

THE CENTRE FOR
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**Public Money:
Federal-State Financial Relations
and the Constitutional Limits on
Spending Public Money**

ANNE TWOMEY



Foreword by Robert Carling

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FOREWORD

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Australian federalism is once again coming under close scrutiny. The Federal government's National Commission of Audit made far-reaching recommendations for reform of fiscal federalism in its report of March 2014. Subsequently, the government announced terms of reference for a major review culminating in a white paper to be issued by the end of 2015.

Any changes in the institutions, policies and practices of federalism will take place within the framework of the Constitution, which sets the rules for the operation of fiscal federalism. The Constitution has shaped the evolution of federalism since 1901 towards its present structure, including the unsatisfactory features; it helps determine what reforms are possible now; and it exposes certain kinds of reform as being impossible without formal Constitutional amendment, which experience tells us would be extremely difficult to achieve. There are also lessons to be learned from the use and abuse of existing Constitutional provisions.

In March 2014 Professor Anne Twomey of the University of Sydney issued a paper, 'Public Money – Federal-State Financial Relations and the Constitutional Limits on Spending Public Money', on the University's Constitutional Reform Unit website. The paper explains the Constitutional provisions relevant to fiscal federalism and the history of their application since 1901. It describes how the Commonwealth managed to achieve a much more expansive

public policy role, intruding upon state responsibilities, than was envisaged by the framers of the Constitution, and how the High Court facilitated that process, at least until recently.

Three High Court cases in the last five years – *Pape*, *Williams No 1* and *Williams No 2* – appear to signal a major turning point in the Court’s hitherto permissive attitude to Commonwealth expansionism. The Court’s decisions in these cases emphasised that the Commonwealth is a central government of limited powers within a federation and that its powers to spend public money are tightly circumscribed by the Constitution.

The history of Australian federalism, as described by Professor Twomey, has seen the Commonwealth expand its effective power and role by thwarting the Constitutional constraints on it and in some respects, as the *Pape* and *Williams* cases have revealed, actually flouting those constraints over many years. In the process, the Commonwealth has spent money in ways for which it has no Constitutional authority and crowded out the Constitutional role of the states.

Adherence to the Constitution is important in its own right, but also because it is critical to the efficient and effective operation of the federation. As Professor Twomey writes, the federal system needs to be ‘restored to optimal efficiency so that public money is spent for the greatest public benefit’. For that to happen there will need to be changes in governmental policies and practices under the existing Constitution or changes in the Constitution itself. If the restrictions imposed on governments by the current Constitution are deemed inappropriate on whatever grounds, the solution is to seek a formal amendment, not for governments to circumvent or flout the restrictions.

Professor Twomey’s paper for the Constitutional Reform Unit was written before the High Court’s *Williams No 2* decision. She has updated the paper to include commentary on that decision and kindly permitted The Centre for Independent Studies to re-publish it for the benefit of its members and the wider public. I recommend it to all those interested in federalism as a scholarly and very readable paper on the relevant Constitutional issues.

EXECUTIVE SUMMARY

Anne Twomey

Professor of Constitutional Law, University of Sydney*

It is uncontroversial that Federal-State financial relations need reform. Every Prime Minister has recognised the problems, but most attempts at reform have failed. Before making further efforts to undertake reform, it is necessary to understand how we got to the current position and what constitutional constraints and principles are relevant to future reforms. These are the matters addressed by this paper.

Those who wrote the Commonwealth Constitution understood that they were handing nearly three-quarters of all tax revenue to the Commonwealth while the States would remain responsible for the vast bulk of spending. They recognised the economic imbalance that this would cause. The Convention Debates show their concern to ensure that most of this revenue would be transferred from the Commonwealth to the States where it was most needed. The framers of the Constitution wanted to keep a massive surplus out of the hands of the Federal Treasurer. They were concerned that the Commonwealth would waste the money on its own interests while starving the States of funds. So they introduced constitutional mechanisms to force the transfer of most of the Commonwealth's revenue to the States.

* The views expressed are the author's own, not those of the University.

This paper explains how those constitutional measures were thwarted in the first 10 years of federation. It shows how the States re-built their financial independence from the Commonwealth by developing new forms of taxation, such as income tax, and how the Commonwealth took over income tax and progressively diminished the tax base of the States and their financial independence. It explains how the Commonwealth started spending on matters that were not within its powers in order to increase its influence over voters and expand its role in State affairs. It points to the use of ‘public money’ for political purposes rather than public benefit.

The paper explains the role of the High Court in supporting all these developments – how it upheld the Commonwealth’s efforts to thwart the constitutional requirement that its surplus be paid to the States; how it upheld the Commonwealth’s take-over of income tax; how it facilitated the reduction of the States’ tax-base; and how it failed to curb the Commonwealth’s spending on matters outside its powers.

The twist in this tale occurs in 2009, where in a series of three cases the High Court started to impose constitutional limits on the Commonwealth’s executive power, including its power to spend public money. An appropriation is no longer enough to support the expenditure of money by the Commonwealth. According to the High Court, the Commonwealth must also have a head of legislative power to spend the money and in most cases it must enact legislation to authorise that expenditure. The Commonwealth has sought to disregard these limitations, but each time the matter has come before the High Court, the limitations have been reinforced and extended. The Court has explicitly stated that the Commonwealth is a government of limited powers within a federation. It cannot maintain its pretensions to being an all-powerful central government. It cannot spend public money on anything it wishes. It has been financially neutered.

This history provides the essential context for discussion of the reform of Federal-State financial relations. The Commonwealth has already received controversial and far-reaching proposals from the National Commission of Audit, which include the Commonwealth’s

withdrawal from some areas of State responsibility and State involvement in the imposition of personal income tax. Further proposals will arise from the White Paper on the Reform of the Federation and a further White Paper on Taxation Reform.

Recognition that the High Court is now serious about enforcing limits on the Commonwealth's expenditure powers may be the impetus that is needed to achieve genuine, long-lasting reform. In order to ensure that such reforms are effective, those developing them must take into account the principles that have recently been applied by the High Court, including respect for the operation of the federal system and the federal distribution of powers, the accountability of the Executive to Parliament, the need for parliamentary scrutiny of expenditure programs and recognition that it is 'public money' that is being spent, not the Commonwealth's own money.



**CHAPTER
ONE**

INTRODUCTION

Introduction

Federal-State financial relations are often described as a 'blame-game'. 'Ending the blame-game' has become a political mantra, but no one has ever succeeded in doing so. One step in that process, however, has to be developing an understanding of the structural, political and constitutional conditions in which this game is played. This paper is intended to fulfil that role.

From a structural point of view, Australia has a high level of vertical fiscal imbalance. This means that the Commonwealth raises far more revenue than it needs to fund its expenditure responsibilities and the States raise far less revenue than they need to fulfil their more extensive expenditure responsibilities. The most expensive services provided by government in Australia, such as health and education, are provided by the States. The greatest tax raiser, however, is the Commonwealth. The ideal, in a federal system, would be for each level of government to raise, and be responsible for raising, all the revenue that it needs to fund its responsibilities.

Where a government is responsible *both* for raising the revenue and expending it, the government has an incentive to be efficient in its expenditure so that it can reduce the financial pain to taxpayers, who are also voters. It also has an incentive, however, to fund services adequately, or it will face the wrath of voters who feel badly served by government. It therefore has to balance revenue-raising against the level and extent of services provided and match this against the needs and wishes of the community it serves. The people of some jurisdictions may prefer to pay lower taxes and receive lower levels of government service, while in other jurisdictions, there may be a preparedness to pay higher taxes if this results in better services or a greater range of services. One of the benefits of a federation is being able to accommodate the different needs and wishes of different parts of the country.

Unfortunately, the ideal is never truly met. All federations have a degree of vertical fiscal imbalance, which in turn undermines the

capacity of governments to take true responsibility for balancing revenue-raising and expenditure. One of the prime reasons for vertical fiscal imbalance is that it is economically inefficient for many types of taxes to be imposed and collected at the sub-national level. This leads to the centralisation of the imposition and collection of major revenue-raising taxes.

Once the central government has to take the pain of being responsible for major tax raising, it tends to take the view that the money raised is ‘its money’ and that it should therefore control the expenditure of that money and gain the political benefits of the largesse involved in its expenditure. This further distorts the delicate balance of responsibility in the federal system. In Australia, the result of this approach has been Commonwealth direct expenditure in areas for which it has no constitutional responsibility, where it can see political advantages in funding pet projects. It has also resulted in the placing of conditions upon grants to the States, which undermine attempts by States to allocate resources efficiently and effectively. This leaves some areas over-funded and some under-funded, with no one taking responsibility for the resulting inadequacies in service-provision. This is the blame-game in action, where the States blame the Commonwealth for inadequate funding of State services and the Commonwealth blames the States for the inadequate provision of services. No one ends up truly accountable for the results.

Does the Constitution require or support this outcome? In recent times the High Court has suggested that it does not. In three cases in recent years, the High Court has held that the Commonwealth can only spend public money if it has a constitutional head of power to do so. It has stressed that money raised by the Commonwealth is not its ‘own money’, to be used for its political advantage, but rather, is ‘public money’, to be spent for the public benefit and not at the whim of the Executive. It must therefore be the subject of parliamentary scrutiny and its expenditure must be supported by a power allocated by the Constitution to the Commonwealth.

This paper explains how we got to this point in Australia’s federal financial relations and what the High Court’s judgments might mean for the future. It starts in Chapter 2 by explaining how the

financial provisions in the Constitution were intended to work and how they were thwarted in the first 10 years of federation. It was always anticipated that there would be a serious problem of vertical fiscal imbalance in the Australian federation, but mechanisms were included to ensure that the Commonwealth was limited to spending money for its own confined responsibilities or purposes, so that there would be a large surplus of public money which would be returned to the States to fund their responsibilities. It took just 10 years for the Commonwealth to avoid its constitutional obligation to limit its expenditure and pass its surplus on to the States.

Chapter 3 explains how the States sought new sources of revenue through taxation, in order to gain some financial independence from the Commonwealth. This was thwarted when the Commonwealth took over income tax from the States and progressively diminished the tax-base of the States, right up to the present day with the elimination of 'inefficient' State taxes under the GST agreement. The effect is to increase even further the dependence of the States on Commonwealth funding.

Chapter 4 explains how the Commonwealth, which is limited to appropriating money 'for the purposes of the Commonwealth', took the view that the 'purposes of the Commonwealth' are whatever purposes the Commonwealth wants to appropriate money for. Relying on some inconclusive High Court judgments, the Commonwealth proceeded to appropriate and spend money on a vast range of matters that do not fall within the legislative power of the Commonwealth. It also relied on the development of long-standing practices – the more it appropriated money for spending on programs outside of its powers, the harder it would be for the High Court to knock down such expenditure, given the widespread effects.

Chapter 5 discusses the *Pape* case. This was the first substantive attempt by the High Court to peg back the Commonwealth's power to spend. The Court held that the Commonwealth needed a head of legislative or executive power to support its expenditure. It could not just spend money on anything it wanted. The Commonwealth largely ignored the High Court's judgment and proceeded to spend on subjects regardless of whether or not it had a head of power to do so. In part this was based upon an assessment that no one was

likely to challenge such expenditure. In part, the Commonwealth's approach also seemed to be based upon a belief that in the end, the High Court would always uphold the validity of Commonwealth spending, even if it had to establish a dubious power (such as one allowing the Commonwealth to deal with emergencies) to do so. In this, the Commonwealth was wrong.

Chapter 6 addresses the *Williams No 1* case concerning the validity of a school chaplaincy program. The High Court held that not only must the Commonwealth have a head of power to support its expenditure, but that in many cases legislation will have to be enacted to support that expenditure. The High Court stressed the importance of 'federal considerations' and the need for the Executive to be accountable to the Parliament. Most importantly, it stressed that the Commonwealth was spending *public money* – not its own money. It therefore had to be accountable for it. The Commonwealth's legislative response was to give general legislative authority to all its spending programs that had previously relied upon executive power alone. In doing so, it defied the High Court's reasoning concerning the need for parliamentary scrutiny of public spending and the importance of federal considerations. It also neglected to consider whether its expenditure programs all fell within a head of Commonwealth legislative power.

Chapter 7 considers the second tilt by Mr Williams at the Commonwealth's chaplaincy program. In the *Williams No 2* case the High Court held that the Commonwealth had no head of legislative power to support the legislative authorisation of its school chaplaincy scheme. It reinforced the limitations on the Commonwealth's spending powers and stressed that the Commonwealth Executive did not have the same unlimited powers as the United Kingdom Government. The Commonwealth Government is a government of limited powers that operates within a federation and can only spend upon matters within its powers. The High Court rejected the Commonwealth's attempt to overturn *Williams No 1*.

Chapter 8 concludes the discussion by tracking the changes in the financial relationship between the Commonwealth and the States from federation until now and suggesting possible future directions.



**CHAPTER
TWO**

**HOW THE
FEDERAL-STATE
FINANCIAL RELATIONS
SYSTEM WAS SUPPOSED
TO WORK**

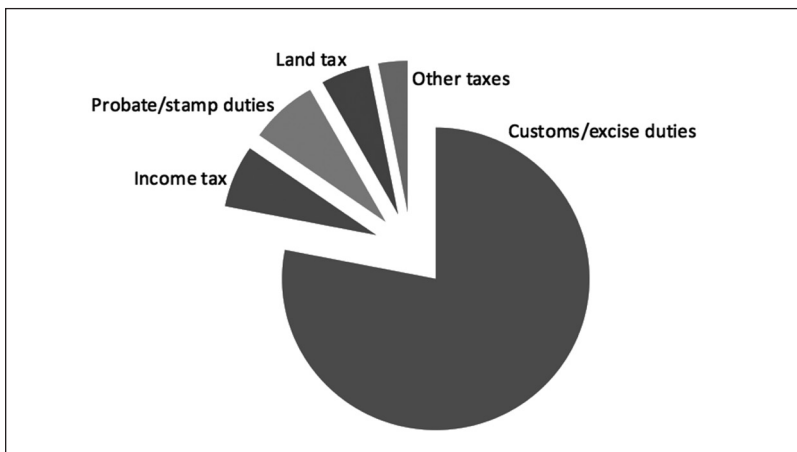
How the Federal-State Financial Relations System was Supposed to Work

This chapter explains how the financial settlement in the Constitution was intended to work and how it was quickly thwarted by the Commonwealth in the first 10 years of federation. It is important to understand this history as it shows that it was never intended that Commonwealth tax revenue should be treated as its own money, to be spent as it wished. It was always intended to be treated as public money, most of which was intended to be redistributed to the States to allow them to fulfil their constitutional responsibilities.

Sources of tax revenue in the Australian colonies

From the very beginning of federation, it was understood that the Commonwealth would receive far more revenue than it needed to fund its responsibilities and that much of this revenue would need

Figure 1: Distribution of taxes imposed by the Australian colonies in 1900



to go to the States to fund theirs. This was because the Constitution gives exclusive power to the Commonwealth to impose duties of customs and of excise, and these were the main forms of revenue at the time of federation. Figure 1 shows the distribution of taxes imposed by the Australian colonies in the year before federation.

The background to this decision was that prior to federation, the different colonies imposed duties on goods as they entered the colony. People living in the Riverina district of New South Wales, who obtained most of their goods from Victoria, had to pay tax upon the goods as they crossed the Murray River. These were the people who formed federation leagues and who revived federalism when it lapsed as a political issue in the mid 1890s. It was therefore a political imperative that exclusive power to impose customs duties and excises (being taxes on goods) be given to the Commonwealth, so that States would not be able to impose such taxes on goods as they crossed State borders. This was reinforced by section 92 of the Constitution which required that trade and commerce among the States be absolutely free.

How should Commonwealth tax revenue be returned to the States?

The question then, for the framers of the Constitution, was how this revenue was to be distributed back to the States. It was envisaged that the Commonwealth, being a government of a very limited number of powers and responsibilities, would have limited spending responsibilities (on matters such as defence, immigration, postal services and the like) but that most expenditure responsibilities (such as health, education, law and order, transport and housing) would remain with the States. If the Commonwealth was confined to spending in relation to the 'purposes of the Commonwealth', how was the rest of the money to be redistributed to the States, where it was most needed?

One of the difficulties in setting up any mechanism for redistributing Commonwealth revenue was that the framers of the Constitution could not really anticipate how the financial arrangements of the States would be affected by federation. They therefore needed a degree of

flexibility, especially in relation to the redistribution of funds amongst the States. Many arguments were had as to whether redistribution should be made by reference to population, or where the tax revenue was raised, or other measures. Richer colonies wanted the return to be based upon where the tax was collected, whereas the poorer colonies preferred distribution per head of population.

In the end, it was agreed to deal with the issue of redistributing money to the States in three different stages. Stage 1 concerned the period from federation until the Commonwealth enacted a law imposing uniform customs and excise duties, which it did on 9 October 1901. Stage 2 ran for the next five years. During these two transitional stages a 'book-keeping' system was imposed by the Constitution. The Commonwealth would credit the State with the customs and excise revenue it collected within the State and then debit the proportion of the Commonwealth's expenditure attributable to the State (calculated by reference to the State's population). The Commonwealth then paid the balance to the State. This method balanced the return of money based upon where it had been collected against the deduction of money expended by the Commonwealth on its limited functions, calculated by reference to population.

While delegates to the Constitutional Convention complained about this 'wretched and miserable book-keeping system', it was generally accepted that 'any other scheme would be unfair to either New South Wales or Victoria'.¹ There was also a special arrangement put in place for Western Australia during this period to help it to adjust to the changed rules, as it was more dependent upon customs and excise duties than the other colonies.²

Most controversial was Stage 3 – the period after the five years in Stage 2 had expired. This was an ongoing period and the framers were concerned that they could not adequately predict future financial circumstances in order to prescribe how the money should be distributed. On the other hand, they did not wish to leave it completely to the discretion of Parliament. It was decided that the Commonwealth would be required to distribute its surplus revenue to the States on such basis as the Commonwealth Parliament should deem fair. This was required by section 94 of the Constitution.

The terms of section 94 are, however, somewhat misleading. The section says that the Parliament ‘may’ provide, on such basis as it deems fair, for the return of its surplus to the States. On its face, this would seem to imply that this return is discretionary, not a constitutional requirement. The provision has not been interpreted in this way. It was always intended that the return of the money to the States would be compulsory, but that Parliament would have discretion about *how* the money would be distributed between the States – ‘on such basis as it deems fair’.³ In the *Surplus Revenue Case* in 1908, the Commonwealth conceded that the States were entitled to have distributed amongst them all the revenue left over that had not been appropriated for Commonwealth purposes.⁴ Justice O’Connor commented that it is ‘no doubt the right of the States under s 94 to have returned to them every month all revenue of the Commonwealth which remains after providing for Commonwealth expenditure’.⁵ Justice Higgins also noted that the ‘States must ultimately get all moneys not actually paid by the Commonwealth’.⁶ The right of the States to receive any surplus has therefore been held to give them grounds for challenging an appropriation as not falling within the ‘purposes of the Commonwealth’, because the States would therefore be entitled to receive the resulting surplus.⁷

While it was anticipated that in a federation a ‘fair’ system would eventually be the distribution of the surplus to each State in proportion to its population, attempts to amend the draft Constitution to require *per capita* distribution at a fixed time failed in favour of parliamentary flexibility.⁸ The framers of the Constitution, being unsure of the date when it would be appropriate to change to a permanent system of *per capita* distribution, left this to Parliament to decide in the future.

In order to ensure that the surplus distribution provision worked, it was necessary to make sure that there was a surplus and that the Commonwealth did not gobble it up through excessive expenditure on its own behalf. As the delegates to the Constitutional Convention noted, a system that leaves a government with a large surplus inevitably leads to a ‘system of waste and extravagance’⁹ and gives rise to a temptation that should be kept ‘out of the hands of the Federal

Treasurer'.¹⁰ Charles Kingston aptly observed, 'there is nothing which conduces more to the reverse of sound finance and good government than an overflowing Treasury'.¹¹

Others, such as Sir John Downer, thought it unnecessary to impose limits on Commonwealth expenditure because this was already achieved by 'the limitation of the subjects of jurisdiction given to the Commonwealth, and the impossibility of extravagant expenditure resulting from the limitation of the area of legislation and action of the Federal Parliament'.¹² As the Commonwealth was to be a government of limited powers, it would also have to be a government of limited expenditure, regardless of whether or not the Constitution imposed additional limitations. This was reflected in section 81 of the Constitution, which limited Commonwealth appropriations so that they could only be 'for the purposes of the Commonwealth'. However, section 81 was also altered to make it subject to the 'charges and liabilities imposed by this Constitution'. This was intended to cover the Commonwealth's liability to make payments to the States,¹³ which might otherwise be regarded as outside of the 'purposes of the Commonwealth'.

A Tasmanian delegate, Edward Braddon, was still not sufficiently satisfied that this would ensure that the States received a sufficient proportion of the Commonwealth's tax revenue from customs and excise duties. He successfully proposed section 87 of the Constitution which stated that the Commonwealth could only spend one quarter of the revenue it received from customs and excise duties, with the rest having to be paid to the States. This ensured that there was a guaranteed surplus of at least three quarters of Commonwealth revenue from customs and excise duties. An attempt was made at the Melbourne session of the Constitutional Convention to limit the effect of the Braddon clause to five years, but this was voted down. It was intended to apply in perpetuity (unless the Constitution was later amended).

Section 87 was extremely controversial and was described by its opponents as the 'Braddon blot' on the Constitution. While New South Wales, in particular, objected to it on the ground that the likely

consequence would be unnecessarily higher Commonwealth taxes,¹⁴ it was generally agreed that it was a necessary evil in order to ensure that a surplus would be available for return to the States.

The draft Constitution, as agreed upon at the 1897–98 Constitutional Convention was then put to a referendum in the different colonies. Although it received support from a majority of voters in New South Wales,¹⁵ it did not reach the requisite minimum support of 80,000 voters (as there was no compulsory voting at that time), so it was deemed to have failed. At a meeting of Colonial Premiers in January 1899 a number of compromises were reached in order to obtain subsequent agreement from the people to the draft Constitution. Two of those compromises related to Federal-State financial arrangements. The NSW Premier, George Reid, had sought the deletion of the Braddon blot.¹⁶ The compromise reached by the Premiers was to limit the Braddon clause in section 87 to a minimum of 10 years, and thereafter until the Commonwealth Parliament otherwise provided. This turned out to be a very short-sighted move on the part of New South Wales.

The second compromise was to insert section 96 in the Constitution, allowing the Commonwealth to make grants upon conditions to States where this was needed. Such a provision had previously been rejected at the Constitutional Convention in Melbourne in 1898.¹⁷ There was a concern that the States would become supplicants to the ‘rich uncle’ of the Commonwealth who would come to their aid in financial trouble. Richard O’Connor, later a Justice of the High Court, was concerned that this would lead to circumstances where one government could pressure or ‘exact terms’ from the other, as this would produce ‘the germs of corruption and improper influence’.¹⁸ Dr John Cockburn thought that such a proposal would ‘certainly sap the independence of the states by placing the Federal Parliament as a sort of Lord Bountiful over the states’. He was prescient in his warning that ‘we may as well strike out the provision that all taxation shall be uniform throughout the Commonwealth if we are to contemplate that after the taxation has been raised the proceeds may be handed over to any one colony’.¹⁹

In 1899, the intention behind inserting section 96 was to avoid the necessity of imposing higher uniform Commonwealth taxes (affecting the more prosperous States, such as New South Wales) in order to provide *per capita* funding to the States at a sufficiently high level to support the more financially needy smaller states (such as Tasmania).²⁰ It was also seen as a concession to the smaller States, especially Tasmania, ‘as a *quid pro quo* for the concession made to New South Wales in the limitation of the Braddon clause’.²¹ It was certainly not intended that section 96 would become the primary means of transferring money to the States. This was the function of section 94, which it was anticipated would involve the distribution of the surplus on a per capita basis, after the transitional period was over. Nor was it intended that the provisions in the Constitution that carefully prescribe that the Commonwealth may not discriminate between the States in imposing taxation were to be undermined by the discriminatory return of the proceeds of taxation to particular States under section 96.²²

Section 96 was, according to the colonial Premiers, only intended to allow the Commonwealth Parliament ‘to deal with any *exceptional circumstances* which may from time to time arise in the financial position of any of the States’.²³ It was thought that such problems would only be likely to arise in the transitional period after federation, while State economies were adjusting to the loss of customs and excise duties. Hence section 96 was stated to apply ‘during a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides’. It was intended to be a temporary measure to deal with financial emergencies.

How the Federal-State financial relations system failed to work in practice

Customs and excise duties had made up about three quarters of colonial taxation revenue prior to federation.²⁴ The loss of this tax revenue was always anticipated to be financially significant for the States. The departments that the States were required to transfer to

the Commonwealth (such as the post and telegraph departments) also tended to raise more revenue than they cost to run, resulting in further financial losses for the States.²⁵ Moreover, it was also recognised that the States would continue to bear most of the burden of public expenditure. For this reason, the transfer of the Commonwealth's surplus to the States was essential. Figures 2 and 3 show Federal and State tax revenue and expenditure in 1901–02.

Figure 2: Federal and State taxes in 1901–02

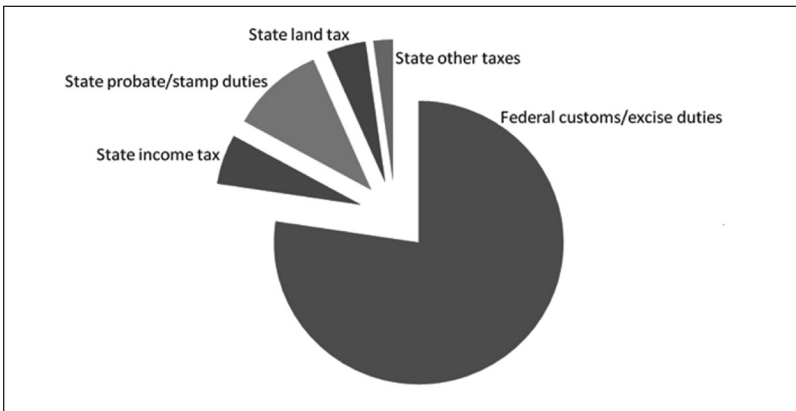
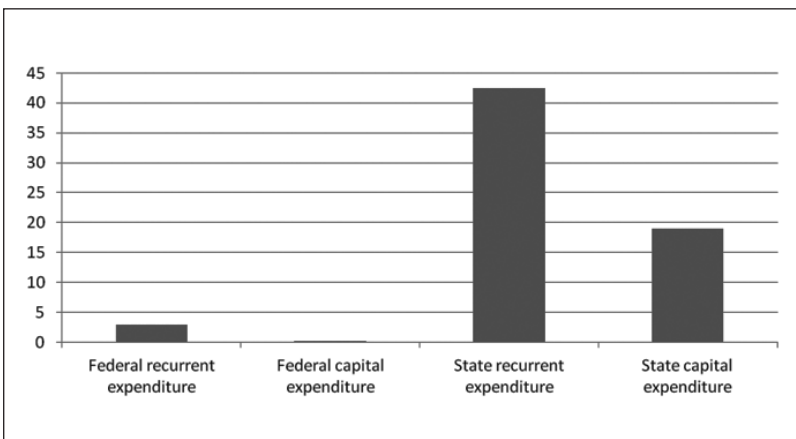


Figure 3: Federal and State recurrent and capital expenditure in 1901–02 (\$million)



Once the customs and excise tax revenue was lost, the States sought to expand other forms of taxation in order to establish at least some degree of financial independence from the Commonwealth. The States had previously levied low levels of income tax. They now developed income tax as their main source of tax revenue, as well as expanding stamp duties and probate (death) duties.²⁶ At the same time, although the Commonwealth imposed only customs and excise

Figure 4: Federal and State taxation in 1909–10

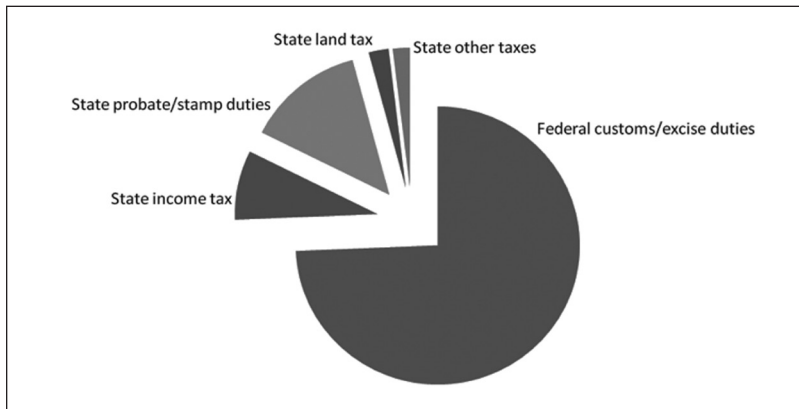
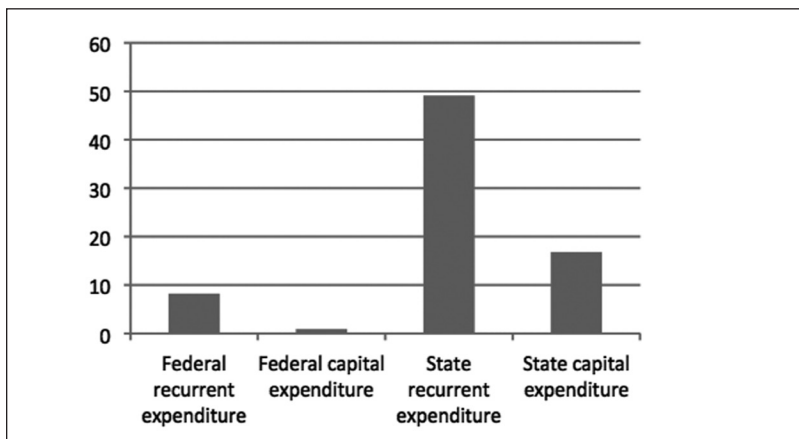


Figure 5: Federal and State recurrent and capital expenditure in 1909–10 (\$million)



duties, it increased the amount raised significantly.²⁷ Figures 4 and 5 show that the proportion of revenue raised by the States, in comparison to that raised by the Commonwealth, remained quite small 10 years after federation, while the expenditure responsibilities of the States remained much greater than those of the Commonwealth.

During the first decade of federation, the Commonwealth complied with the Constitution and provided three quarters of its revenue from customs and excise duties to the States. It also initially paid its surplus revenue to the States. In 1901–02 it paid \$13 million to the States (being three quarters of its net customs and excise revenue under section 87) and \$1.8 million (being additional surplus beyond that required to be paid by section 87).²⁸ But by 1908 the Commonwealth had become reluctant to pass on any surplus to the States. The *Surplus Revenue Act* 1908 (Cth) terminated the book-keeping distribution under section 93 of the Constitution, while replacing it with a statutory version of the same arrangement.²⁹ Critically, however, it deemed any money placed into trust accounts for the purposes of the Commonwealth to be ‘expenditure’ by the Commonwealth.³⁰ It also declared that such an appropriation did not lapse at the end of a financial year, even though the money had not been spent.³¹ The aim was to ensure that money appropriated into trust accounts could not be regarded as a surplus in order to avoid its distribution to the States.

When this Bill was debated in Parliament, it came under attack. Sir John Forrest, a former Premier of Western Australia, argued that the Government was effectively trying to amend section 94 of the Constitution and that it was an unfair attack on the finances of the States. Nonetheless, it passed and its validity was upheld by the High Court.³² Since 1908, the Commonwealth has *never* recorded a surplus. Every time a Commonwealth Treasurer has grandly announced a great surplus, this was not true, or otherwise the money would have had to have been distributed amongst the States. As a consequence of the Commonwealth’s avoidance of the application of section 94 of the Constitution, the primary constitutional provision for the transfer of revenue from the Commonwealth to the States has ceased to be effective, despite the intention that it be the

permanent ongoing mechanism for funding the States and the key to Federal-State financial relations.³³

By 1910, the minimum period of the Braddon clause expired. Because of the compromise reached at the 1899 Premiers' Conference, section 87 of the Constitution applied for a period of 'ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides' in requiring that three quarters of revenue raised by customs and excise duties be paid to the States. The *Surplus Revenue Act* 1910 (Cth) terminated any continuing application of section 87 of the Constitution.³⁴ Instead, it was agreed that the Commonwealth would pay the States 25 shillings per capita of population for 10 years.

An attempt by the States to have this agreement enshrined in the Constitution³⁵ failed at a referendum in April 1910. The Labor Party campaigned against it because it would inhibit the capacity of the Commonwealth to expand its own activities.³⁶ Others complained that it was disgraceful to suggest that the Commonwealth would not provide adequate funds to the States without being required to do so by the Constitution.³⁷ Nonetheless, this is what occurred. Commonwealth payments to the States dropped from \$17 million in 1909–10, which was the final year of operation of section 87 of the Constitution, to \$11.2 million in 1910–11 under the new scheme.³⁸

The Sydney Morning Herald made the following comment about the referendum proposal, pointing out that the issue was all about the distribution of *public money*:

The taxpayers of States and Commonwealth, who are one and the same persons, find ample money wherewith to finance both branches of their business. All that is necessary is that there should be a fair division of that money; that neither the States nor the Commonwealth should get too much or have too little.³⁹

Since the application of section 94 had been thwarted by the Commonwealth appropriating all its surplus money into trust accounts and the requirements of section 87 could be and were terminated

by ordinary legislation after 10 years, the States were left with no constitutional guarantee that the money that was always intended to flow to them would actually be received by them. Faith had to be placed in the Commonwealth Parliament to achieve this outcome, but the Commonwealth soon began to regard the taxpayers' money that it reaped to be its own money, to be used as it wished, rather than public money to be distributed amongst the levels of government according to public need.

The impact of these early developments on the States was mixed. The more prosperous States, such as New South Wales and Victoria, managed to support their economies by developing other forms of direct taxation, such as income tax. Some States, however, struggled to survive, with Western Australia needing special financial grants from the Commonwealth in 1910 and Tasmania needing Commonwealth aid in 1912.⁴⁰



**CHAPTER
THREE**

**HOW THE
COMMONWEALTH
TOOK OVER STATE
TAXATION BASES**

How the Commonwealth Took Over State Taxation Bases

Commonwealth expansion into other forms of taxes

From 1910, the Commonwealth, not satisfied with its significant revenues derived from its excise and customs duties, started intruding into the tax-bases of the States. In 1910, the Commonwealth enacted a land tax.⁴¹ With the onset of World War I, it introduced its own estate duties in 1914 followed by a Commonwealth income tax in 1915. Income taxes, land taxes and estate duties were primary sources of tax revenue for the States. Nonetheless, the States continued to raise a significant proportion of their expenditure through their own sources. As Denis James has noted:

By the end of the First World War (1918-19), the Commonwealth was raising almost three times as much in total taxation as the States and almost twice as much income tax. Nevertheless, the States were still able to raise a significant amount of non-tax revenue and were reasonably self-sufficient – only 17 per cent of total State revenue was derived from Commonwealth grants.⁴²

Both the Commonwealth and the States were placed under serious financial pressure during the Great Depression, but by the end of the 1930s, before the commencement of World War II, their financial positions had improved. The States received 61 per cent of their revenue from their own taxes, half of which

came from State income taxes.⁴³ Only 14 per cent of State and local government revenue came from Commonwealth grants.⁴⁴ As for the Commonwealth, most of its tax revenue came from indirect taxation, being customs and excise duties and its newly introduced sales tax, which together amounted to 75 per cent of Commonwealth tax revenue.⁴⁵ Commonwealth income tax (for individuals and companies) amounted to only 16 per cent of Commonwealth tax revenue.⁴⁶

The loss of income tax

The greatest blow to the financial independence of the States came from the Commonwealth's assumption of sole control over income tax during World War II. The Commonwealth needed significantly greater revenue to fund the war and sought to obtain it by increasing its income taxes. However, different States imposed different levels of income tax, while the Commonwealth could only tax uniformly across the States, because section 51(ii) of the Constitution prohibits it from discriminating between the States in relation to taxation. The effect would have been to place very serious burdens on the people of those States that imposed a high income tax.⁴⁷ It was therefore more efficient for the States to vacate the field and for the Commonwealth then to impose its income tax uniformly at high rates across all the States and to compensate the States for their losses. The States declined to give up their income taxes, knowing that to do so would make them financially dependent upon Commonwealth grants.

The Commonwealth achieved its aim by enacting a package of four Acts. Critically, these Acts gave priority to the payment of the Commonwealth's income tax over that of the States and provided for grants to States on the condition that they did not impose an income tax. Given the high rate of the Commonwealth tax, it was unlikely that taxpayers would have been able to pay both Commonwealth and State income taxes, leaving the States with the likelihood of dealing with tax defaulters and few tax receipts.

From an economic point of view, the States had no choice but to abandon their income taxes and accept the Commonwealth's grants instead. The immediate effect upon the States was for their own taxation receipts to drop from 61% of their total revenue before the war to 28 per cent (most of which came from local government rates).⁴⁸ This reduction in tax revenue made the States much more reliant upon Commonwealth grants. The States challenged the validity of the Commonwealth's income tax takeover package, but they failed.⁴⁹

The Commonwealth's uniform tax package was initially claimed to apply only for the length of the war plus one year.⁵⁰ However, in 1946 the Commonwealth announced that it would continue indefinitely. The States were left with a very narrow tax base – primarily estate duties, motor vehicle taxes, land taxes, stamp duties and local government rates. In 1946, the Commonwealth raised \$764 million in tax, \$416 million of which was income tax and \$278 million of which was from customs duties, excise duties and sales taxes. In comparison, the States only raised \$96 million in tax, \$34 million of which was from local government rates, \$16 million from estate duties, \$11 million from stamp duties and \$15 million from motor vehicle taxes.⁵¹ The States had become substantially financially dependent upon the Commonwealth. A further constitutional challenge to the Commonwealth's takeover of income tax failed in 1957.⁵²

While there is no constitutional constraint that prevents the States from levying an income tax, there are practical constraints. First, there would be immense economic inefficiency in requiring individuals and corporations to deal with two different income tax regimes for income earned in each State, not to mention the creation of incentives for tax avoidance. Second, if a State is to tax the same subject matter as the Commonwealth – i.e. income – then there needs to be sufficient economic room for such a tax to be applied without causing hardship or undermining the strength of the economy.

In the 1970s the Fraser Government, as part of its New Federalism policy, sought to implement a form of income-tax

sharing. Under the first stage of this policy, the existing financial assistance grants to States were replaced by giving the States and local government a fixed proportion of net Commonwealth personal income tax receipts.⁵³ The Commonwealth would continue to control the rate and base of income tax, as well as any deductions, rebates or exclusions. This meant that if the Commonwealth granted tax cuts to taxpayers, or imposed levies, such as the Medicare levy, that were excluded from the amount made available to the States, then the States and local government were directly affected by a reduction in revenue. The States were particularly concerned about the resulting uncertainty as to their revenue, fearing that the Commonwealth would adjust the tax mix, so that it received greater tax revenue from sales tax and less from income tax, as it no longer had as strong a financial interest in the receipts from personal income tax.

Stage 2 of the New Federalism program permitted each State to impose a surcharge upon personal income tax collected within the State or to provide a rebate of such tax.⁵⁴ No State sought to apply such a surcharge. It was widely regarded as a form of double taxation and as breaching the constitutional principle of uniform taxation. Further, the Fraser Government did not make the necessary 'tax room' for such a surcharge, so that it proved impractical.⁵⁵ The experiment was later repealed by the Hawke Government.

The rise and fall of business franchise fees

The effect of the constitutional prohibition of the States upon imposing excises depends upon how narrowly or broadly the High Court interprets the meaning of excise. The early view taken by the High Court was that an excise was a tax levied upon local producers and manufacturers with respect to the goods produced or manufactured. It was the counterpart of a customs duty which was a tax on goods produced or manufactured outside of Australia and imported into Australia. This would leave open the possibility

of the States taxing at other points in the chain before goods are consumed. However, in 1949 the High Court held that a tax imposed upon retailers or at any stage in the distribution of goods before their consumption was also an excise duty,⁵⁶ limiting the field of State taxation even further.

From 1960, however, the States relied upon a loophole in the excise prohibition to develop significant revenue from licence or 'business franchise' fees relating to the right to sell liquor, tobacco and petroleum. These fees rose from 6 per cent of the value of sales in a previous period to 100 per cent by the 1990s. Despite upholding the constitutional validity of these fees over decades, in 1997 the High Court struck down such fees on the ground that they really amounted to an excise.⁵⁷ The States lost revenue estimated to be up to \$5 billion per year.⁵⁸

As a result of this financial blow, the Commonwealth introduced laws that taxed tobacco, liquor and petroleum, returning most of the revenue to the States. Once again, the States were made dependent upon Commonwealth largesse and impeded from raising their own tax revenue.

The GST and the further reduction of the State tax-base

The States had long sought a 'growth tax' that they could levy themselves in order to develop their independence from Commonwealth financial control. While efforts to regain control over income tax failed, in 1971 the Commonwealth agreed to transfer control over payroll tax from the Commonwealth to the States.⁵⁹ This was not enough to provide the States with sufficient own-source revenue, although it remains the major State tax.

The loss of the revenue from the franchise business fees in 1997, and its replacement with an unsustainable temporary safety-net, led to the initiation of more substantial tax reform in the form of the introduction of a goods and services tax (GST). Although the Commonwealth has sought to characterise the GST as a 'State tax', it is in fact a Commonwealth tax and can only be

so because it involves taxes on goods, which are excises that the States are constitutionally prohibited from imposing. While the GST legislation states that the rate and base of the GST cannot be changed without the agreement of the States,⁶⁰ this is not the case. The Commonwealth does not have the constitutional power to abdicate its legislative power in this way (other than by amending the Constitution by a referendum), so the Commonwealth continues to impose the GST, collect the GST, determine the rate and base of the GST and decide on the distribution of the GST.

The proceeds of the GST, after the deduction of the Commonwealth's costs in collecting it, are distributed amongst the States. This gives the States access to the proceeds of a more substantial 'growth tax', although the global financial crisis showed that the proceeds from such a tax can diminish just as much as they can grow. As the 'GST Distribution Review' of Brumby, Carter and Greiner showed, after 10 years of GST, the revenue returned to the States remained barely above the minimum amount guaranteed by the Commonwealth to ensure that the States were not worse off under the GST than under the previous system.⁶¹ The amount of GST revenue, as a proportion of GDP, has also been reducing from a high of 4 per cent of GDP in 2003–04 to less than 3 per cent of GDP in 2012.⁶²

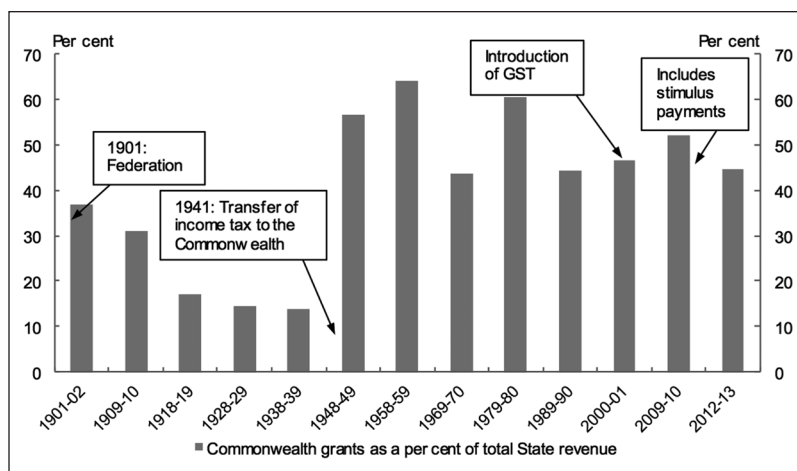
Moreover, the tax is still a Commonwealth tax and is one that in constitutional terms cannot be levied by the States. The States are therefore still beholden to the Commonwealth to receive the proceeds of this tax, and every now and again the Commonwealth threatens to place conditions or limitations on the distribution of the GST proceeds to the States.

One of the conditions of receipt of the GST proceeds was that the States abolish a number of taxes, including bed taxes, financial institutions duties, stamp duties on quoted marketable securities and debits taxes.⁶³ The need to retain certain other 'inefficient' taxes was agreed to be reviewed at a future date. In 2008 the Commonwealth and the States agreed upon a timetable for the abolition of these other taxes, which was to be achieved by 2013.⁶⁴

The effect of these reforms was to increase vertical fiscal imbalance by even further reducing State own-source revenue and making the States even more financially reliant upon the Commonwealth. The major revenue-raising State taxes are now payroll tax and stamp duties on conveyances, motor vehicle taxes, land taxes and gambling taxes.⁶⁵

The Report on the GST Distribution Review by Brumby, Carter and Greiner set out the following graph, showing how vertical fiscal imbalance has risen, fallen and risen again, over time.

Figure 6: Vertical fiscal imbalance over time⁶⁶





**CHAPTER
FOUR**

**COMMONWEALTH
EXPENDITURE IN AREAS OF
STATE RESPONSIBILITY**

Commonwealth Expenditure in Areas of State Responsibility

Commonwealth expenditure and the intention of the framers

As discussed above, some of the framers of the Constitution thought it unnecessary to include the Braddon clause in the Constitution to ensure that there was a surplus that would be transferred to the States under section 94. This was because the Commonwealth was to be a body of limited legislative and executive powers and would therefore be limited in what it could spend its revenue on.

The way the Constitution distributed powers in the Constitution was that the Commonwealth was granted specific legislative powers (primarily in sections 51, 52 and 122 of the Constitution) and could *only* legislate if its legislation was supported by one of these 'heads of power'.⁶⁷ The States, on the other hand, could legislate on absolutely anything without any constitutional authorisation, as long as the power hadn't been taken away from them by the Constitution (such as by section 90 of the Constitution, which prevents the States from imposing an excise).

Just as the Commonwealth had limited powers to legislate, it also had limited power to appropriate and spend money. Section 81 of the Constitution only permitted the Commonwealth to appropriate money if it was for the 'purposes of the Commonwealth'. The Commonwealth would therefore have no capacity to spend money in fields of State responsibility, such as education, health and the like.

It would also have been arguable that the transfer of the Commonwealth's surplus from the Consolidated Revenue Fund to the States was not for the 'purposes of the Commonwealth'. For this reason, section 81 was altered during the Constitutional Conventions

to say that the Consolidated Revenue Fund was to be ‘appropriated for the purposes of the Commonwealth in the manner and subject to the charges and liabilities imposed by this Constitution’. Those ‘liabilities’ included the Commonwealth’s liability to transfer money to the States under sections 87, 89 and 93, which implemented the ‘book-keeping’ system during the transitional period, and section 94 which provided for the transfer of the Commonwealth’s surplus to the States.

The fly in the ointment was section 96 of the Constitution which permits the Commonwealth to grant financial assistance to any State ‘on such terms and conditions as the [Commonwealth] Parliament thinks fit’. It is badly drafted – for example, a Parliament cannot ‘think’. Apparently no drafter was in attendance at the Premiers’ Conference at which section 96 was adopted. Moreover, section 96 does not impose any liability, so it does not fall within the exception in section 81 for charges and liabilities imposed by the Constitution. As for the merits of section 96, its inclusion had already been debated and rejected by the Constitutional Convention. It was only added by the Premiers’ Conference in 1899 after the Constitutional Convention had finished its work. Insufficient consideration was given to how it would fit in with the other financial provisions. Certainly, no one anticipated that it would end up being the sole means by which money was transferred from the Commonwealth to the States. At the time, section 94 (which does not permit the imposition of any conditions on transfers of the surplus) was intended to be the way by which the States received their funding from the Commonwealth.

The relevance of section 96 to the power to appropriate

Given that section 96 was included in the Constitution and that it confers on the Commonwealth Parliament the capacity to ‘grant financial assistance to any State on such terms and conditions as the Parliament thinks fit’, section 81 has to be reinterpreted to incorporate the purpose of giving grants to the States under the

‘purposes of the Commonwealth’⁶⁸ as such grants are not liabilities imposed by the Constitution (unlike section 94 and the transitional provisions). Justice Fullagar of the High Court saw section 96 as ‘declaring, in effect, that the purpose of providing financial assistance for any State is a “purpose of the Commonwealth” within the meaning of s 81’.⁶⁹ This meant that amounts transferred to States under section 96 could be first deducted from Commonwealth revenue before determining the surplus that was to be distributed to the States under section 94⁷⁰ by way of a fair formula (be it by population or the jurisdiction in which the tax was originally collected).

Even though section 96 of the Constitution had the effect of expanding those matters in relation to which the Commonwealth could appropriate, it only did so when the appropriation was made for payment to (and through) the States. It did not permit the appropriation and direct expenditure of money to support projects and programs outside Commonwealth power. As Justice Fullagar observed, Commonwealth funding for roads could only be made through section 96 grants because the ‘Commonwealth had, of course, no power directly to appropriate moneys for application to the making or maintenance of roads’.⁷¹

It was thought necessary to include section 96 in the Constitution, as well as the provisions permitting the Commonwealth to grant bounties on the production or export of goods, to ensure that such expenditure could be made.⁷² Section 96 therefore stands as a clear indication that the Commonwealth cannot expend money in relation to some subject areas, unless it makes grants to the States to do so.⁷³ There are wide areas of activity that lie outside the Commonwealth’s executive power and which may only be dealt with by the Commonwealth through conditions attached to section 96 grants.⁷⁴ Otherwise, as Justice Starke noted, section 96 would be superfluous if the Commonwealth had the power to appropriate money with respect to any subject matter.⁷⁵ These points have most recently been reiterated by the High Court in the *Williams No 1* case.⁷⁶

The meaning of ‘purposes of the Commonwealth’

The Commonwealth, however, bridled against this restriction on its power to appropriate and spend public money. It began, particularly in the 1970s, to spend money directly on subjects that were not within its legislative or executive power. In doing so, it sought to exert pressure on the High Court by establishing a long-standing practice and raising the stakes involved in striking down such wide-spread expenditure. It relied on the circular argument that the mere fact that the Commonwealth Parliament had decided to appropriate funds for a purpose was enough to make it a ‘purpose of the Commonwealth’. If this argument were correct, then the phrase ‘purposes of the Commonwealth’ in section 81 would be meaningless, because all appropriations made by the Commonwealth Parliament would be, by virtue of that very fact, purposes of the Commonwealth.

The question of the meaning of ‘purposes of the Commonwealth’ divided the High Court in the *Pharmaceutical Benefits* case⁷⁷ in 1945 and the *AAP* case⁷⁸ in 1975, in such a way that there was no majority support for either the broad view (that purposes of the Commonwealth meant any purposes for which the Commonwealth Parliament decided to appropriate money) or the narrow view (that the Commonwealth could only appropriate money for purposes within the Commonwealth’s powers). Some judges agreed that the purposes of the Commonwealth were any purposes chosen by the Commonwealth Parliament and identified in the *Appropriation Act*, regardless of whether they fell within Commonwealth legislative or executive power.⁷⁹ These judges were influenced by both the concern that otherwise many past appropriations would be invalid⁸⁰ and the need for the Commonwealth to fund worthy causes, such as exploration and scientific research.⁸¹ Other judges considered that the Commonwealth could only appropriate money for purposes that fell within the Commonwealth’s legislative, executive and judicial powers, including those powers derived from its status as a ‘nation’.⁸² They saw this as more consistent with the other financial provisions in the Constitution, such as sections 94 and 96.⁸³ They also saw it

as the more logical approach to giving meaning to the limitation of ‘purposes of the Commonwealth’. Otherwise, as Chief Justice Barwick noted, it would be a case of “‘words meaning what I says they mean”, a notion more likely to be found in fantasy than in constitutional law’.⁸⁴

Chief Justice Barwick, in the *AAP* case, paid closest attention to the relationship between sections 81 and 94. He said:

The purpose of the restraint on the Parliament’s legislative power to appropriate and authorize the expenditure of the Consolidated Revenue Fund is presently the same as it was in 1900, namely, the ensuring of surplus revenue so that there can be State participation in that Fund.⁸⁵

Chief Justice Barwick drew a critical distinction between on the one hand appropriations supported by section 96, which involved the Commonwealth interfering in State areas of responsibility through the placement of conditions on the grants, and on the other hand appropriations that apply directly to subjects within State areas of responsibility, where no section 96 grant is involved. The difference, as he saw it, was consent. He said:

[A] grant under s 96 with its attached conditions cannot be forced upon a State: the State must accept it with its conditions. Thus, although in point of economic fact, a State on occasions may have little option, these intrusions by the Commonwealth into areas of State power which action under s 96 enables, wear consensual aspect. Commonwealth expenditure of the Consolidated Revenue Fund to service a purpose which it is not constitutionally lawful for the Commonwealth to pursue is quite a different matter. If allowed, it not only alters what may be called the financial federalism of the Constitution but it permits the Commonwealth effectively to interfere, without the consent of the State, in matters covered by the residue of governmental power assigned by the Constitution to the State.⁸⁶

Chief Justice Barwick therefore saw the expenditure of money as a potential form of interference in areas of State responsibility where such grants were not made through section 96 of the Constitution with State consent.⁸⁷ This point was later reinforced by the High Court in the *Williams No 1* case.⁸⁸

The effect of a broad appropriations power upon the expansion of legislative power

Another concern expressed by a number of judges was that if the Commonwealth could expend money on any purpose for which the Parliament chose to appropriate money, then it would also gain an incidental legislative power to make laws with respect to the purpose upon which the money was expended. Section 51(xxxix) of the Constitution gives to the Commonwealth Parliament power to enact laws on matters incidental to the execution of any power vested in the Commonwealth Government. This incidental legislative power gives legislative teeth to any purely executive power, such as an executive power to spend money. If the Commonwealth could spend money on any purpose whatsoever, and then use the incidental legislative power to regulate that expenditure and give force to any program with regard to that expenditure, then this would potentially give the Commonwealth great legislative powers outside of those specifically allocated to it by the Constitution.

Chief Justice Latham, who advocated a broad Commonwealth appropriation power, tried to impose limits on any associated incidental legislative power. He thought that such a power would be contained to ensuring that the money was spent for the particular purpose and preventing it from being misused.⁸⁹ He did not consider that the incidental legislative power would permit the Commonwealth to regulate the subject of the expenditure. Otherwise, through the device of appropriating money for expenditure on a new subject, the Commonwealth could obtain legislative power to regulate and control that subject matter,

contrary to the careful distribution of powers between the Commonwealth and the States in the Constitution.⁹⁰

Justice Murphy took a similar view. While he accepted that the incidental legislative power in section 51(xxxix) of the Constitution enables legislation to ‘effectuate the expenditure’ of appropriated moneys, ‘for which there is no other source of power’, he thought that this was confined to laws that ensure that the money is spent for the nominated purpose. The incidental power did not permit the making of laws that ‘impose obligations on persons generally’ or are coercive, except in a limited area, such as deterring misappropriation.⁹¹

Justice Starke, however, disagreed. He thought that if the appropriations power was broad, so too would be the incidental legislative power to deal with the manner and method of the expenditure.⁹²

The Commonwealth’s response to the High Court’s judgments

In the *Pharmaceutical Benefits* case, the High Court struck down the Commonwealth’s scheme for providing subsidised pharmaceuticals to consumers through doctors and pharmacists. The *Pharmaceutical Benefits Act* contained not only an appropriation but an entire regulatory scheme. Of the six judges who sat on the case, Chief Justice Latham and Justices Rich and Dixon found it invalid on the ground that there was no head of legislative power to support the regulatory scheme. Justices Starke and Williams found it invalid on the ground that the appropriation was not for the ‘purposes of the Commonwealth’. Only Justice McTiernan found it to be valid.

The Commonwealth responded by holding a referendum which successfully inserted section 51(xxiiiA) in the Constitution. It now allows the Commonwealth to make laws with respect to:

The provision of maternity allowances, widows’ pensions, child endowment, unemployment, pharmaceutical, sickness and hospital benefits, medical and dental

services (but not so as to authorize any form of civil conscription), benefits to students and family allowances.

Hence, the Commonwealth's reaction to being told that it did not have the power to enact such regulatory schemes was to initiate a change to the Constitution in a valid manner.

In the 1970s, the Whitlam Government began actively to by-pass the States by making grants directly to local government and community bodies. These grants not only covered funding for roads but many other social policy schemes, such as the Regional Employment Development Scheme.⁹³ Prime Minister Whitlam stated that his government had deliberately 'made and shall make local government a vehicle for our legislation on aged persons' homes and hostels, sheltered employment, handicapped children, meals on wheels, home care and nursing, nursing homes and homeless men and women'.⁹⁴ Yet the main focus of Commonwealth funding was non-profit organisations which were intended to fulfil these roles. Local government could also 'buy into programs' if it wished, but it was not an integral part of service delivery for these programs and it competed with the non-government sector for grants.⁹⁵

As section 96 of the Constitution only gives the Commonwealth power to make grants to the States, not local government, the Whitlam Government sought to amend the Constitution in a referendum in May 1974 to allow it to fund local government directly. This time the referendum failed, achieving only 46% of the vote. Undeterred, the Whitlam Government continued to fund local government and other non-profit bodies directly, relying on the argument that such appropriations were for the 'purposes of the Commonwealth'.

The Whitlam Government was also conscious of the fact that one of the reasons the *Pharmaceutical Benefits Act* was struck down was because of the regulatory scheme it implemented. So when it devised its Australian Assistance Plan (AAP), it did so by a mere appropriation of funds, without any regulatory legislation.

The implementation of the rest of the scheme was to be dealt with by executive action.

The result of the challenge to the AAP scheme was equivocal. Three Justices (Justices McTiernan, Jacobs and Murphy) upheld the validity of the appropriation. Three Justices (Chief Justice Barwick and Justices Gibbs and Mason) held that the AAP scheme was invalid, either because it was not an appropriation for 'the purposes of the Commonwealth' or because the executive action implementing the scheme went beyond the Commonwealth's power. The seventh judge, Justice Stephen, held that the States did not have standing to bring the challenge. Hence the challenge failed, but there was no majority either supporting or rejecting the broad view of the power to appropriate.

The Commonwealth's response was to continue assuming that it did have the power to appropriate and spend money on subjects that were not within its legislative or executive power and it proceeded to do so with little regard to the consequences if it had no such power. While the Fraser Government retreated from this practice, such forms of expenditure gradually increased during the Hawke and Keating Governments, with a significantly marked increase during the Howard Government. This was particularly the case with respect to direct funding of local government and direct funding in relation to schools, avoiding the use of section 96 grants to the States. For the most part, this was a political manoeuvre to maximise votes for whichever party was in government at the Commonwealth level by declaring that benefits given to communities (be they new sporting fields, roads, flagpoles in schools and the like) were the gift of the Commonwealth and had nothing to do with the States. It was also a tactical manoeuvre, as it involved creating a bigger edifice of spending structures, making it much harder and more damaging for the High Court to strike it down.

5

**CHAPTER
FIVE**

THE PAPE CASE – LIMITING THE POWER TO SPEND

The *Pape* Case – Limiting the Power to Spend

In 2009 an academic, Bryan Pape, brought an action challenging the Commonwealth's payment of a 'tax bonus' to taxpayers. The payments were intended to stimulate the economy in response to the global financial crisis. The payments did not amount to rebates of tax already paid or a reduction in tax payable. Instead, they were effectively gifts or grants to taxpayers, which the Commissioner of Taxation was obliged to pay to them if they satisfied certain criteria. There was legislation that provided for the making of the payments as well as an appropriation under section 81. Was section 81, along with the incidental legislative power in section 51(xxxix), sufficient to support the payment of the money to taxpayers, or was it necessary to find another head of legislative power?

Appropriations and the power to spend

The High Court addressed this issue in *Pape v Federal Commissioner of Taxation*. There was disagreement amongst the Justices as to how 'purposes of the Commonwealth' should be applied,⁹⁶ but they managed to avoid having to decide upon it by splitting the acts of appropriation and expenditure. The appropriation (which had to be for 'the purposes of the Commonwealth') was about setting the money aside so that it no longer formed part of the surplus that was payable to the States under section 94 of the Constitution. Their Honours concluded that the critical issue was not the appropriation, but the power to spend the money appropriated.

The High Court shocked the Commonwealth by holding, unanimously, that section 81 was not sufficient to support the expenditure of the money appropriated under it. Another head of

power was needed in order to spend the money.⁹⁷ The Commonwealth had contended for many decades that ‘purposes of the Commonwealth’ meant any purpose the Commonwealth Parliament chose, in order to avoid having to limit its spending to subjects within its power. Now the High Court had moved the goal posts – not in the Commonwealth’s favour. It shifted the argument from whether an appropriation was for the purposes of the Commonwealth, to whether the expenditure of the appropriated sum was supported by Commonwealth legislative or executive power.

In practice, the effect was similar to restricting the purposes of the Commonwealth to those purposes which the Commonwealth had the legislative or executive power to implement. If money had been validly appropriated by the Commonwealth, but there was no power to spend it, then arguably it would form part of a Commonwealth surplus that had to be distributed to the States. Otherwise the money would be suspended in a form of legal limbo, where it had been appropriated for a purpose but could not be spent for that purpose, and therefore could not be dealt with at all.

In moving the assessment to the expenditure stage, the High Court also avoided the argument that no one has standing to challenge an appropriation, which was a significant hurdle in the *AAP* case. There is no problem with taking legal action to challenge actual expenditure. The High Court in the *Pape* case held that Mr Pape had standing to challenge the expenditure simply because he was entitled to receive the benefit of it. The High Court has therefore dealt itself back into the game of assessing the validity of Commonwealth programs that entail expenditure, whether or not they are subject to legislation. This became significant in the following *Williams* cases.

The nationhood power

As to whether there was a separate Commonwealth power to support the payment of the bonuses to taxpayers, a majority of four Justices held in the *Pape* case that although there was no express head of power listed in section 51 of the Constitution, the combination of the Commonwealth’s executive power in section 61 and the incidental

legislative power in section 51(xxxix) was sufficient to give the Commonwealth power to act in a financial emergency to deal with the global financial crisis.⁹⁸ The three minority Justices were very critical of the idea that a national emergency triggers Commonwealth executive and legislative power. They saw the term ‘emergency’ as imprecise and essentially self-defining by the Executive.⁹⁹ Justice Heydon also pointed out that just because something falls within the ‘national interest’ does not necessarily bring it within national power, unless it falls within a power already expressly granted to the Commonwealth.¹⁰⁰

This combination of sections 61 and 51(xxxix) is commonly known as the ‘nationhood’ power – a power that is derived from the Commonwealth’s status as a nation. Its modern genesis is to be found in a statement by Justice Mason in the *AAP* case that the Commonwealth has ‘the capacity to engage in enterprises and activities peculiarly adapted to the government of a nation and which cannot otherwise be carried on for the benefit of the nation’.¹⁰¹ The scope of this power, however, is relatively undefined. While it covers matters that are national in nature that do not fall within State powers, such as the choice of the national flag and the national anthem, it has also been regarded as covering matters such as the celebration of the bicentenary (which presumably could have been celebrated by the States, especially as it was a celebration of the settlement of a State, New South Wales, rather than the Commonwealth.) Without a firm legal footing and clear limits, the nationhood power has the potential to be used to justify almost anything that the Commonwealth regards as a national issue needing national solutions. Justice Heydon criticised the ‘vagueness’ of the nationhood power and the easy slide from one test to a much broader one.¹⁰²

Chief Justice French left open the possibility of accommodating other Commonwealth expenditure by reference to national purposes and established practice. He said:

The constitutional support for expenditure for national purposes by reference to the executive power, may arguably extend to a range of subject areas reflecting the established practice of the national government over many

years, which may well have relied upon ss 81 and 83 of the Constitution as a source of substantive spending power. It is not necessary for present purposes to define the extent to which such expenditure, previously thought to have been supported by s 81, lies within the executive power.¹⁰³

This left the door slightly ajar for an argument that would allow the nationhood power to take over from where the Commonwealth's view of 'purposes of the Commonwealth' left off. The Commonwealth's view of 'purposes of the Commonwealth' was that it encompassed any purposes that the Commonwealth Parliament decided were Commonwealth purposes. The nationhood power, if read broadly, would provide the Commonwealth with both executive and legislative power with respect to any matter that the Commonwealth regarded as national in nature, requiring a national solution and the expenditure of Commonwealth money.

However, the Chief Justice also warned that when it came to coercive laws, it would be unlikely that they would be supported by the nationhood power. A substantive head of power would most likely be required to support them.¹⁰⁴ Justices Gummow, Crennan and Bell also warned that there were potential limitations on the application of the nationhood power,¹⁰⁵ including the need to avoid competition with State executive or legislative competence.¹⁰⁶ So some limits apply to the nationhood power, but they are not well defined or grounded in constitutional principles.¹⁰⁷

Accountability of the Executive

One notable aspect of the judgments in the *Pape* case was the growing concern of the High Court that Parliament's role in relation to appropriations has become diminished and that the Executive was becoming unaccountable in its use of public money. Chief Justice French quoted from evidence given by Professor Lindell to a parliamentary committee that:

Parliament is gradually losing control over the expenditure of public funds. Appropriations are increasingly permanent

rather than annual and they are also framed in exceedingly broad terms.¹⁰⁸

Hence the High Court switched its focus to a requirement that the spending of the money be supported by a power set out in the Constitution. In this case, the Parliament had passed the legislation providing for the payment of bonuses to taxpayers. However, this issue would become more prominent in the subsequent *Williams No 1* case where there was no legislation to support the chaplaincy program and no consequential parliamentary accountability for it.

Federalism

Another factor that started showing glimmers of influence in the *Pape* case was federalism. Chief Justice French pointed to the federal distribution of powers as being an important element in the reasoning of judges in previous cases.¹⁰⁹ He concluded that any nationhood power ‘cannot be invoked to set aside the distribution of powers between Commonwealth and States’.¹¹⁰ However, he thought that the ‘payment of moneys to taxpayers, as a short-term measure to meet an urgent national economic problem’ was not an ‘interference with the constitutional distribution of powers’.¹¹¹

The three dissenting judges, Justices Hayne, Heydon and Kiefel, placed even further emphasis on the federal distribution of powers by the Constitution and the need to avoid the expansion of Commonwealth power through expenditure. The points they raised in *Pape* came to be echoed by the majority in the later *Williams* cases.

Justices Hayne and Kiefel rejected the Commonwealth’s contention that it has a power to expend money that is not limited by subject-matter or purpose. They thought that such a view ‘does not fit easily with the long-accepted understanding of the constitutional structure... of separate polities, separately organised, continuing to exist as such, in which the central polity is a government of limited and defined powers’.¹¹² They pointed out that the ‘executive power of the Commonwealth is the executive power of a polity of limited powers’.¹¹³ This is a significant statement, as the Commonwealth

likes to characterise itself as the dominant, most powerful polity in the federation by virtue of its overriding legislative powers where Commonwealth and State laws conflict. It tries to avoid mention of the fact that the Commonwealth is a polity of limited powers, in comparison with the States, which have full legislative powers.

Justices Hayne and Kiefel thought that if the Commonwealth Executive had unlimited power, it would upset both the delineation between executive and legislative power as well as the federal structure, as unlimited executive power would also result in an unlimited legislative power in section 51(xxxix) to enact laws with respect to matters incidental to the executive power.¹¹⁴ If the Commonwealth has executive power to spend money, then it also has legislative power under section 51(xxxix) to enact laws that facilitate and control that expenditure and its application.¹¹⁵

Justices Hayne and Kiefel rejected the broad proposition that the Commonwealth can spend upon anything as long as it has parliamentary approval through an appropriation. They thought this would ‘effect a radical transformation in what has hitherto been thought to be the constitutional structure of the nation’.¹¹⁶

Justice Heydon argued that the Constitution must be read in the context of the ‘federal nature of the Constitution’.¹¹⁷ He supported an approach to constitutional interpretation by one of the first High Court judges, Justice O’Connor, that entails sometimes giving a narrower meaning to Commonwealth powers if this will give best effect to the construction of the federal compact considered as a whole.¹¹⁸ He noted that ‘the Commonwealth Government, while in one sense a “national government”, is only the central government in a federal nation’.¹¹⁹ If the Commonwealth had executive power to spend on anything and legislative power to control and implement that expenditure, then this would not merely outflank but destroy the distribution of power in the Constitution.¹²⁰

Justice Heydon also criticised the broad view of the appropriation and spending powers on the ground that it would involve by-passing the States and the need for their consent under section 96 of the Constitution.¹²¹ Justice Heydon noted that section 96 grants depend on consultation and cooperation with the States. A broad power

to spend, with an associated incidental legislative power, ‘would be exercisable whether or not the States agreed’.¹²²

The Commonwealth could have paid its bonuses to people by making grants to the States on the condition that the money be paid out according to the relevant criteria. However, it wanted to send out the cheques itself, with a letter from the Commonwealth Minister, pointing out that it was the donor of this beneficence and seeking the resulting electoral kudos for the gift. The desire to buy the support of voters was not a good enough reason to by-pass section 96 of the Constitution.

Boot-strap arguments based upon expanding Commonwealth practices

One approach commonly taken by the Commonwealth, particularly in relation to the power to spend money, is to expand its practice (e.g. by funding local government directly rather than through conditional grants to the States) and then to argue that this is constitutionally valid because it is a long-standing practice. Justice Heydon skewered this proposition in the *Pape* case as follows:

The other fallacy is the Panglossian belief that what is said to have evolved over time as a matter of governmental practice corresponds with the Constitution. It holds, not only that everything which exists is for the best in the best of all possible worlds, but also that what exists in that world is constitutionally valid. It fails to face up to the fact that, magnificent though the framers’ achievement was, the Constitution is not consistent with every human desire. If it is to be changed, s 128 is the means, and the sole means, of doing so.¹²³

He rejected the idea that a ‘living tree’ form of constitutional interpretation can be used to give constitutional support to government practices that move outside the scope of legislative power. He described such an approach as ‘a theory of continuous

constitutional revolution, in which successive usurpations would be constantly seeking to legitimise themselves by claiming de jure status from their de facto position'.¹²⁴ He concluded that the 'Court decides what the Constitution means in the light of its words. It does not infer what the Constitution means from the way the Executive and the legislature have behaved'.¹²⁵ Justice Heydon added for good measure that 'executive and legislative practice cannot make constitutional that which would otherwise be unconstitutional' and that 'practice must conform with the Constitution, not the Constitution with practice'.¹²⁶ This is a lesson to which the Commonwealth Government has turned a deaf ear.

The Commonwealth's response to the *Pape* case

One might have expected that in the light of the High Court's judgment in the *Pape* case, the Commonwealth would have conducted an urgent review of its expenditure to identify those payments that do not fall within Commonwealth power so that they could be secured in a constitutionally valid way. The most obvious way of doing this would be to transfer them into section 96 grants through the States. Curiously, there was no action to transfer doubtful direct grants to constitutionally secure section 96 grants. The Commonwealth instead took a 'business as usual' approach, ignoring the looming constitutional problem.

Members of the legal community were astonished by the Commonwealth Government's lack of action. The former Chief Justice of the NSW Supreme Court, James Spigelman, observed that the Commonwealth held an 'aspirational' view¹²⁷ that its legislation concerning direct funding to local government remained valid. Officers of the Department of the Prime Minister and Cabinet told a Senate Select Committee in 2011 that the Department had received advice from the Attorney-General's Department 'that we should continue with current arrangements unless a demonstrated need arises to change them'.¹²⁸ The Department advised that having taken into account the High Court's judgment in *Pape*, 'the Commonwealth remains able to make grants under its general powers in the Constitution'.¹²⁹

The question was what ‘general powers’ did the Commonwealth have under the Constitution to make grants, other than to the States under section 96? Commonwealth officers could have been referring to the nationhood power, giving it a broad interpretation beyond national emergencies to anything that can best be done on a national basis or that needs funding from the national level of government. Alternatively, it could have been relying on the Commonwealth having the capacities of a legal person, including the capacity to enter into contracts, own property, employ persons and, critically, the capacity to spend money. It has long been recognised that the Crown has the capacities of a legal person, including the capacity to spend. But there is a significant difference between having a *capacity* to do something and having the *authority* to do it. The issue was whether the Commonwealth Executive has the *authority* to spend upon any matter as it sees fit, or whether that authority needs to find its source in the Constitution, legislation or the traditional common law prerogative powers of the Crown. If the authority to spend is confined to those sources, then the distribution of powers in the Constitution imposes a major limitation on Commonwealth expenditure. It was this point that was at issue in the *Williams No 1* case.



**CHAPTER
SIX**

**THE WILLIAMS
NO 1 CASE – SPENDING
PUBLIC MONEY**

The *Williams No 1* Case – Spending Public Money

The Commonwealth's chickens all came home to roost in the case of *Williams v The Commonwealth No 1*. The case concerned Commonwealth funding of chaplains in schools. Mr Williams complained that it was unconstitutional. In this case the Commonwealth had used an executive scheme to fund chaplains in schools. It had no legislative backing, other than an appropriation. This raised the *Pape* issue of whether the expenditure was supported by Commonwealth legislative or executive power. It also raised the additional question of whether legislation had to be enacted to support the expenditure, or whether executive authority to spend the money was sufficient, either on the broad view that the Commonwealth Executive has the capacity of a legal person to spend on any matter it chooses or on the narrow view that the Executive can spend public money on subjects that fall within the scope of Commonwealth legislative power, even when no such legislation was enacted.

In the *Williams No 1* case, a majority of the High Court rejected both the broad and narrow views, deciding that because this involved the expenditure of 'public money', parliamentary authorisation was needed and that the chaplaincy funding program was therefore invalid.

Authority to spend public money¹³⁰

According to the High Court, the Commonwealth has the authority to spend money that has been legally appropriated when the expenditure is:

1. authorised by the Constitution;
2. made in the execution or maintenance of a statute or expressly authorised by a statute;
3. supported by a common law prerogative power;
4. made in the ordinary administration of the functions of government; or
5. (perhaps) supported by the nationhood power.

If expenditure does not fall into any of these categories (and the spending on chaplains did not) then it will not be valid.

1. Expenditure authorised by the Constitution

The Commonwealth Constitution directly authorises expenditure in some cases. For example, section 82 of the Constitution states that the Consolidated Revenue Fund shall be applied to the payment of the costs, charges and expenses incident to its collection, management and receipt. Section 48 provides for the payment of allowances to Members of Parliament and section 66 provides for the payment of the salaries of Ministers, although the amount paid needs to be fixed by Parliament.

Expenditure is also authorised by section 96 of the Constitution, although it must also be authorised by Parliament, arguably putting it in the category below. The difference, however, is that the High Court has found that section 96 grants must be consensual. They cannot, unlike ordinary Commonwealth legislation, be imposed upon the States without their consent. It is up to a State to decide whether or not it accepts a section 96 grant upon the conditions offered.

2. Expenditure authorised by statute

If a validly enacted statute expressly authorises the expenditure of money by the Commonwealth, then that is all that is needed.¹³¹ This process involves proper parliamentary scrutiny and authorisation of the Executive's action. It is therefore consistent with the system

of representative and responsible government. If the Commonwealth statute is validly enacted, this means that it comes within the Commonwealth's legislative power and is therefore consistent with the federal distribution of powers in the Constitution. It is therefore compatible with any 'federal considerations' that arise from the Constitution.

Section 61 of the Constitution also confers on the Commonwealth executive power that 'extends to the execution and maintenance... of the laws of the Commonwealth'. Chief Justice French and Justice Hayne also saw this as a source of power for the valid expenditure of Commonwealth money.¹³² Chief Justice French regarded this power as supporting 'all things which are necessary or reasonably incidental to the execution and maintenance of a valid law of the Commonwealth once that law has taken effect'.¹³³ It is not absolutely clear how far this goes, but it seems that if the Parliament has enacted a law that authorises some kind of program or outcome, then even if the statute does not expressly authorise the relevant expenditure, it is enough that the expenditure is made in executing or maintaining the validly enacted law. Again, this is consistent with parliamentary accountability of the Executive and the federal distribution of powers.

3. Expenditure supported by a common law prerogative

A number of Justices in the *Williams No 1* case also noted that prerogative powers, being those common law executive powers inherited by the Crown from medieval times that have not been removed or replaced by statute, can also be used to support the Executive entering into contracts or spending money.¹³⁴ Prerogative powers include the power to enter into treaties and declare war, the power to pardon offenders and to grant honours, the power to protect the nation and preserve public safety, the power to impose royalties and the right to treasure trove. The prerogatives are limited to those powers that existed in medieval times and which have not since been replaced by statute, so new prerogative powers cannot be created. Few of them are relevant to expenditure, but occasionally expenditure

may be justified under them. For example, the Commonwealth's expenditure on maintaining a disaster emergency alert system to warn people of events that threaten lives¹³⁵ would arguably be supported by the prerogative power to protect the nation and preserve public safety.

4. Expenditure in the ordinary administration of the functions of government

Justices Gummow and Bell noted that Mr Williams had accepted that the Commonwealth could spend appropriated money, without further legislative authority, upon the 'ordinary course of administering a recognised part of the Government of the Commonwealth'. This would include expenditure on the operation of the Parliament and 'the servicing of the departments of State of the Commonwealth, the administration of which is referred to in s 64 of the Constitution, including the funding of activities in which the departments engage or consider engagement'.¹³⁶ This concession potentially has two separate sources. One is section 64 of the Constitution, which permits the Governor-General to establish government departments. The other is the case of *New South Wales v Bardolph* in which the High Court recognised that the power of the Executive extends to entering into contracts and expending money in the 'ordinary course of administering a recognised part of the Government of the State'.¹³⁷

While there was no clear common reasoning for reaching their conclusion,¹³⁸ a majority of the Court accepted the argument of Mr Williams that the chaplaincy program did not fall within the category of the ordinary administration of government. While the money spent on the chaplaincy program was spent *by* a public service department on a government program, such expenditure was not for the administration of a department in the sense required by section 64¹³⁹ or the *Bardolph* case. It was instead a payment to a non-government body in the implementation of a Commonwealth policy to provide chaplains to schools. It was not a matter of funding

the administration of the public service or the ordinary functions of government.

This area, however, is ripe for further analysis. Now that it has been established as a clear exemption from the Commonwealth's need for legislation to support its expenditure, no doubt the Commonwealth will seek to push the boundaries of what falls within the 'ordinary course of administering a recognised part of the Government of the Commonwealth' or the 'ordinary administration of government'. Interestingly, in the course of debate upon the Commonwealth's legislative response to the *Williams No 1* case, the Minister leading for the Commonwealth, Senator Wong, argued that the *Bardolph* exception was confined to 'departmental running costs'.¹⁴⁰ It is likely, however, that the Commonwealth will take a much broader view of this exception in the future.

5. Expenditure supported by the nationhood power

The High Court's final exception to the principle that expenditure must be supported by legislation is expenditure under the nationhood power.¹⁴¹ While 'nationhood' is the short-hand term given to this power by academics, the High Court continues to describe it as 'the capacity to engage in enterprises and activities peculiarly adapted to the government of a nation and which cannot otherwise be carried on for the benefit of the nation'.¹⁴² It was this power that was used to support the expenditure at issue in the *Pape* case.

The nationhood power is subject to many limitations. For example, Justice Crennan warned that it did not necessarily permit the Executive to 'act in aid of *any* subject which the Executive regards as being of national concern and interest',¹⁴³ and nor could it be used simply because it is more *convenient* for something to be done at the national level.¹⁴⁴

To the extent that the nationhood power is being exercised as an executive power (without supporting incidental legislation), it cannot be used to create an offence or dispense with the application of the law or impose taxation.¹⁴⁵ The nationhood power also cannot

be applied in a coercive manner. In the earlier cases where the non-coercive nature of the nationhood power was noted, it seemed to be accepted by some Justices that the placing of conditions on grants and the imposition of penalties on the recipients of grants if they breached these conditions was permissible and not to be regarded as coercive.¹⁴⁶ However, Justices Gummow and Bell in the *Williams No 1* case took the view that conditions placed upon grants *are* coercive in nature to the extent that the breach of those conditions gives rise to criminal penalties.¹⁴⁷ This has potential ramifications for grants to the States under section 96 of the Constitution, which are not able to be coercive either,¹⁴⁸ but which are underpinned by offences.¹⁴⁹

In the *Williams No 1* case the High Court pointed out that it was not possible to say that the funding of a chaplaincy program could not be carried out by the States, because Queensland was already doing so. Nor was it possible to say that such a program was peculiarly adapted to the government of a nation, as it concerned functions that were clearly within the provinces of the States and were being performed by the States.¹⁵⁰ There was no national emergency, as in the *Pape* case, that could only be dealt with nationally.¹⁵¹ The chaplaincy program therefore did not fall within the nationhood power.¹⁵²

The Commonwealth's capacity to spend money

The Commonwealth argued that just as any legal person (such as an individual or a corporation) has the capacity to spend money, enter into contracts, own property and employ people, it too has the capacity to do so. It put this argument at two different levels. The broad view was that it has an unfettered power to spend upon anything, as long as a valid appropriation has been made. The narrow view was that it has the power to spend upon any matter if it *could* validly enact legislation authorising that spending, because it has a constitutional head of power to enact such a law, even though in fact it has not enacted such a law. In other words, the mere fact that the particular proposed expenditure falls within an area of potential

exercise of legislative power means that it falls within the executive power (which follows the contours of legislative power). This, it was argued, is enough to support the power to spend public money.

As noted above, a majority of the High Court rejected both the broad view¹⁵³ and the narrow view.¹⁵⁴ Their Honours took the view that the Commonwealth's power to spend was not unfettered. The Commonwealth's power to spend was limited by virtue of the following considerations:

1. federalism;
2. the requirement that the Executive be accountable to the Parliament; and
3. the fact that the Commonwealth was spending 'public money', rather than its own money.

1. Federalism

The federalist views that had been expressed softly in the *Pape* case became much louder and firmer in the *Williams No 1* case. Whereas in the *Work Choices* case in 2006 a majority of the High Court had been quite dismissive of the idea of there being a requirement of 'federal balance' in the Constitution,¹⁵⁵ a majority in the *Williams No 1* case relied upon 'federal considerations'¹⁵⁶ in interpreting the scope of the Commonwealth's executive power.

Their Honours accepted that Commonwealth expenditure in fields within State competence has the capacity to 'diminish the authority of the States in their fields of operation'¹⁵⁷ and that the limits of Commonwealth executive power must therefore be assessed by reference to the federal system established by the Constitution.¹⁵⁸ Justice Hayne again noted that the Constitution in distributing legislative power, only gives the Commonwealth 'limited' powers.¹⁵⁹ Chief Justice French argued that the 'character of the Commonwealth Government as a national government' does not entitle it, as a general proposition, to enter into concurrent fields of legislative activity by executive action alone. He thought that such an extension of Commonwealth executive powers would

‘reduce those of the States and compromise... the essential and distinctive feature of “a truly federal government”’.¹⁶⁰

One particular aspect of concern to the Court was the use of expenditure under the Commonwealth’s executive power as a means of by-passing the use of grants to the States under section 96 of the Constitution. Justice Heydon had earlier pointed out in the *Pape* case that grants to the States under section 96 have to be consensual.¹⁶¹ A State can always reject such grants. Yet the States do not have the same role in consenting to, or potentially rejecting, grants made under the Commonwealth’s executive power directly to schools or local government or to other bodies that are involved in the implementation of State policy.

In *Williams No 1*, Justices Gummow, Crennan and Bell also expressed their concern about the by-passing of section 96 and the relevance of ‘considerations of federalism’ to the validity of such actions.¹⁶² They quoted from the earlier judgment of Chief Justice Barwick that pointed to the consensual aspect of section 96 grants and the absence of the need for State consent to the direct expenditure on executive programs such as the chaplaincy program.¹⁶³ Justice Hayne went further, arguing that while section 96 grants are not allowed to be coercive, the conditions placed on expenditure under the Commonwealth’s general executive power might well be regarded as coercive if they demand obedience by the recipients. He contended that such executive power ought therefore to be constrained by the application of federal considerations.¹⁶⁴

Justices Hayne and Kiefel both pointed out that section 96 would be rendered redundant if the Commonwealth Executive had power to spend money on whatever subjects it wished and then to legislate to enforce conditions on its expenditure.¹⁶⁵ Section 96 would have no work to do at all, as everything could be done under the executive power and the incidental legislative power. Justices Crennan and Kiefel added that the very presence of section 96 in the Constitution was evidence that the Commonwealth’s executive power did not extend so far and that there are large areas beyond the scope of the Commonwealth’s executive power.¹⁶⁶

While the High Court has long rejected as heresy the notion that certain subject matters are reserved for the States, Justices Gummow and Bell were prepared to acknowledge in the *Williams No 1* case that ‘the conduct of the public school system in Queensland... is the responsibility of that State’.¹⁶⁷ Justice Kiefel also pointed out that if the Commonwealth Executive’s power to expend money was unlimited, then the combination of this power to spend and the incidental legislative power would extend the Commonwealth’s power, allowing it ‘to encroach upon areas of State operation and thereby affect the distribution of powers as between the Commonwealth and the States’.¹⁶⁸ Her Honour considered that chaplaincy services in schools were within ‘the province of the States, in their provision of support for school services’.¹⁶⁹

2. Accountability of the Executive to Parliament

One of the major themes in the *Williams No 1* case was the constitutional requirement in a system of representative and responsible government that the Executive be accountable to the Parliament. It is the Parliament that is intended to be in control of the Executive and, in particular, to have ultimate control over the expenditure of public money.¹⁷⁰ The High Court was therefore concerned about executive expenditure without parliamentary authorisation other than a bare appropriation. Chief Justice French, for example, appeared to accept the argument by Mr Williams that an appropriation is ‘at best a weak control’ on executive power.¹⁷¹ Justices Gummow and Bell were concerned that the Parliament had no role in the ‘formulation, amendment or termination’ of the program for the expenditure of this money,¹⁷² even if it does appropriate the money.

Justice Hayne noted that appropriations are generally stated to be for such broad purposes that Parliament usually has little idea about what the money will be spent on.¹⁷³ The appropriation in the *Williams No 1* case is a classic example. The ‘purpose’ of this appropriation, as described in the relevant *Appropriation Act*, was

the ‘outcome’ that ‘individuals achieve high quality foundation skills and learning outcomes from schools and other providers’.¹⁷⁴ How could Parliament be expected to know that it was authorising the appropriation of funds for a school chaplaincy program and to make a reasoned decision about whether or not to support such a program?

Their Honours also expressed concern that the Senate has limited powers with regard to appropriation bills. It cannot initiate them or amend bills for the appropriation of the ordinary annual services of the government (although it can ‘request’ amendments to such bills). The Senate therefore has more limited powers with respect to appropriations than it does in relation to legislation that authorises expenditure.¹⁷⁵

Finally, Justice Hayne noted that above and beyond any constitutional requirements for executive expenditure to be accountable to the Parliament, it would also be ‘sound governmental and administrative practice’ for such programs to be governed by legislation, making them reviewable both within the Parliament and outside of it.¹⁷⁶

3. The spending of ‘public money’

The third theme in the *Williams No 1* judgments was that there is a distinct difference between the Commonwealth’s power to spend, on the one hand, and the power of a natural person to spend. The difference is that a person is entitled to spend his or her own money. In the case of the Commonwealth, however, it is spending *public money*, not its own money.¹⁷⁷ The Executive, in spending public money, must therefore be accountable to the Parliament, comprised of the representatives of the people, in a way that does not apply to an individual.

Justices Gummow and Bell referred back to an earlier High Court case concerning the Commonwealth’s expenditure of money to support the wool industry, where the Court noted that ‘the position is not that of a person proposing to expend moneys of his own. It is public moneys that are involved’.¹⁷⁸ Justices Gummow and Bell thought that where public money was involved, one needed to look

at such expenditure through ‘different spectacles’, rather than in the same way as expenditure by a natural person.¹⁷⁹

Justice Crennan regarded the principles of representative and responsible government as imposing limitations on the Commonwealth’s powers to spend, as opposed to those of a natural person. She said:

The principles of accountability of the Executive to Parliament and Parliament’s control over supply and expenditure operate inevitably to constrain the Commonwealth’s capacities to contract and to spend. Such principles do not constrain the common law freedom to contract and to spend enjoyed by non-governmental juristic persons.¹⁸⁰

Her Honour concluded that the source of the money, being public money, was a further point of difference from the expenditure of money by a natural person.¹⁸¹

Justice Hayne also rejected the analogy between the Commonwealth’s spending and that of a natural person on the basis that the Commonwealth was spending public money, not its own money.¹⁸² He thought that the analogy with the powers of natural persons ignored the carefully crafted checks on the expenditure of public money, which subject it to parliamentary control. Once parliamentary control of expenditure is accepted, he argued, any analogy with the spending of money by individuals falls away.¹⁸³

The result of the *Williams No 1* case

The High Court held that neither the making of the chaplaincy funding agreement nor the expenditure of money under it was supported by section 61 of the Constitution. The expenditure did not fall into any of the recognised exceptions where legislation was unnecessary, as it was not expenditure for the ordinary administration of government departments, it was not authorised by the Constitution or an existing statute, it was not authorised by any prerogative

power and it was not spent in the exercise of the nationhood power. It was expenditure under a program that was initiated and run by the Executive government with no real parliamentary scrutiny other than an appropriation made for the vague purpose of achieving ‘high quality foundation skills and learning outcomes from schools’.

The Court rejected the view that the Commonwealth could, like a natural person, spend money on anything that it wished. It accepted that for the Commonwealth to have such a broad spending power would be contrary to federalism considerations, which require adherence to the distribution of powers in the Constitution. It would also undermine the application of section 96 in the Constitution and the consensual aspects of grants made to the States under that provision.

The Court stressed that the system of representative and responsible government requires the Executive to be accountable to Parliament for its expenditure, especially because public moneys are involved. This includes Senate scrutiny, which is limited in relation to some appropriation Bills, but may be more extensive in relation to legislation that authorises expenditure.

For these reasons, the chaplaincy scheme failed.

The Commonwealth’s response to the *Williams No 1* case

This time the Commonwealth did respond to the High Court’s judgment, but did so in a way that addressed the formal outcome but not the Court’s reasoning. A week after the Court handed down its judgments in the *Williams No 1* case, the Commonwealth Parliament rushed through the *Financial Framework Legislation Amendment Bill (No 3)* 2012. It took just over 24 hours for the Bill to be introduced and passed by both Houses.

The resulting Act gives legislative authority to the Executive to spend public money on any grant or program specified or described by reference to objectives in the regulations. The regulations (which were included as a Schedule to the Act, presumably to avoid any risk of more leisurely scrutiny under the normal disallowance

procedure for regulations) permit the expenditure of public money by grants and under programs that are extremely wide, including expenditure for 'Foreign Affairs and Trade Operations', 'Payments to International Organisations', 'Public Information Services', 'Regulatory Policy', 'Diversity and Social Cohesion', 'Domestic Policy' and 'Regional Development'. The former Chief Justice of New South Wales, James Spigelman, described some of these programs as being 'identified in such a general language that they could not withstand constitutional scrutiny'.¹⁸⁴

The Act not only validated executive spending on all grants and programs that the public service could think of that existed at that time, but also gave the Executive carte-blanche to enter into and engage in spending upon any grants or programs in the future, without any parliamentary scrutiny at all (other than an appropriation), as long as the program or grant could be shoe-horned into one of the existing broad descriptions in the regulations. If not, the regulations could be amended by executive action to include new grants or programs,¹⁸⁵ although any change by regulation could potentially be disallowed by either House.

The debate on the Bill was desultory, with many speakers not understanding what the Bill did, partly because the Bill was first presented to the House of Representatives one minute before the second reading debate commenced, leaving the participants with no time to consider its terms. Most of the debate concerned support for chaplains in schools, rather than the relationship between Parliament and the Executive and the need to provide parliamentary scrutiny of expenditure programs. Indeed, this Bill was an exemplar of the lack of parliamentary scrutiny for spending programs, as it approved over 400 spending programs in a little over three hours debate in the House of Representatives¹⁸⁶ and just over two hours in the Senate.¹⁸⁷ Needless to say, not one of those spending programs received adequate parliamentary scrutiny at all.

While the Bill was a direct response to the High Court's judgments in the *Williams No 1* case, it appears that the Commonwealth deliberately ignored or simply rejected the High Court's reasoning in that case. The High Court had clearly stressed the importance of

parliamentary scrutiny of executive expenditure, especially because this involved the expenditure of public money. The reason why the enactment of legislation was required (rather than simply permitting executive expenditure where the subject of the expenditure fell under a Commonwealth head of power) was that the system of representative and responsible government requires that expenditure programs be debated and scrutinised by both Houses of Parliament, with the Senate having equal power to do so (unlike its limited power in relation to appropriations). So how did the Commonwealth Parliament, at the behest of the Commonwealth Executive, respond? It gave parliamentary authority for executive spending for any programs, existing or future, which fell within broad categories, without any parliamentary scrutiny whatsoever of the nature and details of those programs. In doing so, it simply defied the High Court and the constitutional system of government of which it is supposed to be a vital constituent part.

The High Court in the *Williams No 1* case had also placed importance on the federal system of government and the distribution of powers between the Commonwealth and the States. It confirmed its findings in the *Pape* case that the Commonwealth cannot simply spend on anything that it wishes and must have a head of legislative power to do so. It also stressed the importance of the consensual aspect of section 96 regarding grants to the States and that it should not be by-passed or rendered redundant by executive spending programs supported by nothing other than the incidental legislative power. So how did the Commonwealth respond? Did it respect the High Court and the federal system by commencing negotiations with the States upon grants under section 96 for expenditure on programs where it has no direct head of legislative power? No. Instead, it again defied the High Court, enacting a law that authorised over 400 spending programs on extraordinarily wide subject areas, regardless of whether there was a head of power to support each program or not.

Indeed, the driving force behind the Bill was the validation of the funding of the chaplaincy program. Of the three High Court Justices who addressed whether there was any head of legislative

power to support this program, two held that there was not, while one held that there was. While there was no clear majority in either direction on this point, there was a fair chance that there was no legislative head of power to support the chaplaincy program along with many other programs for which the Act purported to authorise spending. This brought the constitutional validity of the entire *Financial Framework Legislation Amendment Act (No 3) 2012* into question. At the very least, the parliamentary authorisation of expenditure on those programs that were not supported by a legislative head of power would be invalid.

James Spigelman, in commenting upon how the Commonwealth keeps provoking the High Court by ignoring its judgments on the scope of the Commonwealth's executive power to spend, concluded:

For decades the Commonwealth has had a dream run in the High Court, particularly with respect to the expansion of Commonwealth power at the expense of the States. In the context of the expansive, indeed in substance untrammelled, extent of the Executive power for which the Commonwealth contended, it may be in danger of giving the High Court the impression that the Commonwealth intends to keep bringing the same point back, until the High Court gets it right.¹⁸⁸

Indeed, when Mr Williams again challenged the validity of the schools chaplaincy program, the Commonwealth put directly to the High Court that it was wrong about the scope of the Commonwealth's executive power and requested that it overturn its judgment in *Williams No 1*. Again, the Commonwealth failed.



**CHAPTER
SEVEN**

**WILLIAMS REVISITED –
THE REINFORCEMENT
OF LIMITATIONS ON
COMMONWEALTH
SPENDING**

Williams Revisited – The Reinforcement of Limitations on Commonwealth Spending

Mr Williams embarked upon a second challenge to the validity of the Commonwealth's spending on the chaplaincy program. This time he challenged the validity of section 32B of the *Financial Management and Accountability Act* 1997 (Cth) and Schedule 1AA of the *Financial Management and Accountability Regulations* 1997 (Cth) which had been introduced in 2012 to validate and authorise expenditure on over 400 programs, including Program 407.013 – 'National School Chaplaincy and Student Welfare Program'. On a narrower basis, he challenged their legal effectiveness in authorising the expenditure on the chaplaincy program.

In *Williams v Commonwealth No 2*, the Court unanimously held that there was no Commonwealth head of power to support expenditure on the chaplaincy program and that such expenditure was therefore invalid.¹⁸⁹ Despite the Commonwealth's provocation, however, the High Court chose not to invalidate section 32B of the *Financial Management and Accountability Act* and associated provisions. Instead, it chose to read down those provisions so that they only applied to programs that fell within a legislative head of power of the Commonwealth.¹⁹⁰ As the chaplaincy program did not do so, it was not validated or authorised by section 32B or the Regulations.

The Court noted the argument that section 32B was 'wholly invalid because it constitutes an impermissible delegation of legislative power' but concluded that it was 'not necessary to decide that wider question',¹⁹¹ because it was clear that the chaplaincy

program was not validly supported regardless of whether or not section 32B was valid. This, however, leaves open doubt about the validity of section 32B.

The problem of identifying whether a program is supported by a head of legislative power

One problem that became apparent in *Williams No 2* was the difficulty faced by the Court in assessing whether or not expenditure on a program is supported by a Commonwealth head of power, when the only formal identification of the program is contained in a broad description set out in the regulations. In the case of the chaplaincy program, the parties had to resort to the guidelines for the administration and delivery of the program that had been published by the relevant Commonwealth Department. The High Court queried how reference could properly be made to the guidelines in order to construe the relevant legislative provisions and determine their validity.¹⁹² The issue would normally be reversed – i.e. whether the guidelines fall within, and are authorised by, valid legislation. The guidelines themselves cannot be used to determine the validity of legislation. Yet, without the guidelines it is well nigh impossible to determine the scope of a program in order to ascertain whether or not it is validly supported by a head of legislative power. This is likely to lead to problems in the future in relation to other funding programs.

Limits on the Commonwealth's spending powers regarding corporations and education

The High Court's assessment of two legislative heads of power in *Williams No 2* also raises issues about the validity of many other Commonwealth programs of expenditure. The Court, in interpreting the scope of the Commonwealth's power in section 51(xx) of the Constitution to make laws with respect to trading, financial and foreign corporations, held that this power did not extend to support laws that simply authorise the making of grants or the payment of

money to such corporations. The law would have to do something more in order to be valid, such as authorising or regulating the activities, functions, relationships or business of the corporation.¹⁹³ In short, the Commonwealth's corporations power does not support laws that simply authorise the payment of money to corporations. This may have an impact upon the validity of the many government subsidies and grants given to corporations, unless they can be characterised as bounties on the production or export of goods under section 51(iii) of the Constitution¹⁹⁴ or as laws with respect to inter-state and overseas trade and commerce under section 51(i).

The High Court also took a narrow view of the Commonwealth's power under section 51(xxiiiA) to enact laws for the provision of 'benefits to students'. It regarded this power as limited to welfare payments addressed to identified or identifiable students that are directed to the consequences of being a student (such as lack of income and the need to pay for educational expenses).¹⁹⁵ This may affect the validity of a range of Commonwealth grants in the education sphere. For example, many types of Commonwealth payments to universities, which previously relied upon the support of section 51(xxiiiA), would no longer appear to be supported by that provision, except for those that directly support students, such as loans for the payment of fees. Equally, the Commonwealth can no longer rely upon the corporations power in section 51(xx) as supporting the making of payments to universities on the ground that they are trading corporations, unless those payments are closely connected with laws that have a regulatory impact upon universities. It would seem that the Commonwealth may have to reconsider the use of grants to the States as a means of funding some aspects of education.

The reinforcement of federalism and limits on Commonwealth executive power

In *Williams No 2*, the Commonwealth had sought to re-open and overturn the High Court's judgment in *Williams No 1*, arguing that it involved principles that had not been carefully worked out over

a series of cases, it did not contain a ‘single answer’ to the question of when legislative authority was needed for spending and it ‘led to considerable inconvenience with no significant corresponding benefits’.¹⁹⁶ The High Court rejected these arguments and reinforced its previous statements in *Williams No 1*.

The Commonwealth also sought to persuade the High Court to recognise a broad ‘nationhood’ power that would support executive power to contract and spend in relation to ‘all matters that are reasonably capable of being seen as of national benefit or concern; that is, all those matters that befit the national government of the federation, as discerned from the text and structure of the Constitution’.¹⁹⁷ It saw this as the corollary of the requirement in section 81 of the Constitution that money be appropriated for the ‘purposes of the Commonwealth’. The Court noted the great width of this submission, observing:

It is hard to think of any program requiring the expenditure of public money appropriated by the Parliament which the Parliament would not consider to be of benefit to the nation. In effect, then, the submission is one which, if accepted, may commit to the Parliament the judgment of what is and what is not within the spending power of the Commonwealth, even if, as the Commonwealth parties submitted, the question could be litigated in this Court. It is but another way of putting the Commonwealth’s oft-repeated submission that the Executive has unlimited power to spend appropriated moneys for the purposes identified by the appropriation.¹⁹⁸

The High Court rejected the Commonwealth’s argument, pointing to the ‘false assumption’ drawn by the Commonwealth about the ambit of its executive power. This assumption was that the Commonwealth Government should have all the power befitting a national government such as the Government of the United Kingdom.¹⁹⁹ The High Court stressed that the Commonwealth

was simply the ‘central polity of a federation in which independent governments exist in the one area and exercise powers in different fields of action carefully defined by law’.²⁰⁰ It squashed the Commonwealth’s pretensions to the power of a unitary government and again made clear that the Commonwealth does not have the same power to spend and contract as the British Government.

The Commonwealth’s response

The outcome of the case was that the chaplaincy program was again held to be invalid. Expenditure made under the program had been unlawfully made. The Commonwealth’s first response was to waive any obligation for the repayment to the Commonwealth of the illegally spent money.²⁰¹ Indeed, money already paid to organisations such as Scripture Union Queensland continues to be used to fund chaplaincy programs to the end of 2014, despite the illegality of the scheme.²⁰²

Shortly after the High Court’s judgment, the Commonwealth Parliament also legislated to secure the retention of section 32B of the *Financial Management and Accountability Act*, despite its doubtful constitutional status and the fact that it is most likely ineffective in supporting many of the programs that it purports to validate and authorise. This came about because the *Financial Management and Accountability Act* 1997 was to be replaced by the *Public Governance, Performance and Accountability Act* 2013 (Cth) on 1 July 2014. This new Act, which from 1 July took over the governance of the Commonwealth’s financial operations, is based upon the dubious model of inserting basic principles in the legislation and leaving the detail to rules made by Ministers. By avoiding parliamentary scrutiny and providing a lack of clarity and detail, it purports to make government more ‘accountable’. It does not, however, contain an equivalent of section 32B.

Hence on 24 June 2014 the *Public Governance, Performance and Accountability (Consequential and Transitional Provisions) Bill* was introduced into Parliament. It was rushed through both Houses, passing on 26 June and receiving royal assent on 30 June. What it

did, amongst other things, was to strip out most of the *Financial Management and Accountability Act*, but to preserve section 32B and associated provisions and regulations, and rename the Act the *Financial Framework (Supplementary Powers) Act*. Hence, section 32B and the highly misleading regulations were preserved to be challenged another day.



**CHAPTER
EIGHT**

**THE SPENDING OF PUBLIC
MONEY IN THE AUSTRALIAN
FEDERATION**

The Spending of Public Money in the Australian Federation

The story so far

As this paper has shown, those who framed the Commonwealth Constitution clearly anticipated that it would result in the Commonwealth raising more revenue than it needed while the States would not have enough revenue to fulfil their constitutional responsibilities. The view of the framers of the Constitution was that this was public money, raised primarily from taxpayers, and that it should therefore be redistributed to ensure that the public was served properly by all levels of government. It was never intended that it be regarded as the Commonwealth's own money, to be doled out in exercises of largesse as if by a 'wealthy uncle' or for buying popularity and votes or as a means to interfere in State policy. The framers would have regarded such notions as shocking and unworthy of the Commonwealth that they were creating with this Constitution.

Nonetheless, the framers of the Commonwealth Constitution set up mechanisms to ensure that the Commonwealth redistributed this revenue. The Constitution that they framed established a Commonwealth of limited powers. It expressly limited the Commonwealth's power to appropriate money by requiring that it be for 'the purposes of the Commonwealth'. All surplus money was to go to the States. It even required that at least for the first 10 years, the Commonwealth could spend no more than one quarter of the revenue it received from the primary taxes, customs and excise duties, with all the rest of that revenue being paid to the States.

This system soon broke down as the Commonwealth became progressively less willing to implement this financial settlement and started to regard the money raised by customs and excise duties as its own money, rather than public money intended to serve the public's needs. After the first 10 years of the Commonwealth's existence it had terminated the application of the requirement that it keep no more than one quarter of the revenue from customs and excise duties. It had also avoided the constitutional requirement to pay its surplus to the States by appropriating all surplus money into trust funds so that there was never a formal surplus to redistribute.

As the States became more financially independent by raising other forms of revenue, including income tax, the Commonwealth progressively took over these areas of revenue, binding the States financially so that they again became more dependent upon Commonwealth grants. The tax raising capacity of the States progressively diminished, while Commonwealth spending in areas of State responsibility progressively broadened. It was used as a tool for interfering directly in State policy areas by the imposition of conditions placed upon section 96 grants to the States, resulting in the buck-passing and inefficiency which remains a burden on the economy. The Commonwealth also interfered in areas of State responsibility by directly funding bodies (including local government bodies, community groups, regional groups, schools and other bodies) in order to implement Commonwealth programs in a way that by-passes State involvement and to buy political favour with the public.

For many decades the High Court has aided and abetted the Commonwealth in its quest for power. It did not strike down the Commonwealth's practice of hiding its surpluses in trust accounts to keep the money out of the hands of the States.²⁰³ It permitted the Commonwealth to impose any conditions it wished on section 96 grants regardless of their relationship with the nature of the grant.²⁰⁴ It did not strike down the Commonwealth's take-over of income tax from the States, even though in practical economic terms (if not legal terms) it was coercive in nature.²⁰⁵ Despite the fact that the Commonwealth is a government of limited powers, the

High Court has consistently interpreted those powers as widely as possible, permitting them to expand into all areas of State responsibility.²⁰⁶ In doing so, it helped create a disproportionately powerful constituent part of the federal system.

The High Court's decisions in the *Pape* case and the *Williams* cases are significant as the first real brakes put on this long slide towards Commonwealth dominance. In the *Pape* case, the High Court reinforced the federal distribution of powers in the Commonwealth Constitution by requiring that the Commonwealth have a head of power to support its expenditure of public money. It made it clear that the Commonwealth cannot simply spend public money on anything that it wishes – there is a federal system that distributes power between the Commonwealth and the States and it has to be complied with.

In the *Williams No 1* case, the High Court went further, deciding that apart from some exceptions (such as spending for the ordinary administration of government), legislation must actually be enacted to support executive spending programs. This is not only necessary to uphold the federal distribution of powers and to avoid the by-passing of the States, but also to ensure the accountability of the Executive to the Parliament as required by the constitutional system of responsible and representative government. In the *Williams No 2* case, the Court held that general legislation could not validate or authorise spending on programs that were not supported by a head of legislative power. It also rejected the expansion of the nationhood power and confirmed that the Commonwealth Executive has limited expenditure powers.

The Commonwealth, however, cannot seem to accept that there are limits to its powers. It seems still to regard itself as all-powerful, entitled to spend money upon anything that it wishes, regardless of the federal system, regardless of the need for parliamentary scrutiny and regardless of the fact that it is public money that it is spending, rather than its own money. Both its enactment of the *Financial Framework Legislation Amendment Act (No 3)* 2012 and its extension of the application of section 32B in 2014, under different governments, make this clear. Where parliamentary scrutiny was

required by the High Court, the Commonwealth provided bare and blind parliamentary authority without scrutiny of the programs involved. Where the High Court stressed that the federal system requires a head of legislative power to support Commonwealth spending or the negotiation of consensual section 96 grants with the States, the Commonwealth brazenly persists in spending public money regardless of whether each program is supported by a head of power or not.

Future directions

The Commonwealth Government has commissioned three different reviews to consider ways of dealing with the current problems in Federal-State financial relations. It has initiated a White Paper on Reform of the Federation and another on Taxation Reform, both of which are inter-linked. The Terms of Reference for the White Paper on the Reform of the Federation note:

A major part of the problem is that over time, the Commonwealth has become, for various reasons, increasingly involved in matters which have traditionally been the responsibility of the States and Territories. The States and Territories have become increasingly reliant on revenue collected by the Commonwealth to deliver services in the areas they are responsible for, with around 45 per cent of State and Territory revenue now coming from the Commonwealth.²⁰⁷

The issues to be considered by the White Paper include ‘the practicalities of limiting Commonwealth policies and funding to core national interest matters, as typified by the matters in section 51 of the Constitution’.²⁰⁸ It is interesting that no recognition is given to the constitutional necessity of limiting Commonwealth funding to such matters, except where grants are being made under section 96 of the Constitution. Nonetheless, it is at least contemplating

heading in the direction that the High Court and has been driving it in the *Pape* and *Williams* cases.

The Commonwealth Government also commissioned a National Commission of Audit which reported in February 2014. It recommended the reduction of vertical fiscal imbalance through the States becoming responsible for a share of personal income tax. The Commission stated in its Report:

The Commission supports an arrangement whereby the Commonwealth would lower its personal income tax rates to allow room for the States to levy their own income tax surcharge.

The impact of lower revenue collections for the Commonwealth would be offset through an equivalent reduction in the payment of other Commonwealth financial assistance to the States. In other words, the financial implication would simply be a substitution of a new untied source of revenue to the States (through the personal income tax system) to replace a series of tied grants.

By way of illustration, the Commonwealth could permit States to access the personal tax base directly by reducing the current personal income rate of 32.5 per cent (which applies on incomes from \$37,000 to \$80,000) by 10 percentage points to 22.5 per cent.

A 10 percentage point 'State income tax surcharge' could be introduced to bring the overall rate back to 32.5 per cent. This 10 percentage point State surcharge would be hypothecated to the States providing them, in this example, with an estimated additional revenue source of around \$25 billion per year.

To offset this, the Commonwealth would take \$25 billion out of the \$45 billion in tied grants it currently provides to the States. Included in the \$25 billion, for example, could be the tied grants currently provided for schools and the tied grants paid through the various National Partnership Agreements.²⁰⁹

The Commission also made recommendations concerning the clarification of roles and responsibilities between the levels of government, the readjustment of horizontal fiscal equalisation, the avoidance of duplication and the reduction of administrative burdens and conditions on grants.²¹⁰ It concluded that the Commonwealth should withdraw from involvement in certain areas, leaving them to the States.

So far, the Commonwealth has not indicated its response to these recommendations. In its Budget, it showed a willingness to retreat from some areas of State involvement, but as a cost-shifting exercise, rather than a re-balancing of the federal system where funding capacity is matched to expenditure responsibilities. It is essential that both sides of the equation be addressed as a whole package. Any realignment of roles and responsibilities must be done in conjunction with a realignment of the capacity of the relevant government to fund those roles and responsibilities. Whether this is achieved through the sharing of personal income tax or by other means is a matter for further debate.

In the 1890s, those who drafted the Constitution thought that they had ensured that the bulk of Commonwealth revenue would be transferred to the States so that it could be spent on State responsibilities. Their failure to achieve this outcome has undermined the capacity of the federation to operate efficiently and effectively. Understanding this history should aid us in not repeating the errors of the past. The current reviews need to result in a co-operative process by which the federal system is restored to optimal efficiency so that public money is spent for the greatest public benefit.

Endnotes

- 1 Cheryl Saunders, 'The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution' in G Craven (ed), *The Convention Debates 1891-1989: Commentaries, Indices and Guide* (Legal Books, 1986) p 161.
- 2 Unlike the other States, Western Australia did not have an income tax or a land tax. Nearly all its tax revenue came from customs and excise duties, with a small amount also coming from stamp duties and probate duties: R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 32. The special Western Australian provision ceased to operate on 9 October 1906.
- 3 See: J Quick and R R Garran, *The Annotated Constitution of the Australian Commonwealth* (1901), p 865; R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 52; and *Victoria v Commonwealth and Hayden (AAP Case)* (1975) 134 CLR 338, 358 (Barwick CJ).
- 4 *New South Wales v The Commonwealth* (1908) 7 CLR 179, 197 (O'Connor J).
- 5 (1908) 7 CLR 179, 199 (O'Connor J).
- 6 (1908) 7 CLR 179, 206 (Higgins J).
- 7 *AAP case* (1975) 134 CLR 338, 358 (Barwick CJ); 374 and 382 (Gibbs J); 402 (Mason J). See also regarding the significance of section 94: *Combat v Commonwealth* (2005) 224 CLR 494, [139] (Gummow, Hayne, Callinan and Heydon JJ).
- 8 Constitutional Convention, Melbourne, 1898, pp 1090-9 and 2380-1. See also: J Quick and R R Garran, *The Annotated Constitution of the Australian Commonwealth* (1901), pp 863-5; and Cheryl Saunders, 'The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution' in G Craven (ed), *The Convention Debates 1891-1989: Commentaries, Indices and Guide* (Legal Books, 1986) pp 168-9.
- 9 Constitutional Convention, Sydney, 1891, p 805 (Mr Bray); and Sydney 1897, p 150 (Mr Hackett).
- 10 Constitutional Convention, Adelaide, 1897, p 45 (Sir George Turner).
- 11 Constitutional Convention, Melbourne, 1898, 864 (Mr Kingston).
- 12 Constitutional Convention, Melbourne, 1898, p 898 (Sir John Downer).
- 13 J Quick and R R Garran, *The Annotated Constitution of the Australian Commonwealth* (1901), p 811.
- 14 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 37; J Quick and R R Garran, *The Annotated Constitution of the Australian Commonwealth* (1901), p 207.
- 15 71,595 people voted in favour of the Constitution with 66,228 voting against it: R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 37.

- 16 J A La Nauze, *The Making of the Australian Constitution* (MUP, 1972) p 241.
- 17 Constitutional Convention, Melbourne, 1898, p 1122. See also: Cheryl Saunders, 'The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution' in G Craven (ed), *The Convention Debates 1891-1989: Commentaries, Indices and Guide* (Legal Books, 1986) pp 157 and 169; and R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 49.
- 18 Constitutional Convention, Melbourne, 1898, p 1109 (Mr O'Connor).
- 19 Constitutional Convention, Melbourne, 1898, p 1119 (Dr Cockburn).
- 20 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 49.
- 21 Cheryl Saunders, 'The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution' in G Craven (ed), *The Convention Debates 1891-1989: Commentaries, Indices and Guide* (Legal Books, 1986) p 171. La Nauze described the insertion of section 96 as a 'sop to Braddon': J A La Nauze, *The Making of the Australian Constitution* (MUP, 1972) p 246.
- 22 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 50.
- 23 [My emphasis.] J Quick and R R Garran, *The Annotated Constitution of the Australian Commonwealth* (1901), p 219; R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 38.
- 24 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 24.
- 25 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 31.
- 26 Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) p 215.
- 27 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 63. In 1910, the Commonwealth also started imposing a land tax.
- 28 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 67.
- 29 Section 93 applied for the first five years after the imposition of uniform duties of customs 'and thereafter until the Parliament otherwise provides'. By this Act the Parliament 'otherwise provided'.
- 30 *Surplus Revenue Act* 1908 (Cth), section 4(4)(d).
- 31 *Surplus Revenue Act* 1908 (Cth), section 5.
- 32 *New South Wales v Commonwealth* (1908) 7 CLR 179.
- 33 Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) p 216.

- 34 *Surplus Revenue Act* 1910 (Cth), section 3.
- 35 The amendment would have terminated the application of sections 87, 93 and 94 of the Constitution and instead required the Commonwealth to pay each State an annual sum amounting to twenty-five shillings per head of the number of people of the State, with an extra amount being payable to Western Australia.
- 36 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 68.
- 37 See, e.g. Henry Ellis, Letter to the Editor, *Kalgoorlie Miner*, 14 March 1910, p 4.
- 38 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 69.
- 39 ‘The Referendum in April’, *The Sydney Morning Herald*, 28 February 1910, p 6.
- 40 Denis James, ‘Federal-State Financial Relations: The Deakin Prophecy’, in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) p 217.
- 41 The Commonwealth withdrew from the land tax field in 1952.
- 42 Denis James, ‘Federal-State Financial Relations: The Deakin Prophecy’, in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) pp 218-9.
- 43 In 1938-9 the States (including local government) received \$60 million in income tax, \$10 million in estate duties, \$27 million in local government rates, \$14 million in motor vehicle taxes, \$7 million in stamp duties, \$3 million in land tax and \$11 million in other taxes: R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 166.
- 44 The States received \$30 million in grants from the Commonwealth and \$54 million from the gross surplus of public enterprises: R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 166.
- 45 In 1938-9 the Commonwealth received \$114 million in customs duties, excise duties and sales tax, as opposed to \$24 million in income tax and \$14 million in other taxes: R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 166.
- 46 Denis James, ‘Federal-State Financial Relations: The Deakin Prophecy’, in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) p 221.
- 47 Denis James, ‘Federal-State Financial Relations: The Deakin Prophecy’, in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) p 222.

- 48 Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) pp 224-5.
- 49 *South Australia v Commonwealth* (1942) 65 CLR 373.
- 50 Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) pp 222-3.
- 51 R L Mathews and W R C Jay, *Federal Finance – Intergovernmental Financial Relations in Australia Since Federation* (Nelson, 1972) p 166.
- 52 *Victoria v Commonwealth* (1957) 99 CLR 575. While the priority provision was struck down, the Court continued to uphold the scheme under which the Commonwealth gave grants to the States on the condition that they not levy an income tax.
- 53 *States (Personal Income Tax Sharing) Act* 1976 (Cth). The overall proportion for the States was just over one third of net Commonwealth receipts. It was distributed amongst the States on the basis of relativities determined by the Commonwealth Grants Commission. For local government, the proportion was 1.52 per cent rising later to 2 per cent.
- 54 *Income Tax (Arrangements with the States) Act* 1978 (Cth).
- 55 Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) pp 230-1; John Madden, 'Australia – Central Fiscal Dominance, Collaborative Federalism and Economic Reform' in T N Srinivasan and Jessica Wallack (eds), *Federalism and Economic Reform: International Perspectives* (CUP, 2006) 85, 122-3.
- 56 *Parton v Milk Board (Vic)* (1949) 80 CLR 229.
- 57 *Ha v New South Wales* (1997) 189 CLR 465.
- 58 J Brumby, B Carter and N Greiner, 'GST Distribution Review – 2nd Interim Report, 2012, p 4.
- 59 Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', in G Lindell and R Bennett, *Parliament – The Vision in Hindsight* (Federation Press, 2001) p 227. Payroll tax had been introduced by the Commonwealth in 1941.
- 60 *A New Tax System (Managing the GST Rate and Base) Act* 1999 (Cth), section 11.
- 61 J Brumby, B Carter and N Greiner, 'GST Distribution Review – Final Report', October 2012, p 156.
- 62 J Brumby, B Carter and N Greiner, 'GST Distribution Review – Final Report', October 2012, p 174.
- 63 See Appendix A of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations', in Schedule 2, *A New Tax System (Commonwealth-State Financial Arrangements) Act* 1999 (Cth).

- 64 Intergovernmental Agreement on Federal Financial Relations 2008, Schedule B. The abolition of some of those taxes has since been deferred. For example, NSW announced in April 2013 that in order to implement national education reforms, it would defer the abolition of stamp duty on mortgages, transactions involving shares and units and transactions involving business assets such as good will and intellectual property.
- 65 J Brumby, B Carter and N Greiner, 'GST Distribution Review – Final Report', October 2012, p 168.
- 66 Source: J Brumby, B Carter and N Greiner, 'GST Distribution Review – Final Report', October 2012, p 171. Calculations based on data contained in the AFTS architecture paper (Chart 10.5), State budget papers and 5512.0 Government Finance Statistics, Australia, 2010-11.
- 67 Note also subsequent reliance upon an implied nationhood power.
- 68 *Victoria v Commonwealth* (1957) 99 CLR 575, 630 (Williams J); and 655 (Fullagar J).
- 69 (1957) 99 CLR 575, 655 (Fullagar J).
- 70 *AAP* (1975) 134 CLR 338, 355 (Barwick CJ).
- 71 *Victoria v Commonwealth* (1957) 99 CLR 575, 656 (Fullagar J).
- 72 *AAP* (1975) 134 CLR 338, 374 (Gibbs J).
- 73 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 282 (Williams J).
- 74 *AAP* (1975) 134 CLR 338, 398 (Mason J).
- 75 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 266 (Starke J).
- 76 *Williams v Commonwealth No 1* (2012) 248 CLR 156, [243] and [247] (Hayne J); [501]-[503] (Crennan J); [592]-[593] (Kiefel J).
- 77 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237.
- 78 *AAP* (1975) 134 CLR 338.
- 79 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 251-3 (Latham CJ); 273 (McTiernan J); *AAP* (1975) 134 CLR 338, 394 (Mason J); 419 (Murphy J).
- 80 *AAP* (1975) 134 CLR 338, 418 (Murphy J).
- 81 *AAP* (1975) 134 CLR 338, 394 (Mason J).
- 82 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 266 (Starke J); 282 (Williams J); *AAP* (1975) 134 CLR 338, 358 and 362-3 (Barwick CJ); 373-5 (Gibbs J).
- 83 *AAP* (1975) 134 CLR 338, 360 (Barwick CJ); 374 (Gibbs J).
- 84 *AAP* (1975) 134 CLR 338, 360 (Barwick CJ). Barwick CJ was presumably referring to the well-known saying of Humpty-Dumpty in Lewis Carroll, *Through The Looking Glass* (1872).
- 85 *AAP* (1975) 134 CLR 338, 357 (Barwick CJ).
- 86 *AAP* (1975) 134 CLR 338, 357-8 (Barwick CJ).

- 87 See also *AAP* (1975) 134 CLR 338, 401-2 where Mason J noted that ‘ultra vires acts on the part of the Commonwealth, that is, acts exceeding constitutional power, whether legislative or executive, are in truth intrusions into the area of responsibility left to the State by the Constitution and are in this sense prejudicial to the interest of the States under the Constitution and as constituent elements of the federation’.
- 88 *Williams v Commonwealth No 1* (2012) 248 CLR 156, [148] (Gummow and Bell JJ); [248] (Hayne J); and [501] (Crennan J).
- 89 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 258 (Latham CJ). See also McTiernan J at 274-5.
- 90 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 263 (Latham CJ).
- 91 *AAP* (1975) 134 CLR 338, 424 (Murphy J).
- 92 *Attorney-General (Vic) v Commonwealth* (1945) 71 CLR 237, 266 (Starke J).
- 93 Lyndon Megarrity, ‘Local government and the Commonwealth: An evolving relationship’ Parliamentary Library Research Paper No 10, 3020-11, 31 January 2011, p 8.
- 94 Gough Whitlam, ‘1974 Party Policy Speech’ in E G Whitlam *On Australia’s Constitution* (Widescope International Publishers, 1977) pp 332-3.
- 95 Margaret Bowman, ‘Local Government and Specific Purpose Grants’ in *National Inquiry into Local Government Finance*, Vol 2 – Research and Consultancy Reports (AGPS, 1985), p 22.
- 96 *Pape v Federal Commissioner of Taxation (‘Pape’)* (2009) 238 CLR 1, [53], [81] and [113] (French CJ); [185] and [203]-[204] (Gummow, Crennan and Bell JJ); [290], [305] and [316]-[317] (Hayne and Kiefel JJ); [608] (Heydon J).
- 97 *Pape* (2009) 238 CLR 1, [8] and [111] (French CJ); [178]-[183] (Gummow, Crennan and Bell JJ); [320] (Hayne and Kiefel JJ) and [601]-[602] (Heydon J).
- 98 *Pape* (2009) 238 CLR 1, [112] (French CJ); [213] and [241] (Gummow, Crennan and Bell JJ).
- 99 *Pape* (2009) 238 CLR 1, [352]-[353] (Hayne and Kiefel JJ); [551] (Heydon J).
- 100 *Pape* (2009) 238 CLR 1, [504] (Heydon J).
- 101 (1975) 134 CLR 338, 397.
- 102 *Pape* (2009) 238 CLR 1, [508] (Heydon J).
- 103 *Pape* (2009) 238 CLR 1, [9] (French CJ).
- 104 *Pape* (2009) 238 CLR 1, [10] (French CJ).
- 105 *Pape* (2009) 238 CLR 1, [227], [238], [244] (Gummow, Crennan and Bell JJ).
- 106 *Pape* (2009) 238 CLR 1, [239] (Gummow, Crennan and Bell JJ).
- 107 For a more detailed analysis of this point, see: Anne Twomey, ‘Pushing the Boundaries of Executive Power – *Pape*, the Prerogative and Nationhood Powers’ (2010) 34 *Melbourne University Law Review* 313.

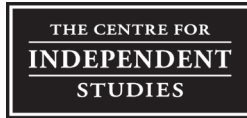
- 108 *Pape* (2009) 238 CLR 1, [65] (French CJ), quoting from Senate, Standing Committee on Finance and Public Administration, *Transparency and Accountability of Commonwealth Public Funding and Expenditure*, March 2007, 15.
- 109 *Pape* (2009) 238 CLR 1, [92] and [96] (French CJ).
- 110 *Pape* (2009) 238 CLR 1, [127] (French CJ).
- 111 *Pape* (2009) 238 CLR 1, [127] (French CJ).
- 112 *Pape* (2009) 238 CLR 1, [325] (Hayne and Kiefel JJ).
- 113 *Pape* (2009) 238 CLR 1, [335] (Hayne and Kiefel JJ).
- 114 *Pape* (2009) 238 CLR 1, [339] (Hayne and Kiefel JJ).
- 115 *Pape* (2009) 238 CLR 1, [342] (Hayne and Kiefel JJ).
- 116 *Pape* (2009) 238 CLR 1, [357] (Hayne and Kiefel JJ).
- 117 *Pape* (2009) 238 CLR 1, [414] (Heydon J).
- 118 *Pape* (2009) 238 CLR 1, [425] (Heydon J).
- 119 *Pape* (2009) 238 CLR 1, [519] (Heydon J).
- 120 *Pape* (2009) 238 CLR 1, [576] (Heydon J).
- 121 *Pape* (2009) 238 CLR 1, [569] (Heydon J).
- 122 *Pape* (2009) 238 CLR 1, [597] (Heydon J).
- 123 *Pape* (2009) 238 CLR 1, [435] (Heydon J).
- 124 *Pape* (2009) 238 CLR 1, [534] (Heydon J).
- 125 *Pape* (2009) 238 CLR 1, [598] (Heydon J).
- 126 *Pape* (2009) 238 CLR 1, [598] (Heydon J).
- 127 James Spigelman, 'A Tale of Two Panels', Speech to the Gilbert + Tobin Centre of Public Law's Constitutional Conference Dinner, 17 February 2012, p 3.
- 128 Commonwealth, Senate Select Committee on the Reform of the Australian Federation 'Australia's Federation: An Agenda for Reform', June 2011, p 91.
- 129 Commonwealth, Senate Select Committee on the Reform of the Australian Federation 'Australia's Federation: An Agenda for Reform', June 2011, p 91. See also Mr English's reference to 'our general capacity to make grants off the Commonwealth's own authority': Committee Transcript, 5 May 2012, p 43.
- 130 A more detailed analysis of this issue is made in: Anne Twomey, 'Post-*Williams* expenditure – When can the Commonwealth and States spend public money without parliamentary authorisation?' (2014) *University of Queensland Law Journal* 9.
- 131 *Williams v Commonwealth* ('*Williams No 1*') (2012) 248 CLR 156, [4] and [22] (French CJ); [193] (Hayne J); [558] (Kiefel J).
- 132 *Williams No 1* (2012) 248 CLR 156, [4] and [22] (French CJ); [193] (Hayne J).
- 133 *Williams No 1* (2012) 248 CLR 156, [34] (French CJ).
- 134 *Williams No 1* (2012) 248 CLR 156, [4] and [22] (French CJ); [484] (Crennan J); [582] (Kiefel J).

- 135 *Financial Management and Accountability Regulations* 1997 (Cth), Schedule 1AA, Part 4, item 402.019 – Disaster Resilience Australia – Emergency Warning System Database.
- 136 *Williams No 1* (2012) 248 CLR 156, [139] (Gummow and Bell JJ).
- 137 (1934) 52 CLR 455, 508 (Dixon J).
- 138 *Williams No 1* (2012) 248 CLR 156, [4] and [34] (French CJ); [139] (Gummow and Bell JJ); [212] (Hayne J); [532] (Crennan J); [582] (Kiefel J).
- 139 *Williams No 1* (2012) 248 CLR 156, [83] (French CJ).
- 140 Commonwealth, *Parliamentary Debates*, Senate, 27 June 2012, pp 4746-7 (Senator Wong).
- 141 Note that while only French CJ expressly stated that the executive nationhood power permitted expenditure without legislative authorisation, other Justices in the majority appear to have assumed the relevance of the nationhood power in this context, as they addressed whether or not the power was applicable to the chaplaincy program.
- 142 *Williams No 1* (2012) 248 CLR 156, [4], [22] and [34] (French CJ); [194] (Hayne J); and [485] (Crennan J); [583] (Kiefel J). See also Heydon J at [402].
- 143 *Williams No 1* (2012) 248 CLR 156, [485] (Crennan J).
- 144 *Williams No 1* (2012) 248 CLR 156, [503] (Crennan J); [587] (Kiefel J).
- 145 *Williams No 1* (2012) 248 CLR 156, [135] (Gummow and Bell JJ).
- 146 *AAP* (1975) 134 CLR 338, 484 (Murphy J); *Davis v The Commonwealth* (1988) 166 CLR 79, 112-3 (Brennan J).
- 147 *Williams No 1* (2012) 248 CLR 156, [158] (Gummow and Bell JJ).
- 148 *South Australia v Commonwealth* (1942) 65 CLR 373, 417-8 (Latham CJ); *Victoria and New South Wales v Commonwealth* (1957) 99 CLR 575, 605 and 610 (Dixon CJ), 636-7 (Williams J).
- 149 *ICM Agriculture v The Commonwealth* (2009) 240 CLR 140, [32] (French CJ, Gummow and Crennan JJ). Note that Hayne J seemed to think that such offences may be contrary to federalism considerations: *Williams No 1* (2012) 248 CLR 156, [248] (Hayne J).
- 150 *Williams No 1* (2012) 248 CLR 156, [146] (Gummow and Bell JJ); [196] (Hayne J); [503] and [506] (Crennan J); and [591] and [594] (Kiefel J).
- 151 *Williams No 1* (2012) 248 CLR 156, [146] (Gummow and Bell JJ); [240] (Hayne J); [499] (Crennan J); and [559] (Kiefel J).
- 152 *Williams No 1* (2012) 248 CLR 156, [83] (French CJ); [146] (Gummow and Bell JJ); [196] and [240] (Hayne J); [402] (Heydon J); [498] and [503] (Crennan J); and [591] and [594] (Kiefel J).
- 153 *Williams No 1* (2012) 248 CLR 156, [38] and [83] (French CJ); [159] (Gummow and Bell JJ); [182] and [253] (Hayne J); [534] (Crennan J); [577] and [595] (Kiefel J). Heydon J found it unnecessary to decide at [407].

- 154 *Williams No 1* (2012) 248 CLR 156, [36] (French CJ); [134]-[137] (Gummow and Bell JJ); [537] and [544] (Crennan J). Hayne J at [286] and [288] and Kiefel J at [569] found it unnecessary to decide upon the narrow ground because no Commonwealth head of legislative power could potentially support the expenditure under the chaplaincy scheme. Heydon J dissented at [403] upholding the narrow view and finding at [441] that the scheme was supported by a legislative head of power.
- 155 *New South Wales v Commonwealth* (2006) 229 CLR 1, [54] and [194]-[196] (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ).
- 156 *Williams No 1* (2012) 248 CLR 156, [54] (French CJ); [143] and [155] (Gummow and Bell JJ); [192]-[199] and [248] (Hayne J); and [395] (Heydon J).
- 157 *Williams No 1* (2012) 248 CLR 156, [37] (French CJ). See also regarding competition with the States, [257] (Hayne J) and [590] (Kiefel J).
- 158 *Williams No 1* (2012) 248 CLR 156, [37] (French CJ); [89] and [155] (Gummow and Bell JJ); [192]-[199] (Hayne J); [540]-[543] (Crennan J); and [581] (Kiefel J).
- 159 *Williams No 1* (2012) 248 CLR 156, [173] (Hayne J).
- 160 *Williams No 1* (2012) 248 CLR 156, [83] (French CJ).
- 161 *Pape* (2009) 238 CLR 1, [569] (Heydon J).
- 162 *Williams No 1* (2012) 248 CLR 156, [143] (Gummow and Bell JJ); [503] (Crennan J).
- 163 *Williams No 1* (2012) 248 CLR 156, [148] (Gummow and Bell JJ); [501] (Crennan J).
- 164 *Williams No 1* (2012) 248 CLR 156, [248] (Hayne J).
- 165 *Williams No 1* (2012) 248 CLR 156, [243] and [247] (Hayne J); and [593] (Kiefel J).
- 166 *Williams No 1* (2012) 248 CLR 156, [501] (Crennan J) and [592] (Kiefel J).
- 167 *Williams No 1* (2012) 248 CLR 156, [146] (Gummow and Bell JJ).
- 168 *Williams No 1* (2012) 248 CLR 156, [581] (Kiefel J).
- 169 *Williams No 1* (2012) 248 CLR 156, [594] (Kiefel J).
- 170 *Williams No 1* (2012) 248 CLR 156, [60] (French CJ); [136] and [145] (Gummow and Bell JJ); [173] and [219] (Hayne J); [516] (Crennan J); [579] (Kiefel J).
- 171 *Williams No 1* (2012) 248 CLR 156, [60] (French CJ).
- 172 *Williams No 1* (2012) 248 CLR 156, [145] (Gummow and Bell JJ).
- 173 *Williams No 1* (2012) 248 CLR 156, [174] and [222] (Hayne J).
- 174 *Williams No 1* (2012) 248 CLR 156, [227] (Hayne J).
- 175 *Williams No 1* (2012) 248 CLR 156, [60] (French CJ); [136] (Gummow and Bell JJ); [532] (Crennan J).

- 176 *Williams No 1* (2012) 248 CLR 156, [288] (Hayne J).
- 177 *Williams No 1* (2012) 248 CLR 156, [151] (Gummow and Bell JJ); [173]] and [216] (Hayne J); [519] (Crennan J); and [577] (Kiefel J).
- 178 *Australian Woollen Mills Pty Ltd v The Commonwealth* (1954) 92 CLR 454, 461 (Dixon CJ, Williams, Webb, Fullagar and Kitto JJ), quoted in *Williams No 1* (2012) 248 CLR 156, [151] (Gummow and Bell JJ).
- 179 *Williams No 1* (2012) 248 CLR 156, [151] (Gummow and Bell JJ).
- 180 *Williams No 1* (2012) 248 CLR 156, [516] (Crennan J).
- 181 *Williams No 1* (2012) 248 CLR 156, [519] (Crennan J).
- 182 *Williams No 1* (2012) 248 CLR 156, [173] (Hayne J).
- 183 *Williams No 1* (2012) 248 CLR 156, [216] (Hayne J).
- 184 The Hon James Spigelman AC, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 24 October 2012, p 10.
- 185 See, e.g. *Financial Management and Accountability Amendment Regulation* 2013 (No 3), which authorised expenditure by the Executive on a national civics education campaign and a communications campaign by those for and against the then proposed local government referendum.
- 186 The first reading of the Bill in the House of Representatives took place at 5.37pm and it was passed on its third reading at 8.43pm.
- 187 Debate in the Senate ran from 12.50pm to 2pm and from 6pm to 6.56pm.
- 188 The Hon James Spigelman AC, ‘Constitutional Recognition of Local Government’, Address to the Local Government Association of Queensland, 24 October 2012, pp 11-2.
- 189 *Williams v Commonwealth No 2* [2014] HCA 23, [48] and [51] (French CJ, Hayne, Kiefel, Bell and Keane JJ). Crennan J agreed generally with the joint judgment at [99]. Gageler J did not sit.
- 190 *Williams No 2* [2014] HCA 23, [36] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 191 *Williams No 2* [2014] HCA 23, [30] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 192 *Williams No 2* [2014] HCA 23, [40]-[41] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 193 *Williams No 2* [2014] HCA 23, [50] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 194 Even then, bounties under section 51(iii) must be ‘uniform throughout the Commonwealth’, so this provisions would not apply to grants to particular manufacturers of cars or chocolate.
- 195 *Williams No 2* [2014] HCA 23, [46] – [47] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 196 *Williams No 2* [2014] HCA 23, [59] (French CJ, Hayne, Kiefel, Bell and Keane JJ).

- 197 *Williams No 2* [2014] HCA 23, [70] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 198 *Williams No 2* [2014] HCA 23, [71] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 199 *Williams No 2* [2014] HCA 23, [78]-[79] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 200 *Williams No 2* [2014] HCA 23, [83] (French CJ, Hayne, Kiefel, Bell and Keane JJ).
- 201 Commonwealth, *Parliamentary Debates*, Senate, 19 June 2014, p 51 (Senator Brandis).
- 202 John Sandeman, 'Chaplains Will Continue to be Paid', *Eternity Newspaper*, 20 June 2014: <http://www.biblesociety.org.au/news/national-school-chaplain-program-will-continue-despite-high-court-funding-ruling> [viewed 14 July 2014].
- 203 *New South Wales v The Commonwealth* (1908) 7 CLR 179.
- 204 *Victoria v Commonwealth* (1926) 38 CLR 399.
- 205 *South Australia v Commonwealth* (1942) 65 CLR 373; and *Victoria and New South Wales v Commonwealth* (1957) 99 CLR 575.
- 206 See, e.g. *Commonwealth v Tasmania* (1983) 158 CLR 1; and *New South Wales v Commonwealth* (2006) 229 CLR 1.
- 207 The Hon Tony Abbott MP, Prime Minister, 'White Paper on Reform of the Federation', Media Release, 28 June 2014.
- 208 The Hon Tony Abbott MP, Prime Minister, 'White Paper on Reform of the Federation', Media Release, 28 June 2014.
- 209 National Commission of Audit, *Towards Responsible Government* (Report, February 2014) Vol 1, p 71. Note that the amount of tax attributable to the States, if received by the Commonwealth, could not be directly hypothecated to the States. It would still have to go into the Consolidated Revenue Fund and be appropriated out by legislation and granted to the States under section 96 of the Constitution.
- 210 National Commission of Audit, *Towards Responsible Government* (Report, February 2014) Vol 1, Ch 6, pp 68-79.



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Public Money: Federal-State Financial Relations and the Constitutional Limits on Spending Public Money

It is uncontroversial that federal-state financial relations need reform, but it is necessary to understand how we got to the current position and what constitutional constraints and principles are relevant to future reforms. Those who wrote the Commonwealth Constitution understood that they were handing over nearly three-quarters of all tax revenue to the Commonwealth, while the states would remain responsible for the vast bulk of spending. So they introduced constitutional mechanisms to force the transfer of most of the Commonwealth's revenue to the states. This paper explains how those constitutional measures were thwarted in the first 10 years of federation and how the High Court supported these developments. But in a series of three cases since 2009, the High Court started to impose constitutional limits on the Commonwealth's executive power, including its power to spend public money. This history provides the essential context for discussion of the reform of federal-state financial relations. Recognition that the High Court is now serious about enforcing limits on the Commonwealth's expenditure powers may be the catalyst for achieving genuine, long-lasting reform. To ensure that such reforms are effective, those developing them must take into account the principles that have recently been applied by the High Court.



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