Paper prepared for the Senate Select Committee on the Reform of the Australian Federation

April 2011.

Oral evidence to be given 5 May 2011

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This submission draws upon the following:
'Processes for Reforming Australian Federalism', *University of New South Wales Law Review*, Special no. 2008 on Reforming Federalism, and
'Fiscal Federalism Then and Now' in Nicholas Aroney, Gabrielle Appleby& Thomas John, eds, *The Future of Australiajn Federalism: Comparative and Inter-disciplinary Perspectives*, forthcoming.

Reform

'Reform', like most big concepts in political discourse, has a contested meaning. Whether something is called a 'reform' depends on the caller having a certain view of federalism that the proposed change advances or approximates. For example, lack of clarity in delineating the division of powers and differentiating roles and responsibilities for the Commonwealth and States might appear to the tidy-minded co-ordinate federalist as a problem to be fixed or 'reformed' via clearer definition. To the more realistic messy-minded coordinate federalist, this is likely to be considered more of a positive feature that allows for the ongoing adjustment of respective roles. A related example is over-lap and duplication: a supposed source of inefficiency to be remedied by the cooperative federalists; but for the competitive federalist a necessary part of the mechanism for sorting out and adjusting the roles of respective governments.

Pseudo-reformism, that draws upon unexamined assumptions and models of federalism and problems that are more imagined than real, has been the bane of Australian federal reform debates. Public discourse on Australian federalism in the past often centered on abolition, with arguments between progressives and conservatives raging over whether we should have it or not. Gordon Greenwood's *Future of Australian Federalism* (1946) was a classic example, arguing that Australian federalism had no future. His book was a mix of polemics and poor appreciation of how government and economy were developing in the twentieth century. Nevertheless, with the federal Labor Party then pledged to its abolition, there was some saliency in Greenwood's attempted justification. Federal abolitionist seem dinosaurs in today's world, however, that is becoming increasingly federalist. Now we are all federalists, by and large, so the debates around federalism have shifted to making it work better.

A second problem hampering public policy discourse and the reform process is the lack of plausible counterfactuals in diagnostic and reform proposals. An all too common tendency is to assume inefficiencies, or to quantify them with crude guesstimates or dubious methodologies that purport to measure the costs of federal inefficiencies. A complementary tendency is to assume all these supposed problems and inefficiencies will simply disappear in some alternative counter-institutional proposal, and other unintended ones will not surface. An examples can serve to illustrate. Health policy in Australia is said to be a federal mess, and in certain respects that is no doubt the case. Australia's overall health system, however, seems tolerably good compared to other federal and unitary countries. All are struggling with rising costs and new technologies, changing demographics particularly aging, and raised community expectations. We need to be careful in framing health policy problems as federal ones and assuming they might be solved if only one level of government occupied the field.

A common fallacy is to cost the inefficiencies of existing arrangements through modeling or guessing—$9 billion every year, or perhaps even $20 billion, according to figures touted by the Business Council of Australia.[1] Estimated costs of supposed duplication

[1] Business Council of Australia, Reshaping Australia's Federation: A New Contract for Federal-State Relations (November 2006), Executive summary vii. This draws upon a Report by Access Economics, The

and overlap are typically exaggerated; they take no account of other benefits of competition that might be accruing at the same time; and they assume no additional costs associated with the proposed alternative. [2]

Reforming Australian Federalism

There are multiple processes for reforming Australian federalism, rather than a singular process, and these are more varied and complex than is often assumed in essentialist notions of reform discourse that tend to view federalism as a static institutional or conceptual construct. These processes are interactive and the interactions are significant in achieving, or indeed frustrating, reforms. The processes are more developmental and ongoing, or incremental, rather than programmatic and discreet.

The most promising avenues for reforming Australian federalism are political rather than constitutional ones. This is contrary to the approach of constitutional lawyers and others who, when they perceive a problem with Australian federalism, reach for the Constitution and set about devising constitutional remedies. Constitutional change is an unlikely vehicle for federal change, however, and in any case most of what needs reforming can be done via sub-constitutional politics.

In thinking about reforming Australian federalism we might identify two different pathways of development articulated by contemporary institutional theory: punctuated equilibrium and incremental change. While in practice the two often morph and mix, articulating them as distinct types might assist our understanding. By way of illustration, the more alarmist, end-of-federalism prognostications sparked by landmark decisions like the *Work Choices* case[3] seem to presume a punctuated equilibrium paradigm; the more benign view that it extends a well-established line of jurisprudence reflects that of incremental change.

As March and Olsen point out, 'the standard model of punctuated equilibrium assumes discontinuous change': 'Long periods of institutional continuity, where institutions are reproduced, are assumed to be interrupted only at critical junctures of radical change, where political agency (re)fashions institutional structures.'[4] Stable continuity is the norm, and change the product of exception interventions or events. In this model, institutions are heavily path-dependent, encapsulating past political formative events and compromises, and continuing on in a more-or-less independent role of shaping subsequent political activity. Change is by significant agency intervention or because of exceptional events. Historical institutionalism draws heavily upon the standard model of punctuated equilibrium sketched above.

Costs of Federalism, Appendix A, which in turn relies upon M L Drummond, 'Costing Constitutional Change: Estimating the Costs of Five Variations of Australia's Federal System', *Australian Journal of Public Administration* (December 2002): 43-56. Among other things, Drummond's model liberates costs of federalism by spreading fixed costs over larger numbers if smaller units/states are amalgamated.

[2] See J Pincus's 'Six Myths of Federal-State Financial Relations', CEDA paper (5/06/2008

[3] *New South Wales v Commonwealth (Work Choices case*) (2006) 229 CLR 1.

[4] March and Olsen, above n 6, 12.

Yet, as critics like Colin Hay point out, there has been 'an emphasis upon institutional genesis at the expense of an adequate account of post-formative institutional change'. In so far as post-formative institutional dynamics have been considered, Hay claims, 'they tend either to be seen as consequence of path dependent lock-in effects or, where more ruptural in nature, as the product of exogenous shocks such as wars or revolutions.'[5] It has long been recognized that institutions can both shape and constrain political activities, and as well be shaped by political agents and activities. There is typically a dynamic interplay between structures, agents and ideas that Hay calls 'constructivist institutionalism'.[6] Moreover, the process of interdependency is ongoing, adaptive and often opaque—perhaps more akin to an evolutionary process of mutation, adaptation and struggle than rational design or measured dialectic. Political, and especially constitutional, institutions operate in a crowded environment with other institutions that have different purposes, logics and human agents so there are clashes and collisions as well as ordered agency, and so large areas of indeterminacy where 'reformers are often institutional gardeners more than institutional engineers'.[7]

In such an unruly garden, we should expect to see incrementalism but of diffuse and non-linear kind, as well as some disjunctive change perhaps in response to dramatic external shocks or adaptive selection of deviant mutations. True, constitutionalism in a polity like that of Australia is at the more structured end of institutionalism, but the process of change is a dynamic and evolutionary one with multiple actors involved. Government legislative initiatives provoke court challenges; in deciding cases the High Court reinterprets constitutional provisions that go beyond the case in point; but governments can respond in a range of strategies for adapting to or getting around formal constraints to their power. Even so, we still have to confront the challenges that the punctuated equilibrium model frames more directly: when does incremental creep add up to substantial institutional change? Is there a tipping point when an incremental change pushed the established order over into something different? And in a choked garden, how might we spot it? If these questions were not difficult enough, there is also scope for dialectical responses and regressions and digressions as the implications of particular change become apparent and spark responses.

To illustrate, *Work Choices* might be an instance of punctuated equilibrium for the s 52 (xx) corporations power, but only incremental change for constitutional federalism more broadly. But added to all the other incremental changes, including the *Uniform Tax* cases[8] (1942, 1957) that legitimated the Commonwealth's monopoly over income tax, and the *Tasmanian Dams* case[9] (1983) that sanctioned an open-ended Commonwealth power over external affairs to include domestic matters with external aspects, *Work Choices* might still be a tipping point in reshaping constitutional federalism in a centrist manner.

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[5] C Hay, 'Constructivist Institutionalism', in R A W Rhodes, S A Binder, and B A Rockman, eds *The Oxford Handbook of Political Institutions* (Oxford University Press, Oxford, 2006) 56, at 63.
[6] Hay above n 10.
[7] March and Olsen, above n 6, 15.
[8] *South Australia v Commonwealth (Uniform Tax* case) (1942) 65 CLR 373; *Victoria v Commonwealt (Second Uniform Tax* case) (1957) 99CLR 575.
[9] *Commonwealth v Tasmania (Tasmanian Dams* case) (1983) 156 CLR 1.

Federal Constitutional Change

Federal constitutional change can occur through referendums, albeit rarely in practice, or through judicial review by the High Court that has been an ongoing means of federal development and adjustment in Australia. These two avenues for reforming federalism are both potent and available, but unlikely avenues for practical reform. It is worth reviewing briefly the reasons why.

Referendums

Examples of changing Australian federalism by referendum were adding a new Commonwealth power to provide certain social services in 1946, and in amending the s51 race power to allow the Commonwealth to pass laws with respect to Aboriginal people in 1967. The social services amendment was endorsed by 54% of voters and the Aborigines' amendment by a record 91% of voters, and both were carried in all six states. These are among the eight exceptions of referendums that have passed among 44 that have been put and failed. Many more have been mooted and brought to Parliament, but were either scuttled or died for one reason or another.

Australia's referendum record is not exceptional for comparable, federal countries like the United States and Canada that were founded as democracies and have not experienced revolution or conquest. Australia is exceptional in the persistent hankering after constitutional change, and the sorts of unpalatable proposals that have been put to the people by Commonwealth governments.

Through a brief review of Australia's referendums we can highlights the reasons for high failure rates. Labor has been persistent in hankering after expanded Commonwealth powers but largely unsuccessful. All 15 of Labor's referendum proposals prior to 1974 were to increase Commonwealth power over aspects of the Australian economy, and all failed. Post Whitlam, Labor has worked with federalism, and directed its referendum proposals to machinery of government issues. Ten proposals were put in three batches in 1974, 1984 and 1988, but all failed, including on each occasion a proposal to vary the Senate's electoral cycle and bring it more into line with that of the House of Representatives. Liberal style governments (Protectionist, Fusion, Nationalist, and Liberal Coalition) have been in office for most of Australian federal history and have put 19 proposals to referendum, with seven passing. Early attempts to increase Commonwealth powers failed; and persisting with proposals that previously failed has also proved futile. Only one of the eight proposals to increase Commonwealth power passed—in 1967 to make laws with respect to Aboriginal people. In contrast, six of the eleven non-power proposals have passed. Three were earlier on and relatively minor: one made an electoral adjustment for the Senate, and two entrenched fiscal arrangements. The other three successes were put as a slate in 1977: filling casual Senate vacancies from the same party, allowing territorians to vote in referendums, and setting the retirement ages for federal judges at seventy.

The record shows that Australian people do not usually support increasing Commonwealth constitutional powers, or changing the independent electoral cycle of the

Senate. They are discerning in approving some measures and rejecting others when slates of proposals are put, as was the case in 1946, 1967 and 1977. Since 1977 all eight proposals put on three occasions, 1984, 1988 and 1999, have been defeated, seven of them voted down in all States and five receiving less than 40% support of voters. On the face of it, some of these proposals might appear sensible, but in the political context of their time they were all half-baked or contentious and likely to fail. Two, in 1984 and 1988, were repeats of past failures to change the Senate's fixed term. The other three failures in 1988 were for 'fair elections' that would bring the States under Commonwealth purview, recognition of local government, and extending three rights guarantees applying to the Commonwealth to the States. The occasion was the 1988 bicentenary, and the referendums a precursor to more sweeping proposals for an entrenched bill of rights that the Constitutional Commission was drafting and might be put subsequently. The package was seen as a teaser for more substantial changes down the track, poorly supported by the Labor Government and stridently opposed by the Opposition. Not surprisingly, all failed badly. The 1999 proposals for republicanising the head of state and adopting a preamble statement were even worse. They were put by a Liberal Coalition government with Prime Minister Howard opposed to the idea but honouring an undertaking he had made to sideline the issue during the election campaign. If most people supported a republic, as opinion polls suggested, the republican majority was deeply divided over the presidential model with 'real republicans' who supported an elected head of state joining with monarchists to defeat the proposal with almost two-thirds of voters opposed. The preamble was a hotchpotch of aspirational banalities that appealed to even less people.

A close look at the record shows that Australia poor referendum record is in fact a record of poor referendums. The Commonwealth controls the referendum process, so can put whatever it likes, but the Australian people do not usually support Commonwealth proposals for expanding economic and regulatory powers, or for adopting divisive changes. While referendums remain a possible avenue for federal reform—providing sensible proposals that have broad support are put to the people, as 1946 and 1967 showed—it is not promising. In any case, there is no real need for reforming Australian constitutional federalism via referendums because of the enormous flexibility in the existing broadly defined and structurally concurrent division of federal powers. There is further scope through taxing and spending provisions for Commonwealth initiatives. Indeed, these have all been so broadly interpreted by the High Court that those who flirt with the idea of using referendums in the twenty-first century will likely be federalists wanting to curb Commonwealth powers—for example, curbing Commonwealth fiscal dominance—rather than centralists wanting to expand them as was the case in the early twentieth century. Referendums are an unlikely avenue for restraining the Commonwealth, however, since the Commonwealth controls the process. Nor are referendums that might seek to overturn High Court decisions promising, as Menzies abortive 1951 attempt to ban the Communist Party showed.

Judicial Review by the High Court

The more normal means of changing constitutional federalism has been through judicial review by the High Court: often in incremental ways, but periodically in landmark cases

like the *Engineers* case (1920)[10] that established the interpretive method of the Court, and such landmark applications of that expansionist method in *Uniform Tax* (1942 and 1957), the *Tasmanian Dams* case (1983) and *Work Choices* (2006). The recent *Work Choices* decision that greatly expanded the Commonwealth's s51 corporations power to cover much of the extensive field of industrial relations illustrates just how potent the High Court can be in shaping Australian federalism through sanctioning extensive centralization of Commonwealth power. Nevertheless, in the *Pape* case (2009) the Court ruled that the Commonwealth could not spend money on whatever it liked under the appropriations power (s.81), even though it allowed the Rudd government's cash payments to people as an emergency response to the Global Financial Crisis.

Pape aside, High Court decisions since *Engineers* (1920) have been broadly to sanction the ever-increasing expansion of Commonwealth powers. In saying this it is important to keep in mind that the Court sanctions rather than initiates; and probably follows rather than leads in the nation building process. That having been said, the Court's interpretive method, adopted in *Engineers* and applied ever since, purports to be federally neutral, but applied to the Australian Constitution's American-style specification solely of the Commonwealth's powers is anti-federal. If only one set of powers are spelt out and those are interpreted in a full and plenary way regardless of the impact on the States' unspecified residual, the results are inevitable expansion of Commonwealth powers and shrinking of the States' residual. Distinguished judges, both in the majority and dissenting in landmark cases such as *Uniform Tax* and the *Tasmanian Dams* case, have acknowledged that, as have dissenters like Kirby and Callinan who dissented in *Work Choices*.

How High Court changes to constitutional federalism affect political federalism is not a simple process. The Howard Government's Work Choices legislation was significant in sparking the High Court challenge that greatly expanded Commonwealth power. On the other hand, the political consequences were in part responsible for Howard's electoral defeat, and Work Choices legislative was withdrawal by the Rudd Labor Government. Most of Howard's senior ex-ministers admitted their Work Choices legislation was politically unwise, having been passed in such extreme form, ironically, only after the coalition parties won control of the Senate. Future Commonwealth governments might well resile from such initiatives.

The High Court's opening up avenues for expanding Commonwealth power through broad interpretation of its s51 heads of enumerated power may or may not be taken up by governments, depending on political circumstances and opportunities. A notable historical example was the reluctance of the Bruce-Page government in the 1920s to exploit the jurisdictional space that the Engineers Court opened up, including through a curious interpretation of s92 that made its restrictive guarantee of 'absolutely free trade' apply only against states' interferences. Subsequent Courts closed this avenue of Commonwealth regulation of trade by re-applying s92 restrictions to the Commonwealth.

[10] *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd (Engineers* case) (1920) 28 CLR 129

A more recent example is the Commonwealth's large environmental power opened up by the *Tasmanian Dam* case that was lamented by critics at the time as another nail in the coffin of Australian federalism. In the environmental sphere, however, the Commonwealth retains a broad constitutional power that it only partly draws upon. Because of the complexity of environmental challenges and policy, it is unlikely that the Commonwealth will ever occupy the entire field. Indeed the environment is typical of many large and complex policy domains that have sub-national—state and local—as well as international dimensions that make monopoly regulation by any one sphere of government unlikely.

Whether the ever increasing centralism that culminated in *Work Choices* and sparked renewed controversy over the Court's interpretive method is sufficient to cause sober second thoughts and a future Court to draw back from the extremes of *Engineers* methodology, or begin to craft an interpretive method more suited to a federal constitution remains to be seen. Proposals are already being canvassed, including by Andrew Lynch and George Williams to commit to a federal relationship rather than an arid acknowledgment of federal structure that has little interpretive scope.[11] Judicial review based upon extreme *Engineers* methodology is not in principle a credible way of interpreting Australia's federal constitution, and in many respects has worked to undermine it. However, it is so well entrenched as the orthodoxy of Australian constitutional jurisprudence that it is unlikely to change in the medium term. To say the least, federal reformers should not look to the High Court: it is part of the problem rather than the solution.

Political Federalism

Politics has always been significant, and has become more so as the High Court's role in federal adjudication has effectively waned. The High Court has virtually left detailed sorting out of respective Commonwealth and state roles and responsibilities to the political process in which the Commonwealth has both formal and fiscal dominance. How much real power the Commonwealth exercises, what roles and responsibilities it actually takes on vis-à-vis the states, and how the federal balance between the two is determined, all depend on politics. There are two main sorts of politics: party/electoral politics at the Commonwealth level, and inter-governmental rivalry and cooperation between the Commonwealth and states, including through new and established institutions of intergovernmental relations. We can illustrate both sorts of political change to federalism by reference to developments in Australian politics over the last couple of decades.

The Hawke/ Keating period (1983-1996) was significant for constructive reforms in making federalism work better. Despite slippage on fiscal reform that was linked to Keating's more traditional Labor commitment to centralized fiscal arrangements—vertical fiscal imbalance was a 'design feature' and not a design fault of the constitution, Keating claimed in a National Press Club speech in the run up to his wresting the prime ministership from Hawke—there was extensive reform of intergovernmental affairs

[11] A Lynch and G Williams, 'Beyond a Federal structure: Is a Constitutional Commitment to a Federal Relationship Possible', (2008) *UNSW Law Journal* [this no. ref].

through a series of special premiers' conferences culminating in the formation of the Council of Australian Governments (COAG). Both the Commonwealth and states were major players in an extensive overhaul of intergovernmental arrangements and adoption of national standards, competition policy, mutual recognition of regulatory provisions across jurisdictions, and integration of road, rail and electricity systems.[12] Much was achieved in streamlining governments' roles and achieving greater efficiencies in major policy areas.[13] Of course there is much more to be done in policy areas such as health[14], and from concerted efforts on a broader economic reform agenda.[15] Nevertheless, the intergovernmental reforms along with other key micro-economic measures such as extensive tariff reduction, a more flexible labour regime, and floating the Australian dollar, helped deliver the subsequent sustained period of high economic performance during the late twentieth and early twenty-first centuries.

Most notable, especially as it came from the Liberal coalition that had been the traditional champion of federalism in the past, was prime minister John Howard's 'aspirational nationalism' that was invoked to support Commonwealth intrusions and take-overs by a tired government facing electoral defeat. A notorious micro example was the Howard government's highly politicized take-over of the Mersey Valley hospital in regional Tasmania that was scheduled for closure under a state rationalization plan. A macro example was the Howard government's massive, army-led 'intervention' in the Northern Territory to address substance and child abuse in Indigenous communities. Both were hastily contrived ploys to shore up flagging electoral support, and directed at sub-national Labor governments that were blamed for policy failures. Indeed, much of the Howard government's anti-federalism was grounded in partisan politics as it faced a solid wall of state and territory Labor governments. Earlier on Howard had finessed the introduction of the GST by promising that all the proceeds would be distributed to the states, giving them a much needed growth tax in place of other grants. [16] In that instance Howard's pro-federal initiative won the state premiers' support and helped sell the new tax electorally. His subsequent anti-federal initiatives and blaming state governments reflected a switch in electoral strategies when his government was facing electoral defeat.

Ironically, in view of Labor's traditional opposition to federalism, the Rudd Labor government, that replaced the Howard Liberal coalition in 2007, championed 'cooperative federalism' and promised to end the 'blame game'. Kevin Rudd was exceptional in having a background in intergovernmental relations as a senior official in Queensland government during the 1980s when the Hawke-Keating Labor government

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[12] M Painter, *Collaborative Federalism: Economic Reform in Australia in the 1990s* (1998).
[13] A Twomey and G Withers, Federalist Paper 1, Australia's Federal Future: Delivering Growth and Prosperity, A Report for the Council for the Australian Federation (April 2007) 28-29; J Pincus, 'Six Myths of Federal-Stare Financial Relations', CEDA paper (5/06/2008) 41-42.
[14] See Cameron Stewart, 'Health: The First Challenge of Federal Reform' ' (2008) *UNSW Law Journal* [this no. ref].
[15] Productivity Commission (2005); COAG (2005). [Refs from JP 47]
[16] A Parkin and G Anderson, 'The Howard Government, Regulatory Federalism and the Transformation of Commonwealth-State Relations', *Australian Journal of Political Science* 42(2) (2007): 295-314.

achieved major intergovernmental and policy reforms. The Rudd government had the unusual opportunity of working with a solid phalanx of sub-national Labor regimes that Howard had previously demonized, and began serious, albeit Commonwealth dominated, intergovernmental collaboration with state and territory governments. That could not be sustained by an increasingly erratic prime minister and his incompetent government that sought to shore up support by bold Commonwealth policy initiatives. One was a hasty decision to put insulation in all Australian homes as part of the Commonwealth's massive spending to counter the global financial crisis, and to do so without the states and territories that had jurisdiction and expertise in the area. This proved a costly failure that had to be abandoned. Rudd's waning popularity plunged when he abandoned the National Emissions Trading scheme (ETS) that he had talked up but failed to have passed by the Senate. An increasingly desperate prime minister switched his attention to taking over public hospitals as a bold measure that might restore his image as a policy innovator.

Public hospitals were already partly funded by Commonwealth grants, but obviously not coping with increasing public demand and rapidly rising medical costs. Prime minister Rudd proposed to increase the Commonwealth's stake to a controlling level of approximately two-thirds, and to fund this by taking back one third of the GST that had been wholly allocated to the states and territories. To do so without breaching Commonwealth legislation that enshrined the earlier agreement that the Howard government had made with the states and territories—that the GST would not be changed without unanimous consent—Rudd had to win over all the state and territory premiers and first ministers. He managed to do this using the accustomed carrots and sticks of intergovernmental bargaining with all the Labor leaders, but failed to bring on board the newly elected Liberal coalition premier Barnett of Western Australia who refused point blank to surrender substantial control over the state's public hospitals and cannibalize the GST.

Rudd's earlier federal fixing and his latter adventurism were both unsuccessful. He and his government were exposed as erratic and incompetent.[17] Rudd lost the leadership of the Labor government to Julia Gillard, and Labor lost its majority in the 2010 election, being forced to rely upon independents to stay in power and the Greens to pass legislation through the Senate. Government at the Commonwealth level is now at its weakest for forty years, since the demise of the Liberal coalition in the early 1970s. At the same time a new counter cycle of state politics is underway with the major states turning out long serving Labor governments and switching to the Liberal coalition alternative. The first to change was Western Australia with Premier Colin Burnett refusing to hand over increased shares of public hospitals and the GST to the Commonwealth. Next to change was Victoria where Ted Bailleau and the Liberal National Party coalition won office and control of the upper house in state elections at the end of 2010. This was somewhat unexpected as the Brumby Labor government was the most competent of the remaining Labor regimes, and the Victorian economy and public sector were in reasonable shape. Premier Bailleau has given notice that he will review the hospitals agreement, and all indications are that Victoria will take a more assertive role in intergovernmental politics.

[17] George Megalogenis, *Trivial Pursuit: Leadership and the End of the Reform Era*, Quarterly Essay 40 (Melbourne: Black Inc.), November 2010.

The same is likely for New South Wales that voted overwhelmingly for Barry O'Farrell's Liberal Coalition at the state election in 2011. Even if the other states do not change their Labor governments, the politics of intergovernmental relations will become more federal and state centred.

To sum up, recent Commonwealth leaders and governments have been opportunistic in their approach to federalism, waxing and waning as it seemed to suit their political advantage. Commonwealth governments overreached their jurisdictional boundaries when it seems to suit them politically, but in so doing went beyond their policy competencies and failed. The window of opportunity that prime minister Rudd enjoyed in having a full suite of supposedly cooperative subnational Labor governments was wasted because of inept Commonwealth leadership. Previously prime minister Howard had worked with state premiers to sell the GST, but later turned on them and sought to reinvigorate his ailing government by boisterous Commonwealth initiatives in their jurisdictional domain. Both Labor and Liberal coalition parties have shown little appreciation or respect for federal limitations when in government, and disregarded them for political gain. But political federalism has its own complex cycles and corrections, with the Commonwealth government weakened and the states coming into a resurgent mode.

VFI

Vertical Fiscal Imbalance (VFI) is the elephant in the federal reform arena. VFI allows, even encourages, the Commonwealth posturing and adventurism outlined above. The Commonwealth has more money than policy sense or competence, even after extensive transfers to the States. An obvious federal reform would be to reduce VFI: limit the Commonwealth's taxing to what is required for its own expenditure needs, for stable economic managements and for equalization; and allow the States taxing powers or a share that covers their expenditure portfolio.

The essentials of VFI are well known. The Commonwealth government collects most of the revenue needed for all governments' expenditure, and has a monopoly on the most lucrative taxes—personal and corporate income tax, and the GST (Goods and Services Tax). The states and local government are restricted to more modest revenue earners such as payroll and property taxes. Thus the Commonwealth collects much more revenue than it needs for its own expenditure purposes, and has become accustomed to using tied grants to influence state policies in large areas of state jurisdiction, for example in education, health and infrastructure. For their part the states and territories provide the bulk of public services and depend on Commonwealth grants for around 40 percent of their expenditure needs. Approximately two-thirds of Commonwealth grants are untied, and one-third have tied policy conditions set by the Commonwealth although these have been broad-banded in recent years. Moreover, the Commonwealth government decides the aggregate level of grants. The distribution of total grant monies among the states and territories is determined by a Commonwealth agency, the Commonwealth Grants Commission that advises the Commonwealth government. Although appointed by the Commonwealth government, the Grants Commission is an independent body with its own secretariat and research capabilities. It takes into account both revenue and

expenditure advantages and disadvantages in determining the relative needs of each state and territory and, by including tied grants in its calculations, offsets the fiscal effect of such grants[18]. In short, Australia's fiscal federalism is well established with sophisticated institutional arrangements. Although it is highly centralized with the Commonwealth having the whip hand, the states are complicit and adept at working the system to their advantage.

Part of the explanation for centralization is to be found in Australia's constitutional design or fiscal constitution that does not mandate fiscal centralism, but nor does it prevent it. A complementary reason is judicial interpretation of the constitution's fiscal provisions, or fiscal constitutionalism, that has legitimated fiscal centralism using *Engineers* interpretive methodology. The main driving force has been intergovernmental politics with Commonwealth governments expanding and consolidating the Commonwealth's fiscal power for political purposes, and embedding this in institutions and practices that serve its purposes. But the Commonwealth does not have unlimited political or fiscal power, as recent developments have shown. Ambitious go-it-alone ventures by successive Commonwealth governments breaching traditional federal jurisdictional boundaries have failed. Federal politics have punished the Commonwealth's overreach, and a new cycle of state politics that promises to be more assertive of state interests is underway. Nor does the Commonwealth have unrestricted spending power as the High Court ruled in the *Pape* case (2009).

Few perhaps prefer the status quo in Australian fiscal federalism—for federalists it is too centralized, but for centralists it is too complex and variegated from state to state. Prospects for change are not promising, however. The Commonwealth was dealt the superior hand by the constitution, and that superiority was embellished and legitimated by the High Court. Commonwealth governments have exploited their fiscal advantage, and Commonwealth expansionism has been sanctioned or at least tolerated by the voting public. These recent plays in political federalism show the limitations of Commonwealth political power and policy competency. Having superfluous resources to go-it-alone in disregard of the states and territories does not ensure the Commonwealth success.

Modes of Intergovernmental Relations, especially Competitive

Concurrency or sharing of policy domains is the dominant mode of Australian federalism, with the Commonwealth having the whip hand. VFI extends both concurrency and Commonwealth dominance, opening up most major policy areas to Commonwealth participation. Various commentators have tried to capture the essential workings of the federal system and intergovernmental realations, with varying success. Critical awareness of the different models and mechanisms is important for serious thinking about federal reform.

Two that have been prominent in Australian commentary are *coercive*, with the Commonwealth driving the interstate agenda, and *cooperative* where there is more

[18] For a critical view, see Neil Warren, 'Reform of the Commonwealth Grants Commission : It's All In the Detail', *University of New South Wales Law Journal*, 32(2) (2008), 530-552.

harmonious interaction. Russell Mathews popularized this as a handy way of categorizing historical phases and major initiatives in Australian federal history.[19] The Grants Commission is usually characterized as a cooperative institution, although Victoria, New South Wales and more recently Western Australia have voiced spirited criticisms. On the other hand, section 96 tied grants are seen as coercive of States, even though the States might avidly pursue them. Cooperation was recently trumps in public discourse, with Labor Prime Minister Rudd working intensively with wall-to-wall Labor State and Territory Labor governments to improve 'disfunctional' federalism and improve intergovernmental relations.

There are other modes that are also in play or plausible. These are *coordinate* and *competitive*. I have argued elsewhere that coordinate—separate and distinct roles and responsibilities— is not the paradigm of Australian federalism, nor do I think it could be of any sophisticated modern federal system. If it has any value at all, it might be as a conceptual counter in discussion about federalism. Too often, however, it is a quixotic distraction that leads analysts into futile exercises of trying to distill separate and distinct roles and responsibilities for Commonwealth and state governments. If there were ever a bottle with separate internal compartments for Commonwealth and state powers, the genie escaped long ago and has so infused major policy domains in concurrent intermixing that there is no putting it back. The Commonwealth and states share roles and responsibilities *within* most major policy areas: that is a fact of life, and occurs for good reasons of governance matching policy and political needs.

Competitive federalism is much more potent and important for understanding how federalism works and the processes for its reform, and is the preferred paradigm for economists. Indeed, Cliff Walsh[20] argues that competition is the main principle of federal systems and best explains their operation. In his view, competition is the dominant mode, and cooperation a lesser mode that is nevertheless important and finds it place alongside, or within the competitive paradigm. Competition occurs on both vertical, Commonwealth versus States, and horizontal levels, among States. It is the primary way that roles and responsibilities are sorted. The mechanism for horizontal competition can be though citizens migrating to preferred State regimes. But more significant, as Albert Breton[21] has explained, is political competition through benchmarking: citizens wanting or seeing better programs and demanding the same from their own government. Vertical competition draws the Commonwealth into areas of demand or opportunity.

Walsh's championing of competitive federalism draws mainly on economic arguments and evidence, but is even more strongly supported by political ones. Indeed political competition is behind much of my analysis of Australian federalism above, including the Commonwealth's expansion of section 96 grants and takeover of income taxation. We

[19] R Mathews, 'Innovations and Developments in Australian Federalism', 7(3) *Publius: The Journal of Federalism* (1977) 9-19.
[20] C Walsh, 'Competitive Federalism—or Welfare Enhancing?' in Productivity Commission, Productive reform in a Federal System, Roundtable Proceedings 28 October 2005 (2006) 53-84
[21] A Breton, *Competitive Government; An Economic Theory of Politics and Public Finance* (1996).

should not pose competition and cooperation as binary opposites, but allow that they can coexist and adjust in dynamic combinations. Nor do they exclude coercion.

Once this perspective of concurrent and competitive federalism is adopted, many of the perceived problems with Australian federalism disappear—they are really products of wrong-headed thinking about federalism. As well, the processes for reforming Australian federalism are better appreciated—indeed they are already in operation and working tolerably well in the federal processes and outcomes that we see around us. A notable one is 'so-called overlap and duplication that is part of the process and outcome of governments at Commonwealth and state levels "sorting themselves" between activities'. Governments compete through policy initiatives where they have some political or economic advantage in their delivery. There is also obvious room for cooperation where complementarities and externalities need addressing. Australian fiscal federalism is a prime example of competitive and cooperative modes. VFI might be considered coercive on the Commonwealth's part, but is accepted across all governments. Hence it is better explained, as Walsh puts it: 'as being a result of mutually-beneficial agreements between national and state governments to centralize revenue-collection from at lest some tax bases', with the proviso that the resulting transfers of revenue back to the States will entail tied grants 'by mutual agreement'. Horizontal fiscal equalization is a means for stabilizing potential inter-jurisdictional rivalries and avoiding 'a race to the bottom'. [22]

Competition and cooperation are complementary dynamics in Australian intergovernmental politics and public policy. Besides explaining the fiscal federalism and how it has developed in Australia, these two modes capture the dynamics of political federalism and intergovernmental relations. The processes operate both within and across major policy areas, something that is not readily appreciated by those with a coordinate mindset. We hear a good deal of loose talk from politicians and senior bureaucrats and advisors about one government having one big policy area, say health, and the other level of government a separate and distinct policy area, say education. Both, however, are large and complex policy areas with multiple sub-domains and intersections requiring aspects of both national and state policy input and management. It is unrealistic for good political and policy reasons not to have shared jurisdiction within the particular policy area. This is even more so for the environment, water sustainability and other challenging areas. Working out better arrangements and systems for intergovernmental management across jurisdictions within large policy areas is the biggest challenge facing modern Australian federalism, and is currently being tackled by COAG. This is where the effort and attention should be.

Regionalism

Regionalism is a variant of decentralized government but within a predominantly centralist paradigm. Hence it is not strictly federalism because that entails two spheres of government with powers shared between them in such a way that neither is predominant.[23] If one prefers 'sovereignty' discourse (that is not strictly applicable to

[22] Walsh, above n 44, 82.

[23] For a classic account, see D J Elazar, *Exploring Federalism* (University of Alabama Press, Tuscaloosa, 1987); in the Australian context, B Galligan, *A Federal Republic: Australia's Constitutional System of*

federalism because neither sphere of government can be sovereign) federalism requires divided sovereignty—strictly a contradiction in terms, but perhaps a forceful metaphor for articulating the distinctive character of federalism. Substituting regionalism for federalism is not a plausible option for Australia because the States and the Northern Territory are already super-regions, well established with distinctive geographical domains, state cultures and semi-autonomous governments. Moreover, regionalism is alive and well at the sub-state level for certain governance purposes and policy delivery regimes and can be a preferred identifier for groupings of people concerned with or responding to certain issues However, it remains only one of numerous identifiers and tends to be fluid and ill-defined. Regionalism is significant because, as A J Brown shows,[24] it is out there, alive and well. I agree, but in my view regionalism adds to the richness and complexity of identity, governance and policy communities in Australia, but is a sub-federal matter and likely to remain within the interstices of the federal system.

Government (Cambridge University Press, Cambridge, 1995), especially Chapter 2 'Federal Theory and Australian Federalism' 38-62.

[24] A J Brown, 'In Pursuit of the "Genuine Partner": Local Government and Federal Constitutional Reform in Australia' (2008) *UNSW Law Journal* [this no. ref].