



## PRESS RELEASE

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### Call to preserve strengths of federal financial system

AT A TIME of renewed controversy over Australia's federal finances, a new study of the history and future of Australia's federal finance system has been published.

The study argues that some recent criticisms of Australia's federal financial system are misplaced.

Called *Financing the Federation*, the study was published by the South Australian Centre for Economic Studies, a joint research centre of Adelaide and Flinders Universities. It was written by Jim Hancock (an economist at the Centre) and Julie Smith (a tax historian at the Australia Institute and the Research School of Social Sciences at ANU). It was commissioned by the South Australian Department of Treasury and Finance as its contribution to the Centenary of Federation.

"Two features of Australia's federal financial system stand out in contrast to other nations," said Mr Hancock

"The first is that unavoidable differences in the financial capacities of State Governments are offset by the distribution of Commonwealth grants (otherwise known as "fiscal equalisation") and the second is a high degree of State Government reliance on Commonwealth grants.

"These features have attracted criticism in the public debate, but our report shows that much of the criticism is unfounded," he said.

"There has long been a view in official circles that fiscal equalisation has merit on grounds of equity and in the interests of viability of all the States. And indeed this has been reflected in the fiscal equalisation processes the Commonwealth has operated since the 1930s. However, an important conclusion of this study is that there is also a strong efficiency case for fiscal equalisation."

Mr Hancock goes on to argue that the large volume of Commonwealth grants to the States is not likely to seriously undermine the accountability of State Governments.

"The reality is that the existing structure requires that, at the margin, States fund their own discretionary spending decisions dollar-for-dollar from their own revenue or savings efforts."

"However, some reforms to the allocation of taxation powers are still worth consideration, such as giving the States modest access to the income tax base, including some capacity to vary the tax take according to State priorities".

Julie Smith explains the origins and evolution of the federal finance system to 1970. She shows that the framers of Australia's Constitution deliberately provided flexibility to deal with the different economic and budgetary circumstances of the federating States.

"Fiscal equalisation was not, as some would have it, a compensation for uneven impact of Australia's now defunct protective tariff. Rather the system was to protect our fledgling nation against political and financial instability due to excessive geographic economic disparities."

The paper can be downloaded at <http://www.adelaide.edu.au/saces/publications/other.html>.

Comment on strengths and weaknesses of the current arrangements and developments since the 1970s from Jim Hancock on 08 8303 5515. Comment on the evolution of financial arrangements to 1970 from Julie Smith on 0416 199 630.