A VITAL CONSTITUTIONAL COMPROMISE

I.

One of the most striking conclusions of Federal experience in Australia has been the importance of injecting the maximum flexibility into the fiscal relations between the Federal Government and States. [1] In a country of vast area, with a diversity of States in size, population, natural resources, and state of economic development, it is neither possible nor desirable to frame a permanent financial settlement. The reasons are clear. First, the interaction of six economic, political and administrative units in an internal free-trade area releases a process the consequences of which are extremely difficult to assess. Secondly, the impact of Federal economic policy on the individual States is equally difficult, if not impossible, to gauge. Thirdly, unforeseen circumstances, such as war, depression, or natural catastrophe, demand a ready and easy adaptation of fiscal relations.

It is now generally acknowledged that section 96 of the Constitution has contributed substantially to the flexibility of federalism in Australia. [2] From an obscure and scarcely litigated section, negatived at the Melbourne Convention of 1898, and ushered into the Constitution as a last-minute compromise, it has emerged as a vital cornerstone of the federal structure. A glance at the table of Commonwealth legislation passed from 1901 to 1946 in relation to the several provisions of the Constitution [3] provides a significant commentary on the increasing Federal reliance on section 96 to buttress a growing proportion of its legislation. By means of this section the periodic financial anaemia of the necessitous States has been alleviated. A measure of inter-State equalization has been effected through the agency of the Commonwealth Grants Commission. A national minimum standard in important social services has been established. State instrumentalities which had lagged through inadequate financial resources were energised. Housing, health, unemployment, roads, railways, and drought relief each experienced the ameliorative activity of this section. The indebtedness of the Australian primary producer to section 96 is considerable. Either

[1] See e.g. Giblin, Economic Record, Nov. 1926, pp. 145, 159.

[2] Sec. 96. "During a period of ten years after the establishment of the Commonwealth and thereafter until Parliament otherwise provides the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit." See also, Bailey, "The Uniform Income Tax Plan (1942)", Economic Record, Vol. XX, No. 39 (Dec. 1944), p. 185.

[3] Vol. 44, Commonwealth Acts, (1946) pp. ccli-ccliii.

by means of the section alone or in combination with the Federal tax power [4] the chronic plight of the wheat industry was relieved time and again. Indeed, section 96 has become an indispensable constitutional lubricant. Without it, the Federal mechanism could only function, if at all, with the greatest possible difficulty.

II.

In view of its importance in the working of federalism in Australia, it is difficult, at first, to understand the passionate hostility it aroused in the Convention debates. "I have no hesitation," said O'Connor, "in saying that it would be disastrous were any such power given to the Commonwealth." Cockburn, with no less asperity, scorned the clause as "preposterous"; and Reid fervently hoped "that these words will not be inserted in the Constitution." An examination of the debate for their motives is interesting.

It is clear that Henry, the Tasmanian delegate who sponsored the clause, regarded it simply as a temporary safeguard against the first five years of finance under the rigid "bookkeeping" arrangement. Beyond insuring the States against the administrative and political difficulties of the transition period, the clause had little further use. In moving "that the Parliament may, upon such terms and conditions and in such manner as it thinks fit, render financial aid to any State," Henry seemed completely unaware of its implications or its ultimate importance. His sole concern was to make assurance doubly sure that the States—and particularly Tasmania —would not suffer from the severity of the financial disturbance in the critical years of the Federal union.

"It is the first five years," he said, "which will be really the crucial period, in which the States will be passing through a trying financial time. So far as we have gone in these financial proposals, we have tied the hands of the Federal Parliament in a very rigid manner as to the mode of distribution of the surplus. I do not see how the Federal Parliament could possibly employ any portion of the surplus in aid of any particular State since we have tied it down as we have done." [5]

Opponents of the clause were mainly led by representatives of the two wealthiest and most influential States, New South Wales and Victoria. A formidable array of talent which included two future judges of the High Court [6] impugned the proposal on four counts; first, it was a disastrous commentary on the efficiency of the existing financial proposals; secondly, it would encourage irresponsible fiscal policy in a State in the belief that prodigality would be rescued by a beneficient Federal treasurer; thirdly, it would lead to a continuous struggle between the States for better terms; finally, the clause was too vague and indefinite.

[4] *Moran v. Deputy Federal Commissioner of Taxation (N.S.W.)*, (1940) 63 C.L.R. 338.
[5] Conv. Deb., Melb., (1898) Vol I, 1121.
[6] Isaacs and O'Connor.

In the opinion of the "ideal bourgeois" [7] Premier of Victoria, Sir George Turner, the clause simply offered a "worthless" guarantee to the public and a "valueless" aid to the States. [8] What else was a request for financial assistance by a State except a confession of bankruptcy and an inability to conduct its affairs? The man who founded his principles in expediency [9] had no doubt of the answer. To avoid the embarrassing publicity of bankruptcy, no State would resort to this aid.

Bernhard Wise approached the issue with infinite delicacy and tact. He exuded the sweet air of compromise. The brilliant Oxonian whom Deakin portrayed as an "erratic genius" [10] agreed that the clause "was only a guarantee to the public with regard to dangers that are never likely to happen." In his view "the whole of the financial apprehensions were baseless." Yet he would support the motion. Why? His reasons reveal some of the scholastic ingenuity which must have excited Deakin's admiration. With some care, Wise pointed out that he was entirely opposed to the insertion of powers already implied in the draft constitution. He was equally opposed to "placard" clauses solely designed to assuage baseless fears. But this issue was exceptional. His support rested entirely on the strategic need to defeat "the enemies of the union."

". . . . an idea has got abroad that every State is going to be made bankrupt by means of federation. . . . . The enemies of the union in every State have got hold of a series of figures . . . . which lend more or less colour to that fiction . . . . and what we have to do is to put a clause in the Constitution which will prevent the figures put forward by any of those enemies of the union who may choose to falsify the returns of statisticians having any effect on the uninstructed voter. Now I believe that if a clause of this sort is limited to five years it will accomplish that purpose. I would not have it go further than five years." [11]

The Victorian Attorney-General, Isaac Isaacs, joined Turner in an uncompromising hostility to the clause. Bernhard Wise's dialectics and strategic support left him unimpressed. The jurist who twenty-two years later expelled the doctrine of implied prohibition from the Constitution [12] ridiculed the view that financial assistance to a State was a "necessary implication from the fact of Union."

"From the consideration and study which I have been able to give to the Constitution, I have no hesitation in saying that there is no such power implied. . . . . If any act were carried giving monetary assistance to any State it would be unconstitutional. . . . ." [13]

[7] Deakin, "The Federal Story," p. 66.
[8] Conv. Deb., (1898) Vol I, 1102.
[9] Deakin, *op. cit.*, p. 66.
[10] Deakin *op. cit.*, p. 63.
[11] Conv. Debs., *op. cit.*, 1104.
[12] *Amalgamated Society of Engineers v. Adelaide Steamship Co. Ltd.*, (Engineers' Case) (1920) 28 C.L.R. 129.
[13] Conv. Deb., *op. cit.*, 1108.

In common with those who maintained an unshaken confidence in the "bookkeeping" arrangement, Isaacs dismissed the fear that any State would be reduced to penury by federation. Clearly, the right of each State to a "fair return" of the surplus revenue should be ensured. Beyond that, however, no further guarantee was necessary.

". . . . When you go beyond that, and introduce a provision allowing any State to come forward and ask not for rights but for favours I say that such a provision is foreign to the Constitution." [14]

Support for the clause came, significantly, from the delegates of States which were to become the most consistent suppliants of Federal aid—Forrest of Western Australia, Holder and Symon of South Australia, and Lewis, Douglas and Braddon of Tasmania. [15] Their arguments were throughout dominated by one desire—to secure absolute financial security against the risks of federation. To succeed with Henry's proposal, however, they had to draw from the future a convincing basis for their financial fears. By its very nature their task was tremendous. They had to foresee the incidence of Federal economic policy; the unequal effects of a competitive free-trade economy; and the likely need for periodic "redistribution" of revenue from the more favoured to the less fortunate members of the union.[16] American federal experience offered no precedent. Beyond a vast corpus of constitutional and political ideas, it knew, as yet, little of the unique travails of federal public finance. Neither Isaacs nor Turner were easily disposed to prophetic warnings; and few of those who supported the clause filled the role of prophet with conviction.

More: Isaacs, Turner, and Richard O'Connor, another vigorous critic of Henry's proposal, had enclosed the three future "mendicants" in a tight ring of logic. Each in turn applied the narrowest possible interpretation to the clause. Each of them, Isaacs, Turner, and O'Connor, had assumed that the clause would operate only in the case of bankruptcy. Then with this crippling interpretation, they posed a skilful dilemma for its supporters to answer.

"If there is any truth in the statement that every State is going to be made bankrupt by reason of federation, it shows very plainly either that we ought to have no federation at all, or that our financial proposals are absolutely wrong in their basis. On the other hand, if there is no truth in the suggestion that every State is going to be made bankrupt, why should we put on the face of the Constitution,

[14] Conv. Debs., *op. cit.*, 1110.

[15] The position of the South Australian delegates is rather interesting. While the delegates from the other States presented a common opposition to or common support of the clause, the South Australian delegates were divided in their opinion. Thus for instance Cockburn opposed the clause (Conv. Debs., Melbourne, 1898, Vol. 1, 1119), while Symon agreed that the power 'might be absolutely essential to the stability and even to the existence of a particular State' (*ibid*, p. 1116.)

[16] See 1st Report of the Commonwealth Grants Commission, (1939) p.p. 14-15.

which is to last for all time, an assumption that States may be driven to such straits in their dealings with the Commonwealth that they may have to ask for pecuniary aid?" [17]

True, Lewis of Tasmania and Symon of South Australia had criticised the prejudicial tendency "to assume that financial aid is to be given in the case of the practical insolvency of any State." True, Braddon of Tasmania had pointed to the possibility of natural disaster.

"It is quite possible to conceive some serious calamity happening to a State, such as a conflagration, extending far more widely than those which have recently occurred in Victoria and Tasmania, and carrying with it such loss to the community as to very seriously hamper that community and possibly bring a colony to the verge of insolvency." [18]

Beyond this, however, most of those who supported Henry's proposal argued within the narrow limits set by their opponents. None fully grasped the implications of the clause. None fully exploited the weakness of a financial settlement based on the economic equality of each member. [19] Beyond a stubborn, often vague claim for security, few rose to the challenge of Isaacs, Turner, and O'Connor.

Of all the delegates, perhaps the Premier of Western Australia, Sir John Forrest, sensed the ultimate value of Henry's proposal. Early in the debate he had pointed out that the clause neither reflected on the efficiency of the financial arrangement, nor implied its use solely in the case of virtual bankruptcy. [20] It was to be more than a temporary measure to safeguard the States against the difficulties of the transition period, to assuage baseless fears, or protect the "uninstructed voter" from the enemies of the Union. Above all these reasons, its real purpose was to provide for the unpredictable circumstances of the future. With a hint of the astute foresight which distinguished Forrest, he told the Convention,

"It is not for the first five years that I am thinking about so much in regard to this matter . . . . It will be plain sailing at the beginning. But I am thinking of the more distant future—of a time further ahead than we can see now." [21]

III.

The proposal was negatived. While support for Henry's proposal is understandable, the reasons for its rejection are not readily apparent. Of the possible explanations, however, two seem to be

[17] Con. Debs., *op cit.*, 1108, Richard O'Connor.
[18] *ibid*, p. 1118.
[19] See Giblin, Economic Record, Nov. 1926, pp. 147-48.
[20] Con. Debs., *op. cit.*, p. 1121: "There are a great many ways in which it may be necessary for the Federal Parliament to assist the States. There may be great public works which are altogether beyond the means of a State itself, but which are very necessary in the interests of Australasia."
[21] *ibid*, p. 1122.

outstanding; first, the general character of the assumptions underlying the financial settlement in the Constitution; and second, the fear of the wealthier States that they would be compelled to share the burden of financial assistance. [22]

It is clear that except for the temporary concession to Western Australia, the financial clauses of the Constitution do not contemplate any differential treatment of the States on the grounds of their disparity in natural resources, state of development, or any other reason. [23] The common assumption underlying the financial settlement in the Constitution is that the States, in proportion to population, would be, in the long run, of equal financial strength. [24] Whatever the reasons for this assumption, [25] this much is clear; that a financial settlement framed on this basis is not concerned to do more than provide an acceptable formula for the distribution of the revenue relinquished by the States to the Federal Government. Once this is achieved, then the constitution need not (and in fact does not) "contemplate the possibility that any State should be less able than its neighbours to take its full share, on a population basis, of Federal responsibilities whether from natural inferiority of resources or from the Federal scheme working to its disadvantage." [26] On this assumption, moreover, the confidence of Isaacs, Turner, Wise and O'Connor in the efficacy of the financial settlement is easily understood; the financial fears of Western Australia, Tasmania, and South Australia appear groundless; and Henry's proposal anomalous.

The second factor arises directly out of the effect of Henry's proposal on the distribution of the customs and excise revenue under the "bookkeeping" arrangement. Most of the Convention understood that in balancing the customs revenue collected in each State against the "expenditure of the Commonwealth" the Federal Government was entitled to debit each State "in proportion to population" the amount of financial aid granted to any State. [27] If for no other reason, the realisation that financial assistance could be taken

[22] The fear of vesting the Commonwealth with a power which could work to the prejudice of the States is not excluded. Cockburn's distaste for a clause which might "sap the independence of the States by placing the Federal Parliament as a sort of Lord Bountiful over the States, to whom admisericordiam appeals could be made" may have been equally shared by other delegates (*ibid*, p. 1119). Nevertheless, the opposition to Henry's proposal seems to stem primarily from these two factors.

[23] See secs. 81, 86-89, 90, 93-96.

[24] See Giblin's penetrating analysis of Commonwealth-State financial relations in which this viewpoint is given its clearest expression; Economic Record, Nov., 1926, pp. 147-148; cf. Rowell-Sirois Report, Book i, p. 45.

[25] One reason suggested by Giblin is the political difficulty of obtaining an agreement, even in principle, to a financial arrangement based on the differential treatment of members (see Giblin, *op. cit.*) A second reason may be the practical difficulty of defining the precise terms in which differential treatment should operate.

[26] See Giblin *op. cit.*

[27] See Secs 89, and 93 of the Constitution. These sections substantially embody the 'bookkeeping' clauses of the Commonwealth of Australia Bill at the 1897 and 1898 conventions; see especially Quick and Garran, pp. 870-871.

out of revenue was sufficient to prejudice the clause in the eyes of the wealthy States. While they were prepared to enter into federation for limited purposes, they were scarcely prepared to become permanent philanthropists to necessitous States.

IV.

Although the clause was rejected, the debate served an excellent purpose. Any illusions regarding the power of the Federal Government to grant financial aid to a State were dispelled. [28] In spite of this disillusionment, however, Henry's threat—"without some such assurance as that the Federal Government may come to the aid of a State in a necessitous condition . . . . I fear that some States may be deterred from entering this Federation"—proved empty.

Following the Melbourne Convention the draft constitution was submitted to the electors in four States. [29] With the exception of New South Wales, the Bill received a decisive majority in each State. In Tasmania, despite the keen disappointment with the lack of financial "guarantees," the Bill received an overwhelming majority. Western Australia, which joined the Tasmanian delegation in supporting Henry's proposal, did not hold a referendum. Instead, a joint select committee was appointed to consider the draft constitution. Surprisingly, however, in the list of recommendations submitted to Parliament no mention whatever is made of Henry's proposal. [30].

At this stage, it seemed extremely likely that, if the requisite majority of votes had been obtained in New South Wales, section 96 would have been omitted from the Constitution. [31] The Premiers' Conference called by Reid soon after the first referendum, however, provided Tasmania and Western Australia with a further opportunity to urge the inclusion of Henry's proposal in the Constitution.

Unfortunately, other than the resolutions, there is no detailed record of the discussions which took place at this crucial Conference. [32] This much is clear, however; of all the issues discussed by the Premiers none caused so much heartburning and perplexity as the financial question. Reid, tremulous and chastened by the referendum in New South Wales, came to the Conference determined to excise the detested "Braddon Blot" from the Bill. According to Reid, [33] "The Premiers were willing to abandon the "Braddon Blot" . . . . but when we all tried to get a substitute that would give the

[28] See Conv. Debs., *op. cit.*, 1120.
[29] New South Wales, Victoria, South Australia, and Tasmania.
[30] See Western Australia, Votes & Proceedings, 1899, Vol III No. A 10., pp. i-iv.
[31] If this had occurred, it is probable the Commonwealth would have attempted to found a grant-in-aid power in section 81 of the Constitution.
[32] Deakin gives a brief account in the 'Federal Story,' pp. 97-99; see also Quick & Garran, pp. 218-220; and Reid, N.S.W. Parl. Debs., Vol 97, p. 48.
[33] "My Personal Reminiscences" by Sir George Reid, p. 177; Cassell & Co. Ltd. 1917.

smaller populations financial security in some other form none of the plans submitted was acceptable . . . ." Eventually a compromise was found by two means; first, by imposing a time limit on the Braddon clause; [34] and secondly, by the inclusion of section 96 in the form substantially suggested by Henry with a time limit similar to the Braddon clause.

What induced this compromise? What persuaded the Victorian Premier, Sir George Turner, to accept a clause he had rejected twelve months earlier? What induced the New South Wales Premier, Reid, to refer to the clause as this "valuable feature of elasticity" and "distinct improvement in the Bill"? [35] Was he placating an Assembly which gave him only a limited mandate to the Premiers' Conference? [36] Or had he become genuinely convinced of the value of Henry's proposal? Quick and Garran suggest two reasons for the insertion of the clause; first, to compensate "the smaller States for the amendment in the Braddon clause," and secondly, "to meet the difficulties that might be caused in the first few years of the uniform tariff, by the unyielding requirements of the distribution clauses." [37] If this view is correct, then it is possible that the Premiers of the two wealthy States were influenced by two other reasons; the belief that the Braddon clause would act as an effective check on the new clause; [38] and the hope that it would eventually disappear with the end of the Braddon period. Whatever the reasons, however, one thing is clear that few, if any, of the Premiers at the conference were conscious of the vital role the section was destined to play in the constitutional and economic life of the Federation.

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[34] See sec. 87 of the Constitution.

[35] See Reid's speech on the Address in Reply in the Legislative Assembly after his return from the Conference. He had concluded his speech and sat down, when the Minister for Public works drew his attention to the new clause. Reid arose and added, somewhat apologetically, "There is a new clause inserted next to the Braddon clause which gives the Commonwealth Constitution a very valuable feature of elasticity in connection with the finances." Quoted in Quick & Garran, p. 870.

[36] See Reid, N.S.W. Parl. Debs., Vol 97, p. 48. "I want hon. members to understand, first of all, that I did my best to carry all the suggestions which were adopted by the House, that unfortunately for us there were other interests to be considered . . ."

[37] Quick & Garran, p. 869.

[38] See Quick & Garran, p. 871. Indeed the Federal Parliament did not make use of section 96 until the end of the Braddon period. See for example, Surplus Revenue Act, No. 8 of 1910.