Beware
Most peaceful, free and affluent democracies have federal constitutions, which divide the business of governance between two or three tiers and encourage competition among various governments. This of course inflicts costs, but the resulting checks and balances have the weighty long-term advantage that the rulers’ power is controlled and that the creative search for better administrative solutions to emerging policy problems is encouraged. A federal constitution is a precious possession that helps to safeguard individual freedom and promotes good governance. As the collectivist tide that had characterised most of the twentieth century petered out, more and more nations have adopted federal constitutions and devolved powers to competing lower-level authorities—for example, Spain and Russia. Even formally unitary countries—such as Britain, France, Indonesia and China—have been moving in the direction of greater devolution. And one reason why most Europeans are rejecting the proposed EU constitution is that—official lip-service to subsidiarity notwithstanding—it shifts too much power to unelected rulers in far-away Brussels.

Friends of freedom favour federalism because they understand the dilemma inherent in all collective governance. It was described by the great American constitutionalist James Madison in this masterful way: ‘If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable government to control the governed; and in the next place oblige it to control itself.’ Alongside electoral democracy and openness to the world, no constitutional provision has been more effective than federalism in obliging those wielding political power to control their political opportunism.

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The Australian federal dilemma

The Australian Federation began with a robust commitment to strong States and a limited role for the Commonwealth. This has served the nation well. Nevertheless, Australia has been moving against the global trend. Canberra has ceaselessly tried to centralise powers, often eagerly assisted by the High Court, which performed juridical conjuring tricks with the external affairs and the corporations powers to relieve the States of some of their original roles.

The Achilles heel of Australian federalism has been a lop-sided fiscal arrangement, which makes the Commonwealth the predominant tax collector and the States dependent on hand-outs to fund their tasks. This fiscal constellation is often justified with an egalitarian aspiration: distribution according to need, and equal living conditions irrespective of performance or luck. It inspired much of Australia’s collectivist ‘Settlement’ at the time of Federation, but most of its props have long been jettisoned. Industrial protectionism on a ‘needs basis’, centralised wage-fixing, and welfare handouts without responsibility are all gone. The only surviving collectivist residue from that long-past era is the Federal–State financial system; indeed, the members of the rulers’ cartel have even managed to strengthen the protections against both competition amongst governments and political responsibility.

Despite occasional protestations to the contrary, State politicians have gladly connived in the centralisation of the tax system. That shielded them from the opprobrium for raising taxes, gave them access to Canberra hand-outs and allowed them to blame Canberra for shortfalls and blunders. The result has been much fiscal irresponsibility, spin-doctoring, arm-twisting and State-Federal acrimony—as well as a growing dependency of the subordinate authorities and an emaciation of Australia’s original federalism. Why should State governments promote the growth of their own economies by enterprise-friendly arrangements as a means of enhancing their tax base? The tax pipeline from Canberra often even rewards them for hindering economic development by poor regulations. Whereas the constitutional principle of ‘fiscal equivalence’—that each State should raise the taxes to finance its tasks—would create a balance of responsibility between public spending and raising taxes, the Australian tax-sharing model has removed fiscal discipline and induced State governments to pursue political aims, whether this hurts the local economy or not. It has also introduced rigidities and removed incentives to learn and adapt by experimentation—features that are crucial in times of rapid change.
When fundamental constitutional rules are altered to suit the political opportunity of the moment, security, confidence and freedom are diminished.

True liberals have always seen federalism as a political problem-solving device and one of the means of maintaining control over the (alas, necessary) rule of men. By contrast, social democrats and conservatives have often taken a more collectivist approach, centralising or cartelising political powers. They tend to believe in mechanistic interventions and have a static view of social interactions, whereas genuine liberals know that every action in our complex, evolving societies has unexpected side-effects and that no individual or governing committee has the knowledge necessary for top-down interventions.

Conservatives and social democrats also tend to see government more as a master than a servant of the citizens. Labor governments in Canberra have typically been overly confident that central policies can achieve set objectives and have consequently favoured centralisation, such as centralised wage-fixing or using the lure of central funding to take over what originally were State functions. One stereotypical occurrence was the Whitlam Government’s takeover of the universities in the 1970s, followed in the 1980s by the ‘Dawkins reforms’ of the Hawke era, which created a ‘unitary tertiary system’. Quality competition amongst diverse universities and a diversity of higher-education establishments with different purposes and approaches to conveying knowledge and skills were not promoted by these measures, but administrative command-and-control mechanisms and juicy bureaucratic career opportunities proliferated.

In recent years, the Howard Government has deftly accelerated Canberra’s anti-federalism trend. Thus, the overdue reform, which gave us the goods and services tax, came with the fatal birth defect that the State-financing GST is collected by the Federal Treasury, and not by self-responsible States. The States became even more dependent on transfers from Big Daddy in Canberra. Then, new Commonwealth workplace legislation centralised industrial relations matters and de facto did away with diverse, potentially competing State systems. Those who applauded the reform because of its more market-conforming nature overlooked the fact that such institutional centralisation gives a future union-driven federal government the powers to overturn the new workplace rules in one fell swoop. Most recently, all the traditional niceties about the States’ sovereign role were cast aside when the Murray–Darling waters were placed under Commonwealth control, one Tasmanian hospital was singled out for preferential takeover by the Commonwealth, as were complex matters of local Aboriginal administration in the Northern Territory. It has, of course, always been easy to identify some good, specific reason for such takeovers. But the cumulative effect is that the federal constitution is being hollowed out.

Admittedly, liberal values can be promoted by a powerful centre. In the history of the West, liberals have often placed their hopes in enlightened reformers at the centre. Recent Australian history, too, shows that liberalisation can be enforced from the top down. But, over the long run, the consequences of centralism tend to be negative in terms of social harmony, individual freedom and prosperity. The progressive concentration of political power is invariably likely to turn the good intentions even of freedom lovers into arrogance, stupidity and a reluctance to learn. Power concentrations therefore always carry within themselves the seeds of destruction.

One consequence of vertical tax transfers and federal takeovers is that under-performing State governments need not fear that the electorate will punish them at the next poll—a right of the citizens and one of the classic ways to control governments which Madison had in mind. When special-purpose grants or direct Federal takeovers reward State irresponsibility, the citizens consider Canberra, which pre-empts their judgements, as high-handed and arrogant. They feel sidelined. Little wonder, also, that the centralists in all parties unite to argue for the abolition of the States.

People who understand the importance of the rule of law (in contradistinction to the arbitrary rule of ambitious men) know that fallible humans need reliable rules to guide them. When fundamental constitutional rules are altered to suit the political opportunity of the moment, security, confidence and freedom are diminished. People then need to invest much costly effort into co-ordinating their pursuits, and political risks and insecurity prevent many potentially useful actions. Liberal philosophers, such as Friedrich Hayek, rightly made the point that it is often essential to uphold a confidence-inspiring rule, irrespective of practical consequences in a particular circumstance. He warned that unprincipled political opportunism gradually destroys the constitution of liberty.

Maybe the spreading cynicism among Australians about the ad hoc opportunism at Canberra Centre, too, is informed by a vague understanding of the costs to liberty and prosperity that centralising interventionism and the disempowerment of the States inflict. Perhaps voters perceive that Canberra cannot solve all problems in this wide, diverse land and should confine itself to fewer tasks, but do them better, instead of scheming Napoleonic takeovers when it suits them politically. Australians appear to have a pretty good understanding of the merits of ‘subsidiarity’—that governance tasks should be undertaken at the lowest possible level, where the rulers are close to the action and where citizens are well informed. Of course, rulers are never keen on citizen control and often pursue ideological causes irrespective of local aspirations. The bien pensants may assume that the rulers are angels, but the more worldly wise know the perils of distant government and weak
constitutional controls. Observers with a sense of history know that elected representatives work less conscientiously on behalf of those whom they represent and scheme more recklessly to stay in power, the more remote they are from the people.

**Why competitive federalism?**
Federalism protects the freedom and prosperity of the citizens, controls opportunistic governments and promotes the nation's international competitiveness best, if it embraces the following constitutional elements:

The **rule of origin** ensures that any good or service, which is legally produced in any one State can be sold and traded without regulatory impediments in all others (free trade). Thus, if Canadian salmon can be sold legally in Sydney, it must not be prohibited from sale in Hobart, as this would offer unfair protectionism and profit advantages to local salmon producers.

The **tasks of governance** should be assigned exclusively to one level of government, so that duplication costs are avoided and citizens can hold one particular authority accountable. Thus, we should not have Federal as well as State departments of health or education duplicating services or even scheming against each other.

**Fiscal equivalence** has already been mentioned. It is the principle that each government should raise the taxes (and be responsible for the public debts) to finance constitutionally assigned and politically chosen tasks. It is a guarantee that the subordinate levels of government remain incorruptible and autonomous. When the powers to tax are insufficient or have been surrendered by opportunistic leaders, the States lose their autonomy. They also become irresponsible and in the eyes of the people maybe even illegitimate: No representation without taxation! Copious vertical and horizontal transfers only make the give-and-take in public policy non-transparent and promote political opportunism. They penalise States with good economic policies and reward the reckless spenders. 'Welfare for the States' thus destroys proper incentives and promotes mediocrity and dependency.

Since governments have coercive sovereign powers to tax and incur debts, it is also necessary for a proper system of competitive federalism to have an enforceable **ban on political discrimination**. A national competition policy is needed to implement something akin to the most-favoured nation clause in the international trade order: If a preferment is offered to one, it must be offered to all comers. When a State, for example, offers a subsidy to attract one car manufacturer, such subsidies must be made available to all. Otherwise, State politicians might be driven by short-term opportunism to engage in costly subsidy wars to attract industries away from other States, instead of competing by providing good institutions and policies. Subsidy wars can easily be conducted at the expense of other, legitimate public policies and unfairly burden future generations.

These points, which were made in two publications of the IPA's Federalism Project in 1995 and 1996, are even more pertinent to good governance today than they were then. The citizens are better informed and more mobile than ever. The electronic age empowers us to network and move assets independently of big government, big business and big media. The global competition for mobile capital and enterprises among different jurisdictions is hotting up. This means that job creators shop around for those jurisdictions that offer the best support services for competitive costs in terms of taxes and user fees. We do not need self-seeking rulers, but support organisations that help us to keep our jobs in Australia and beat the overseas competition. In particular, the challenge for government administrations now is to provide good infrastructures and trustworthy institutions by legislation, administration and expedient adjudication. The best school for learning this is competitive federalism as outlined above. International competitive success begins with good competition at home, which is one reason why so many other jurisdictions now opt for greater devolution.
Can we revive the federal spirit?

Given the emasculation of State loyalties in the Senate by central party discipline and the lack of commitment by political parties to a truly federalist cause, the question arises: Will the call for competitive federalism simply remain a pipe dream as far as Australia is concerned? Will we see future Commonwealth governments take over more and more specific management tasks, whatever the cost? Can we believe political assurances that Commonwealth interventions will be short-term and cheap, only to witness subsequent government failure and cost blowouts?

One cannot be optimistic in the light of the Federation’s history. However, Australians—like those ardent and successful federalists, the Swiss—have a healthy measure of scepticism about political authority and a disposition for solving problems by fair compromise and cooperation. This seems a good attitudinal basis for a revival of the federal spirit at a time when globalisation is increasing the competitive pressures on the average Australian. People now understand that the recent reforms of capital, labour and product markets, as well as privatisations, have underpinned a record rise in prosperity, but that treating any particular sector, such as the public sector, as a holy cow, which is exempt from competitive challenges, distorts the entire system. It places unfair burdens on those whose jobs have to compete in open markets. In any event, a return to a comprehensive, egalitarian and protective ‘Australian Settlement’ is unthinkable in today’s fast-moving, open world. We would suffer almost immediate losses of living standards and individual freedom. Nor would a construct, which makes many citizens dependent on caring governments, prove robust and resilient in the face of military or terrorist aggression.

This means that we—the citizens who are the principals in the national political venture—must ask our temporarily elected political agents to devolve powers and to compete with each other. To this end, we must give up unrealistic egalitarian dreams, because egalitarianism in present-day circumstances would cost the next generation its prosperity, security and freedom.

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The Central Office
Satire by Kurt Tucholsky, 1925

The Central Office watches over everything, it has faith in its overview, it keeps the record files. At the Central Office, men are busy among themselves with endless quarrels, but they slap you on the shoulder and say: ‘My dear friend, you cannot understand this from your individual vantage point! We are the Central Office…’

The prime concern of the Central Office is to remain a Central Office. God have mercy on the subordinate entity that dares to act independently. Whether something is sensible or not, necessary or not, urgent or not— the Central Office must first be consulted. Why else is it the Central Office? It is because it is: make note of that! Subordinates out there better learn to cope.

The men at the Central Office are not clever, just wily. A man who tends to his own little job may be clever, but he is not wily. If he were, he would duck out of it and for that there is only one thing to do – the reform proposal! Thanks to this proposal, a new department is created, which, it goes without saying, is subordinate to the Central Office and under its charge… One person chops wood and thirty-three others just stand around and watch – this is the Central Office.

Kurt Tucholsky was a German journalist, satirist and writer. He died in Sweden in 1935.