Briefing Note

Commentary on the Proposal to Provide for a Balanced Budget in the New South Wales Constitution

by

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1. INTRODUCTION

On 13 September 1994 the Premier, the Hon J Fahey MP, and the Treasurer, the Hon P Collins MP, announced that NSW is to become the first Australian State to introduce legislation to guarantee a balanced budget. It was said that the legislation would be "enshrined in a referendum" to coincide with the March 1995 election. It is reported that voters will be asked to support a change to the NSW Constitution to ensure a debt-free annual balance sheet by 1997. It seems that not only would the Budget have to be balanced under the proposed scheme, but forward estimates contained in it would also have to show balanced Budgets into the future. According to the Premier, this would be based on certificates given by the Treasurer and the Secretary of the Treasury indicating it is within proper accounting procedures, otherwise the Budget appropriation bill "will not be valid or passed".[1] Budget deficits would be permitted but only in exceptional circumstances, such as natural disasters and other "emergencies".[2] The Treasurer elaborated, "Obviously in balanced-Budget legislation, you have to have provision for unforeseen consequences; natural disasters for example, major cyclical changes and as American States mostly provide, a stipulation in balanced legislation that should there be an overrun, that there will be a recovery in a specified period of time".[3] In support of the proposal it was also pointed out that every State but two in the US has balanced budget legislation.[4]

This briefing note looks first at certain constitutional considerations arising from the proposal and secondly at some of its economic implications.

2. CONSTITUTIONAL CONSIDERATIONS

(i) An entrenched provision?

Specific details of the proposal are not known at this stage. However, one possibility is that any proposed amendment to the *Constitution Act 1902* would take the form of an "entrenched" provision involving a restrictive procedure for its repeal or amendment, outside the normal legislative process. A number

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1 "People may get vote on balanced Budgets", *The Sydney Morning Herald*, 14 September 1994.

2 "Balanced budgets to be law", *Telegraph-Mirror*, 14 September 1994.

3 "Collins back-pedals over balanced Budget move", *The Sydney Morning Herald*, 15 September 1994.

4 The Treasurer, Mr Collins, speaking on the 7.30 Report, ABC, 14 September 1994.

of mechanisms can be used for this purpose, including requirements for special majorities. More likely in this context is a manner and form provision similar to sections 7A and 7B of the Constitution Act. Under section 7A a referendum is required for bills abolishing the Legislative Council or altering its powers (and for certain other matters). Similarly, section 7B requires a referendum for bills affecting the Legislative Assembly in certain respects, specifically: compulsory voting; the requirement of single member electoral districts; redistribution; the number of voters in electoral districts; the conduct of Legislative Assembly elections; and the duration of the house beyond four years. Further provision for a referendum procedure is found in section 5B which refers to disagreements between the two houses. Any "Bill appropriating revenue or moneys for the ordinary annual services of the Government" is excluded from the operation of section 5B.

What may be proposed therefore is an entrenched provision mandating a balanced budget which could not be repealed without a referendum.

At one level the matter goes to the issue of parliamentary sovereignty, in particular to the question as to whether the NSW Parliament is disabled from fettering its own legislative action. Can it deprive itself and its successors of the power to legislate on any particular topic or to repeal any statute it may enact?[5] Put another way, what is the basis for requiring restrictive procedures for the repeal or amendment of any statute?

Peter Hanks explains[6] that the power to legislate so as to require restrictive procedures for legislation is derived from two sources: the general legislative power of each State Parliament; and from the *Australia Act 1986* (Cth). The general legislative power of the NSW Parliament "to make laws for the peace, welfare and good government of New South Wales in all cases whatsoever" is found in section 5 of the Constitution Act. In *Clayton v Heffron* (1960) 105 CLR 214 the High Court held that section 5 of the Constitution Act confers a full constituent power on the NSW Legislature and that the enactment of section 5B of the Act is a valid exercise of that power.

Section 6 of the *Australia Act 1986* (Cth), on the other hand, makes effective a restrictive procedure which prescribes a "manner and form" for the enactment of certain categories of legislation. It provides that where a State Parliament legislates respecting the constitution, powers or procedure of the Parliament of the State, its legislation will be of no force or effect unless it is made in such manner and form as may be required by a law made by that Parliament. Its effect is substantially the same as section 5 of the *Colonial Laws Validity Act*

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[5] P Hanks, *Australian Constitutional Law: Materials and Commentary*, 5th ed, Butterworths 1994, p 126.

[6] *Halsbury's Laws of Australia*, Vol 5, Butterworths 1993, at 164,394.

1865 (UK). In the *Trethowan case* (1931) 44 CLR 394 it was held that section 7A of the Constitution Act was within the power conferred by section 5 of the Colonial Laws Validity Act. At issue was the validity of legislation to repeal section 7A and to abolish the Legislative Council. The High Court held that legislation to repeal the provision was a law respecting the powers of the legislature; the legislation to abolish the Legislative Council was a law respecting the constitution of the legislature; and the requirement that such laws be approved by the voters at a referendum was "properly described as requiring a manner in which the law shall be passed".[7]

It is clear, therefore, that the law-making power of the NSW Parliament can be constrained by means of a self-imposed requirement that a special legislative procedure be followed by the legislature.[8] Section 5 of the Constitution Act may provide a more general power in this respect, whereas reliance on section 6 of the Australia Act is explicitly restricted to laws on the subject of the constitution, powers or procedure of the Parliament. A referendum requirement is consistent with that provision. As King CJ said in *West Lakes v South Australia* (1980) 25 SASR 389

> a requirement that an important constitutional alteration be approved by the electors at a referendum....although extra-parliamentary in character, is easily seen to be a manner and form provision because it is confined to obtaining the direct approval of the people whom the 'representative legislature' represents (at 397).

A further question is whether (a) a mandatory balanced budget provision would be a law on the subject of the "constitution, powers or procedure of the Parliament" according to section 6 of the Australia Act, or (b) failing that, whether State Parliaments may impose manner and form requirements in relation to issues not within the meaning of that phrase, pursuant to the general legislative power under section 5 of the Constitution Act?

As to question (a) above, at issue is whether the mandatory budget provision could be characterised as a law with respect to the powers of the legislature to enact legislation. RD Lumb discusses the limits of section 6 of the Australia Act in this regard, noting

> It may be pointed out that a Bill of Rights which gives protection to civil rights (such as life, liberty, and property) and which imposes a manner and form requirement (such as a

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[7] *Attorney-General (NSW) v Trethowan* (1931) 44 CLR 394, at 432 (Dixon J).

[8] *McCawley v R* [1920] AC 691; *Attorney-General (NSW) v Trethowan* (1931) 44 CLR 394.

> referendum) for the passage of inconsistent legislation could not operate under s. 6 of the Australia Acts to affect or control legislation inconsistent with the Bill of Rights, for the reason that the later legislation would have been characterised as legislation on specific matters and not as legislation relating to the constitution, powers or procedure of the legislature.[9]

It seems that on this analysis an entrenched Bill of Rights would have to rely on the plenary law-making power under section 5 of the Constitution Act. Lumb goes on to say in this respect that the changes made in recent years to State constitutions (e.g. relating to the position of the Governor, the Supreme Court and electoral matters) have not depended on section 6 of the Australia Act. The key point is that the power to make manner and form provisions under section 5 of the Constitution Act appears to be much broader, qualified only by considerations of a procedural kind. Thus, Lumb concludes that the State Parliament "cannot make legislation unrepealable or impose a manner and form provision which is in effect a limitation of substance designed to inhibit the power of a State legislature to repeal the legislation. Viewed in another light, it would amount to an abdication of the power of the representative legislature to legislate in a particular area".[10] The example is given of a provision requiring that the repealing Bill be approved by ninety per cent of electors voting at referendum.

In any event, whether reliance is placed on section 5 of the Constitution Act or section 6 of the Australia Act, it is clear that an entrenched balanced budget provision, modelled on section 7A and others in the Constitution Act, would be legally valid. Thus, entrenchment of parts of the State's Constitution does not derogate from the sovereignty of the NSW Parliament, so long as the form of entrenchment is not too rigid in nature.[11]

The same conclusion would apply a fortiori if the proposed provision were not in an entrenched form. The provision could be repealed through the normal parliamentary procedures and so the legislature would not have bound itself or its successors in any way.

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[9] RD Lumb, *The Constitutions of the Australian States*, 5th ed, University of Queensland Press 1991, p 119.

[10] ibid, p 131.

[11] That view finds support in *Bribery Commissioner v Ranasinghe* [1965] AC 172.

(ii) An issue of constitutional practice and principle?

Having crossed the threshold of legal validity, the next step is to consider how the proposal sits within the framework of constitutional practice and principle informing the operation of the Westminster system of responsible government.

One general point is that, as a matter of constitutional principle, it is said that one Parliament should not stay the hand of its successors by entrenchment for the reason that circumstances change, as do community needs and values, and Parliament must be as free as possible to change with them. As the Legal and Constitutional Committee of the Victorian Parliament said in its report on the *Constitution Act 1975* (Vic), "A past Parliament is in no position to confidently predict the future, and so it should not seek to confine the liberty of action of its successors in attempting to cope with that future. Thus, as a general principle, entrenchment is to be avoided as comprising an intrusion of the dead hand of the past into the present".[12] However, one exception was noted, with the Committee stating, "It is widely accepted that the entrenchment of truly fundamental constitutional precepts and values may be appropriate, provided that the degree of entrenchment is not so great as to in practical terms completely incapacitate a future parliament from action".[13] Thus, the first matter the Committee considered was whether or not the constitutional entrenchment of the Supreme Court under section 85 of the Victorian Constitution Act was justified as "fundamental to the constitutional well-being of Victoria". If not, then, the practical difficulties of procedural and legal uncertainty created by that entrenchment would be unwarranted as a matter of constitutional principle. The Committee went on to approve the entrenchment on the grounds that it protected the fundamental principle of the Rule of Law. The argument has not met with universal acceptance, with Carol Foley contending that the Committee read "the concept of Rule of Law too narrowly and that it is not at all clear that s 85(1) does encapsulate the rule of law".[14]

Looked at in this context, the issue is whether the balanced budget proposal

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[12] Legal and Constitutional Committee of the Victorian Parliament, *Report Upon the Constitution Act 1975*, 39th Report, p 10.

[13] Ibid

[14] CA Foley, "Section 85 Victorian Constitution Act 1975: Constitutionally Entrenched Right...or Wrong?" [1994] 20 *Monash University Law Review* 110-150. Foley comments: "It has been said that the Rule of Law is 'a set of concepts encompassing legal rules, institutions [and] processes of reasoning' and as such 'encompasses a great deal more than Courts' which merely provide a 'physical and institutional site' for the Rule of Law to be exercised. If this is so, then protecting the jurisdiction of the Supreme Court has little to do with protecting the Rule of Law; it is simply protecting the jurisdiction of the Supreme Court" (p 128).

constitutes a fundamental constitutional precept or value of sufficient weight and significance to require entrenchment. The issue, then, is not one of legal validity per se but of conformity with constitutional principle and established practice.

(iii) Responsible government and representative democracy

Further to this line of reasoning, it can be asked how the proposal would sit with the doctrine of responsible government, in particular as this relates to the making and passing of appropriation Bills. Under the doctrine of responsible government ministers are individually and collectively answerable to the Parliament and can retain office only while they have the "confidence" of the lower House, that is, the House of Representatives in the case of the Commonwealth and the Legislative Assembly or the House of Assembly in the case of the States. This is not the place to deal with this matter in any detail. It is enough to note the critical role played by the debate concerning the "power of the purse" in the historical development of responsible government and representative democracy. The crucial point is that responsible government has been linked, conceptually and practically, to the ability to obtain supply in the lower House of the legislature. In this way a link was forged between popular government and popular control. Thus, David Mayer refers to

> the constitutionalist interpretation of responsible government which links the convention that the prime minister should resign when denied supply, to the position of the government in the popular house. The ability to obtain supply indicates that the government has a majority in the lower house. The convention is not simply that denial of supply requires resignation. 'It is rather that *failure to retain majority support in the lower house, of which ability to obtain supply is the crucial test, requires resignation*'.[15]

That account of responsible government finds very clear expression in section 5A of the NSW Constitution Act, which accords legislative supremacy to the Legislative Assembly in relation to "any Bill appropriating revenue or moneys for the ordinary annual services of the Government". The section was inserted in the Constitution Act in 1933.

The compatibility of an entrenched balanced budget provision with the theory and practice of responsible government is open to various interpretations,

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[15] DY Mayer, "Sir John Kerr and Responsible Government" in *Responsible Government in Australia*, ed by P Weller and D Jaensch, Drummond Publishing 1980, p 53.

which in turn depend on the different meanings attached to the term "responsibility". AH Birch set out three possible meanings of responsibility.[16] The one of least interest in this context is the idea of collective and individual ministerial responsibility. A second meaning is that of responsiveness to public opinion; thus, responsible government refers to the exercise of democratic authority in a liberal democratic state. It could be argued that a referendum requirement would enhance that aspect of responsible government. In *Trethowan's case*, Rich J described a referendum as a mode of manner and form legislation which "includes the electorate as an element in the legislative authority in which the power of constitutional alteration resides" (at 421). An entrenched balanced budget proposal would extend the operation of that popular involvement in Parliament's legislative authority, taking it into an area which constitutes one of the core testing grounds of popular control. However, neither the nature nor extent of this popular involvement should be overstated: it would be basically procedural in kind, limited to the passing (or rejecting) of the original Bill at referendum and to any subsequent referendum for amending the provision. On both occasions the decision to hold a referendum would be made by Parliament itself.

Alternatively, it could be argued that a balanced budget proposal would constitute an unnecessary appendage to the legislative authority of the lower House, one which may even be seen as compromising its pre-eminent position in relation to appropriation Bills, at the same time putting a question mark over the Legislative Assembly's claim to be the people's House. Arguably, it would introduce an uncomfortable tautology into the Constitution, whereby the defining legislative authority of the people's House would itself be subject to popular constraint. On this basis, it could be argued that the balanced budget proposal would fetter Parliament as a popular or representative body.

This leads into the third meaning of "responsibility", with AH Birch referring to prudent and consistent government in which unpopular decisions may be taken in the "national interest" (the terminology used by Birch was that appropriate to a unitary state). With the necessary modifications required for a federation, this third meaning suggests that good government may not always coincide with popular government and, further, that parliamentary representatives are not mere delegates or agents of their constituents, since they are expected to exercise their judgment and discretion in enacting legislation. Further to this, the comment can be made that a mandatory balanced budget proposal would inevitably fetter judgment and discretion. It could also be said that budgetary matters are quintessentially of this kind: discretionary in nature, varying according to circumstance, requiring popular and sometimes unpopular judgment and decision on the part of government. Of

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[16] Birch's view are summarised in JR Archer, "The Theory of Responsible Government in Britain and Australia" from Weller and Jaensch, op cit, p 23.

course there is always another side to these conceptual debates, which on this occasion may lead to an alternative argument based, for example, on considerations of fiscal responsibility. One advantage which could be cited by proponents of the balanced budget proposal is that it would effectively de-couple the business cycle from the electoral cycle. Further to this, the comment can be made that a balanced budget proposal seeks to create the fiscal underpinning needed for the economic and social stability upon which responsible, stable government depends.

The above discussion suggests the extent to which the balanced budget proposal impacts on the matrix of conventions and practices basic to our system of government.

What is clear is that any proposal would have to be considered in the light of its potential effect on the operation of section 5A of the NSW Constitution Act.

(iv) Procedural and definitional uncertainty

Without in any way attempting to pre-empt the form any proposal will take, it is worth at least noting the obvious concern about procedural and definitional uncertainty which can arise in relation to any constitutional provision. Mention was made in passing to the difficulties of this kind which have arisen in regard to section 85 of the Victorian Constitution Act, but the point is not limited to that example. The wider issue relates to the level of generality of language which tends to be used in constitutions and the uncertainties which flow from this. Also, as Pilita Clark explained in *The Sydney Morning Herald* of 16 September 1994 in regard to the US debate on the balanced budget rule, "judges, rather than politicians, would become the ultimate umpires in any dispute about whether the terms of the balanced budget laws have been met".

The difficulty in this context is that a term such as "budget deficit" has no agreed legal meaning. Indeed it may even be the case that professional economists do not agree as to its meaning. If that is true, then statements of the following kind need to be read with caution: "A budget deficit is simply the amount by which government's expenditures exceed its revenues during a particular year".[17] A NSW Treasury guide to *The Budget & How It Works* defines "deficit" thus: "General term used to describe an excess of government expenditure over revenue. *Its definition varies between different States*" (emphasis added).[18]

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[17] J Jackson, R McIver and C McConnell, *Economics*, 4th ed, Mcgraw-Hill Book Co 1994, p 277.

[18] NSW Treasury, *The Budget & How It Works*, p 32.

A key issue, then, relates to what constitutes government expenditure for budgetary purposes, along with the method of calculation. Naomi Caiden made the point in an American context, adding that whatever categories are excluded from the definition of expenditure will automatically attract spending: "Everything depends on the wording of the limitation and how it is interpreted".[19] One obvious question is whether both the capital budget and current revenue outlays would have to be in balance, or would the provision be limited in its application to the latter, as seems to happen in some of the US States.[20] Beyond this, some indication of the complexities that may arise is gained from a NSW Treasury publication of 1991, which states: "Most budgets provide for discretionary expenditure by the executive, the budgets do not incorporate the financial operations of all public sector agencies and most governments have trust funds which receive dedicated revenues".[21] Bob Walker makes the point that the NSW budget "relates to a part of government activities, mainly government departments" and that it excludes some of the public sector's most important agencies and activities.[22]

Writing in *The Australian* of 12 June 1992 Paddy McGuinness commented on the potential difficulties involved in these terms

> The prospect of having lawyers debating and deciding fundamental issues of economics and accountancy like the definition and significance of Budget deficits is hardly attractive to the serious analysts of fiscal policy, even those who believe

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[19] N Caiden, "Problems in Implementing Government Expenditure Limitations", from *How To Limit Government Spending* by A Wildavsky, University of California Press 1980, p 150. Caiden adds, "It is probably impossible to frame an amendment which cannot be avoided".

[20] JR Cranford, "State Budgets: Deceptive Models", *Congressional Quarterly Weekly Report*, 13 June 1992. Cranford comments, "Nearly every State segregates major construction projects into a capital budget that is partly or mostly financed through borrowing. The philosophy is that current expenses should be financed with current revenue - the balanced part of the budget - while long term investment should be paid for over the life of the project. In addition, many States used separately financed funds for special projects. That often results in special State-issued bonds that are paid off with dedicated revenue sources, such as tolls."

[21] D Nicholls, *Managing State Finance: The New South Wales Experience*, NSW Treasury 1991, p 156.

[22] B Walker, "Budget's lost balance", *The Sydney Morning Herald*, 15 September 1994. Cited as examples are the Department of Public Works and government trading enterprises. Walker adds: "the government of the day might decide what it will include and what it will exclude from its 'budget sector'".

that Budgets in some sense should be balanced.

McGuinness proceeds to say of the Gramm-Rudman Bill, which requires a balanced Federal budget in the US, that "it has led to a great deal of creative accounting by Congress, and the invention of numerous different concepts of what a Budget deficit is".[23] The same fate has been predicted for the NSW proposal.[24]

It may be that a provision could be drafted which makes no direct reference to the term "budget deficit", except perhaps in the section heading. This is the case with some of the comparable provisions found in the constitutions of the US States. For example, Article III, section 52 (5a) of the Maryland Constitution provides

> The Budget and the Budget Bill as submitted by the Governor to the General Assembly shall have a figure for the total of all proposed appropriations and a figure for the total of all estimated revenues available to pay the appropriations, and the figure for total proposed appropriations shall not exceed the figure for total estimated revenues. Neither the Governor in submitting an amendment or supplement to the Budget shall thereby cause the figure for total proposed appropriations to exceed the figure for total estimated revenues, including any revisions, and in the Budget Bill as enacted the figure for total estimated revenues always shall be equal to or exceed the figure for total appropriations.

It has been indicated that exceptions would be made to the balanced budget provision in NSW to accommodate "emergencies" of various kinds and, according to the Treasurer, in the event of "major cyclical changes". The provision would therefore have to provide both for a balanced budget and a sufficient measure of flexibility required to deal with a range of contingencies. Taken with the comments made already about the scope for potential uncertainty, this further complication adds to the perception of difficulty involved in the transformation of a mandatory balanced budget proposal into a constitutional provision. Procedural matters would have to be spelt out with great care to include, presumably, appropriate mechanisms for revising the expenditure limit. To offer an American example again, the Louisiana Constitution provides that "The expenditure limit may be changed in any fiscal year by a favourable vote of two-thirds of the elected members of each house.

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[23] A detailed account of the Bill and its history is found in J White and A Wildavsky, *The Deficit and the Public Interest*, University of California Press 1989.

[24] "Mr Collins's Budget Stunt", *The Sydney Morning Herald*, 15 September 1994.

Any such change in the expenditure limit shall be approved by passage of a specific legislative instrument which clearly states the intent to change the limit".[25] An alternative approach may be to draft a provision which could be set aside or modified relatively easily. Indeed, the initial suggestion seems to have been that if "a government wanted to run a deficit, the Treasurer would be required to present a valid reason to the Parliament".[26]

3. ECONOMIC CONSIDERATIONS

(i) Annually or cyclically balanced budgets?

The debate about balanced budgets is part of the wider discussion among economists of the relative merits and de-merits of the Keynesian and neo-classical approaches to fiscal policy. Within this discussion it is asked whether it is desirable to incur deficits and thereby realise a growing public debt, or should the budget be balanced annually? A corollary to this is whether the budget should be balanced annually or across the business cycle?

Following Jackson et al it can be said that until the 1930s the annually balanced budget was generally accepted as a desirable goal of public finance: "Upon examination, however, it becomes evident that an annually balanced budget largely rules out government fiscal activity as a counter-cyclical, stabilising force. Worse yet, an annually balanced budget actually intensifies the business cycle". The example is offered of a situation of high unemployment, falling incomes and declining tax receipts. To balance its budget the government must increase tax rates and/or reduce government expenditures, both of which are contractionary in nature, resulting in a further dampening of aggregate expenditures. The conclusion, according to Jackson et al, is that an annually balanced budget is not economically neutral: "the pursuit of such a policy is pro-cyclical, not counter-cyclical".

Jackson et al pose the alternative of a cyclically balanced budget which sees government exerting a counter-cyclical influence and at the same time balancing its budget. The budget would not be balanced annually but over the course of the business cycle. It is remarked that "there is nothing sacred about 12 months as an accounting period". The authors comment

> The basic problem with this budget philosophy is that the upswings and downswings may not be of equal magnitude and duration and hence the goal of stabilisation comes into conflict

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[25] Article VII, section 10 (2)

[26] "Fahey to make Budgets balance", *The Sydney Morning Herald*, 14 September 1994.

> with balancing the budget over the cycle. For example, a long and severe slump, followed by a modest and short period of prosperity, would mean a large deficit during the slump, little or no surplus during prosperity and therefore a cyclical deficit in the budget.[27]

At least two issues are raised here. One concerns the general desirability of an annually balanced budget. A second refers to the conditions under which a deficit would be permitted. As noted, the Treasurer cited the example of those American States which provide a "stipulation in balanced legislation that should there be an overrun, that there will be a recovery in a specific period of time". For example, the Louisiana Constitution provides, "If a deficit exists in any fund at the end of a fiscal year, that deficit shall be eliminated no later than the end of the next fiscal year".[28] Further to Jackson et al, the difficulty is that business cycles are irregular in length and that, on their analysis, it may not always be prudent to seek to balance the budget within a fixed time period. Alternatively, a constitutional provision which made reference to "the business cycle" (or some equivalent term) may only intensify the potential problems of legal interpretation alluded to earlier in this briefing note. Again, one option could be to adopt a relatively flexible provision, perhaps avoiding definitional disputes by allowing Parliament itself to determine the time-period over which the budget is to be balanced, with that time-period being defined in terms of "the business cycle" or otherwise.

It should be emphasised that the comments referred to here do not of themselves deny the benefits that might flow from some kind of balanced budget provision. Such a provision could well facilitate good economic management practices, resulting perhaps in budget surpluses during economic upturns, or at least in the avoidance of debt. The absence of debt would then place the government in a better position to deal with any downturn in the economy. Looking to the extremes among the Australian States by way of illustration, the difference alluded to here is between the way Queensland, on one side, and Victoria, on the other, has been equipped in a fiscal sense to respond to recessionary pressures over recent years. A further argument is that a balanced budget policy would assist with the foreign debt problem which, arguably, is an important contributing factor to the boom-bust cycle experienced by the Australian economy. Perhaps the more general point to make is that there probably is no such thing as an economically neutral approach to public finance; rather, the choice is between competing alternatives, all of which are infused with the value judgments of the opposing schools of economic thought. It is in this context that the debate about

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[27] J Jackson, R McIver and C McConnell, op cit, pp 277-278.

[28] Article VII, section 10 (4) (G)

mandatory balanced budget legislation takes place.

(ii) Other economic issues

The following questions have been posed:

- would the proposal restrict unduly the State government's ability to finance capital projects?[29]

- would the proposal compromise the principle of intergenerational equity in the financing of capital projects? The argument is that the costs of building and maintaining the State's infrastructure of roads, schools, hospitals etc should be shared between generations of taxpayers and the concern is that balanced budget legislation may impede the application of that principle of social justice. Ian McDonald states: "Under a balanced government budget, the current population is forced to sacrifice income to pay for government investment. The benefits from that investment will be enjoyed by people in the future. Is it fair that one group of people bears the costs and another group gets the benefits? Surely fairness would require that taxes and charges to pay for the investment are levied on the people who enjoy the benefits from the investment. Those who use the roads, hospitals, universities, etc. should be the ones who pay for the construction, not the people unlucky enough to be around at the time of construction".[30]

  As with all economic arguments and propositions, the above needs to be handled with some care. For example, it seems that the argument of fairness only really works if the savings level of the current generation is not for some reason disproportionately low. If the savings level is distorted in some way, then it may indeed be fair to ask the present generation to pay for capital projects.

- would the constitutional provision refer to cash accounting or accrual accounting for its standard of measurement?[31] Bob Walker has commented that "cash-based budgets and budget results don't cover unpaid financial commitments which are included in measures of State

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[29] RL Heilbroner and JK Galbraith, *Understanding Macroeconomics*, 9th ed, Prentice-Hall 1990, p 302. The comment is made in relation to the US Federal budget but the point it makes is of wider interest and relevance.

[30] IM McDonald, *Macroeconomics*, John Wiley & Sons 1992, p 455.

[31] "Balanced Budget proposal raises political stakes", *The Sydney Morning Herald*, 14 September 1994.

liabilities....Hence governments could readily evade any such legislation by running up liabilities through GTEs or other agencies outside the scope of their self-defined 'budget sector'".[32]

- would the proposal engender forms of creative accounting, leading to a loss of faith on the public's part in budget estimates?[33]

- does the proposal rely for its popular appeal on a "household analogy" of budgeting, the validity of which can be questioned in its application to economic-wide management? The Premier is reported to have said, "it's the household analogy: you can't spend what you haven't got".[34] The validity of that analogy was questioned by John Veale in these terms: "If a household is spending more than it is earning, it can lower its expenditure, and for every dollar expenditure is lowered, the excess of expenditure over income will be similarly lowered. This occurs because the household's income is independent of its expenditure. This is not the case at the macro-economic level. The level of government income, that is, tax revenue, depends upon the level of government expenditure. If the government lowers the level of expenditure this leads to a multiplied decrease in the level of income and a fall in tax revenue".[35]

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[32] B Walker, "Budget's lost balance", *The Sydney Morning Herald*, 15 September 1994. The issue of cash-based versus accrual accounting was discussed in *The Economist* of 15 August 1994 in an article headed "New Zealand Inc". The article commented: "Under the crude cash-based method of accounting which governments have traditionally used to measure their budget deficits, revenue and expenditure are recorded when the cash is received or paid out. Accrual accounting, by contrast, records spending and taxes when they are incurred, regardless of when the money actually changes hands. Cash-based accounting gives a false sense of security about the sustainability of government policies. It does not distinguish between current and capital expenditure....Accrual accounting should provide a more accurate picture of a government's financial position because it keeps track of the changing value of assets and liabilities....it would also expose all the financial tricks in conventional budget accounts, such as using asset sales to reduce a budget deficit". It has been said that the NSW Government has been a leader in introducing accrual accounting - the form of accounting used by public companies ("Balanced Budget proposal raises political stakes", *The Sydney Morning Herald*, 14 September 1994).

[33] "Mr Collins's Budget stunt", *The Sydney Morning Herald*, 15 September 1994.

[34] "Fahey to make Budgets balance", *The Sydney Morning Herald*, 14 September 1994.

[35] J Veale, "Fiscal Policy - Fiscal and Monetary Impacts" in *Australian Macroeconomics: Problems and Policy*, 2nd ed, edited by J Veale, G Walker, T Murphy and L Perry, Prentice-Hall 1983, p 86.

- would the proposal compromise the principle of "reasonable management flexibility" discussed in the NSW Treasury's publication of July 1991?[36]

- would the proposal impose significant pressure on tax rates in NSW at a time when all States are using tax concessions to attract new businesses?[37]

(iii) A comment on the United States

As noted, the existence of balanced budget legislation in the US is used to support its proposed introduction in NSW. The US experience has also been used in opposition to the proposal. This raises an empirical question as to the success or otherwise of the US States in the implementation of balanced budget legislation. Also, it raises the issue of comparative analysis in an acute form. Basically, the question is "are we comparing like with like?".

Meaningful and reliable answers to either question would require substantial research work; anything that follows by way of comment needs to be read in that light, as no more than tentative and partial observations.

Central to the issue of comparability is the way fiscal arrangements differ between federations. Much has been written in recent years about the extent of vertical fiscal imbalance in Australia, both in absolute terms and relative to other federations. The contrast has been made with the US States, for example, many of which have their own income taxing powers. The contrast with the US position is particularly striking. Unlike Australia, there are few constitutional or legal limitations on the taxing powers of the US States, which thus enjoy considerable fiscal sovereignty.[38] In any event, the general point is that budgetary matters in a federation must be understood in the context of inter-governmental fiscal and other arrangements, which obviously vary from

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[36] D Nicholls, op cit, p 156.

[37] "Rethink on the balanced budget", *The Sydney Morning Herald*, 19 September 1994.

[38] CE McLure, "A North American View of Vertical Imbalance and the Assignment of Taxing Powers" from *Vertical Fiscal Imbalance and the Allocation of Taxing Powers*, ed by DJ Collins, Australian Tax Research Foundation 1993, p 253. Another comparative account is found in TA Rounds, *Tax Harmonization and Tax Competition*, Federalism Research Centre 1992. Rounds comments: "The United States Constitution provides relatively little direction in the division of tax bases vertically between levels of government and consequently except for customs duties, all tax bases are shared between two or more levels of government" (p 17).

one federation to another. True comparisons are therefore difficult to make.

It is also the case that budgetary considerations vary within as well as between federations. The argument is put that significant variations exist among US States in revenue-raising capacity and service needs, considerations which further complicate any commentary on the merits and de-merits of balanced budget legislation.

As always with economists, different accounts can be found of the success or otherwise of such legislation in the various States. A common observation is that, in aggregate, US State governments experienced considerable fiscal stress during the recent economic downturn, with many States having to deal with record-level projected budget deficits in an effort to conform to their constitutional or statutory requirements to balance their budgets.[39] The blow-out in Medicaid financing is often cited as a source of continuing fiscal stress, as are court orders to reform school finances and relieve prison overcrowding, plus decreases in the real value of discretionary Federal grants-in-aid.[40] However, this gloomy picture has been revised in last year or so. A survey conducted by the National Governors' Association and National Association of State Budget Officers calls the outlook for State budgets "the most favourable since the start of the national recession in 1990".[41]

The one thing that can be said with confidence is that balanced budget legislation is certainly prevalent among the US States. One 1992 account said that every State but one - Vermont - has either a constitutional or statutory requirement for a balanced budget. The article went on to say that the following methods were used to control deficit spending:

- in all but six States, the Governor must submit a balanced budget to the legislature;
- in all but twelve, the legislature has to pass a balanced budget;
- in all but nineteen, the Governor must sign a balanced budget; and

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[39] HA Coleman, "External Limits on State Taxation of Business Activities", from *Economic Union in Federal Systems*, edited by A Mullins and C Saunders, The Federation Press 1994, pp 194-214.

[40] MA Howard, "State Finances in a Changing Economy", *The Book of the States 1992-1993*, The Council of State Governments, pp 346-350.

[41] J Connor, "Budget outlook may lead States to ease taxes", *The Wall Street Journal* 28 April 1994. For a brief overview of the current situation see HS Wulf, "State Government Finances, 1992", *The Book of the States*, 1994-1995, The Council of State Governments, pp 323-331.

- in all but nine, the Government cannot carry a deficit over to the following year.[42]

Mandatory balanced budget provisions are undoubtedly popular in the US and, to that extent at least, they deserve serious scrutiny and analysis.

4. CONCLUSION

The proposal to include a mandatory balanced budget provision in the NSW Constitution Act presents us with interesting and novel issues of constitutional analysis. Economically, its implications are both highly complex and contentious, going as it does to the very heart of the matters which divide the different schools of economic thought on the vexed question of public finance. Constitutionally however things are more clear cut.

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[42] JR Cranford, op cit.

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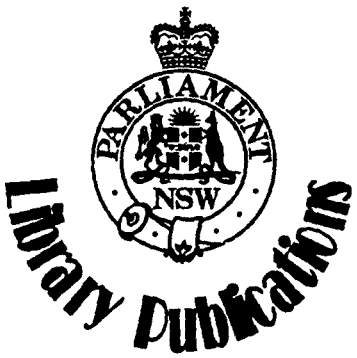

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