GOVERNMENT BORROWING IN AUSTRALIA

BY CHERYL SAUNDERS*

[*The level of government borrowing has been a major issue in the debate on Australian economic problems in recent years. Beyond an assumption that borrowing takes place through the Loan Council under the Financial Agreement of 1927 the actual procedures followed have received almost no attention. This article examines both the history and the current operation of government borrowing procedures in Australia. While they represent a long standing example of the familiar phenomenon of intergovernmental relations they are also in many respects unique, partly because of their constitutional basis in section 105A. The article shows that the practices now followed in government borrowing have departed so far from the legal form as to make the latter a fiction. It suggests that the opportunity should be taken to restructure and reform government borrowing arrangements, preferably in the context of federal financial arrangements as a whole.*]

I *INTRODUCTION*

Government borrowing occupies a special place in the story of Australian federalism. The co-ordination and control of borrowing has been a recurring theme, predating federation itself. The reasons it has attracted the interest of successive governments have varied with prevailing economic and political circumstances but a connection of some kind between borrowing and that other perennial problem, revenue redistribution, has usually been present.

There are also other reasons for the particular significance of the borrowing arrangements. First, they have contributed to two of the most dramatic moments in Australian political life: the dismissal of Premier Lang by the Governor of New South Wales in 1932 and, in an uncanny echo forty-three years later, the dismissal of Prime Minister Whitlam by Governor-General Kerr. Second, unlike most intergovernmental arrangements, those for borrowing are formally structured, even to the point of having an explicit constitutional basis.[1]

This distinguishing feature, itself a point of interest, is made even more noteworthy by the fact that the actual purpose and functions of the borrowing arrangements have now departed so far from the originals that the formal structure is positively misleading. And finally, the borrowing arrangements have given rise to various complex legal questions, characteristic of the problems which tend to be posed by intergovernmental arrangements generally for the Australian constitutional system.

This paper considers government borrowing in Australia from each of these perspectives. The final section looks to the future. The arrangements for government borrowing in Australia no longer serve the purpose for which they were originally devised. Partly because an old form has been so extensively

* LL.B. (Hons) (Melb.), B.A. (Melb.), Ph.D. (Melb.), Professor of Law, University of Melbourne. The assistance of John Daley, research assistant, in collection of materials for parts of this paper is gratefully acknowledged.

[1] S. 105A.

adapted to new purposes, there are serious accountability problems and apparent inefficiencies in the current system. One question which arises is whether co-operative processes now should be retained at all and, if so, for what purpose. Whatever the answer, it is clear that the existing arrangements require extensive change. Ironically, this may be difficult to achieve. Governments are accustomed to working with the present structure. Some might lose financially from change, at least in the short term. One argument which could inject greater urgency into the debate is that the binding quality of the existing arrangements has expired through effluxion of time. This issue is addressed at the end of the paper.

II *THE RECURRING THEME*

Pre-federation

The Constitution of the Commonwealth of Australia was drafted by representatives of the Australian colonists in two successive Conventions in the 1890s, before final enactment by the United Kingdom Parliament in 1900. Government borrowing was a major issue from the start. One participant in the Melbourne Conference of 1890, which led directly to the National Australian Convention of 1891, described the unification of Australian government debt as a *sine qua non* of the establishment of federal government.[2] The level of colonial debt, largely attributable to the provision of railways and other forms of communications, was high.[3] The cost of servicing it was exacerbated by competition between colonies for loan funds in London, where most of the Australian debt was raised. As the federation movement gathered pace, towards the turn of the decade, the net yield on colonial securities in the London market was rising, government liquidity was declining, and a trend against investment in colonial stock was becoming apparent.[4] In these circumstances, the elimination of competition between the colonies, through the creation of a single Australian stock or otherwise, had an obvious attraction.[5]

These considerations alone probably would not have forced a result with such dramatic implications for the autonomy of the several colonies as co-ordination of government borrowing. A further stimulus was provided, however, by the emergent link between borrowing and revenue redistribution. An essential feature of the new federal structure on which everyone agreed was exclusive

[2] Australasian Federation Conference, Melbourne 1890. *Proceedings and Debates* (hereafter, *Melbourne, 1890*) 94.

[3] Butlin, N. G., *Investment in Australian Economic Development 1861-1900* (1964) 291. One delegate to the Convention of 1891, Thomas Playford (S.A.) estimated the total public debt of the Australian colonies at £150m., contrasting it with a national debt of between £10-£12m. in Canada at the time of federation: *National Australasian Convention, Official Report of the Debates* (1891) (hereafter, *Sydney, 1891*) 55.

[4] Butlin, N. G., *op. cit.* n. 3, 447-8.

[5] 'Now, the borrowing powers of Australia must under a federal government be wonderfully improved in the old country. We have had rather sad rebuffs lately . . .', Joseph Abbott (N.S.W.), *Sydney, 1891*, 303.

Commonwealth power over customs duties. It was assumed, perhaps too readily, to involve exclusive power over duties of excise as well. The colonies were heavily dependent on these sources for between one-quarter and one-half of their revenue;[6] even when allowance was made for the expenditures that would also be taken over by the Commonwealth, they would be out of pocket by more than £5 million,[7] and the Commonwealth would enjoy an equivalent surplus.

One option for adjusting the imbalance was the transfer to the Commonwealth of all or part of existing State debt, the interest on which, in 1891, was estimated to be just short of £7 million.[8] It was widely, although not universally, assumed that this would require co-ordination of future borrowing as well. The properties to be transferred to the Commonwealth on federation were a further complicating factor, both because they represented assets for which part of the debt was incurred and because the compensation payable for them might also be handled by a transfer of State debt.

Despite the inordinate amount of time devoted to discussing these issues in the Conventions of 1891 and 1897-98, they were not finally resolved in the Constitution of 1901. Section 87 guaranteed the return of three-quarters of the customs and excise revenue to the States for a period of only ten years. Section 85 required the Commonwealth to compensate the States for transferred properties, leaving the difficult questions of the extent and manner of compensation to negotiation or unilateral Commonwealth action. And section 105 merely enabled the Commonwealth to take over pre-federation debts of the States, in proportion to the population of the States. There was some link between these sections, in that both revenue redistribution and compensation payments could be applied towards meeting the interest on State debts, should they be taken over, but it was a far cry from the comprehensive package that had been mooted ten years before.

The abandonment of the transfer of State debt as a solution to the revenue redistribution problem had three main causes. First, it was not clear whether it would require Commonwealth control of future State borrowing: if it did, it was considered unacceptable, whatever the advantages on the London market might be. Secondly, there were significant differences between colonies in the level of *per capita* debt, making it difficult to calculate a basis on which debts might be transferred that would be both equitable and acceptable. And finally, the adherents of free trade, principally from New South Wales, opposed this as they opposed any other proposal that might force a high tariff after federation. Thus, at the end of the process Premier Reid of New South Wales could say: '. . . we can federate without taking over the debts . . . If this were one of the essentials of union, I should say at once — "It must go in", but it is not.'[9]

6 *Melbourne, 1890*, 65.

7 Gilbert, R. S., *The Australian Loan Council in Federal Fiscal Adjustments, 1890-1965* (1973) 12.

8 *Sydney, 1891*, 837.

9 Australian Federal Convention, *Official Record of the Debates* (1898) 1564.

The First Decade

The impermanence of the revenue redistribution arrangements ensured that borrowing also would remain on the agenda in the years immediately after federation, particularly as the end of the first decade approached. Transfer of the debt and co-ordinated borrowing were discussed in the context of revenue redistribution at Premiers' Conferences from 1903 onwards.[10] When agreement was finally reached, however, at the Conference in August 1909, the two were not conceptually linked. The revenue problems would be solved by the annual payment to each State of 25/- *per capita*, in lieu of a proportion of customs and excise duties. And as far as borrowing was concerned:

> . . . to fulfil the intention of the Constitution by providing for the consolidation and transfer of State debts, and in order to ensure the most profitable management of future loans by the establishment of an Australian Stock a complete investigation of this most important subject shall be undertaken forthwith by the Governments of the Commonwealth and the States . . .[11]

To prepare the ground for any results of such investigation a proposal to amend section 105 of the Constitution to enable the Commonwealth to take over State debts incurred after, as well as before, federation was put to referendum and passed, with majorities in all States.[12] A companion referendum to entrench payment of the *per capita* grants in the Constitution was defeated. Instead, Commonwealth legislation, again limited to a ten year period, authorised the grants to be made.[13]

The Voluntary Loan Council

By the time the debate on revenue redistribution revived again, in 1919, borrowing was once more an issue in its own right. Both levels of government were borrowing heavily: the Commonwealth to redeem or convert war debt, and the States for development. The competition between them for funds on the domestic market was intense and economically damaging, although some co-operation in overseas borrowing was beginning to occur.[14]

These pressures led in 1923 to the establishment of a voluntary Loan Council. The Commonwealth and all States were participants initially, although New South Wales withdrew in 1925, when the Lang Government took office. The purpose of the Council was to facilitate agreement on the timing of issues and on interest rates and other conditions of loans. In this it was generally regarded as successful: the rate on new Commonwealth loans fell from a high of 6.6 *per cent* in 1921-22 to 5.25 *per cent* in 1926-27, with some fluctuations in the intervening

10 Government of Victoria, *A Message to the Victorian Federal Electors concerning the Financial Agreement* (1910) 8-10.

11 *Report of the Agreement, Resolutions, Proceedings and Debates of the Inter-State Conference* (1909) v.

12 Constitution Alteration (State Debts) 1909. It was estimated that a further £50m. had been added since federation to the pre-federation debt of £200m.: Government of Victoria, *op. cit.* n.10, 13.

13 Surplus Revenue Act 1910 (Cth).

14 State Loan Acts 1916, 1917 (Cth).

years.[15] Each government was free to raise its own loans and to decide how much to borrow, although by 1926 the Commonwealth was raising loans in both Australia and New York on behalf of the States and State borrowings on the London market were co-ordinated through the Council.[16]

The Financial Agreement

The voluntary Loan Council provided both a precedent and a useful model when revenue redistribution and borrowing became linked again, in 1926. Relations between the Commonwealth and the States over revenue redistribution had been uneasy since 1919. The *per capita* grants had continued to be paid, although their reduction to 10/- was threatened in both 1919 and 1923. Various proposals had been advanced to separate Commonwealth and State finances, including the withdrawal of the Commonwealth from specified taxation fields in favour of the States.[17]

The issue was finally forced in 1927. The Commonwealth repealed the Surplus Revenue Act 1910, on which the capitation grants were based, and made provision for comparable grants to be made monthly, for a further year, while alternative arrangements were worked out.[18] A proposal for a composite solution to the problems of revenue redistribution, debt, future borrowings and transferred properties was put to the States at Premiers' Conferences in June and July and agreed to in principle, although negotiations continued for the next few months. The Financial Agreement was signed on behalf of all governments in December 1927 and ratified by all Parliaments in 1927-28. A proposal to include a new section 105A in the Constitution as a basis for such agreements was passed at referendum with majorities in all States in 1928.[19] An Act to validate the Agreement was passed by the Commonwealth Parliament, using its new constitutional powers, in 1929.[20]

In outline, the scheme of the Agreement was as follows. The Commonwealth would finally use its long-neglected power in section 105 of the Constitution and take over all State debts. The Commonwealth would itself contribute the amount it had previously paid in *per capita* grants towards the interest due on the debts for a period of 58 years, which was assumed to be sufficient to amortise them. Similarly, the Commonwealth would meet all liabilities on an amount of debt agreed to represent the value of the transferred properties.

For the future a Loan Council, representative of all governments, would be established to make decisions about terms and levels of borrowing. Most decisions would be by majority, with the Commonwealth having two votes and a casting vote, and the States one vote each. With a few exceptions all borrowing would be carried out by the Commonwealth. The States would be liable to the

15 Gilbert, R. S., *op. cit.* n. 7, 60.

16 Mathews, R., *The Australian Loan Council: Co-ordination of Public Debt Policies in a Federation* (1984) Reprint Series 62, 3; States Loan Acts 1924, 1925-27.

17 *Conference of Commonwealth and State Ministers, Memoranda, Report of Debates and Decisions Arrived At, May-June 1923* (1923) vi; States Grants Bill 1926.

18 States Grants Act 1927 (Cth).

19 Constitution Alteration (State Debts) 1928.

20 Financial Agreement Validation Act 1929 (Cth).

Commonwealth for interest on the loans and the Commonwealth would be liable to the bond holders: the doubt which subsequently was raised on this point, when the Lang Government defaulted on payments, was resolved by the Financial Agreement (Commonwealth Liability) Act 1932. Both the Commonwealth and the States would make fixed contributions to a sinking fund in respect of both existing and new debt for periods of up to 58 years.

Much of the detail of the Agreement was modelled on the experience of the voluntary Loan Council, although the driving force behind co-ordinated borrowing had shifted somewhat since 1923.[21] Certain aspects of the new arrangements require closer examination.

The first concerns the structure of the Agreement. It was divided into four parts. Part I established the Loan Council and laid down the rules to govern future borrowing. Parts II and III between them dealt with the resolution of the immediate financial problems: the transfer of State debt; Commonwealth payments towards the interest on the debt; the settlement for the transferred properties; and the sinking funds for existing and future debt. Part II applied during the transition period while constitutional amendment was sought. Part III would come into force only if the constitutional amendment succeeded and would govern arrangements thereafter. For this reason, no doubt, its provisions were described as 'permanent', although some of them clearly were not. To compound the confusion, the key provisions of Part I were expressed to be dependent upon the continuation 'in force' of Part III. Part IV dealt with miscellaneous matters, including the constitutional amendment.

Part I made provision for extensive, but not comprehensive, co-ordination of future borrowing. Clause 3 required each government to submit the total of its borrowing program to the Loan Council each year. Clause 4 provided that the total approved by the Council would be borrowed by the Commonwealth on behalf of all governments. There were, however, important exceptions. The Commonwealth was not obliged to submit to the Council 'loans for Defence purposes approved by the Parliament of the Commonwealth.' (cl. 3(8)). Borrowings for 'temporary purposes' were, by and large, excluded as well, although the term was not defined (cls 3(8), 5(3), 6(3)). Each government had a certain latitude to borrow moneys within its jurisdiction 'from authorities, bodies, funds or institutions (including Savings Banks) constituted or established under Commonwealth or State law or practice and from the public by counter sales of securities' and to 'use any public moneys' available under its own laws (cls 5,6). Any securities issued were required to be Commonwealth securities; in this case the amount would be deemed to be included within the loan program of the government concerned. There was, however, no obligation to issue securities. The Loan Council could, by unanimous decision, allow a State to borrow outside Australia in its own name (cl. 4(1)).

Most of these qualifications of the general rule subsequently turned out to be

21 Scott, R. H., *The Australian Loan Council and Public Investment* (1983) Occasional Paper 31, 7.

significant loopholes. Their inclusion at the time, not surprisingly, was attributable to contemporary practice and to assumptions based on the experience of the voluntary Loan Council.[22] The stress which the Agreement laid on control of conditions of borrowing, of which the level of borrowing was perceived as a product, also probably reflected the concerns of the earlier period. Thus the power of the Loan Council to approve borrowing of a lesser amount than that sought by all governments was predicated on the total being unable to be borrowed 'at reasonable rates and conditions' (cl. 3(9)); similarly, borrowing by governments within their own jurisdictions under clauses 5 and 6 continued to be subject to maximum loan charges set by the Loan Council. Again, the emphasis on conditions of borrowing was linked conceptually and exclusively to the question of the availability of loan funds. Scott has noted that the relevance of interest rates to the allocation of resources or the choice of financing mechanisms would not have been fully appreciated in 1927.[23]

The most striking demonstration of the contemporary roots of the Financial Agreement was the provision to resolve any deadlock between governments about how an amount which was less than that originally sought was to be divided between them. Clause 3(10) entitled the Commonwealth to one-fifth of the total and provided a formula to distribute the remainder between the States. As Gilbert has shown, the Commonwealth share of total loan expenditure in 1926-27 and 1927-28 was just short of one-fifth,[24] providing a yardstick for the maximum Commonwealth entitlement under the new Agreement which quickly became inappropriate as the Commonwealth prospered. Clause 3(10) has proved a dead letter, largely because of inadequacies in the formula for inter-State distribution, but the possibility of the Commonwealth claiming one-fifth of the total has been another potential disincentive to its use.

A further, albeit minor, illustration of the same phenomenon was the recent amendment[25] of the National Debt Sinking Fund Act to delete reference to the Chief Justice of the High Court as an *ex officio* member of the National Debt Commission. The Commission was originally established in 1923, contemporaneously with the voluntary Loan Council. The amendment was explained on the basis that the membership of the Chief Justice was attributable to British precedents, and was considered unnecessary by the present Chief Justice.

Section 105A

The new section 105A, included in the Constitution following the successful referendum in 1928, empowered the Commonwealth to 'make agreements with the States with respect to the public debts of the States'. Whether constitutional underpinning would have been necessary for that purpose alone may be doubted. The driving force behind the proposed amendment rather was to ensure that Agreements would be binding. The question of how such Agreements could or

22 The origins of the various clauses are traced in Gilbert, R. S., *The Future of the Australian Loan Council* (1974) Research Monograph 6, *passim*.
23 Scott, *op. cit.* n.21, 12.
24 Gilbert, *op. cit.* n.22, 82.
25 National Debt Sinking Fund Amendment Act 1989 (Cth).

should be enforced against a defaulting government was more difficult to resolve. It caused some dissension during the drafting process and has remained an unsatisfactory aspect of the borrowing arrangements since.

An early draft of the new section would have conferred power on the Commonwealth Parliament to 'make laws for carrying out or giving effect to any such agreement'. Alterations were made at the instance of the Victorian Government, following their receipt of the famous Ham and Menzies opinion, which advised that the power conferred on the Parliament could be given a 'very extended' meaning by the High Court and that the Commonwealth, on the other hand, would be relatively unconstrained by the Agreement, as a matter of law. The upshot was an addition, proposed by Victoria, of a new section 105A(5) to provide that Agreements should be 'binding upon the Commonwealth and the States parties thereto notwithstanding anything contained in this Constitution or the Constitution of the several States or in any law . . .' Contrary to the Victorians' expectations, the power of the Parliament to make laws for carrying out the Agreement was retained, although in a more limited form.[26]

Subsequent History

The Financial Agreement of 1927 has been directly amended on four occasions, in 1934, 1944, 1966 and 1976. Some of the amendments have been significant, for either the organisation of the Loan Council or the detail of the financial arrangements, but none has been sweeping. The 1976 amending Agreement formally effected transfer to the Commonwealth of a further $1 billion of State debt and substituted new sinking fund arrangements, in Part III of the Agreement, which apparently apply in perpetuity. These amendments are potentially relevant to the question, discussed towards the end of the paper, whether the legal force of the Financial Agreement is now spent.

While the text of the Agreement has remained relatively static and while, ostensibly at least, it continues to regulate government borrowing in Australia, vast changes in fact have taken place both in its operation and in the functions of the Loan Council. These are traced more fully below. Their measure can be gauged from the fact that in 1989-90 the States will receive no loan funds under the Agreement at all. By contrast, in the same period States or their authorities are expected to borrow $3.7 billion on their own behalf, on both domestic and overseas markets. A significant proportion of these funds will find their way into State consolidated revenue.

The link between revenue redistribution and borrowing has continued although the original link, constituted by Commonwealth contributions towards the interest on State debt, ceased in 1985. The revenue imbalance between the Commonwealth and the States, inherent in the original Constitution but exacerbated by the uniform income tax scheme has been a major contributing factor to Commonwealth domination of the Loan Council and change in the operation of

[26] These events may be traced through correspondence between Victoria and the Commonwealth in the Australian Archives: CRS A461: 1 344/1/8 Pt.1.

the Financial Agreement. The transfer of additional State debt to the Commonwealth in 1970-75 was in part a response to claims that the Commonwealth now was lending to the States under the Agreement the surplus revenue which it was supposed to distribute under section 94 of the Constitution. That argument may be raised again in 1990 in the wake of the Commonwealth budget surplus of $9122 million, which once more will result in loans to the States by the Commonwealth through the Loan Consolidation and Investment Reserve.[27]

A new and different link was created more recently when the general revenue assistance provided to each State under the States Grants (General Revenue) Act 1988 was conditioned on State compliance with the global limits for its own and its authorities borrowings specified in the Act or varied by agreement between the Commonwealth and State Treasurer.

III *TWO DRAMATIC EPISODES*

The Financial Agreement has contributed to two of the most dramatic and contentious episodes in Australian political history. Both involved the dismissal of an elected head of government by a vice-regal Head of State, in exercise of the most controversial of all the hotly disputed reserve powers of the Crown. Both had some connection with the issue of enforcement of the Financial Agreement, for which ambiguous and partial provision had been made in Constitution section 105A. While it may largely be coincidence that the origins of both episodes can be traced to the Financial Agreement, the central significance to governments of the power to borrow may also have been a contributing factor.

Lang

The first episode concerned the Lang Government of New South Wales and occurred shortly after the Financial Agreement came into effect. The depression followed hard on the heels of the implementation of the Financial Agreement; some of its first manifestations, indeed, may have been influenced by the pressures of successfully concluding negotiation of the Agreement.[28] The early Loan Council thus encountered difficulty both in converting existing loans and in financing new ones, making it potentially vulnerable to pressure from lending institutions. Amongst the various options canvassed at the time for dealing with the depression were, on the one hand, default by governments on external interest payments to enable unemployment within Australia to be relieved; and on the other, contraction of government expenditure to balance budgets, control inflation and meet commitments. The Australian political scene was already unsettled and political views were sharply divided between these alternatives, within parties as well as along party lines.

The strategy eventually adopted, which became known as the Premiers' Plan, was to reduce government expenditure and limit deficits. The origins and significance of the Plan have been analyzed fully elsewhere[29] and the ground

[27] *Commonwealth Budget Paper No. 1, Budget Statements 1989-90*, 5.11.
[28] Schedvin, C. B., *Australia and the Great Depression* (1970) 6-7.
[29] *Ibid.* chs X, XI.

need not be traversed again here. What is relevant, however, is that the Plan was adopted by and through the Loan Council; that in choosing this option governments were acting under very considerable pressure from the banks, aided by conservative opposition in the Senate; but that nevertheless during this period the Loan Council played a major role in designing and pursuing a national economic strategy under which each of the parties agreed to restrain expenditure and limit borrowing.[30]

The Lang Government preferred the option of default on overseas loans. Despite failing to meet interest payments to the Commonwealth in early 1931 and deliberate absence from the Loan Council for the first half of that year, however, Lang acceded to the Premiers' Plan and rejoined the Council in June 1931 under severe financial pressure. But in January 1932 New South Wales defaulted again and this time the Commonwealth Government, now of a different political persuasion, was less forgiving. The Financial Agreement Enforcement Act 1932 (Cth) was enacted to compel payment of moneys owed by the State. A High Court challenge to its validity was mounted by New South Wales and failed.[31] Some desperate last-minute manoeuvrings by Lang, culminating in an order to New South Wales officers to disregard a Commonwealth proclamation to pay State revenues directly to the Commonwealth, were cut short when Lang was dismissed from office by Governor Game. The dismissal was attributed specifically to Lang's alleged unlawful action in defying the Commonwealth proclamation.[32] Lang was defeated in the election which followed.

The Enforcement Act was expressed to come into effect only after various procedural steps had been taken. Its requirements included a certificate by the Auditor-General that moneys were due, payable and unpaid, a resolution of the Parliament and, except in emergency conditions, a finding of the Court. Ultimately, however, its scheme was to involuntarily assign to the Commonwealth revenues payable to New South Wales so that under Part II of the Act, for example, a payment directly to New South Wales would not in fact discharge the liability of the debtor, even though the debt was owed to the State. Section 15 prescribed a further procedure whereby the Commonwealth Treasurer could require the balance of amounts standing to the credit of a State with a bank to be applied towards the discharge of any liabilities of the State under the Financial Agreement. The Act and the associated litigation thus provided an opportunity for the first judicial pronouncements on the nature of the Financial Agreement and on those parts of section 105A which had been the subject of last minute negotiations between Victoria and the Commonwealth.

The principal issue in the litigation was the source of the power of the Commonwealth to enact such a law. Obvious candidates were the power in section 105A(3) to make laws for 'the carrying out by the parties thereto of any

30 Cowper, N., 'The First Financial Agreement: Its Effect upon the Relations between the Commonwealth and the States', *Economic Record* December 1932, 173-90; reprinted in Prest, W. and Mathews, R. L., (eds), *Development of Australian Fiscal Federalism* (1980) 109-24.

31 *New South Wales v. Commonwealth (No. 1) (Garnishee case)* (1932) 46 C.L.R. 155.

32 Evatt, H. V., *The King and his Dominion Governors* (2nd ed. 1967) 157-74.

such agreement' and the incidental power in combination, if necessary, with the overriding effect conferred on the Financial Agreement by section 105A(5). The objections to each of these were first, the inequality of an enforcement regime which in practice would operate only against the States and secondly, the impact of the particular mechanism in the Enforcement Act on such a fundamental link between Parliament and the Executive under a system of responsible government.

Despite ingenious, textual, legal argument, the challenge failed.[33] A majority of the Court comprising Rich, Starke, Dixon and McTiernan JJ. held that the Act was a valid exercise of section 105A(3) and probably of section 105A(5), in combination with the incidental power, as well. Gavan Duffy C.J. and Evatt J. dissented, the latter with passion and at length. A challenge to the validity of section 15, with particular reference to special deposit and other accounts on the ground that the moneys did not in fact belong to the State, so that the section exceeded constitutional power, also failed.[34] The same majority of the Court did not accept the State's analysis of its legal relationship with the bank and the depositors with respect to these funds; to the extent that the section exceeded constitutional power it could in any event be read down under section 15A of the Acts Interpretation Act.

The judgments produced some broader observations, which subsequently proved ambiguous, about the nature of an Agreement made under section 105A. Rich and Dixon JJ. described the effect of section 105A as 'to make any agreement of the required description obligatory upon the Commonwealth and the States, to place its operation and efficacy beyond the control of any law of the seven Parliaments, and to prevent any constitutional principle or provision operating to defeat or diminish or condition the obligatory force of the Agreement.'[35] For Starke J. the Agreement was 'part of the organic law of the Commonwealth'.[36] McTiernan J. waxed lyrical: 'Sec. 105A(5) is not a dead letter: it pulsates with the vitality of the Constitution itself and imbues with the force of a fundamental law any agreement to which it applies.'[37]

The imprecision of the concepts of 'organic' or 'fundamental' law, the unevenness of the enforcement procedures and the impact of the Financial Agreement on the principles and practice of parliamentary government are continuing problems which will be taken up below.

Whitlam

Forty-three years later, the Financial Agreement was a major cause of the dismissal of the Whitlam government. There were some similarities in political circumstance: in particular there was, once again, a federal Labor Government which lacked a majority in the Senate. The operations of the Loan Council were

33 *New South Wales v. Commonwealth (No. 1) (Garnishee case No. 1)* (1932) 46 C.L.R. 155.
34 *New South Wales v. Commonwealth (No. 3) (Garnishee case No. 3)* (1932) 46 C.L.R. 246.
35 *New South Wales v. Commonwealth* (1932) 46 C.L.R. 155, 177.
36 *Ibid.* 186.
37 *Ibid.* 228-9.

by now dramatically different, however. The need to obtain Loan Council approval of its own purpose borrowings had long since ceased to be a concern to the Commonwealth which had been a net creditor since 1961.[38] Times were changing, however. The Commonwealth experienced budget deficits again in 1973-74 and for a period after 1975-76 became a net borrower.[39]

The event which began what subsequently became known as the 'Loans Affair' was a purported authorization by the Commonwealth Executive Council of the Commonwealth Minister for Minerals and Energy to borrow, as agent for the Commonwealth, a sum 'not exceeding' $US 4000 million. The authorization extended to determining the conditions of borrowing and approving and executing necessary documents.[40] The Executive Council Minute described the borrowing as 'for temporary purposes'. Although there was considerable speculation at the time about its precise purpose, it seems now to be generally accepted that the intention was to gain access to funds held by Arab Governments in the wake of the oil revolution for the development of Australian oil, gas and mineral resources. Documents tabled in Parliament suggested that the period of at least one loan would have been twenty years.[41]

The authority was limited to $US 2000 million in January 1975 and countermanded in May. By then, however, a series of negotiations with financial intermediaries had taken place, although none had reached a conclusion.

The news about the proposed borrowings broke slowly and painfully in the Commonwealth Parliament. Aspects of it which caused controversy included the authority of the initial Executive Council meeting which was neither attended nor summonsed by the Governor-General or the Vice-President of the Council. The central issues, however, concerned the propriety of the proposed borrowing itself.

The Loan Council had not been approached about the loan at any stage. Was it possible to argue that what had taken place so far was merely exploratory, so that compliance with the Financial Agreement was still possible? Alternatively, might these proposed borrowings fall within the exclusion of loans for temporary purposes? The Executive Council Minute appeared to make the latter assumption. Any conclusion on the issue was made more difficult by the absence of a definition of temporary purposes in the Agreement, although the purposes and duration of this particular loan seemed to most observers to stretch any likely interpretation. The possibility that a loan of this magnitude could be raised outside the Financial Agreement also led to a further question of a different kind, about the need for authorization by the Commonwealth Parliament.

[38] McAuley, J. P., *The Structure of Australian Public Debt* (1980) Research Monograph No. 34, 6.

[39] Advisory Council for Inter-Government Relations, *Australian Loan Council and Intergovernmental Relations* (1982) 34-5.

[40] Sawer, G., *Federation under Strain* (1977) 65.

[41] Commonwealth, *Parliamentary Debates*, House of Representatives, 9 July 1975, 3613.

[42] Sawer, op. cit. n.37, 107.

The loans affair was a major factor on which the Opposition relied in seeking to force an early election in October 1975. The motion in the Senate to defer the Appropriation Bills and, ironically, a Loan Bill, described what had occurred as 'an attempt by the Government to subvert the Constitution, to by-pass Parliament and to evade its responsibilities to the States and the Loan Council'.[42] The Government was unable to secure passage of the Bills and an election duly followed the dismissal of Prime Minister Whitlam by Governor-General Kerr on the grounds that he was unable to obtain supply from the Parliament. The issue rumbled on, however, even after the election, which Whitlam lost. A private prosecution launched against four members of the former government in 1976, for conspiracy to effect an unlawful purpose, provided another opportunity for the High Court to consider the nature of the Financial Agreement.[43] The decision in *Sankey v. Whitlam* is discussed below.

IV *STRUCTURED BUT DECEPTIVE*

Structured

Intergovernmental arrangements in Australia in practice have become largely the domain of executive government, whatever the theory might be. Parliaments and the public probably know less about intergovernmental activity than about any other category of governmental endeavour. In this general company, the borrowing arrangements appear distinctive. A formal, publicly available agreement establishes the Loan Council and sets out quite specific procedural rules. The Agreement is authorised and given force by the Commonwealth Constitution itself. Both the Agreement and any amending Agreements historically have been ratified by Parliaments and scheduled to legislation, although it is not obvious from the terms of section 105A that this is strictly necessary in law. The regular, annual meetings of the Loan Council are usually attended by considerable publicity and public comment.

Deceptive

This appearance of structure is largely deceptive. The actual operation and function of the Financial Agreement and the Loan Council differ significantly from the public record. Thus the allocation of voting strength under the Financial Agreement is largely irrelevant because the Commonwealth dictates the size of the State government program. The size of the Commonwealth's own program is rarely an issue: Commonwealth outlays financed by borrowings are almost always identified as outlays for State purposes, leaving Commonwealth outlays for its own purposes to be financed from revenue. The interest of each State in decisions made under the Financial Agreement is now focused almost exclusively on its proportionate share of the total loan program. In turn, this has

43 *Sankey v. Whitlam* (1978) 142 C.L.R. 1.

tended to harden into assumptions about the proportionate share to which each State, historically, is entitled. The Loan Council has not purported for some time to make decisions about conditions of borrowing. Those powers were delegated to the Chairman of the Loan Council, the Commonwealth Treasurer, by a series of decisions dating from June 1982.[44]

The actual State government program under the Financial Agreement in any event has been very small in recent years. It disappeared altogether in 1989-90. By contrast, very extensive borrowings are undertaken outside the Financial Agreement, by central borrowing agencies established by each State, which for practical purposes constitute borrowings by the States themselves. The total program, presently called the global limits, is formally acceded to by the Loan Council, although this is not a power conferred on it under the Agreement.

By contrast with its public image again, the processes of the Loan Council are little known and understood. The meetings are closed. A press release is usually made by the Commonwealth after a Loan Council meeting but there is no formal report by the Loan Council or individual members of it to the Parliaments or the public. An extraordinary degree of sensitivity, moreover, appears to attach to Loan Council documents. This was exemplified in *Sankey v. Whitlam*[45] where the Court gave some credence to the Commonwealth argument that Loan Council documents, alone of all the other documents for which privilege was claimed, should receive special protection from discovery.

These dramatic changes in the operation of the Financial Agreement are the result of two parallel but related sets of developments.

Development of the Government Borrowing Program

The purposes for which it was sought to use the Financial Agreement inevitably changed with economic circumstances. The principal function conferred on the Council by clause 3(9), to determine the total which could be borrowed at reasonable rates and conditions, proved adaptable to a variety of ends. Thus the initial emphasis on eliminating competition for loan funds in the 1920s changed to an emphasis on management of total borrowings and expenditure during the depression years, to restraint in the cause of anything but the war effort in 1939-45 and to control of the level of interest rates in the 1950s.[46]

At the same time, changes took place in the roles which the respective governments played on the Council. In the early years of the Financial Agreement there was at least an expectation that collegiate decisions would be made by the Council, albeit sometimes after bitter dispute or under external pressure. As the position of the Commonwealth on the Council became increasingly dominant, however, its purposes became the purposes of the Council and the preoccupations of the States became the quite different ones of obtaining

[44] *Commonwealth Budget Paper No. 7, Payments to or for the States, the Northern Territory and Local Government Authorities, 1982-83*, 28.
[45] (1978) 142 C.L.R. 1.
[46] Scott, *op. cit.* n.21, 18.

borrowing approvals at maximum levels and maintaining their proportionate shares of the total.

The divergence between the interests of governments on the Loan Council began early but initially took place more slowly. The seeds of Commonwealth domination were always there, in the Commonwealth's weighted vote which, although eminently justifiable by reference to Commonwealth responsibilities under the Agreement, offered a path to total control with the support of only two States. Such support may have been expected from the outset, with at least two States, Western Australia and Tasmania, in regular receipt of special grants even at this stage.

Ultimately, however, the shift in the balance of power was achieved less through the formal voting arrangements than through external pressures and influences. The Commonwealth's position as national government and sole borrower made it the obvious negotiator on behalf of the Loan Council with would-be lenders: as the economic climate changed, policy initiative within the Loan Council thus automatically came from the Commonwealth. As early as 1936, the Premier of Tasmania noted that 'important statements prepared by [Commonwealth] Treasury officers are circulated while Ministers are at the table', and pleaded for the representatives of the States to 'have this information, where possible, a day or two before the Council Meetings or, at any rate, overnight.'[47] As the Commonwealth increased direct control over the banking system, from the 1940s, its role in this regard was reinforced.

A second major influence on the roles of the respective governments within the Loan Council was the imbalance in financial resources available to them. The tenuous separation of Commonwealth and State finances achieved by the Financial Agreement was destroyed indefinitely by the Commonwealth assumption of sole responsibility for income taxation in 1942. One result was to virtually eliminate Commonwealth reliance on Loan Council decisions for borrowing for its own purposes. Another, even more important, was to establish the Commonwealth as a potential creditor of the States. Thus in 1951, when the view was taken that the total State loan program could not be borrowed on the market, the Commonwealth agreed to underwrite a program reduced by 25 *per cent*. The same process was followed in 1952, despite opposition from all six States.

The underwriting agreement enabled the Commonwealth to stipulate the terms on which it would underwrite the State program and, if necessary, make special loans to the States. It also entrenched the existing proportionate shares of the States in the total, in the absence of any realistic process by which a different allocation might be made. Thus between 1952-53 to 1986-87 no State share varied by more than two *per cent*: in most cases the variation was far less and in the last three years of that period there was no movement at all.[48] In 1987-88 a

47 Australian Archives: CRS A571 Item 36/1583. Letter, Premier Ogilvie to Treasurer Casey.

48 Scott, *op. cit.* n.21, 32-3; *Commonwealth Budget Papers No. 7, 1983-84, 1984-85, 1985-86*, ch.III.

reallocation did take place, under which Queensland's historical share was almost halved from 11.95 *per cent* to 6.03 *per cent*, the shares of New South Wales and Western Australia dropped slightly and those of the other three States increased. It was explained that the aim of the new allocation, which took place in the context of upheavals in both the total and allocation of general revenue payments, was to ensure that 'each State . . .bore a similar percentage reduction in the level of general purpose (recurrent and capital) assistance compared with the levels in the Forward Estimates of Budget Outlays for 1987-88.'[49] The same allocation was made in 1988-89 and 1989-90.[50]

Underwriting by the Commonwealth has continued since the early 1950s, notwithstanding the protestations of the Prime Minister of the time.[51] The irony of a situation in which the Commonwealth lent its excess revenue to the States in the face of constitutional provision for surplus revenue to be distributed to the States[52] caused the next significant upheaval in the early 1970s, by which stage one fifth of all State debt was owing to the Commonwealth.[53] The Commonwealth took over a further $1000 million in State debt and the practice began whereby a proportion of between one-third and one-half of the State Loan Council program was made up by the Commonwealth as an interest free capital grant.

Two consequences of the capital grant system deserve mention. The first is that, allied with the underwriting procedure, it further entrenched the power of the Commonwealth to determine the outcome of both Loan Council meetings and the Premiers' Conference. The most important decision made at these meetings, over which the States retain any shadow of discretion, is the global limit for authority borrowings. Agreement to the global limits was made a condition of underwriting in 1988-89 although, when Queensland refused to comply, the sanction actually threatened was reduction of the revenue redistribution payments.

With hindsight, the capital grants arrangements may have contained the seeds of destruction of the government borrowing program. Capital grants constituted a Commonwealth budget outlay and from this time at the latest, however illogically, the entire State government program began to be passed through the Commonwealth budget. As soon as the Commonwealth's own budget deficit became a matter for concern in the mid 1970s, it was inevitable that attention

49 *Commonwealth Budget Paper No. 4, Commonwealth Financial Relations with other levels of Government 1987-88*, 43. The proportions are not exactly comparable with previous years, because Northern Territory borrowings have been included in the total.

50 *Commonwealth Budget Paper No. 4, Commonwealth Financial Relations with other levels of Government 1988-89*, 46; *1989-90*, 46. The latter notes that the distribution 'still does not closely relate to the present day capital needs of the States'.

51 Mathews quotes Menzies in the budget debate as decrying any intention to accept permanently 'the burden and obloquy of imposing extra taxation in order to provide funds for State works programmes in excess of the savings of the people': Mathews, R., 'Fiscal Federalism — 1951 Style — Revisited' (1982) Reprint Series 45, 8.

52 Commonwealth Constitution s. 94.

53 Mathews, R., 'Australian Loan Council: Co-ordination of Public Debt Policies in a Federation' (1984) Reprint Series 62, 15.

would focus on the level of the State government borrowing program and that attempts would be made to keep it down. And that has occurred, with a vengeance. In each year between 1975-76 and 1985-86 the government program fell in real terms and sometimes in money terms. In 1986-87 it dropped 23 *per cent*, with a further 56 *per cent* reduction in 1987-88. It was held static in 1988-89, at $533 million: less in money terms than the six-State borrowing program for 1963-64. What is euphemistically described as the Loan Council program is set at the same level again in 1989-90, although it no longer includes a loan component.[54]

In a sense the government borrowing program as originally conceived under the Financial Agreement vanished some time ago. The 1982 Loan Council meeting allowed the States to nominate a proportion of the loan component of their allocation for public housing at concessional rates of interest. In both 1987-88 and 1988-89 the total program was nominated for housing. During those two years at least, there was no general State loan program and presumably, no function exercised by the Loan Council under the Financial Agreement. The decision to convert the loan component of the program to grants under the Commonwealth-State Housing Agreement in 1989-90 has completed the process.

Development of the authorities' program

It has always been accepted that the requirement in clause 3(8) for the Commonwealth and each State to submit borrowing programs to the Loan Council does not include borrowings by semi- government or local government authorities. The omission was recognised at the time: the contemporary Ham and Menzies opinion, prepared for the Victorian Government, noted that: 'If any Government desiring more money than its quota allocated by the Loan Council decided that it would create some of its public utilities into statutory corporations with independent powers of borrowing . . . each statutory corporation could then go on the money market itself and raise its own loans. Such an expedient, if at all widely adopted, would mean the complete breakdown of the provisions we have just been considering.'

The problem appears to have been put aside in part because of the number and variety of the authorities involved. These considerations have become more, rather than less, complex, over the years. There is an unresolved question whether the Financial Agreement applies to authorities 'within the shield of the Crown'.[55] Once governments decided to control authorities' borrowings a further distinction was found to exist between statutory authorities and bodies incorporated under the general law which are wholly or partly owned by government or

[54] Treasurer Keating, *Press Release, Premiers' Conference/Loan Council Outcome*, 18 May 1989.

[55] Or, in other words, sufficiently closely related to government to be entitled to its inherent privileges and immunities.

by another governmental authority. Another complication is introduced where authorities' borrowings are guaranteed by either the Commonwealth or a State. More recently there has been anxious examination of whether government business enterprises, however defined, should be subject to the same rules as other authorities for the purpose of the borrowing arrangements.

Not surprisingly, in view of its potential, the question of authorities' borrowings was discussed at Loan Council meetings almost from the outset. Attempts were made in the early years to restrain the creation of further authorities and to ensure that the amount, terms and timing of authorities' borrowings were fixed in consultation with the Chairman of the Loan Council.[56] When this proved unsatisfactory, by 1936, the arrangements were institutionalised in the form of what was called the Gentlemen's Agreement.

As its name implies, the Gentlemen's Agreement had no legal force. It consisted merely of resolutions of the Loan Council, acting outside the Financial Agreement. The resolutions were amended from time to time and for a long time were treated as confidential. Not until the 1970s were copies available for the asking and at no stage was the text of the Agreement regularly published. Compliance with the Agreement was voluntary as a matter of law, although an effective practical sanction applied from the 1950s, when compliance became a condition of the underwriting agreement. In more recent times it has become likely that the Commonwealth could unilaterally control at least some aspects of authorities' borrowings: overseas borrowings through the trade and commerce power (s. 51(1)) and, perhaps, the borrowing of all trading or financial corporations through the corporations power (s. 51(20)).[57]

The mechanism of the Gentlemen's Agreement was to regulate the terms and timing, and to restrain the amount, of the borrowing of semi-government and local government authorities. Within those limits, each authority borrowed on its own behalf. While the details varied over time, the general scheme was to categorize authorities as larger or smaller, by reference to the amount they sought to borrow. The maximum borrowing ceiling for smaller authorities grew from $200,000 in 1961-62 to $1.8 million in 1983-84. After 1962-63, there was no limit on aggregate borrowings of smaller authorities as long as each one kept within the ceiling. A total program for larger authorities was approved by the Loan Council each year and allocated between States in proportions which, again, resisted alteration over time. Each State allocated its own share between its authorities. Except in special cases, where additional amounts were approved, the Loan Council did not concern itself with the purposes for which governments or their authorities sought the borrowed funds. All authorities were subject to Loan Council direction in the timing and terms of their loans.

This system ultimately distorted the whole pattern of government borrowing.

56 Australian Archives CRS A571 Item 33/2791.

57 This is a possible consequence of the decision of the High Court in *Commonwealth v. Tasmania* (1983) 158 C.L.R. 1.

First, because this was the only part of the borrowing arrangements that did not affect the Commonwealth budget result it was most likely to be the vehicle for any significant growth in borrowing approvals. Increases in the larger authorities program were steady, reaching $1296.5 million in 1978-79. In the same year, under pressure for increased borrowing approvals, arrangements were introduced whereby the Loan Council agreed to large new borrowings for particular infrastructure projects which met specified criteria including significance for development. Over the period to 1984-85, when these arrangements ceased in turn, infrastructure borrowings amounted to $2323.6 million. In 1982, in an associated development, domestic borrowings of major electricity authorities were exempted from the authorities' program, on conditions which sought to ensure that some degree of Loan Council surveillance could be exercised over the result.[58]

More important still was widespread avoidance of the Gentlemen's Agreement, by all governments, but in particular by the States, chafing under the constraints of Loan Council decision-making in which they played little effective part. Three principal devices were used. Borrowing by incorporated companies in which a government had an interest were treated as not subject to the Agreement. Significant numbers of smaller authorities were created by the States during this period, apparently for no better reason than to obtain access to their borrowing entitlement. And a range of different financing mechanisms was developed, including security deposit arrangements, leasing, buyer or supplier credit and deferred payments, none of which were deemed to be borrowings, but all of which were comparable from the perspective of the total public sector borrowing requirement. This last device had particularly dramatic effect. By 1984 it was estimated that, in the previous year, only one quarter of State authority borrowing fell within programs approved by the Loan Council, as opposed to 95 *per cent* in 1979-80.[59]

Recent Developments

Two related developments over the last five years have brought total borrowings back under central control while contributing significantly to the farcical quality of the formal borrowing arrangements.

The first was the establishment by all States of central borrowing agencies to co-ordinate their authorities' borrowings. In part, this development was an obvious practical response to the significance of authorities' borrowings for capital raising by the State public sector. It was expected that the centralisation of borrowing within each State would have advantages in terms of lower costs, greater access to public markets and improved marketability of stock. In some

[58] *Supra* n. 44, 30-1.

[59] *Commonwealth Budget Paper No. 7, Payments to or for the States, the Northern Territory and Local Government Authorities, 1984-85*, 30. Borrowing by electricity authorities was excluded from the larger authorities' program by this stage.

respects they mirrored the advantages sought for government borrowing through the voluntary Loan Council in 1923.

The decision to establish central borrowing agencies also represented a response to the recommendation of the Campbell Committee of Inquiry into the Australian Financial System for greater co-ordination of authorities' borrowing.[60] It was in any event consistent with the general move that occurred in the early 1980s towards a more market-oriented approach to public-sector borrowing. In relation to the Gentlemen's Agreement this was marked by the release in 1983 of all major authorities from Loan Council control of the terms and conditions of their domestic borrowing.[61] Shortly before, comparable developments had taken place under the Financial Agreement, with the introduction of the system of sale of Treasury Bonds by tender and the broad delegation of power to the Commonwealth Treasurer, as Chairman of the Loan Council, to make necessary decisions in relation to them.[62]

Decisions about the establishment and structure of central borrowing agencies were matters for each individual State. Within the terms of the Gentlemen's Agreement, however, some acquiescence of the Loan Council was required to prevent deduction of the borrowings of a central borrowing agency on behalf of smaller authorities from the State's larger authorities' program. That acquiescence was forthcoming in 1982 under 'approved working arrangements'[63] which were swept away with the Gentlemen's Agreement itself two years later.

In the wake of the 1982 Loan Council decision, all States established central borrowing agencies. The agencies, which still exist, operate at a sophisticated level and borrow funds both domestically and overseas. A significant proportion of the borrowed funds, moreover, finds its way into the consolidated revenue of the State concerned. The precise technique whereby this is achieved varies between States but all rely on a very literal interpretation of the power in clause 5 of the Financial Agreement for a State to borrow from sources within the State. The result is that the Financial Agreement can now be by-passed entirely, even for the purposes of government borrowing.

This process can be illustrated by the Victorian experience although all other States have similar arrangements. The Victorian central borrowing agency, known as Vicfin, was established by the Victorian Public Authorities Finance Act 1984. Vicfin is a body corporate, managed by a Board, two members of which are nominated by the Victorian Treasurer and two by participating authorities. Participation is voluntary; some of the large Victorian authorities in particular choose to borrow in their own right. Vicfin is authorised to borrow on behalf of 'public authorities' but not on behalf of government; and section 17 specifically provides that it is not 'deemed to represent the Crown for any

60 *Final Report of the Committee of Inquiry into the Australian Financial System* (1981) 201-3.

61 *Commonwealth Budget Paper No. 7, Payments to or for the States, the Northern Territory and Local Government Authorities 1983-84*, 29.

62 *Ibid.* 32.

63 *Surpa* n. 44, 34

purpose whatsoever.' It borrows both within Australia and overseas and through both promissory notes and inscribed stock.

In 1985 Victoria established, by Order-in-Council, a non-statutory Capital Works Authority. The Authority is authorised to borrow for Victoria: all moneys are to be credited to the Consolidated Fund or to the Works and Services Account in the Trust Fund. The Victorian budget papers describe its purpose as 'to enable global limit borrowings to be used for works and services expenditure purposes approved by way of appropriation.'[64] In 1988-89, borrowings via Vicfin and the Capital Works Authority were estimated to constitute $880.6 million out of total receipts of $2038 million in the works and services sector of the Consolidated Fund. A further $106.4 million of that total was estimated to be received from proceeds of the State Development Account, derived from the management of long-term investments of Victorian authorities. Only $123 million represented Loan Council receipts, in the form of both nominated funds and capital grants.[65]

The basis on which this mechanism avoids the Financial Agreement is as follows. Vicfin itself is a statutory authority and therefore not subject to the Financial Agreement. Any possible complication on this score is avoided by the fact that Vicfin, unlike the agencies initially established by the other States, clearly does not fall within the shield of the Crown. Nor can it be considered an agent for Victoria, as it is empowered only to lend to public authorities.

The Capital Works Authority is a public authority to which Vicfin can lend. It therefore borrows from Vicfin and then lends to the Victorian government, in accordance with its constituent Order-in-Council. The Capital Works Authority clearly does represent the Crown in right of Victoria but Vicfin is an authority constituted under State law, within the terms of clause 5 of the Agreement, so that its borrowings fall within that exception. Moreover, the Capital Works Authority issues only receipts for moneys borrowed, not securities as defined by the Financial Agreement, so that the total is not included within the State's loan program. Borrowing by the State from the Capital Works Authority is based on a similar analysis.

The introduction of these procedures caused dissension on two grounds. First, there was a question whether they were, in fact, in conflict with the Financial Agreement. This question was raised more acutely in relation to the agencies of other States, which had power to lend directly to the State concerned. These doubts apparently were swept under the carpet when the economic, if not the legal, hole in Loan Council control of government borrowing levels was plugged through the global limit arrangements. Secondly, the establishment of the Capital Works Authority through prerogative power, rather than by statute, raised questions about the ability of the executive to borrow without parliamentary authority. The answer to those questions is surprisingly elusive, possibly because borrowing was not a major source of public funds in the period of the great

64 *Victorian Budget Paper No. 4, Consolidated Fund Receipts 1988-89*, 44.45.
65 *Ibid.* 6

constitutional struggles when Parliament asserted its authority over the Crown.[66] The nature of the Australian debate on the question, however, may be a reflection of the extent to which the intergovernmental borrowing arrangements have obscured the role of Parliament in this regard.

The level of off-program borrowings and the establishment of the central borrowing agencies, coupled with deterioration of the national economy, led to the replacement of the Gentlemen's Agreement by the Global Approach in 1984-85. Under these arrangements, the distinction between larger and smaller authorities is abandoned. Instead, an amount which is intended to cover all new money borrowings by all authorities, however constituted, is identified and allocated between governments which in turn allocate it between their authorities, including central borrowing agencies. Borrowings are defined broadly to cover all the financing devices previously employed 'and other means of financing capital programs.'

Control of authorities' borrowings is one aspect of the borrowing arrangements over which all governments retain some bargaining power. The Global Approach was initially described as 'voluntary': the adjective was dropped after the first few years and became a complete misnomer in 1988, when compliance was made a condition of the revenue redistribution grants. The principal inducement for the States to enter into the arrangements in the first place was access to overseas public markets for authorities' borrowings, on a basis controlled by the Loan Council. In 1988-89 authorities were permitted to borrow in eleven overseas public issue markets.[67]

From the standpoint of the Commonwealth, the attraction of the Global Approach lay in greater Commonwealth control over total public sector borrowing requirements. The power has been used: the relatively generous global limit for State authorities of $6772.4 million in 1984-85 was cut to an estimated $3750.1 million in 1989-90.

Not all of the problems of the earlier arrangements have been eliminated, however. The question whether Loan Council constraints should apply to commercial authorities, however defined, which is almost as old as the Gentlemen's Agreement itself, is still unresolved. It chafes the Commonwealth as much as the States and lies behind the recently revived interest in privatisation of the government airlines. Further, while there is now a greater flow of information to the Commonwealth from most States about authorities' borrowing programs there is no real assessment of need or merit either in determining the global limits or in allocating it between States. Some variation in the historical shares appears to have occurred in 1988-89, although the budget papers obfuscate both its extent and the basis on which it took place.

The coverage of the Global Approach has already been the subject of interpretation and dispute. One instance concerned the nature of the Victorian

66 Groenwegen, 'Concluding Commentary' in Mathews, R. (ed), *Public Sector Borrowing in Australia* (1982) 73.

67 *Commonwealth Budget Paper No. 4, Commonwealth Financial Relations with other levels of Government 1988-89*, 51-2.

Equity Trust, under which Victoria sought to raise equity capital for a range of its major authorities. The problem underlying the issue was as much the unexpressed purpose of the borrowing arrangements as the ill-defined description of their coverage. On that occasion, after a short period of uncertainty and compromise, the Commonwealth insisted that equity financing fell within the Global Approach. More recently, at the 1989 Local Council meeting, one of several Commonwealth initiatives to deflect criticism about shortage of public housing was the agreement that 'borrowings by private sector bodies with State Government support to raise funds for home purchase assistance to individuals would fall outside the global limits.'

The self-governing territories

Finally, for the sake of completeness, the place in this picture of borrowings by the two self-governing territories, the Northern Territory and the Australian Capital Territory, should be noted. The territories are not parties to the Financial Agreement. Their representatives therefore are not members of the Loan Council acting under the Financial Agreement, although as the Loan Council currently makes no decisions under the Agreement that consideration is relatively unimportant.

Borrowings by the Territories as entities originally fell into the same category as authorities' borrowings and came under Loan Council surveillance on that basis. More recently, since self-government, the Northern Territory has been treated in a manner superficially comparable to the States: it has received capital grants, a loan allocation for nomination for housing, and a share of the global limits.[68] Similar treatment was extended to the Australian Capital Territory in 1989 when it too obtained self-government.

In strict analysis, however, the position of the Territories in getting and using these allocations is different to that of the States. The Territory governments are not bound by the Financial Agreement, even if all other Australian governments still remain bound. The systems set up by the Territories to use their borrowing allocations therefore do not have to be designed with one eye on the Financial Agreement as is necessary for the States and, to some extent, for the Commonwealth as well. On the other hand, both Territories require Commonwealth approval of their borrowings and those of their authorities under their constituent self-government Acts.[69] Borrowing allocations to the Territories therefore lie

[68] The origins of this treatment lie in the Memorandum of Understanding between the Commonwealth and Northern Territory Governments, executed at the time of self-government: *Commonwealth Budget Paper No. 7, Payments to or for the States, the Northern Territory and Local Government Authorities 1978-79*, 88. There appears to be no similar Memorandum for the Australian Capital Territory, although section 59 of the Australian Capital Territory (Self-Government) Act 1988 (Cth) requires the Commonwealth to 'conduct its financial relations with the Territory so as to ensure that the Territory is treated on the same basis as the States . . .'

[69] Northern Territory (Self-Government) Act 1978 (Cth) s. 47; Australian Capital Territory (Self-Government) Act 1988 (Cth) s. 61.

solely within Commonwealth discretion under a legal relationship which is relatively straightforward in fact, although somewhat obscured by the appearance of uniformity that has been stamped on State and Territory borrowing arrangements.

V *SOME LEGAL AND CONSTITUTIONAL QUESTIONS*

Whether because of its unusual form or its sensitive and complex subject-matter, the Financial Agreement has given rise to a rich assortment of legal and constitutional issues. Those mentioned already include the use of Commonwealth legislation, under section 105A, to override the requirement of State parliamentary appropriation of moneys for government expenditure; the difficulty of defining and enforcing limits on the borrowing of governmental authorities; and the interpretation of the exceptions to the borrowing arrangements in clauses 5 and 6, at the hands of individual governments anxious to raise capital funds. Three other significant issues are outlined below.

Status of the Financial Agreement

There is room for confusion about the nature and effect of an agreement between governments approved by statute and given some form of constitutional force. The product is an unusual mixture of legislative and executive power, potentially capable of attracting both public and private law concepts.[70] The confusion is compounded by section 105A(3) and (5), which, apparently, were intended to relieve it. It will be remembered that a power to make laws for carrying out or giving effect to the Agreement was conferred on the Commonwealth Parliament by the original draft; in the face of Victorian complaints that the enforcement mechanism was both too broad and too one-sided, a stipulation that agreements were to be binding on the parties notwithstanding anything in the Constitutions or laws of the Commonwealth or the States was included, in a new section 105A(5), but a modified power for the Parliament to make laws for the carrying out of an agreement was retained.

The first and fundamental question is the nature or legal character of an Agreement made under section 105A. Two other, practical questions follow. Is an Agreement enforceable by the parties against each other, and on what basis? And is a transaction in breach of an Agreement invalid, with consequent ramifications for third parties?

If nothing else, it is clear that an Agreement is a contract. That much was suggested in the *Garnishee* case,[71] and supported by the observations of Latham C.J. and Williams J. in the *Melbourne Corporation* case.[72] In the latter case both

[70] Intergovernmental grant arrangements under s. 96 of the Constitution have similar hybrid characteristics which are not generally recognised: Saunders, C., 'Towards a Theory for Section 96', Part 1 (1987) 16 M.U.L.R. 1 ; Part 2 (1988) 16 M.U.L.R. 699.

[71] *New South Wales v. Commonwealth (No. 1)* (1932) 46 C.L.R. 155.

[72] *Melbourne Corporation v. Commonwealth* (1947) 74 C.L.R. 31, 63, 101.

Justices were prepared to find, despite the absence of argument by the parties, that a prohibition on banks conducting banking business for a State without the consent of the Commonwealth Treasurer was contrary to the right of a State to borrow on overdraft for temporary purposes under clause 5 of the Agreement. The contractual nature of the Agreement was finally confirmed in *Sankey v. Whitlam.* [73] The specification in section 105A(5) that Agreements are binding on the parties presumably explains why the question of justiciability on which attempts to enforce some other intergovernmental agreements have foundered has not been raised.[74]

The real question, of course, is whether the statutory and constitutional connections of the Financial Agreement make it anything more than a contract. In the *Garnishee* case, in which the issue was the power of the Commonwealth to enact the enforcement legislation, the Agreement was described as 'organic' or 'fundamental' law. In the *Bank Nationalisation* case, Rich and Williams JJ. referred to it as having 'overriding statutory force'.[75] *Sankey v. Whitlam*, on the other hand, emphasized the contractual nature of the Agreement, explaining the effect of section 105A (5) as merely to ensure that the contract was binding on the 'quite special parties' involved.[76] Although some of the judgments, at least, seem to claim more for the Agreement than binding contractual status,[77] the Court generally agreed to distinguish legislation which makes provisions of a contract binding on the parties 'notwithstanding that their agreement alone cannot produce that result because of some lack of power or other source of invalidity' from 'legislation which imposes a statutory obligation on the parties to carry out the terms of the contract, a provision which gives to these terms themselves the force of law'.[78]

The issue in *Sankey v. Whitlam* may have had a disproportionate influence on the outcome, as far as the status of the Financial Agreement is concerned. Sankey was a private individual, who brought an action against former Ministers of the Whitlam Government in connection with the Loans Affair, alleging a conspiracy to effect a purpose unlawful under a law of the Commonwealth within the terms of section 86(1)(c) of the Commonwealth Crimes Act. In the circumstances the argument was highly artificial: to dismiss it, however, the Court was required to decide either that the proposed borrowing could not be characterised as 'unlawful' under the Financial Agreement or that the Agreement was not a 'law of the Commonwealth'. It held against the complainant on both points.

The upshot of the cases appears to be that, in the absence of Commonwealth legislation under section 105A(3), enforcement of the Financial Agreement by

73 (1978) 142 C.L.R. 1.

74 *South Australia v. Commonwealth* (1962) 108 C.L.R. 130.

75 *Bank of New South Wales v. Commonwealth* (1948) 76 C.L.R. 1, 282.

76 *Sankey v. Whitlam* (1978) 142 C.L.R. 1, 74, *per* Stephen J.

77 Gibbs A.C.J. referred to the provisions of the Agreement as paramount over the Constitutions and laws of the Commonwealth and States: (1978) 142 C.L.R. 1, 30. Stephen J. drew a distinction between laws and other instruments 'which may have an operation or effect similar to what are undoubted laws', at 76.

78 *Sankey v. Whitlam* (1978) 142 C.L.R. 1, 106, *per* Aickin J.

the parties against each other must be based in contract. Presumably all the usual contractual remedies would be available, although a decree of specific performance or an injunction are the only ones likely to be practically useful and it would be a bold Court that would grant either in some of the circumstances that might arise. Breach of the Agreement can be made unlawful by Commonwealth legislation under section 105A(3) which is unlikely, however, to be directed against breach by the Commonwealth itself. If either the Commonwealth or a State enacted legislation to extricate itself from its contractual obligations, a claim that the legislation was inoperative could be made either in a declaratory action or in the course of proceedings in contract.[79]

The effect of a borrowing by the Commonwealth or a State in contravention of the Financial Agreement, from the standpoint of the lender, is less clear. Commentators on the Agreement in the 1930s[80] and the 1960s[81] assumed that the transaction would be invalid, strongly raising the possibility that the lender would be out of pocket. This result is less obvious if, as *Sankey v. Whitlam* suggests, the Financial Agreement is merely a contract and not a constraint on power. A further complication, raised again below, is the unsettled question of the power of the executive branch to borrow without legislative authority. If there is no prerogative power to borrow, a borrowing in breach of the Financial Agreement would lack statutory authority and would be invalid for that reason. The effect of a borrowing contrary to the Financial Agreement may still be sufficiently unpredictable for Mitchell's warning that 'no lender . . . can, consistently with prudence and safety, lend to the Commonwealth or the State for non-temporary purposes without being satisfied that the conditions precedent . . . have been complied with'[82] to retain some force. If it is correct, however, Mitchell's corollary should also apply:

> that makes it almost essential that if the Loan Council did not sit in public, it must at least, after each sitting, publish minutes of what it has decided.[83]

In this context it is relevant that the production of Loan Council documents which was so vigorously resisted in *Sankey v. Whitlam* was sought for the purpose of establishing that the Council had not approved the $4,000 million loan.

Accountability

Political accountability for executive action in Australia formally lies through Cabinets, Parliaments and their committees and ultimately the electorate. Accountability of a different kind may be enforced through the courts, in determining whether executive action is in accordance with law. Both systems require knowledge and information about executive action in order to be effective.

[79] *Ibid.* 75 (*per* Stephen J.).
[80] Mitchell, E. F., *What Every Australian Ought to Know* (1931) 54.
[81] Gilbert, *op. cit.* n. 22, 104.
[82] Mitchell, *op. cit.* n. 80, 54-5.
[83] *Ibid.* 55.

In fact, as has been seen, public knowledge of action taken under the intergovernmental borrowing arrangements is very limited. The Loan Council meets in closed session. It releases no minutes or other formal record of its decisions; on the contrary, experience suggests that it actively opposes their release. The informal agreements which supplement the Financial Agreement are not publicly available, a particularly serious shortcoming when the practical operation of the borrowing arrangements now relies almost exclusively on these agreements. The material presented in the budget papers, while welcome as the only official source of information, is nevertheless, in the circumstances, scant.

Accountability consequently is limited for decisions about the raising and allocation of sums which in 1988-89 amounted to $621 million for the State and Northern Territory borrowing program and $7,485 million for new money raisings for all authorities. These decisions are not submitted to, approved by, or even formally made available for the information of Parliaments at either level. The current practice of providing the Commonwealth 'offer' to the States at the last minute gives State Cabinets themselves inadequate opportunity to make decisions about levels and allocation of borrowings for the State. These features are the direct result of the intergovernmental character of the arrangements. If each level of government was immediately and formally responsible for its own borrowing, it is inconceivable that there would not be more public and parliamentary debate and full Cabinet consideration of such matters as the levels of borrowing and their justification, the allocation of borrowing between the inner budget sector and authorities, the allocation of borrowing between programs or projects and the respective levels of domestic and overseas borrowings. The erosion of accountability in the name of co-ordination is particularly ironic when governments are once again borrowing largely on their own behalf.

Similarly, the effectiveness of judicial review as a restraint on the exercise of power under the borrowing arrangements is impaired by their intergovernmental character, further aggravated now by the extent to which practice has departed from law. A hint of the divergence appeared in the Melbourne Corporation case, where Latham C.J. characterised section 48 of the Banking Act, which he later held invalid for inconsistency with the Financial Agreement, as an attempt to subject the State in the exercise of its right to borrow on overdraft 'not even to the control of the Loan Council (which consists of both Commonwealth and State representatives), but to the control of the Federal Treasurer, who is one of the members of the Loan Council.'[84] It was illustrated more starkly 35 years later, in *Tasmanian Wilderness Society v. Fraser*,[85] when Commonwealth domination of the Loan Council was much further advanced.

Fraser was another episode in the long-running battle for preservation of the Franklin-below-Gordon River in Tasmania, where the Tasmanian hydro-electric authority proposed to construct a dam. An interlocutory injunction against the Commonwealth Prime Minister and Treasurer was sought one week before the

[84] *Melbourne Corporation v. Commonwealth* (1947) 74 C.L.R. 31, 63.
[85] (1982) 153 C.L.R. 270.

Loan Council meeting at which it was alleged that Tasmania would seek funds for the implementation of its proposal for the dam.

Although there was no reference to the source of the power of the Loan Council in this matter, the application concerned a State authority and the decision therefore would have been made under the Gentlemen's Agreement. It may be assumed that it was part of the infrastructure borrowing arrangements: Tasmania had already received general approval under these arrangements, in 1979-80, to borrow $75 million for hydro-electric power development. The issue in June 1982 would have been the proportion of that amount to be borrowed in the coming year.

The plaintiff sought to restrain the defendants from voting in favour of the Tasmanian application. The substantive argument was that the defendants would be in breach of two Commonwealth Acts for the protection of the Australian heritage and the environment, which imposed a duty on each Minister to 'do all such things as, . . . can be . . . done . . . for ensuring that . . . any authority of the Commonwealth in respect of which he has ministerial responsibilities, does not take any action that adversely affects . . . ' the area in question. 'Authority of the Commonwealth' was defined to include bodies established under the laws of the Commonwealth.

In the wake of *Sankey*, the short legal answer was obvious. The Loan Council was not an authority, because it is not established by a law of the Commonwealth. This answer was duly given. The following characterisation of the Commonwealth Treasurer's role on the Loan Council, however, suggests a problem of responsibility for Loan Council decisions more generally: the Treasurer was 'not merely acting in his capacity as a Minister; in one sense he is representing the Commonwealth and in another he is acting as a member of the A.L.C. What he does is outside the realm of administering his department and taking responsibility for a statutory authority.'[86] This analysis is clearly correct as a matter of law, but far removed from the fact that policy positions developed within the Commonwealth Treasury determine most key Loan Council decisions. And in that case, where does the responsibility lie?

In the event, and probably not by coincidence, electricity authorities were released altogether from Loan Council control of their domestic borrowings at the June meeting. The Commonwealth budget papers blandly record that '14 of the 29 approved projects under the infrastructure financing guidelines are now outside Loan Council control and have not been allotted any program.'[87]

Parliamentary control of finance

Parliamentary control of finance is the lynch-pin of the Australian system of responsible government. It is accepted to require the imposition of taxation by

86 *Ibid.* 277.
87 *Supra* n. 44, 35.

Parliament and appropriation of the proceeds by Parliament. Its application to borrowing and loan funds is less clear. On the one hand it can be argued that borrowing is merely a form of contract; that governments can contract and therefore borrow without parliamentary authority; and that Parliament's role is safeguarded sufficiently by the need for appropriation to meet interest and other loan charges. The contrary view is that borrowing of moneys without legislative authority is not within executive power because of its potential to circumvent the fiscal control which Parliament theoretically exercises within the system. In this regard it is relevant that interest and loan charges are usually met from standing appropriations and that only New South Wales and, perhaps, the Commonwealth are subject to constitutional requirements for the appropriation of loan funds[88] as opposed to the statutory requirements which operate in all other States. In any event, for whatever reason, all Australian Parliaments regularly authorised government borrowings before the Financial Agreement came into force, whereas now the practice is relatively rare.

The surprising obscurity of constitutional law on such a fundamental point has been further confused by the emphasis on executive action under the Financial Agreement. Since it came into effect, government borrowing decisions in most jurisdictions have been made and implemented largely under the authority of the Agreement alone.[89] If a statutory basis is required it is presumed to be provided by the Acts approving the Agreement, or, perhaps, overridden by Constitution section 105A(5). Similarly, the traditional attitudes and practices which reflect the responsibility of government to Parliament appear to have become modified where borrowing is concerned, partly no doubt because of the complexity of the borrowing arrangements but partly also because of the diminished role of Parliament under them.

The issue became briefly contentious in Victoria in 1985, when the Capital Works Authority was established. It will be remembered that the purpose of the Authority was to borrow on behalf of the Government funds raised by Vicfin under the Global Approach. The Authority was created by Order-in-Council in exercise of the prerogative and it had no statutory basis. Its borrowings were outside the Financial Agreement and therefore could not rely on whatever comfort might have been provided by Victorian legislation approving the Agreement. The debate which raged in the Victorian Legislative Council canvassed constitutional history from the Norman Conquest to the Loans Affair, dwelling with particular relish on the fate of the Stuart Kings and their allegedly comparable habits.[90] The underlying constitutional questions, such as they are, remain unresolved.

[88] Constitution Act 1902 (N.S.W.) (as amended by the Constitution (Consolidated Fund) Amendments Act 1982) ss 39, 45. S. 81 of the Commonwealth Constitution has not been interpreted to require loan moneys to be credited to the Consolidated Fund; a constitutional requirement for the appropriation of loan moneys can however be derived from Constitution section 83.

[89] Queensland and Western Australia continue to use Loan Acts, and Tasmanian legislation also authorises borrowings from time to time.

[90] Victoria, *Parliamentary Debates*, Legislative Council, 14 August 1985, 1-23.

VI CONCLUSION

The formal Agreement which is still assumed to structure intergovernmental borrowing in Australia was executed in 1927. Some of its clauses date back to the formation of the voluntary Loan Council in 1923. It was designed to meet objects which have long since passed, on the basis of economic theory which has long since been overtaken. The accusation that the Constitution, which at least has the advantage of generality, has outlived its time, pales into insignificance by comparison with an Agreement designed to tailor the borrowing activities of governments in the 1920s, which continues to do so today.

Not surprisingly, the form of the Financial Agreement now bears no relationship to reality either in procedure or in substance. The voting arrangements are irrelevant. The terms and conditions of borrowing in fact have been delegated formally to the Commonwealth. Decisions about the levels of borrowing effectively are made by the Commonwealth. And in any event, borrowing under the Financial Agreement has now completely ceased. Each Australian government is in fact borrowing on its own behalf, if it is borrowing at all, outside the Financial Agreement. The total is controlled by the Commonwealth by the threat, whether expressed in legal form or not, of the reduction of revenue redistribution payments.

Any intergovernmental arrangement raises problems for traditional accountability mechanisms, whether through the political processes or the courts.[91] They are compounded when the form of the Agreement departs so dramatically from practice. Nor is the problem confined to institutional accountability: it is widely assumed by both the media and the public, in both Australia and overseas, that the Financial Agreement has a bearing on government borrowing.[92] The effect of this lack of accountability on the behaviour and performance of governments in relation to borrowing over, say, the last forty years, is impossible to establish.

Even on its face, however, the current system is open to criticism on grounds of effectiveness. The basis on which both the government and authorities programs are divided between States has historically been frozen: even if some change has been achieved in the last year or so, there has been no clear explanation of its basis and nothing whatsoever to suggest either an economic rationale or an assessment which can be judged through the political process. Equally, the borrowing arrangements over time have, quite irrationally, distorted allocations between different parts of the public sector, incidentally distorting the structure of the public sector itself. From the 1930s until quite recently this was most evident in the artificial distinction between governments and their authorities. One recent manifestation has been the manner in which loan funds are allocated to public housing. The issue has also bedevilled government decisions

[91] Saunders, C., *Accountability and Access in Intergovernmental Affairs: A Legal Perspective* (1984) Papers on Federalism, 2.

[92] Chessell, D., 'Issues for the Future: An Overview', a paper delivered to a conference on *Smaller Government: Can the Federal System Deliver?* organised by the Business Council of Australia, 23 November 1987.

about the operation and financing of government business enterprises for most of this decade, and continues to do so.

Clearly the time has come to decide what the next step should be. Various commentators have suggested different options which could form a basis for the debate. Scott, for example, has proposed a model under which the Commonwealth would be given direct power over aggregate government borrowing; the allocation of the total between governments would be determined in accordance with economic criteria, under the guidance of an independent Loan Council secretariat; conditions of borrowing would be left to the market; each government would borrow in its own right; and each government would be accountable for its own decisions through normal processes.[93] Mathews would confer on a (presumably genuine) intergovernmental decision-making body the responsibility for determining total borrowings, their distribution (at least between governments) on objective criteria, and the terms and conditions of borrowing.[94] Chessell has drawn attention to possible advantages of much more extensive deregulation of government borrowing in Australia.[95] Whatever the solution, it is essential that it be co-ordinated with the rest of the federal fiscal system and, preferably, constitute part of its comprehensive overhaul.

In fact there is little immediate incentive for change, from the standpoint of the actual parties to the arrangements. Governments have adapted the outward form and the practical operation of their borrowing activities to the current system. At the Commonwealth level there would be concern about possible diminution of the substantial power that has been accumulated over decades, without the usual encumbrances of public accountability. State governments would apprehend even greater Commonwealth domination and the elimination of the few remaining but important loopholes that arguably exist.

A catalyst for change may be the possibility that the Financial Agreement already has expired as a matter of law. If the argument were correct, it would leave compliance with decisions of the Loan Council by the States as voluntary as their abstinence from income taxation. The distinction may not be great in practice. Nevertheless, public acceptance that the borrowing arrangements were no longer legally binding and that the Loan Council had no more formal authority than any other intergovernmental ministerial council could be expected to have some influence, in a relatively short period of time. The argument about expiry is the last of the line of legal conundrums presented by the Financial Agreement. It has been explored in greater detail elsewhere and need not be repeated here, except in outline.[96]

Six central provisions in Part I of the Agreement, including the obligation to submit borrowing programs to the Loan Council and the prohibition on borrowing otherwise than in accordance with the Agreement, are expressed to continue 'while Part III of this Agreement is in force'. Part III contains four clauses, to

93 Scott, *op. cit.* n. 21, 47-56.
94 Mathews, *op. cit.* n. 16, 20-1.
95 Chessell, *op. cit.* n. 92, 19-20.
96 Saunders, C., *The Expiry of the Financial Agreement* (1985) Papers on Federalism 4.

transfer debts from the States to the Commonwealth; to require the Commonwealth to meet fixed interest changes on the debt taken over for 58 years, in lieu of the *per capita* payments; to prescribe sinking fund payments; and to settle the transferred properties question. Until the 1976 amendments to the Agreement the sinking fund arrangements were theoretically finite, in the sense that they terminated 58 years after the debts initially taken over and 53 years after the last subsequent loan. The sinking fund arrangements substituted in 1976 are unlimited in operation.

In these circumstances, the meaning of references to limited duration in Part I are far from clear. The interpretation favoured by most commentators[97] is that Part I was intended to continue until the last sinking fund payment was made under Part III. Even before 1976 this interpretation would effectively have given the Financial Agreement perpetual operation, unless ended by the parties. The 1976 amendments would have removed even the theoretical possibility that the Financial Agreement would expire through effluxion of time.

One difficulty with this interpretation, compounded by the staggered dates from which the sinking fund provisions originally were expressed to operate, is that it effectively makes nonsense of the words of limitation in Part I. Nor was there anything in the documents recording the negotiations which took place over the amending Agreement in 1976 to suggest that the participants thought that they were doing anything so fundamental as giving the Financial Agreement perpetual operation. Contemporary evidence in 1927 when the original Agreement was drafted, moreover, overwhelmingly suggests a general belief that the duration of the Agreement was limited to 58 years.[98] Possibly by coincidence, circumvention of the Agreement through central borrowing agencies dates approximately from the end of that period, with the apparent acquiescence of all parties.

A possible alternative would construe the words of limitation in Part I as a reference to the duration of what may be regarded as the key provision in Part III, namely, the payments in lieu of *per capita* grants for a period of 58 years. A justification for this approach, which admittedly involves a somewhat strained interpretation of the words of limitation themselves, is that these payments represented the main inducement for the States to enter into the Agreement in the first place. If it were accepted as correct, the binding quality of the obligations in Part I would have ceased on 30 June 1985. It would thus have the additional advantage of bringing recognised law into line with practice.

[97] For example, Gilbert, *op. cit.* n. 22, 10-1; Prowse and Morey, *Financial Agreement and the Future of the Loan Council* (1976) Occasional Paper 4.

[98] Some are quoted in Saunders, *op. cit.* n.96, 11-2. They include the following:

'I know of nothing more absurd than that this House should attempt solemnly to legislate for 58 years ahead in the supremely important realm of finance. If I thought that the arrangement would last for that term I should not view it as favourably as I now do. It is merely a good temporary arrangement.' (Gullett, Minister for Trade and Customs: Commonwealth, *Parliamentary Debates*, House of Representatives, 21 March, 1928, 4011); and

'The Government has always realised that although the agreement is for 58 years, it cannot be regarded as a solution to the financial problems of Australia for the whole of that time. Inevitably with the passing of years, the development of Australia, and the change in circumstances, both the Commonwealth and the States will realize that a review of the agreement will be to the advantage of all.' (Prime Minister Bruce, Commonwealth, *Parliamentary Debates*, 7 March 1929, 870-1).