

THE ADVERSE ATTRIBUTES OF SPECIFIC PURPOSE PAYMENTS IN AUSTRALIA

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Commonwealth legislation and High Court decisions throughout the 20th century have left Australian State governments with the power to raise little more than half of the revenue they require for the services and facilities they provide. For a substantial portion of supplementary revenue, States rely on Specific Purpose Payments provided by the Commonwealth. These payments are ‘tied’ so that they are conditional upon Commonwealth/State agreements. Because States are able to raise little of their own revenue, they are in a poor bargaining position when these Specific Purpose Payments are negotiated. This has allowed the Commonwealth to encroach upon the traditional realm of State responsibility by tying payments in areas such as health and education. The consequence of this has been to undermine the principles of democratic accountability and federalism in Australia. While the outlook for any practical change in this situation is bleak, there are a number of underlying principles to which both the State and Commonwealth governments could refer, that would help to ease this vertical fiscal imbalance.

I INTRODUCTION

In 1942, in the midst of fighting the Second World War, Australia faced a dramatic escalation of costs based on the forecast of war expenditure.¹ The need for a more concentrated military effort made it necessary for the Commonwealth government to introduce a federally coordinated tax system. It did this by introducing three pieces of legislation to usurp the power of the Australian State governments to levy taxes and deny grants to any state that did so.² The *Income Tax Act 1942 (Cth) (ITA 1942)*, the *Income Tax Assessment Act 1942 (Cth) (ITAA 1942)*, and the *States Grants*

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¹ S J Butlin, *Official Histories: Second World War Vol IV War Economy 1942-45* (1977) Australian War Memorial <<http://www.awm.gov.au/histories/chapter.asp?volume=33>> at 2 May 2005.

² ‘States’ refers to States and Territories unless otherwise noted.

(*Income Tax Reimbursement*) Act 1942 (Cth) (*States Grants Act 1942*) together became known as the 'Uniform Income Tax Legislation' and governed federal-State funding until repealed in 1959. In 1959, the Menzies government passed the *States Grants Act 1959* (Cth) (*States Grants Act 1959*), which slightly changed the basis and formula for the distribution of grants. Despite this and various other changes in law, there has been little change in the form of the policy or the substantive financial arrangement, and since 1942, States have continued to rely on the federal government for funding.

The Commonwealth's Uniform Income Tax Legislation made it too burdensome for the public to pay both State and Commonwealth taxes so the States were effectively forced to relinquish their power to levy income taxes. Further, ss 90 and 92 of the *Australian Constitution* restrict States from the imposition of taxes on goods (the latter insofar as taxes would affect free trade between States).³ Consequently, States are able to raise only 56% of the revenue they require for the services and facilities they provide.⁴ This figure is an average percentage from 2001-02 to the projected 2005-06 Specific Purpose Payment funding, though the quantity of funding does remain fairly constant.⁵ To raise this revenue States rely on such fees as they can charge for the provision of their services such as 'business licence fees, motor-vehicle registration fees, taxes on transactions (such as gambling) and stamp duties on land registration.'⁶ The remaining 44% of combined State revenue, or \$53 billion,⁷ is provided by the federal government under s 96 of the *Constitution*, which allows Parliament to grant financial assistance

³ *Australian Constitution* ss 90, 92.

⁴ Australian Government Department of Treasury, *2002-3 Budget Paper No 3* (2003) <http://www.budget.gov.au/2002-03/bp3/html/07_BP3AppB.html> at 15 October 2005.

⁵ *Ibid.*

⁶ J Harrison, *Total Tax Review: Major Reform Issues* (2003) Parliament of Australia Parliamentary Library <<http://www.aph.gov.au/library/pubs/CIB/1996-97/97cib7.htm>> at 10 October 2005.

⁷ Committee for the Review of Commonwealth-State Funding, *Review of Commonwealth-State Funding Final Report* (2002) 39.

to any State ‘on such terms and conditions as the Parliament thinks fit.’⁸ These grants, which now constitute an essential contribution to the maintenance of State responsibilities, are currently made in two ways; these are General Purpose Grants and Specific Purpose Payments.

General Purpose Grants are given to States without condition and can be used for any purpose the States wish. The result of this is that States can decide where and, just as importantly, when money is best spent. Specific Purpose Payments (SPPs) are given solely for the implementation of specific projects. They generally stem from agreements between the State and Commonwealth governments and include conditions on the availability and use of funding.⁹ The 2002-03 Commonwealth budget predicted approximately 97 different SPP projects for the 2004-05 financial year.¹⁰ In 2002 these projects ranged from \$6 000 to \$6.6 billion.¹¹ Of the \$53 billion given to States in 2002, General Purpose Grants made up approximately 60.3%, or \$32 billion, and SPPs made up the remaining 39.7%.¹²

The inability of States to produce the revenue that they require, and their subsequent reliance on grants, has led to what is known as ‘vertical fiscal imbalance’, that is, minimal correlation between what governments earn and what they spend. In Australia’s case, the federal government uses tied grants to influence State spending decisions.

In section II, this paper will look at how SPPs have developed since the 1942 Uniform Income Tax Legislation and become more prevalent throughout the second half of the 20th century to the point where they are now a powerful Commonwealth tool. In section III, it will track the corresponding reliance on SPPs by the States, and, using a number of examples, demonstrate how this has practically

8 *Australian Constitution* s 96.

9 A Harding et al, ‘The distributional impact of selected Commonwealth outlays and taxes and alternative Commonwealth grant allocation mechanisms’ (2002) 35(3) *Australian Economic Review* 325.

10 Australian Government Department of Treasury, above n 4.

11 Committee for the Review of Commonwealth-State Funding, above n 7, 59.

12 *Ibid.*

effected federal encroachment upon areas of State responsibility. It will then be argued in sections IV and V that the twin principles of democratic accountability and federalism are becoming increasingly distorted by the distribution method of Commonwealth SPP funds.

It will be contended in section IV, that Australian voters look for different qualities in a State government than in a federal government; and will be argued that, given this, a State government should not be democratically elected and nevertheless share a substantial portion of its spending decisions with a federal government elected on a very different basis. This is a problem because it has the potential to seriously undermine the principle of democratic accountability by obscuring which level of government is responsible for which policy decisions.

The control that the federal government has over the States by virtue of SPPs also undermines the fundamental notion of federalism.¹³ Democratic accountability and federalism somewhat overlap in that within both of their respective realms are issues of who will exercise which governmental powers. However, where democratic accountability affects the political accountability of governments, federalism affects the very role of States in a federal system, that is, to provide a second and more direct level of democracy. If States decide not to follow the policy directions of the federal government, then 39.7% of their Commonwealth funding can be withheld. It will be argued in section V that the detrimental effect this would have on the provision of State services would in turn diminish the role of the State as a second level of popular public participation.

In section VI, this paper will also look at the possible techniques that both State and federal governments have at their disposal to remedy the way that funds are delivered from the Commonwealth to the States to better reflect these principles.

¹³ B Harris, *A New Constitution for Australia* (2002) 137.

II A BRIEF HISTORY OF GENERAL PURPOSE GRANTS AND SPECIAL PURPOSE PAYMENTS

As noted, State revenue as provided by the Commonwealth is currently distributed as either a General Purpose Grant or as SPPs. However, it is useful to examine the earlier origin of State grants, as State reliance upon Commonwealth grants predates this General Purpose Grant/Special Purpose Payment distinction.

A The Original Federal Financial Arrangements 1901-42

The original vision at federation, as enshrined in ss 87 and 90 of the *Constitution*, was that the States would cede to the Commonwealth their customs and excise duties and thus the ability to raise what then amounted to 76% of their revenue.¹⁴ In exchange for this, s 87 provides that no less than three-quarters of the net Commonwealth revenue from duties of customs and of excise should be returned to the States without control over its use for ‘a period of ten years ... and thereafter until the Parliament otherwise provides.’¹⁵ Under s 94 of the *Constitution*, ‘after five years from the imposition of uniform duties of customs’,¹⁶ States were also to receive the surplus revenue generated by the Commonwealth, on such a basis as the Commonwealth deemed fair.¹⁷

The situation changed in 1908 when the *Surplus Revenue Act 1908* (Cth) was passed, that would allow the Commonwealth to retain its surplus revenue instead of passing it on to the States, in preparation for the provision of federally provided pensions.¹⁸ In an effort to

¹⁴ B Grewal and P Sheehan, *The Evolution of Constitutional Federalism in Australia: An Incomplete Contracts Approach* (2001) Victoria University Centre for Strategic Economic Studies <<http://www.cfses.com/documents/wp22-mk.PDF>> at 14 July 2005.

¹⁵ *Australian Constitution* s 87.

¹⁶ *Australian Constitution* s 94.

¹⁷ *Australian Constitution* s 94.

¹⁸ Australian Government Department of Treasury, *Towards Higher Retirement Incomes for Australians: A History of the Australian Retirement Income System Since Federation* (1999) Press Release <<http://www.treasury.gov.au/documents/110/RTF/4round.rtf>> at 10 October 2005.

make up some of this loss, the Commonwealth resolved to provide grants to the States. Consequently, at the end of the 10 year prescribed period, surplus Commonwealth revenue would be fully retained by the Commonwealth. As compensation a supplementary grant would be made to the States. This grant, as well as customs and excise duties revenue, were pooled and distributed to the States. This was the system that endured until the early 1930s.

Originally grants were provided on an equal per capita basis. However, gradually States in a poorer economic position began to lobby for additional financial assistance.¹⁹ It was this situation that precipitated the need for two further distinct payments, Special Purpose Payments and Equalisation Grants, both of which were very similar to today's Special Purpose Payments and were justified under the *Constitution's* s 96 'financial assistance grants'.²⁰ Thus between 1910 and 1930 all States received a General Purpose Grant and poorer States could receive Special Purpose Payments and/or Equalisation Grants, though the latter two were distributed spasmodically, based on requests by the States which were considered 'at best [with a] haphazard assessment by a variety of bodies and institutions.'²¹

As the situation in the poorer States worsened during the Great Depression, the Commonwealth Grants Commission (CGC) was established as a statutory authority in 1933 to clarify the situation and better evaluate the ever-changing financial needs of those States.²² Originally, the CGC was concerned with 'helping distressed States, rather than equalising all States to a similar standard.'²³ However, its methodology left the door open not just to the three States who were originally most disadvantaged by federation (Western Australia, South Australia and Tasmania) but to

19 Committee for the Review of Commonwealth-State Funding, above n 7, 22.

20 *Australian Constitution* s 96.

21 Committee for the Review of Commonwealth-State Funding, above n 7, 23.

22 Commonwealth Grants Commission website *The Commission and its History* <<http://www.cgc.gov.au/>> at 28 March 2005.

23 *Ibid.*

any State wishing to make a claim. The result of this was an eventual metamorphosis in the late 20th century ‘into the doctrine for comprehensive equalisation encompassing all States.’²⁴

By the end of the 1930s all States received a General Purpose Grant and successful applicant States received Special Purpose Payments and Equalisation Grants. This money was made up of customs and excise revenue and some of the surplus revenue collected by the Commonwealth. The situation was less favourable than it had been in the first 10 years after federation, but States were at least able to supplement their income from the federal government with their own income tax revenue.

B 1942: Uniform Income Tax Legislation and Aftermath

At the Premiers’ Conference in 1941 the States rejected the federal government’s proposal to take over income tax for the duration of the war. Nevertheless, in 1942, Uniform Income Tax Legislation²⁵ was passed under an expanded federal wartime power²⁶ and under s 96 of the *Constitution*,²⁷ which allows Parliament to grant financial assistance to any State ‘on such terms and conditions as the Parliament thinks fit.’²⁸ This meant that the States lost much of the power to raise their own revenue.

The States challenged the Commonwealth legislation in the High Court, first in *South Australia v Commonwealth* (1942) 65 CLR 373 and then in *Victoria v Commonwealth* (1957) 99 CLR 575, respectively the First and Second Uniform Tax Cases. In the First Uniform Tax Case, the States challenged aspects of all three pieces of federal legislation. The States’ first challenge was aimed at the

²⁴ A Morris, ‘The Commonwealth Grants Commission and horizontal fiscal equalisation’ (2002) 35(3) *Australian Economic Review* 320.

²⁵ *Income Tax Act 1942* (Cth); *Income Tax Assessment Act 1942* (Cth); *States Grants (Income Tax Reimbursement) Act 1942* (Cth).

²⁶ *Income Tax (War Time Arrangements) Act 1942* (Cth).

²⁷ *Deputy Federal Commissioner of Taxation (NSW) v WR Moran Pty Ltd* (1939) 61 CLR 735.

²⁸ *Australian Constitution* s 96.

fixing of a very high tax rate, in the *ITA 1942*, which made it near impossible for people to pay both State and Commonwealth taxes. Secondly, the States challenged s 221 of the *ITAA 1942*, which provided that residents of every State must pay Commonwealth taxes before State taxes. Thirdly, they challenged the *States Grants Act 1942*, which would authorise grants to States only where States had not levied their own income tax. The practical effect of these three enactments together meant that the States could no longer politically afford to levy income tax.

In the First Uniform Tax Case, the High Court confirmed the validity of each piece of legislation separately and refused to entertain the argument that their legality was different because of their cumulative effect.²⁹ The Court was unanimous in declaring the legitimacy of the *ITA 1942* and the *ITAA 1942*, although the *States Grants Act 1942* was held valid by a 4:1 majority, and the *Income Tax (War Time Arrangements) Act 1942 (Cth)* was held valid by only a 3:2 majority.³⁰ The case drew a distinction between a coercive law, which would fall outside s 96, and a law which offers financial inducements to a State not to exercise its powers in a particular way. Despite the severity of the legislation it was still held to be an inducement rather than coercion.

While the powers over income tax taken by the Commonwealth were originally to help the war effort,³¹ the failure of the States' High Court challenge meant that the Chifley government was able to retain the power after the war. In 1946, the Commonwealth repealed the *States Grants Act 1942* which had been created with only a limited duration,³² but then the same scheme was repeated in a permanent form in the *States Grants (Income Tax Reimbursement) Act 1946 (Cth)* (*States Grants Act 1946*) to stop States from ever re-entering the income tax field. The effect of the Act was to 'oblige

²⁹ *South Australia v Commonwealth* (1942) 65 CLR 373, 415.

³⁰ *Ibid.*

³¹ Butlin, above n 1.

³² R Fisher and J McManus, *The Long and Winding Road: A Century of Centralisation in Australian Tax* (2002) Australian Taxation Studies Program Discussion Paper Series No 8, University of NSW.

States either to forgo levying income taxes or to operate without Commonwealth grants.’³³

To forgo government grants would have been near impossible in 1946, given the amount of money the States were, by that time, receiving in grants. Adding to this difficulty was the fact that the federally dominated Loan Council, which coordinated loans to State and Commonwealth governments, had, since 1942, ‘severely restricted’³⁴ State borrowing so that finance for the war effort would not be impeded.³⁵

The Second Uniform Tax Case held invalid the priority provision of the first. Chief Justice Dixon said, in a summary of the various arguments used on behalf of the States, ‘no satisfactory legal reason could be advanced’³⁶ towards the State’s case. The other justices were similarly unsympathetic and ultimately the States were unsuccessful, the full court ruling unanimously that the use of s 96 to coerce States to give up taxation powers was valid.³⁷ The *States Grants Act 1946* was also held unanimously to be valid.

By this decision the High Court confirmed the ability of the Commonwealth to allocate grants virtually without restraint over the conditions it could impose. State grants could now be subject to any Commonwealth condition, even where such conditions could be expected to remove a State’s capacity to exercise their constitutional power to raise taxes other than customs and excise duties.³⁸

By 1946 States were almost wholly reliant on Commonwealth grants. The situation would ease as States broadened their capacities

³³ Committee for the Review of Commonwealth-State Funding, above n 7, 26.

³⁴ Australian Government Department of Treasury, *Annual Report 2000-01* <<http://www.treasury.gov.au/documents/109/RTF/Part3.rtf>> at 10 October 2005.

³⁵ Ibid.

³⁶ *South Australia v Commonwealth*, above n 29, 379.

³⁷ Ibid.

³⁸ D Hamill, ‘Taxing Federalism: The Australian Federation in its Second Century’, Paper Presentation to the Paddington Workers’ Club Program (2004) <http://www.fabian.org.au/library/event_papers_2004/1103604591_11277.html> at 17 August 2005.

to generate income from business licence fees, taxes on gambling and the like, but for the meantime State taxes as a percentage of gross domestic product fell from 8% in 1939 to around 2.5% in 1946, making the States heavily reliant on the Commonwealth for subsistence.³⁹

The situation improved only slightly from the 1950s to the early 1970s and by 1976 State income tax as a percentage of GDP was at 6%, but Commonwealth taxes were correspondingly at their highest point ever, which demonstrates no relative gain for the States, only higher taxes.

In 1959 the Menzies government passed the *States Grants Act 1959* and repealed the *States Grants Act 1946*. The purpose was to introduce a new government scheme where a basic grant would take the place of existing tax reimbursement grants and supplements.⁴⁰ Grants were renamed Financial Assistance Grants to remove any connotations of them being reimbursements.⁴¹ This legislation would slightly change the basis and formula for the distribution of grants, but would not alter State reliance upon them or even substantially alter the total amounts given to States, though this amount did increase slightly.⁴²

C Expansion of Federal Funding

In 1972 Whitlam came to office with an agenda of reform in areas that were traditionally and constitutionally the domain of the States. The States were in a vulnerable position, generating a small percentage of their own revenue and relying heavily on Commonwealth grants. To this point the powers realised in the Uniform Tax Cases had not been used to their full potential. General Purpose Grants were still the custom and these did not impose the conditions that the High Court said they had the potential to. Over

³⁹ Committee for the Review of Commonwealth-State Funding, above n 7, 27.

⁴⁰ Fisher and McManus, above n 32.

⁴¹ P Ayres, *Malcolm Fraser: A Biography* (1987) 324.

⁴² Fisher and McManus, above n 32.

his three years in office, Whitlam would oversee the increase of tied SPPs as a total percentage of payments to the States from 20% in 1972, to 43% in 1975.⁴³ This was a long way from the 15% low of 1952, but it would steadily increase under the Hawke/Keating and then Howard governments to a high of 50% in 1999.⁴⁴

Whitlam moved SPPs into the areas of education, health, housing, transport, urban and regional development, and direction of local government.⁴⁵ There was little the States could do, since the loss of their major tax source and inadequate compensation in General Purpose Grants had left them without the money to provide these services themselves.

In 1973 the *Grants Commission Act 1973* (Cth) was passed, which substantially changed the role of the CGC. Until now the CGC had maintained a minor role, distributing only SPPs and Equalisation Grants, and only to States in a dire economic situation. This meant they were distributing only a small percentage of Commonwealth grants (20%). Under the new legislation the CGC would now distribute the much bigger General Purpose Grant instead of SPPs and Equalisation Grants. Further, where the General Purpose Grant had been distributed as compensation to States for the losses of their customs and excise and income tax revenues, the CGC would now distribute the General Purpose Grants in an aim to equalise the States to a standard where the living conditions in each State were not appreciably different from those in other States.⁴⁶ General Purpose Grants would be given to every State, taking into account up to 60 different factors that contribute to a State's inability to provide essential service or create its own wealth.

In other words, General Purpose Grants would take over the former fluxing equalisation role of SPPs and Equalisation Grants, and SPPs would now be the constant add-on of funds that States required to perform their functions and services. Importantly, this change

⁴³ A Simpson, 'Cashing in on the Whitlam formula (Commonwealth grants to states)', *The Australian*, 7 December 1979.

⁴⁴ Committee for the Review of Commonwealth-State Funding, above n 7, 63.

⁴⁵ Simpson, above n 43.

⁴⁶ Commonwealth Grants Commission, above n 22.

coincided with a drop in General Purpose Grants which would now comprise only up to 60% of federal funding, down from 80% in 1972.⁴⁷

SPPs would continue to be a supplement, but this supplement, because of a vast increase in size, would now be a wholly necessary one for every State. Instead of being distributed by the CGC they would be distributed by the Commonwealth, conditional upon the fulfilment of agreements between States and the Commonwealth. Essentially, the Commonwealth had lowered the amount of total funds it was distributing itself, but by taking on the role of distributor of SPPs instead of General Purpose Grants, it had increased its overall importance in the State/federal funding arrangement and thus its bargaining power.

This general scheme is still in operation, but with one more significant progression: the 1999 Intergovernmental Agreement on Reform of Commonwealth-State Relations (Intergovernmental Agreement). In 2000, the Howard government implemented *A New Tax System* which revolved around a Goods and Services Tax (GST) to supplement a cut in income tax. The 1999 Intergovernmental Agreement, signed by all Australian governments, provided that the GST would be distributed to States according to Horizontal Fiscal Equalisation principles as determined and administered by the CGC.⁴⁸

In the distribution of General Purpose Grants, the CGC aims to give a higher share of grant money to States that are judged to have a lower capacity to raise their own revenue or have a higher service delivery cost because of factors such as a lack of rural access to essential services or differences in natural resources.⁴⁹ In this way, the Commission aims to level out per capita financial discrepancies

⁴⁷ Simpson, above n 43.

⁴⁸ J Howard, *Intergovernmental Agreement on Reform of Commonwealth-State Relations* (1999) <http://www.pm.gov.au/news/media_releases/1999/intergovernmental_agreement.htm> at 18 September 2005.

⁴⁹ G Ross and F Vince, 'Issues in Commonwealth-State funding' (2002) 35(3) *Australian Economic Review* 298.

between States so that average cost/wage ratios standardise across State borders.

The fact that the GST was to be distributed instead of other government revenue such as customs and duties excise or Commonwealth income tax surplus, was essentially a change in name rather than substance as the monetary amounts were very similar. However, what did change was the control that the Commonwealth has over the system. Where, formerly, the States had battled the Commonwealth over the level of funding they would receive, this amount would now be relatively predetermined by the amount that the GST brings in. In return for this, the Intergovernmental Agreement leaves the Commonwealth with 'considerable discretion over the size and quantity of SPPs and, therefore, over total payments to the States.'⁵⁰ As a bonus the States now have access to a tax that will grow as the economy grows, but as a detriment the entire system is now controlled by, and can be unilaterally overturned by, the Commonwealth.

The current situation involves a stark division between General Purpose Grants and SPPs, since the prominence of the latter has more than doubled since 1972. The increase of SPPs has coincided with the rapid decline of the States' power to raise their own revenue as relative to what they require to run their projects. The major problem with this is that the federal government is now so closely intertwined with the distribution of SPP funds that it effectively takes over a significant part of what have been traditionally State matters.

III HOW DO SPPS ENCROACH UPON THE ROLE OF THE STATES?

Specific Purpose Payments stem from agreements between the State and Commonwealth governments and include conditions on the availability and use of Commonwealth funding. Since systemic reform in the early 1970s, SPPs have been used by the Commonwealth to exert influence in areas outside its constitutional domain. The recent rise in the proportion of SPPs as against General

⁵⁰ Committee for the Review of Commonwealth-State Funding, above n 7, 37.

Purpose Grants has meant that the Commonwealth is now gaining more control over State policy than ever before and weakening the autonomy of States.

SPPs have thus far been used primarily in three ways: the achievement of national standards, payments for the delivery of Commonwealth programs, and ‘the pursuit of Commonwealth objectives in areas of State constitutional responsibility.’⁵¹ These uses are not discrete and the purpose for which particular grants are made can be difficult to define. It is nevertheless accurate to say that the majority of SPP funding has the effect of influencing Commonwealth objectives in areas of State constitutional responsibility. Areas such as aged care, government schools, and vocational education that are traditionally State areas of responsibility have all been the subject of SPP agreements. In fact in 2002 an average of 86% of SPP funding was directed towards just 10 intergovernmental agreements, all in traditionally State areas of responsibility.⁵²

To understand the extent of Commonwealth government control in State areas, it is necessary to look in more detail at particular terms of some of the more significant Australian SPPs. As examples, this paper will look at The Australian Health Care Agreement, the AusLink Agreement, and the Schools Quadrennial SPP. All three are of national application. It will examine the first two as they apply to Tasmania, so as not to generalise State specific contracts even though their practical effect is substantially equivalent, and the third as it applies to all States.

A The Australian Health Care Agreement SPP

Tasmania provides a good example of the effect of SPPs on a State’s income and spending. In Tasmania, \$629.9 million or 18.5% of the State’s funding came in the form of SPPs in the 2004-05 financial

⁵¹ Committee for the Review of Commonwealth-State Funding, above n 7, 44.

⁵² Ibid 62.

year.⁵³ Of this amount 45.6% is derived under the Australian Health Care Agreement (AHCA). The AHCA is a five year agreement that commenced in all Australian States in July 2003, but with minor differences from State to State. This agreement provides a base grant to ‘assist states in providing the full range of hospital services and to assist with public hospital quality improvement and the provision of palliative care’,⁵⁴ as well as several other smaller payments such as, in Tasmania, a payment towards the implementation of the National Mental Health Reform Strategy.

This Health Care Agreement SPP is unusual in that while it does suggest plans that are to be implemented, the funds are not actually tied to expenditure for these particular purposes within the signed agreement. Nevertheless, the funds remain effectively tied because, for States to maintain funding under the agreement, ‘they are required to meet strict performance targets in the delivery of public hospital and other health services.’⁵⁵ These targets are administered ‘at a national level’⁵⁶ by the Australian Institute of Health and Welfare. This federal agency receives a ‘National Minimum Data Set’ from each State bound by the AHCA. The data set is comprised of information such as a *Community Mental Health Care National Minimum Data Set*, an *Elective Surgery Waiting Times National Minimum Data Set*, a *Health Labour Force National Minimum Data Set*, and around 36 other data sets.⁵⁷ For States to meet their required targets, they effectively must implement at least the type of programs proposed by the Commonwealth.

While it is no doubt standard practice for a hospital to have these strict reporting requirements, the fact that they are made to a federal

53 Tasmanian Government, Department of Treasury and Finance, *Budget Information* (2005) <<http://www.treasury.tas.gov.au/domino/dtf/dtf.nsf/0/c0d6fed109efdc05ca256fe7001bfc13?OpenDocument>> at 17 August 2005.

54 Ibid.

55 Ibid.

56 Australian Institute of Health and Welfare, *AIHW Publication List* (2005) <<http://www.aihw.gov.au/publications/index.cfm/series/52/startRow/11>> at 22 August 2005.

57 Ibid.

agency, which is then ‘directly accountable’⁵⁸ to a federal minister, rather than to a State agency or department, means that choice and accountability are substantially taken from the States. Not only is the initial determination as to the placing and timing of funds removed, but so too is the future liability for the area until the end of the SPP.

The credit or responsibility for a rise or fall in hospital standards now falls at least partially to the federal Minister for Health and Aging. Examples of this abound on the Health and Aging Department’s website, where it claims joint credit by virtue of its membership of the Council of Australian Governments (COAG) for initiatives such as Improving Care for Older Patients in Public Hospitals, New Funding for Mental Health Nurses, and Expanding Suicide Prevention Programmes.⁵⁹ Information about these programs is printed alongside programs where COAG has not been consulted with only this acronym to distinguish them. No specific mention is made of any State having a role in the determination of any program.

The AHCA will end for Tasmania in 2008. The agreement will also end for all other States at this time, but it is not always necessarily the case that national SPPs will start or end together given their possible State-specific nature. In the meantime, three major SPP agreements are listed for Tasmania’s negotiation during 2005, the biggest of which is the AusLink agreement.

B The AusLink SPP

The AusLink program aims to nationalise much of Australia’s transport infrastructure by, for example, creating the East Coast Rail Link and replacing the ‘National Highway System’ and ‘Roads of National Importance’ with a ‘broader and more strategic network of

⁵⁸ Australian Institute of Health and Welfare, *AIHW About Us* (2005) <<http://www.aihw.gov.au/aboutus.cfm>> at 11 October 2005.

⁵⁹ Australian Government Department of Health and Aging, *Budget 2006-7 Health Measures* <<http://www.health.gov.au/internet/budget/publishing.nsf/Content/budget2006-healthindex.htm>> at 20 May 2006.

transport corridors.’⁶⁰ The former Minister for Transport and Regional Services, John Anderson, was quoted as saying that AusLink ‘will move Australia from a parochial and ad hoc system to a clear national land transport plan that all levels of government can support and deliver together.’⁶¹ Yet Tasmania has raised several objections to the AusLink project. Tasmania has protested that under the proposed arrangement there appears to be ‘cost-shifting to the states’⁶² whereby States are liable for the further development and maintenance of the National Network. It argued that a requirement that States maintain the long-term funding effort is problematic ‘given the uneven nature of infrastructure spending.’⁶³ It argued that there is an ‘inequitable allocation of funding risks between the Australian Government and the states’, and also noted that it was against the requirement to apply the Australian Government’s Implementation Guidelines for the National Code of Practice for the Construction Industry, as this would involve considerable implementation costs.⁶⁴

The benefits of a move to a nationally coordinated road network are obvious and no doubt many areas under the constitutional management of the States require a national strategy of implementation. However, when SPPs are used by the Commonwealth to achieve these types of measures, States sometimes have little choice but to agree because of their aforementioned heavy reliance on Commonwealth funding. As a consequence, agreements can be reached in areas of traditional State responsibility that are potentially against State interests.

State specific transport infrastructure is in the constitutional domain of the States, yet the AusLink agreement, which effectively nationalises the project will see certain areas of this responsibility

60 Australian Government Department of Transport and Regional Services, *AusLink White Paper* (2004) <http://www.dotars.gov.au/auslink/downloads/dotars_auslink.pdf> at 22 August 2005.

61 Ibid.

62 Tasmanian Government, Department of Treasury and Finance, above n 53.

63 Ibid.

64 Ibid.

taken from the States under an arrangement that, as Tasmania's objections demonstrate, some States could potentially find unfavourable.

C *The Schools Quadrennial SPP*

The previous two examples, though national in application, were specific to Tasmania in their respective clauses and objections. A final example of the loss of choice and accountability is the Schools Quadrennial SPP. It is a relatively small payment but one made in identical terms on a national scale and with potentially widespread ramifications.

The Commonwealth Department of Education, Science and Training is directly responsible for the Australian Government Quality Teacher Program (AGQTP).⁶⁵ In 2002 the AGQTP launched the Celebrating Discovering Democracy Project in order to provide small grants to primary and secondary schools to assist them in participating in the national initiative, 'Celebrating Democracy Week'. The aim of the grants was to 'strengthen the understanding of the teaching profession in the area of civics and citizenship education'.⁶⁶ Similarly the aim of the Week was to pass this information on to students. During this week, Prime Minister John Howard advocated that schools 'should conduct regular ceremonies to recognise our national flag and sing the national anthem to encourage students to appreciate the essential values of our democratic society and to learn more about the symbols that underpin them.'⁶⁷

To this end, in June 2004, the Prime Minister revealed that, as part of the Schools Quadrennial Funding Agreement, all primary and

⁶⁵ Australian Government Department of Education Science and Training, *National Information Exchange on Quality Teaching* (2004) <http://www.qualityteaching.dest.gov.au/Content/Item_1050.htm> at 10 July 2005.

⁶⁶ Ibid.

⁶⁷ Australian Government Department of Education Science and Training, *Flagpoles for Schools* (2004) <http://www.dest.gov.au/sectors/school_education/programmes_funding/general_funding/capital_grants/flagpoles/> at 10 July 2005.

secondary school Commonwealth funding would become conditional upon the school having a flagpole by the beginning of 2005. The Australian Government Department of Education Science and Training website states that ‘schools would need to possess a functioning flagpole as a condition of receiving Australian Government funding.’⁶⁸ The federal government pledged up to \$1 500 per school to ensure that schools were not out of pocket when purchasing a new flagpole or repairing an old one. However, if schools wish to be eligible for such funding they must carefully note this fine print:

Schools are requested to promote the new flagpole to the local school community and acknowledge the assistance from the Australian Government for the flagpole. This includes a plaque, a report to the local school community either in a school newsletter or letter to parents about the funding and installation of the flagpole, and providing an opportunity for an Australian Government representative to attend a flag raising ceremony at the school.⁶⁹

This means that if a primary or secondary school did not have a flagpole at the beginning of 2005 its entire year’s budget was subject to it getting one. If it did then get one, to be eligible to have the federal government pay for it, the school must have it constructed with a plaque in recognition of the federal government, notify all the parents and invite a Member of Parliament or similar to attend a flag raising ceremony.

These seem to be rather onerous conditions to impose upon an apolitical education system, motivated at least in part by party politics. The conditions seem all the more burdensome when one considers that the federal government is supposed to have no jurisdiction in this area. Primary and secondary education has long been the uncontested domain of State Parliaments under their residual powers.

⁶⁸ Ibid.

⁶⁹ Ibid.

D SPPs and the Federal Encroachment Upon the States.

As we have seen from these examples, the recent rise in the proportion of SPPs has meant that the Commonwealth has been able to exert influence in areas outside its constitutional domain. The AHCA has made a federal department accountable in some health-related areas, the AusLink Agreement will also change an area of Tasmanian responsibility to one of substantial federal responsibility, in spite of Tasmanian objection to the terms of the agreement, and the Schools Quadrennial SPP demonstrates the ability of the federal government to implement reform in Australia's primary and secondary schools.

As has been noted, an average of 44% of State revenue is currently provided by the Commonwealth, and for the rest they are self sufficient.⁷⁰ Of this 44%, 39.7% is distributed in the form of SPPs. This means that an average 18.5% of a State's revenue is provided by the Commonwealth in the form of SPPs. Further, Commonwealth control over this 18.5% equates to an effective control over a much larger percentage of State funds when, as is the case for many of the SPPs, States are required to match these grants dollar for dollar in order to receive the funds.⁷¹ Conditions such as this 'reduce a state's control over its own Budget priorities'⁷² by limiting discretion as to how its existing financial resources can be applied. Even where dollar for dollar matching is not a requirement, overall, SPPs make up relatively small proportions of what States themselves spend in areas that the SPPs are used. Proportions vary between cases, but a median example is that SPPs form an average of approximately 27% of State expenditure on education.⁷³ This means that 73% of the States' education budget is raised by the State and yet because a State would find it very difficult to function without Commonwealth funding, States will potentially agree to an SPP agreement that

⁷⁰ Committee for the Review of Commonwealth-State Funding, above n 7, 39.

⁷¹ Tasmanian Government, Department of Treasury and Finance, above n 53.

⁷² Ibid.

⁷³ State and Territory Treasuries, *Specific Purpose Payments Discussion Paper* [4] (1999) <http://www.dtf.wa.gov.au/cms/uploadedFiles/SPP_Discussion_July_99.pdf> at 16 October 2005.

removes control from their sphere or that they do not fully agree with. This agreement will necessarily affect the use of the 27% but will, therefore, more than likely, also affect the spending direction of at least some of the remaining 73% lest the two sums be spent in areas which would negate each other, for example building one school and closing another.

To summarise, if a State cannot operate in a certain area without SPP funding, and must dedicate its own funds of the same order to essentially Commonwealth agenda, in order to receive this funding, the State ends up being influenced by the Commonwealth to the order of some 37% of its spending. This number is even greater when the SPP guides where some or all of the rest of the State's money will be spent.

IV SPPs AND THE UNDERMINING OF STATES' DEMOCRATIC ACCOUNTABILITY

To this point, it has been argued that SPPs are enabling Commonwealth encroachment upon the role of the States. However, it has also been suggested that some of the aforementioned SPPs are in areas, such as the national roads system, that are rightly dealt with on a federal level. This might seem contradictory but what is at issue is the way that SPPs forcibly remove decision-making power from States rather than allowing legitimate deals between the States and the Commonwealth. This process of unequal SPP bargaining undermines the notion of democratic accountability that is essential to our system of government.

At the core of the notion of democratic accountability is a combination of the two principles of 'legal authority' and 'a mandate'. The foremost principle of public law is that governments and government agencies need legal authority for anything they do or authorise.⁷⁴ This authorisation will come in the forms of constitutions, legislation, and common law presumptions.⁷⁵ The principle also reflects the 'Rule of Law'. Also, it is convention in

⁷⁴ R Creyke and J McMillan, *Control of Government Action* (2005) 366.

⁷⁵ Ibid.

Australia that the political party or coalition of parties with a majority in the lower house shall form the government. This is what is meant by having a mandate to govern. The government, by virtue of its majority in the lower house, shall then be deemed to have popular support to implement its election manifesto 'or take other action deemed necessary in the public interest'⁷⁶ subject to legal authority.⁷⁷

A *The Mandate*

Any government, State or federal, must have both a mandate and legal authority in its actions in order to be held to the established methods of accountability and to legitimately govern. In the case of SPPs it is argued that the Commonwealth government is able to make policy decisions that are outside the constitutionally determined sphere, and implement them through State governments. State governments accept these policy directives because they have little choice or bargaining power. The act of a State signing an SPP (effectively a contract) gives the Commonwealth legal authority, but does not give it a mandate to direct policy where it was not elected to do so.

The Committee for the Review of Commonwealth-State Funding fault the current SPP funding system for being 'incomprehensible to most Australians, obscuring political accountability at Commonwealth and State levels.'⁷⁸ By this, the Committee is implying that if State governments are elected on a policy platform, and yet their hand is forced by the federal government, then both federal and State accountability is obscured. Mathews supports this, stating that, 'where grants or other revenue-sharing arrangements have depended on unilateral decisions by federal governments which have broken the link between spending and taxing decisions for both granting and recipient governments, there has been a loss of

⁷⁶ C Kukathas, *Democracy, Parliament and Responsible Government* (1990) <<http://www.aph.gov.au/Senate/pubs/pops/pop08/pop8.pdf>> at 1 July 2005.

⁷⁷ Creyke and McMillan, above n 74, 366.

⁷⁸ Committee for the Review of Commonwealth-State Funding, above n 7, 3.

accountability.’⁷⁹ Where citizens do not know which level of government is making which policy decisions, then neither level of government can truly be said to have a mandate from the people to make those decisions, no matter what the previous election result was.

A lack of mandate equates to a loss of accountability. A loss of accountability is likely to have two consequences. First, any loss of accountability will likely ‘weaken democratic controls.’⁸⁰ Accountability in this sense refers to the ‘need to explain, justify, convince or demonstrate to taxpayers that the revenue is indeed necessary and that the funds raised will be spent responsibly.’⁸¹ It follows then that if the public does not know or understand which government is behind which policy decisions, then accountability is diminished and spending decisions are open to abuse.

Democratic accountability requires popular support, but popular support is amiss where it is procured under the popular misapprehension that States have the unfettered power to implement their own policy objectives.

The second consequence of a loss of accountability is a loss of government responsiveness. The concept of responsiveness refers to ‘the ability of a government to respond meaningfully and effectively to specific demands and policy requirements of its electorate.’⁸² The Commonwealth government is not popularly recognised and is, therefore, not accountable as an influential force in the State sphere, but it nevertheless influences State spending decisions. There consequently exists the potential for States to have an insufficient financial capacity to ‘properly assess and respond to the unique

⁷⁹ R Mathews, *Revenue Sharing in Federal Systems* (1980) Research Monograph No 31, Centre for Research on Federal Financial Relations, Australia National University.

⁸⁰ Ibid.

⁸¹ Centre for Strategic Economic Studies Victoria University Melbourne, *Vertical Fiscal Imbalance in Australia: A Problem for Tax Structure, not for Revenue Sharing* (1995) <<http://www.cfses.com/documents/wp2cses.pdf>> at 2 May 2005.

⁸² Ibid.

needs of regional and local economies and societies'⁸³ through no fault of their own, and yet be blamed by the public for this miscalculation. Similarly, just as a State government would receive undue criticism for a fault, the Commonwealth government could potentially avoid criticisms where it has directed money to be spent in an area which is wasteful or arranged at the expense of State election promises.

B *Evidence of a Mandate*

It has been stated that democratic accountability theoretically requires a mandate. However, some funding overlap and thus confusion is almost inevitable as total vertical fiscal balance is nearly impossible. Responsibility sharing between governments is growing, as is the size and cost of the entire public sector.⁸⁴ Now that the system is entrenched where income tax and the GST are collected on a Commonwealth level, income sharing must occur in some form. This raises the question: can any government determine the mandate it is given over its money raising or spending? It is suggested that Australians have practically demonstrated support for vertical fiscal balance with the current electoral disparity between State and Commonwealth governments.

Australia is presently in the situation of having a Liberal-National federal government and universally Labor State governments. In the 2004 federal election John Howard won a landslide victory for the Coalition. The Howard government is now in the beginning of its 10th year and fourth term in office. In the 1999 Victorian State election, Steve Bracks secured an upset Labor victory with a huge swing in the vote from the previous election. Many recent State victories have been by large margins and in every State and Territory government except South Australia, where the last Liberal

⁸³ Commerce and Industrial Relations Group, *Public Finance and Vertical Fiscal Imbalance Richard Webb Economics* (2002) <<http://www.apf.gov.au/library/pubs/rm/2002-03/03rn13.htm>> at 7 July 2005.

⁸⁴ T Blackshield and G Williams, *Australian Constitutional Law and Theory: Commentary and Materials* (3rd ed, 2002) 920.

State government fell in early 2002, the present Labor government has been tested at the polls.⁸⁵

These examples show that the present State/federal situation is no accident. What these results suggest is that State and federal governments are elected by the same people who look for some different quality, attribute or policy direction at different levels of government. Whatever this differing quality might be, it is argued that the mere fact that it exists gives State governments a mandate to govern in areas constitutionally assigned to the States.

The Liberal-National Coalition certainly has a mandate at the federal level, but these election results show that the Coalition does not have a mandate at the State level. Rather, voters expect that the State government they elect will have power over what have traditionally been seen as State realms. There is therefore, not only theoretical justification, but popular support among Australian voters for State governments to be able to exercise the power to implement the policy that they were elected to implement. This power covers such areas as aged care, government schools, vocational education, roads, and many other areas where, in reality, Commonwealth SPPs now influence the State agenda.

A funding overlap does make public confusion almost inevitable. However, Australia has (since World War II) 'had a much larger mismatch between expenditure responsibilities and revenue at each level of government than any other Federation'.⁸⁶

Where there is a perception that State funding is controlled only by the States and the States do have popular support to govern in their constitutionally defined areas, then there is clearly a need to reduce the vertical fiscal imbalance.

⁸⁵ 'Labor's State of Sunshine', *Sydney Morning Herald*, 9 February 2004, <<http://www.smh.com.au/articles/2004/02/08/1076175031234.html?from=storyrhs>>.

⁸⁶ R Webb, *Public Finance and Vertical Fiscal Imbalance*, Parliament of Australia Parliamentary Library (2002) <<http://www.aph.gov.au/library/pubs/rn/2002-03/03rn13.htm>> at 12 October 2005.

C Legal Authority

A further and related issue, inexorably linked to the principle of democratic accountability, is whether States actually have the power to hand over their decision-making power to another body. A large body of law surrounds this issue but it is necessary to touch on it only slightly.

In any legislation that makes provision for some policy directive to be carried out, the legislation will nominate that person (usually a minister, secretary or board council). A legal presumption has developed that the validity of a policy decision 'will hinge on whether it was made by the person nominated in the legislation.'⁸⁷ This principle was tested and confirmed in *Re Reference Under Ombudsman Act s 11* (1979) 2 ALD 86 (*Re Reference*).⁸⁸ This legal presumption has its roots in the ideal of accountability and aims to both link the particular accountable body to the job, and to regulate the 'legal control of decision making.'⁸⁹ To wholly delegate the law making power of one level of government to another level will unavoidably obscure accountability.

While the SPP system contributes to the obscuring of accountability in much the same way as a State completely ceding its law making power to the Commonwealth, the States in this case are not actually ceding their law making powers, rather they are accepting financial inducements to exercise these powers in a particular way. While this is a procedural difference rather than a substantive one, it means that the States do not actually cede their power and it is therefore unnecessary to follow the theme of whether a State may or may not cede its powers, which has been raised as a potentially unconstitutional act.⁹⁰

While the outcome of a State contractually agreeing to perform a Commonwealth proposal that it could not avoid agreeing to is

⁸⁷ *Re Reference Under Ombudsman Act s 11* (1979) 2 ALD 86 (*Re Reference*), 93.

⁸⁸ *Ibid.*

⁸⁹ Creyke and McMillan, above n 74, 418.

⁹⁰ C Saunders, 'A New Direction for Intergovernmental Arrangements' (2001) 12 *Public Law Review* 274, 277.

effectively similar to a State ceding its powers, the use of this contractual method means that neither the Commonwealth or State governments are in breach of their duty to act within their legal authority. State/Commonwealth SPP arrangements do, however, lack the mandate required under the second branch of the notion of democratic accountability.

V SPPS AND THE UNDERMINING OF FEDERALISM

The second primary criticism of the current Commonwealth use of SPPs is that it also undermines Australian federalism by increasing the power of the Commonwealth at the expense of the States.

Since *Amalgamated Society of Engineers v Adelaide Steamship Co* (1920) 28 CLR 129 (*Engineers Case*), the High Court's interpretations of Commonwealth powers has been increasingly broad.⁹¹ This case discredited the 'reserve States powers'⁹² doctrine, which refers to the principle that the *Australian Constitution* 'impliedly reserved to the States their traditional areas of law-making power'.⁹³ This approach was replaced with the theory that the ambit of Commonwealth grants of power should be determined before any claim to the residual can be made by a State.

Since then, broad High Court interpretations of the external affairs power, the corporations power, the industrial relations power and others have all increased the legislative capabilities of the Commonwealth. Over many years the High Court bench has created a strong centralised Commonwealth.

One example of these broad interpretations was the case of *Koowarta v Bjelke-Petersen* (1982) 153 CLR 168 (*Koowarta*). In *Koowarta*, the Commonwealth government had attempted to use the *Racial Discrimination Act 1975* (Cth) to overturn a Queensland housing policy that blocked the purchase of land by Aboriginal people in Northern Queensland. The High Court was asked to

⁹¹ *Amalgamated Society of Engineers v Adelaide Steamship Co* (1920) 28 CLR 129 (*Engineers Case*), 140.

⁹² R Menzies, *Central Power in the Australian Commonwealth* (1967) 117.

⁹³ *Engineers Case*, above n 91, 140.

determine whether the external affairs power was a sound head of power for the Commonwealth discrimination legislation. The High Court held that it was because the *Racial Discrimination Act 1975* (Cth) was intended to give effect within Australia to the United Nations *Convention on the Elimination of All Forms of Racial Discrimination* (CERD), which Australia had signed.⁹⁴ The High Court's interpretation of the matter as an 'external affair', even though it applied entirely within Australia meant that the Commonwealth government was able to influence a State housing policy. This interpretation has effectively meant, argues Sharman, that the Commonwealth has the 'unilateral ability to amend the scope of its jurisdiction in areas of settled State administration without the need for formal constitutional change.'⁹⁵ This is true of the Commonwealth in a legal sense, however whether it has the political ability to make such changes is another matter.

Such interpretations have often been justified by their returns in economic efficiency and national unity. Latham writes, the 'real ground [of the decision in the *Engineers Case*] was... that the Constitution had been intended to create a nation'.⁹⁶ However, it is possible to reach a point at which the system is so unbalanced that it ceases to be a recognisably federal system. According to Professor Wheare, this point is a matter of degree.⁹⁷ It is argued that the current use of SPPs is causing this point to rapidly advance and a degree of rebalancing is needed. This raises the questions: how much centralisation is too much and what qualities should the Australian federation prize?

It is arguable, as Galligan and Walsh suggest, that no matter what the level of centralisation in a nation, any federation should value

⁹⁴ Blackshield and Williams, above n 84, 780.

⁹⁵ C Sharman, 'Secession and Federalism', Proceedings of the Third Conference of the Samuel Griffith Society, The Esplanade Hotel, Fremantle, 5-6 November 1993, 101.

⁹⁶ Richard Latham, 'The Law and the Commonwealth' in W K Hancock, *Survey of British Commonwealth Affairs, Problems of Nationality 1918-1936* (1937) vol 1, cited in Blackshield and Williams, above n 84, 307-8.

⁹⁷ B Galligan and C Walsh, 'Australian Federalism Yes or No?' in G Craven (ed), *Australian Federation* (1992) 95.

strong and independent States. Around Australia there are notable differences between State policies that are evidence of the independent character of each State. Galligan and Walsh, believe that these differences are evidence that federalism ‘allows public goods to be more finely tailored to popular preferences.’⁹⁸ Certainly, they acknowledge there are also some strong similarities between State policies, but they argue that similarities alone might simply mean that ‘all State political communities have similar policy preferences.’⁹⁹ Goods, policy, and laws, they argue, can be better suited to smaller polities because of an increased popular participation in politics. This can therefore be said to enhance democracy.¹⁰⁰

It therefore follows that the stronger, more self-determined and independent a State, the more control over policy decision it has, and the greater is this ‘enhancement of democratic participation through dual citizenship and multiple governments.’¹⁰¹

However, this enhancement of democratic participation at the State level must be weighed against the benefits of centralisation that federation brings. Where these two issues are opposed, the enhancement of democracy must trump a more effective centralised nation.

National effectiveness can be achieved in ways that do not undermine the strength of the State and, therefore, its democratic value as a second level of government. To do this requires a federal system flexible enough to respect the needs of the States, yet with a strong enough central government to achieve national effectiveness. Such a system requires bargaining on a level economic playing field as its primary attribute.

Some argue that a system of strong and independent States is not the model best suited to Australia, nor was Australia designed to resemble a traditional federalist state. Blackshield and Williams

98 Ibid 195.

99 Ibid.

100 Ibid 199.

101 Ibid.

support this view by pointing to a number of constitutional provisions, notably the inclusion of a Senate to ‘intrude State interests into the federal authority’¹⁰² and s 96 which empowers the Commonwealth to make grants to the States. They argue that while the Australian federation was modelled on that of the United States and was supposed to be a functioning federation, it was adapted to be a much more cohesive system.¹⁰³

Although agreeing with this sentiment, arguably this type of cohesive federation can only exist where the States and Commonwealth have equal bargaining power. Cohesion in this sense is not meant to imply uniformity of decision, since such uniformity might imply a degree of State or Commonwealth hegemony when just the opposite should occur. Cohesion in politics should be typified by a mutually beneficial agreement where all parties have equal bargaining power and all parties surrender something of value for some perceived gain. Mathews states that in the current system ‘there is no reason to believe that any revenue-sharing arrangements which result from the bargaining [between States and the Commonwealth] will achieve vertical fiscal balance.’¹⁰⁴ The system that Blackshield and Williams posit has not come to fruition. Rather we have a blemished variety of it, where States find it increasingly difficult to play a major role because of the power dynamics that so favour the Commonwealth.

At the other end of the scale, Wheare states that a test in determining the existence of a federal state is whether ‘a system of government embodies predominantly a division of powers between general and regional authorities, each of which, in its own sphere, is co-ordinate with the others and independent of them’.¹⁰⁵ Wheare’s test rigidly separates general and regional governments into separate spheres. A separation of this kind in Australia would indeed be going too far.

¹⁰² Constitutional Commission, *Final Report of The Constitutional Commission* (1988) vol 1, 16.

¹⁰³ Blackshield and Williams, above n 84, 249.

¹⁰⁴ Mathews, above n 79.

¹⁰⁵ Constitutional Commission, above n 102, 18.

Rather there must be a balance between Wheare's strict federalism and Blackshield's and Williams' quasi-federalism so that both States and the Commonwealth can bargain on more equal economic grounds.

Australia should prize strong independent States, but only because it already has a strong independent Commonwealth government. The current operation of SPPs creates an imbalance in Australian federation. A balance between rigid and flexible federalism is needed to correct the discrepancies in bargaining power, and thus work towards vertical fiscal balance.

VI WHAT CAN BE DONE TO REVERSE THE ENCROACHMENT?

It has been argued that SPPs in their present form encroach on the constitutional role of the States and in doing so undermine both democratic accountability and federalism. The problem of how to adjust Australia's vertical fiscal imbalance can be split into two areas: first, States are not able to raise enough of their own revenue, which makes them reliant on tied Commonwealth funds; and second, the Commonwealth ties SPPs to its own policy initiatives. The solutions to each of these problems lies in the hands of the respective levels of government, and so each problem will be looked at separately.

A What the States Can Do

The most straightforward thing that States could do to reduce the vertical fiscal imbalance would be to re-enter the income tax field. However, as will be seen shortly, this would be very difficult in practice and undesirable in principle. Another suggested reform is legislation to permanently divide income tax equally between the States and the Commonwealth. However this would involve constitutional reform, which is rarely attainable in Australia. It will be argued that there are only two desirable and feasible ways in which States can decrease the vertical fiscal imbalance. The first is to incrementally increase the breadth of their current styles of revenue raising, though this has major drawbacks and could achieve only temporary advantage. The second is to lobby for the

implementation of a set of guiding principles that the federal government should use when drafting SPP agreements. It is this pathway that has the most potential to strengthen genuine cooperation between the two levels of government in the longer term.

1 *States Resume Taxing Income*

Wiltshire suggests that States can fundamentally restructure their own financial arrangements to resume income taxation, even without federal government support. He states, ‘the States could reasonably easily resume their income taxing powers given the political will to do so.’¹⁰⁶ It is argued that this is impossible in practical terms, as demonstrated by Fraser’s ‘New Federalism’.

The Fraser government instigated a unilateral precursor to what is now the Intergovernmental Agreement, under the *States (Personal Income Tax Sharing) Act 1976* (Cth).¹⁰⁷ While the reforms in this Act itself were significant, its major effect was to repeal the 1946 Uniform Income Tax Legislation so that States could now levy income tax. Under this new system, instead of receiving the GST, States would receive a specific share of personal income tax of just over a third of the total revenue. This situation was very much like the one we have today, in that the States had access to a relatively fixed sum broad based tax that would grow over time. Fraser cut the percentage of funding distributed as SPPs and increased General Purpose Grants. He also attempted to increase the revenue raising capacity of the States. To this end his reforms included giving local government access to the revenue funds, ‘offering States a share in the resources and mining royalties from the territorial sea.’¹⁰⁸ As well as ‘passing laws to enable States to raise their own taxes’¹⁰⁹

¹⁰⁶ K Wiltshire, ‘Barriers to Rationalising Commonwealth/State Overlap’ in *Towards a More Cooperative Federalism?*, Economic Planning Advisory Council, Discussion Paper 90/04 (1990).

¹⁰⁷ Ayres, above n 41, 327.

¹⁰⁸ *Ibid* 324.

¹⁰⁹ *Ibid*.

and a policy preference for reasonable negotiation between State and Commonwealth departments.

However, while Fraser's reforms 'did at least mark a rhetorical shift',¹¹⁰ they were largely a practical failure. In a 2002 submission to the Committee for the Review of Commonwealth-State Funding, Fraser claims that the overall plan for decentralisation did make 'modest gains' but the scheme was generally unsuccessful in reducing vertical fiscal imbalance.¹¹¹ Fraser suggests, 'for this innovation [legislation for State re-entry to the income tax field] to have been practically useful, the Commonwealth would have needed simultaneously... to reduce its rate of income tax.'¹¹²

Without the Commonwealth government lowering taxes, the States in 1976 could not have re-entered the income tax field. To do so would have been a sudden and immense increase in taxation, which would have been too burdensome for the Australian people and a very unpopular concept with voters.¹¹³ What this demonstrates is that, even with Commonwealth legislative support, unless the federal government is willing to substantially reduce its income taxes, the States cannot unilaterally re-enter the income tax field.

Even if it were practically possible for States to levy income tax, this leads to wasted resources and is thus theoretically undesirable. Some of the benefits that the federal government claims are inherent in a uniform tax are, 'maximum tax revenues, minimised tax expenditures and duplication, it requires minimum redistribution of income and supports economic growth, it provides national uniformity, has minimum microeconomic impact reducing compliance costs, minimises the possibilities of avoidance and evasion, and supports foreign investment.'¹¹⁴

¹¹⁰ J Nethercote (ed), *Liberalism and the Australian Federation* (2001) 218.

¹¹¹ Committee for the Review of Commonwealth-State Funding, above n 7, 30.

¹¹² *Ibid.*

¹¹³ Ayres, above n 41, 323.

¹¹⁴ Harrison, above n 6.

2 Constitutional Alteration to Guarantee Fiscal Balance

A suggestion, made by Harris,¹¹⁵ Saunders,¹¹⁶ and the Committee for the Review of Commonwealth-State Funding,¹¹⁷ is that we look to international federal models for guidance in amending our own Commonwealth/State fiscal arrangement. It is argued that this is of limited use, as the adoption of international federal models would either require severe constitutional alterations or unilateral Commonwealth government policy reversal. In either case the simpler answer would be for the federal government to simply stop tying payments to projects.

In his comparison, Harris looks first to Germany. In Germany, the *Constitution* requires that income tax be divided between the state and federal governments equally after taking out a share for local government.¹¹⁸ The share to be taken out is determined by federal legislation, which must pass through the *Bundesrat* (or state's house) as well as the lower house.¹¹⁹ In this way, both state and federal representatives determine what remainder will be divided between the two remaining levels of government. This situation works very well but it is constitutionally mandated. To adopt this system in Australia would require the adoption of a new section in the *Australian Constitution* that similarly enshrined the division of money between the States and the Commonwealth. To pass such a proposal would likely need the support of the federal government and there is no reason that the federal government should wish to alter the *Constitution* when it could simply stop tying payments to projects if vertical fiscal balance was its objective.

Canada is another example of a federation with a high degree of vertical fiscal balance and its system is not constitutionally mandated, rather it works similarly to the Australian system. In

¹¹⁵ Harris, above n 13, 138.

¹¹⁶ C Saunders, 'Administrative Law and Relations Between Governments: Australia and Europe Compared' (2000) 28(2) *Federal Law Review* 273.

¹¹⁷ Committee for the Review of Commonwealth-State Funding, above n 7, 12.

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid.*

Canada, ‘provincial governments derive significant revenue from taxes they levy themselves.’¹²⁰ The provinces also receive equalisation payments from the federal government, however these payments are usually unconditional and are distributed ‘in accordance with a formula designed to provide assistance to the poorer provinces.’¹²¹

This would seem to be an ideal example for Australia to follow, except that, as noted above, s 96 of the *Constitution* is currently used by the Commonwealth to make grants to the States on any ground it thinks fit. For the Canadian model to work in Australia, this section would either have to be removed, or again the federal government would have to stop using it. Neither option would be likely to receive Commonwealth support and to be passed as a constitutional amendment would have to receive the overwhelming support of the people.

While it is theoretically possible for the *Australian Constitution* to be amended without the support of the Commonwealth government, it would clearly require huge support from the people and it is unlikely that this support exists. Harris notes that ‘anyone proposing constitutional reform in Australia is either over-optimistic or expects a lifespan beyond the expected norm.’¹²² Having said this, if a constitutional change were to be sought by the States, their present domination by one political party would mean that now would be the best time to propose such a change.

Yet even a constitutional change may not be enough. Saunders theorises that even if s 96 was removed from the *Constitution*, ‘a limited power to make grants to the States’¹²³ might be implied by the High Court, and the Commonwealth could certainly continue to make grants to the States ‘in the exercise of its substantive heads of Constitutional power.’¹²⁴

¹²⁰ Harris, above n 13, 138.

¹²¹ Ibid 139.

¹²² Harris, above n 13, 261.

¹²³ G Brennan (ed), *Constitutional Reform and Fiscal Federalism* (1987) 35.

¹²⁴ Ibid.

Moreover, McMillan, Evans, and Storey argue that more constitutional change is required than merely the removal of s 96. The *Constitution*, they argue, divides powers between the Commonwealth and the States, but what is required is a ‘corresponding allocation of financial responsibility.’¹²⁵ To redress this they suggest examples such as giving the States exclusive tax rights in certain fields. This paper addresses the idea of States re-entry into the field of tax in section VI(A)(1), and finds against it, but the point made by McMillan, Evans, and Storey is nevertheless a valid one. Without a positive constitutional financial power in their favour, the States seem destined to lose any constitutional battles that seek to alter their situation.

3 States Increase Their Range of Revenues

A more realistic way to make headway in rectifying the vertical fiscal imbalance could come from upward pressure by the States increasing their range of revenues. There are many revenue sources that are being utilised in individual States that could be adopted across Australia. By way of example, since July 2005, Queensland has had a new Payroll tax, to tax registered employers.¹²⁶ In April 2004, New South Wales announced that it would amend the *Duties Act 1997* (NSW) to allow for the imposition of a vendor transfer duty of a percentage of consideration received on all sales and disposals of property.¹²⁷ This tax was withdrawn the following year because it damaged the real estate market,¹²⁸ however, these

¹²⁵ Gareth Evans, John McMillan and Haddon Storey, *Australia’s Constitution: Time for Change?* (1983) 104.

¹²⁶ Queensland Government, Office of State Revenue, *Queensland’s New Payroll Tax System* (2004) <<http://www.osr.qld.gov.au/taxes/payroll/newsys.htm>> at 12 September 2005.

¹²⁷ Freehills, *State Tax Changes in New South Wales Mini-Budget* (2005) <http://www.freehills.com.au/publications/publications_1165.asp> at 12 September 2005.

¹²⁸ New South Wales, *Second Reading Speech (Hansard)*, Legislative Assembly, ‘*Duties Amendment (Abolition of Vendor Duty) Bill*’ (2005) <http://www.parliament.nsw.gov.au/prod/PARLMENT/hansArt.nsf/V3Key/LA20050914035> at 3 July 2006.

examples demonstrate that, even without entering the income tax field, the States could adopt each other's taxes and gain some ground on lost revenue.

However, these would be very unpopular moves and there is potential for backlash from both the public and the Commonwealth. Nevertheless, in the short to medium term, it would likely give the States a strong bargaining chip by reducing their reliance on the Commonwealth. This bargaining power would be useful in negotiating some long term SPPs that would be of benefit to the States. The difference between this approach and re-entering the income tax field is that State charges and tariffs can be implemented gradually and pressure parties into discussion, as opposed to an immediate double income tax, which would unfairly burden the people of Australia.

As well as being politically difficult, broadening the State's revenue base might prove practically difficult. In 1997 the High Court heard together the two cases of *Ha Lim v New South Wales* (1997) 189 CLR 465 and *Walter Hammond and Associates Pty Ltd v New South Wales* (1997) 71 ALJR 1080 (together, *Ha and Hammond*). In *Ha and Hammond*, the High Court was asked to clarify the scope of s 90 of the *Constitution*.¹²⁹ Section 90 grants the Commonwealth exclusive rights to impose duties of customs and of excise on the production or export of goods. In this case, NSW had been charging fees for a licence to sell tobacco. While this was not explicitly an excise on the tobacco itself, the High Court majority nevertheless declared that, 'an excise is not confined to a tax on the local production or manufacture of goods.'¹³⁰ Rather, 'duties of excise are taxes on the production, manufacture, sale or distribution of goods.'¹³¹ This decision effectively declared all State business franchise fees to be constitutionally invalid.¹³² This wide interpretation of s 90 has ramifications for the potential broadening

¹²⁹ *Ha Lim v New South Wales* (1997) 189 CLR 465; *Walter Hammond and Associates Pty Ltd v New South Wales* (1997) 71 ALJR 1080.

¹³⁰ *Ibid.*

¹³¹ *Ibid.*

¹³² Harrison, above n 6.

of State revenues and any move to this end must consider the potential constitutional validity of legislation in light of this decision. Yet while this type of progress may prove untenable it is at least desirable from a vertical fiscal imbalance perspective.

4 Guiding Principles for Specific Purpose Payment Agreements

A final suggestion is that the States lobby for the federal government to implement a set of guiding principles for use in the drafting of SPP agreements. These guidelines would be designed to better reflect the principles of democratic accountability and federalism.

To discuss the full scope of such possible guidelines is beyond the range of this paper, however, it is certainly worth noting some underlying principles that such SPP guidelines should seek to be consistent with.

The following principles reflect a number of qualms that the States had with the Commonwealth in the State and Territory Treasuries Commission *Specific Purpose Payments Discussion Paper* (1999),¹³³ as well as some of the further points so far raised in this paper. These principles also include suggestions or examples as to the methods that could be used to implement them.

(a) Maximise Flexibility

As noted, the use of SPPs in funding arrangements raises the problem of responsiveness and the danger that States will not be able to adequately respond to local issues. Tied funds reduce the ability of State governments to 'address policy priorities from a regional perspective.'¹³⁴ This problem is compounded when SPPs are implemented on a national scale without reference to the differing demographic, economic and social circumstances in each State.

¹³³ State and Territory Treasuries, above n 73.

¹³⁴ R Albon, *Commonwealth financial dominance, fiscal balance or reverse revenue sharing?* (1996) 3(3) AGENDA 289.

Flexibility is needed to allow changing regional circumstances to be dealt with at the local level and funds to be applied as and when they are most needed.

Flexibility should be used as a guiding principle to ensure that SPP arrangements do not 'place decision making further away from the point of service delivery.'¹³⁵

(b) Minimise State financial risk

Many areas of SPP arrangements expose States to a financial risk. It was noted that Tasmania made this particular objection to the AusLink SPP. Any financial risks that occur should be shared equally by the States and the Commonwealth, lest State liability for unforeseen costs widen the vertical fiscal imbalance further. Presently, States are exposed to financial risk when they 'must meet increases in costs of a program but have no policy control over cost increases.'¹³⁶ Further, while an SPP may be terminated or decreased unilaterally by the Commonwealth, there will likely be 'considerable pressure'¹³⁷ on States from service providers (such as in building contracts) and the public, to continue the programme at the same level. Such was the case in the implementation of the Dental Health Scheme and Legal Aid SPPs. A related issue is the under-estimation of wage increases that has left the States liable for a 3.4% wage increase where only a 1.5% increase was predicted.¹³⁸

To address this principle, an agreement on the termination of funding could be included in the agreement with contractual remedies such as cost provisions. Also, there could easily be a clause created to make provision for unforeseen costs up to a maximum limit.

¹³⁵ State and Territory Treasuries, above n 73, 8.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ Ibid 9.

(c) *Minimise Administrative Costs*

Where money can be saved, this will be of benefit to all parties. The Commonwealth does presently contribute to State administrative costs (\$77 million in 1996-97)¹³⁹ and if money were saved in this area it could be passed on as funding to the States. A problem with the entire SPP system is that SPPs require 'Commonwealth bureaucrats to monitor and oversight the activities of State bureaucrats who themselves are monitoring and oversighting the delivery of particular programs.'¹⁴⁰ This duplication costs an estimated \$20 billion per annum.¹⁴¹ If this system were streamlined then administrative costs could be lowered. This could be achieved by joint committees of State and Commonwealth representatives overseeing and running the projects. Such a system would also enhance the accountability of both the States and the Commonwealth because a joint committee could be designed to give States the influence that they would be perceived to have, as opposed to the present situation where States are perceived to have total policy control but in practice do not. Administration costs could also be lowered by combining various small SPPs where details must be submitted for every program as well as considered and approved by the Commonwealth into larger, less specific, SPPs. This would also provide greater flexibility for State implementation.

(d) *Restrict State Input Controls*

The Commonwealth often seeks to deter States from spending money in ways that counter its policies. It does this by 'applying restrictive conditions upon State inputs',¹⁴² ie applying clauses

¹³⁹ Federal State Relations Committee, *Register of Specific Purpose Payments Received by Victoria* (2004) <<http://www.parliament.vic.gov.au/fsrc/report4/contents.htm>> at 10 October 2005.

¹⁴⁰ State and Territory Treasuries, above n 73, 9.

¹⁴¹ M Drummond, 'Costing Constitutional Change: Estimating the Costs of Five Variations on Australia's Federal System' (2002) 61(4) *Australian Journal of Public Administration* 43.

¹⁴² *Ibid* 10.

which require the ‘maintenance of effort’ or ‘fund matching’ clauses. The effect of this is to emphasise the amount of money that is spent in a particular area rather than the results obtained. This reduces the flexibility to stop spending money when the job is done, thereby promoting waste by States with better funds management or less localised hindrances such as transport issues. Responsiveness to changing needs will also be affected. Again, greater flexibility in SPPs would counter this problem. Using outcome-based performance measurement is another possible solution.

(e) Use Common Data to Determine Financial Impacts

The need for this policy draws attention to the problem that many SPP negotiations are characterised by ‘considerable debate ... over the accurate quantification of the impact of proposed programs.’¹⁴³ Debate of this kind requires a great deal of administrative work to reach a solution, which again increases the costs. Such debate also leads to frustration in negotiating agreements, as was the case with the Australian Health Care Agreements.¹⁴⁴ The formation of a joint State/Commonwealth body with the power to implement SPPs, as has been suggested, would ease this problem. This body could also control a common data source for use by both State and Commonwealth governments.

(f) Maximise Accountability

Throughout this paper, emphasis has been placed on the importance of accountability in the democratic process. It is essential in a liberal democracy that people understand how, why and how much they are being taxed.¹⁴⁵ By their very nature SPPs undermine this. To this end, reporting requirements similar to those linked to legislation should be advocated. For example at a State level, the *Subordinate Legislation Act 1994* (Vic) requires State government departments

¹⁴³ Ibid.

¹⁴⁴ Ibid 11.

¹⁴⁵ Harrison, above n 6.

who are preparing potential regulations (subject to exceptions in ss 8 and 9) to commission an independent regulatory impact statement,¹⁴⁶ or, where the primary effect of the regulation will be commercial, a business impact assessment. These documents must include statements about the objectives and expected effects of the proposed rule, as well as a cost benefit analysis and discussion of alternate options.¹⁴⁷ This document must then be released for public discussion and noted in both the Government Gazette and a daily Victorian newspaper.¹⁴⁸ Prior notification with an invitation of discussion as well as publication would greatly enhance the understanding of SPPs and cultivate their transparency to the community.

B What the Commonwealth Should Do

The easiest, most practical and one of the most beneficial solutions that the Commonwealth could undertake would be to apply the underlying principles developed in this paper to a set of rules that would guide future SPP agreements. However, the problem of vertical fiscal imbalance exists by the will of the Commonwealth government. There are a number of other options open to it that would resolve this situation but it has chosen not to take them. One of the more effective of these options would be to simply stop tying payments to projects and instead grant untied money as General Purpose Grants under the Horizontal Equalisation Principles. Alternatively, it could not require that funding be matched to be received. However, the trend of the Howard government is toward centralisation, and the argument over the abolition of SPPs revolves much more around the question of why the federal government should do it than how. There are, however, several reasons for decreasing the vertical fiscal imbalance.

First, as it has been argued, increased popular participation in politics at State level is a second level of democracy. In any federal

¹⁴⁶ *Subordinate Legislation Act 1994* (Vic) s 7.

¹⁴⁷ *Subordinate Legislation Act 1994* (Vic) s 10.

¹⁴⁸ *Subordinate Legislation Act 1994* (Vic) s 11.

system, States are ‘quasi-independent political communities which can and do play a major political role.’¹⁴⁹ This political role, one of the major functions of a State, is as a protector of democratic process. In 1976 Malcolm Fraser argued:

States remain as vital realities. Each maintains its own distinctive political tradition. Each remains, to a large extent, a genuine regional community, with its own media, its own industrial interests, its own social life, its own organizations and associations.¹⁵⁰

It follows that the more independent is a State, the more valuable is this power of democratic choice. Democracy is certainly something the Commonwealth should seek to cultivate where possible.

Secondly, the present SPP system obscures political accountability at both federal and State levels by giving the federal government power in perceived State domains and making the financial trail too difficult for many people to follow. While this maybe of benefit to the government, it should still acknowledge that it is clearly undesirable.

A third argument is that a decentralised state is the will of the Australian people. No matter what arguments are advanced in favour of political centralism, the ‘Australian people have rejected again and again... proposals to concentrate more power in Canberra’s hands.’¹⁵¹ To support this contention, we can look to when Australia has been asked to vote on these issues. In the last 40 years the following referenda have been defeated. In May 1967, a proposal sought to alter the *Constitution* so that the number of Members of the House of Representatives could be increased without necessarily increasing the number of Senators.¹⁵² In December 1973, two proposals were introduced, the first to give power to the Australian government to control prices, the second to enable the Australian

¹⁴⁹ Galligan and Walsh, above n 97, 199.

¹⁵⁰ D White and D Kemp (eds), *Malcolm Fraser on Australia* (1986) 154.

¹⁵¹ *Ibid.*

¹⁵² Parliament of Australia Parliamentary Library, *Referendum Results* (2005) <<http://www.aph.gov.au/library/elect/referend/results.htm>> at 11 September 2005.

government to legislate with respect to incomes.¹⁵³ In May 1974, a proposal that amendments to the *Constitution* could be carried if approved by a majority of Australian voters and a majority of voters in half the States.¹⁵⁴ These are all amendments that would have further centralised Australian government. However, referenda are notoriously difficult to pass; of the 20 proposals in the last 40 years, only four have been carried, all in quite non-partisan areas of law. Certainly then, an argument can be made that these results do not fully characterise the will of the Australian people. Nevertheless they can act as a guide to what Australia will not vote for, which is the creation of an unencumbered central government.

Finally, and perhaps the greatest reason for change, is the problem which fuels the Prime Minister's own frustration, namely the inefficiency of the present system. On Sydney radio in 2004, Howard expressed his disappointment at 'the increasingly dysfunctional character of our federal system'.¹⁵⁵ This statement was based, it seems, on an underlying perception that whenever State and federal governments meet, their conversation subsists of 'we want more money/you've got enough.'¹⁵⁶ Australia's current form of federalism continues a culture of what former federal Labor leader Mark Latham referred to as, 'buck-passing, blame-shifting and bureaucratic waste.'¹⁵⁷ It has been argued throughout, that this is due in large part to Australia's vertical fiscal imbalance, which in turn would not be so much of a problem if the States had control over the finances to govern their constitutional domains. It is SPPs, in large part, that diminish this control by forcing State governments into politically compromising funding agreements that they cannot afford to reject.

153 Ibid.

154 Ibid.

155 G Samuels, 'Federalism: The Same old Refrain', *The Age Online* (2004) <<http://www.theage.com.au/articles/2004/07/17/1089694606187.html?from=storylhs>> published 11 August 2005.

156 Ibid.

157 Ibid.

VII CONCLUSION

Since the Uniform Income Tax Legislation of 1942, Australia has been on a path towards greater concentration of power in the hands of the central government at the expense of the power of its State governments. A substantial factor in this development has been the development of the use of SPPs.

A number of examples of the use of SPPs in Australia have been detailed, including the AusLink, Australian Health Care Agreement and Celebrating Discovering Democracy SPPs and it has been noted in passing that SPPs govern areas such as aged care, government schools, and vocational education. All of these SPPs now govern traditionally State controlled areas. It has also been noted that for every SPP that is created to govern a State domain, currently 18.5% of a State's spending in that area will then be governed by the federal government. In addition many SPPs require the States match this number to receive this funding, but even where this is not required, SPPs make up relatively small proportions of what States themselves spend in areas where SPPs dictate the policy. In this system, State and Commonwealth accountability, State independence and a properly balanced federal division of powers, which should be prized in any federal nation, are being increasingly lost. And yet the prospects for reform are weak. While there may be some chance for States to increase their bargaining power through a broadening of their revenue base, at the moment this seems unlikely. The only practically feasible method of reducing the vertical fiscal imbalance presently open to the States is to lobby for reform in the bargaining of SPPs. The Commonwealth, on the other hand, has more options but, despite opposing arguments, it is presently following a trend towards centralisation.

