REIMAGINING FISCAL FEDERALISM: SECTION 96 AS A TRANSITIONAL PROVISION

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I INTRODUCTION

Section 96 of the *Australian Constitution* plays a pivotal role in fiscal arrangements between the Commonwealth and the states. The provision is entitled 'Financial Assistance to States'. It reads as follows:

> 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.

Section 96, as traditionally interpreted, allows the Commonwealth to grant financial assistance to the states on whatever terms it desires. The states are under no obligation to accept aid offered under this provision, but financial and other incentives may induce them to do so. The Australian states now rely significantly on tied grants under s 96 to finance their ordinary expenditures.

The High Court has adopted a flexible interpretation of s 96 in a series of significant cases. It has ruled that there is no constitutional impediment to the Commonwealth attaching conditions to grants under s 96 requiring the states to enact particular legislation or adopt specified policies.[1] The High Court approved this practice on the basis that the states could decide voluntarily whether to accept the grant and its conditions, notwithstanding that the Commonwealth enjoys significant leverage in inducing the states to accept its terms.

The High Court has subsequently declined to place any substantive limits on s 96, allowing the power to be used by the Commonwealth to exercise control over such areas as state income taxes,[2] private education,[3] road construction[4] and the acquisition of property other than on just terms.[5] Taxation is a concurrent power of the Commonwealth and the states under s 51(ii), but education and roads fall outside the Commonwealth's enumerated powers and the power to acquire property otherwise on just terms is excluded by s 51(xxxi). The High Court's interpretation of s 96 has therefore effectively allowed the Commonwealth to usurp areas denied to it under the constitutional division of powers.

The issue of income tax provides a stark illustration of the impact of s 96 on federalism. Both the Commonwealth and the states levied income taxes prior to the Second World War. The Commonwealth seized sole control of this taxation stream in

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1 *South Australia v Commonwealth* (1942) 65 CLR 373 (*First Uniform Tax Case*); *Victoria v Commonwealth* (1957) 99 CLR 575 (*Second Uniform Tax Case*).

2 *First Uniform Tax Case* (1942) 65 CLR 373; *Second Uniform Tax Case* (1957) 99 CLR 575.

3 *Attorney-General (Vic) (Ex rel Black) v Commonwealth* (1981) 146 CLR 559 (*DOGS Case*).

4 *Victoria v Commonwealth* (1926) 38 CLR 399.

5 *Pye v Renshaw* (1951) 84 CLR 58.

1942. This was initially depicted as a wartime measure. The Commonwealth's takeover of income tax relied upon the taxation and defence powers in s 51(ii) and (vi). Political pressure was also applied. The Commonwealth laws enacted in 1942 implemented a four pronged strategy, involving dramatic increases in federal income tax levels; grants to the states roughly equivalent to their income tax revenue, conditional on the repeal of state taxes; compulsory acquisition of state tax office staff and facilities; and a rule requiring taxpayers to pay federal tax before state tax, increasing the likelihood of defaults. These measures made it practically and politically difficult for the states to continue to levy their own income taxes.

The measures mentioned above were challenged by the states in the *First* and *Second Uniform Tax Cases*.[6] The High Court twice upheld the substance of the plan. The increased taxes and the priority rule were said to be authorised by the taxation power, while the conditional grants to the states were authorised by s 96. The High Court declined to recognise that the use of s 96 in this context overstepped the bounds of the provision, notwithstanding that the package of measures adopted by the Commonwealth left the states with little choice but to accept the grants on the offered terms. The Commonwealth's takeover of income tax has had far reaching consequences for the Australian federation, contributing to the significant vertical fiscal imbalance that marks current federal arrangements.

The far reaching impact of s 96 on Australian federalism is somewhat at odds with the wording of the provision. The phrase 'until the Parliament otherwise provides' is a standard form of words used in the *Constitution* to mark out provisions designed to lapse after the transitional period immediately following federation.[7] Section 96 also mentions a specific period of ten years during which the provision is intended to operate. This is the same period mentioned in s 87, another provision dealing with financial assistance to the states following the Commonwealth takeover of excise and customs duties. We will see below that the drafting history of s 96 indicates that it was intended as a transitional measure.

The continuing operation of s 96, contrary to the framers' intentions, also raises broader puzzles of constitutional interpretation. There is an apparent tension between s 96 and the Commonwealth spending power under s 61 of the *Constitution*. This tension was remarked upon by several justices in *Williams v Commonwealth*.[8] A broad reading of the Commonwealth spending power makes s 96 seem redundant, while even the somewhat more restrictive reading adopted in *Williams* creates significant overlap between the provisions and raises questions about their respective roles. This tension would be avoided if s 96 were viewed as transitional. A reconceptualisation of s 96 along these lines may also help to focus the High Court's thinking about the purpose and scope of the spending power under s 61.

There is, of course, no real chance of either the Commonwealth Parliament or the High Court treating s 96 as a spent provision. It is too deeply entrenched in federal arrangements. Nonetheless, it is a useful exercise to consider what fiscal federalism might look like if s 96 were removed from the picture. We begin this article by discussing the drafting history of s 96. We then consider its interaction with the Commonwealth spending power, focusing on the discussion in *Williams*. The article concludes by asking what consequences would follow from treating s 96 as transitional. We argue that such a reconceptualisation could have salutary consequences for Australian federalism. More broadly, it might aid our understanding

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6 *First Uniform Tax Case* (1942) 65 CLR 373; *Second Uniform Tax Case* (1957) 99 CLR 575.

7 See, for example, *Australian Constitution* ss 3, 7, 10, 20, 29, 30, 31, 34, 39, 46, 47, 48, 65, 66, 67, 73, 87, 93, 97.

8 (2012) 248 CLR 156 (*Williams*).

of the role and limits of the fiscal powers of the Commonwealth to consider the extent to which they authorise grants to the states outside s 96.

II THE CONSTITUTIONAL CONTEXT

It is useful to begin our discussion by considering why s 96 was included in the *Constitution*. The provision appears in Chapter IV of the *Constitution*, dealing with finance and trade. The chapter begins with provisions dealing with the establishment of a Consolidated Revenue Fund (CRF) and requiring appropriations to be made by law.[9] It then moves to a series of provisions dealing with the transfer of officers, departments and revenue streams from the states to the Commonwealth. The main concern of the chapter is to transfer the collection of customs and excise duties to the Commonwealth, in order to establish free trade between the states. However, the reliance of the former colonies on these revenue streams necessitated transitional arrangements in order to protect them from financial difficulties.

The need for transitional measures to ease the financial position of the states following federation loomed large in the debates over the drafting of the provisions in Chapter IV. Considerations of fairness between the states, taking account of their different economic circumstances, were also prominent. An important component of the measures adopted to insulate the states from the loss of customs and excise revenue after federation was the so-called 'Braddon clause' found in s 87 of the *Constitution*. This section provides as follows:

> During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides, of the net revenue of the Commonwealth from duties of customs and of excise not more than one-fourth shall be applied annually by the Commonwealth towards its expenditure.
>
> The balance shall, in accordance with this Constitution, be paid to the several States, or applied towards the payment of interest on debts of the several States taken over by the Commonwealth.

The purpose of s 87, as revealed by the Convention debates, was twofold. The main purpose of the section was to guarantee the states a certain proportion of the lost revenue from customs and excise duties.[10] A secondary purpose was to impose economic discipline on the newly established Commonwealth government.[11] It is notable that s 87 commences with exactly the same words as s 96: '[d]uring a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides'. These words were inserted at the Premiers' Conference of 1899. They represented a compromise between New South Wales, which wanted the clause omitted entirely, and the other smaller states, which wanted a guaranteed revenue stream for the period after federation.[12]

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9 *Australian Constitution*, ss 81-83.

10 *Official Report of the National Australasian Convention Debates, Adelaide 1897* (Government Printer, 1897) 1053-67; *Official Report of the National Australasian Convention Debates, Melbourne 1898* (Government Printer, 1898) 890-3, 2378-9, 2422-31, 2456-7.

11 Convention Debates, Adelaide, ibid, 1053-56; Convention Debates, Melbourne, ibid, 890-3, 2423, 2427-8, 2456-7.

12 John Quick and Robert Randolph Garran, *The Annotated Constitution of the Australian Commonwealth* (Angus and Robertson, 1901) 825.

Chapter IV of the *Constitution* sets out a reasonably precise timeframe for the transition to uniform excise and customs duties collected by the Commonwealth. Uniform duties of customs are to be imposed within two years.[13] Transitional arrangements are made for the period before the imposition of uniform customs duties, according to which states shall be entitled to repayment of the surplus from duties collected in their territory, once Commonwealth expenditures have been deducted proportionally to the states' population.[14] After customs duties become uniform, the power to impose them becomes exclusive to the Commonwealth.[15] Trade between the states shall then be absolutely free.[16]

The *Constitution* then divides the period following the imposition of uniform customs duties into five year stages. During the first five years after imposition of uniform duties, each state shall remain entitled to repayment of surplus duties on goods consumed in its territory.[17] Special transitional arrangements are made for Western Australia during this initial period.[18] After five years has elapsed, the Commonwealth may then provide for repayment of surplus revenue to the states 'on such basis as it deems fair'.[19] However, during the ten year period following federation, the Commonwealth may not apply more than one quarter of its net revenue to its own expenditures. The rest must go to the states.[20]

Section 96 appears in the context of this transitional framework. The provision was inserted into the *Constitution* due to concerns that the preceding provisions did not leave enough discretion to the Commonwealth to make special provision for aid to the states outside of the formula included in those sections.[21] The preceding sections in Chapter IV allow for surplus revenues to be credited to the states based on their contribution, with Commonwealth expenditures debited based on population. Smaller states, such as Tasmania, feared being disadvantaged by this method. Section 96 was intended to leave some discretion to the Commonwealth to overcome the difficulties posed by the rigidity of the general formula.

Section 96, in its final form, was adopted at the Premiers' Conference of 1899.[22] Its opening words make clear that it is intended, like the 'Braddon clause' in s 87, to operate for a ten year period following federation. The position of the clause within the broader context of Chapter IV bolsters this impression.[23] There is, however, a peculiarity in the wording of the clause that makes it unlike other transitional provisions. Section 96 confers a broad power on the Commonwealth to make grants to the states 'until the Parliament otherwise provides'. This means that the Commonwealth enjoys the power until it gives it up. John Quick and Robert Garran note in their commentary that the Commonwealth is unlikely to voluntarily and permanently deprive itself of such a power. They conclude that, while the provision was likely only intended to operate for the same period as s 87, it 'may be considered, for all practical purposes, as a permanent part of the Constitution.'[24]

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13 *Australian Constitution*, s 88.
14 Ibid s 89.
15 Ibid s 90.
16 Ibid s 92.
17 Ibid s 93.
18 Ibid s 95.
19 Ibid s 94.
20 Ibid s 87.
21 Convention Debates, Melbourne, above n 10, 1100-22.
22 Quick and Garran, above n 12, 869.
23 The wisdom of placing a time limit on the clause was also discussed at the convention debates, although not clearly resolved. Strong views were presented on both sides of the issue. See Convention Debates, Melbourne, above n 10, 1104-12.
24 Quick and Garran, above n 12, 870.

Quick and Garran's conclusion, however, is open to question. A case can be made that the Commonwealth Parliament should have followed the spirit of s 96 and brought the power to a close ten years or so following Federation. It could, indeed, have phased out the power at any point thereafter. The responsibility to apply the *Constitution* does not rest solely with the High Court, but also belongs to the other branches of government. It is also arguable that the High Court, after a certain period, could have either declared the provision spent or given it a narrow interpretation consistent with its purpose. The High Court's actual approach to s 96, however, has been to give it wide operation. This seems inconsistent with both the framers' intentions and the place of the section within the *Constitution*.

It is true that the wording of s 96 confers discretion on the Parliament to determine when to cease the continuing operation of the section. However, the High Court has demonstrated its willingness to play an active role in bringing provisions it has interpreted as transitional to an end. It is interesting, in this respect, to contrast the High Court's approach to s 96 with its interpretation of s 41, dealing with the voting rights of state electors. Section 41, unlike s 96, does not contain the words 'until the Parliament otherwise provides'. Its drafting history is ambiguous, but there is nothing in its wording to suggest it was merely intended to have transitional effect. Nonetheless, the High Court held in *R v Pearson; Ex parte Sipka* that s 41 was spent and no longer of any effect.[25] We have argued elsewhere that the High Court's reasoning in *Pearson* was seriously flawed.[26] However, the general acceptance of the Court's decision in that case to read s 41 out of the *Constitution* at least casts doubt on the assertion that the Court's hands are tied in its interpretation of s 96.

III SECTION 96 AND THE SPENDING POWER

The interaction between s 96 and the Commonwealth's spending power pursuant to ss 61 and 51(xxxix) of the *Constitution* was examined by the High Court in *Williams*.[27] The case concerned a challenge to Commonwealth funding pursuant to the National School Chaplaincy Program (NSCP). The NSCP was an initiative of the Howard government in 2006, which sought to provide chaplaincy services in schools for a period of three years and was extended by the Rudd government in 2009.[28] The NSCP was not established or regulated by legislation.

On 9 November 2007, the Commonwealth entered into an agreement with Scripture Union Queensland (SUQ) (the Funding Agreement).[29] The initial duration of the Funding Agreement, as noted above, was three years. The parties later changed the commencement date of the Funding Agreement to 8 October 2007 and extended its term to 31 December 2011.[30] Under the Funding Agreement, and until about 11 October 2010, SUQ provided chaplaincy services to the Darling Heights State School, where the plaintiff's four children were enrolled. In return for its services, SUQ received four payments totalling $93,063.01.[31]

The plaintiff, Mr Ronald Williams, challenged the validity of the Funding Agreement and the associated expenditure of public funds. In the absence of any supporting legislation, the High Court was required to consider whether the entry into

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25 (1983) 152 CLR 254 (*Pearson*).

26 Jonathan Crowe and Peta Stephenson, 'An Express Constitutional Right to Vote? The Case for Reviving Section 41' (2014) 36 *Sydney Law Review* (forthcoming).

27 (2012) 248 CLR 156.

28 Ibid 182 [10] (French CJ).

29 Ibid 183 [13] (French CJ), 284 [299] (Heydon J), 336 [450] (Crennan J).

30 Ibid 217 [87] (Gummow and Bell JJ), 284 [299] (Heydon J), 339 [470] (Crennan J).

31 Ibid 183 [14] (French CJ), 221 [101] (Gummow and Bell JJ), 284 [299] (Heydon J).

the Funding Agreement and the payments made to SUQ pursuant to it were a valid exercise of Commonwealth executive power. The majority of the High Court, consisting of French CJ, Gummow, Hayne, Crennan, Kiefel and Bell JJ (with Heydon J dissenting), held that the executive power under s 61 and the incidental legislative power under s 51(xxxix) of the *Constitution* did not support the entry into and making of payments by the Commonwealth pursuant to the Funding Agreement.[32] The Commonwealth required statutory authority, beyond the Appropriation Acts, to enter into the Funding Agreement and expend public funds for that purpose.[33] Accordingly, the Funding Agreement and the payments made in its performance were held to be invalid.

The significance of this decision for Commonwealth spending is twofold.[34] First, the High Court has imposed a limit on the Commonwealth executive's power to contract and spend. In the wake of *Williams,* it would appear that these activities must now be authorised by the Parliament. The decision also raises the possibility of the Commonwealth increasing its reliance on grants to the states made pursuant to s 96 of the *Constitution,* as a means of funding policy initiatives in areas outside its legislative authority. The importance of s 96 was considered by Gummow and Bell JJ (together) as well as Hayne, Crennan and Kiefel JJ. In each of these judgments, their Honours expressed some concern that s 96 could be made redundant if Commonwealth executive power was afforded a wide interpretation.

Hayne J considered the consequences which would follow if he accepted the 'broad submission' of the Commonwealth, namely that the Commonwealth executive had power to spend money lawfully appropriated to it, regardless of the purposes for which the expenditure was applied.[35] One consequence of this argument, according to his Honour, would be a 'very great expansion in what hitherto has been understood to be the ambit of Commonwealth legislative power.'[36] The second, more 'telling' consequence was that this interpretation would not leave any room for the continuing operation of s 96.[37] Hayne J considered that if the executive was given almost unlimited power in relation to Commonwealth expenditure through a broad reading of the executive power in s 61 and the incidental legislative power in s 51(xxxix), then s 96 would be 'superfluous.'[38] Keifel J echoed this concern, referring to Heydon J's comment in *Pape v Federal Commissioner of Taxation*[39] that s 96 would become 'otiose' if the executive's power to spend was unbounded.[40]

Conditional grants made by the Commonwealth to the states under s 96 are theoretically 'consensual,' in that the states are under no legal obligation to accept them. However, in practice and as a result of Australia's vertical fiscal imbalance, the states have little choice but to accept these grants and the conditions attached. In *Williams,* several members of the Court expressed some concern that if the Commonwealth was conferred with a broad spending power, the 'consensual' aspect of grants to the states under s 96 would be removed. Hayne J observed that a law made

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32 Ibid 179 [4], 216-217 [83] (French CJ), 233 [138] (Gummow and Bell JJ), 271 [253], 281 [289] (Hayne J), 355 [534] (Crennan J), 373-374 [595] (Kiefel J).

33 Ibid 179 [4] (French CJ), 233 [138] (Gummow and Bell JJ), 353 [524], 355 [534] (Crennan J), 373-374 [595]-[597] (Kiefel J).

34 For a critical discussion of the significance of *Williams,* see Shipra Chordia, Andrew Lynch and George Williams, '*Williams v Commonwealth*: Commonwealth Executive Power and Australian Federalism' (2013) 37 *Melbourne University Law Review* 189.

35 *Williams* (2012) 248 CLR 156, 267 [241]-[243].

36 Ibid 267 [242].

37 Ibid 267 [243].

38 Ibid 269 [247].

39 (2009) 238 CLR 1, 199 [569] (*Pape*).

40 *Williams* (2012) 248 CLR 156, 267 [243] (Hayne J), 373 [593] (Kiefel J).

under s 51(xxxix) as incidental to the executive spending power could potentially demand obedience from the recipient.[41] In a similar vein, Gummow and Bell JJ[42] echoed the concerns of Barwick CJ in *Victoria v Commonwealth*[43] that:

> Commonwealth expenditure of the Consolidated Revenue Fund to service a purpose which it is not constitutionally lawful for the Commonwealth to pursue … not only alters what may be called the financial federalism of the *Constitution* but it permits the Commonwealth effectively to interfere, without the consent of the State, in matters covered by the residue of governmental power assigned by the *Constitution* to the State.[44]

Crennan J also concluded that there was, in this case, 'nothing to explain or justify the absence of special legislation or any involvement by Parliament, beyond the appropriation Acts, or the bypassing of s 96.'[45] Accordingly, in the interests of protecting the 'financial federalism of the Constitution,'[46] the majority in *Williams* was prepared to rely upon s 96 as placing a limitation on the scope of Commonwealth spending power.[47] Their Honours found support for this proposition in Mason J's judgment in the *AAP Case,* where his Honour remarked that the very presence of s 96 in the *Constitution* confirmed that Commonwealth executive power 'is not unlimited.'[48] Hayne J pointed to s 96 as an 'immediate textual foundation for limiting the power to spend,'[49] noting that the *Constitution* divides and distributes powers between the Commonwealth and the states.

Gummow and Bell JJ (together) and Crennan and Kiefel JJ also considered that the division of responsibilities between the Commonwealth and the states could be impacted if the scope of executive power was permitted to extend beyond matters which are otherwise the subject of Commonwealth legislative power. Kiefel J distinguished the facts of *Williams* from *Davis v Commonwealth*[50] on the basis that funding for school chaplains was not a situation where Commonwealth executive or legislative action involved no real competition with state executive or legislative competence.[51] Their Honours also considered that the provision of school chaplains was a matter within the competence of the Queensland government and pointed to the policy directives and funding undertaken by Queensland in the area of chaplaincy and pastoral care to support this contention.[52]

Several members of the Court also distinguished the circumstances in *Williams* from *Pape,*[53] as it was not a case which required short term and urgent payments to be made in response to a national crises or emergency.[54] Their Honours were not persuaded that the NSCP required the invocation of Commonwealth executive powers

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41 Ibid 270 [248].
42 Ibid 235-236 [148].
43 (1975) 134 CLR 338 (*AAP Case*).
44 Ibid 357-358.
45 *Williams* (2012) 248 CLR 156, 348 [503].
46 *AAP Case* (1975) 134 CLR 338, 357-358 (Barwick CJ).
47 *Williams* (2012) 248 CLR 156, 235-236 [146]-[148] (Gummow and Bell JJ), 270-271 [251] (Hayne J), 347 [501] (Crennan J), 373 [592] (Kiefel J).
48 *AAP Case* (1975) 134 CLR 338, 398.
49 *Williams* (2012) 248 CLR 156, 270-271 [251].
50 (1988) 166 CLR 79 (*Davis*).
51 *Williams* (2012) 248 CLR 156, 372 [588]-[590].
52 Ibid 235 [146] (Gummow and Bell JJ), 346-347 [497]-[500] (Crennan J), 373 [594] (Kiefel J).
53 (2009) 238 CLR 1.
54 *Williams* (2012) 248 CLR 156, 189 [30] (French CJ), 235 [146] (Gummow and Bell JJ), 346-347 [499]-[500] (Crennan J).

otherwise peculiarly adapted to the government of Australia as a nation[55] and concluded that executive power could not extend to support the entry of the Commonwealth into the Funding Agreement.

Although the High Court in *Williams* fell short of providing an exhaustive definition of executive power, the majority was willing to impose limits on the Commonwealth executive's power to contract and spend. The judgments of Gummow and Bell JJ (together), Hayne, Crennan and Kiefel JJ express some concern that s 96 could be the casualty of an expanded executive power. However, as we saw in the first part of this article, s 96 was never intended to be a permanent constitutional provision. The majority in *Williams* was right to note that a puzzle arises from the interaction of s 96 and the spending power under s 61. However, they were wrong to think that s 96 is an indispensable part of the case for imposing boundaries on the Commonwealth's ability to spend its revenue as it chooses.

The most straightforward constitutional case for placing limits on the Commonwealth spending power under ss 61 and 51(xxxix) derives from the distribution of powers effected by ss 51 and 107 of the *Constitution*. The Commonwealth enjoys enumerated powers, while the remaining powers are reserved for the states. The High Court has eviscerated s 107 since the *Engineers Case*,[56] but if the provision has any content it must mean that the legislative and executive powers of the Commonwealth are not unbounded. Sections 51 and 107 therefore provide the 'immediate textual foundation' for limiting Commonwealth power that Hayne J sought in *Williams*.[57] Section 96 becomes, at best, a side issue.

There is, nonetheless, a puzzle concerning the relationship between s 96 and the Commonwealth spending power. The majority justices in *Williams* thought the spending power under s 61 could render s 96 redundant. This can be avoided by restricting the scope of the former power. However, a further problem then arises. Section 96 potentially allows the Commonwealth to evade the limits of its fiscal powers by funding topics that fall under state jurisdiction. The power therefore limits the effectiveness of any restrictions placed on the Commonwealth spending power, insofar as these impact on federal arrangements. Section 96 does not exactly render such restrictions otiose, but it makes them relatively impotent. The tension between the two sources of power is therefore not resolved by the interpretation placed on the spending power in *Williams*. A more fundamental issue still remains.

IV A TRANSITIONAL PROVISION?

We have argued in this article that the drafting history and constitutional context for s 96 indicate that it was meant as a transitional measure. We have also noted the puzzle posed by the interaction between s 96 and the Commonwealth spending power under s 61. The tension between these two Commonwealth powers would evidently be removed if s 96 were treated as merely transitional. This, of course, is unlikely to happen. However, it raises an interesting question about the fiscal underpinnings of Australian federalism. What would federalism look like if s 96 were removed from the constitutional picture? How would such a change impact on the balance of power between the Commonwealth and the states?

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55 Ibid 250-251 [196] (Hayne J), 346 [498], 348 [503] (Crennan J), 372 [589]-[590] (Kiefel J).

56 *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129. For further discussion, see Suri Ratnapala and Jonathan Crowe, *Australian Constitutional Law: Foundations and Theory* (Oxford University Press, 3rd ed, 2012) ch 10.

57 *Williams* (2012) 248 CLR 156, 270-271 [251].

It is useful to begin our exploration of this issue by returning to the intentions of the framers. We argued above that the framers intended s 96 to be a temporary measure for the same ten year period covered by s 87. How, then, did the framers conceive the financial relationship between the Commonwealth and the states? We can begin by noting the decision of the framers to grant both the Commonwealth and the states concurrent power over taxation under s 51(ii), while making customs and excise duties exclusive to the Commonwealth under s 90. It seems clear, then, that the drafters of the *Constitution* envisaged that the states would retain their own independent sources of taxation revenue under s 51(ii).

It was recognised that the transfer of customs and excise duties to the Commonwealth might result in a temporary vertical fiscal imbalance, necessitating the transitional arrangements found in Chapter IV. However, this was not expected to be a systemic problem.[58] The framers could not have foreseen the aggressive moves the Commonwealth would take after the Second World War to seize control of income tax. They certainly would not have anticipated that such a step would be partly authorised by s 96. The vision of the framers, then, was one of much greater financial independence between the levels of government than is presently the case. This picture removes much of the need for a provision like s 96.

The drafters of the *Constitution* also seem to have thought that the size of the Commonwealth government would remain relatively modest compared to the states. Section 87 envisages that the Commonwealth could fund its activities through no more than a quarter of the net revenue from customs and excise duties, with the remainder to be returned to the states. Indeed, the view was regularly expressed that the Commonwealth would be overfunded by this formula.[59] Section 87 is a transitional measure, but it was envisaged that the Commonwealth may continue to run a surplus more than ten years following federation. Section 94 therefore makes separate provision once five years have elapsed for the Commonwealth to return its surplus to the states 'on such basis as it deems fair'.

The present state of Australian federalism is, of course, significantly different from the picture outlined above. The Commonwealth dwarfs the states in terms of revenue and expenditure. There is a large and seemingly permanent vertical fiscal imbalance.[60] Nonetheless, it is still possible to imagine how federalism would look without s 96. We noted above how s 96 might be less necessary if the Commonwealth returned to the states control over revenue streams under s 51(ii). This would be a positive development, since it would help reinstate the fiscal accountability that comes with having the same level of government responsible for both setting taxation levels and overseeing the expenditure of the resulting revenue streams. However, there are also constitutional mechanisms other than s 96 that would enable the Commonwealth to offer continuing financial assistance.

The interaction between s 96 and the spending power of the Commonwealth was explored in the previous section of this article. We saw there that the spending power, as interpreted in *Williams*, would enable the Commonwealth to grant financial assistance to states under legislation on any topic falling within its enumerated heads of power. The High Court has taken an expansive approach to interpreting Commonwealth powers since the *Engineers Case*.[61] The spending power therefore

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58 See, for example, Convention Debates, Melbourne, above n 10, 1104-12.

59 See, for example, Convention Debates, Adelaide, above n 10, 1053-67.

60 See generally Anne Twomey, 'Reforming Australia's Federal System' (2008) 36 *Federal Law Review* 57, 64-9; Ratnapala and Crowe, above n 56, 301-2.

61 *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129. For discussion, see Ratnapala and Crowe, above n 56, ch 10.

covers a wide range of subject areas. There also appears to be limited provision for the Commonwealth to authorise special expenditures in response to national emergencies.[62] Financial assistance made under the spending power would have to be authorised by law, but the High Court has been willing in recent decisions to approve expenditures authorised in fairly general terms under legislation.[63]

Grants made under the spending power for a particular purpose would have to fit within a Commonwealth head of power. They could not be required to be spent on something outside Commonwealth jurisdiction. This barrier, however, could be overcome by utilising s 51(xxxvii), which allows a state or states to refer matters to the Commonwealth Parliament.[64] This provision could be used to supply a constitutional basis for a funding agreement between the Commonwealth and the states for purposes otherwise beyond Commonwealth power.

The Commonwealth can also make grants to the states for general expenditures. We have seen that s 94 authorises the Commonwealth to return surplus funds to the states. The High Court has allowed the Commonwealth to avoid making payments under this provision by placing its surplus in trust funds.[65] However, the Commonwealth could equally rely on s 94 to make payments to the states by designating surplus amounts for this purpose. The intention behind s 94 was clearly that funds would be returned to the states on a recurring basis for general expenditures, rather than being earmarked for specific programs.[66] However, the Commonwealth could still communicate to the states that the funds are intended for a particular purpose, such as road construction, without making this a condition of the grant.

The removal of s 96 would therefore leave the Commonwealth able to grant financial assistance to the states in a variety of ways. At the same time, however, it would shift the focus of these funding arrangements away from tied grants and towards funding for Commonwealth purposes, in response to state requests or as a return of surplus funds for general state spending. The Commonwealth could probably accomplish many of the same things it currently pursues through s 96 grants, but it might have to think about them in a slightly different way. It would have to begin by drawing a meaningful distinction between Commonwealth and state areas of power. This would be necessitated by the boundaries of the spending power under s 61 as defined by the High Court in *Williams*.

A possible drawback of utilising the spending power as an alternative to s 96 is that the Commonwealth could coercively impose grant conditions on the states on topics within its jurisdiction by relying on s 109 of the *Constitution*. However, it would not generally be in the Commonwealth's interests to do this. Negotiation with the states would likely prove more effective. Any attempt to force the states to do the Commonwealth's will might also raise issues of intergovernmental immunities under the *Melbourne Corporation* principle.[67] It also bears noting that the Commonwealth's use of incentives to induce the states to accept tied grants under s 96 is often aggressive and sometimes overtly coercive. It therefore seems likely that the imposition of Commonwealth grants under the spending power would not look considerably different from the current use of grants under s 96.

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62 *Pape* (2009) 238 CLR 1.

63 *Combet v Commonwealth* (2005) 224 CLR 494; *Pape* (2009) 238 CLR 1.

64 For a helpful discussion of some uncertainties surrounding the operation of s 51(xxxvii), see Twomey, above n 60, 69-71.

65 *New South Wales v Commonwealth* (1908) 7 CLR 179.

66 See, for example, Convention Debates, Melbourne, above n 10, 1085-9. For further discussion, see Quick and Garran, above n 12, 863-5.

67 *Melbourne Corporation v Commonwealth* (1947) 74 CLR 31. For a helpful summary, see *Clarke v Federal Commissioner of Taxation* (2009) 240 CLR 272, 299 (French CJ).

The Commonwealth may, of course, also wish to make grants for purposes not falling within its enumerated powers. The framework outlined above gives two mechanisms for achieving this. The first would involve s 51(xxxvii). This would require the states to take an active role in requesting the grant, thereby potentially shifting the focus away from Commonwealth terms, as under s 96, and towards the states' needs. The second possible mechanism falls under s 94. This possibility would involve a shift away from tied grants for particular purposes and towards general contributions to state revenue. There is much to be said for this model. Indeed, the Intergovernmental Agreement for the distribution of revenue from the Goods and Services Tax has already taken steps in this direction.[68]

The Intergovernmental Agreement undermines attempts to return taxation revenue streams to the states, insofar as it obliges the states not to impose certain kinds of taxes. However, it guarantees the states a stream of centrally collected general revenue. Special purpose grants from central to regional governments are internationally recognised as ineffective and wasteful compared to block grants, as the latter allows for greater local autonomy and efficiency in implementation.[69] The removal of s 96 from the constitutional framework would not prevent the Commonwealth from making tied grants in all circumstances. However, it would place limits on their use and require other methods to be considered. This could hold real benefits for Australian federalism.

V CONCLUSION

We have argued in this article that there are compelling reasons to regard s 96 of the *Constitution* as a transitional provision. The framers clearly intended it to be transitional. Furthermore, the interaction of s 96 with the executive power of the Commonwealth raises puzzles that could be resolved by treating it as a spent provision. We have further argued that omitting s 96 from the constitutional framework could have significant positive consequences for fiscal federalism. It might encourage the Commonwealth to hand back revenue streams to the states. It would encourage the Commonwealth to take the limits of its powers more seriously when making tied grants. Finally, it would shift the focus of Commonwealth aid to the states away from special purpose payments designed by the Commonwealth and towards either specific state requests or general financial assistance.

It remains extremely unlikely that either the Commonwealth Parliament or the High Court will declare s 96 a spent provision. What, then, is the purpose of reimagining fiscal federalism as we have done in this article? There is, of course, value in seeking to understand the constitutional context and purpose of s 96 and the other provisions in Chapter IV. However, even if s 96 continues to operate, all branches of government have the ability to make changes that will affect the way fiscal federalism evolves in the future. Imagining what fiscal relationships between the levels of government would look like in the absence of s 96 offers one method of thinking creatively about possible ways forward for Australian federalism. The Commonwealth would do well to decrease its reliance on s 96 grants as a form of financial assistance to the states, regardless of the constitutional status of the provision.

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[68] *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth) sch 2.

[69] For a useful discussion, see Twomey, above n 60, 64-69.