Chapter 8

Competitive Federalism
A Reassessment

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Our federal culture has never had the anti-statism of the United States. Federalism in Australia has usually been seen by most as a pragmatic necessity rather than a means to control leviathan.

Our federal roots do not have the same fear of faction that motivated Hamilton, Jay and Madison as they wrote the most detailed argument for the proposed Constitution of the United States in *The Federalist* essays. Similarly, the Australian federation has never had the distributed power of the United States, nor the demographic dynamism that has dramatically reshaped its centres of democratic authority.

When the United States Constitution was written in Philadelphia in 1787, the most important centres of power were Pennsylvania and Virginia; New York had yet to rise and eclipse them. In the time that the Constitution of Australia has been in place, New York itself has been eclipsed as the dominant centre of democratic power: firstly, by the rise of the west led by California; and, more recently, challenged by the south, as typified by Texas and Florida.

Yet during this time New South Wales and Victoria have remained demographically dominant in Australia, as have their capitals, Sydney and Melbourne.

Similarly, the largest handful of cities in the United States has never been as dominant as have our capital cities, even within the less populous States. New York City, Los Angeles, Dallas and Miami not only are not the capitals of their respective States, but their populations historically dominate them less so than our mainland capitals, with the possible exception of Brisbane, dominate their respective States.

Australia's federation has always had a different flavour than the document which inspired the authors of its Constitution.

Why is all this relevant? Because there have been fewer forces for competition in our federation, with fewer strong and competitive actors. These forces in the United States have acted as forces for federalism, and for a more competitive federalism.

Yet, despite these important differences, those of us who retain a passion for federalism and the dispersal of power have usually supported competition between States as a primary reason for supporting a federal structure, not simply in terms of economic measures and competing economic policy regimes, but also as a democratic measure, to reflect the priorities and wishes of different communities.

We often also utilise the argument of States as "policy laboratories," where policies can be trialled and costs and benefits ascertained and borne locally, before measures are adopted more widely or discarded.

So, as the Federation white paper process is underway, we have again turned to the idea of competitive federalism as a guiding principle for reform, particularly competition between States. But we face substantial challenges in doing this.

In this paper I plan to outline what I consider to be significant constitutional barriers to this traditional view of competitive federalism and float another perspective.

Competitive Federalism

What do I mean by competitive federalism?

At the second conference of The Samuel Griffith Society, in a paper, "Making Federalism Flourish," Professor Wolfgang Kasper outlined comprehensive criteria for application of competitive federalism.[1] I shall rely on Kasper's paper in describing the traditional view of competitive federalism, particularly as it could apply to Australia.

Professor Kasper expanded on this work on several other occasions as well, but the tests remain essentially similar.[2] I cannot do complete justice to all his work on this, but I do wish to cover the tests he outlined in various works.

He outlined **four principles** for a competitive federal regime: subsidiarity; a rule of origin; fiscal equivalence; and exclusivity.

Subsidiarity, while I dislike the term with is European Union overtones, means, in this case, simply that tasks of collective action should be carried out at the lowest possible level of government administration.

The **rule of origin** is the principle of complete mutual recognition between different States. That is, if a good or service meets the standards of one State, then it is automatically acceptable in others.

It is the latter two, **fiscal equivalence** and exclusivity, which pose the real challenge for Australia's constitutional arrangements.

Fiscal equivalence requires that each level of government must finance its assigned and chosen tasks with taxes, fees and borrowings for which they are directly responsible.[3]

Exclusivity requires that the areas of collective action are assigned "exclusively, clearly and explicitly to one level of government."[4]

Do our constitutional arrangements meet these tests?

I suggest that our constitutional arrangements erect substantial barriers to the meeting of these arrangements.

First, the test of fiscal equivalence. I do not think I need to go into a long or detailed explanation that, whether by accident or otherwise, our financial arrangements characterised by extraordinary levels of vertical fiscal imbalance simply fail this test. Similarly, the extent of horizontal fiscal equalisation has reached heights never imagined even a decade ago with respect to one State, Western Australia.

Second, and more critically, exclusivity is not provided by our Constitution. A little federal theory is relevant here, as Australia's federation has often been mischaracterised.

For many years, the dominant view of federalism was what is described as "coordinate" federalism. This can be summed up by the phrase often commonly used, the levels of government being "sovereign within their own sphere". This is simply explained as the situation where governments are clearly assigned powers and authority to act independently within defined domains or spheres of influence. For many years, this was the typical view of the operation of a

federation, and particularly our federation, as outlined by Gordon Greenwood, Geoffrey Sawer and K. C. Wheare.[5]

But this simply is not true of Australia's constitutional arrangements. Not only are most of the powers granted to the Commonwealth concurrent in nature, thereby granting the Commonwealth the ability to increase the ambit of its activity within these ennumerated areas, I will not surprise anyone by observing that the method of interpretation of these has seen a constant expansion of Commonwealth activity, and a larger overlap of activities with the States as the Commonwealth has exercised the full powers available to it, both via explicit constitutional authority and High Court interpretation.

Even when the Commonwealth is not exercising these concurrent powers this overlap is not addressed, as political debate about whether to do so creates uncertainty and fails to meet the test of exclusivity outlined above.

But I also want to suggest that there are three specific Commonwealth powers that are highly expansionary in nature, and particularly when considered in combination. These powers effectively give the Commonwealth the means to legislate on virtually any matter it sees fit.

The expansive powers

First, ***the corporations power***. Since the *WorkChoices* case, the power of the Commonwealth to legislate with respect to constitutional corporations has been clear. Just considering the integral role corporations play in our economic life illustrates the scope of this power. I can do no better than quote the President of The Samuel Griffith Society in the *WorkChoices* case to illustrate the impact this may have on the authority of the States. As Justice Callinan outlined in dissent: "The reach of the corporations power, as validated by the majority, has the capacity to obliterate powers of the State hitherto unquestioned." [6]

Justice Kirby further outlined that the States had "correctly in my view, pointed to the potential of the Commonwealth's argument, if upheld, radically to reduce the application of State laws in many fields that, for more than a century, have been the subject of States' principal governmental activities." [7]

One of the lessons I have learnt both from my studies and my relatively short period in public life is that the Commonwealth eventually utilises the powers available to it. Political demands for a central authority to act inevitably grow – after all, it is easier for vested interests to capture one authority than six.

We do not yet know the full capacity of this power and how it may be applied in unknown ways to regulate the activities of corporations and those who interact with them.

Second, the expansionary nature of ***the external affairs power*** has been detailed at length on many occasions, so I do not need to convince this readership of the devastating potential of this power to expand the legal competence of the Commonwealth – if not competence in the common meaning of that term.

To use a recent instance in public debate, there are proponents of utilising it to extend not only into areas of responsibility of State parliaments but also into areas that have never been subject to government activity, namely the raising of children, by banning the simple smacking of one's child.[8]

I think it can safely be asserted that if the Commonwealth wielded its ratification pen to the fullest degree possible, it could find a legitimate international instrument on just about any matter it wished. And if it turned its hand to legislating the most intimate of activities, how we discipline our own children within reason, then there is little this power cannot be used to regulate.

Finally, we must turn to ***the financial power*** of the Commonwealth and the uses of tied grants.

This cannot be discussed without reference to Alfred Deakin, whom I have long considered to be Australia's Alexander Hamilton. He may not have been the "father of federation" or the prime author of the Constitution but, as Hamilton was to the new United States, Alfred Deakin was the dominant force in the nation that was brought into being once the Constitution took effect, and the decades that followed would have been immeasurably different without his influence.

Deakin's famous statement in 1902 about the financial power of the Commonwealth is oft-quoted precisely because of its insight into the impact of the constitutional arrangements that were instituted:

> As the power of the purse in Great Britain established by degrees the authority of the Commons, it will ultimately establish in Australia the authority of the Commonwealth. The rights of self-government of the States have been fondly supposed to be safeguarded by the Constitution. It left them legally free, but financially bound to the chariot wheels of the Central Government. Their need will be its opportunity. The less populous will first succumb; those smitten by drought or similar misfortune will follow; and finally even the greatest and most prosperous will, however reluctantly, be brought to heel. Our Constitution may remain unaltered, but a vital change will have taken place in the relations between the States and the Commonwealth. The Commonwealth will have acquired a general control over the States, while every extension of political power will be made by its means and go to increase its relative superiority.[9]

While I am aware that the author of one address to the 1997 Conference of The Samuel Griffith Society objected to too great a foresight being attributed to Deakin in this regard,[10] I am persuaded by another paper in 1998 by Alan Wood in which he described the Constitution as a "permissive framework" for the Commonwealth to act as it has, and Deakin has been proved right.[11]

Section 96 is effectively limitless in application, and while the States are so dependent upon Commonwealth financial support, it has been used for everything from roads to public transport, schools funding, to fund and regulate the conduct within State-owned public hospitals and now, with some degree of irony, for school chaplains.

Importantly, this is the route by which the Commonwealth can avoid the consequences of the *Pape* and *Williams* cases, assuming the State governments agree. The truth is that in the overwhelming number of cases, the State governments do eventually agree to take the Commonwealth silver.

The *Williams* case does at least theoretically place a limit on the Commonwealth's ability to appropriate and spend money at its own initiative. Yet the impact of that on Commonwealth activity has not been great – as yet, if, indeed, it ever will be. I note Anne Twomey's work in this regard, but I have not seen it reflected in the activity of the Parliament, or in wider public debate.

Maybe the Commonwealth considers the second *Williams* case as nothing more than a nightmare that has receded as morning has broken.

These powers are not only expansionary in themselves, they can also be used in conjunction with existing enumerated powers vested in the Commonwealth to attack State discretion and activity directly. The external affairs power was used directly to attack the Kennett Government's changes to industrial relations enacted following a landslide victory in 1992.

Various conventions of the International Labour Organization and the existing power regarding arbitration were utilised by the Keating Government to support enactment of the *Industrial Relations Reform Act* 1993 and override the provisions for private sector workers and for public sector employees as well.

This was such a successful attack on the previously large State-regulated labour market that the Kennett Government handed all industrial relations powers to Canberra.

The impact on political culture

Lack of constitutional constraint on the Commonwealth also has a dramatic impact on political culture. If there are few or no limits on Commonwealth activity then there are no limits on issues that "demand" the attention of the Commonwealth Government no matter where responsibility has historically lain, nor where local majorities may wish responsibility to reside.

This further undermines the principle of exclusivity I outlined above. I have spoken elsewhere on how important political constraints have been in our past.[12] When bank nationalisation was ruled unconstitutional in the late 1940s, it had the effect of removing that as a realistic and responsible policy measure from day-to-day political debate.

This stands in stark contrast to the nationalisation debates that occurred in the United Kingdom at the same time – the lack of a constraint on such measures saw significant expansion of government in the United Kingdom over many years.

Similarly, the constant failure of measures to grant the Commonwealth power over prices limited the political potency of specific promises to act in that regard. With the operation of the corporations power today, there is no such constraint.

Constitutional constraints upon the Commonwealth are not only legally important in maintaining exclusivity and protecting subsidiarity, they are important measures in limiting political demands of central action. Yet in Australia they are weaker than they have ever been.

This undermines the ability of States to compete directly, lest the losers from economic measures that free up consumers, businesses and resources demand action be taken at a national level.

Political debate in Canberra is no longer subject to any limits on the Commonwealth's ability to legislate or act. And there will never be a time when the Labor Party and the Greens, united in their centralism, seek to limit the house on the hill from debating issues as allegedly "national" ones.

I hasten to add that the Liberal Party is far from sinless in this regard. I will only add a personal defence in that I am usually on the losing side of such debates on the limited occasions they occur.

Can we construct a different view of competitive federalism?

So, given that these constitutional arrangements and barriers are not likely to be addressed via referendum in the near future, is another view of competitive federalism possible? I will only briefly discuss this with reference to two fields of public policy, as it is rightly the subject of another paper.

Competitive federalism is often seen through the prism of competition between States, but I think we should take a step back and look at it from the perspective of the consumer, the citizen.

At the beginning I outlined some of the demographic differences between our federation and that of the United States. One of the consequences of a much more centralised population, with fewer dominant cities, is less population mobility. I do not simply mean that in absolute terms, either, but in practical terms.

Owing to the more evenly dispersed population and consequent economic activity despite the closer physical proximity and the greater discretion in many policy fields available to States including, for example, taxes and school education, it is more feasible for a citizen of New Jersey to move between his or her home State and the neighbouring States of New York or Connecticut to choose a different policy regime or to take advantage of opportunities that arise, or even avoid costs, than it is for Australians to move between Melbourne, Sydney and Brisbane.

Indeed, the last decade has heard public lamentations of the unwillingness of Australians to move west, where there were shortages of labour during the greatest mining boom since the Victorian gold rush that turned my home town, Melbourne, whose 180th birthday is today, into a major metropolis and driving force of the nation in a matter of a few short decades.

The explosion in economic activity initially in the west and then in the south of the United States led to profound population shifts that we have not seen to a similar degree in Australia. Australia's population is simply not as mobile, for personal as much as other factors. A model of competitive federalism that assumes a high level of population mobility will not work as well here.

Yet the concept of "vertical competition," where there is some degree of competition provided by different levels of government in key areas of public activity, can ensure that the citizen does benefit from the public sector being subject to competition. This concept of vertical competition in Australia has been outlined previously by authors such as Professor J. J. Pincus.[13]

I will provide one brief public policy example of how this works in action, and how vertical competition and Commonwealth involvement delivers real, meaningful competition for consumers, in this case, parents.

This relates to school education. Australia has a highly competitive school system – and by competitive I refer to the opportunity of parents to choose different schools. Most parents can choose between the free, public, secular education system, the Catholic school system or independent schools with varying ranges of fees.

For all but the most expensive independent schools, this is a direct result of Commonwealth involvement. Without going into the history of school funding in Australia, the explosion in low-fee independent, usually Christian, schools, and the maintenance and subsequent expansion of the Catholic schools, has only occurred because the Commonwealth supports them financially when parents choose them for their children.

The history of the States, owners and funders of the State school systems, was similar to any monopoly provider – they did not show any inclination to fund their competitors or to open their systems to competitive influences. They have no interest in a more competitive market in schools.

If the Commonwealth were to withdraw from school funding, and this matter was solely left to State parliaments and electorates, there would likely be less choice and less competition.

Conclusion

Federalism is not intended to be a "clean" system of government, providing simplistic answers to questions. Inherent in a federal system is a degree of "messiness" in addressing questions of public policy. Inherent is a degree of competition, both horizontal across State jurisdictions, and vertically between jurisdictional levels. Compounding demographic and population factors, Australia's constitutional arrangements militate against competition.

From the time of the Financial Agreement and the Loan Council, through to the debates today about GST distribution, measures have been taken, and not just initiated by Commonwealth power grabs, to reduce the competitive pressures and, indeed, differences between States.

Menzies referred to the "curse of uniformity," and it is one we still hear in the modern demand for "harmonisation". We often hear of the desire for cooperative federalism, particularly from the Left, which I prefer to describe as cartel federalism.

This simplistic call to reduce the variations between, and autonomy of, the States to act independently creates seemingly simple solutions. It also undermines one of the key rationales for a federation.

I might add that the failure of the Liberal side of politics to argue the case, aggressively, for a limited central authority, and to act on that argument when given the opportunity, is one of the reasons that these appeals for "cooperation" or "harmonisation" have a degree of resonance.

In outlining the barriers to the traditional view of competitive federalism above, I hasten to say I would like to address them. I do not, however, think that constitutional amendment is particularly realistic, at least in the short or even medium term.

Furthermore, in addressing the political culture, it is not a popular thing to say inside any government, including the current one, that something is not a problem for the Commonwealth to fix, let alone for government to act upon at all.

So in considering the path forward in the short term, I keep in mind the purpose of federalism is not only to limit the power of temporary majorities, particularly national ones overriding local ones, it is also to provide choice to Australia's citizens. In the modern era this should include choice in the provision of public services that are dominated by the public sector.

In the end federalism is about the citizen having greater autonomy, not simply one level of government in a particular constitutional arrangement.

Endnotes

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http://samuelgriffith.org.au/docs/vol2/v2chap7.pdf.

2. See Wolfgang Kasper, *Competitive federalism: promoting freedom and prosperity*, IPA Federalism Project Issues Paper No. 3, Institute of Public Affairs, Melbourne 1995; and *Competitive Federalism: may the best state win*, in Geoffrey de Q Walker (et al), *Restoring the True Republic*, Centre for Independent Studies, Sydney, 1993.

3. Kasper, *Competitive Federalism*, 1995, 39.

4. Ibid., 37.

5. Gordon Greenwood, *The Future of Australian Federalism,* University of Queensland Press, 1946; Geoffrey Sawer, *Modern Federalism,* CA Watts & Co, 1969; K. C. Wheare, *Federal Government*, Oxford University Press, 1946.

6. Justice Callinan, Workchoices Case – *New South Wales & Ors v Commonwealth* [2006] HCA 52 at 794, quoted in Stewart, A. & Williams, G., *Work Choices, what the High Court said,* The Federation Press, Sydney, 2007.

7. Justice Kirby, WorkChoices Case, *op.cit.,* at 539.

8. *"United Nations wants Australia to ban smacking, prosecute offending parents",* published on www.news.com.au, December 12, 2013; see: http://www.news.com.au/lifestyle/parenting/united-nations-wants-australia-to-ban-smacking-prosecute-offending-parents/story-fnet085v-1226780993923; and *"Parents urged to stop smacking kids as Australian Research Alliance for Children and Youth releases national plan",* published on www.news.com.au, November 17, 2013; see: http://www.news.com.au/national/parents-urged-to-stop-smacking-kids-as-australian-research-alliance-for-children-and-youth-releases-national-plan/story-fncynjr2-1226762071662.

9. Alfred Deakin, *Letter to Morning Post,* 1 April 1902, quoted in L. F. Crisp, *Australian National Government*, Longman, 1965, 83 (unsourced).

10. Bhagan Grewal, "Economic Integration and Federalism: Two Views from the High Court of Australia," *Upholding the Australian Constitution*, Proceedings of The Samuel Griffith Society, 9th Conference, The Samuel Griffith Society, 1997; available at: http://samuelgriffith.org.au/docs/vol9/v9chap6.pdf.

11. Alan Wood, "Beneath Deakin's Chariot Wheels: The Decline of Australia's Federation", *Upholding the Australian Constitution*, Proceedings of The Samuel Griffith Society, 10th Conference, The Samuel Griffith Society, 1998; available at: http://www.samuelgriffith.org.au/papers/html/volume10/v10chap10.htm.

12. *The Federalist Papers*, IPA Great Books of Liberty sessions address to the Institute of Public Affairs, 24 September 2009, available at: http://scottryan.com.au/media/media-speech/liberty-sessions-the-federalist-papers-transcript.

13. J. J. Pincus, "Commonwealth-State relations, the case for competitive federalism", Papers on Parliament No. 53, Parliament of Australia, 2010; available at: http://www.aph.gov.au/About_Parliament/Senate/Research_and_Education/pops/~/link.aspx?_id=9E988B12F96D40D2BBF6A3F7B0A9B0F9&_z=z.