the sums they would have collected from their own state income taxes but on condition that they levied no such taxes themselves.

This legislation, which was plainly designed to give the Commonwealth a monopoly of in-
come tax, was upheld by the High Court in spite of the opposition of four of the six states. One of the main contentions of the states was that the legislation, if valid, would not only erode their financial independence but would allow the Commonwealth to formulate a system of grants under which all state legislation and functions might ultimately be controlled and supervised. To this argument Chief Justice Latham said that:

... if the Commonwealth Parliament were prepared to pass such legislation, all state powers would be controlled by the Commonwealth—a result 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.

The monopoly of income tax which the Commonwealth gained in this way was continued after the end of the Second World War but in conjunction with a more generous system of tax reimbursement grants to the states. These grants were made on the express condition that each state should refrain from levying its own income tax during any year in which it received a grant and, if it failed to comply with this condition, the grant would become repayable. This form of conditional grant was the subject of a further constitutional challenge in the High Court by two states in 1956, but the actions were dismissed. The judgments confirmed earlier decisions on the grants power and even extended its scope, as the following statement of Chief Justice Dixon shows:

Before the meaning of s. 96 and the scope of the power it gives had been the subject of judicial decision no one seems to have been prepared to speak with any confidence as to its place in the constitutional plan and its intended operation. It may be said perhaps that while others asked where the limits of what could be done in virtue of the power the section conferred were to be drawn, the Court has said that none were drawn; that any enactment is valid if it can be brought within the literal meaning of the words of the section and as to the words "financial assistance" even that is unnecessary.

The Grants Power and Commonwealth Policies

At a practical level this decision showed unlimited potential for the use of grants of financial assistance as a means of controlling state policies and functions, for it would be within the Commonwealth's power to create a situation of need and use that situation as the basis for making a grant of financial assistance upon conditions which the Commonwealth would have no direct legislative or executive power to implement.

In the ensuing years down to 1972, during which the Liberal-Country Party Coalition was in power, the Commonwealth employed the device of specific-purpose conditional grants in a number of new fields, some being within its constitutional powers only by their extension in 1946 to include social services. These grants were additional to the grants of general financial assistance made unconditionally to the states on a formula basis in substitution for the tax reimbursement grants. The general inflationary trends of the time were taken into account in the formula ascertaining the general financial assistance payments, but the states claimed that the growth factors were inadequate to enable them to maintain existing services. Generally therefore, specific-purpose conditional grants were acceptable to the states.

After 1957 the number and range of specific-purpose payments was extended by successive Commonwealth governments to a variety of additional topics, including educational research, assistance to child migrants, nursing homes, drug education, welfare and home care services for the aged, paramedical services, the construction of pensioners' dwellings, unemployment assistance, Aboriginal advancement, railway and power house construction, assistance to various industries, and so on. At the same time most existing programs entailing assis-
tance for health, tertiary education, housing construction, war service land settlement, and road construction were continued.

**Labor Government's Policies from 1972**

When the Labor Party gained power at the federal elections in 1972, it saw that resort to conditional grants under section 96 of the Constitution could be used to implement its policies in areas which were beyond the legislative powers conferred by the Constitution and which were traditionally within the province of the states. Notable among these were all areas of education, urban development, the planning of growth centres, community health, legal aid, and urban public transport. In announcing to the premiers of the states his government’s intention to take this course, the Prime Minister, the Hon. E. G. Whitlam, Q.C., said:

> Where the national government undertakes new or additional commitments which relieve the states or their authorities of the need to allocate funds for expenditures at present being carried by them, there should be adjustments in the financial arrangements between us to take account of the shift of new financial responsibilities. These adjustments will normally take the form of appropriate reductions in the general purpose funds allocated to states. We have proposed such reductions, for example, as part of the programme by which the Australian Government will assume financial responsibility for tertiary education.

From now on, we will expect to be involved in the planning of the function in which we are financially involved. We believe that it would be irresponsible for the national government to content itself with simply providing funds without being involved in the process by which priorities are met, and by which expenditures are planned and by which standards are met.\(^{18}\)

In the years 1973–75, the number and type of special-purpose grants increased considerably, conformably with the policy stated by the Prime Minister. What is possibly of most significance is that during these years the initiative for the grant programs generally originated from the Commonwealth’s desire to achieve a measure of reform and uniformity throughout the states, rather than arising from one or more of the states’ seeking financial assistance to cope with a specific or general problem. The grants made for distribution to local government authorities and community bodies were peculiarly of this nature.

The states reacted to these new grants programs in different ways. Some states protested and sought changes in the conditions which entailed a measure of protracted negotiation and bargaining. In a few instances, accusations of “blackmail” were even made against the Commonwealth, but only in a few cases were the offers of grants rejected. However, at least one major program for direct grants to community bodies, made under what was called the Australian Assistance Plan, provoked a challenge in the High Court by the states as travelling beyond the Commonwealth’s legislative power.\(^ {19}\)

In the Budget Papers for 1975–76, tabled in August 1975, the lists of specific-purpose payments to the states and local government authorities were formidable enough, numbering 39 of a revenue character and 60 of a capital character. However, more were in prospect—grants for public libraries, museums, cultural collections, the preservation of historic buildings, and other purposes had been proposed or were under consideration when the Labor government was dismissed at the end of 1975. Had this not occurred, it is probable that the stage might have been reached where, as Chief Justice Latham said in the First Uniform Tax Case, the states would have lost, if not their political independence, a large measure of their capacity to initiate their own policies.

**Liberal-Country Party Government Policies from 1975**

The change of government following the elections in December 1975 marked a change in direction. The Liberal-Country Party policy formulated earlier that year made express reference to the matter of specific-purpose grants
under section 96, after observing that such grants had been used to a point where they dominated state revenues. The policy stated:

Many of the existing Section 96 grants are now part of well-established and universally accepted programmes within the states. The moneys for such programmes could be transferred to general purpose revenue reimbursement and ultimately absorbed in the states' income tax revenue.\(^{20}\)

A review of individual grants programs was promised, and the adoption of the principle of "block grants" was proposed in suitable circumstances to achieve proper national concern. The concluding sentence in this part of the policy read as follows:

Indeed, Section 96 will be used as it was originally intended it should be used, namely to make grants to the States for special purposes and not to make inroads into the constitutional responsibilities of the states.

At the first Premiers' Conference, held early in 1976 after the elections, the prime minister, the Rt. Hon. J. M. Fraser, said:

Specific purpose assistance has been an area of very rapid growth in recent years. It would accordingly be surprising if, given the overriding need for expenditure restraint, it was not found that there are some programs which are not a justifiable charge on the taxpayer . . . .

 Secondly, there are some programs—or parts of programs—which represent areas of expenditure which clearly deserve continuing Commonwealth support but in which there is no obvious need that my government can see for the Commonwealth to be involved in a specific way. There are matters in respect of which priorities should appropriately be left to the states and their authorities to determine.

In such cases, some form of absorption of specific purpose funds into general purpose funds would be appropriate.\(^{21}\)

At the basis of the proposals to phase out specific-purpose grants was a scheme for revenue sharing of personal income tax collections with the states and with local government authorities according to fixed percentages to be incorporated in legislation, the percentage of income tax collections available for the states being 33.6 and that for local government, 1.52.\(^{22}\)

While there was some pruning of the range and number of specific-purpose grants to the states in the years immediately following the election of the present government in 1975, the importance to state governments of Commonwealth grants and their relative magnitude diminished only slightly. In the financial year 1977–78, the total of all Commonwealth general-purpose financial assistance under the income tax sharing scheme represented nearly one-half of all state revenues; and, when specific-purpose payments were taken into account, the total proportion exceeded 60%. This is illustrated by Table 3, which also shows that all four less populous states were dependent on Commonwealth payments for as much as two-thirds, and in one case three-fourths, of their revenues. The position is substantially the same for later years, but complete figures for those years are not presently available. Payments to the states for distribution to local government bodies as a supplement to the general revenues of those bodies increased between 1975–76 and 1979–80, by 175% in money terms, and a further substantial increase has been promised in 1980–81.

**Current Policy Trends**

These trends, and especially the maintenance of a high level of specific-purpose payments, have been the subject of criticism in some quarters as a negation of the policies on which the present government was elected. Recently a Western Australian Liberal member of Parliament attacked what he described as the Commonwealth's policy of centralism and its neglect of the policies on which it was elected. He also claimed that "some federal Ministers are either unable or unwilling to shake free and recognize that some matters are simply none of their business" but are exclusively matters of state concern which should not be controlled
### Table 3

**COMMONWEALTH REVENUE PAYMENTS TO THE STATES AND STATE TAXATION, 1977–78**

(in thousands of Australian dollars)

<table>
<thead>
<tr>
<th></th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. States' Share of Tax Entitlements</strong>&lt;sup&gt;a)&lt;/sup&gt;</td>
<td>$1,319,609</td>
<td>$984,690</td>
<td>$770,539</td>
<td>$507,761</td>
<td>$519,891</td>
<td>$214,150</td>
<td>$4,316,641</td>
</tr>
<tr>
<td><strong>2. State Taxation (including mining royalties and land tax)</strong>&lt;sup&gt;b)&lt;/sup&gt;</td>
<td>1,729,126</td>
<td>1,353,488</td>
<td>565,686</td>
<td>366,230</td>
<td>397,797</td>
<td>94,771</td>
<td>4,507,098</td>
</tr>
<tr>
<td><strong>3. Commonwealth Specific-Purpose Payments of a Recurrent (noncapital) Nature</strong>&lt;sup&gt;c)&lt;/sup&gt;</td>
<td>1,012,715</td>
<td>783,402</td>
<td>400,846</td>
<td>291,615</td>
<td>295,359</td>
<td>89,684</td>
<td>2,873,621</td>
</tr>
<tr>
<td><strong>4. Totals:</strong></td>
<td>3,048,735</td>
<td>2,338,178</td>
<td>1,336,225</td>
<td>873,991</td>
<td>917,688</td>
<td>308,921</td>
<td>8,823,728</td>
</tr>
<tr>
<td><strong>1 + 2</strong></td>
<td>2,332,324</td>
<td>1,768,092</td>
<td>1,171,385</td>
<td>799,376</td>
<td>815,250</td>
<td>303,834</td>
<td>7,190,261</td>
</tr>
<tr>
<td><strong>1 + 3</strong></td>
<td>4,061,450</td>
<td>3,121,580</td>
<td>1,737,071</td>
<td>1,165,606</td>
<td>1,213,047</td>
<td>398,605</td>
<td>11,697,360</td>
</tr>
<tr>
<td><strong>1 + 2 + 3</strong></td>
<td>5,402,509</td>
<td>4,167,668</td>
<td>2,914,606</td>
<td>2,928,367</td>
<td>3,045,935</td>
<td>1,196,566</td>
<td>20,511,060</td>
</tr>
</tbody>
</table>

**5. State Taxation—Commonwealth Revenue Percentages:**

<table>
<thead>
<tr>
<th></th>
<th><strong>1 expressed as a percentage of 1 + 2</strong></th>
<th><strong>1 + 3 expressed as a percentage of 1 + 2 + 3</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>43.2388%</td>
<td>42.1136%</td>
</tr>
<tr>
<td></td>
<td>57.6654%</td>
<td>58.0968%</td>
</tr>
<tr>
<td></td>
<td>56.6523%</td>
<td>56.0523%</td>
</tr>
<tr>
<td></td>
<td>69.3219%</td>
<td>69.3219%</td>
</tr>
<tr>
<td></td>
<td>48.9208%</td>
<td>48.9208%</td>
</tr>
</tbody>
</table>

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<sup>a</sup> Source: Payments to or for the States, the Northern Territory and Local Government Authorities 1978–79, Budget Paper No. 7.


<sup>c</sup> Source: As for (a) above. Any discrepancies between totals and sums of totals are due to rounding.

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by the imposition of conditions on grants to the states.<sup>23</sup>

In spite of such criticism, it must be conceded that there are considerable difficulties, political and otherwise, in terminating specific-purpose grants programs or reducing the amounts voted annually under those programs. Quite apart from the prospect of electoral backlash, continued Commonwealth involvement is regarded as essential to ensure reasonable uniformity from state to state in the standards of the services provided by the states with the assistance of Commonwealth grants. This is especially the case with education, health, and hospital services, which are the subjects of the largest grants to the states. Moreover, if the major specific-purpose payments were phased out and the amounts saved added to the general tax entitlements of the states, there would be no assurance that the policy objectives of the Commonwealth government would be respected by those states which have differing political objectives or philosophies.

In the result, it is not to be expected that there will be any dramatic change in Commonwealth grants policies in the foreseeable future. With the political diversity of the two most
populous states, New South Wales and Victoria, the Commonwealth government must tread warily in introducing any fundamental change. Debates at conferences of Premiers about questions of the allocation of funds support the improbability of the states' gaining any greater proportion of the total income tax revenues collected by the Commonwealth than they presently have. On this and allied questions, two leading political scientists commented:

The 1977 Premiers' Conference was unable to agree on the future funding of the specific purpose grant content of the intergovernmental fund transfers. It has become clear to the State Premiers that Mr. Fraser's much-vaunted "New Federalism" will return no greater share of tax revenues to the states than they would have received under the old formula assistance grants, nor does the federal government propose to vacate tax fields to allow the states to impose their own taxes and augment their revenue sources in that way.

It seems much more likely therefore, that federal resource-allocation priorities and perspectives in areas of state constitutional responsibilities will prevail still, even if section 96 is used less obviously. 24

Specific-purpose payments to the states under section 96 of the Constitution have been made in many areas for so long that they are taken for granted and the source of power and method of verification of expenditure are not questioned. This makes the use of the conditional grant mechanisms less obvious. Other devices add to the illusion, especially (a) the resort to statutory authorities or commissions as the medium for assessing needs and priorities and recommending the amounts of grants, and (b) the negotiation of agreements between the Commonwealth and each of the states to regulate the amounts of the grants, the policy to be applied in their expenditure, and the method of certification that the conditions have been fulfilled.

There are no uniform constitutional or administrative procedures governing these matters. Most forms of financial assistance to the states for educational purposes, for example, derive from recommendations of independent statutory commissions—the Tertiary Education Commission and the Schools Commission. On the other hand, the largest single specific-purpose payment made to the states is to meet part of the running costs of public hospitals and is made under a series of individual agreements, substantially identical in form, entered into by the Commonwealth with each of the states.

Grants to the states for road construction were originally made under agreements in common form entered into with each state, but, since 1975, they have been based on proposals made by the Commonwealth Bureau of Roads (now merged in the Bureau of Transport Economics), an expert body appointed to make reports to the minister upon specified matters relating to roads. For a number of the other grants the arrangements have been of an ad hoc nature and have often related to the particular needs of a single state or a group of states.

Even when all of the states have participated in a specific-purpose grants program, there has been no uniformity or consistency in the proportionate sums allocated to each state on a per capita or any other basis. There are, indeed, considerable differences, not only between the proportionate shares of each of the six states in most of the specific-purpose grants, but also between the individual state's share of those grants and the general-purpose grant now made under the income tax sharing arrangements which have been effective since 1976. This is illustrated by Table 4 which sets out in relation to state populations the distribution among states of the total tax entitlements and specific-purpose payments of a recurrent nature.

**Interstate Relativities of Commonwealth Grants**

While there is no clear present proposal to modify the aberrations in states shares of specific-purpose grants, there is a firm prospect of some rationalisation in the manner of distribution between the states of the share of general revenue assistance now represented by the income tax collections earmarked under the government's revenue sharing policies for allocation to the states. Legislation passed to im-
implement these policies provides for a review of the respective shares of each of the six states to be made before June 1981, on a basis which should ensure a fair and equitable distribution; further reviews will be made as required after 1981. The major principle to be applied in the review is that:

... the respective payments to which the states are entitled ... should enable each state to provide, without imposing taxes and charges at levels appreciably different from the levels ... imposed by the other States, govern-

ment services at standards not appreciably different from the standards ... provided by the other states.25

This process of fiscal equalisation is to take account of differences in the capabilities of the states to raise revenues, and differences in the amounts required to be spent by them in providing comparable government services.

The implementation of this chapter and a direct comparison of services provided by each state may well have the effect of reducing the significance of specific-purpose grants simply because any differences in the standard or cost

<table>
<thead>
<tr>
<th>Table 4</th>
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</table>

ESTIMATES OF THE STATES’ INCOME TAX-SHARING ENTITLEMENTS(A) AND SPECIFIC-PURPOSE RECURRENT GRANTS IN 1979–80

(dollar figures in Australian dollars)

<table>
<thead>
<tr>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population as of 31 December 1979:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thousands of Persons</td>
<td>$5,113.6</td>
<td>$3,879.6</td>
<td>$2,198.4</td>
<td>$1,296.8</td>
<td>$1,256.1</td>
<td>$419.1</td>
</tr>
<tr>
<td>Percent</td>
<td>36.10%</td>
<td>27.39%</td>
<td>15.52%</td>
<td>9.16%</td>
<td>8.87%</td>
<td>2.96%</td>
</tr>
<tr>
<td>I. Tax-Sharing Entitlements:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Per capita relativities(B)</td>
<td>1.02740</td>
<td>1.00000</td>
<td>1.39085</td>
<td>1.52676</td>
<td>1.66516</td>
<td>2.00188</td>
</tr>
<tr>
<td>B. Percentage distribution between states (%)</td>
<td>30.72%</td>
<td>22.69%</td>
<td>17.88%</td>
<td>11.58%</td>
<td>12.23%</td>
<td>4.90%</td>
</tr>
<tr>
<td>C. Share of 39.87% of $12,670.8 million ($ million) (B)</td>
<td>$1,552.0</td>
<td>$1,146.1</td>
<td>$903.2</td>
<td>$584.9</td>
<td>$617.9</td>
<td>$247.8</td>
</tr>
<tr>
<td>D. Per capita entitlements ($)</td>
<td>$303.5</td>
<td>$295.4</td>
<td>$410.8</td>
<td>$451.0</td>
<td>$491.9</td>
<td>$591.3</td>
</tr>
<tr>
<td>II. Specific-Purpose Grants:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Payments for recurrent purposes ($ million)</td>
<td>$1,204.1</td>
<td>$923.9</td>
<td>$481.1</td>
<td>$331.0</td>
<td>$343.5</td>
<td>$105.3</td>
</tr>
<tr>
<td>B. Percentage distribution between states (%)</td>
<td>35.53%</td>
<td>27.26%</td>
<td>14.19%</td>
<td>9.77%</td>
<td>10.14%</td>
<td>3.11%</td>
</tr>
<tr>
<td>C. Per capita distribution ($)</td>
<td>$235.4</td>
<td>$238.1</td>
<td>$218.8</td>
<td>$255.2</td>
<td>$273.5</td>
<td>$251.2</td>
</tr>
</tbody>
</table>

a. SOURCE: Payments to or for the States, the Northern Territory and Local Government Authorities, 1979–80, Budget Paper No. 7, Tables 6 and 83. Excluding special grant to Queensland and disregarding guarantee of states’ shares based on 1975–76 formula.
of comparable services from state to state will be reflected in the amounts to which each state is entitled under the tax-sharing arrangements. This may pave the way for the states to achieve greater autonomy in the expenditure of their revenues, whether those revenues consist of state taxes or Commonwealth grants.

The review of relative state shares of income tax collections is to be conducted by a special division of the Commonwealth Grants Commission, consisting of the chairman and two members of the commission together with three associate members, one nominated by the states of New South Wales and Victoria and two by the other four states. The states have agreed to the review and are cooperating in its expeditious conduct.

The Commonwealth Grants Commission, which was established in 1933, is a quasi-judicial body whose principal normal function is to investigate and report on applications by the states for grants of special financial assistance. It conducts public hearings and takes evidence on oath but has its own expert secretariat to assist in the investigation of state finances and the preparation of its reports. In the 47 years since the commission was created, its recommendations have invariably been accepted by the Commonwealth government regardless of its political colour, and legislation to implement those recommendations has been passed by both Houses of Parliament, usually without any major dissent. The commission has been described by one state treasurer as "the final court of appeal which the states have" against an adverse financial situation, and since 1933 its work has represented "a major contribution to the fiscal theory of federalism."27

Although the continued existence of the Commonwealth Grants Commission is not assured by any provision in the Australian Constitution, it is now accepted as an essential element in the fair adjustment of the financial position of those states which suffer financial disabilities relative to the more prosperous states. It may be that the expanded role of the commission will not only rationalise the basis of distribution between the states of a substantial part of all Commonwealth grants, but also act as a medium to defuse some of the more sensitive features of intergovernmental financial arrangements in the Australian federal system.28

FOOTNOTES

3 Section 90, ibid.
4 Section 87, ibid.
14 61 Commonwealth Law Reports 764.
16 Ibid. 429.
19 Victoria v. Commonwealth, supra n. 7.
20 Federalism Policy, September 1975, p. 10.
22 These percentages were subsequently adjusted and increased to 39.87 and 1.75, respectively.
This paper is concerned with two aspects of local government in Australia: first, general features of local authority areas with respect to such elements as population, outlay and revenue; and, second, relations between state governments and local authorities. Any survey of local government in Australia must by its very nature be broad, since local government has developed differently not only between the states but also within individual states. Thus when statements are made about local government, these statements must be interpreted generally within a complex situation where significant disparities exist among individual local authorities within and between states, and where there is no such body as an average or representative local authority in Australia.

GENERAL FEATURES OF LOCAL AUTHORITIES IN AUSTRALIA

Population and Area

Perhaps the most striking feature of local authorities in Australia is the divergence in size...
Table 5
CLASSIFICATION OF AUSTRALIAN LOCAL GOVERNMENT AUTHORITIES
BY POPULATION SIZE AS OF 30 JUNE 1976

<table>
<thead>
<tr>
<th>Range of Population</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All States</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 999</td>
<td>1</td>
<td>1</td>
<td>11</td>
<td>20</td>
<td>27</td>
<td>8</td>
<td>68</td>
</tr>
<tr>
<td>1,000- 4,999</td>
<td>85</td>
<td>88</td>
<td>60</td>
<td>69</td>
<td>66</td>
<td>22</td>
<td>390</td>
</tr>
<tr>
<td>5,000- 9,999</td>
<td>49</td>
<td>43</td>
<td>26</td>
<td>17</td>
<td>19</td>
<td>7</td>
<td>161</td>
</tr>
<tr>
<td>10,000- 24,999</td>
<td>27</td>
<td>31</td>
<td>19</td>
<td>13</td>
<td>13</td>
<td>8</td>
<td>111</td>
</tr>
<tr>
<td>25,000- 49,999</td>
<td>24</td>
<td>25</td>
<td>8</td>
<td>8</td>
<td>10</td>
<td>3</td>
<td>78</td>
</tr>
<tr>
<td>50,000- 99,999</td>
<td>15</td>
<td>20</td>
<td>6</td>
<td>6</td>
<td>2</td>
<td>1</td>
<td>50</td>
</tr>
<tr>
<td>100,000- 249,999</td>
<td>13</td>
<td>3</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>1</td>
<td>17</td>
</tr>
<tr>
<td>250,000-</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>214</td>
<td>211</td>
<td>131</td>
<td>133</td>
<td>138</td>
<td>49</td>
<td>876</td>
</tr>
</tbody>
</table>

2. Population in local authority areas ('000s)

<table>
<thead>
<tr>
<th>Range of Population</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All States</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 999</td>
<td>282</td>
<td>263</td>
<td>164</td>
<td>165</td>
<td>134</td>
<td>66</td>
<td>1,073</td>
</tr>
<tr>
<td>1,000- 4,999</td>
<td>364</td>
<td>305</td>
<td>178</td>
<td>121</td>
<td>135</td>
<td>44</td>
<td>1,148</td>
</tr>
<tr>
<td>5,000- 9,999</td>
<td>437</td>
<td>503</td>
<td>296</td>
<td>205</td>
<td>203</td>
<td>119</td>
<td>1,763</td>
</tr>
<tr>
<td>10,000- 24,999</td>
<td>851</td>
<td>882</td>
<td>266</td>
<td>315</td>
<td>349</td>
<td>118</td>
<td>2,771</td>
</tr>
<tr>
<td>25,000- 49,999</td>
<td>1,059</td>
<td>1,361</td>
<td>427</td>
<td>410</td>
<td>143</td>
<td>50</td>
<td>3,449</td>
</tr>
<tr>
<td>50,000- 99,999</td>
<td>1,777</td>
<td>329</td>
<td>—</td>
<td>—</td>
<td>162</td>
<td>2</td>
<td>2,268</td>
</tr>
<tr>
<td>100,000- 249,999</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>250,000-</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>4,769</td>
<td>3,644</td>
<td>2,034</td>
<td>1,229</td>
<td>1,143</td>
<td>402</td>
<td>13,219</td>
</tr>
</tbody>
</table>

3. Proportion of number of local authority areas (percent)

<table>
<thead>
<tr>
<th>Range of Population</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All States</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 999</td>
<td>0.5%</td>
<td>0.5%</td>
<td>8.4%</td>
<td>15.0%</td>
<td>19.6%</td>
<td>16.3%</td>
<td>7.8%</td>
</tr>
<tr>
<td>1,000- 4,999</td>
<td>39.7</td>
<td>41.7</td>
<td>45.8</td>
<td>51.9</td>
<td>47.8</td>
<td>44.9</td>
<td>44.5</td>
</tr>
<tr>
<td>5,000- 9,999</td>
<td>22.9</td>
<td>20.4</td>
<td>19.8</td>
<td>12.8</td>
<td>13.8</td>
<td>14.3</td>
<td>18.4</td>
</tr>
<tr>
<td>10,000- 24,999</td>
<td>12.6</td>
<td>14.7</td>
<td>14.5</td>
<td>9.8</td>
<td>9.4</td>
<td>16.3</td>
<td>12.7</td>
</tr>
<tr>
<td>25,000- 49,999</td>
<td>11.2</td>
<td>11.8</td>
<td>6.1</td>
<td>6.0</td>
<td>7.2</td>
<td>6.1</td>
<td>8.9</td>
</tr>
<tr>
<td>50,000- 99,999</td>
<td>7.0</td>
<td>9.5</td>
<td>4.6</td>
<td>4.5</td>
<td>1.4</td>
<td>2.0</td>
<td>5.7</td>
</tr>
<tr>
<td>100,000- 249,999</td>
<td>6.1</td>
<td>1.4</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>1.9</td>
</tr>
<tr>
<td>250,000-</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>0.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

4. Proportion of total population in local authority areas (percent)

<table>
<thead>
<tr>
<th>Range of Population</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All States</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 999</td>
<td>0.3%</td>
<td>1.1%</td>
<td>1.5%</td>
<td>1.5%</td>
<td>1.3%</td>
<td>0.3%</td>
<td>0.3%</td>
</tr>
<tr>
<td>1,000- 4,999</td>
<td>5.9%</td>
<td>7.2%</td>
<td>8.1</td>
<td>13.4</td>
<td>11.7</td>
<td>16.4</td>
<td>8.1</td>
</tr>
<tr>
<td>5,000- 9,999</td>
<td>7.6</td>
<td>8.4</td>
<td>8.7</td>
<td>9.8</td>
<td>11.9</td>
<td>11.0</td>
<td>8.7</td>
</tr>
<tr>
<td>10,000- 24,999</td>
<td>9.2</td>
<td>13.8</td>
<td>14.6</td>
<td>16.7</td>
<td>17.7</td>
<td>29.6</td>
<td>13.3</td>
</tr>
<tr>
<td>25,000- 49,999</td>
<td>17.8</td>
<td>24.2</td>
<td>13.1</td>
<td>25.7</td>
<td>30.6</td>
<td>29.2</td>
<td>21.0</td>
</tr>
<tr>
<td>50,000- 99,999</td>
<td>22.2</td>
<td>37.4</td>
<td>21.0</td>
<td>33.3</td>
<td>12.5</td>
<td>12.5</td>
<td>26.1</td>
</tr>
<tr>
<td>100,000- 249,999</td>
<td>37.3</td>
<td>9.0</td>
<td>—</td>
<td>—</td>
<td>14.2</td>
<td>—</td>
<td>17.2</td>
</tr>
<tr>
<td>250,000-</td>
<td>—</td>
<td>—</td>
<td>34.3</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>5.3</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

NOTES: 1. Population of states excludes persons living in unincorporated areas (total for all states 20,000) or classified as migratory (total for all states 15,000). Most of the persons living in unincorporated areas are in South Australia (16,000).
2. Population figures are census count, not official estimates after adjustment for under-enumeration as revealed by post-census survey.
3. The symbol (...) indicates a proportion smaller than 0.05%.

of population in and area of the constituted localities. Table 5 outlines the situation with regard to population at the last census date 30 June 1976, when there were 876 local authority areas in the six states. Parts 1 and 3 of this table refer to the number of local authorities in each of eight population ranges, and Parts 2 and 4 are concerned with the total population living in the local authority areas in these population ranges. This table indicates that in absolute terms a majority of local authorities in Australia have small populations; 458, or 53%, of the 876 constituted areas have populations smaller than 5,000 persons, and 68 of these have populations of less than 1,000. These very small authorities are concentrated in the four less populous states of Queensland, South Australia, Western Australia and Tasmania. In total, these 53% of all local authorities contained only 8.4% of the population of the six states.

By contrast, only 68 or 8% of all local authorities had populations of 50,000 and over, although the percentage was much larger than this in the more populous states of New South Wales and Victoria. These local authorities with populations of 50,000 and over contained 49% of the population of the six states, although in the individual states the proportion ranged from a low of 13% in the least populous state, Tasmania, to a high of nearly 60% in the most populous state, New South Wales.

The uneven distribution of population among local authorities is also associated with an uneven distribution of spatial areas. Thus the 68 largest local authorities, with populations of 50,000 and over, encompassed 11,800 square kilometers, so that their 49% of the population lived in 0.2% of the incorporated areas of Australia. At the other extreme the 68 smallest local authorities, with populations less than 1,000 and containing 0.3% of the total population, covered 1.2 million square kilometers, or 22.1% of the total incorporated areas of the six states. Local authorities with large areas and small populations tend to be predominant in Queensland and Western Australia, whereas in South Australia the small populations tend to live in relatively small areas, because in this state only about 15% of its total area has been included in incorporated localities.

Some idea of the wide range of areas and populations among local authorities can be seen from Table 6, which shows the minimum and maximum values for each state. For all states the area range is from one square kilometer to nearly 368,000 square kilometers, while for populations the range is from 67 to 697,000. These wide variations are common to all states, except that the upper population level in Queensland (City of Brisbane Area) is much higher than in the other states.

The same kind of variation in population size occurs in the metropolitan areas of the six states. These metropolitan areas contain 64% of the combined populations of the states, ranging from 40% in Tasmania to 72% in South Australia. At 30 June 1976, 8.5 million people living in the six metropolitan areas were governed by 174 local authorities which, as Table 7 indicates, had a wide range of population in each state.

**Functions and Outlay**

The functions that local authorities are empowered to undertake are specified in the individual Local Government Acts of the six states. These powers are fairly common among the states, particular emphasis being given to the following functions:

1) **physical infrastructure**, including roads, streets and drainage, and business undertakings such as electricity, water and quarries;

2) **protection of the environment**, including sewerage, sanitary, and garbage collection and disposal services;

3) **recreation and community facilities**, including parks, gardens, community swimming pools, caravan parks, libraries, halls and other community buildings;

4) **social welfare and health services**, including cemeteries, immunisation, post and antenatal clinics, creches and kindergartens, home help, meals on wheels, social workers, senior citizens centres, and housing and emergency accommodation;

5) **supervisory and control functions**, including town planning and controls over land uses and buildings, food in-
### Table 6
**RANGE OF AREAS AND POPULATIONS OF LOCAL AUTHORITIES**  
**30 JUNE 1976**

<table>
<thead>
<tr>
<th>Item</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Area (sq. km.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>minimum</td>
<td>4</td>
<td>4</td>
<td>16</td>
<td>4</td>
<td>1</td>
<td>28</td>
<td>1</td>
</tr>
<tr>
<td>maximum</td>
<td>51,395</td>
<td>10,795</td>
<td>122,849</td>
<td>6,355</td>
<td>377,647</td>
<td>6,187</td>
<td>377,647</td>
</tr>
<tr>
<td>Population</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>minimum</td>
<td>595</td>
<td>472</td>
<td>222</td>
<td>227</td>
<td>67</td>
<td>312</td>
<td>67</td>
</tr>
<tr>
<td>maximum</td>
<td>169,939</td>
<td>117,144</td>
<td>696,740</td>
<td>77,477</td>
<td>162,313</td>
<td>50,384</td>
<td>696,740</td>
</tr>
</tbody>
</table>

**SOURCE:** As for Table 5.

### Table 7
**LOCAL AUTHORITIES AND METROPOLITAN AREAS**  
**30 JUNE 1976**

<table>
<thead>
<tr>
<th>Metropolitan Area (Capital City Statistical Division)</th>
<th>Number of Local Authorities</th>
<th>Population in Metropolitan Area</th>
<th>Range of Populations in Local Authorities Wholly in Area '000s</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Wholly in Area</td>
<td>Partly in Area</td>
<td>'000s</td>
</tr>
<tr>
<td>Sydney</td>
<td>45</td>
<td>—</td>
<td>3,022</td>
</tr>
<tr>
<td>Melbourne</td>
<td>53</td>
<td>3</td>
<td>2,604</td>
</tr>
<tr>
<td>Brisbane</td>
<td>4</td>
<td>5</td>
<td>958</td>
</tr>
<tr>
<td>Adelaide</td>
<td>28</td>
<td>3</td>
<td>900</td>
</tr>
<tr>
<td>Perth</td>
<td>26</td>
<td>—</td>
<td>806</td>
</tr>
<tr>
<td>Hobart</td>
<td>3</td>
<td>4</td>
<td>162</td>
</tr>
<tr>
<td>All</td>
<td>159</td>
<td>15</td>
<td>8,452</td>
</tr>
</tbody>
</table>

**NOTE:**
1. The metropolitan area is taken as the Statistical Division for the capital city of each state.
2. In four states the boundaries of the Capital City Statistical Divisions divide a number of local authorities, so that the populations of these local authorities fall in two divisions.

**SOURCE:** As for Table 5.
special, regulation of restaurants and other eating places, and noxious weeds, private swimming pools, and the keeping of animals; and

6) other business undertakings, such as abattoirs, ferries, public transport, and saleyards.

There is, however, a difference between the functions which local authorities are empowered to undertake and those which they perform in practice. Some indication of functions undertaken is given by statistics of local government outlay. Table 8 gives data on outlay for the year 1975–76, by all Australian local authorities, the outlay being classified by the purpose of expenditure, using the national accounting approach. The items are divided into three broad categories, final consumption expenditure (C), outlay on new fixed assets and other gross capital formation (I), and transfers and advances other than intergovernmental transactions (T). The statistics can be compared to two ways. The second last column shows the distribution of expenditure among functions for all local authorities and identifies functions which are important for their budgets. The largest expenditure items are roads, general administration, recreation and related cultural services, interest, electricity, sewerage and drainage, sanitation and protection of the environment, and water supply. The last column relates the local authority sector to the whole public authority sector, by indicating the proportion of outlay by all public authorities which was made by local government.

Overall, local government was responsible for 6.7% of all public expenditure in 1975–76, but the proportion was 16.9% for capital expenditure. Functions for which local authorities provided a significant proportion of total public outlay were community amenities, sanitation and protection of the environment, roads, water supply, electricity, and services to mining, manufacturing and construction industries. The proportion of interest on public debt paid by local authorities was also relatively high, indicating the importance of loan funds for financing capital outlay by local authorities. However, as Table 9 shows, there were significant differences among the six states in these expenditure patterns.

Receipts and Financing Items

The major items of receipts for local authorities are from rates (taxes levied on land), net income from business undertakings, other property income, grants from the Commonwealth and state governments, and net borrowing. The relative importance of these items for the year 1975–76, is shown in Table 10 and again the variation among the states is indicated by the differences in the relative importance of the sources of funds.

Rates levied on land provided nearly one-half of the total funds of local authorities, although this proportion ranged from about one-third in Queensland to three-fifths in South Australia. In the total Australian situation, local government taxes are not relatively large and comprised only 4.3% of total taxes raised in 1975–76, state taxes constituting 16.3% and Commonwealth taxes 79.4%. Rates are levied on the valuation of land, the method of valuation varying among the states, the methods being unimproved capital value, net or assessed annual value, and site value. Grants from state and Commonwealth governments amounted to over 22% of total local government funds, and net borrowing advances to 16%.

The fact that only 16% of the total funds of local authorities was obtained from net loans highlights a particularly important feature of local government finance in Australia, namely that local authorities finance a considerable proportion of capital expenditure from current revenue. Thus in 1975–76, while borrowed funds constituted only 16% of total funds, capital outlay represented 63% of total outlay.

A GENERAL REVIEW OF STATE-LOCAL RELATIONSHIPS

The second feature of local government in Australia which is examined in this paper concerns relationships between local authorities and state governments. These relationships are reviewed under the headings of state legislation, administrative control, fiscal relationships, administrative and operative agents, and organisational structures.
<table>
<thead>
<tr>
<th>Purpose</th>
<th>C</th>
<th>I$_g$</th>
<th>T</th>
<th>Percent of Total Outlay</th>
</tr>
</thead>
<tbody>
<tr>
<td>General administration</td>
<td>$185.6</td>
<td>$103.8</td>
<td>$289.4</td>
<td>15.6% 17.8%</td>
</tr>
<tr>
<td>Law, order and public safety</td>
<td>5.7</td>
<td>1.2</td>
<td>6.9</td>
<td>0.4  0.8</td>
</tr>
<tr>
<td>Other education</td>
<td>6.6</td>
<td>4.2</td>
<td>10.8</td>
<td>0.6  1.1</td>
</tr>
<tr>
<td>Hospitals and clinical services</td>
<td>0.6</td>
<td>0.3</td>
<td>0.9</td>
<td>... ...</td>
</tr>
<tr>
<td>Other health</td>
<td>37.9</td>
<td>1.5</td>
<td>39.4</td>
<td>2.1  9.5</td>
</tr>
<tr>
<td>Social welfare</td>
<td>13.8</td>
<td>6.2</td>
<td>20.0</td>
<td>1.1  5.5</td>
</tr>
<tr>
<td>Housing</td>
<td>0.5</td>
<td>4.4</td>
<td>4.9</td>
<td>0.3  0.9</td>
</tr>
<tr>
<td>Community and regional development</td>
<td>11.8</td>
<td>2.8</td>
<td>14.6</td>
<td>0.8  9.5</td>
</tr>
<tr>
<td>Sewerage and drainage</td>
<td>1.7</td>
<td>86.7</td>
<td>88.4</td>
<td>4.8  2.9</td>
</tr>
<tr>
<td>Sanitation and protection of the environment (not elsewhere included)</td>
<td>44.4</td>
<td>25.4</td>
<td>69.8</td>
<td>3.8  71.2</td>
</tr>
<tr>
<td>Community amenities</td>
<td>8.0</td>
<td>1.1</td>
<td>9.1</td>
<td>0.5  94.8</td>
</tr>
<tr>
<td>Recreation and related cultural services</td>
<td>157.6</td>
<td>81.6</td>
<td>239.2</td>
<td>12.9  41.4</td>
</tr>
<tr>
<td>Soil and water resources management</td>
<td>0.8</td>
<td>—</td>
<td>0.8</td>
<td>... ...</td>
</tr>
<tr>
<td>Other services to agriculture and pastoral industries</td>
<td>4.2</td>
<td>—</td>
<td>4.2</td>
<td>0.2  1.4</td>
</tr>
<tr>
<td>Services to mining, manufacturing and construction</td>
<td>7.8</td>
<td>10.7</td>
<td>18.5</td>
<td>1.0  12.0</td>
</tr>
<tr>
<td>Electricity and gas</td>
<td>—</td>
<td>110.7</td>
<td>110.7</td>
<td>5.9  17.0</td>
</tr>
<tr>
<td>Water supply</td>
<td>—</td>
<td>53.7</td>
<td>53.7</td>
<td>2.9  17.5</td>
</tr>
<tr>
<td>Road systems and regulation</td>
<td>24.9</td>
<td>617.7</td>
<td>642.6</td>
<td>34.5  46.1</td>
</tr>
<tr>
<td>Air transport</td>
<td>0.6</td>
<td>0.7</td>
<td>1.3</td>
<td>0.1  0.8</td>
</tr>
<tr>
<td>Sea transport</td>
<td>0.1</td>
<td>—</td>
<td>0.1</td>
<td>... ...</td>
</tr>
<tr>
<td>Urban transport</td>
<td>0.1</td>
<td>1.5</td>
<td>1.6</td>
<td>0.1  2.9</td>
</tr>
<tr>
<td>Other economic services and purposes (not elsewhere included)</td>
<td>11.4</td>
<td>5.1</td>
<td>16.5</td>
<td>0.9  0.2</td>
</tr>
<tr>
<td>Other gross capital formation</td>
<td>—</td>
<td>42.6</td>
<td>42.6</td>
<td>2.3  18.7</td>
</tr>
<tr>
<td>Interest</td>
<td>$168.4</td>
<td>168.4</td>
<td>168.4</td>
<td>8.1  11.5</td>
</tr>
<tr>
<td>Advances</td>
<td>6.3</td>
<td>6.3</td>
<td>12.6</td>
<td>0.3  1.4</td>
</tr>
<tr>
<td>Other transfers</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>... ...</td>
</tr>
<tr>
<td>Total</td>
<td>$524.1</td>
<td>$1,161.9</td>
<td>$1,686.0</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

**Percent of total local authority outlay**

- Local authority outlay as percent of outlay by all public authorities

- 4.6% 16.9% 1.9% 6.7%

**NOTES:**
1. Column headings: C = expenditure on final consumption; I$_g$ = expenditure on new fixed assets and other gross capital formation; T = transfers and advances; LAs = all local authorities; PAs = federal, state and local authorities.
2. "Other education" includes education services and facilities other than those connected with primary, secondary, university and advanced education.
3. "Other economic services and purposes n.e.i." includes general research, external affairs, defence, primary and secondary education, university and advanced education, forestry resources management, rail transport, pipelines, communications, other economic services n.e.i., and all other purposes.
4. Final consumption expenditure is shown net of income received from economic services.
5. For capital outlay all amounts other than that for "other gross capital formation" are expenditure on new fixed assets.
6. Transfers and advances exclude intergovernment transactions.
7. The symbol (...) indicates a proportion smaller than 0.05%.

### Table 9
**OUTLAY OF LOCAL AUTHORITIES BY STATE, 1975–76**

Percentage of Total Current and Capital Outlay by All Local Authorities in:

<table>
<thead>
<tr>
<th>Function</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roads</td>
<td>35.7%</td>
<td>36.3%</td>
<td>27.7%</td>
<td>19.8%</td>
<td>16.2%</td>
<td>13.4%</td>
<td>15.6%</td>
</tr>
<tr>
<td>General administration</td>
<td>10.7</td>
<td>22.5</td>
<td>15.7</td>
<td>19.8</td>
<td>16.2</td>
<td>13.4</td>
<td>15.6</td>
</tr>
<tr>
<td>Recreation and related cultural services</td>
<td>11.7</td>
<td>13.3</td>
<td>8.6</td>
<td>14.9</td>
<td>25.4</td>
<td>18.6</td>
<td>12.9</td>
</tr>
<tr>
<td>Interest</td>
<td>9.2</td>
<td>5.7</td>
<td>15.4</td>
<td>5.1</td>
<td>7.1</td>
<td>12.7</td>
<td>9.1</td>
</tr>
<tr>
<td>Electricity and gas</td>
<td>12.2</td>
<td>1.0</td>
<td>2.8</td>
<td>0.8</td>
<td>0.6</td>
<td>—</td>
<td>5.9</td>
</tr>
<tr>
<td>Sewerage and drainage</td>
<td>3.3</td>
<td>—</td>
<td>13.8</td>
<td>7.8</td>
<td>1.7</td>
<td>14.5</td>
<td>4.8</td>
</tr>
<tr>
<td>Sanitation and protection of the environment</td>
<td>3.2</td>
<td>5.0</td>
<td>3.2</td>
<td>4.2</td>
<td>3.7</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Water supply</td>
<td>2.1</td>
<td>0.1</td>
<td>11.1</td>
<td>—</td>
<td>—</td>
<td>3.8</td>
<td>2.9</td>
</tr>
<tr>
<td>All other purposes</td>
<td>12.0</td>
<td>16.1</td>
<td>1.8</td>
<td>9.6</td>
<td>9.1</td>
<td>1.6</td>
<td>10.5</td>
</tr>
<tr>
<td><strong>Total Outlay</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current outlay</td>
<td>32.8</td>
<td>42.5</td>
<td>36.8</td>
<td>40.5</td>
<td>41.3</td>
<td>41.5</td>
<td>37.2</td>
</tr>
<tr>
<td>Capital outlay</td>
<td>67.2</td>
<td>57.5</td>
<td>63.2</td>
<td>59.5</td>
<td>58.7</td>
<td>58.5</td>
<td>62.8</td>
</tr>
</tbody>
</table>

**SOURCE:** As for Table 8.

### Table 10
**RECEIPTS AND FINANCING ITEMS, 1975–76**

Percentage of Total Funds of All Local Authorities in:

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>New South Wales</th>
<th>Victoria</th>
<th>Queensland</th>
<th>South Australia</th>
<th>Western Australia</th>
<th>Tasmania</th>
<th>All States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rates</td>
<td>45.9%</td>
<td>54.3%</td>
<td>34.9%</td>
<td>60.1%</td>
<td>51.8%</td>
<td>47.2%</td>
<td>47.4%</td>
</tr>
<tr>
<td>Licences, fees and fines, and other taxes</td>
<td>1.0</td>
<td>2.8</td>
<td>2.0</td>
<td>2.0</td>
<td>1.9</td>
<td>1.4</td>
<td>1.8</td>
</tr>
<tr>
<td>Income from business undertakings</td>
<td>9.0</td>
<td>1.2</td>
<td>13.0</td>
<td>—</td>
<td>0.2</td>
<td>0.4</td>
<td>5.5</td>
</tr>
<tr>
<td>Property income</td>
<td>3.3</td>
<td>1.3</td>
<td>2.7</td>
<td>1.7</td>
<td>2.4</td>
<td>—</td>
<td>0.2</td>
</tr>
<tr>
<td>Grants from state authorities</td>
<td>12.1</td>
<td>18.1</td>
<td>22.5</td>
<td>23.2</td>
<td>22.5</td>
<td>10.7</td>
<td>16.7</td>
</tr>
<tr>
<td>Grants from Commonwealth authorities</td>
<td>5.9</td>
<td>4.0</td>
<td>6.3</td>
<td>7.6</td>
<td>7.8</td>
<td>12.2</td>
<td>5.9</td>
</tr>
<tr>
<td><strong>Sub-total receipts</strong></td>
<td><strong>77.2</strong></td>
<td><strong>81.7</strong></td>
<td><strong>81.4</strong></td>
<td><strong>94.4</strong></td>
<td><strong>86.9</strong></td>
<td><strong>76.9</strong></td>
<td><strong>80.7</strong></td>
</tr>
<tr>
<td>Financing Items</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net borrowing—local government securities</td>
<td>15.6</td>
<td>9.3</td>
<td>25.2</td>
<td>5.7</td>
<td>14.9</td>
<td>21.1</td>
<td>15.1</td>
</tr>
<tr>
<td>Advances from state authorities</td>
<td>0.8</td>
<td>0.1</td>
<td>5.1</td>
<td>—</td>
<td>0.4</td>
<td>—</td>
<td>0.2</td>
</tr>
<tr>
<td>All other items</td>
<td>6.4</td>
<td>9.0</td>
<td>11.7</td>
<td>0.2</td>
<td>—</td>
<td>1.6</td>
<td>1.8</td>
</tr>
<tr>
<td><strong>Sub-total financing items</strong></td>
<td><strong>22.8</strong></td>
<td><strong>18.3</strong></td>
<td><strong>18.6</strong></td>
<td><strong>5.5</strong></td>
<td><strong>13.1</strong></td>
<td><strong>23.1</strong></td>
<td><strong>19.3</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

**NOTE:** "All other items" includes changes in cash and bank balances, changes in holdings of securities, and depreciation allowances.

State Legislation

Local government in Australia operates under individual state legislation which prescribes, with considerable interstate variation, such matters as the functions that local government should or may perform, its powers to levy taxes on land (rates) and other kinds of charges, electoral procedures, and the types of local government areas that may be constituted. Moreover, state governments retain the power to constitute new local government areas (by amalgamating all or portions of existing areas), to incorporate as local government areas those parts of the state not already incorporated, and to allow a local authority area to be governed by a state-appointed administrator instead of an elected council. The provisions of the six constituent local government acts vary considerably among the states, and this makes it difficult to generalise other than in broad terms about the features of local government in Australia.

Apart from the powers given to local authorities by the constituent acts, the authorities are also given powers and responsibilities by a number of general acts, each relating to a specific subject (e.g., land valuation, planning, public health, foods and drugs, ambulances), so that a complete understanding of the legislative background of local government in Australia involves the consideration of a very large number of individual statutes in each state. In general, however, the system of local government established in Australia is one where local authorities have been constituted by a grant of specific powers, the constituent and general legislation giving local councils permission to undertake all or any of a number of enumerated functions and activities, with or without the approval of the state administration. As a result, local government cannot extend its functions other than as a result of amending state legislative enactments.

Administrative Control

Not having been given a grant of general power to undertake those activities which in their judgment will tend to promote the satisfactory administration and general welfare of the areas under their control, Australian local authorities operate under a considerable degree of administrative control by state government departments. This control ranges from a general supervision and examination of projects, to a fine detail of control over the forms of financial statements and the qualifications required for senior staff appointments.

An illustration of a grant of specific power which is subject to substantial state government control is that related to environmental or town planning. All local authority acts in the six states permit local government to regulate the growth of urban areas by introducing approved planning schemes. However, in practice the local authority is empowered merely to develop a proposed planning scheme which, after the consideration of objections, is evaluated by a state local government department or statutory planning board or commission.

Final acceptance of the plan depends on the approval of the relevant minister, who in some instances may amend a proposed scheme even without consultation with the local council. In general, involved administrative procedures have been laid down for planning schemes. These procedures have in practice led to long delays in approval being given, delays which have been said to have extended even up to ten years. In the interim period, the local authority has had to plan on the basis of interim development orders or specific bylaws.

The political and administrative relationships between local authorities and state governments are therefore not ones of partnership between coordinate authorities, with local authorities being independent bodies capable of exercising specified powers in their own right. However, such a relationship is implicit in the frequently stated form of federalism in Australia, the federation being described as consisting of a three-tier structure of government. In fact the Australian Constitution refers only to the Commonwealth and state governments. Local government in reality remains an administrative arm of state government, the local authorities carrying out their delegated activities under varying degrees of administrative and legislative control exercised by state administrations.

Fiscal Relationships

Relationships between state and local governments also extend into the fiscal area, where
in a financial sense the local authorities operate within the sphere of influence of state treasuries and must balance their budgets. As well, local authority borrowing programs are determined by state governments within the broad framework of the public loan-raising program approved by the Australian Loan Council. While intergovernmental financial transfers are not as significant for local authorities as they are for state governments in Australia, local authorities have generally received specific and general purpose grants from state governments for a variety of reasons, including street lighting, flood control and drainage, riverbanks and beaches, soil erosion, public halls, parks and gardens, swimming pools, libraries, senior citizens and youth centres, home help, child minding, and subsidies for loan expenditure on electricity supply, water and sewerage.

In recent years grants to local authorities by state governments have amounted to about one-third of the taxes raised by local councils. Prior to 1974–75, the Commonwealth Government provided only negligible grants to local authorities (omitting road grants that the states passed on to local authorities), but from that year the Commonwealth began to make general purpose grants of a fiscal equalisation kind, grants which have now been linked to the personal income tax-sharing arrangements in which state governments also participate. The combined grants from state and Commonwealth governments are now about one-half the size of local government taxes.

**Administrative and Operative Agents**

State governments, and to some extent the Commonwealth government, also utilise local authorities as administrative and operative agents for carrying out their own policies and programs, either through the provision of specific purpose grants or through more direct contractual arrangements. For example, in recent years both state and Commonwealth governments have used local authorities as a vehicle for unemployment programs by making specific purpose grants to local authorities for employment-creating projects.

In many cases, however, the grants provided have not covered the full costs of these projects, so that this relationship has also involved outlay-sharing features, although this outlay sharing has not been an explicit component of the unemployment programs. Specific purpose grants of these kinds have been made by the Commonwealth for child care facilities, Aboriginal advancement, various kinds of community amenities and recreation facilities, urban public transport, home care services, aerodromes, senior citizens centres, development of tourist facilities, preservation of the national estate, and sewerage. These have been in addition to the grants made by the states mentioned previously.

The major function for which local authorities have a combination of independent, shared and agency-type functions is road construction and maintenance. Most roads in local authority areas are constructed and maintained by local authorities, but certain of the important major roads are under the control of state roads departments, although in some instances the funds for these major roads are supplied jointly by the state and local governments.

Local authorities receive a substantial proportion of funds for road works through the specific purpose grants made to the states by the Commonwealth government for roads. In many cases, especially for rural local authorities in country regions, the major activity of the local authority is to act as the road construction and maintenance authority for the state roads administration, and the accounts of these local authorities show substantial outlay on roads offset by reimbursement from the state government.

**Organisational Structures**

Given their overall power to control the operations of local authorities, individual state governments have at times used that overall power either to establish organisational structures to enable local government to carry out particular functions or to create new regional authorities or semigovernment instrumentalities to take over the particular function from local government. In some instances, state governments have thus allowed regional bodies of local authorities to be formed to administer specific projects concerned with electricity, water supply and aerodromes. The major example of this kind is the system of County Councils in New South Wales.

However, in other cases state governments
have established statutory bodies, some with local government representation, to administer activities concerned with water storage and supply, sewerage and drainage, electricity generation and distribution, ambulance services, control over ports and harbours, and slaughter houses and abattoirs. In these latter cases the states have formed specific purpose local and regional authorities as a substitute for widening the powers of the general purpose local government authorities.

RESPONSIBILITY TO ELECTORS

It has been stated above that state governments exert a considerable degree of control over the activities of local authorities through state legislation, administrative controls and fiscal arrangements. In this respect, however, it is necessary to realise that state control over the activities of local authorities does not mean that local authorities are merely bodies which carry out the wishes and policies of state governments. The situation is, rather, one where the local authorities are subject to administrative controls but, provided the local councils do not infringe the acts under which they are constituted or which confer powers on them, they are in the last resort responsible to the electors of their respective localities, electors which as a body are in most states of Australia the ratepayers, but which in Queensland are those persons within the provisions of the adult franchise requirements (i.e., aged 18 years and over).10

Thus in saying that local government is an administrative arm of state government, it is not meant to imply that the establishment of local government in Australia has been merely a means by which state governments have spatially decentralised and deconcentrated their activities, establishing local bodies which look to state governments for their guidance and direction in local affairs. The local authorities have been established within a system which confers on those authorities powers of decision making in prescribed areas at the local level, powers of choice which are sufficient to designate the Australian system as one of local government.

SUMMARY

In summary, therefore, the relationships between state and local governments in Australia are characterised by local authorities being subject to the requirements of the specific acts constituting local government in each state, and so being responsible to the state minister for local government. In addition, local authorities are responsible to other ministers where they have been given powers under other acts to undertake specific activities and functions, or where they act on behalf of the state government. The local authorities are subject to the general fiscal control of state treasuries, and assume other responsibilities because of the requirements of various intergovernmental financial transfers. Despite these limitations on their powers to act, local authorities retain autonomy in the decisionmaking area for general functions which they are permitted to undertake, and in this sense local authorities are responsible to their electorates, not to state governments.

FOOTNOTES

1 For a detailed list by states see Margaret Bowman, Local Government in the Australian States, Australian Government Publishing Service, Canberra, 1976, pp. 5–8.
2 A similar analysis for any given state would reveal wide differences between the expenditure and revenue patterns of individual local authorities or between the outlay and revenue patterns of local authorities of similar type. See C.P. Harris, Local Government and Regionalism in Queensland 1859 to 1977, Centre for Research on Federal Financial Relations, Distributed by Australian National University Press, Canberra, 1978, Chapters VI-VII.
3 Ibid.
4 In this regard, it should be noted that all expenditure on roads is classified as capital outlay and, as Table 8 shows, expenditure on roads constituted from 28% to 36% of total outlay in the individual states.
5 Local authorities are variously constituted as cities, towns, boroughs, municipalities, shires and district councils. However, the population, area, functions performed, and financial structure differ among local authorities of the same type both between and within states.
6 For example, Margaret Bowman lists 257 acts in the six states applicable to the operations and activities of local government, the number ranging from 25 in Victoria to 65 in Tasmania, op.cit., pp. 68–74.
7 See C.P. Harris and K.E. Dixon, Regional Planning in New South Wales and Victoria since 1944, Centre for
The agency relationship implied is not a legal one between principal and agent. The term is used somewhat loosely to mean that the Commonwealth or state government carries out its own purposes, or achieves its own aims, by influencing or determining the activities and functions of local authorities.

For example, in the four-year period 1974–75 to 1977–78, the states passed on to local authorities road grants totalling $347 million, which represented 20% of the total grants for roads the states received from the Commonwealth. These grants represented about 13% of the funds expended by local authorities on roads.

New South Wales and South Australia have a combination of adult franchise and property franchise, while in Victoria, Western Australia and Tasmania the electorate has a property franchise and plural voting is possible. Elections are held every year in Victoria, Western Australia and Tasmania (excluding Hobart); every two years in South Australia and Tasmania (Hobart); and every three years in Queensland and New South Wales. The number of elected members varies from four to 24.
Chapter 6

The Australian Loan Council

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The Australian Loan Council is a unique institution among federations in that it controls the borrowing of the entire public sector in Australia, other than borrowing for temporary purposes and for defense. The amount which may be borrowed each year for public investment by the federal government, state governments, state semigovernment authorities (that is public corporations) and local authorities is determined by the Loan Council and not by their own parliaments and executive bodies.

The Loan Council consists of the Prime Minister of the Commonwealth of Australia (the federal government) and the Premiers of the six states. The member representing the Commonwealth is chairman of the Loan Council. Any member may nominate one of his cabinet ministers or, in special circumstances, some other person to represent him. In practice, the Treasurer of the Commonwealth is usually nominated as his representative by the Prime Minister and acts as chairman of the Loan Council even though the Prime Minister takes part in the meetings. State Premiers represent their states except in special circumstances. If the Premier is not also Treasurer of his state, the

Treasurer will attend also. Officials of the governments represented are always present as advisers.

A meeting of the Loan Council may be convened at any time by the Commonwealth and must be convened if at least three states request a meeting. A meeting is always held near the end of the financial year (30 June) to determine loan programs for the ensuing 12 months. Frequently another meeting is held about the following February to review the program in the light of developments in the economy. Meetings at other times of the year are not common.

The Commonwealth has two votes and a casting vote, while each state has one vote. The Commonwealth can therefore muster a majority of votes (5 to 4) if two of the six states vote with it. It takes at least five states to outvote the Commonwealth. Some decisions require a unanimous vote, the most significant of these being the allocation of loan funds among the states.

Loan Council meetings are always held in parallel with Premiers' Conferences, at which the Prime Minister and the State Premiers deal with intergovernmental financial arrangements (including, more recently, Commonwealth grants to local authorities) together with any other matters of mutual concern. Loan Council meetings are always held in camera which facilitates serious discussion, statements intended for the ears and eyes of the media being launched outside the meetings.

The Commonwealth Treasury provides the secretariat for the Loan Council and the Reserve Bank (Australia's central bank) acts as the agent of the Council in issuing, converting and redeeming securities. All securities issued for the Commonwealth and the states are Commonwealth securities, guaranteed by the Commonwealth.

These procedural arrangements strengthen the position of the Commonwealth to some extent, but a much more significant advantage arises from the fact that the Loan Council's advice on the terms and conditions on which loans should be issued in Australia, and on the amount which might be raised, necessarily comes from the Reserve Bank. The Reserve Bank is in a position to influence the bond market through its open market operations. However, the bond market is very thin in Australia and open market operations have a much greater effect on rates of interest than on liquidity. If, in the interests of monetary policy, the Reserve Bank acts to force up interest rates, tension can arise within the states which dislike increases in interest rates for budgetary reasons and also deplore the adverse effects on loan raising of the consequential drop in the market value of existing bonds.

Origins of the Loan Council

The Loan Council began as a voluntary body which met for the first time in February 1924 as a result of suggestions made by the Commonwealth Treasurer, Dr. Earle Page, at the Premiers' Conference in 1923. The Commonwealth had incurred a very substantial war debt during World War I and the conversion and redemption of maturing war loans was a sizeable program in itself. In addition, the states had embarked on a major program of postwar development, involving the borrowing of large amounts of money in Australia and overseas.

Despite setbacks, including the withdrawal of the most populous state, New South Wales, from July 1925 to December 1927, the voluntary Loan Council was reasonably successful in promoting an orderly approach to loan markets, including agreement on uniform rates of interest, the amounts to be raised, a timetable for loan issues by each state and the issue of uniform Commonwealth securities for both Commonwealth and state loans in Australia and New York (though not in London).

In June 1927, Page submitted to the voluntary Loan Council the draft of a proposed Financial Agreement. The agreement provided for the setting up of the Australian Loan Council on a compulsory basis to regulate borrowing by the Commonwealth and the six states; for contributions by the states to the National Debt Sinking Fund to provide for the gradual redemption of state as well as Commonwealth debt; and for grants by the Commonwealth to the states to meet part of their obligations for interest and sinking fund. The present article is concerned only with the first of these proposals.

The Financial Agreement

All seven parliaments enacted the legislation
necessary to implement the Financial Agreement during 1928, displaying unusual speed and unanimity. The preamble to the agreement indicated that it could not be given permanent effect until the Commonwealth Constitution had been amended, but affirmed that, pending a referendum, the parties would observe the agreement during the two years from 1 July 1927 to 30 June 1929.

G. Sawer has commented that:

the part of the agreement providing for the Loan Council might not have been constitutionally valid, or at least might have been subject to withdrawal at will by the parties if it had rested merely on Commonwealth and state legislation, and there were doubts about the constitutional validity of other parts of the agreement . . . .¹

A referendum was held in November 1928, in conjunction with federal elections. The electors were asked to approve the insertion of section 105A into the Commonwealth of Australia Constitution, authorizing the Commonwealth to make agreements with the states with respect to the public debts of the states along the lines set out in the new section. The referendum was supported by all political parties and it was approved in all states, 74% of the voters endorsing the proposal in Australia as a whole.

It is abnormal in Australia for proposals amending the Constitution to be successful at referenda, and the overwhelming support given on this occasion has always puzzled commentators. There was a positive phobia in Australia at the time about the burden of public debt. Enthusiastic assurances were given to voters that the amendment would result in the restriction of future borrowing by governments and that the National Debt Sinking Fund would ensure that the existing public debt would be paid off.

Section 105A of the Constitution included a provision that the Commonwealth Parliament may make laws for the validating of any agreement made in accordance with its terms before it became part of the Constitution. This was done by the Commonwealth Parliament early in 1929, so giving the Financial Agreement permanent effect. Thereafter, although section 105A provides that an agreement made under it “may be varied or rescinded by the parties thereto” no one party can escape from the obligations imposed by the Financial Agreement unless the consent of all other parties can be obtained (nor may any new state be admitted to participate in the agreement without the consent of all existing parties). Enforcement of the Financial Agreement was entrusted to the Commonwealth government, not the states, under section 105A.

The Loan Council in the Great Depression

The Loan Council became involved in all the stresses and tensions of the Great Depression soon after its inauguration, even more so because overseas loans were cut off abruptly in 1930, and the interest payments due. These debts, mainly to overseas lenders, became an abnormally high proportion of government expenditure and of overseas payments. Those who wished to maintain public investment as a means of ameliorating the appalling unemployment that was characteristic of the early 1930s, debated the issue with the exponents of balanced budgets in the forum provided by the Loan Council.

In the event, the Commonwealth Bank of Australia, which was carrying out some of the functions of a central bank,² exercised a decisive role as a supporter of “sound finance,” though it had to compromise to some extent by making very substantial “temporary” loans to the states in 1931 and 1932, to cover budget deficits. These loans, which took the form of Treasury Bills with a currency of three months, were renewed and renewed until finally converted into long term debentures in 1936.

The Gentlemen’s Agreement

In order to escape the restrictions imposed on borrowing by the Loan Council, New South Wales from 1932 to 1936 increased borrowing by autonomous public corporations. Neither these bodies, which came to be known as “semigovernment bodies,” nor local authorities were subject to the control of the Loan Council under the original Financial Agreement and could borrow independently.

By 1936, there was general agreement among members of the Loan Council that autonomous government bodies which could borrow independently were a threat to the system of order-
ly borrowing by the public sector. In May 1936, therefore, the Loan Council agreed, under what came to be known as the Gentlemen’s Agreement, that the loan programs of semigovernment and local government authorities were henceforth to be subject to approval by the Loan Council.

In practice, each state government submits a list of those semigovernment and local government authorities seeking more than a prescribed amount of loan money, showing the amount sought by each. A statement of the total amount sought by those semigovernment and local authorities, which wish to borrow but need only the ceiling amount or less, is also furnished by each state.

The prescribed amount has been increased from time to time under the impact of inflation and was set at $800,000 for the year 1976–77. Since 1962–63, semigovernment and local authorities seeking less than the prescribed amount have been given automatic approval to do so but must conform to the terms and conditions applying under the Gentlemen’s Agreement. It was accepted that the total amount raised by the smaller authorities was never a threat to the loan program as a whole.

The Loan Council determines the amount which may be raised by each authority seeking more than the ceiling amount and also the rate of interest payable (0.25 to 0.4% higher than the rate for Commonwealth securities). A number of the larger authorities are permitted to issue their own debentures. The Loan Council secretariat arranges a timetable for each public loan which is binding on the authorities concerned. A large proportion of the money borrowed is raised in the form of private loans from savings banks and life insurance offices.

State semigovernment and local authorities are represented on the Loan Council by their parent governments, federal or state, and local authorities in particular resent their exclusion. The Labor government which held office between 1972 and 1975, attempted to amend the Financial Agreement to permit the representation of local authorities on the Loan Council, but the states unanimously rejected the proposal.

Local authorities have traditionally played a very minor role in Australia; until recently most of their activities being related to sanitation services and the construction and maintenance of local roads. The states have carried out all the major functions associated with local authorities in the United States and the United Kingdom, such as the provision of schools, hospitals and police services. State statutory authorities, which usually operate as public enterprises, provide a good deal of the electricity, water supply, transport services, provision of houses and so on, either for the state as a whole or for areas within the state corresponding to a group of local authorities. As noted above, these intermediate authorities have traditionally been described as “semigovernment authorities.” They are now coming to be known as public corporations.

**Allocation of Loan Raisings**

One of the major decisions confronting the Loan Council has always been the distribution of loan proceeds among its members. The Financial Agreement requires a unanimous vote for this decision and, failing unanimity, an allocation of 20% to the Commonwealth, if it so desires, with the states sharing the balance in proportions equal to the ratios of their net loan expenditures during the preceding five years to the “net loan expenditures” of all states during that period.

Doubts have been expressed as to how the term “net loan expenditure” would be interpreted by the High Court and, because of this, the allocation has always been the result of a unanimous vote. Very often, however, the allocation accepted unanimously conformed to the proportions indicated in tables showing the net loan expenditure of each state as interpreted by the secretariat. In recent years, the allocation has usually been based simply on the previous year’s allocation.

The tendency for each state to defend its “entitlement” in the allocation of loan raisings has imparted an undesirable element of rigidity to the process. In cases where there were significant demographic movements or marked upsurges in development in particular states, such as what resulted from the great mineral discoveries in Western Australia and Queensland, historical shares of loan funds were unlikely to be a reasonable guide to rational allocations. New South Wales and Queensland also suffered from low entitlements in the late 1950s and early 1960s, due to the fact that in
the early post-war years they had drawn on surpluses earned from the transport of men and munitions on their railway systems during the war, in preference to incurring debt.

Marginal adjustments were sometimes made to entitlements by agreement among the states, those whose entitlement was favorable yielding a little of their allocation to states which were hard pressed. Sometimes a state's entitlement to loan funds for its local and semigovernment authorities was favorable where its state entitlement was not, and some transfer of funds could be arranged. Occasionally, to solve a severe shortage of loan funds for a particular state a sum of money would be added to its allocation and to the total program on the understanding that this would not increase its entitlement in subsequent years. This required the agreement of the Commonwealth and the other states.

In 1974-75, New South Wales received a permanent addition of $10 million to its loan program and a further $10 million for the loan program of its local and semigovernment authorities. This adjustment increased the state's proportionate entitlement for future years but was accepted by the Commonwealth and all the states in recognition of the fact that New South Wales's entitlement had been inadequate for many years and was not likely to be improved sufficiently without special measures.

**Post-War Domination of the Loan Council By the Commonwealth**

During World War II, normal public investment fell away to minimal levels and borrowing was concentrated on defense needs. The Loan Council returned to importance after the war, when governments faced the task of eliminating the backlog of public investment projects and providing for economic growth. Initially, shortages of equipment and materials restricted the need for finance but the amount borrowed rose rapidly each year until, by 1950-51, loan raisings by state governments, state semigovernment and local authorities reached 6.8% of gross domestic product.

For the following year, 1951-52, the states sought an increase of 85% in their loan programs. The Commonwealth could see no prospect of raising the amount proposed at reasonable rates of interest and proposed an increase of 40%. However, it volunteered to underwrite the lower amount by making up any shortfall in public loan raisings from its own resources. Four states, in the full flush of restoring the community's infrastructure, rejected this proposal but the votes of Western Australia and Tasmania, with the Commonwealth's normal two votes and its casting vote, gave a majority of 5 to 4 for the state loan program proposed by the Commonwealth.

In the event the amount raised was less than half what had been raised in the previous year from public loans, and was equivalent to only one-third of the approved loan program. The Commonwealth actually provided 67% of the approved program from its own resources, some from the proceeds of loans raised overseas but most from its own surplus taxation revenue. The money was issued to the states in the form of a so-called "special loan" at market rates of interest. In total, the loan program of the states, state semigovernment and local authorities amounted to 8.2% of the gross domestic product, the peak proportion during the whole of the post-war period.

In 1952-53, the states sought a much more moderate 10% increase in their loan programs, to $495 million. However, the Commonwealth insisted on a 20% reduction to $360 million, again offering to provide any shortfall between this amount and loan raisings as a special loan to the states. The states rejected this proposal out of hand and unanimously voted for a loan program of $495 million. This became the state loan program approved by the Loan Council.

Loan raisings in the market totalled $117 million and the Commonwealth subscribed $263 million or 69% of the total program of $380 million, the Commonwealth finally having agreed to $20 million more than it had originally stipulated. It was now demonstrated that it was a fruitless exercise for the states to use their voting power to approve a larger loan program than the Commonwealth was prepared to approve, unless the market could yield the amount they desired.

The Commonwealth had no wish to make the underwriting of state loan programs a permanent feature of Loan Council operations. The Prime Minister R. G. (later Sir Robert) Menzies told Parliament that the Commonwealth had no intention of accepting permanently "the burden and obloquy of imposing extra taxation in
order to provide funds for state works programs in excess of the savings of the people...."

Nevertheless, during the 25 years from 1951-52 to 1975-76, the Commonwealth has made good through special loans any shortfall between the state loan programs and loan raisings from the public. A shortfall has occurred in 22 of those years and it has been substantial in nearly all of them. In addition to underwriting state loan programs, the Commonwealth underwrites the redemption of maturing securities originally issued on behalf of the states and not converted to new securities at maturity.

Since 1966, all borrowing overseas has been left to the Commonwealth which, indeed, has a charter from the Loan Council to borrow abroad when the opportunity arises on acceptable terms. This charter is colloquially known as a hunting license, but cannot be used to raise funds for defense purposes or for normal public investment requiring Loan Council approval. It is used to provide funds for the special loans or to meet redemptions of Commonwealth or state debt maturing overseas which cannot be met from the National Debt Sinking Fund.

The retirement of the states from overseas borrowing has not prejudiced the availability of loan funds for their works programs, because they are assured of the amount underwritten by the Commonwealth. The negotiation of terms for cash or conversion loans overseas is much more simplified when the agreement of the states does not have to be secured step by step. When the proceeds of overseas loans are used to finance special loans or to meet redemptions of state debt, the states incur a debt to the Commonwealth on which interest is charged at the current long-term bond rate in Australia, not the rate actually paid on the overseas loans.

As well as having the finance for their loan programs and redemption of maturing debt guaranteed by the Commonwealth, the states are provided with their loan funds in regular monthly installments. Like the Commonwealth, the states are empowered under the Financial Agreement to borrow money for temporary purposes without seeking the approval of the Loan Council; they could therefore smooth out seasonal fluctuations in funds in this way. The Commonwealth is much better placed to do this, however, because of its access to the Reserve Bank for temporary finance.

The Commonwealth attaches conditions to its underwriting of the state loan programs, namely acceptance of the Commonwealth's proposals for the amount of the aggregate programs, an undertaking to ensure the compliance of the larger state and local authorities with the approvals given by the Loan Council, and public support by the states for Commonwealth loan raisings. The Commonwealth has never specified how the funds provided for state loan programs are to be expended. The whole of these programs, whether from public loan raisings, Commonwealth underwriting or Commonwealth grants, have always been treated as general purpose funds to be expended in accordance with state priorities.

The system has resulted in public investment becoming an area of stability in the economy. Since the early 1950s, public investment has not been used as an instrument of compensatory fiscal policy—the underwriting mechanism has been used to prevent violent changes in public investment. Borrowing by state semi-government and local authorities, though not underwritten by the Commonwealth, has also enjoyed a considerable measure of stability because private loans from savings banks and life insurance offices have insulated them from fluctuations in the proceeds of public loans.

The Commonwealth did not need to obtain the approval of the Loan Council for its own capital works program during the post-war period until 1975-76, let alone invoke its entitlement to 20% of loan proceeds. Normally, Commonwealth revenue exceeded expenditure (including capital expenditure) by a very substantial amount. The surplus in the Consolidated Revenue Fund was transferred to subsidiary accounts which provided most of the funds for the special loans each year in support of the state loan programs.

In years when the Commonwealth's cash commitments exceeded revenue, which happened when the amounts needed for special loans were high, part of the expenditure on defense was charged to Loan Fund instead of to the Consolidated Revenue Fund, enlarging artificially the "surplus" available for transfer to subsidiary funds. The amount charged to Loan Fund was financed by temporary borrowing. It will be remembered that neither defense ex-
penditure nor temporary borrowing is subject to the control of the Loan Council.

Changes in Relative Debt Positions During the 1970s

Although the operations of the Loan Council in the 1950s and 1960s, led to a secure provision of loan funds for state governments, state semigovernment and local authorities, they also led to a steady increase in indebtedness for those authorities. The Commonwealth government, on the other hand, with a monopoly of income tax, customs and excise duties, sales tax and payroll tax, was reducing its net indebtedness year by year from 1948-49 onwards, and by the late 1960s, had become a net creditor in relation to all other sectors of the economy combined. It was a particular grievance of the states that most of the special loans from the Commonwealth to supplement public loan raisings came from the Commonwealth’s surplus taxation revenue.

The equity or otherwise of this arrangement was not a simple matter to determine. The Commonwealth was gradually paying off a very substantial war debt and state governments, state semigovernment and local authorities were investing a good deal more money in revenue-earning public enterprises than was the Commonwealth. In the five years from 1948-49 to 1952-53, however, the Commonwealth was able to spend an amount equivalent to 1.3% of the gross domestic product on fixed capital investment for public enterprises from its surplus of revenue over current expenditure and still lend more money to the states and other sectors than it borrowed. In fact it reduced its net indebtedness by an amount equivalent to 3.0% of the gross domestic product.

During the same period, borrowing by state governments, state semigovernment and local authorities exceeded their lending by an amount equivalent to 5.7% of gross domestic product. Of this, an amount equivalent to 4.9% of gross domestic product was needed for the acquisition of fixed capital assets for public enterprises and the balance was used for other types of expenditure, including fixed capital expenditure of a nonrevenue-producing nature (such as for school buildings). Clearly, the subnational authorities were borrowing to finance nonrevenue-reducing expenditure as the Commonwealth had been obliged to do during the war.

The position with respect to debt slowly improved from the point of view of subnational authorities during the 1950s and 1960s. During the five years ending 30 June 1970, they increased their net indebtedness by an amount equivalent to 3.4% of gross domestic product and needed 2.6% for investment in public enterprises. However, the Commonwealth was still reducing its net indebtedness (by an amount equivalent to 1.4% of gross domestic product during the same five-year period) while financing investment in public enterprises from surplus revenue by an amount equivalent to 1.1% of gross domestic product.

At the Premiers’ Conference held in 1970, the state governments presented a demand for a share of income tax to improve their relative financial position. The Prime Minister, J. G. Gorton, rejected this proposal but made a number of changes designed to improve the position of the states, including an increase in revenue grants as a proportion of gross domestic product, the transfer of $1 billion of state debt and the charges thereon to the Commonwealth over a period of five years, and the substitution of capital grants for loans for nearly one-quarter of the state works and housing programs. In 1971, the Commonwealth also agreed to transfer payroll tax to the states; this has become the biggest tax under their control.

Subsequently, in 1974 and 1975, the Labor government greatly increased grants to the states for schools and hospitals and significantly expanded cash social service benefits which in Australia are provided to citizens by the Commonwealth. By 1975–76, the relative position of the Commonwealth and the subnational governments had turned around. In that year, the net indebtedness of state governments, state semigovernment and local authorities increased by the equivalent of 2.0% of gross domestic product and they needed 2.2% for capital investment in public enterprises.

The Commonwealth, on the other hand, increased its net indebtedness by 2.8% of the gross domestic product and needed only 0.9% for financing the capital expenditure of public enterprises. These data demonstrate that there has been a marked change in the relative financial position of the Commonwealth and subna-
tional governments during the 1970s, to the ad-

vantage of the latter. The states and their
subsidiary authorities are now borrowing less
than they need to provide capital investment
for their public enterprises, while the Com-
monwealth is borrowing a great deal more than
it needs for the same purpose, basically to fi-
nance grants to the states. In 1975–76, the
Commonwealth sought Loan Council approval
for loan raising for some of its expenditure and
did so again in 1976–77, for the Australian
Telecommunications Commission, one of its
public corporations.

If the Commonwealth is becoming more be-
holden to the Loan Council, two states may be
coming less so. These are Queensland and
Western Australia, in which enormous mineral
resources have been discovered in recent years
leading to massive developmental expenditure
and a great increase in exports. These states
have not been crippled by the increase in capi-
tal expenditure needed or by the inability to
obtain additional funds from the Loan Council
as might be expected.

The companies which have developed the
mineral resources have been required to pro-
vide most of the capital for the necessary
infrastructure (including port facilities, rail-
ways and even townships) and to guarantee
sufficient use of transport facilities to cover
operating expenses. In Queensland, the state
has repaid debt on mineral railway lines fi-
nanced in this way from revenues from freight
charges which include a royalty element. In ad-
dition, the companies have been paying explic-
it royalties to the states concerned, initially at
rather low rates but recently at higher rates.

These developments have strengthened the
financial position of the two outlying states
and promoted a disposition to question Com-
monwealth supremacy in the Loan Council.
Western Australia, in particular, has proposed
that it be permitted to set up a state develop-
ment authority which would seek loan funds
overseas independently of the Loan Council.
Whether the states finance their developmental
infrastructure through direct borrowing over-
seas or by compelling the companies who are
granted mining leases to provide the funds,
their dependence on the Loan Council is less-
ened.

Another development which has some poten-
tial for weakening the authority of the Loan
Council is the use of leasing arrangements.
Queensland has thus leased office buildings
from state enterprises and the New South
Wales Transport Commission recently leased
some 200 buses. If state authorities made a
practice of obtaining capital assets by means of
leasing arrangements, with an obligation or op-
tion to purchase, they could escape Loan Coun-
cil supervision even though they would be, in
fact, borrowing money and paying interest on
the loans. The fact that the amounts of the
loans and the interest are not clearly distin-
guished puts the transactions in a grey area as
far as the Loan Council is concerned. There is
no evidence, however, that any state intends to
take advantage of this loophole in order to es-
cape control by the Loan Council.

A similar transaction was engaged in many
years ago by the Brisbane City Council, the lo-
cal authority governing the capital city of the
State of Queensland. Unable to obtain a loan al-
location to complete the sewerage of Brisbane,
an enterprising Lord Mayor entered into what
was virtually an installment purchase arrange-
ment with a contractor. The contractor fi-
nanced the work and the Brisbane City Council
undertook to repay him over a period of years
at a rate of interest which seemed high at the
time.

In this case the local authority was seeking to
escape from the indifference, if not jealousy of
the state government rather than the control of
the Loan Council. The Queensland government
had for many years been more interested in
securing increased loan funds for its own proj-
ects than in making a case for the Brisbane City
Council. Its disposition was rather to switch
loan raising entitlements from subsidiary au-
thorities to state loan funds.

A Possible Threat to the Permanence of the
Loan Council

The powers of the Loan Council are set out in
Part I of the Financial Agreement and most of
them are subject to a curious proviso which
reads "while Part III of the Agreement is in
force." It has been suggested that Part III of the
Financial Agreement may no longer be in
force, in a legal sense, when commitments set
out in some of its clauses cease to have effect. In
this case, most of the powers of the Loan
Council would lapse.
It would seem that the phrase, "while Part III of the Agreement is in force," was meant to delay the assumption by the Loan Council of the powers given to it in Part I of the Financial Agreement, until the provisions requiring the Commonwealth to meet part of the obligations for interest and sinking fund contributions on state debt came into force. Whether or not this interpretation would be acceptable to the High Court, it seems unlikely that the termination of some of the obligations imposed on the Commonwealth by Part III of the Financial Agreement would result in a ruling by the High Court, if the matter were brought before it, that Part III was no longer in force.

A number of amendments to the Financial Agreement were agreed to by the Commonwealth and the states in 1976. One of them was to replace a provision relating to sinking fund contributions in Part III by new sinking fund arrangements which are interminable. The only commitment under Part III which will now cease (in June 1985) is the annual grant made to each state by the Commonwealth of amounts aggregating $15,169,824 by way of an interest offset on state debt.

If there is substance in the argument that the termination of any part of Part III could put an end to the powers of the Loan Council set out in Part I, an amendment to the Financial Agreement, agreed by all parties, would be necessary if the powers of the Loan Council were to be preserved.

**Temporary Borrowing and the Loans Affair**

Reference has been made earlier to the power of the Commonwealth and of each of the states to borrow for temporary purposes without seeking the approval of the Loan Council. Clause 6(7) of Part I of the Financial Agreement reads:

> Notwithstanding anything contained in this Agreement, the Commonwealth may use for temporary purposes any public moneys of the Commonwealth which are available under the laws of the Commonwealth or may, subject to maximum limits (if any) decided upon by the Loan Council from time to time for interest, brokerage, discount and other charges, borrow money for temporary purposes by way of overdraft or fixed, special or other deposit, and the provisions of this Agreement other than this sub-clause shall not apply to such moneys.

The clause has proved exceedingly useful in dealing with seasonal variations in cash flows. Typically, the Commonwealth draws on the Reserve Bank for cash in times of seasonal shortage, issuing Treasury Bills to the Bank with a maturity of three months and an interest rate of 1%. When there is a seasonal surplus of cash, Treasury Bills are redeemed. As grants to the states and funds for the loan program are paid over to the states in regular monthly installments, the Commonwealth also irons out seasonal fluctuations in the receipts of the states. During the early 1970s, the Commonwealth accumulated substantial cash balances and made no use of Treasury Bills.

The term "temporary purposes" was not defined in the Financial Agreement. From 1930 onwards it came to be identified with the issue of Treasury Bills to the Reserve Bank in place of an overdraft and to Commonwealth Government subsidiary funds which had unused balances to invest. More recently, the Commonwealth has issued Treasury Notes carrying market rates of interest with a currency of three months or six months which are used by large organizations in the private sector, especially financial institutions, as an outlet for surplus cash to be redeemed when cash is short. As Treasury Notes affect the call on Treasury Bills by the Commonwealth, they have been accepted by the Loan Council as a form of temporary borrowing. Borrowing for temporary purposes has come to be identified with the issue of Treasury Bills and Treasury Notes, even though a pool of such securities may be on issue at all times.

If the term "temporary purposes" lacked any clear legal definition, there was no question that borrowing for temporary purposes was not subject to approval by the Loan Council or to any limitation as to the amount borrowed, provided the interest rate and other borrowing costs conformed to current Loan Council decisions. This situation led to a bizarre incident during the Whitlam government's period of office.

At some time during 1974, a number of ministers were informed that a foreign financier could arrange a loan of $4 billion from Arab oil sources, repayable at the end of 20 years. The
amount was enormous by Australian standards for foreign borrowing. In December 1974 the Prime Minister, Treasurer, Attorney-General and Minister for Minerals and Energy signed an Executive Council Minute authorizing the raising of $4 billion for temporary purposes. The Commonwealth was thereby enabled to avoid reporting the proposed loan to the Loan Council or seeking its approval.

Prolonged and totally fruitless negotiations followed with the go-between. Meanwhile, the story leaked out and was orchestrated by the opposition and the media for much of 1975. No firm statement was ever made by the government of the uses to which the loan proceeds would have been put, although it was suggested that they were to have been used for the development of energy resources. It has also been suggested that the loan could have been used to provide some of the funds denied to the government by the Senate when it deferred consideration of the Budget for 1975–76. But this would not have solved the government's problem as Senate approval of the appropriation bills would have been necessary to provide authorization of the proposed expenditure.

The secrecy surrounding the signing of the Executive Council Minute and the obvious attempt to make use of a legal technicality to keep the matter from the scrutiny of the Loan Council told heavily against the government. Apart from that, it is inconceivable that Treasury officials, if they had ever been consulted, would have given any credence to the proposition that a loan of such magnitude could have been obtained through an unauthenticated unofficial source. The affair was a continuing source of embarrassment for the Prime Minister, and played a significant part in the government's defeat at the election in December 1975.

Conclusion

The Australian Loan Council was set up 50 years ago when the financial structure of the country was much simpler and the responsibilities of government much less. Then as now, all the major functions of government were concentrated in the hands of the Commonwealth and six states. It would probably be much more difficult to set up a Loan Council now than it was then. It is hardly conceivable that a similar body could be set up in a federation like the United States, with its vast population, its multitude of local authorities exercising major functions of government, its 50 states and its complex economy.

The Loan Council has served Australia extremely well and is likely to continue to do so. The coordination of borrowing and the achievement of uniformity in interest rates are sufficient benefits in themselves. But, in addition, the Commonwealth has been able to control the amount of loan raising of the whole of the public sector since 1952, and has done so to prevent either excessive or inadequate public investment. Coupled with the fact that, since 1942, the Commonwealth has had a monopoly of income taxes and commodity taxes, and provides the states with more than half their revenue in the form of grants, the federal government of Australia has been in a position to implement fiscal policy in a manner that simply is not open to the federal government of the United States.

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FOOTNOTES

2 The Commonwealth Bank's central banking functions were not complete until 1945. It was not until 1960 that they were separated from the Bank's trading and savings bank functions and handed over to a new central banking institution, the Reserve Bank of Australia.
3 R. S. Gilbert details the relevant arguments (which he himself disputes) in The Future of the Australian Loan Council, Chapter 2, Research Monograph No. 6, Canberra, Centre for Research on Federal Financial Relations, The Australian National University.
SELECTED ACIR
PUBLIC FINANCE REPORTS


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The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from states nominated by the National Governors' Association, the National Conference of State Legislatures, the National League of Cities, U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

Each Commission member serves a two year term and may be reappointed.

As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently being placed on traditional governmental taxing practices. One of the long range efforts of the Commission has been to seek ways to improve Federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration, and reduced compliance burdens upon the taxpayers.

Studies undertaken by the Commission have dealt with subjects as diverse as transportation and as specific as state taxation of out-of-state depositaries; as wide ranging as substate regionalism to the more specialized issue of local revenue diversification. In selecting items for the work program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policies.