

THE CASE FOR FEDERALISM

James Allan argues that federalism creates a more competitive and prosperous society

I have a confession to make. In this country, it's more in the nature of revealing a dirty little secret. Now don't gasp with horror, but you see, I'm a federalist. I believe you get better outcomes across a range of criteria when states have real power and are not at the mercy of the central government's diktats.

Yes, yes, yes, I know that the vast preponderance of our federal politicians, on both sides of the House, are centralists. For them, the states are at best an annoyance, and at worst, something to be gotten rid of as soon as they figure out how. Meantime, they opt to parade around under the pretence of 'cooperative federalism,' as though that phrase means anything more than having two layers of bureaucracy, with the states kowtowing to the Commonwealth.

You see, there's a widespread belief in Australia that federalism just means duplication and extra layers of bureaucracy. But in well-functioning democratic federal states, federalism is always competitive, not cooperative. Think of Switzerland, the United States, Canada, or Germany: the states or provinces or cantons or *lander* in all those countries compete against each other.

You don't have to live in Australia very long to hear the case against federalism from all points on the political spectrum—it's inefficient; it's just an extra layer of duplication; and it gives us too many politicians for the number of people. And then there's this one that seems to be a clear favourite, namely, that those elected to the state legislatures just aren't up to the job. They're second-rate hacks compared to those who go into Commonwealth politics.

I don't buy any of that. Maybe it's because I'm a native-born Canadian, but I think there is a great deal to be said for federalism. I don't think either side of politics at the Commonwealth level is remotely serious about promoting federalism, which is a shame because federalism by and large delivers good consequences.

The one-size-fits-all rule

Take a few of the arguments in favour of federalism. First off there's this point, and it's amazing how often it is overlooked. Uniformity and standardisation are only good things if you assume that the uniform or one-size-fits-all rule that's chosen is the best one on offer. So if we're talking about what school curriculum to follow in educating our kids or how to run a medical system, uniformity is bad if the one-size-fits-all rule that ends up being chosen is less than great.

This is where our attitude to government comes into play. If you think government almost always makes the right policy decisions, then federalism is indeed a dumb idea because it would only entail duplication. But why should we assume that the government always gets it right? In reality, any government would be lucky to get things right even half the time. If we agree that government is not always right, we certainly

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don't want one curriculum across the country. We want six or more curriculums. Some will be awful. Some will be not so bad. But the best bits from here and there can be replicated.

Of course, if you're sure that government almost always gets things right, then you should be able to easily defend the new national school curriculum. Others, like me, will point to Canada where none of the 10 provinces would dream of letting the national government tell them how to draw up a school curriculum. Sure, some provinces have what most of us would think are awful school curriculums, but some are very good; indeed, Alberta's school results rank extremely highly internationally.

So this first defence of federalism starts from the very plausible premise that one-size-fits-all rules are overwhelmingly sub-optimal ones. As someone who works in a top Australian university, where the obsession with one-size-fits-all rules surpasses even that of the former East Germany, I can tell you there is little reason to believe any bureaucracy or government can be trusted to choose the best or optimal set of rules.

More to the point, if federalism really is so inefficient, why are the United States and Switzerland among the wealthiest nations in the world? For that matter, Germany and Canada too. These countries take federalism far more seriously than Australia. Don't forget that on the face of things, capitalism also looks a lot less efficient than central planning. In capitalism, companies regularly go under; lots of businesses make the same product (but differently); and one-size-fits-all products and services are shunned. Command economies with central planning from the top down, by contrast, have a superficial veneer of efficiency, when in fact they're a disaster.

So on a purely comparative basis, and this goes strongly against the 'get rid of the states' position mouthed by a good many Canberra politicians, centralists need to tell us why one-size-fits-all centralised countries such as France and New Zealand do not do as well economically as the multi-layered federal countries such as Switzerland or the United States or Canada. (The size of the population doesn't explain this either.)

Citizens' preferences

A second argument for federalism also revels in differences. This is the argument that claims that different rules in different parts of a country can satisfy more citizens' preferences. So it's not just that you get more efficient outcomes over time (that's the first argument), it's that you satisfy more of your citizens' preferences.

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Take something contentious, like legalising euthanasia or prostitution. Imagine that either way you go, about half the population of your country will disagree with the government's choice and be unhappy. But if you leave it to the states to decide, meaning that Queensland can do what it wants and NSW what it wants, or California can go one way and Texas another, you may find that 60% to 70% of citizens will be living under rules they think appropriate.

This is not to say that everyone in, say, New York State will agree with the socially liberal choices of its government or that everyone in Texas will concur with a more conservative choice there. Clearly there will still be plenty of people who dislike where the line in their state has been drawn. But across the country as a whole, there will be many more people satisfied. Instead of an issue splitting the country 50-50, it becomes 60-40 or 70-30 under federalism. More preferences are satisfied because decision-making takes place at the state level, and different states can reach different decisions according to their own citizens' wishes.

Checks and balances

A third argument for federalism points to its effects on checks and balances and citizens' freedoms that can come with a federal arrangement, rather than with the unitary (or one-size-fits-all) state. By dispersing power, you minimise the dangers of its misuse. (Although many defenders of federalism think this is the

most potent argument, though I am a something of a sceptic on this count.)

Here's the thing. Federalism really only makes sense if it involves differences across the country. At its heart, federalism is about competition and difference. Of course I well know that bureaucrats and planners and lots of big businesses and not a small number of judges dislike this idea of a diversity of arrangements and different regulatory regimes. Life can be far more difficult for them under federalist arrangements. And if that were the ultimate test of what we should do, it might be determinative. But of course it's not.

The federal system in Australia is in disarray, largely because of the High Court of Australia and a series of awful decisions where it consistently sided with the Commonwealth over the states.

When a government talks about 'cooperative federalism,' that talk is almost incoherent; indeed, it's a sham. Federalism simply is not a cooperative endeavour. It's a competitive one. Different jurisdictions try different things, and with luck, one or two occasionally get it right. And other places eventually, not soon but eventually, copy them. If you take away the differences and competition in the name of feel-good slogans like 'cooperative federalism' or 'intelligent federalism,' you take away the core benefit of federalism. And then it really does seem bizarre to have two different levels of government doing exactly the same thing.

Cooperation really just means standardisation, at which point you've thrown out the baby with the bath water.

State taxes

Then there are the practical problems with federalism in Australia that aren't in evidence in Canada or the United States. States in Australia are too enervated and emasculated. For all practical purposes, they lost their income taxing powers back in the 1940s, so there isn't competition over what tax you pay—as in the United States or Canada. In fact, over the past

nine decades, our states have been at the losing end of just about every important High Court decision related to Commonwealth-state disputes over who has what powers.

I don't think any of the framers of our Constitution would believe how weak and insipid the states have become. To make federalism work you can't be a supplicant; you can't be in the position of begging for grace and favour handouts. You need to be able to look the Commonwealth in the eye and tell it to get stuffed, and then enjoy or suffer the consequences.

So in Canada, the United States, and Switzerland, you have a federal income tax for the country as a whole and each state sets its own income tax. Each of these states competes with all the other states, and spends the money it collects. You get competition. You can live in high taxing, high service providing California or low taxing, fewer services providing Texas. The same goes for Canada with high taxing Ontario looking quite different to low taxing Alberta.

Federal dysfunction in Australia

The federal system in Australia is in disarray, largely because of the High Court of Australia and a series of awful decisions where it consistently sided with the Commonwealth over the states. The top judges decided a treaty could be used to let the Commonwealth stop a dam being built in Tasmania under the external affairs power; it implausibly relied on the corporations power to let the Commonwealth win the *WorkChoices* case; it sided with the centre in the cases that moved all the income tax raising power (in practice, whatever the theoretical remnants for the states might be) to the Commonwealth.

Just take the last of those. We in Australia have the worst sort of vertical fiscal imbalance imaginable. The states have to spend large amounts of money on education and health, areas clearly within their domain, but they have no capacity to raise much money. So the government spending the money is not the one raising it, and the one raising it is not the one spending it.

This causes problems of accountability; it generates perverse incentives; and it creates a vertical fiscal imbalance. Australia's fiscal imbalance is as bad as it gets in the developed

democratic world. I can't think of another functioning federal democracy where states don't have income tax powers. But in Australia, the level of government that spends the bulk of money (on education and health) is the level that doesn't raise that money. Talk about perverse incentives!

And despite the numerous academic conferences on fixing Australian federalism, one can't help but be massively pessimistic. What we really need to do is return revenue raising powers back to the states. Given that we can't hope for our top judges to start reading the Constitution in the federalist way it was intended, the only hope is for some state premiers to start telling the one-size-fits-all prime minister and treasurer to get stuffed. What few remaining revenue raising sources we have, we're going to do with as we please.

Which brings me to Colin Barnett in Western Australia, and more recently, Campbell Newman in Queensland. Where do I sign up to their fan clubs? I ask because both premiers are doing this country a great service in standing up to the Commonwealth government.

Take Barnett's grievances and you'll see that he's correct on just about every count right down the line. Does Western Australia get a bad deal financially? Yes. Does it put in way more than it gets out? Yes. Do you win in the long term by giving in to the bullies in Canberra? Never.

One of the big differences one notices as an ex-pat Canadian living in Australia is that Canadian premiers regularly and often tell the national prime minister to get stuffed. And they do it especially fiercely when they both come from the same political party. They do not put their party above their state. In Australia, state premiers are far more inclined to follow party diktat because they are essentially mendicants having to go, cap in hand, to the Commonwealth for money. In Canada, they have far more financial room to manoeuvre.

So our premiers are generally far too lily-livered. I know, I know, I know, that's what comes from being a mendicant hoping for Commonwealth handouts. Alas, there is no obvious solution.

But that doesn't change the fact that this Labor government's Obama-like and high flown rhetoric

about touchy-feely cooperative federalism is a lot of hot air. Take every mention of 'cooperative federalism' and replace it with 'do as we say and we might throw you a few crumbs you otherwise won't get' and you'll have a more or less workable idea of what is going on.

Don't get me wrong. The Howard government was no better. A bit less adept at high flown rhetorical sloganeering perhaps, but every bit as centralist.

Again, ask yourself why decentralised federal states like Switzerland, Canada, the United States and Germany outperform one-size-fits-all unitary ones like France, the United Kingdom, or New Zealand. Or ask yourself which of those two camps are wealthier? It's a no-brainer.

Conclusion

The conceit in this country is that a one-size-fits-all central government would spend money better than the states would. And there is a further assumption that every service and outcome ought to be the same across the entire country. That first conceit is generally empirically false, and the second assumption is a highly contestable moral position.

All of us who care about lean, efficient government in Australia ought to be cheering on the Newman and Barnett governments as they appear to be giving a hint of life to a workable federalist system of government in this country. I work in a top Australian university. I experience every day the most thorough going mania for one-size-fits-all regulation imaginable. And I can assure you that it does not translate to efficiency or particularly good outcomes.

Think of how chaotic capitalism looks with loads of duplication and failures, at least compared to a centrally controlled command economy. And then think of how the former massively outperforms the latter.

The analogy is far from perfect but the same sort of unspoken bias is at work with those who disparage federalism. They think those at the centre have sufficient information and skill to make better decisions than a more decentralised arrangement. And they dislike different regimes and arrangements that compete against each other.

I think such people are wrong.