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ABSTRACT

This paper presents an assessment of the development of fiscal federalism in Australia over the two decades from 1972 to 1992. This period covers the administrations of four Prime Ministers, Whitlam, Fraser, Hawke and Keating, which witnessed phenomenal change in the functioning of the Australian federal system. It is argued that while fiscal dominance of the Commonwealth remained a feature throughout this period, fiscal centralisation reached new heights during the Hawke-Keating period of 1983-1992.

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THE WHITLAM YEARS

Economic Background

By the time the Whitlam Government came to power in December 1972 on a platform of economic and social change, the Australian Labor Party had been in opposition for 23 years. The last half of the 1950s and the 1960s had been a period of unprecedented economic growth, full employment and low inflation. In the ten years to 1969–70, gross domestic product (GDP) grew in real terms at an annual rate of 5.3 per cent, the consumer price index (CPI) increased by only 2.5 per cent a year and the rate of unemployment averaged only 1.75 per cent. In most years, Australia had a positive trade balance and, with a high level of foreign investment offsetting an overall current account deficit, the Australian dollar traded strongly throughout the period at a value 10–12 per cent above that of the American dollar.

At the beginning of the 1970s, however, the situation was changing. Political instability in the ruling Liberal and Country Parties, following a series of leadership disputes and differences between the coalition partners, resulted in the Australian dollar becoming seriously undervalued. A speculative capital inflow and consequential increases in the money supply, combined with a national wage decision and award increases which accelerated the growth in wage rates and earnings, contributed to rapidly rising inflation (Table 1). Contractionary Commonwealth budgets in 1970 and 1971 (Table 2) did not impede the wage inflation or the growth in the money supply but contributed to increased unemployment and a downturn in the rate of growth. As a result of strong export growth, however, the current account deficit in the balance of payments was falling and about to go into surplus, for the first time in 16 years.

A Reformist Government with a New Philosophy of Social Democracy

The Whitlam Government was a reformist government, long in vision but short on experience. Much of the vision came from Whitlam himself. While in opposition, he had led the Labor Party away from its historical obsession with socialism and nationalisation and had overseen the development of policies consistent with the ideals of a modern social democracy.

Writing in 1985, Whitlam said that the Party's reform program was developed so as to be consistent with the existing Constitution and in accordance with its political relevance and its relevance to the needs of modern Australia. But the program also had a philosophical relevance, in that policies were related to what Whitlam called the doctrine of positive equality. This doctrine had as its primary goal not income equality but greater equality of the services provided by government, within a pluralistic system in which the private sector would continue to play the greater part in providing employment and growth.

This approach was based on the following concept:

> increasingly, a citizen's real standard of living, the health of himself and his family, his children's opportunity for education and self-improvement, his access to employment opportunities, his ability to enjoy the nation's resources for recreation and cultural activity, his legacy from the national heritage, his scope to participate in the decisions and actions of the community, are determined not so much by his income but by the availability and accessibility

of the services which the community alone can provide and ensure. (Whitlam, 1985, p. 3)

Whitlam considered that, in order to meet the real needs of the Australian people, urban policy occupied a central role in the reform program. But comprehensive and cohesive policies were also developed for schools, health, housing, social security, national resources, transport and other functional fields. Most of these fields were State responsibilities under the Constitution, but Whitlam asserted that reforms could only be achieved in Australia through the involvement of the Federal Government. This was because in no other federal system was there such an imbalance between the financial resources of each level of government and the functions it performed. 'In Australia, if a significant function is not financed by the national Government it will be unfairly financed, inadequately financed, or not financed at all' (Whitlam, 1985, p. 3).

Whitlam's Approach to Federalism

This response to the chronic vertical fiscal imbalance, which Australia had experienced since the Second World War as a result of the Commonwealth's income tax monopoly, implied that balance could only be restored by shifting expenditure responsibilities from the States to the Commonwealth as opposed to shifting tax powers back to the States. It was to prove a major source of contention in intergovernmental relations throughout the Whitlam Government's period of office, as indeed it had been with the Government's predecessors and was to continue to be with its successors. Specific purpose payments became the principal instrument of the Commonwealth's incursion into State functions. These had been used increasingly by non-Labor Governments, but the range and level increased dramatically under Whitlam.

Whitlam also said:

> Each of our three levels of government has functions which it is best able to perform. The key to effective performance is not domination but consultation, not centralization but co-ordination. (Whitlam, 1974, p. 306)

While such a statement was unexceptionable as a guide to intergovernmental relations, it was overshadowed, so far as States perceptions about the Commonwealth's intentions were concerned, by another rhetorical statement in the same paper, which continued to be quoted against Whitlam whenever he sought State co-operation on policies:

> The State boundaries arranged at Whitehall in the middle of the last century and the local government boundaries devised in the State capitals early this century have little relevance to today's needs. Ideally, one continent should have neither so few State governments nor so many local government units. We should not have a federal system of overlapping parliaments and a delegated but supervised system of local government. We should have a House of Representatives for international matters and nationwide national matters, an assembly for the affairs of each of our dozen largest cities and regional assemblies for the few score areas of rural production and resource development outside those cities. (Whitlam, 1974, p. 300)

Of course there was not the slightest possibility of establishing that kind of system either within the existing constitutional framework, which Whitlam had accepted as constraining his Government's policies, or through constitutional reform. But such a statement guaranteed the kind of hostility from the States that the Government faced throughout its term of office.

The ensuing conflicts were not all the fault of the Commonwealth. Throughout their history, the States had failed to co-operate constructively and co-ordinate their policies even where uniformity was necessary in the national interest. Given the hostility of the non-Labor State Governments towards the Whitlam Government, the coercive use of its fiscal and other powers was the only way in which a progressive national policy framework for education, health, urban, transport and other policies could be established.

Late in the life of his Government, at the 1975 Premiers' Conference, Whitlam made another statement which could surely be accepted by all levels of government and all parties as providing a blueprint for co-operative federalism:

> The Australian Government will be seeking in the longer term a more rational and co-ordinated system of assessing needs, setting priorities and allocating resources in the public sector — one based on co-operation between Governments. It may take years to develop a new approach of the kind we have in mind, of the kind discussed among our officials. But we believe a start should be made now.
>
> The view of the Australian Government is that in seeking better co-operative planning arrangements it would be best to begin with particular important functions where there is a clear need for co-ordination and where early progress seems possible. Three such functions have been suggested in the discussions among our officers — transport, health and urban development ...

But by then it was too late to mend fences and it was left to the Fraser Government to attempt a new approach to federalism.

The three principal pillars of the Whitlam Government's approach to federalism, as reflected in policies rather than rhetoric, were:

(1) the use of specific purpose payments to establish national policies in education, health, housing, urban affairs, transport, resources, Aboriginal affairs, the environment and other fields of State constitutional responsibility;

(2) support for a wider and stronger role for local government through Commonwealth financial assistance (including a new system of general revenue grants through the Commonwealth Grants Commission), participation of local government in the Constitutional Convention, and unsuccessful attempts to have local government represented on the Loan Council; and

(3) attempts, generally opposed by both State and local governments and in the end unsuccessful, to establish a system of regional organisations with responsibilities in urban planning, social development, area improvement, growth centres, local government general revenue grants and Commonwealth Government administration.

Economic and Fiscal Policies

The principal economic decisions made by the Whitlam Government were:

(1) Progressive revaluations of the Australian dollar in 1972 and 1973 to correct its under-valuation and end speculative capital inflows, and a 25 per cent across-the-board tariff cut designed to moderate inflation and, with other measures, to improve efficiency.

(2) Failure to curb strong wage inflation, which Whitlam said was due to a failure on the part of the trade union movement to recognise that living standards depended on what he called the social wage, which was increasing rapidly as a result of the Government's spending on education, health, housing, etc, as well as on money wages. But the effect of inflation on effective tax rates and real wages was also a major factor in the burgeoning wage claims.

(3) A credit squeeze late in 1973 which Whitlam claimed was the result of bad policy advice from the Treasury. This, combined with a contractionary budget and the inflationary effects of the energy crisis following a 70 per cent hike in oil prices by the Organisation of Petroleum Exporting Countries, sent the Australian economy into recession. Henceforth, Australia was adversely affected by what had become world-wide inflation, recession and disturbances to international trade.

(4) After a modestly deflationary budget in 1973, the Commonwealth budget in 1974 was strongly expansionary as the Government's vast new spending programs became effective. Commonwealth spending grew by 20.6 per cent in real terms, with a massive shift in the proportion of Commonwealth outlays to GDP from 22.8 per cent in 1973–74 to 27.7 per cent in 1974–75 (Table 2).

(5) Failure to restructure, at least until the 1975 Budget, the income tax system in response to the savage impact which high inflation was having on effective tax rates for individuals and business enterprises. In 1974–75, every 1 per cent increase in personal incomes was generating a 2 per cent increase in tax yields. The resulting revenue bonanza was undoubtedly a major factor contributing to the Government's spending spree. Not only did the Commonwealth use the buoyant revenues as a means of avoiding difficult choices on the expenditure side, but the large flow-on of funds to the States through specific purpose and general revenue grants enabled them to do likewise.

(6) Relations between the Government and the Treasury virtually broke down in 1974 and 1975. The Government increasingly sought advice from other sources, or acted independently of traditional sources of advice, often with disastrous results as in the case of the Loans Affair.

(7) As a result of the explosion in government spending and the rapid rise in unemployment, wage rates and inflation (Table 2), the economy was getting out of control by the end of 1974, but monetary, fiscal and other policy measures introduced from that time somewhat moderated the rate of inflation and held unemployment to 4.7 per cent in August 1976 compared with 4.6 per cent a year earlier. Wage indexation, introduced in April 1975 by the Arbitration Commission with the support of the Whitlam Government, succeeded in breaking the cycle of inflationary wage expectations. The Government was not prepared to introduce tax indexation as proposed by the Mathews Committee on Inflation and Taxation in May 1975, but the Hayden Budget in August 1975 halved the rate of growth in government spending, restructured the personal income tax system and extended tax concessions beyond the substantial reductions which had been made in November 1944. Table 2 shows that the

Commonwealth's budget deficit continued to increase in 1975–76, due to revenues increasing less rapidly than expenditures.

Fiscal Federalism

The Whitlam Government began and ended its life with Australia having one of the most highly centralised tax systems in the world. As a consequence, it also exhibited an excessive degree of vertical fiscal imbalance, as represented by an acute mismatch between own-source revenues (or own-purpose outlays in the case of the Commonwealth) and total outlays.

State own-source revenues as a proportion of total State outlays fell from 40.6 per cent in 1972–73 to 35.6 per cent in 1975–76, reflecting the fact that Commonwealth grants grew faster than State own-source revenues during the period. Commonwealth own-purpose outlays (total outlays net of grants to other governments) as a proportion of its total outlays fell from 66.8 per cent in 1972–73 to 61.9 per cent in 1975–76.

Horizontal fiscal imbalance was also more pronounced at the end of the Whitlam years than it had been at the beginning. This was because only one State — Queensland — remained in the equalisation process. The three States with the lowest fiscal capacities — Western Australia, South Australia and Tasmania — had been given special deals by the Commonwealth Government, the last two by the Whitlam Government, to enable them to withdraw from claimancy before the Grants Commission.

The failure to seek or achieve equalisation in the distribution of general revenue grants was accentuated by the inconsistent and inequitable distribution, without regard to relative needs, of some of the main specific purpose grants by the Whitlam Government. Thus those States which had been spending least on their secondary schools were given the largest per capita grants on the basis of need, while those which had been spending most on their hospitals received the largest grants under the hospital cost-sharing scheme, whereby the Commonwealth met 50 per cent of the net operating costs of hospitals irrespective of relative efficiency or need.

But the Whitlam Government did introduce a comprehensive system of equalising general revenue grants for local governments, which improved their financial position and contributed to horizontal balance at that level.

Although there was a massive increase in specific purpose recurrent and capital payments to or for the States between 1972–73 and 1975–76, there was also significant growth in general revenue grants (Table 3). Only general purpose capital funds declined as a proportion of GDP, and this was due primarily to the changed treatment of housing through specific purpose advances.

In view of the continuing bitter conflict between the States and the Whitlam Government throughout its period of office, it is ironic that State finances overall improved more markedly during that period than at any time since the Second World War. They would have improved still further if the decisions taken at the 1975 Premiers' Conference to increase financial assistance grants after 1975–76 had been put into effect. It is true that most of the improvement was centred on specific purpose grants which the States opposed on principle, but such payments undoubtedly improved the overall budgetary situation of the States. This was because most of the specific purpose grants could be substituted for own-source revenues by the States as the means of financing their expenditures.

The most important of the new or expanded specific purpose programs were as follows:

(1) **Education**. The Commonwealth took over full responsibility for financing tertiary education, abolishing fees in the process, brought teacher colleges into the advanced education sector, and provided additional funding for the TAFE sector. In accordance with the recommendations of an Interim Committee for the Australian Schools Commission, funds were provided for both government and non-government schools to lift their resources to what the Committee regarded as minimum standards, involving increases in recurrent funds of at least 40 per cent for primary schools and 30 per cent for secondary schools, by 1979, one-third in 1974 and 1975. Between 1972–73 and 1975–76, outlays by the Commonwealth for education purposes increased by 326 per cent, or as a proportion of GDP from 1.0 per cent to 2.5 per cent.

(2) **Health**. The most important initiative of the Whitlam Government in relation to health was the introduction of Medibank or universal health insurance. As part of this scheme and to compensate the States for the loss of fee revenue, the Commonwealth entered into cost-sharing agreements with the States so as to provide for free hospital treatment. Commonwealth outlays on health increased from 1.7 per cent of GDP in 1972–73 to 3.9 per cent in 1975–76.

(3) **Urban and regional development**. Programs in this area, to which the Whitlam Government attached special importance, were directed mainly towards the establishment of regional growth centres, land acquisition and development, area improvement and sewerage works.

(4) **Transport**. Apart from roads, the principal payments were for railway projects, urban public transport, and shipping and harbours.

(5) **Social welfare**. Most of the social welfare initiatives of the Whitlam Government did not involve large payments to the States. Under the Australian Assistance Plan, regional councils for social development were established with functions directed to the co-ordination of social welfare on a regional basis. The Plan did not survive the demise of the Government, although some of the regional councils did. Grants for unemployment relief were the most important specific purpose programs. The Henderson Commission of Inquiry into Poverty, which had been appointed by the McMahon Government, issued numerous reports during the Whitlam period. Some of its recommendations were concerned with improving Commonwealth, State and local co-ordination of welfare policies, but in most cases to little effect.

Institutions

The Whitlam Government attempted to reform the structure of government in Australia in three principal ways. First, it relied heavily on statutory commissions and other forms of independent inquiry, including task forces, commissions and committees of inquiry. Secondly, as noted above it tried to develop the concept of regions as a fourth tier of government. Thirdly, it appointed the Coombs Commission on Australian Government Administration to undertake a major review on the administrative organisation and services of the Commonwealth Government. (The terms of reference did not include relations with the States, thereby precluding consideration of one of the most important sources of administrative inefficiency in Australian government.)

Statutory commissions had been used before by Commonwealth Governments, notably the Grants Commission and the Universities Commission, which Whitlam said he used as a model. From 1973 he proceeded to appoint the Schools Commission, the Hospitals and Health Services Commission, the Social Welfare Commission, the Children's Commission, the Technical and Further Education Commission, and the Australian Heritage Commission. The

Cities Commission replaced a similar body that had been appointed by the McMahon Government, and the Advanced Education Commission and the Commonwealth Bureau of Roads, like the Grants Commission and the Universities Commission, were already in existence. In addition, the Inter-State Commission was reconstituted to advise on transport matters, and the Grants Commission was given the added responsibility of advising on grants for local government.

The reason for using statutory commissions rather than government departments as sources of advice was said by Whitlam to ensure that assessments of need were made on the basis of processes of systematic, impartial and objective inquiry.

Unfortunately, there were inherent weaknesses in the constitution and method of operation of the advisory commissions. In the first place, there were problems of defining their relationship to the executive government and Parliament, and a tendency for some of their functions to be duplicated in the government departments.

Secondly, it proved to be difficult for the Commonwealth to fit the recommendations of the commissions into the normal budgetary processes of priority determination and financial appropriation. This problem arose because each commission made its assessment of needs independently without regard to budget constraints. Each assessment was therefore open-ended in its budgetary implications. When all the recommendations were added together and substantially adopted by the Government, they amounted to the massive expansion in government outlays that has been noted above. The inflationary consequences were so severe that cut-backs had to be made in 1975–76, with resulting dislocation not only in the new programs but also throughout the whole range of Commonwealth and State activity.

Thirdly, the commissions did not operate as intergovernmental agencies, despite the fact that they were concerned with making recommendations on grants to the States for purposes which were State constitutional responsibilities.

Evaluation of the Whitlam Government's Economic and Fiscal Performance

The Whitlam Government's economic and fiscal performance has been universally condemned as destabilising in its effects on economic growth, unemployment and inflation. In retrospect, however, its performance may be judged not to have been as bad as has been claimed, especially when it is put in the context of the world-wide inflation and recession that occurred after 1973. Of the principal economic indicators in Table 1, only the CPI and wage figures are open to severe criticism.

The Government was certainly primarily responsible for the high cost and wage inflation. Until 1975 it failed to rein in excessive wage claims, indeed even encouraged them in the public service. It failed to reform the tax system to prevent its destructive effects on wages and business enterprises as a result of its interaction with inflation. It showed no sense of priority or restraint in its open-ended spending policies.

Even the excessive spending had its compensations. It was intended to overcome a long period of neglect in the public sector and most of the programs concerned had a lasting impact on the quality of Australian life. To its credit, the Whitlam Government was the last Australian Government to make full employment an over-riding objective of economic policy, and if it did not altogether succeed in this its failure was not great compared with the performance of its successors.

The Government's principal fault was that too much was attempted too quickly, so that too many demands were placed on limited resources and, in the haste to develop policies, many of the programs suffered from administrative and financial shortcomings and a failure to co-ordinate them with the ongoing, mainstream activities of the States. Lack of policy co-ordination with the States was a major shortcoming, but the States shared responsibility for this.

In the case of fiscal federalism, deterioration in both vertical and horizontal fiscal imbalance as between the Commonwealth and the States was matched by a significant improvement in horizontal balance among local governments. As a result of the rapid growth of both general revenue grants and specific purpose grants, moreover, the actual financial positions of the States and local governments were considerably eased.

THE FRASER YEARS

Economic Background

As noted earlier, at the end of the Whitlam period the economy was experiencing serious difficulties, some of which had been caused by international events and others which were of the Government's own making. Inflation was high, unemployment was high and increasing, and the annual rate of increase in earnings was still very high, although it had declined from the unprecedented level of 28 per cent in 1974–75. Real GDP growth had declined to 1.3 per cent in 1974–75, which was only slightly higher than one-third of the rate of growth in the previous two years (Table 1).

Under the Whitlam Government, the Commonwealth budget deficit had increased in 1974–75 to 3.8 per cent of GDP and in 1975–76 to 4.7 per cent of GDP (Table 2). The current account balance in the balance of payments had deteriorated into a deficit equalling 1.7 per cent and 1.8 per cent of GDP in 1974–75 and 1975–76 respectively.

Monetary and Fiscal Policies

In contrast to the Whitlam Government, the Fraser Government which was elected in December 1975 was committed to a conservative economic philosophy of smaller government and lower deficits. Given the economic indicators of inflation, unemployment and interest rates at the time, its policies might seem to have been unobjectionable. However, instead of unemployment, the Fraser Administration made the control of inflation its number one priority and pursued it relentlessly through contractionary monetary and fiscal policies. The monetarist theory underpinned its approach to tight monetary policy and inflation. Throughout the Fraser years, target rates of money supply growth, measured by M3, were announced in every budget, although in most years the targets were not met.

Moreover, the policy did not succeed in curbing inflation. After falling in 1977–78 and 1978–79, the rate of inflation again rose and reached 11.5 per cent in 1982–83 (Table 1).

The Australian Financial System

The process of fundamentally changing the Australian financial system was commenced by the Fraser Administration, even though it was left to the Hawke Labor Government to implement the wholesale deregulation of the system. In 1979, the Fraser Government set up a Committee of Inquiry into the Australian Financial System (the Campbell Committee). The Campbell Committee submitted an Interim Report in May 1980 and a Final Report in November 1981, recommending almost complete deregulation of the Australian financial system.

The important changes introduced by the Fraser Government in this field included:

- the introduction of a tender system for the sale of Treasury notes, replacing the tap system, and for Treasury bond sales
- removal of interest rate ceilings on deposits with trading and savings banks
- changes in the banking system, including approval for the establishment of a new bank (the Australian Bank) and for mergers between the Bank of NSW and the Commercial Bank of Australia, and between the National Bank of Australasia and the Commercial Banking Company of Sydney
- abandonment of quantitative bank lending guidelines and relaxation of portfolio controls on savings banks
- removal of Loan Council control on borrowings by electricity authorities
- approval for the formation of central borrowing authorities by the States for the borrowings of local and smaller semi-government authorities

Fiscal Policy

The general stance of fiscal policy between 1976–77 and 1982–83 remained contractionary, more so in some years than in others. As figures in Table 2 show, the Fraser Government's budget in 1976–77 was the most contractionary, reducing the budget deficit by 1.6 percentage points of GDP. The following two years maintained the deficit at about the same level in relation to GDP. The 1979–80 budget reduced real outlays and substantially increased revenues, so that the budget deficit fell by 1.5 percentage points of GDP. Both 1980–81 and 1981–82 budgets witnessed positive real growth in budget outlays. However, as budget revenues increased even higher, the budget deficit was further reduced to 0.3 per cent of GDP in 1981–82. The economy went into recession in 1982–83 and real GDP declined by 1.4 per cent (the first fall since the Great Depression). Fiscal policy was relaxed with budget outlays increasing by 7 per cent in real terms and budget revenue falling by 1.6 per cent, so that the budget deficit increased to 2.6 per cent of GDP in the last financial year of the Fraser Administration.

External Policy

Under pressure from a speculative capital outflow, the dollar was devalued by 17.5 per cent in November 1976. In 1980–81, Australia again experienced large capital inflows, brought about largely by the resources boom which followed the second oil price shock. The inflow of capital exceeded the amount that was necessary to finance the deteriorating balance of payments and flowed into growth of the domestic money supply. But the resources boom was short-lived. By August 1981, the Australian dollar had fallen in value by about 12 per cent relative to the US dollar (Table 1), and was allowed to depreciate gradually as the current account deficit deteriorated further.

Wages and Labour Market Policies

In spite of the high rate of growth in wages and its contribution to inflation, the Fraser Government did not have a credible wages policy. The Government argued before the Arbitration Commission that wage indexation should be partial rather than compensating fully for the rise in prices. From 1976 partial indexations became the norm, except for full indexation in 1978. However, as wage increases also occurred outside the arbitration system, the overall level of increase in wages was higher than indexation decisions would have allowed for.

In July 1981, the Arbitration Commission abandoned wage indexation. The Government now argued in favour of decentralised collective bargaining. In 1981–82 average earnings increased by 13.8 per cent. This was on top of an increase of 13.3 per cent in 1980–81, and it was followed by another increase of 12.8 per cent in 1982–83. The Government unsuccessfully attempted to freeze wages by means of a so-called wage pause in 1982, but failure to prevent the second wages explosion (as it was dubbed in reference to the earlier wages explosion of the Whitlam years) marked the failure of Fraser Government's labour market policies.

The Fraser Government's Approach To Federalism

Shortly before it was elected to Government in December 1975, the Liberal–National Country Party Coalition had announced, as a major plank in its electoral platform, a new federalism policy.

There were important philosophical differences between the federalism policy of the new Government and that of the Whitlam Government, although the words in the policy statement seemed to place the same kind of emphasis as the latter had done on the need for policy co-ordination: '... we must restructure our forms and institutions of government and our attitudes of mind to achieve co-operation not conflict, partnership and not domination' (Liberal and National Country Parties, 1975).

Arguing that powers and functions must be distributed among the three levels of government so as to provide a barrier against what they called centralist authoritarian control, the Liberal and National Country Parties said that they viewed federalism as a philosophical rather than as a structural concept, which would prevent undue concentration of power and thus help to guarantee political and individual freedom.

The principal features of the Fraser Government's federalism policy related to income tax sharing, specific purpose grants, local government financial assistance and machinery for intergovernmental co-operation.

The policy statement indicated that, under tax-sharing arrangements designed to take the place of the financial assistance grants arrangements, the States would be given a specified share of personal income tax collections.

The policy statement also provided that, by agreement with the States, some specific purpose grants would be absorbed into general purpose funds provided under the tax-sharing arrangements, thereby increasing State budget flexibility. In suitable circumstances, the principle of block grants would be used.

The local government bodies would receive a fixed share of personal income tax collections (to be determined by the Commonwealth) in lieu of the equalisation grants provided on the recommendation of the Grants Commission.

The new federalism policy also provided for an independent statutory body, to be called the Council for Inter-government Relations, to be established with wide-ranging advisory and investigatory powers.

The role of the Premiers' Conference was to be extended to make it a forum for general debate on broad economic matters and on issues developed by the Council for Inter-government Relations. The functions of intergovernmental ministerial councils and consultative bodies (such as the Australian Agricultural Council) were to be strengthened in such a way as 'to maintain and assist national concerns and to stimulate initiative, while eliminating unnecessary overlapping, waste and interference'.

Fiscal Federalism in Practice

Tax-Sharing Legislation

The new tax-sharing legislation was initially based on agreements which had been reached with the States at Premiers' Conferences in 1976, through so-called points of understanding.

The original *States (Personal Income Tax Sharing) Act* 1976 gave effect to Stage 1 of the tax-sharing arrangements, whereby the States received 33.6 per cent of personal income tax collections in the current year, commencing in 1976–77.

The *Income Tax (Arrangements with the States) Act* 1978 was intended to give effect to Stage 2 of the tax sharing arrangements, whereby each State was to be permitted to vary the personal income taxes levied on its residents to its own benefit or cost.

The *States (Personal Income Tax Sharing) Amendment Act* 1978 provided for the States' tax sharing entitlements from 1978–79 onwards to be calculated as 39.87 per cent of personal income tax collections in the preceding year instead of 33.6 per cent of the current year's collections.

It was also agreed that the States' Stage 1 entitlements in any year would not be less in absolute terms than in the previous year, and that during the first three years of the new scheme (1976–77 to 1978–79) the entitlements would not be less than the amounts of the financial assistance grants which would have been payable under the *States Grants Act* 1973–75.

Subject to these guarantees, under the new arrangements the total State entitlement of personal income tax collections continued to be dependent on decisions by the Commonwealth Government. The revenue base continued to be determined by the Commonwealth. Provision had been made for surcharges and rebates designated by the Commonwealth to be excluded from the revenue base, but the Commonwealth Government was also able to change the schedule of rates and allowances, thereby changing State entitlements. The Government's introduction of personal tax indexation at that time was only the most obvious illustration of the way in which the revenue flowing to the States could be affected by Commonwealth decisions. The total entitlement was to be distributed among the States on the basis of existing per capita relativities for financial assistance grants, but in 1978 legislation was passed providing for the review of the State tax-sharing relativities by an expanded Commonwealth Grants Commission, in the first instance by 30 June 1981, but with provision for subsequent periodic reviews.

The arrangements for State surcharges and rebates to operate under Stage 2, the target for which was the year 1977–78, provided that each State would be able to legislate to impose a percentage surcharge on personal income tax in that State or to give (at cost to the State) a percentage rebate on personal income tax payable under Commonwealth law and to authorise the Commonwealth to collect the surcharge or grant the rebate.

Specific Purpose Grants

Under the Fraser Administration, many specific purpose grants programs were abandoned or run down, particularly in urban affairs, social welfare, housing and transport. Capital grants were especially affected by the cuts (see Table 3). Programs for education were roughly maintained in real terms.

The major change that led to a significant absorption of specific purpose grants occurred in the area of health funding. Following the recommendations of the Committee of Inquiry into Efficiency and Administration of Hospitals (the Jamison Committee), the Commonwealth announced that hospital cost-sharing agreements with the States (other than South Australia and Tasmania) would not be renewed on expiry on 30 June 1981. Instead, the Commonwealth decided to make general purpose payments which were identifiable as its contributions towards the cost of health programs in the States and the Northern Territory. The new grants were called Identified Health Grants and were expected to be eventually fully absorbed into the tax-sharing grants. The cost-sharing agreements with South Australia and Tasmania were not due to expire until 30 June 1985. The identified health grants for these two States covered only assistance in lieu of payments formerly made for community health and school dental programs. The changed proportions of general revenue and specific purpose recurrent grants in 1981–82 reflected the changed treatment of health grants (column 2 of Table 3).

Intergovernmental Machinery

The Advisory Council for Inter-government Relations was established by Commonwealth legislation on the basis of a memorandum of agreement between the Prime Minister and Premiers. It consisted of three Government and two Opposition members of the Commonwealth Parliament; one representative from each State (but Queensland decided not to participate); six representatives from local government; and five citizens representing different community interests, one of whom was appointed Chairman.

Payments to or for the States

The Government's good intentions with respect to its federalism policies were soon sacrificed on the altar of fiscal restraint. Consistent with its objective of reducing the Commonwealth budget deficit, the Fraser Government reduced Commonwealth payments to the States quite drastically, from 11.2 per cent of GDP in 1975–76 to 9.0 per cent in 1981–82. In 1982–83, under an expansionary budget, payments increased to 9.5 per cent of GDP. As a percentage of Commonwealth Budget outlays, payments to or for the States declined from 39.0 per cent in 1975–76 to 32.9 per cent in 1982–83. As a share of Commonwealth revenue the fall was even more striking, from 46.6 per cent in 1975–76 to 36.2 per cent in 1982–83.

As noted above, tax-sharing grants were subject to guarantee arrangements for most of this period and were consequently protected from the fall. The reductions in payments were concentrated on capital payments. Specific purpose capital payments fell from 2.4 per cent of GDP to 1.0 per cent. General purpose capital funds, which included Loan Council borrowings and capital grants, fell from 1.7 per cent of GDP to 0.8 per cent (Table 3).

Taken together, reductions in specific purpose and general purpose capital funds progressively starved the States of capital funds during this period. The lower rates of growth in Commonwealth payments to the States were a part of the Commonwealth's budgetary policy to reduce its outlays and to make the States accept greater responsibility for their own finances. At the June 1979 Premiers' Conference, the Commonwealth Treasurer (Mr J. Howard) said that all governments needed to exercise economic restraint and must play a part in reducing the demands made by the public sector upon financial markets.

In 1979 the Commonwealth indicated that the guarantee arrangements for tax-sharing entitlements would not be extended beyond 30 June 1981, when the tax-sharing arrangements as a whole were to be reviewed and when the review of State tax-sharing relativities by the Commonwealth Grants Commission would be completed.

This review of tax-sharing arrangements was undertaken at the May 1981 Premiers' Conference. The Commonwealth decided that, after a transitional year in 1981–82, the tax-sharing grants would be calculated as a percentage share (20.72 per cent) of the total tax collections, excluding designated imposts which were so nominated by the Commonwealth, instead of the former net personal income tax collections. However, the guarantee that the grant payable to each State (and the Northern Territory) in any year would not be less, in absolute amount, than in the previous year, continued to apply.

The *States (Tax Sharing and Health Grants) Act* 1982 retained the right of a State to impose a surcharge on personal income tax or to grant a rebate. No State had taken advantage of this, however, presumably because the Commonwealth did not make tax room available by reducing its own tax rates. This was a fundamental flaw in the Government's new federalism policy, since any reduction in tax rates should have been accompanied by an equivalent reduction in tax-sharing grants, which the Commonwealth was precluded from making by the guarantee arrangements. The 1982 Act also provided for consultations to occur between the Commonwealth and the States on changes in Commonwealth taxes which affected the tax base and hence the tax-sharing grants.

The unilateral decisions taken by the Commonwealth in 1981 and 1982 effectively ended the tax-sharing arrangements which had been the centre-piece of the Fraser Government's new federalism policy. Far from State fiscal autonomy and responsibility being increased, the arrangements now consolidated Commonwealth control over State finances and hence the centralisation of Australian public finances considered as a whole. General revenue grants joined specific purpose payments and capital funds as being subject to unilateral Commonwealth control.

Horizontal Fiscal Equalisation

The Fraser Government's approach to fiscal equalisation, another key element of the new federalism policy, was both half-hearted and confused. It bowed to the opposition from the less populous States and did not implement the 1981 Report on State relativities assessed by the Commonwealth Grants Commission, which would have given larger shares of tax sharing grants to New South Wales and Victoria. Instead, the Grants Commission was asked late in 1981 to undertake a second review of tax-sharing relativities among the six States, along with a review of the distribution of the identified health grants in which the Northern Territory was to participate for the first time, and to report by 31 May 1982.

The 1982 review was similar in scope and procedures to the 1981 review and the Commission adopted the same distribution model. The three-year review period that had been used in the 1981 review was extended to a four-year period by the inclusion of an additional year 1980–81; this also was not without its difficulties, as important demographic data from the 1981 Census were not available in time for the Report.

The 1982 assessments implied smaller gains for New South Wales and Victoria relative to the existing distribution and a larger gain for Queensland than had been implied by the 1981 assessments. Tasmania's position was virtually unchanged, while South Australia and Western Australia were better off under the 1982 than the 1981 assessments.

At the Premiers' Conference in June 1982, the Commonwealth announced its decisions on the Grants Commission's *Report on State Tax Sharing and Health Grants 1982,* as follows:

(a) the Commission's assessed relativities, modified to preserve for South Australia and Tasmania the benefits of their hospital cost-sharing grants, were to be phased in over the three years 1982–83 to 1984–85 at the rate of one-third each year;

(b) there was to be a guarantee that each State's tax-sharing grant would increase in real terms by 2 per cent in 1982–83 and 1 per cent in each of the following two years;

(c) the States' 20.72 per cent share of total tax collections was to be divided into two pools, a basic tax-sharing pool of 20.323 per cent to be distributed among the States in accordance with the arrangements for phasing in the new Grants Commission relativities, and a supplementary pool of 0.397 per cent to be used to fund the guarantee;

(d) no special grants were to be paid to the States during the phasing-in period (this did not affect the Northern Territory, which was not a party to the tax-sharing arrangements).

Having initiated the process of comprehensive fiscal equalisation, the Fraser Government shrank from the final step of implementing the Commission's assessments in the face of strong opposition from the three smaller States. The effect of the guarantee provisions was to make the States assessed as needing additional grants responsible for assisting the States assessed as being over-equalised, thereby nullifying the equalisation for New south Wales and Victoria and limiting it for Queensland.

The Loan Council and Government Borrowings

The major decisions made by the Loan Council during the Fraser years included the following:

- at the June 1978 meeting the Loan Council accepted the need for special additions to semi-government borrowing programs for infrastructure financing, and issued guidelines under which each proposal for special additions to borrowings was to be examined;
- at the April 1979 meeting the Loan Council agreed to change the system of marketing Treasury notes to a tender system and to replace the system of selling Commonwealth bonds through periodic cash loans by a 'tap' issue system;
- at its June 1982 meeting, the Loan Council decided that, for a trial period of three years, domestic borrowings by Commonwealth and State electricity authorities were to be removed from the control of the Council with respect to amounts, interest rates and terms and conditions, and left to individual governments to determine;
- at its June 1982 meeting, the Loan Council also approved working arrangements which would permit States to establish central borrowing authorities, which among other things could raise funds on behalf of local governments and smaller authorities;
- also at the June 1982 meeting, the Loan Council agreed to the sale of Treasury bonds by tender and to the delegation to the Commonwealth Treasurer of the power to decide maturities, coupons, amounts to be offered and timing in respect of each tender;
- on 24 June 1982 the Commonwealth also moved to end leverage leasing arrangements between State statutory authorities and private companies which had given States freedom to raise capital outside Loan Council allocations, by announcing that equity participants in such arrangements would no longer be entitled to claim income tax deductions attributable to the assets (including depreciation, interest and investment allowances).

Payments to Local Government

Under the Fraser Government's new federalism policy, the equalisation grants, which had been payable on the recommendation of the Commonwealth Grants Commission under the Whitlam Government's approach, were modified in a number of important respects:

- from 1976–77, the total amount of assistance was related to personal income tax collections, the initial proportion of 1.52 per cent being raised to 1.75 per cent in 1979–80 and to 2.0 per cent in 1980–81;
- although the Commonwealth Grants Commission continued to advise the Government on the interstate distribution of the grants, the allocation among local governments within States was now to be based on recommendations of State Grants Commissions established for the purpose;
- in distributing grants to its local governments, each State was required to meet two conditions: first, not less than 30 per cent of the total amount must be allocated on a population basis, including population size and density and, second, the remainder could be allocated on an equalisation basis.

The effect of the new arrangements was to weaken the equalisation effect of the grants.

Evaluation of the Fraser Government's Economic and Fiscal Performance

The Australian economy at the end of the Fraser years was in serious recession. The number of unemployed had reached nearly 10 per cent of the workforce. In the fiscal year 1982–83 alone, the number of unemployed increased by 263,000.

As compared to the previous recession of 1974–75, there had been a much sharper fall in manufacturing activity — of the order of 11 per cent — in the latest recession. Private investment in dwelling construction had declined by around 25 per cent. The recession in the non-farm sector was accompanied by a sharp fall in the product of the farm sector, leading to the first reduction in gross domestic product since the Great Depression. In 1982–83, real Gross Domestic Product fell by 1.4 per cent compared with the previous financial year.

Prices for farm products, which had fallen the year before due to a continuation of depressed demand for Australian rural products on world markets, remained depressed in 1982–83. At the same time, prices for labour and material inputs increased, leading to a fall in farm incomes in real terms of 53 per cent, the largest percentage fall in 30 years (Commonwealth Budget Statement 1983–84, p.15).

To make things even worse, the decline in economic activity and employment was accompanied by a high rate of inflation and high interest rates. The Consumer Price Index increased by 11.5 per cent in 1982–83, more than twice the rate of inflation in Australia's major trading partners. This was despite the fact that, during the second half of the financial year 1982–83, the pressure on prices had eased somewhat, due to a slowing in the growth of labour costs, the breaking of the drought, and the slowing of inflation overseas. The annualised rate of increase in the CPI in the June quarter of 1983 was 11.2 per cent as compared with the same quarter of 1982.

Interest rates overseas as well as in Australia fell in 1982–83, after having peaked in 1981–82. The five year bond rate on 30 June 1983 was 14.35 per cent as compared with 16.40 per cent a year earlier. The Australian financial markets witnessed a substantial change in the net lending and borrowing positions of the major sectors of the economy. The corporate sector's net borrowings fell sharply, having risen significantly in 1981–82, despite reduced corporate profitability and cash flow. This was due mainly to a slump in fixed investment and a fall in inventories. Public sector net borrowings in 1982–83 more than doubled, however, rising from $4600 million in 1981–82 to $9800 million.

As noted earlier, the lack of an effective wages policy was a major failure of the Fraser Government. After falling in 1978–79, the annual rate of increase in average earnings started to get out of hand and reached nearly 14 per cent in 1981–82 (Table 1). The 'wage pause' imposed by the government in 1982 for a period of 6 months was a desperate measure which could at best postpone but could never remove the pressure of wage increases. As more than two-thirds of States' recurrent outlays represented wages and salaries, this failure also created budgetary problems for them, not just for the private sector and the Commonwealth.

The difficulties faced by the Fraser Government in its external policy were evident in the fact that the Australian dollar depreciated by 26.2 per cent against the trade-weighted index between 1975–76 and 1982–83. During the same period the current account deficit worsened to 5.8 per cent of GDP in 1981–82 and 4.0 per cent in 1982–83.

In summary, the combination of monetarism, deregulation of financial markets, uncontrolled wages and fiscal restraint resulted in conditions of high inflation and unemployment, a worsening trade position, and a debilitated public sector. Despite its policy failures and its attachment to monetarism, however, the Fraser Government was a moderate conservative government which did not apply, as its successor was to do, extremist free market ideology, so as to lay to waste the public sector and many manufacturing and rural industries, while allowing financial markets to effectively determine economic policies.

The tax-sharing arrangements fell far short of the promise of the new federalism policy. By 1983, vertical fiscal imbalance was even further entrenched than it had been in 1975 and, despite two wide-ranging inquiries by the Grants Commission progress towards horizontal fiscal equalisation had stalled. The Commonwealth Treasury's monetarist and fiscal conservatism ideology, and political expediency, had won the policy battle. The losers were the States and the Australian people.

THE HAWKE-KEATING YEARS

The Economy and Government Budgets

The economy recovered strongly in 1983–84. Gross domestic product increased by 5.6 per cent in real terms, and the rate of unemployment declined to 8.5 per cent at the end of August 1984. This recovery was also accompanied by a sharp fall in the rate of inflation. The increase in the CPI in 1983–84 was only 6.9 per cent and it fell further to only 3.8 per cent during the June quarter of 1984 as compared with the June quarter of 1983.

The Australian Labor Party had won the general election held on 3 March 1983, and assumed office under the leadership of R.J. (Bob) Hawke. One of the first, and arguably the most successful, economic policies put in place by the Hawke Government was the Prices and Incomes Accord, which had been reached between the ACTU and the Labor Party while in Opposition in the Federal Parliament. The Accord has since been retained under several different variations; by 1991 Accord Mark 6 was in place. The Accord agreements were not only about wage levels; the core of the Accord consisted of wage indexation to maintain real wages, wage increases to depend on productivity, a return to centralised wage determination, prices surveillance and, later, tax, social security and superannuation trade-offs. In contrast to the experience of the Fraser years, average wage increases slowed down immediately and significantly after the Labor Government came to power. As shown in Table 1, the increase in average earnings fell to 4.8 per cent in 1983–84, and except for 1985–86 remained below the inflation rate until 1990–91. The rate of inflation also fell consistently, except for reversals of the trend in 1985–86 and 1986–87. But unemployment remained high. Although it fell slightly in most years to 1988–89, it then increased to levels that have only been surpassed during the Great Depression.

Financial Deregulation

In a break with Labor traditions, the new Government embraced with missionary zeal policies of financial deregulation and, after 1984–85, even greater fiscal restraint than the Fraser

Government had imposed. The result was to be further impoverishment of the States and the Australian public sector, continuing balance of payments instability, chronically high interest rates and massive unemployment. Without precedent for a Labor Government, full employment ceased to be a policy objective and the Fraser Government's preoccupation with inflation was taken over by the Hawke Government as its major concern.

On 8 March 1983 the dollar was devalued by 10 per cent. On 12 December 1983, the dollar was allowed to float and most of the exchange controls were removed. In April 1983, the Government had appointed the Martin Committee to review the findings of the Campbell Report on the Australian Financial System. According to the account of events published recently by Hawke (1994), the Government had already made up its mind about the deregulation of the financial system before the Martin Committee was set up:

> What we needed was a short, sharp inquiry as a top-up to Campbell's report, now more than two years old. More importantly, we needed to shake the Campbell report free of its Fraser Government origins. Our own inquiry into Campbell's recommendations would give us a chance to dress Campbell in Labor cloth. (p. 235)

A wholesale deregulation of the Australian financial system followed the Martin Committee's report, which supported the thrust of the Campbell report. The process had started in December 1980 with the removal of interest rate ceilings on trading and savings bank deposits. Remaining ceilings on deposits and ceilings on lending rates, except for small home loans, were removed in 1985. Meanwhile, all controls on bank deposits had been removed and savings banks were permitted to offer chequeing facilities. In early 1985, sixteen foreign banks were invited to apply for licences to set up branches in Australia; fifteen of these eventually did open branches. Banking licences were also granted to certain buildng societies, credit unions and other non-banking financial institutions. In May 1985, the liquid assets government securities (LGS) ratio was replaced by a prime asset ratio (PAR). In September 1988, the statutory reserve deposits (SRD) ratio was replaced by non-callable deposits with the Reserve Bank.

In the 1983–84 and 1984–85 budgets, the Hawke Government continued with the practice of announcing targets for money supply growth as measured by M3. But in the wake of the deregulation of the financial sector, these targets became both difficult to maintain and far less useful indicators for policy. In early 1985, announcement of M3 targets was abandoned in favour of an approach under which monetary policy was determined in the context of major economic and financial indicators. Subsequently this approach was replaced by an approach which variously concerned itself with inflation, current account deficits, the exchange rate and interest rates.

The financial deregulation led to a credit explosion between 1983 and 1988. Bank credit increased by 140 per cent during this period and lending by all financial institutions increased by 113 per cent. As much of this credit flowed into asset purchases, it fed the asset inflation that occurred in this period. Except for some easing in 1987 and 1988, particularly in the wake of the stock market crash of 1987, monetary policy was kept tight throughout the 1983 to 1990 period.

Fiscal Policy

The credit explosion in the private sector, much of which supported speculative booms in securities and property and international currency manipulation, contrasted strangely with the credit restrictions which the same financial markets were urging on the public sector. However, in the Hawke Government's first two budgets, the objective of reducing unemployment was considered important and resulted in an expansionary fiscal policy. As a percentage of GDP, budget outlays increased from 28.8 per cent in 1982–83 to 29.9 per cent in 1984–85 (Table 2). Budget outlays in 1984–85 were higher in relation to GDP than in any other year since World War II. The budget deficit as a percentage of GDP increased in 1983-84, but fell in 1984–85, assisted by an upsurge in revenue in the latter year.

Despite the Government's success in increasing growth and reducing unemployment, concerns were expressed that the Government needed to restrain the growth in outlays and to reduce the budget deficit (Hawke, 1994, p. 262). Reflecting these concerns, Prime Minister Hawke announced the so-called Trilogy, which was a commitment not to increase Commonwealth taxation, public sector expenditure, and the budget deficit, as proportions of GDP, relative to the levels in 1984–85. At that time, both expenditures and taxes were at an all-time high as proportions of GDP. The Trilogy was not met in the case of revenue, which increased from 26.8 per cent of GDP in 1984–85 to 27.2 per cent in 1985–86 and 27.8 per cent in 1986–87. But outlays were reduced as a proportion of GDP in each of the subsequent five years, which also saw the budget deficit converted into a surplus in 1987–88.

The combination of Keynesian policies of fiscal expansion and the Prices and Incomes Accord in 1983–84 and 1984–85 had succeeded to a substantial extent in achieving high rates of growth, falling rates of inflation and, less dramatically, falling unemployment (Table 1). But the deregulation of financial and foreign exchange markets left the current account deficit as the Achilles heel of Australian economic policy. With the abandonment of expansionary policies in 1985–86, Australia became committed to a regime of low growth, high unemployment, continuing current account deficits and high interest rates.

The rate of growth in Commonwealth budget outlays fell slightly in 1984–85 and more so in 1985–86 and became negative in later years until 1990–91. The rate of growth of Commonwealth revenues in real terms also fell and, after rising in 1989–90, became negative. The Government's main preoccupation became one of reducing the budget deficit. Indeed, from 1987–88 to 1990–91, the budget was in surplus.

The budget for 1985–86 also marked the beginning of an era which was to last for seven years (ending 1991–92), in which each year witnessed a real terms reduction in general purpose payments and total net payments to the States and the Northern Territory.

From 1986–87, fiscal policy was also directed, not very successfully, to controlling the current account deficit. In 1985–86 the current account deficit had increased to 6.1 per cent of GDP, and was the worst on record. The seriousness of the situation was summed up by the Commonwealth Treasury in the following terms:

> By 1986 Australia was thus confronted with external accounts which were unsustainable in all but the near term. External constraints had closed in on the economy, requiring adjustments in policies, expectations and economic behaviour

> if living standards were to be improved in the longer term. (Budget Statement 1987–88, p. 42).

These events led to policy responses many of which profoundly affected the nature of fiscal federalism in Australia. These effects worked particularly through the high interest rates, tight control on public sector borrowings, and contractionary fiscal policy. It has been argued by Sheehan, Pappas and Cheng (1994) that, occurring in an environment of floating exchange rates and the broader process of financial deregulation , the large current account deficits put great pressure on financial markets and led to a sharp decline in the value of the currency. The Government's response was to adopt a policy of high interest rates to sustain the currency and to moderate the pace of economic activity. The consequential large differential between Australian and overseas interest rates created the conditions for a sharp increase in Australia's overseas debt. On the one hand, the interest differentials provided a strong incentive for Australian firms to borrow overseas. On the other hand it also became much more attractive for foreign investors to prefer lending to the provision of equity capital for Australian firms. Sheehan *et al* show (charts 9.1, p. 213) that Australia's international debt to equity ratio increased eight-fold from 0.36 in 1981 to 3 in 1986), and that the growth in Australia's net debt was strongly correlated with interest rate differentials between Australia and the U.S.A. (chart 9.2, p. 214).

Against this background, from 1985–86 onwards, contractionary fiscal policy and tight monetary policy shaped the Commonwealth's attitude towards, and the outcomes of the Premiers' Conferences and Loan Council meetings regarding the level of general purpose grants to the States and borrowings of their semi-government and local authorities.

Between 1985–86 and 1989–90, the Commonwealth pursued the aim of ruthlessly reducing public services and public sector borrowing. As shown in Table 2, the Commonwealth budget deficit was reduced progressively from 2.3 per cent of GDP in 1985–86 to a surplus of 2.2 per cent of GDP in 1989–90. Commonwealth Budget outlays as a proportion of GDP fell from 29.5 per cent in 1985–86 to 23.7 per cent in 1989–90. Commonwealth payments to or for the States were among the first category to be targeted by this contractionary fiscal policy, falling from 9.3 per cent of GDP in 1985–86 to 7.0 per cent in 1989–90.

The same restraint was not shown in the Commonwealth's own-purpose expenditures, except in the case of social security and welfare where substantially increased expenditures were necessitated by the Government's failure to achieve anything approaching full employment.

By the end of 1989–90, the real rate of growth of GDP had fallen to 3.4 per cent, and the rate of unemployment, while lower than it had been in 1983–84, was clearly rising again. The rate of inflation as measured by the CPI was still high. The exchange rate had fallen both against the U.S. dollar and the trade-weighted index. The five-year bond rate was higher in 1989–90 at 13.8 per cent than in 1985–86. The current account deficit had increased to 5.7 per cent of GDP. All in all, the Australian economy was in a worse state at the end of 1989–90 than it had been in 1983–84.

With Australia now in the grip of a serious recession, gross domestic product actually fell in 1990–91 and the unemployment rate increased to 8.4 per cent.

Extraordinary as it was, the Commonwealth persisted with tight fiscal and monetary policies and brought down a budget in 1990–91 aimed at producing an even larger surplus. Not until 1991–92, after Treasurer Keating had resigned, was the budget strategy changed to provide some stimulus to the economy.

The Labor Government issued two new statements in 1991–92 addressing the economic situation. On 14 November 1991, Prime Minister R.J. Hawke released the Statement on the Economy and Employment which outlined major expansions of labour market programs and education and training opportunities. The Statement also included measures for bringing forward infrastructure spending and spending on industry development programs. On 26 February 1992, the new Prime Minister P.J. Keating released the One Nation Statement which included furtehr measures aimed at providing 'a significant short-term boost to economic activity'. Expansionary budgets continued in 1992–93 and 1993–94.

Evaluation of the Economic Performance of the Hawke and Keating Governments

The Hawke Government, whose fiscal policies had been developed by Treasurer Keating in line with the deregulation and other economic fundamentalist policies being promoted by Commonwealth Treasury, shared with the Fraser Government a refusal to examine its economic performance in the light of its professed objectives, and hence a refusal to modify policies that were clearly not working. Judged by the outcome of its policies with respect to economic growth, unemployment, interest rates and the current account deficit, the Hawke and Keating Governments' performance has been appalling — as bad as or worse than that of the Fraser Government. Only their wages policy was an unqualified success; although they succeeded in pegging back inflation, this was only achieved by pushing the economy into deep recession.

Although the Hawke/Keating policies of microeconomic reform have had some success in improving the efficiency of the Australian economy, they have been associated with a doctrinaire approach to privatisation, job-shedding in both the public and private sectors without corresponding action to create new jobs, discrimination against Australian manufacturers and primary producers through exposure to unilateral free market policies, a coercive impoverishment of the State public sector, subservience to financial and foreign exchange markets in making economic policy decisions, and a shift in income distribution from the poor to the rich. Together they add to a strange mix of policies for a Labor Government.

Payments to or for the States

Over the period of the Hawke and Keating Governments total payments to or for the States fell from 9.5 per cent of GDP in 1982–83 to 7.3 per cent of GDP in 1993–94 (Table 3). The really savage reductions occurred between 1984–85 and 1989–90, when payments fell by 2.7 percentage points as a share of GDP, from 9.7 per cent to 7.0 per cent.

General Revenue Grants

Unlike the Fraser years, the heaviest reductions in this period were concentrated in general revenue grants, which fell from 5.4 per cent of GDP to 3.3 per cent between 1982–83 and 1993–94. (About half of the reduction between 1987–88 and 1990–91 was, however, due to a reclassification of identified health grants to specific purpose payments and to general revenue grant offsets in recognition of the transfer of some taxing powers to the States.) This unprecedented change could not have happened if formula funding arrangements, which had been in place in one form or another since 1942, had continued. The Commonwealth abandoned the formula funding arrangements in 1985-86 when it refused to renew the tax-sharing arrangements then in place. Financial assistance grants, as the name of general revenue grants then became, were determined for 1985–86 as an interim year at the same real level as in 1984–85. In 1986–87 these grants increased by 2 per cent in real terms. After a year in 1987–88 when there was no real growth in financial assistance grants, they were substantially reduced in real terms until 1991–92, 1992–93 and 1993–94, when the lower level reached in the previous year was maintained. In 1994–95, the best that the Commonwealth could do, after many years of reducing or constant grants in real terms, without any recognition of population growth or of the growing fiscal needs of the States, was to adjust the financial assistance grants to maintain their level in real per capita terms. There was still no real growth and the States remained in the grip of the Commonwealth's financial straitjacket.

With the Hawke Government's decision to end formula funding, the level of revenue-sharing grants was determined unilaterally and arbitrarily by the Commonwealth in the light of its own budgetary priorities, not those of the States. The consideration given to the fiscal needs of a Commonwealth Government department was always greater than that given to the needs of the States. The level of general revenue grants simply became the first and principal casualty in the drive for reductions in Commonwealth budget deficit. Vertical fiscal imbalance thus remained acute. Although the States responded to the loss of grant revenue by increasing their own taxes, the net result was a significant reduction in the level and quality of government services. The down-sizing of government was, indeed, an explicit intention of the Commonwealth as part of its laissez-faire economic policies.

Horizontal Fiscal Equalisation

On the other hand, horizontal fiscal equalisation became firmly established as the principle determining the distribution of general revenue grants among the States. The Fraser Government had only half-heartedly implemented the assessments made in the 1982 and 1983 reviews by the Commonwealth Grants Commission. The Hawke Government implemented fully the relativities assessed by the Commission in the 1985 and 1988 reviews of relativities. It also reached agreement with the States to have the relativities updated on an annual basis from 1989, while continuing with the major reviews of the methodology of fiscal equalisation every five years. The process of achieving horizontal fiscal balance, which the Fraser Government had commenced but left unfinished, was therefore complete.

One consequence of the application of the principle of fiscal equalisation was that some States, particularly New South Wales and Victoria, received progressively smaller shares of the declining overall pool of Commonwealth grants until 1993–94. This certainly accentuated the budgetary pressures in these two States during this period. This effect of 'double whammy' is well documented in Victoria's and New South Wales's budget papers for this period.

Commonwealth Budget outlays declined from 28.8 per cent of GDP in 1982–83 to 26.9 per cent in 1992–93 (Table 2). The reduction in Commonwealth payments to or for the States accounted for most of this fall.

Specific Purpose Payments

Specific purpose payments increased as a percentage of GDP, from 3.3 per cent in 1982–83 to 3.8 per cent in 1991–92, 4.2 per cent in 1992–93 and 3.9 per cent in 1993–94 (the figures for 1992–93 were inflated by an assistance package for South Australia to reduce the State's debt burden and to provide for the sale of the State Bank of South Australia, and by tax compensation to New South Wales for the sale of the Government Insurance Office).

The growth in specific purpose payments relative to GDP was due partly to an increase in basic health funding, from 0.74 per cent in 1982–83 to 0.94 per cent in 1992–93 as a consequence of the Government's Medicare program, and partly to a proliferation of recurrent programs in social security and welfare, housing and community services, culture and recreation, and legal aid. During the mid-1980s, employment programs were also important. The number of recurrent programs increased from 45 in 1982–83 to 72 in 1992–93, emphasising the Commonwealth's increasing intrusion into State affairs. By contrast, both the number and the level of capital payments fell over the period, in line with the Hawke and Keating Governments' general approach to capital funding.

Repayments of Commonwealth specific purpose advances and sinking fund payments by the States, which had amounted to $320.1 million or 0.2 per cent of GDP in 1982–83, increased to $2670.2 million or 0.7 per cent of GDP in 1992–93 — further evidence of the deterioration in State finances.

With the exception of health, most of the major specific purpose grant programs received funding cuts or were barely maintained. Higher education grants were reduced from 0.95 per cent of GDP in 1982–83 to 0.74 per cent in 1993–94, despite very large Government-stimulated increases in student numbers (from 350,000 in 1983 to over 600,000 in 1994). Hardly any improvement was recorded in TAFE funding (from 0.13 per cent to 0.14 per cent of GDP), despite large increases in enrolments and many other prospective students being denied admission. Schools funding was roughly maintained, from 0.69 per cent to 0.71 per cent of GDP. Road funding fell from 0.50 per cent to 0.44 per cent of GDP, while housing funding increased from 0.20 per cent to 0.24 per cent. However, the reduction in road grants was associated with a partial shift to general revenue funding when the Commonwealth confined itself to financing the National Highway System. The 1992–93 level of road funding was unusually high and was reduced by more than half in the next two years. There was little joy for the States in respect of Commonwealth support for their major constitutional responsibilities.

General Purpose Capital Assistance

General purpose capital assistance to the States continued to diminish under the Hawke Government as it had done under the Whitlam and Fraser Governments, until by 1989–90 it had virtually disappeared (Table 3). One reason for this was that after 1988–89 no new loans were raised by the Commonwealth on behalf of the States under the Financial Agreement of 1927. Concessional loans for housing were replaced by additional grants under the Commonwealth–State Housing Agreement, while general purpose capital grants were continued but at a diminishing real level until they were abolished from 1994–95. From 1991–92, however, they were supplemented by small grants under the Commonwealth's Building Better Cities Program.

The new borrowing arrangements from 1989–90 were intended to make the States responsible for financing and managing their own debt. Most State and local borrowing was undertaken by State central borrowing authorities, at higher rates than the Commonwealth has to pay. Since 1984 the so-called global approach had operated to bring nearly all borrowing by Commonwealth and State semi-government and local authorities within global limits that were effectively determined by the Commonwealth. Some public trading enterprises operating in a fully commercial manner were exempted. The global approach also did not cover borrowings by statutory marketing authorities, public financial enterprises, and borrowings by the Commonwealth under the Financial Agreement.

At the June 1990 Loan Council meeting, it was agreed that the States would progressively redeem the debt which the Commonwealth had issued on their behalf under the Financial Agreement, by making annual payments to the National Debt Sinking Fund so as to fully take over the debt by 2005–06. The Financial Agreement was accordingly amended to permit the States to borrow in their own names in the domestic market, and to remove the requirement that Commonwealth and State borrowing must be approved under the provisions of the Financial Agreement. The Commonwealth agreed to provide compensation for the additional interest payable by the States as a result of the refinancing of Commonwealth debt as State debt, and the global borrowing limits were increased to allow for the additional borrowing to refinance maturing Financial Agreement debt.

The net effect of the new arrangements was to change the structure of Australian public sector debt, but not the amount. State indebtedness to the Commonwealth was replaced by indebtedness to the private sector, and Commonwealth debt to the private sector correspondingly reduced. Because there was no change in the effective risk attaching to the securities, the higher interest rates under new arrangements represented a gain for private sector and overseas lenders and a net cost to taxpayers.

The replacement of the Commonwealth debt to the private sector by State debt was described by the Commonwealth as a significant structural reform in Commonwealth-State financial relations in that it placed full responsibility on the States and Territories for financing and managing their own debt, and exposed their borrowings to growing scrutiny by community and financial markets (Commonwealth Budget Paper No. 4 (1990–91, p. 65).

A New Instrument of Fiscal Restraint

A problem that had developed with the global limits, which was similar to the problem that had led to the adoption of the global approach in the first place, was that the limits were being circumvented by various sophisticated financing devices designed to remove borrowing from Loan Council control.

Accordingly at meetings in December 1992 and July 1993, the Loan Council adopted new arrangements involving a switch from gross borrowings and global limits to a measure of the aggregate financial requirements of governments, as indicated by net borrowings based on their deficits (or surpluses). The new measure, on which so-called Loan Council Allocations (LCAs) were to be based, was considered to be a better indicator of the impact of the public sector on the economy and of the exposure of a government to financial markets. (Commonwealth Budget Paper No. 3, 1993).

Under the new arrangements, borrowings were no longer allocated among governments on a population-based formula, but were set by the Loan Council after each government had nominated its intended allocation, which was based on its deficit/surplus plus specified memo items, described as transactions with the characteristics of borrowings but not usually borrowings in a formal sense. Projections in the *National Fiscal Outlook* report were used by governments as a basis for their nominations, thereby facilitating a more co-ordinated approach to fiscal policy.

Memo items included: operating leases, transactions involving the sale of assets that are financed on a recourse basis, private sector involvement in public sector infrastructure, public sector superannuation funds, local government borrowings, statutory marketing authorities and, as exempt transactions under the global approach, the deficit/surplus of central borrowing authorities and the deficit/surplus of exempt public trading enterprises (as negative memos).

The Loan Council then considered the nominated LCAs from the perspective of macroeconomic policy, comparative fiscal circumstances, infrastructure requirements and the capital needs of individual governments; and negotiated adjustments if it considered them to be necessary. If the Council had concerns about the fiscal outlook for a particular government it could require justification or require a change. Governments with negative or modest LCAs would be exempt from the adjustment process.

The new arrangements were to be supported by the development of uniform and more comprehensive arrangements for the reporting of public sector finances, with governments reporting quarterly and annually. During a transitional period, global limit equivalents were set against the LCAs and could be used as a basis for reporting.

As finally approved, the LCAs consisted of the sum of three components: the general government deficit, the net financing requirement of public trading enterprises, and the memo items. With the Commonwealth included fully in the LCA process, all public sector borrowings were now brought within the purview of the Loan Council and became subject to Loan Council approval. To give individual governments some flexibility and allow for difficulties in estimating budgets, small tolerance limits were set to apply between the time of LCAs being approved and the budget LCA, and with respect to a government's compliance with its budget LCA. If the tolerance limits were to be exceeded, the Loan Council would require public explanation and could take other action.

The new system was summarised, in a 1993 Budget Paper issued by the Commonwealth Treasurer (Mr John Dawkins), as being intended to:

- facilitate financial market scrutiny of public sector finances via better reporting and so make jurisdictions more accountable to markets;
- enhance the role of Loan Council as a forum for coordinating public sector borrowings in the light of the national fiscal situation and the fiscal policy imperatives confronting individual governments;
- promote greater public and financial market understanding of budgetary processes; and
- provide the basis for States assuming greater freedom and responsibility in determining their financing requirements consistent with their fiscal and

> debt position and overall macroeconomic constraints. (Commonwealth Budget Paper No. 3 (1993, pp. 67–8).

If the Loan Council were to become a truly federal body, with the States having the same financial strength and the same ability to influence economic policy decisions and determine their financing requirements as the Commonwealth, the new arrangements could represent a significant improvement in macroeconomic management and a move towards greater fiscal balance between the Commonwealth and the States. The policy-co-ordination role of the Loan Council would be similar to the role it played in determining economic policies during the Great Depression.

Despite the claims made for the new system, however, it is not likely to result in any real improvement in either macroeconomic policy-making or in the overall fiscal position of the States. Indeed, it seems more likely to be used as an additional instrument for enforcing the Commonwealth's deflationary policies and its fiscal stranglehold over the States.

The National Fiscal Outlook (NFO) report, which is prepared annually by a working party of Commonwealth and State Treasury officers, makes projections of the Commonwealth and State budgetary outlook in the medium term (over 5 years), on the assumptions of no policy changes and current trends in real GDP, employment, wages and the CPI. The NFO projections then become the basis of State LCA nominations and of the Loan Council determination of the aggregate borrowing requirement of governments.

The whole approach is essentially an exercise in fiscal restraint, with the major emphasis in 1993 and 1994 being placed on reduction in budget deficits and reductions in government outlays, rather than on positive goals of reducing unemployment, fostering growth and reversing the run-down of the public sector.

In the 1993 NFO report, one of the conclusions was that consideration needed to be given 'to the financial position of the States having regard to the growing demands on their resources. Areas that could be reviewed include Commonwealth/State financial relations (in particular the extent of the States' own-source revenue base and the allocation of functional responsibilities for expenditure between the Commonwealth and the States) and wage arrangements in the public sector.'

There is no evidence that the Loan Council or the Commonwealth responded to this in any positive way. The Loan Council considered that the 1993–94 LCA aggregate would need to be wound back in future years (Commonwealth Budget Paper, 1993, p. 69). In 1994–95, LCAs agreed by the Loan Council were well below those agreed for 1993–94, although they were not very different from actual outcomes. The National Fiscal Outlook report for 1994 projected real falls in State outlays, due among other things to announced measures to reduce the public sector workforce, and to falling capital expenditure. It even indicated, in relation to its projections of reductions in expenditure on capital works (as a result of completion of projects and restraint on future capital expenditure), that its projections might 'reflect a conservative bias inherent in the no policy change assumption' (Working Party of Commonwealth, State and Territory Treasury Officials, 1994, p. viii).

The foregoing statement that the new LCA system was designed to facilitate financial market scrutiny of public sector finances and 'make jurisdictions more accountable to the markets' is itself an indictment of the Commonwealth's priorities (Commonwealth Budget

Paper, 1993, p. 4). The Australian governments' first responsibility is to their citizens, and it is them that the governments should be accountable and not to the financial markets.

Assistance to Local Government

Until 1984–85, the arrangements in place under the Fraser Government continued to apply and general purpose assistance to local authorities was determined as 2 per cent of net personal tax collections. In 1985–86, these arrangements were replaced by the *Local Government (Personal Income Tax Sharing) Amendment Act* 1985, and assistance provided in 1984–85 was increased by 2 per cent in real terms. These arrangements were replaced in 1986–87 by the *Local Government (Financial Assistance) Act 1986* following the report of the National Inquiry into Local Government Finance (chaired by Professor Peter Self). In 1986–87 and 1987–88, general revenue assistance to local authorities was determined by increasing the amount received in the previous year by the larger of (a) the percentage increase in the CPI in the year ending March Quarter or (b) the percentage increase in general purpose payments to the States. As the latter were actually declining in each of these two years, the increase in CPI became the effective choice. From 1988–89, however, assistance to local authorities increased at the same rate as general purpose payments to the States.

Commencing in 1986–87, the distribution of total assistance to the States was phased to an equal per capita basis by 1989–90, each year moving pro-rata to the new base. Each State and the Northern Territory was obliged to develop by 1 July 1987, and to implement by 1 July 1991, principles for the distribution of its share among local authorities. These principles were required to have regard to the objective of horizontal fiscal equalisation and had to be approved by the relevant Commonwealth Minister. When the rate of growth in general purpose payments to the States was reduced due to the application of the offsets principle or adjustments in the classification of payments (as occurred in 1989–90 when half of the Loan Council program of the States was transferred to the Commonwealth–State Housing Agreement), the underlying, not the actual, rate of growth was applied for determining assistance to local authorities. In 1991–92, the legislation was amended to enable the use of the rate of growth in general revenue assistance to the States, instead of general purpose assistance, as the reference rate. This virtually meant that the real level of assistance to local authorities was maintained.

Reform of Fiscal Federalism

In July 1990, Prime Minister Hawke announced that under the auspices of a Special Premiers' Conference a wide-ranging review of intergovernmental relations would be undertaken. The objective of this process was to examine, in a co-operative way, the scope for altering the current distribution of functions between the levels of government to enhance national efficiency and international competitiveness, and to improve the delivery and quality of the services provided by the governments. A review of intergovernmental financial relations was also a part of this process. Initially, in the Prime Minister's statement, the review of financial relations only referred to the need for an examination of specific purpose grants with a view to minimising the overlap between the different levels of government. Subsequently, however, the Premiers succeeded in also putting on the agenda the issue of vertical fiscal imbalance and the States' taxing powers.

Two separate working parties of Commonwealth-State officers were asked to prepare reports on the issues of tied grants and vertical fiscal imbalance. These reports were to be considered by the Special Premiers' Conference in November 1991. However, the struggle for the leadership of the Parliamentary Labor Party intervened to halt this process before tangible progress could be made. After losing a challenge for the party leadership in June 1991, P.J. Keating resigned as Treasurer and from Cabinet. In October 1991, in the capacity of a Labor backbencher, he addressed the National Press Club and expressed strong opposition to the proposal, at the time a part of the draft report of the officers' working party, to allow the States to impose personal income tax (with a corresponding reduction in financial assistance grants and in the Commonwealth tax rates so that neither the total tax burden on the community nor total cost to the Commonwealth budget would be increased). Mr Keating's opposition was directed to the potential erosion of Commonwealth's dominance in the economy that he said would follow such a change:

> Economic management has had to develop from the Commonwealth's power over revenue and the creation of a monetary authority. The national perspective dominates Australian political life because the national government dominates revenue raising, and only because the national government dominates revenue raising. (Keating, 1991)

In other words, the only reason given for opposing a more rational and efficient distribution of taxing powers was one not of principle but of retaining fiscal dominance; might was asserted to be right.

Following a disagreement between the Commonwealth and the States on the status of vertical fiscal imbalance on the agenda of the Special Premiers' Conference, the meeting scheduled for 21 November did not take place and the process of reform came to a halt.

A number of useful initiatives in other areas had been taken under the Special Premiers' Conference process, directed towards the creation of a national electricity grid, standardised licensing and charging for heavy vehicles, and the creation of a national market for products, services and professions. Work on some of these initiatives has since been resumed under the auspices of the newly-created Council of Australian Governments (COAG), which now meets regularly as a virtual non-financial Premiers' Conference. The Prime Minister, Premiers and Chief Ministers are members of COAG. The COAG meeting in May 1992 asked Commonwealth and State Treasury officers to prepare a National Fiscal Outlook document outlining the medium term budgetary outlook for both the Commonwealth and the States. The report on the National Fiscal Outlook is now an annual publication and, as seen above, has become a part of the Loan Council process.

From the standpoint of fiscal federalism, the period between 1982–83 and 1992–92 witnessed a marked increase in the centralisation of economic policy making. As noted above, this had been made possible by the vertical fiscal imbalance which gives the Commonwealth a commanding position over public revenues. But the policy stance also appears to be entrenched in the belief that every important economic decision must be made by the Commonwealth Government, irrespective of the availability of the necessary information in Canberra on which to base the decisions. This zeal for centralisation in public affairs is in striking contrast to the Hawke/Keating Governments' policies towards the private sector, reflecting an ideology which asserts that decentralised decisions produce the best outcomes for the nation.

Institutionalised arrangements, which had for many years represented the federal character of Australian public sector, were dismantled in this period if they stood in the way of centralised policy-making. This is particularly true of the tax-sharing arrangements in place since 1976 and the formula based general revenue grants of earlier years. Legislation empowering the States to impose surcharges or grant rebates on income tax was repealed, even through, as noted earlier, the States had not taken advantage of the opportunity provided by it. Institutions such as the Advisory Council for Inter-government Relations were unceremoniously abolished. New Loan Council arrangements, ostensibly purporting to open up government borrowing to market forces in line with the Government's ideology, further tightened the screws on the States. And when it became a potential threat to the Commonwealth's fiscal dominance, even the Special Premiers' Conference was abandoned.

In one sense, there is an underlying continuity between the philosophical positions adopted towards the States by the Whitlam Government and the Hawke and Keating Governments. In both periods, the States were treated with scorn and suspicion and their fiscal autonomy undermined. In both cases, the Commonwealth exploited its fiscal dominance to the full. In the Whitlam period, this took the form of a virtual flood of specific purpose funds. In the latter period, it took the form of a virtual drought of funds, particularly general purpose funds, and a drying up of capital funds through tight control of the Loan Council.

The following quotation sums up the situation even if it was written several years ago:

> It is paradox of Australian political philosophy and economic policy that the shift to deregulation of the private sector and to privatisation of public enterprises has been accompanied by very little relaxation of the control which the Commonwealth Government exercises over the constitutionally autonomous States. Although there was a move towards circumvention of Loan Council constraints and deregulation of semi-government and local borrowing during 1982 and 1983, both Labor and non-Labor parties and governments, State as well as Federal, seemed to have more enthusiasm for deregulating financial markets in the private sector than for adopting decentralising or co-ordinating policies to ensure that governments with constitutional and political responsibility for taxing and spending decisions all have an effective voice in the making of those decisions. (Mathews, 1986)

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Table 1: Selected Economic Indicators

Year	Real GDP (% change)	Rate of unemployment (%)[a]	Change in CPI (%) annual average	Average earnings [c]	Exchange rate $US[d]	Exchange rate TWI[d] (May 1970=100)	Five year bond rate[d]	Change in M3 (%)[e]	CAD (% of GDP)
1969–70	6.4	1.4	3.2	8.4	1.1159	99.6	6.62	6.2	–2.2
1970–71	5.0	1.7	4.8	11.1	1.1266	99.8	6.53	6.8	–2.1
1971–72	4.0	2.5	6.8	10.4	1.1910	98.5	5.50	10.5	–0.7
1972–73	4.5	1.8	6.0	9.6	1.4167	107.9	6.42	25.7	1.7
1973–74	4.6	2.4	12.9	18.1	1.4875	117.3	9.92	14.5	–1.7
1974–75	1.3	4.6	16.7	28.3	1.3258	105.3	9.03	15.4	–1.8
1975–76	2.4	4.7	13.0	15.2	1.2356	105.3	9.41	14.4	–1.9
1976–77	2.9	5.7	13.8	12.9	1.1155	92.5	10.21	11.0	–2.8
1977–78	0.9	6.2	9.5	10.0	1.1475	86.2	9.09	8.0	–3.2
1978–79	5.0	5.9	8.2	7.4	1.1211	83.1	10.00	11.8	–3.4
1979–80	2.4	5.9	10.2	9.6	1.1576	85.0	11.78	12.3	–1.6
1980–81	3.4	5.6	9.4	13.3	1.1480	92.9	13.10	12.7	–3.9
1981–82	1.6	6.7	10.4	13.8	1.0223	88.2	16.40	11.3	–5.8
1982–83	–1.4	9.9	11.5	12.8	0.8745	77.7	14.35	12.5	–4.0
1983–84	5.6	8.5	6.9	4.8	0.8613	79.2	12.90	10.6	–3.8
1984–85	5.4	7.9	4.3	6.9	0.6655	65.0	13.35	17.5	–5.3
1985–86	3.9	8.0	8.4	6.2	0.6772	56.3	12.80	13.0	–6.1
1986–87	2.5	7.8	9.3	7.2	0.7203	56.6	13.10	12.8	–4.7
1987–88	4.8	6.8	7.3	6.8	0.7940	59.8	11.95	13.3	–3.7
1988–89	4.1	5.7	7.3(b)	7.2	0.7553	59.4	14.20	27.9	–5.3
1989–90	3.4	7.0	6.7(b)	6.6	0.7890	61.6	13.80	14.4	–5.7
1990–91	–0.2	8.4	5.6	5.7	0.7681	58.9	11.05	6.4	–4.2
1991–92	0.4	10.4	3.2	4.5	0.7488	58.2	7.85	2.9	–3.1
1992–93	2.5	11.0	2.0	3.4	0.6722	52.3	6.85	10.1	–3.8

Notes:
(a) Figures are from the Labour Force Survey and refer to the rate of unemployment at the end of August each year. The unemployment rate is defined as the ratio of unemployment to the labour force, expressed as a percentage.
(b) A changed treatment of mortgage interest charges was introduced in the March quarter 1989, affecting these figures
(c) The ratio of non-farm wages, salaries and supplements to the number of non-farm wage and salary earners, expressed as a weekly average.
(d) Figures are for 30 June each year.
(e) Currency plus bank deposits of the private non-bank sector (with the exception of savings banks prior to 1989). These figures are averages of weekly figures; data for those banks previously classified as savings banks are averages of end-month data (May and June) prior to 1989.
(f) International reserves 30 June.

Table 3: Payments to or for the States 1972–73 to 1993-94[(a)]

	$ million	% of GDP	% of total	$ million	% of GDP	% of total	$ million	% of GDP	% of total	$ million	% of GDP	% of total
	1972–73			**1973–74**			**1974–75**			**1975–76**		
Gen. rev.	1,700.9	3.8	47.1	1,923.5	3.6	44.1	2,513.5	3.9	38.3	3,111.6	4.1	36.4
Sp. pur. rec.	389.5	0.9	10.8	609.7	1.1	14.0	1,221.5	1.9	18.6	2,316.2	3.0	27.1
Sp. pur. cap.	541.6	1.2	15.0	958.4	1.8	22.0	1,745.5	2.7	26.6	1,836.3	2.4	21.5
Gen. pur. cap.	982.0	2.2	27.2	867.0	1.6	19.9	1,087.4	1.7	16.6	1,291.0	1.7	15.1
Total	3,614.0	8.1	100.0	4,358.6	8.1	100.0	6,567.9	10.2	100.0	8,555.0	11.2	100.0
	1976–77			**1977–78**			**1978–79**			**1979–80**		
Gen. rev.	3,722.6	4.3	40.7	4,341.4	4.6	42.5	4,800.4	4.4	44.8	5,428.3	4.4	47.7
Sp. pur. rec.	2,387.6	2.7	26.1	2,873.9	3.0	28.1	3,047.7	2.8	28.4	3,360.3	2.7	29.5
Sp. pur. cap.	1,680.9	1.9	18.4	1,575.2	1.7	15.4	1,437.8	1.3	13.4	1,345.8	1.1	11.8
Gen. pur. cap.	1,356.0	1.6	14.8	1,433.8	1.5	14.0	1,433.8	1.3	13.4	1,245.0	1.0	10.9
Total	9,147.1	10.5	100.0	10,224.3	10.8	100.0	10,719.7	9.9	100.0	11,379.4	9.3	100.0
	1980–81			**1981–82**			**1982–83**					
Gen. rev.	6,313.1	4.5	49.2	8,249.3	5.3	58.8	9,221.8	5.4	58.8			
Sp. pur. rec.	3,978.8	2.8	31.0	3,152.6	2.0	22.5	3,918.2	2.3	25.0			
Sp. pur. cap.	1,194.9	0.9	9.3	1,296.1	0.8	9.2	1,711.6	1.0	10.9			
Gen. pur. cap.	1,345.5	1.0	10.5	1,345.5	0.9	9.6	1,413.2	0.8	9.0			
Total	12,832.3	9.2	100.0	14,043.5	9.0	100.1	16,264.8	9.5	103.6			
	1983–84			**1984–85**			**1985–86**			**1986–87**		
Gen. rev.	10,362.1	5.4	55.5	10,978.9	5.1	52.9	11,913.5	5.0	54.0	13,216.0	5.0	56.6
Sp. pur. rec.	4,600.9	2.4	24.6	5,441.8	2.5	26.2	5,749.6	2.4	26.1	6,026.6	2.3	25.8
Sp. pur. cap.	2,239.3	1.2	12.0	2,579.1	1.2	12.4	2,648.8	1.1	12.0	2,790.6	1.1	11.9
Gen. pur. cap.	1,512.0	0.8	8.1	1,610.3	0.8	7.8	1,736.0	0.7	7.9	1,336.0	0.5	5.7
Total	18,714.3	9.7	100.2	20,610.1	9.6	99.3	22,047.9	9.3	100.0	23,369.2	8.9	100.0
	1987–88			**1988–89**			**1989–90**			**1990–91**		
Gen. rev.	14,248.2	4.8	59.1	12,543.0	3.7	51.2	12,905.0	3.5	50.1	13,167.0	3.5	47.4
Sp. pur. rec.	6,392.6	2.2	26.5	8,617.0	2.6	35.2	9,372.0	2.5	36.4	10,334.0	2.7	37.2
Sp. pur. cap.	2,830.3	1.0	11.7	2,710.0	0.8	11.1	3,163.0	0.9	12.3	3,994.0	1.0	14.4
Gen. pur. cap.	621.0	0.2	2.6	621.0	0.2	2.5	311.0	0.1	1.2	296.8	0.1	1.1
Total	24,092.1	8.1	100.0	24,491.0	7.3	100.0	25,751.0	7.0	100.0	27,791.8	7.3	100.0
	1991–92			**1992–93**			**1993–94**					
Gen. rev.	13,294.0	3.4	46.3	13,700.0	3.4	44.1	14,050.9	3.3	45.3			
Sp. pur. rec.	11,802.0	3.0	41.1	12,570.2	3.1	40.4	13,494.5	3.2	43.5			
Sp. pur. cap.	3,302.0	0.8	11.5	4,362.3	1.1	14.0	2954.0	0.7	9.5			
Gen. pur. cap.	338.3	0.1	1.2	461.5	0.1	1.5	508.0	0.1	1.6			
Total	28,736.3	7.4	100.0	31,094.0	7.7	100.0	31,007.4	7.3	100.0			

Notes: (a) Excludes the Northern Territory before 1980–81. Excludes the ACT and payments direct to local governments.

Source: *Payments to or for the States and Local Government*, various years 1977–78 to 1993–94, Budget Paper No. 7, or No. 3; *Commonwealth Financial Relations with Other Levels of Government*, 1993–94, Budget Paper No. 3, Table 2 and *Final Budget Outcome 1993-94*, AGPS, August 1994, Table 5.