RESEARCH AND EVALUATION

Dilemmas of Federalism and the Dynamics of the Australian Case

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This paper provides a synoptic account of the distinguishing features and broad tendencies of federal systems in general and the main characteristics and challenges of Australian federalism in particular. In doing so, it canvasses questions of purpose and rationale, constitutional design and evolution as well as fiscal federalism and intergovernmental relations. It highlights the obsolescence of the traditional division of powers around which Australian federalism was originally organised; the degree to which the system has become centralised; and the search for a new basis on which the two levels of government can most effectively and efficiently work together in today’s world of concurrent responsibility.

Key words: Federalism, Fiscal Federalism, Constitution, Intergovernmental Relations

For very practical reasons if nothing else, virtually every country has multiple levels of government. There is great variation between countries, however, in the importance, status, roles, structures and powers of those different governments. In practice, some systems are highly centralised, others decentralised. However, apparent similarities can obscure a fundamental difference in design. Irrespective of how they operate in practice, federations are based on the principle of shared sovereignty while unitary states are based on the principle of overriding central authority. Within these broad categorisations, however, there still remain substantial differences. Federalism operates very differently in different cases and each federation has evolved substantially over time. Similarly, despite their single locus of sovereignty, unitary systems, too, vary enormously in their degree of practical centralisation, with some having strong traditions of local government and/or undergone processes of devolution. While not explored specifically in this background paper, decentralised administration under unitary systems may exhibit some similar attributes to those of federations in terms of a degree of autonomy and responsiveness to local needs and priorities. In those cases, as in federal systems, intergovernmental relations and intergovernmental fiscal arrangements are important components of governance.

This paper focuses on federal systems in general and on the Australian federal system in particular. Australia is one of the oldest contemporary federations but what can it teach others about managing the challenges of federal and other decentralised forms of government? In particular, what lessons can be drawn in relation to general principles, roles and responsibilities, financial management, relationship management and accountability?
Federalism and the Federal Experience

In a federation, sovereignty is shared and powers divided between two levels of government each enjoying a direct relationship to the people (Hueglin and Fenna 2006: 32–33). By contrast with unitary states, this requires the establishment and maintenance of a balance between the constituent units and the central government.

Formation of Federal Systems

Federalism is a system of government with a deep history. Its elements can be traced back at least as far as the mutual defence pact that brought the original three founding cantons of the Swiss Confederation together in 1291 (Forsyth 1981). Confederation has been a concession to the desire to retain local autonomy while gaining the strategic and economic benefits of a larger union. In this classic process of federating, constituent units voluntarily concede a degree of sovereignty according to terms established in a binding agreement. To varying degrees, this ‘coming together’ was the process that characterised the formation of the Swiss, American, Canadian, German and Australian federations.

Federalism can also come about via the reverse process whereby a constitutional devolution of authority takes places, such as occurred in India with independence from Britain, or Spain after the end of the Franco dictatorship (Moreno 2001). However, even in those cases, devolution reflects a deep history of multiple identities and/or fragmented political development — contrasting with states such as China with deep unitary characteristics developed over a more than millennium (Fukuyama 2011).

Constitutional Sureties

What distinguishes a federal system from other forms of decentralised multi-level governance, are the constitutional guarantees of its ‘federal’ character (Hueglin and Fenna 2006). The respective powers of the two levels of government are entrenched in a constitution that is protected from unilateral alteration. Indeed, the Constitution of the Federal Republic of Germany goes so far as to insist that the federal principle is unamendable altogether.

That emphasis on the binding contractual nature of the union in turn calls for constitutional interpretation and adjudication to be carried out by an independent judiciary. Judicial review originated with the US Constitution and established itself as an integral and central feature of constitutional practice in US and other federal systems. The one exception to this is Switzerland, where a uniquely strong culture of direct democracy substitutes. In either form, federalism is reliant on a sufficient degree of democracy and an established culture of the rule of law to ensure credible commitments. It also places a premium on negotiated compromises between governments.

Local Control

Typically in the classic ‘coming together’ federations, the constituent units agree to transfer only what they see as the minimum necessary sovereign authority to the new overarching central government they are creating. Indeed, they often began as confederal arrangements where the new central government was but an agent of the constituent units — much as we have seen with the European Union in our own time (Kincaid 1999, Majone 2006). Retention of most domestic governance responsibilities by the constituent units enable a high degree of local control and accountability and a high degree of possible diversity between the jurisdictions. Tasks assigned to the central government tend to be those concerned with maintaining the integrity of the economic union and managing external relations. In the European tradition, the principle that authority should be retained locally unless functions cannot be adequately exercised at that level is known as subsidiarity.

Subsidiarity is a normative concept, one expressing the view that governance arrangements ought to be organised in as thoroughly devolved a manner as possible. This is the principle that underlies the principle of federalism and it is justified on the basis of values that federalism helps preserve or benefits it can deliver.
These include the scope for protection of difference between the constituent units of a federation and the freedom for policy diversity; the constitutional safeguards that come from having sovereignty shared between two levels of government; and the potential for comparison, policy experimentation and learning between jurisdictions.

**Dividing Powers v. Dividing Functions**

Federalism entails an agreed-upon division of powers and responsibilities between the two levels of government. In the American model, replicated in Canada and Australia, jurisdiction was divided by assigning full responsibility for the making of policy in assigned areas, as well as its, implementation and administration to one or the other level of government. Ideally, this model of legislative federalism meant that the two levels of government need have little interaction, each operating autonomously in its own sphere – a notion that came to be known as 'co-ordinacy' (Fenna 2007a).

In the German model, by contrast, jurisdiction was divided by assigning a broad policy making function in many areas to the central government while leaving the constituent units with responsibility for implementation and administration. Germany’s administrative federalism necessitated from the outset a close working relationship between the two levels of government and a veto for the constituent units over national policies. Provision for that veto was built into the design of the second chamber of the German parliament, the Bundesrat or Federal Council representing the executive governments of the constituent units.

**Evolution and Adaptation**

Much has happened in the world since the pre- or early-industrial times when the original federations were formed and their governance systems have been subject to stress and strain accordingly. In particular, when the first federations were designed, far fewer responsibilities of government had a significant national dimension and allowed for a far greater diversity of practices than is accepted today (Fenna 2007b). Thus there has been an endemic pressure for centralisation. This process has been most obvious and most disruptive in the Anglo federations with their supposedly co-ordinate division of powers.

These centralising pressures have been evident in an expanding role for central governments in federations, which has generally been achieved through expansive interpretation of enumerated powers or exploitation of fiscal superiority. This expanded role means that far from operating in their respective spheres, the two levels of government are closely entangled in a variety of policy and service delivery areas. This so-called cooperative or concurrent federalism has come to look in places like the German model of centralised policy frameworks and local implementation. It places a premium on effective processes of intergovernmental coordination.

At the same time, it must be noted that each federation is distinctive in its underlying character. Some federations are federal in no small part because maintaining national unity amongst the different cultures or language groups would be impossible without it. Others have little or none of such underlying federal diversity, or have seen their underlying federal diversity fade into insignificance over time. Today, those federations with strong underlying federal characteristics have resisted the centralisation trend much more than those, such as Australia, where there is little real difference across the country (Fenna 2012d).

**The Australian System: design**

Australia was one of the ‘coming together’ federations, formed through aggregation. This means, in contrast to many of the more recent cases, the Australian federation was formed from six pre-existing and largely self-governing political entities that were keen to protect as much of their existing power and responsibility as possible. The challenge for those designing the new institutions was to determine which of these must necessarily be transferred to the central government if their ambition to form a single nation was to be realised.
**Primacy of the States**

As with other ‘coming together’ federations, representatives of the Australian colonies agreed to give up only those minimal elements that were necessary in defining the nation state — international relations and trade and the areas necessarily to create a single market such as a common currency. Because most business was conducted within the boundaries of each State and each State was regarded as a political community, all other matters, including regulatory responsibilities and service provision were left in the hands of the States. Such minimal arrangements were intended to protect and maintain the autonomy of the constituent units — though, for reasons to do with and social changes realities and weaknesses of design, this was not how things turned out (Fenna 2007b; Hollander and Patapan 2007; Parkin and Anderson 2007).

**Roles and Responsibilities**

The minimalist design adopted in Australia at the end of the nineteenth century may have already been out of date for several reasons. It was based on the US design of a century earlier, which assumed that localism would continue to prevail and therefore State governments would be in the best position to meet the needs and aspirations of their constituents much as they had done over previous decades. Thus, service delivery was to remain in the hands of the States, an arrangement that continued for much of the twentieth century. Indeed, given the financial considerations and commitment to Horizontal Fiscal Equalisation (HFE) it is somewhat surprising that the States retained as much autonomy as they did for as long as they did.

Following the American design, powers were divided by assigning a limited list of specific or enumerated powers to the new Commonwealth government (s.51) and assigning a general or ‘residual’ authority to the States to carry on with the broad range of domestic responsibilities they had undertaken as colonies (s.107). The underlying assumption was that to specify was to contain and that enumeration of State powers would be impossible because of their plenitude and unwise because it might likewise serve to limit (Zines 1986).

**The Australian System: evolution**

The constitutional architects assumed that businesses would remain small and the volume of interstate trade modest, and underestimated the degree of interstate mobility. The increase in mobility, of not only goods and services, but also labour, capital and other inputs has increased the need for a single national market bringing with it demands for consistency, if not uniformity, in a diverse array of areas from business regulation to education.

The constitutional architects also underestimated the degree of spill-over that characterises a range of policy areas. Decisions taken in one jurisdiction have a tendency to impact on its neighbours especially when communities span borders. This characteristic is clearly evident in relation to environmental policy because of the trans-boundary nature of ecosystems. The experience in dealing with the Murray–Darling Basin, which spans four States, provides us with a good example. In this case, water allocation decisions made by the Queensland government, far to the north, have the potential to affect the urban community of Adelaide over 1500 kilometres away.

In addition, the American model assumed that governments themselves, at every level, would remain relatively small. By the end of the nineteenth century, the relevance of this assumption to Australia was already questionable. Australian governments in the colonial era were major players in the development and provision of infrastructure. Indeed, economic historians coined the term ‘colonial socialism’ to describe this active government role (Butlin 1959; Fenna 2012c). Twentieth century developments in the form of the redistributive welfare state and macroeconomic manager only consolidated what previously existed.

The centralisation of power and responsibility and the increase in Commonwealth engagement characterising the Australian federation was aided and abetted by several factors.
First, there was little to distinguish the different colonies from each other. While they had enjoyed a large measure of self-government, their institutional arrangements were largely similar, and the differences in political culture and practice that did exist were subtle. The ethnic, language and other cultural cleavages that characterised other federations were largely absent. Thus, federalism in Australia did not seek to give recognition to ancient nations that had been subsumed into an overarching polity and this made it more difficult to successfully prosecute any States’ rights campaign.

Secondly, the Commonwealth enjoyed a superior fiscal position from the outset and learned to use its surplus revenues to make conditional grants imposing its own priorities in areas of State jurisdiction. That fiscal dominance increased over the twentieth century as the Commonwealth achieved monopoly control over major revenue sources to a degree quite unusual in federal systems. Commentators generally see Australia as having a degree of fiscal centralisation well beyond that necessary or healthy in a federal system (Fenna 2008; Warren 2006).

Third, the failure of the Commonwealth Constitution to enumerate any State powers or to entrench the principle of federalism has facilitated an expansive interpretation of the Commonwealth’s enumerated powers by the High Court. Not least among those has been the ‘external affairs’ power, s.51(xix) — which allows the Commonwealth to legislate in areas of State jurisdiction pursuant to any matter that is subject to an international treaty.

**Fiscal Federalism**

How a parchment division of powers operates in practice is inevitably going to be heavily influenced by access to the necessary financial resources. Financial arrangements in Australia have had a profound impact on the relationship between the Commonwealth and the States. Whether by deliberate design or by accident, the Commonwealth has become responsible for raising the bulk of revenue by controlling both direct and indirect taxation. By contrast with other federations, the Commonwealth exercises exclusive control over both income and sales taxes. This has left the States dependent on Commonwealth transfers — transfers that are entirely at the discretion of the Commonwealth — to fund their activities and provided the Commonwealth with two channels of influence.

**General and Specific Purpose Payments**

For many years, the bulk of the Commonwealth’s surplus revenue was transferred back to the States as general purpose payments. However, from modest beginnings in the 1920s, a growing share came to be assigned for specified tasks until by the mid-1970s the split between general and specific purpose payments was roughly 50/50. Since 2000, general purpose payments have been made to the States by an Intergovernmental Agreement that sees the net revenue of the national Goods and Services Tax (GST) hypothecated to the States.

Specific purpose payments (SPPs), or ‘tied grants’, carrying various conditions are authorised by the Constitution under s.96 and have been employed in a wide range of policy areas that in principle fall within the exclusive jurisdiction of the States (Fenna 2008). Through this method, the Commonwealth has been able to nullify to significant extent the original division of powers. Under the sweeping reforms of 2009, a new system was introduced whereby a large number of those SPPs were rolled into a small number of block grants with reduced conditionality (Fenna and Anderson 2012; Treasury 2009). Alongside those, the Agreement made allowance, however, for so-called National Partnership Payments (NPPs) which retain greater scope for conditionality — and thus continue to rankle with the States (O’Meara and Faithful 2012).

**Sharing the wealth**

The Commonwealth’s commanding fiscal position and the absence of underlying federal difference in Australian society has operated to ensure the principle of horizontal fiscal equalisation (HFE) whereby wealth is shared across...
Dilemmas of Federalism

the country. In 1933 this was formalised by creation of the independent statutory agency the Commonwealth Grants Commission (CGC) whose task it is to calculate the distribution (CGC 1995, 2008). Along with Germany, Australia has the most comprehensive system of equalisation operating in any federation. Under the current practices, the Commonwealth distributes the GST revenue according to an elaborately-calculated formula designed to ensure that States have an equal capacity to provide services given their respective own-source revenue capacities and spending needs. With massively increased resource revenue in some of the States over the past few years this has led to debate about the merits of such a high degree of equalisation (Fenna 2011; GST Distribution Review 2011; Porter 2011).

The Australian System: towards performance-based federalism

The reforms of Australian federalism agreed to between the Commonwealth and the States in 2008–09 were formalised in the binding but non-justiciable Intergovernmental Agreement on Federal Financial Relations and passed into law in the Federal Financial Relations Act 2009 (Clth). As a quid pro quo for rationalising the often intrusive and burdensome tied grants, the Commonwealth received a commitment from the States to cooperate in a system of performance assessment. The previous system of seeking to achieve the desired ends by imposing input controls on the States in exchange for grant monies was replaced with one focusing on outcomes measurement (Fenna 2012a).

For a decade and a half the States had already been cooperating in a joint performance measurement exercise, the Report on Government Services (ROGS), coordinated by the Commonwealth’s arms-length research agency, the Productivity Commission (Banks and McDonald 2012). However, under the auspices of the COAG Reform Council, that performance reporting has been taken to a new level of accountability (O’Loughlin 2012). This follows an emerging pattern in federations to develop ‘benchmarking’ systems in an attempt to promote the kind of comparison and learning between jurisdictions that is seen as one of the virtues of federalism. This is an emergent mode of governance in multi-level governance generally, but one that presents particular challenges in federal systems where the central government exercises less constitutional authority over the constituent units (Fenna 2012b).

Cooperative Federalism and Intergovernmental Relations

Given that the two levels of government in Australia were originally envisaged as operating in the largest part independently of each other, it is not surprising that the Constitution makes little provision for intergovernmental relations. The only intergovernmental mechanism provided for was the Interstate Commission — a body designed to investigate matters relating to interstate trade and commerce but which but which only existed from 1913 to 1920 (Radbone 1982).

With the very high degree of effective concurrency that operates today as a result of the enormous expansion in the Commonwealth’s reach, considerable need now exists for cooperative and collaborative action. Like other federations, practices have emerged and developed over the years to fill the gap and again like those other federations, very few of those have been established on any kind of institutional or legal footing. Annual premiers’ conferences have evolved into the slightly more formalised Council of Australian Governments (COAG), which sits above a panoply of portfolio-based ministerial councils (Anderson 2008). Under COAG’s auspices operates the COAG Reform Council reporting on progress achieved in service delivery performance under SPPs and NPPs. While the intergovernmental grants system was significantly reformed in 2009, there were no accompanying reforms to the system within which intergovernmental relations operates in Australia. Perhaps the most frequent suggestion is that COAG itself be given some institutional identity (Kildea and Lynch 2011; Wanna et al. 2009).
Conclusion

Federalism institutionalises multi-level governance in a way intended to preserve the autonomy and roles of the constituent units, minimising encroachment by the central government. Underpinning this is the proposition that policy self-determination at the subnational level can deliver governance benefits ranging from protection of diversity to local accountability. The challenge for all such systems has been threefold: how to craft a suitable and effective division of responsibilities; how to sustain an appropriate division over time; and how to manage the ongoing relationship between the two levels. The challenges have been very much evident in the Australian experience. There we have seen a federal design premised on a division of powers that faced challenges of obsolescence in the twentieth century; an aggregation of fiscal power by the Commonwealth government and resulting growth in scope for unilateralism; and a very ad hoc and limited construction of a system of intergovernmental relations.

What are the lessons that can be drawn from the Australian experience? On the one hand, we can see that a strong federation requires the following: that roles and responsibilities be assigned and adjusted via a process that gives powerful roles to the constituent units and the people as a whole rather than simply the central government; that fiscal capacity be proportional to responsibilities while maintaining the principle of equity; and that formal institutions and mechanisms of intergovernmental bargaining and decision-making be in place. Conversely, to achieve effective decentralisation whilst maintaining central control requires centralised fiscal domination; a high level of policy capacity; and overarching powers. This is Australia’s ongoing dilemma.

Endnote

1. Grundgesetz, Art. 79(3)

References


Dilemmas of Federalism

References


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