

THE WORK OF THE COMMONWEALTH GRANTS COMMISSION.

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WHEN the Federation was formed, various financial problems arose in connection with the relations of the States and Commonwealth. To meet these, the Braddon and other clauses were inserted in the Constitution, and various payments have since been made to the States. These are concerned, though very inexactly, with the question of State disabilities under Federation. At present, under this head, there are the *per capita* payments fixed by the Financial Agreement, grants to Road Funds, grants towards unemployment relief, contributions towards interest and sinking funds on State debts, grants to wheatgrowers, and others. The Grants Commission is not concerned with these, which still go on, but only covers grants in addition to those payments. The grants they recommend usually total only about 2-2½ million pounds, out of total grants to States of about £16,000,000. Their grants relate to a problem not foreseen by the framers of the Constitution—that of keeping the States going, and at a fairly common standard.

Under the Commonwealth Grants Commission Act, No. 3 of 1933, the Governor-General shall appoint three members to constitute the Commission, each appointment to be for a term not exceeding three years. The Governor-General shall also appoint the Chairman. Meetings may be convened by the Chairman whenever he thinks proper, and shall be convened by him whenever he is requested so to do by the Minister. Two members constitute a quorum. If the members present are equally divided over a matter, its determination is to be postponed until all members are present. The Governor-General can suspend any member for misbehaviour or incapacity, and must lay before each House within seven sitting days of that House, after the date of suspension, a full statement of the grounds. If within sixty days after the statement has been laid before them, both Houses pray for the restoration of the member, the Governor-General shall restore the member.

The Commission is to enquire into and report to the Governor-General on—

- (a) Applications made by any State to the Commonwealth for the grant by Parliament of financial assistance in pursuance of Section 96 of the Constitution;
- (b) any matters relating to grants of financial assistance made in pursuance of that section by Parliament to any State which are referred to the Commission by the Governor-General; and
- (c) any matters relating to the making of any grant of financial assistance by Parliament to any State in pursuance of that section, which are referred to the Commission by the Governor-General.

The Commissioners appointed are: F. W. Eggleston, a Victorian lawyer; Professor L. F. Giblin, a Tasmanian, resident in Victoria for

seven or eight years; and J. W. Sandford, a South Australian business man.¹

Their function is to advise the Government on certain subjects, as experts examining facts and arriving at certain conclusions with respect to those facts as far as possible by purely scientific methods. To read their reports shows plainly that they are a scientific body of experts, not subject to "political" influences of any sort; that they only depart from strictly scientific methods when lack of data forces them to guess—their guesses are based on their broad and sound knowledge of facts, and not on their pro-State, or pro-Commonwealth or pro-small State political sympathies. The only influence which the nativity of the members could have on the conclusions of the Commission is that it may give more intimate knowledge of the true circumstances of certain States—and that may affect the conclusions in either direction.

The Act creating the Commission wisely refrains from laying down any conditions of procedure or principles to be followed—the Commissioners are left alone as experts to discover the best solution to their problem. The principle on which they work is that, if a State, making reasonable efforts both in taxation and economy, cannot come up to the minimum standard determined, then a grant must be made to enable them to do so. This principle of "needs" is not the one that is usually urged by the States themselves, and it is useful to examine first their idea of the grounds for a grant—that grants should be made as compensation for disabilities, such as the effect of the financial relations of the States and Commonwealth, of Federal policy, and of poverty of natural resources.

The effect of the financial relations is directly on the Budget only, and therefore cannot be the ground for grants additional to those based on the principle of "needs." The other two involve not only Budget losses, but also losses to private citizens—"community losses." These have to be considered separately.

The most important feature of Federal policy in this question of State disabilities is, of course, the tariff. Let us consider it first from the point of view of the Budget. A great deal of effort has been put into an attempt to measure the total net adverse effects on States of the tariff, but it is quite impossible to obtain results with any degree of accuracy. But there is convincing evidence that the total net adverse effects on each of the claimant States is very considerably less than the "needs" of the State. Nor is there any immediate prospect of the position being reversed. Even if it were, there would be no justification for making a grant on those grounds. A State should never be compensated for disabilities if, despite them, their financial position is relatively good. The States entered into Federation voluntarily, and should be prepared to accept disabilities just as they accept benefits. There may be relief of distress due to legislation (as there was in Tasmania, in regard to the flour tax), but this

1. Two additional members have been appointed since the writing of this article.—Ed.

is not compensation. Some States claim that the grants should be based on needs or compensation for disabilities, whichever is the greater, but this cannot be upheld. Suppose all States are financially equal, and one State is compensated for disabilities to the extent of £1,000,000 then the States paying this compensation (through the Commonwealth) should in turn be compensated on the ground of needs, to restore financial equality, which would leave the disabled State as it was. Therefore the principle of compensation for disabilities can stand neither if it is used alone nor if it is used in conjunction with the principle of "needs."

Now consider the effects on the people of the States. If economic conditions are changed by price movements, equilibrium is restored only by the proper economic reactions to that situation—if price-movements indicate that certain production is no longer wanted, then that production must be curtailed. Similarly, when economic conditions are changed by legislation, people must be left to adapt their activities accordingly. They must be left free to move from less profitable occupations to more profitable ones, and compensation would only hinder this. The difficulty is that the tendency to re-adjustment does not act quickly enough to be really efficient—thus if the large number of wheat growers who have been working at a loss since 1930 had left their farms and gone to the city, the result would have been to heavily increase the number of unemployed. So this argument does not altogether dispose of community losses. These losses are mainly due to the tariff, and tariff costs are for the most part passed on, under the Australian system of wage-fixation, from the place of their first incidence, by means of the vicious circle of higher prices causing higher wages and hence higher costs, which again cause higher prices and so on, until finally by far the largest part of the tariff costs come to rest in unsheltered export industry which, having to sell its products in a world market at a world price which it can influence very little, cannot pass on its increased costs. Therefore the burden of the tariff falls most heavily on the claimant States not as such, but because an abnormally large proportion of their production is primary unsheltered export production. If compensation or relief is to be given for the effect of tariff on individuals, then it must be given by industries and not by States. It would not be fair to grant relief in the claimant States to wheatgrowers and refuse it to Victorian wheatgrowers because their State as a whole is financially efficient. The most satisfactory method is to put all States on an equal financial footing by the principle of "needs," and let the unsheltered producers, probably already receiving some uniform relief from the Federal Government, look for the remainder to State Governments who are, within limits, equally able to give it. If the amount required is relatively greater in a claimant State because of the greater proportion of unsheltered industry, the additional expense will be reflected in the budget, and therefore in the recommendation of an increased grant. Such relief must not amount to full compensation, which would take away the incentive to change

to more profitable forms of production. So if the inequalities of the financial positions of the States are removed, that affords all the special relief necessary for the differential effects of Federal policy on the people of different States.

Coming now to the question of poverty of natural resources—i.e., resources that are unprofitable relatively to Australian standards. Where this is wholly or partly the cause of an inferior budgetary position, the deficiency will be met by a grant according to “needs.” Where the poverty is adverse to individuals, it is the State Governments that must give relief—but not enough to remove the incentive to readjustment. Here, again, the expense will be taken into account by a grant based on needs. So no case can be made for compensating individuals.

Governments of States, however are in a different position. They cannot change their occupations or move where conditions are better. They must continue to function and pay their way. The law of self-preservation is fundamental—a Federation lives only as long as its constituent Governments live. If one becomes, or threatens to become, unable for financial reasons to discharge its functions adequately, then the Federation must give such help as will enable it to do so. If a State sincerely tries to keep going—taxes adequately, is not extravagant in social services or administration, charges reasonably for business services—and cannot, then the Federation must help it. Otherwise the State must default and the Commonwealth will be responsible for its debts and interest charges. The interest charges of the three claimant States are over £10,000,000 per annum, and in the worst period of the depression, their “needs” have been estimated at under £3,000,000, so it is obviously cheaper to keep the State solvent. Difficulties may be due to a variety of causes—the adverse effects of the financial provisions of the Constitution, of various aspects of Federal policy, unprofitable past loan expenditure, extravagance in administration or social services, depleted or inferior natural resources. But the cause is irrelevant. The important test is whether a State making reasonable effort can keep going. Difficulties arise with regard to the interpretation of such ideas as “practicable limits,” “reasonable effort,” “minimum standard,” but the principle is clear. The only importance of the cause of financial inferiority is that, if a State has got into difficulties through its own mistakes or extravagance, it is reasonable to expect that State to make a higher degree of effort than if its position is due largely to the effects of Federal policy.

Thus theoretically the Commission is working on a purely scientific principle. Unfortunately, the lack of data leaves many gaps, and these have to be filled by the judgment of the Commissioners. I am convinced that it is perfectly true to say that they make these judgments as scientists, and are not subject to “political” influences. Many cases arise where, although the data are insufficient for an exact result to be obtained, it is sufficient to allow a reasonably accurate guess to be made.

Let us consider now their determination of standards. The recommendation of grants requires both an inquiry into the inherent financial position of each State and the determination, through the experience of non-claimant States of standards—the “normal” standard for financial operations of States and a “minimum” standard below which a State cannot be expected to operate efficiently.

In Australia, there are only three non-claimant States, and these vary widely in deficits per head, severity of taxation, economy, scale of social services, etc. Here the Commissioners judge that Victoria and Queensland are fairly balanced—the first conservative financially and the second liberal—and therefore use a simple average in respect to deficits per head, severity of taxation, provision of social services, and all other items, as a basis for the normal standard. They leave out New South Wales because it has many abnormal features in respect to the provision of social services and the general scale of Government expenditure.

In a Federation like Australia, the minimum standard cannot be allowed to fall far below the normal standard. States must retain population because of the dead-weight debt. The limits of economy are narrowly circumscribed—the Federation’s expenditure for general purposes (e.g., war and pensions, which alone cost £5 per head per annum) may be on a scale which the less wealthy States could not have undertaken for themselves. Wages and many salaries are determined, within fairly narrow limits, by the Federal Arbitration Court. If we exclude debt charges, which are fixed, and call the remainder adjustable expenditure, then wages and salaries make for all States about two-thirds of adjustable expenditure. Moreover the States have to maintain a fairly equal scale of social services. Nor can one State afford to tax abnormally highly because differences easily divert capital and employment from one State to another.

So a comparatively small defect from the “normal” standard will entail a considerable effort or sacrifice. The effort or sacrifice required should be sufficient to give ample stimulus to a State to try to escape from its position of financial inferiority. The decision as to what is a “reasonable effort” which should be expected from a claimant State can be varied according to the cause of the financial difficulty, the greatest effort being expected from States whose difficulties are due to its own mistakes. These two objects are attained by using for the claimant States a standard for social services more severe than the normal standard (6 per cent. lower than the normal in the 1935 recommendations) and a variable standard of taxation which discriminates between the claimant States according to causes found for their financial position (in 1935, the discriminating penalty varied from 0 to 10 per cent. on severity of taxation).

The methods used are not easy to follow in a short survey, but it is necessary to know their procedure in order to be satisfied that they are in fact basing their recommendations on a scientific examination of the situation.

The basis of their work is a comparison of the budget position of the States. Adjustments are made in order to make the budget

deficit a fair reflex of the net result of all financial operations for which the State is responsible in the year in question; and to reduce important phases of State finance, such as taxation and cost of social services, to common standards. For grants recommended in 1935, they have to work on 1933-34 data, because nothing later is available. If conditions are changing rapidly, this may be a serious defect, but the error is not cumulative, as there is a constant lag.

The budget adjustments cover items included in some State budgets but not in others (e.g., water supply, electricity) and the transference of items of revenue and expenditure so that they refer only to the activities of the year in question, and elimination of the effects of windfalls in revenue, emergency expenditure and of all variations in accounting practice (e.g., New South Wales Liquor Compensation Fund transferred to Revenue). These adjustments give comparable deficits per head, and the arithmetic average of Victoria and Queensland give the normal standard.

The next step is to compare the States' potential financial positions by finding out how the real budget positions would be affected if they all functioned on a common—the normal—standard of Government. The adjustments made are in respect to—

- (i) maintenance of capital equipment—especially railways;
- (ii) costs of administration—size of personnel and scale of salaries;
- (iii) scale of social services—education, health, law and order, unemployed relief. The minimum standard was expressed in terms of social services because that was the element of cost for which comparative data were most satisfactory. A standard of 6 per cent. below the normal is taken—i.e., they expect the poorer States to exercise greater economy or greater effort in raising revenue, and this is expressed by the minimum standard, which is applied, purely for convenience, to this item. The States can effect the greater economy or effort in any avenue they choose. In determining a minimum standard and reasonable effort the Commission is in no sense using these terms morally. They are not condemning the States for excessive social services, under-taxing, and the like. They are merely measuring the claimant States against average standards. If they wish to live above these standards, then they must be willing to pay above the standard.
- (iv) standard of effort in raising revenue—
 - (a) scale of charges for services;
 - (b) severity of taxation—a very important but difficult comparison. A comparison of income tax can be made fairly confidently but that gives no index to the comparative levels of other forms of taxation. They get two indexes of severity of taxation—the first by a direct comparison of rates of income tax and death duties, the second by measuring capacity to pay State taxation (from Commonwealth assessments of taxation

in different States under a uniform law, similar to that of the States) and dividing actual tax collected per head by this capacity to pay and so getting a measure of severity of taxation.

The Commission then considers the causes of the States' positions and decides that South Australia and Western Australia should put up with taxation higher than the normal on account of past extravagance; Western Australia is the worse offender, but is reduced to the same level as South Australia because of the moral responsibility of the Commonwealth in respect to Group Settlement and the North-West.

They make all these adjustments to the amount necessary to bring comparable deficits to the normal standard and finally, in bringing the grants recommended to round numbers, they make allowance for various factors for which there have been insufficient data to justify a more exact allowance.

It is suggested that the whole idea of grants is unhealthy and gives undue power to the Commonwealth and the stronger States—that the financial relations of the States should be revised to put the distribution of revenue on some equitable but automatic basis. The States do not wish to raise their own revenue because the Commonwealth has superior powers in this respect and the poorer States profit by the arrangement—the Commonwealth raises revenue according to taxable capacity and spends it according to population (e.g., the 25/- *per capita* payment, now a constitutional obligation under the Financial Agreement). Tasmania, for instance has benefited by about £100,000 a year on this account. However, there is, of course, no guarantee that these payments are going to give the States all they need. So it has been found necessary to set up the Grants Commission to determine the grants necessary. It is this that is objected to. It is felt that the distribution to the States should be based on some automatic system. But the Commission has sought in vain for a satisfactory formula. It appears to be impossible either to arrive at the total amount which should be distributed, or the method by which it should be distributed. Suggestions such as handing over all direct taxation to the States, or a certain proportion of indirect taxation, obviously are no index to the needs or deserts of States. One can say broadly that the most useful suggestion is to increase both direct taxation and grants to States, but it is difficult to determine the amount necessary and apparently impossible to evolve an automatic formula. The inverse of the index of taxable capacity has been suggested but the Commission maintain that this is quite unsatisfactory. As is seen from their Report, a thorough investigation of State finances is needed to get even a moderately satisfactory measure of the relative financial position of States.

One can say in conclusion that it would be good to see this principle of having experts to advise grants on scientific grounds extended to replace the present haphazard system under which the Commonwealth grants various forms of assistance to the strongest political forces.