Chapter IV.

A. Grants-Phenomenon in Modern Political Systems : Canada.

Federalism & Finance in Canada.

The peculiar colonial heritage of Canada created diversified cultures with different linguistic, religious and political background. But the proximity of a powerful neighbour brought them together in a closely knit federation with a strong centre. As a consequence, as much as 83 percent of the provincial revenue was vested with the dominion at the inception of the federation in 1867. It was, therefore, inevitable that the provinces were heavily dependent on the Dominion for the bulk of their finances. But the fact that they were dependent on the Dominion for a substantial part of their financial requirements remained a live source of irritation for a long time. Meanwhile, Provincial activities kept increasing in volume and intensity. The evergrowing demand for social and economic overheads meant an enormous strain on the provincial revenues which were not as elastic as those of the Dominion.(1) Thus "the nature of Canadian federation with its close-knit structure and its strong Centre, ensured a balance of power heavily tilted in favour of the Dominion".(2)

The British North America Act 1867, the constitutional basis of Canada, enacted by the British Parliament, was the culmination of years of labour aimed at striking out a fair balance between the urge for preservation of local loyalties and cultural heritage on the one hand and an urgent need for consolidation of strength and solidarity of the Colonies on the other.(3)

Under the British North America Act, the Parliament of Canada has the right to raise money by any mode or system of taxation, while the provincial legislatures are restricted to direct taxation within the province in order to raise revenue for provincial purposes. Thus the Provinces have a right to share only in the field of direct taxation while the federal government is not restricted in any way in matter of taxation. The British North America Act also empowered the Provincial legislatures to make laws regarding "municipal institutions in the province". This means that the municipalities derive their incorporation with its associated powers, fiscal and otherwise, from the Provincial government concerned. Thus, municipalities are also limited to direct taxation.(4)

Despite efforts on the part of the Provinces in Canada to tap new sources of revenue such as personal

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income, corporate profits and real estate, they became increasingly dependent on Dominion subsidies. The Dominion was anxious to step up expenditure on social services and welfare schemes. But the courts as well as the Privy Council did not allow them to assume those functions which constitutionally belonged to the Provinces. Therefore, since 1912, the Dominion Government resorted to conditional grants as a means of furthering Dominion objectives,(5) although "ever since the dawn of Confederation, Canada has followed a system of unconditional federal grants to Provinces. In earlier years these grants were given largely on political rather than economic considerations".(6) Thus, this device of assistance violated the widely known principle of 'independence and responsibility', which means, according to B.P.Adarkar, "the responsibility of raising revenue and the freedom of spending it ought to go hand in hand".(7) To James A. Maxwell, in the past, the "shameful history of unconditional subsidies" was set forth and "time after time better terms have been granted to pay political debts or to win political support and each concession has raised fresh demands ....".(8)

Evolution of grants-system.

In a federation of heterogeneous cultural and linguistic units with widely different fiscal

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capabilities, it is quite natural that a device like grants-in-aid would be ~~mmmm~~ convened to put a balance between unequal economic structures. But "the Rowell-Sirois Commission was bitter against the chaotic and illogical system of subsidies under which grants were paid on a variety of bases and suggested their substitution by a system of two forms of grants,(9) viz.,(i) fiscal need or, as the Commission called them, national adjustment grants to enable the Province to provide services at a national standard which it recommended as irreducible; and (ii) emergency grants to be made only in the event of financial stringency".(10)

National security, national development and the fostering of trade and commerce by appropriate regulation were regarded by the Founding Fathers of the Canadian federation as great functions of government. These were also the functions which they thought likely to expand in the future. When these had been transferred to the Federal Government, the Provinces were left with functions, the burden of which was not expected to grow. The Provinces would be required to support a civil government establishment to maintain a number of local public works and to undertake the administration of justice. But the heaviest duties of civil government and burden of the great public works would be lifted from their shoulders. The support of education was

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to come within their sphere and their control over generally all matters of a merely local or private nature in the Province and over the establishment, maintenance and management of hospitals, asylums, charities and eleemosynary institutions in and for the Province, implied responsibility for social welfare problems which got beyond the resources of charitable and municipal organisation.(11)

But even this great diminution in the number and costliness of the Provincial functions did not bring the expenditure of the Provinces down to a level where it would not exceed the revenue. The two sources of income remaining were direct taxes and the odd fees, royalties, permits and sales of small services which the Province still retained. No one in the 1860's expected direct taxation to be used to any degree, so the main reliance was placed on the second miscellaneous group which was clearly insufficient. The gap was, therefore, filled by the Dominion agreeing to make a number of payments or subsidies to the Provinces and these contributions were embodied in Sections 102-26 of the British North America Act. Those payments which might conceivably lead to further claims were optimistically declared to be "in full settlement of all future demands on Canada" - a statement which joined the group of non-operative clauses in the Act shortly after confederation.(12)

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Till the First World War, the Dominion Government had restricted itself to levying only 'customs and excise', leaving direct taxation to the Provinces. It, however, introduced income taxes alongwith "sales" and a long range of 'commodity taxes' during the War. Besides, sweeping economic and social changes took place in Canada since the introduction of the British North America Act, in 1867. Problems of urbanization, various technological developments and with them expansions of highways, civic amenities and education, caused the Provinces to place before the Dominion a demand for greater assistance to cope with new situations. The Dominion government responded to these demands by introducing a system of conditional grants-in-aid for housing, highways, education and other civic needs.(13) "In the opinion of the Royal Commission the supervision and control involved in conditional grants became an additional source of irritation. These difficulties were aggravated by the unequal developments of the different states. Whereas the maritime Provinces benefitted most by the growth of industries and trade, the agricultural states were very much worried about the fluctuating prices and deteriorating terms of trade".(14)

The Great Depression of the 1930's badly shook the foundations of the federal system and changed the

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whole fabric of Dominion-Provincial relations. In August 1937, therefore, the then Prime Minister of Canada submitted a report to the Privy Council asking for the re-examination of the economic and financial basis of Confederation and of the distribution of legislative powers in the light of the economic and social developments of the last seventy years. Consequently a high powered Commission was appointed under the chairmanship of Newton Wesley Rowell to undertake this task.(15)

After the crucial years of the Great Depression and the Second World War, the Dominion-Provincial relations in Canada had shown some signs of change. The Provinces did not feel equal to the tasks presented to them by the Depression. The Dominion Government felt hopeless in view of the constitutional obstructions. But the growing awareness that there should be a reallocation of revenues and functions so as to enable the Dominion Government to formulate suitable fiscal measures to ensure stability in income and employment came to be embodied in the recommendations of the Royal Commission on Dominion-Provincial Relations (Rowell - Sirois Commission) which submitted its report in May, 1940. This Report proposed that the Provinces should relinquish some direct taxes such as the income tax, corporation tax as well as succession duties besides surrendering all their

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rights to subsidies. In return the Dominion was to take over public debt, unemployment relief, old age pensions etc.. In exchange, the Provinces, were to be entitled to a new set of grants such as national adjustment grants and emergency grant, the latter being for a one year period under exceptional economic circumstances.(16)

The original payments to the Provincial Governments fell into four classes : (1) Payments on Debt Allowances - in order to equalize the treatment among the Provinces, so that the extravagant would not reap the same reward as the frugal, the device of the debt allowance was used; (2) Annual Grants To Support Provincial Governments and Legislature - The Original Provinces of Canada received grants ranging from $ 50,000 to $ 80,000 a year (in order of size) for the above purpose and as new Provinces entered the federation, they received similar grants. In 1907, this grant was raised and made to vary with the population; (3) Per Capita Grants - this grant has been manipulated on a number of occasions to render aid to needy Provinces. In 1907, however, the subsidies were revised for all the Provinces and the amounts of subsidy would vary with population : eighty cents a head upto a population of 2,500,000; sixty cents a head on any excess over that number; (4) Special Grants - These grants have been allotted ever since Confederation for a wide variety of causes : some were given

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to satisfy legitimate claims; some for convenient grievances; some simply in response to political pressure. New Brunswick received as part of the Confederation agreement $ 63,000 a year for ten years, for the excellent reason that she could not balance her budget without it. The "better terms" agitation in Nova Scotia resulted not only in the increase in her debt allowance, but also in an extra $ 82,698 a year for a ten year period. Saskatchewan and Alberta received special grants on entering the Dominion to compensate them for the Dominion retention of their natural resources. The Maritime Provinces, as a result of a long agitation for redress of grievances, received in 1932 additional subsidies totalling $ 2,225,000 a year and in 1958 another $ 25,000,000 annually, increased to $35,000,000 in 1962.(17)

Thus, author like R.M.Dawson believes that the world of Dominion-Provincial finance in Canada has for much of its history an air of grotesque unreality(18) and "the history of subsidies demonstrates not only that final and unalterable agreements can be and are subject to frequent revision, but that population figures can be invented when the actual ones proves unsuitable ..... and that when a subsidy is increased in order to equalize the treatment among the Provinces, further adjustments become immediately necessary in order to overcome the injustices

which have been occasioned by the very act of equalization".(19)

The financial provisions of the British North America Act became useless in the face of circumstances over which the Provinces had virtually no control. The quantity and intensity of the Provincial activity grew at an accelerating rate.(20)

As one of the methods of meeting Dominion-Provincial problems of finance, grants-in-aid have been made since 1912 and the scheme has been used for various purposes, such as, technical and agricultural education, public health services, employment agencies, highways, old age pensions and unemployment relief. One purpose of grants-in-aid is that it is designed to help the needy Provinces pay for certain desirable services and its success to this endeavour cannot be denied. But some grants have increased Provincial expenditures. Some have induced the poorer Provinces to undertake admittedly praiseworthy and even necessary activities, but activities for which they could ill afford to pay under prevailing theories of taxation; while those grants which were of limited duration frequently left a Province saddled with a venture which was beyond its means to retain. The Provinces, in short, did not benefit much financially from the prevalent system of grants since they received more and better services, but they pay

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out more of their income in the process and few of them could always afford assistance on these terms.(21)

The Rowell-Sirois Commission Report.

The Report of the Rowell-Sirois Commission, "one of the great State papers in Canadian history", was focussed "primarily on the two fundamental problems - the position of the Provinces vis-a-vis the Dominion and the inequality of resources in different Provinces. For the first, the Commission recommended a transfer of certain functions and a shifting of taxing powers; for the second, it urged the payment from the Dominion Treasury of special grants which would be based on the needs of each Province and would be designed to equalize to some degree the economic and financial position of all the Provinces. The Commission thus sought not only to reestablish the general balance between Provincial revenue and expenditure, but also to break away entirely from the old subsidy system. The latter, which had been formulated essentially on Provincial equality .... was to be replaced by a plan of Dominion contributions given solely on the principle of Provincial need".(22)

The Provinces would relinquish the personal income tax, taxes on corporations and on corporate income, and succession duties; and they would also surrender all the

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old Provincial subsidies. In return, the Dominion would assume (with a few special adjustments) all the Provincial debts and accept responsibility for all relief of the employable unemployed. The Dominion would also respect the remaining revenue source of the Provinces, would pay to a Province 10 per cent of the net revenue derived from mining and oil-producing companies within that Province and would pay to the more needy Provinces a 'national adjustment grant'. The latter was determined in the first instance for each Province (Ontario, Alberta, and British Columbia were to receive nothing) by its existing financial position, and this amount was to be permanent and irreducible. It could, however, be increased; and it was to be subject to review every five years by an independent commission which would advise whether any change should be made. Emergency grants, made for one year at a time, could also be given to any Province which had suffered under exceptionally bad economic conditions.(23)

The Rowell-Sirois Commission Report was considered at a Dominion-Provincial conference few months after it was presented; but opposition from several Provinces caused it to be shelved. The drastic federal war taxes imposed in 1941 as part of the comprehensive financial policy of the federal government compelled the Provinces to enter into an agreement with the Dominion. A number of the

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Rowell-Sirois recommendations were thus carried out piecemeal.(24)

The first post-war Dominion-Provincial Conference held a number of meetings extending from August, 1945, to May, 1946. The proposals embodied a number of the Rowell-Sirois recommendations, but looked a more positive and aggressive federal action than did the earlier suggestions. The most drastic part of the new scheme brought forward was that the old annual subsidies should be replaced by very much larger ones which would be calculated for each Province on one of several alternative formulae. These would constitute the minimum payments to be made to each Province and would each year be adjusted (above that minimum) to correspond to any increases in the national income. The Dominion would be given complete control, in return, over personal income tax, corporation tax and succession duties.(25)

The proposals of the Government of Canada, Dominion-Provincial Conference on Reconstruction, 1945, "rejected 'Provincial need' as a basis for federal grants(one fundamental principle of the Rowell-Sirois Commission Report) and put in its place a straight per capita subsidy. To be sure, Provincial need was recognized incidentally by the new grant in that poorer Provinces might receive more thereby

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than they would lose by conceding the taxing powers above named, so that a certain levelling off would be likely to occur. But there was no reason to suppose that the poorer Provinces would not be returning under any such arrangement to the old intolerable situation on being unable to keep abreast of their opulent neighbours in some of the essential services, for by its very nature a per capita grant is unable to discriminate between recipients in different economic circumstances ....."(26)

The first five-year rental agreements came into being in 1952, and with some changes were renewed in 1957. The federal government drafted a totally 'new plan' for 1957-62. The country was faced with new requirements which were different from those prevailing in 1952 and the necessity for economic stabilization through complete federal control of taxation had been supplanted by a growing recognization of the principle of fiscal need. It was also seemed desirable that fiscal need subsidies should be determined on an objective basis, instead of individual bargaining between the Provinces and the federal government. These led to separate provision being made for three main purposes: equalization grants to meet the problem of fiscal need, stabilization grants to ensure Provincial income against economic recession (both meaning abandonment of the straight

per capita principle of grants), and tax rental and collection agreements to maintain simplicity in tax administration.(27)

Equalization grants are unconditional grants to the poorer Provinces, based on fiscal need and these are designed to enable the less affluent Provinces to provide a moderate level of Provincial services without the necessity of carrying an abnormal load of taxation. Stabilization grants are to guarantee that the revenue from the standard taxes ('standard taxes' meant the amount that would be derived from a tax within a province equal to 10 per cent of the tax payable under the Dominion Succession Duty Act and 9 percent of the net taxable income of a Corporation) and equalization payments will not decline by more than 5 percent below the average of the two preceding years. The third part of the new agreement provides an opportunity for the Provinces to rent the exclusive use of their succession duties, income taxes and corporation taxes to the Dominion Government. Should a Province wish to rent one or more of these taxes to the federal government, it must enter into an agreement for the five-year duration. Any Province doing so then receives in payment the yield in that Province of the standard rate of the tax that is rented with

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appropriate adjustments applicable to the rented and non-rented taxes.(28)

"The Dominion government proposed to replace the tax-agreements, upon their expiry in 1962, with a new tax collection scheme whose essentials are neatly summarized in a resolution which the Minister of Finance moved in the House of Commons on July 11, 1961 :

Resolved that it is expedient to introduce a measure to authorize Tax collection agreements with the governments of the Provinces and to provide that the minister may pay to a Province, out of the Consolidated revenue fund, in respect of any fiscal year in the period commencing on the 1st day of April, 1962 and ending on the 31st day of March, 1967,

(a) a tax equalization payment;

(b) a provincial revenue stabilization payment;

(c) additional annual grants of ten and a half million dollars to each of the provinces of Nova Scotia, New Brunswick and New Foundland, and three and a half million dollars to the province of Prince Edward Island;

(d) a further additional annual grant of eight million dollars to the province of New Foundland;

(e) where a province does not levy a succession duty, an amount equal to the standard estate tax

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applicable to the province for the fiscal year; and

(f) advance payments on account of amounts collected under a tax collection agreement that may be entered into with the province".(29)

The main result of these proposals, amended somewhat and enacted into law, was that the Provinces were obliged to levy their own direct taxes in order to maintain an income comparable with that formerly obtained with the aid of tax-rental agreements. The Dominion acts a tax collector for Provinces which wish it, provided that the Provincial tax base is identical with that of the Dominion.(30)

Grants System in Canada Today.

As it is revealed from above, the Dominion, for many years, has paid grants-in-aid to the Provinces and contributed to shared cost projects for a variety of purposes. These purposes has ranged from "the construction of the Trans-Canada Highway to assistance for the aged and from hospital construction to forest development".(31) The total federal transfers to the Provinces in 1959 was nearly two hundred and fifty millions, and in addition the Dominion paid another thirty millions to the municipalities.(32) Conditional grants, whereby the federal government reimburses the Provinces for an

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agreed-upon portion of the costs of specific programmes, such as hospital insurance, medicare and Canada Assistance Plan, results from agreements formally entered into by the federal government and a Province or Provinces.(33) Fiscal transfer payments are also the result of Dominion-Provincial agreements and these do have no 'strings' attached.(34) Such payments include statutory subsidies set out by the British North America Act.(35) The uneven distribution of income among different regions of Canada and the non-correspondence that has traditionally existed between the resources and responsibilities of the governments of the component units has led time to time to the development of intergovernmental fiscal arrangements of various types and the resulting transfers of important revenues between levels of government.

"A number of important proposals were put forward at two conferences during the fall of 1966. At the first of these conference, in September, the federal government outlined the equalization and stabilization formula to be used for the period 1967-72, and proposed that the Provinces take over certain shared cost of health and welfare programmes with the federal government withdrawing further from the personal income tax fields as compensation. Under the federal proposal the Provinces would take over

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hospital insurance, the health grants programmes and the programmes grouped under the Canada Assistance Plan. In return the federal government would cede an additional 17 percent of the personal income tax to the Province and the associated equalization payment plus a final adjusting payment or refund would make the total transfer equivalent to what the federal share of these programmes would have been. It was intended that eventually this transfer would not be tied to Provincial programme costs but would instead be an unconditional grant of equalized abatement points and federal supervision would be eliminated. None of the Provinces accepted this proposal readily".(36)

The Federal-Provincial Fiscal Arrangements Act, 1967, passed in March, 1967, provided for a number of changes in the structure of federal payments to the Provinces. Under these arrangements, both the equalization formula and the stabilization formula were expanded by changing their forms - relating them to all Provincial revenue sources instead of the 'standard' taxes and natural resource revenue.(37)

A new arrangement for federal-Provincial fiscal relationship in Canada became operative on and from 1st April, 1972 to run upto March, 1977. The equalization formula for 1967-72 took into consideration 16 Provincial

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income sources while the formula for 1972-77 based itself on 19 sources.(38) "For each income source a base was chosen which is as close as possible to the actual base of the income source in all provinces. The percentage of the total base attributed to a particular province was to be calculated along with the percentage of the population in that province. The difference between the percentage of the base and the percentage of the population multiplied by the total income in all provinces from a particular source gives the equalization payment for the income source in the province. The total equalization payment for the province was the sum of the payments for each income source".(39)

The federal government, by stabilization formula, as noted above, guarantees the Provinces in which revenues drop below those received for the preceding year, a contribution intended to make up for the difference between the potential revenue of the latter year, based on the tax rates and structure of the preceding year and the actual revenue. Total net general revenues of the Provinces, including equalization and other unconditional grants from the federal government were used to determine payments.(40)

The vertical federal balance of power in Canada has so far been tilted in favour of the national government as it is evident from above discussion and the

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Canadian Provinces are sore about "their financial dependence on the Dominion".(41) At the same time, the Provinces are also extremely sensitive to Dominion interference into their administration under the guise of 'conditions' attached to grants.(42) Existence of horizontal federal imbalance has also been found in Canada among different units of "varying economic capabilities"(43) although "the special needs of the poorer states have not been openly recognized".(44)

The Great Depression had brought into surface the "serious maladjustments in the distribution of functions and revenues which was sought to be remedied without any fundamental alterations of the Constitution. The preservation of economic stability, the reduction of regional disparities and promotion of social welfare came to be regarded as the primary responsibility of the Dominion".(45) Side by side, it is to be remembered that the Dominion "can raise money by any mode or system of Taxation. The provinces have no exclusive fields of taxation whatever, but their responsibilities continue to grow".(46) However, it cannot be denied that Canada has seen the withdrawal of Federal Government to some extent from the dominant position it held in the field of taxation in the nineteen-forties, and a genuine attempt has been made, along rather different lines

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from those suggested by the Rowell-Sirois Commission, to allow the Provinces more financial autonomy.(47) "Wherever the Constitution obstructed the Dominion from assuming direct responsibility in the discharge of ..... functions, the Dominion sought to evolve a rational system of taxation and grants by mutual agreements".(48)

Table : 4.1.

Fiscal Transfer Payments (Selected years) in Canada.

	Forecast Expenditure 1973-74: ($ millions)	Proposed for 1974-75 ($ millions)
Statutory Subsidies :		
Subsidies Under The British North America Act.	33.8	33.8
Fiscal Arrangements :		
Revenue Equalization and Estate Tax Sharing	1,523.5	1,623.3
Others :		
Utilities Income Tax Transfers	27.0	33.6
Payments to Quebec - Established Programmes.	185.7	184.4
TOTAL	1,770.0	1,839.1

Source : "How Your Tax Dollar is Spent, 1974-75", Information Canada, Ottawa, 1974, P.24, cited in J.P.Sharma, "Federal Financial Relations in Canada", in "Federal Financial Relations in India", Reprinted from the Journal of Constitutional and Parliamentary Studies, Vol.VIII, No.4, Oct.-Dec.,1974, New Delhi, P.185.

B. Australia.

Federation and Finance in Australia

The federation of Australia which came into being with effect from January 1, 1901, under the Commonwealth of Australia(Constitution) Act, 1900, is half in size and population than Canada and consists of six unit governments : New South Wales, Victoria, Queensland, South Australia, Western Australia and Tasmania.(49) Historically speaking, the "German expansionist activities in the Pacific Ocean during the days of European Colonial rivalry, in the context of historical enmity between Germany and Great Britain, compelled the British colonies in Australian continent to unite together to face their common threat or to protect from their common enemy. Secondly, they came to realize the fact that separated as they were by vast tracts of land of the continent, they could not develop their trade and commerce to the hilt. Consequently, they saw the advantages of economic unification of their geographically adjacent areas and also foresaw the economies of scale resulting from the formation of wide market for trade and industry ..... Another distinguishing feature to be noted in the origin of the Australian federation is that formerly independent colonies came together voluntarily and agreed to create a

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common national government and hence, formed a federation of Australia by aggregation".(50)

Australia provides a peculiar example of financial inequality between the units. Ever since its inception there have been at least two of its states which are consistently poor, and another two which are comparatively rich. Tasmania and Western Australia belong to the first category and New South Wales and Victoria to the latter. The remaining two States - Queensland and South Australia come in between; however, the former is fairly close to the richer class while the latter has consistently been closer to the poorer group.(51)

Again, "from the beginning", the federal government in Australia, "has been well placed financially" and "the financial position of the states, on the other hand, has steadily deteriorated".(52) "All the six units which federated themselves had more or less independent existence, of course, directly under the British Crown. At the time of federation, therefore, local interests were strong enough to retain as much power as possible in their hands. The states were responsible for the creation of the infra-structure such as railways, roads, harbour, power and gas which in view of its space and low density of population involved quite a sizable investment and maintenance expenditure. Of course,

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social services were in their domain. But the need for uniformity in tariffs deprived the states of one of their most lucrative sources of revenue".(53) As a result, the Commonwealth Government which had only a few heavy responsibilities to discharge possessed elastic sources of revenue eversince the birth of the Commonwealth.(54) It may be mentioned that "the Australian Constitution enumerates the legislative powers and financial resources of the Commonwealth Government and all other residuary powers and resources are left to the State Governments. Consequently the State Governments in Australia are supposed to be as powerful constitutionally as the Commonwealth government perhaps more powerful in terms of their residuary powers. However the wide use of Section 96 of the Constitution by the Commonwealth Government to provide financial assistance to the States in the context of the loss of their income tax power and the upholding of Section 109 of the Constitution by the judiciary, which makes Commonwealth law supreme in case of a conflict with a State law, have made Australian States in effect as much subordinate to the Commonwealth government as their Indian counterparts to the Union Government, instead of coordinate entities in a federation".(55)

The insertion of Section 96 into the Constitution, in a sense, proves that the Framers had

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realised the importance of grants-in-aid in a federal system[56] as a method to mitigate the financial disharmony existing in the country.[57]

Evolution of grants system.

Section 96 of the Australian Constitution reads : "During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides, the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit".[58] "Regardless of this provision, it was initially agreed that the Commonwealth Government should distribute three-fourths of the Customs revenue to the states for ten years from the inception of the federation. Any budgetary surplus that might show up in the Commonwealth Treasury was to be dished out to the states surplus grants, though this arrangement was given up after 1906-07. In addition, special grants to finance highway development or to cover deficits in railway finance were also extended from time to time. At the end of one decade, the sharing of customs was displaced by a fixed payment at the rate of 25 shillings per head. The modified system continued for nearly Seventeen years when (in 1927) a New Financial Agreement was concluded between the states and the Commonwealth Government".[59]

Before this Agreement had come into

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existence, there was considerable expansion of social services and facilities for transport and communication which involved a large outlay on the part of the States. Consequently, the states began to agitate for more financial assistance as there was no corresponding increase in their revenues and the Commonwealth Government fought shy of shouldering larger commitments. Special grants were extended, in response to these agitations, to the claimant states during 1923-33. States began to resort to borrowing also which occasionally amounted to recklessness.(60)

Under the Financial Agreement of 1927, the Commonwealth Government agreed to take over the responsibility for the servicing and partial retirement of the loans hitherto incurred by the states. In return, the states agreed that subsequent borrowings should be coordinated by the Australian Loan Council the main concern of which was to avoid uneconomic competition between different layers of Government for limited loanable funds available in the market.(61) "In 1928, Federal power was increased by a Constitutional amendment by referendum and before the Amendment had become law and given constitutional effect by it, the Financial Agreement was arrived at between Federal and State Governments under which the former became responsible for the payment of interest on State debts, but the States themselves contracted to make annual payments to cover the

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share of the interest burden allotted to them in the Agreement.(62) The Loan Council was provided by that Financial Agreement, which would consist of the Federal Prime Minister and the State Premiers, or their deputies.(63) But it widely felt that some better method of distributing financial resources between the Federal and the State Governments must be found. "The inadequacy of the resources at the disposal of the states" in relation to the federal government i.e., vertical imbalance, and "the inequality that was growing between them", i.e., horizontal imbalance, "were seriously exposed by the outset of the Great Depression which gave birth to the Commonwealth Grant Commission"(64) in 1933.

It is noteworthy that the financial encroachment of the Commonwealth Government even upon concurrent fields of taxation coupled with judicial interpretation and decision-making have nearly reversed the order of importance that the constitution appears to establish in the financial sphere. This has created vertical federal fiscal imbalance in the Australian federation. The inadequacies in regard to the resources in the context of expanding developmental functions and unfavourable judicial interpretations of the financial positions of the constitution have been further aggravated by the

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centralisation of borrowing powers under Section 105(A) of the Constitution. Recognizing the original inherent imbalance between the functional responsibilities of the States and their financial resources, the Commonwealth Government was empowered under Section 96 of the Constitution to make grants of such amount and on such principles as prescribed by the Commonwealth Parliament. This financial provision of the Australian Constitution has given rise to the Commonwealth Grants Commission which recommends unconditional special grants to only needy States annually, and to conditional specific purpose grants made at the discretion of the Commonwealth government for specific developmental programmes of the States, as the Commonwealth cannot directly spend on these functions under the constitution which restricts its expenditure under Section 81 to only functions allotted to the Commonwealth Government explicitly. Besides, general revenue grants have been provided by the Commonwealth Government to the States, mostly for compensating their loss of revenue on account of its assumption of the entire income-tax field, on the basis of the criteria generally agreed to in the annual Commonwealth and State Premiers' Conference.(65)

The Commonwealth Grants Commission was established in 1933 by the Commonwealth Grants Commission Act of that year.(66) That Act, which was of essential

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simplicity, covered less than four pages, taking effect under Section 96 of the Constitution and was described as "an Act relating to a Commission to deal with the matter of grants by the Commonwealth of financial assistance to the States". It provided for a "Commonwealth Grants Commission of three members, made provision for the term of their appointments, the conduct of business.... and defined its functions as to : Inquire into and report to the Governor General upon - (a) applications made by any State to the Commonwealth for the grant by the Parliament of financial assistance in pursuance of section ninety-six of the Constitution; (b) any matters relating to grants of financial assistance made in pursuance of that section by the Parliament to any state which are referred to the Commission by the Governor General; and (c) any matters relating to the making of any grant of financial assistance by the Parliament to any state in pursuance of that section, which are referred to the Commission by the Governor General. The Act authorised the Minister to lay any report of the Commission before each House of Parliament and made it mandatory for him to do so before any proposed law relating to the subject of the report originates in the Parliament".(67)

Commonwealth Grants Commission.

Thus, since 1933 Commonwealth Grants Commission has been performing the arduous tasks of assisting the

need y states which apply for special grants to maintain a minimum standard of social service not appreciably below that of other states in the federation. Fiscal need, it should be made clear, is the basis on which these grants are being disbursed. But in computing the fiscal need it reduces the budgets of all the state governments to a comparable basis. Then it takes the per capita expenditure incurred on the services by the non-claimant states on the services in question as the standard. This standard is deflated by 10 percent with an additional penalty for extravagance or mistakes in loan policy. On the revenue side, the claimant state is required to make an extra effort ranging from 7 to 10 percent over the standard severity. The Commonwealth Grants Commission aims at maximum objectivity by following an elaborate complex and technical procedure in the determination of the gap. Nevertheless, the commission recognises that the determination of the standards involves broad judgement based on political and economic realities. Perhaps the Commonwealth Grant Commission is striving after accuracy where approximation is more appropriate.(68)

Before the Grants Commission was appointed, there were two methods of providing grants to the states. The first was the system of giving grants to the three claimant states of Tasmania, Western Australia and South

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Australia. Generally these grants were made after elaborate public enquiry. The second kind of grants consisted of specific allocations made to the units for purposes such as construction of roads or relief and rehabilitation. After the Commission came into being, it formulated ..... principles for the making of grants. First ..... the commission recognised the right of the claimant states to maintain the same standards of service as the non-claimant states. The Commission stated that the proper basis for determining special grants to the states should be their financial position as reflected in their budgets".(69)

Grants System In Australia Today.

Commonwealth grants to States in Australia are generally of three patterns; "grants recommended by the Commonwealth Grants Commission, grants coming under the Uniform Tax Plan and finally grants made to tide over special difficulties".(70) The first type of grants, recommended by the Commission, on detailed examination of the claims put forward by the states are generally sanctioned by the Parliament each year.(71) The second type is the allocation of funds to states to compensate for the loss of revenue from income and entertainment taxes which are taken over by the Commonwealth under the Uniform Tax Plan.(72) The third type of assistance is made to enable the States to meet special difficulties such as depression, fire, drought etc..(73) Grants take both conditional and unconditional

forms in Australia.(74)

Sometimes a state which makes a vigorous tax efforts is likely to be penalised as against a relatively prosperous state with a sluggish tax effort. Perhaps this was one of the reasons which prompted the Commonwealth Treasury to demand that the Commonwealth Grants Commission should insist on economy in expenditure or higher tax effort or a lower standard.(75)

During the Second World War, the Commonwealth Government exercised a monopoly over the income tax and tax reimbursement grants were paid to the states on the basis of the average yield in the three years preceding 1942. The grants were subsequently increased and a new formula was evolved under the Income Tax Reimbursement Act of 1946 on the basis of population and wage payments of the respective states. In order to protect this statutory formula, the Commonwealth Grants Commission had to introduce supplementary grants outside the formula which has become a political bargaining ground.(76) In recent years "a two part system has been introduced in order to bring about suitable adjustments for variations that occur between the prospective financial need as was anticipated by the Commonwealth Grants Commission and the actual position that emerges from the accounts".(77)

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In recent years, the grants have become the most vital source of the finances of the states in Australia. Whereas in 1939 the proceeds from the state taxes were 3.3 times as large as the grants, in 1955 grants constituted 2.1 times the state taxes. In a way this was inevitable on account of the emergence of a welfare state in the post-war period. It must at the same time, be noted that the special grant system seems to be an unending phenomenon in Australia.(78)

It is remarkable that as much as 70 percent of the total federal financial aids in Australia is unconditional grants, specific grants (viz., in aid of hospitals, Universities etc.) are relatively few. However, recently, provision has also been made for matching grants.(79)

Special Grants.

It is wellknown that "Unconditional grants are those federal fiscal transfers which are intended to reduce vertical and/or, horizontal federal fiscal imbalances without requiring the recipient unit governments either to use the grants for any specific purpose or to make any matching contributions".(80) In Australia, the present special grants are provided in the form of unconditional grants(81) as it is clear from the above discussion. The Third Report of the Commonwealth Grants Commission precisely defined its principle of assessing the fiscal need of a claimant state for special grant: "Special

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grants are justified when a state through financial stress from any cause is unable efficiently to discharge its function as a member of the federation and should be determined by the amount of help found necessary to make it possible for that state by reasonable effort to function at a standard not appreciable below that of other states".(82) The principle of equalisation of minimum fiscal needs implied in the above statement had been the guiding principle of the CGC till 1974, but it was a long standing demand of the claimant states that the special grants be disbursed on the basis of the principle of compensation under which the Commonwealth Government was asked to compensate their loss of revenue owing to the formation of federation which resulted in transfer of customs duties to the Commonwealth Government.(83) But the principle of compensation has not been accepted by the Commission since a State should not be entitled to a special grant if its budget reflected a prosperous position; it was difficult or even impossible to assess net disabilities including any advantages arising from Commonwealth policy, and to translate the result into terms of loss to a State budget; and net disabilities as reflected in the state budgets, would be taken into consideration under the principle of financial need.(84) As has been pointed out earlier, the principle of equalization of minimum fiscal needs has been translated by CGC into special grants by estimating the minimum fiscal needs of the claimant states. "Once the standard level of fiscal

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performance to which the claimant states' fiscal performance should be raised is determined by the Commission, it estimates the 'fiscal need' of each claimant state as compared to the average fiscal performance of standard states".(85) Standard states are those richer states in Australia (viz., New South Wales and Victoria) whose level of fiscal performance has been accepted by the Commission as a standard to which the fiscal performance of the claimant states should be brought at par.(86) In estimating the 'fiscal need' of each claimant state, till 1974, the Commission followed a method which involved "estimating the budget result known as budget-result component, expenditure- result known as the expenditure-result component and revenue-result known as the revenue-result component of the fiscal need. Thus, the basic ..... special grant was equivalent to the sum of the amount required to reduce the claimant states' budget deficit to the non-claimant standard state's standard deficit, the amount required to raise the level of supply of certain specified public services and merit goods in the claimant state to that of the non-claimant standard states, and the amount required to reduce tax and non-tax revenue burden in the claimant state to that of the non-claimant standard states".(87)

But in 1974, in its 41st Report, the Commission decided to switch over to a direct method of assessing the fiscal needs of the claimant state since

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hitherto existing indirect method of it seemed inadequate in the face of a number of factors most important of which, perhaps, was that the earlier method of estimating special grants emphasizing mostly on equalization of minimum fiscal needs of the claimant states was unsuitable for assessing the relative fiscal needs of several hundred local governments in the context of the Commission's well considered decision to use one common method of assessing the relative fiscal needs of the claimant states and local governments.(88)

Under the present system of special grants, the Commission simply estimates the relative fiscal need of a claimant state as the sum of the revenue component and expenditure-component. Thus special grant to a claimant state is equivalent to the sum of "(a) its revenue needs defined as the difference between (i) the revenue it would have raised if it had applied the average revenue effort of the standard states (the standard revenue effort) to its own revenue base, and (ii) the revenue it would have raised, on the basis of the standard revenue effort, if its per capita revenue base (or its revenue-rising capacity) had been the same as the average revenue base of the standard states; and (b) its expenditure needs, defined as the additional costs to the claimant state of providing its population with state services of the same average range and quality as those provided for their populations by the standard states".(89)

The Commission modifies or improves one or the other aspect of its calculations virtually every year. Such continuous modifications and improvements have made the Commission's methodology of estimating the relative net fiscal needs of the claimant states reasonably flexible.(90) Again, it is very often criticised that the Commission occasionally resorts to arbitrary calculations.(91)

It is charged that the budget standard determination has no consistency; the Commission's adjustments in the budgets of standard and claimant states fail to consider the changing pattern of government's functions at the state level, for instance, in the first two reports the Commission did not consider "unemployment relief" as an item of expenditure for want of data - later on it has been taken into account - but such exclusions do affect the net fiscal needs of the claimant states; in the case of expenditure component of the fiscal need, the Commission excludes a number of items of revenue expenditure, which may be considered to supply either pure public goods or merit goods, for instance, expenditure on general administration and social security are not taken into account; an imperfection may affect the Commission's estimation of the own revenue effort of the claimant states by the fact that no allowance is made separately for inter-state variations in price level and inter-state variations in tax-rates; all calculations of the

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Commission relating to the relative net fiscal needs of the claimant states are very much affected by the revenue and expenditure policies of the non-claimant standard states over which the commission has no jurisdiction for any purpose, thus if it may so happen that the standard states tend to impose relatively heavy taxes in those areas where they have relatively large revenue bases, it might be argued that the Commission is not setting a high enough standard of revenue effort for the claimant states by using a standard tax structure derived from the standard states; the Commission in its sincere attempt to make its estimation of relative net fiscal needs of the claimant states, forgets the actual imperfections creeping into a two-part grant system that it follows of which the first part, that is, the final completion grant is not made on similar detailed estimation on the relative net fiscal needs of the claimant states and this means that the second part may not be based on a fair assessment of the relative net fiscal needs of the claimant states; finally, whatever financial discipline the Commonwealth Grants Commission has been trying to impose on the claimant states might lose its effectiveness so long as they can obtain financial assistance from the Commonwealth government in the form of unconditional grants (which the Commonwealth government is making since 1942 and recently the basis of distribution of which is changing to federal fiscal equalisation from the previous compensation principle)which constitute a considerably large portion of the revenues of the States in Australia.(92)

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These irregularities in the methodology of the CGC perhaps provoked B.K.Nehru and B.P.Adarkar to maintain that "the general impression that we have received from a study of the commission's changing techniques is that there is too much arbitrariness involved in 'corrections' and 'adjustments' of various kinds" and, in studying the Commission's report, one is reminded of what the late Lord Keynes, in another context, once said of Prof. Tinbergen's statistical methods, "It becomes like those puzzles for children where you write down your age, multiply, add this and that, substract something else, and eventually end up with the number of Beast of Revealation".(93) Someone may not agree with such a comment, and there is widespread belief that "its (the Commission's) recommendations and decisions have been ..... objective and impartial",(94) still it can not be denied that there is much scope for the improved calculations by the Commission of the fiscal needs of the claimant states and an improvement is also essential with regard to necessary data required for the purpose of such calculations.

Specific Grants.

Conditional grants in Australia are known as 'specific grants' or 'specific purpose grants' since these are directed to assist the State Governments in certain nationally important specific fields of public responsibility. These grants are provided both in the forms of block grants and loans and are rendered for both revenue and capital expenditure purposes.(95)

Both special and specific grants are

provided by the federal to the State Governments under Section 96 of the Constitution, although, certain earmarked specific purpose grants are provided under Section 105-A of the Australian Constitution. While specific grants under Section 96 involve some sort of discretion on the part of the Commonwealth Government, those under section 105-A are constitutionally binding for it and the Commonwealth Parliament. Specific periodic legislative enactments, specifying the purpose, matching requirements and other conditions are required for the discretional specific purpose grants sanctioned by the Commonwealth Parliament.(96)

In Australia, specific purpose grants have grown both in number and in amount in recent times. "The total amount of specific purpose grants increased from $40.84 million in 1950-51, to $99.54 million in 1955-56, to $ 169.72 million in 1960-61 to $ 330.59 million in 1965-66, to $584.40 million in 1970-71, and further to an estimated amount of $1,645.90 million in 1973-74 and $2,184 million in 1974-75".(97) The relative position of this type of grant in the total federal fiscal transfers measured in terms of its "proportion to the total Commonwealth payments to the State Governments, though declined from 32.78 per cent in 1950-51 to 22.09 per cent in 1955-56, has increased since then to 23.34 per cent in 1960-61 to 29.25 per cent in 1965-66, to 38.30 per cent in 1970-71 and to 47 per cent in 1973-74".(98)

It may be made clear that the specific purpose grants which are made under Section 96 of the Commonwealth

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Constitution are made both at the discretion of the Commonwealth Parliament through specific legislative enactments and at the discretion of the Commonwealth Government. The former is a legislative decision and the latter is an executive decision. The programmes under the former case are generally scrutinized as they involve huge amounts of expenditure and require continuous payments of grants. Constitutionally speaking, the Commonwealth government has no constitutional power to undertake these programmes, the Commonwealth Parliament empowers it to assist the State Governments financially so as to achieve the purpose. In the case of the latter, it is the Commonwealth government which determines the amount and the mode of payment such as whether it should be a loan or a grant and the nature of other conditions to be attached. These grants are usually for relief measures and as such they do not involve huge amounts and continuous payments. Certain general considerations which are undertaken in making specific grants under Section 96 of the Constitution in the Australian federal system are that no such grant is normally made without a request for it from one or more State Governments; the need for specific purpose grant is considered by the Commonwealth Government normally when a State Government is unable to find the required funds from its own sources for the specific purpose concerned; such grants are made only if the Commonwealth government has got funds to meet the State Governments' request for financial assistance; these grants are made only for those purposes which

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benefit the nation directly or indirectly as well as for phenomena where national responsibility is involved. These general considerations behind the specific purpose grants are normally followed by specific conditions, matching requirements and principles of allocation which are different, naturally, for different specific purpose grants made through legislative enactments of the Commonwealth Parliament.(99)

Specific purpose grants have covered a large number of State's functions in Australia. These have grown enormously for programmes like road and education development. This has raised the doubt that whether some of the functions, such as University education, which are performed by the State Governments with the funds provided by the Commonwealth Government should continue to be state subjects or should be transferred to the realm of the Commonwealth Government.(100)

There is a common notion of public finance that state funds which might have been used for other purposes are diverted into federally aided activity as a result of federal grants operations. That means grants-in-aid with their varying amounts, purposes and matching provisions may cause important governmental functions to be neglected relative to the subsidized activities. This idea "is not only prevalent in Australia but also becoming strong on account of the increasing predominance of specific purpose grants",(101) and hence "the Commonwealth Government will have to assume responsibility for proper allocation of its specific purpose grants within each state so as to achieve uniform standards of

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public services and to reduce wastage of national resources".(102)

The other vital instrument of federal fiscal transfers in Australia, which does not come within the purview of this discussion, is the Australian Loan Council. It functions, according to the Financial Agreement of 1927 are: to decide the annual amount of public borrowing during the ensuing financial year and the terms and conditions of such borrowing, and, to allocate the funds, to be borrowed among the State Governments and the Commonwealth Government.(103) Capital expenditures of the states in Australia are generally met from budgetary surpluses or out of borrowings which is regulated by the Load Council.(104) But the fact that remains is that here the "balance of the constitution has been permanently tilted towards the Federal side...."(105) since "all the states depend for their solvency on federal grants. During the first ten years of federation, these grants were regulated by the federal Constitution itself. Since then, they have been in the discretion of the federal Parliament, which can impose conditions and practice has grown of making grants on conditions which control state administration. In 1923, the federal government surrendered some of its potential control by conditional grants; it converted the major part of its subsidy to the states into a regular unconditional contribution to state loan indebtedness. But enough in the way of grants for special purposes remained to be of critical importance to the state of budgets".(106)

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Judicial interpretation of Section 96 of the Australian Constitution has also some responsibility in creating vertical federal imbalance in this political system. By interpreting Section 96, the High Court of Australia has validly empowered the Commonwealth of Australia to exclude the States from the domain of income taxation. The Commonwealth Parliament has passed a legislation providing for a uniform income tax throughout the country and also for grants to be made to any of the States that refrained from imposing tax on income. When the measure was challenged, the High Court of Australia gave approval to some propositions: that the Commonwealth, by offering a money grant may properly induce a State to exercise its power in a particular way; that it may, by offering a money grant, induce a state to abstain from exercising any of its powers (including taxation powers); that it can 'induce' in doing the above but cannot 'compel'.(107)

However, in Australia, the Chief body "to recommend how big the grants should be each year and on what principles they should be decided"(108) (of course, relating to special grants-in-aid) continues to be the Commonwealth Grants Commission. For years this body has made recommendations which every Federal Government, irrespective of party, has accepted. Although the states concerned have sometimes grambled, there is widespread

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recognition that the Grants Commission's (as it is presently known) work has been disinterested and efficient. It is tempting to feel that the major problems of dividing Uniform Tax and loan resources fairly between Federal and State Governments should be placed in the hands of such a body as the Commission. It could examine the various projects which the governments were submitting, and estimate their value; it could look at the level of education, hospitals and other amenities in the various States and decide whether these needed more money spent on them.(109)

"But the difficulty is that this new function would be performed on a different basis from that on which the Commission now operates. As it stands, it is essentially a federal instrumentality, appointed by the Federal Government and recommending the distribution of Federal funds. If it or a body like it were called upon to decide the distribution of the total proceeds of Uniform Taxation or the loan fund, it could do so in the same manner only if the Federal Government were regarded as the owner of the money to be distributed, as it is at present the owner of the money which is paid, on the Commission's recommendations, as special grants to Tasmania and Western Australia (South Australia no longer claims). The States could not agree to this. They would say that the Financial Agreement clearly envisaged Federal and State Governments as partners, not as master and subordinates, in the raising

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and distribution of loan moneys and that the Federal Government had gained possession of their tax revenues only by a fortunate trick. No permanent solution, in their view, could come from recognizing the Federal Government as master and then shifting to a Commission the burdens of deciding how funds should be allotted. They might agree to a Commission appointed jointly by themselves and the Federal authority, but the question would soon arise whether this new Commission was of any value if its decisions were not accepted by both Federal and State authorities. The prestige of the present Grants Commission has developed largely from the fact that its recommendations have always been accepted. A similar body would lose a great deal of its prestige if its recommendations were to be upset".(110)

Tax Reimbursement and Supplementary grants.

Any discussion of the system of grants-in-aid in Australia will remain incomplete unless references are made to Tax Reimbursement and Supplementary grants. "The tax rental arrangement which is operating at the moment in Australia has ..... avoided vertical as well as horizontal federal tax overlappings".(111) This arrangement has provided the Commonwealth with an elastic source of revenue "to raise funds nationally and distribute them among the States in the form of various grants to promote national objectives".(112) But this has not been able to redress the fiscal imbalances of the Australian

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federal system and corresponding vertical and horizontal imbalances of power in that federal structure.(113)

What is wrong with the present scheme is "the method through which the financial assistance grants are made to the states, and the consequent financial indiscipline of those states whose financial affairs are not periodically or regularly scrutinized either by the Commonwealth Government or by any independent expert body" and "the tax rental arrangement has brought too much of political bargaining process into the federal fiscal operations of Australia".(114)

"The States Grants Act, 1959, repealed the State Grants (Tax Reimbursement) Acts of 1946, 1947 and 1948 and provided for payment of financial assistance to the states of an amount, specified for 1959-60, to be increased annually on the basis of movements in population in each state and the increases (if any) in the level of average wages per person employed".(115) But in practice these financial assistance grants have come to be provided to enable each state to provide Government services of a standard broadly comparable with those of each other state without imposing higher taxation or other charges - a basis which is followed by the Commonwealth Grants Commission in recommending special grants since 1933.(116) Thus if these financial assistance grants are in effect a part of unconditional grants (the other part being one which is disbursed on the recommendations of CGC), what can be the justification for distributing it

through a process of political bargaining is generally not known. In his proposal for the determination and distribution of future financial assistance grants in Australia, Prime Minister Mr. John Gorton said in 1970 : "while we believe that the present distribution of the grants is a fair one, we do not believe that it is necessarily correct in precise terms .... I strongly feel that it would be desirable to have independent investigation and advice on this question for the purposes of the next review of the arrangements. I believe that if the Premiers were disposed to accept this the best approach might be for the Commonwealth Grants Commission to be given this task ..... But in any case the Commission could be given the task of recommending on the distribution of the grants between all the states, not necessarily annually but mainly for the purposes of the regular reviews .... But the success of any scheme along these lines would obviously depend on full co-operation being given by the States..."[117] However this type of proposal has not yet been materialised due to opposition by certain (populous, richer and status-seeking) states.[118]

Hence the position that continues to remain is that the financial assistance grants provide about (or nearly) one-half of the total budgetary revenues of the States ~~arx~~ and are determined yearly on the basis of a formula under which the grants paid to a state in the previous year are increased in proportion to the increase in its population and in level of average wages for Australia

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as a whole. In addition two 'betterment factors' - percentage increase in wages and percentage increase in population in the year (the distribution formula was made to provide for 20 percent increase in each case since 1965) is to be considered for the increase in grants. This formula virtually results, in the long run, in the grants growing faster than the economy as a whole.(119)

Table : 4.2a

Federal Payments to and for the States (in Australia: Selected years).

($'000)

	1965-66	1966-67	1967-68	1968-69
General Revenue Grants*..	799,121	877,435	956,946	1,049,585
Specific Purpose Grants .... (Capital and Revenue)	330,593	352,272	408,462	423,899
Total ...	1,129,715	1,229,708	1,365,408	1,473,483

* includes Special Grants paid to the Claimant States on the recommendations of the CGC.

Source : Australia Handbook, 1970, Australian News and Information Bureau, Canberra, P.93.

Table: 4.3.

Financial Assistance Grants in Australia.

($ A'000)

Year	New South Wales.	Victoria	Queensland	South Australia	Western Australia	Tasmania	Total
1959-60	166,900	121,250	72,750	55,350	59,924	21,826	439,000
1960-61	183,977	134,743	79,901	61,454	55,954	23,960	539,989
1961-62	198,493	146,029	87,460	66,451	60,171	25,671	584,280
1962-63	206,642	152,267	91,083	69,552	62,480	26,616	608,640
1963-64	215,712	159,482	94,821	72,729	65,597	27,626	635,967
1964-65	230,537	171,750	101,111	78,155	70,488	29,297	681,349
1965-66	255,001	191,922	113,356(a)	86,467	78,474	32,131	757,351
1966-67	276,794	208,790	125,514(a)	84,346	86,396	34,773	826,613(b)
1967-68	302,827	223,254	139,601(a)	102,738	96,152	37,968	907,539
1968-69	333,393	250,563	155,963(a)	112,768	123,796(c)	41,710	1,018,193
1969-70	373,908	280,005	176,522(a)	125,706	138,835(c)	46,340	1,141,316

C. An Assessment.

A.H.Birch has drawn attention towards some important developments which have bearings upon federal balance of power in the three federations (viz., the U.S.A., Canada & Australia) in the post-Second World War period. "Some of these developments are new, such as, Tax Rental Agreements in Canada, the Uniform Tax Plan in Australia and the institution of variable grants in the United States. Others are merely extension of earlier institution and tendencies. They have come about partly as a consequence of the war itself, partly because the high costs of defence in a period of continuing international tension have put a heavy financial burden on the national governments and partly because of the increased demand for social and economic security".(120) Birch has underlined some specific notable phenomena to substantiate his opinion. "In the first place, the taxation of incomes is now virtually monopolized by the federal government in all three countries ..... Secondly, the State Governments are considerably more dependent upon federal payments than they were before the War ..... Third, in all three countries the federal payments now give a disproportionate amount of aid to the poorer states ..... In Australia the poorer States gain partly from the special grants that are determined on a basis of fiscal need, as estimated by the Commonwealth Grants Commission, and partly from the fact that they have secured more than their share, in terms of population

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of the arbitrary increases that have been made in the Tax Reimbursement. In Canada the poorer provinces gain partly from the fact that their statutory subsidies have been increased, over the years, to a greater extent than those of the wealthier provinces, and partly .... from the fact that the grants they receive under the Tax Rental Agreements exceed the revenues they could derive from income tax .... In the United State, since the war, Congress has accepted the view that some of the specific grants for particular services should be weighted to favour the poorer states, and it is likely that this principle will be extended in future legislation .... Finally, the provision of social welfare, which is the most extensive field of action left to the State and Provincial governments by the constitutional division of power, is now largely controlled by federal legislation and financed from federal sources". (121) Thus the post-war federations have been broader in connotation than the classical definition of a federation provided by K.C.Wheare since a federal government today is not limited to its own sphere when it passes a good deal of legislation relating to matters within the sphere of the state governments; again, state governments are not in practice independent of the federal government now, when they derive a considerable proportion of their revenue from federal payments; Moreover, the fact that the federal governments give a disproportionate amount as aid to the poorer states implies at least a partial acceptance of responsibility by the federal authorities for

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the maintenance of national minimum standards in some state services.(122) To Birch these developments go on to prove Harold Laski's famous view untrue that federalism has become obsolescent as a system of government, on the contrary, these devices have made it more adaptable to the changing needs of time and prolonged its life.(123) None can perhaps deny it now that for the sake of a reasonable balance among different power centres of a federal political system what is needed most essentially at this moment is a cooperative approach towards functioning of different levels of government. Birch reminds us of this important aspect also when he maintains that "if the new developments in the older federations are considered together with the new characteristics of the post-war federations, it seems clear that federalism has entered a new phase. Perhaps this may conveniently be called the phase of cooperative federalism. For whereas the guiding principle of eighteenth and nineteenth century federalism was the independence of state and federal authorities, the guiding principle of twentieth century federalism is the need for cooperation between them...."(124) He felt it necessary to redefine federalism in the perspective of these new developments of this century which would "include the practice of administrative cooperation between general and regional governments the partial dependence of the regional governments upon payments from the general governments and the fact that the general governments, by the use of conditional grants, frequently promote developments in matters which are constitutionally assigned to the regions...."(125)

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In fact, any penetrating study of the principles of federalism reveals its flexible and cooperative character in such a way that neither level of Government "is wholly dependent on the other, nor wholly independent of the other".(126) Thus, modern federal system "falls somewhere between a unitary government and a loose association of sovereign states".(127) It has developed a difference of kind with a confederal model; it has brought about a difference of degree with a unitarian system.(128) The national and regional Governments may be coordinate, according to the traditional concept of federalism, constituting independent political systems at the general and constituent levels; under modern interpretation, both of them constitute a single system containing within it several overlapping subsystems.(129) A study of latest trends in federalism further suggests that if the centre dominates the units, the units themselves dominate one another in particular situations, through the mechanism of cooperative federalism by virtue of their bargaining skill and capacity in addition to their geographical size, population, natural resources, strategic situation etc.. It ~~xk~~ is also inferrable that the system of grants-in-aid also plays a vital role in the process. And thus the currents and cross-currents of vertical and horizontal balance of intergovernmental powers always interact with one another to make the system a lively one. Prof.Ronald J.Hay, a celebrity in the field of federalism, has, however,

Current notion of federalism.

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seen the process from the view point of decision-making. To him, the inequalities of the units are "reflected in the Central Government's decision-making functions in two ways. First, because of superior number and perhaps, wealth, that part of the Central Government's electorate which resides in the large units is likely to exercise stronger influence over the Central Government's policy output than that which resides in the small unit; second, to the extent the relative size and wealth affect the bargaining capabilities of unit governments, the government of the large unit is likely to have more influence over the Central Government's policy output than the government of the small unit. The policy output of the Central Government is, therefore, more likely to correspond to the interests of the large unit than to those of the small unit". (130) It is true to say that all the power units in a federal system exercise their powers in a way that enables them to neutralise or turn to their advantage those conditions which they find uncongenial for their purposes; nevertheless, to what extent they are able to do so will always depend upon their legal (constitution) power, political influence and resources. (131) Needless it is to mention here that the present study on grants-in-aid is concerned with the last factor, the operation of which in a federation involves a considerable amount of pulls and counter-pulls among the parties concerned. The decision-making and decision-executing processes are influenced and determined not only by means of mutual participation of national and regional governments but also

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by means of the bargaining power and skill in the midst of 'supreme' position of the centre by virtue of an unmistakable tendency of centralisation of powers and 'superior' capacity of the units inter se by virtue of their respective position - demographic, strategic, political, economic etc.(132)

The Framers of the Constitution of India were perhaps well acquainted with abovementioned developments in the field of federalism and they seemed to have "benefited greatly by the experience of the development of federal-state financial relations in the three Federations" (viz., U.S.A., Canada and Australia).(133) "In India we have avoided the confusing problems of overlapping and multiple taxation. In the Second place, there is considerable flexibility in federal-state financial relations in so far as they can be modified in emergencies or can be adjusted to changing requirements of economic policies ..... The framers of the Constitution very wisely took the view that a permanent or immutable formula would not serve any useful purpose in view of the changing economic and social conditions. They thought that the basis of allocation should be flexible and adjustable and be reviewed periodically without causing friction between the Centre and the States. The adjustment of intergovernmental financial relations has been eased by the creation of a non-political, expert reviewing body like the Finance Commission. In the third place, the states have been given taxing powers which have possibilities of expansion if they can rise equal to the occasion. At the same time

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a sizable amount of revenue is received by them from the Centre as an obligatory payment under the Constitution."(134)

Finance and Balance of Power.

According to an author "we have an elaborate and diversified system of transfer of revenue from the Centre to the states including (1) Tax-sharing in respect of several centrally levied and collected taxes; (2) Unconditional grants ...; (3) purposive and conditional grants given to the states at the discretion of the federal government for the execution of nation building programmes. There is no doubt that we have accepted the principle of fiscal need and the progressive principle of modern, 'functional' federal finance, viz., that the object of public finance is to equalize, as far as possible, the wealth and, particularly, economic opportunity in different parts of the country".(135)

"In the U.S.A. as well as in other federations, the rapid growth of social services on the basis of conditional grants has been in the opinion of the experts, of a rather haphazard, uncoordinated, chaotic, and lopsided character, because ad hoc legislation providing for these grants has naturally ruled out proper planning of the development which comprehends not only social services, but also, what is more important, basic economic development. The scope of functional federal finance is thus broader in India than in the other three federations. But one must not

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lose sight of the fact that in this broader context, allocation of federal resources on the basis of conditional grants, assessed according to the objective principles of allocation, becomes an extremely intricate problem. In this respect the experience of the three federations in the limited field in which they have been operating federal grants-in-aid is likely to be instructive...."(136) This experience is essentially beneficial for our country in the light of the fact that "In recent years ..... grants-in-aid have come to be used increasingly, particularly, as a means of correcting inter-regional disparities in resources",(137) that is to say, horizontal federal imbalance; and in India, "Grants-in-aid also facilitate the exercise of certain measure of federal control and coordination over essential welfare services on a national scale",(138) which invariably leads to vertical imbalances of federal power.

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