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Development Issues

*The subsidiarity principle and
decentralisation: perspectives from
Australia's federal experience*

Cliff Walsh and Christine Fletcher

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2382317

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Published by the National Centre for Development Studies

Printed in Australia by Better Printing Service,
1 Foster Street, Queanbeyan, NSW, 2620.

The Economics Division acknowledges the contribution made by the Australian International Development Assistance Bureau towards the publication of this working paper series.

ISBN 0 7315 1939 6

ISSN 1038-412X

Key to symbols used in tables

- n.a. Not applicable
- .. Not available
- Zero
- . Insignificant

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abstract

The equitable distribution of national resources is recognised as a primary function of central government in both industrial and developing economies. The nature of the organisation of government authority at a national level and the paths through which revenue and expenditure powers are exercised are likely to have a significant impact on the effectiveness of government arrangements and administrative functions in any country. Governments, universally, are attempting to address these issues through decentralisation policies.

Political communities in post-industrial democracies and in the developing world are increasingly looking at new methods to address the problems associated with regional economic disparities and political inequities. In some countries, particularly those with transitional economies, local and regional populations have been disadvantaged, and some economies destabilised as a result of a disequilibrium between the needs of regional governments and the power of central authorities. Central regimes in some countries, for example, the Philippines, Pakistan, and also China, are attempting to make the system more responsive by decentralising their decision-making process. For the most part, this requires institutional reform and, in some countries where centralised power is viewed with deep suspicion, for example in South Africa and in eastern Europe, political communities actively reluctant to endorse central government policies passively, whether they be decentralisation policies or not. In many cases, regional communities have been disenfranchised and there are now pressures for exercising central authority without first ensuring that

- there is a relatively equitable set of principles to guide the distribution of national resources
- there is an institutional framework to support the less powerful local communities throughout economic and political transitions

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Journal of Economic Surveys

Volume 12, Number 4, December 1998
Pages 431-450

Abstract

The paper discusses the role of the state in the development of the private sector in emerging markets. It argues that the state's role is not simply to provide a legal and institutional framework, but also to actively promote private sector growth. This is done through a variety of means, including the provision of credit, the establishment of state-owned enterprises, and the implementation of industrial policies. The paper also discusses the impact of government intervention on the private sector, and the role of the state in the development of the private sector in emerging markets.

Key words and phrases

- Not applicable
- Not available
- Zero
- Insufficient

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the subsidiarity principle and decentralisation: perspectives from Australia's federal experience

Decentralisation and subsidiarity

National governments adopt decentralisation policies as part of a program of economic and administrative reform. Decentralisation is more closely associated with governments in unitary, rather than federal systems mainly because federal constitutions are based on governing principles designed to constrain the authority, and therefore the political ambition, of national governments.

Political communities in post-industrial democracies and in the developing world are increasingly looking at new methods to address the problems associated with regional economic disparities and political inequities. In some countries, particularly those with transitional economies, local and regional populations have been disadvantaged, and some economies destabilised as a result of a disequilibrium between the needs of regional governments and the power of central authorities. Central regimes in some countries, for example, the Philippines, Pakistan, and also China, are attempting to make the system more responsive by decentralising their decision making process. For the most part, this requires institutional reform and, in some countries where centralised power is viewed with deep suspicion, for example in South Africa and in eastern Europe, political communities indicate reluctance to endorse central government policies passively, whether they be decentralisation policies or not. In many cases, regional communities have been disenfranchised and there are now provisos for endorsing central authority without first ensuring that

- there is a relatively equitable set of principles to guide the distribution of national resources
- there is an institutional framework to support the less powerful local communities throughout economic and political transitions

- decentralisation is not simply an attempt by central authorities to assert uniform control over local/regional communities.

As we argue in this paper, local dissatisfaction leads to economic and political instability. In the long term, recognising the need to build responsive regimes is far more cost efficient than attempting to redress instability caused by unresponsive central planners: extreme cases can be found among the African nations.

These are key issues of debate among the member states of the European Union as they attempt to redefine the economic and political institutions that will impact on the wellbeing of their communities in the lead-up to European monetary union.

Basically, debates about decentralisation, subsidiarity and federalism are debates about the organisation of authority and the distribution of equity. It is our view that, as global market pressures increase, these same principles will be of critical importance to the overall stability of developing countries, particularly those whose economies are in transition.

The basis for change in any economy is embodied in the constitutional allocation of authority. One way to explain the significance of the relationship between powerful central authority and institutional stability is to compare, specifically, the governing principles that support unitary systems with those that limit the activities of national governments in federal systems. In unitary systems, whether industrial or developing, sub-national governments are generally subservient to the national government, some examples being Britain, China, Indonesia, New Zealand, South Africa, Italy and so on. Federal systems, on the other hand, are designed to impose limits on national government. This underlying principle was factored into systems such as Australia, India, the United States, Germany, Canada and, more recently, it was borrowed for the purpose of designing a supra-national federal structure for the European Union. Basically, federalism is designed specifically to protect the regional communities—usually, consensus has to be reached between sub-national and national governments before central authority can impose its will on the people. This slows the decision-making process but stabilises the outcome.

In Europe, for example, the member communities of the European Union, in an effort to control the potential powers of the new European authority, have tentatively adopted the principle of subsidiarity. In Europe, subsidiarity has come to be defined recently to imply, broadly speaking, that each function of government (the public sector) should be devolved to the lowest level of government consistent with public (that is, the Community as a whole's) interest.

Subsidiarity has become a governing principle—a potential guide to the way resources might be distributed among the regional governments. The European Union

member states see their role as decentralising power to the centre which, in their view, will need close monitoring if they are to preserve their sovereignty intact.

At one level, subsidiarity is an organising principle. In theory, it is supposed to control the devolution of government functions, to guard against unfair resource allocation and to be able to withstand pressure from regional communities either in federal or unitary systems. It is, by definition, a principle which is closely associated with problems of decentralisation. Delores (1989) for example, describes subsidiarity as 'the interface between economic and political integration'. In view of the problems of 'decentralisation' and the associated questions that arise from cross-country comparisons, the aim here is to provide a critique of the principles of both subsidiarity and federalism. Although national government practices differ markedly, the theories that support these organising principles are applicable to all forms of government.

The Australian federation is some distance from Europe—politically, institutionally, and geographically. Although one of the authors has recently been involved as a member of an Expert Group preparing a report for the European Commission in which the principle of subsidiarity played a significant role (Commission 1993), we cannot be sure that we are fully up-to-date on the way the subsidiarity principle currently is being interpreted in Europe. What we do feel sure of, however, is that subsidiarity either is a principle which is essentially empty of sustainable operational content or, alternatively, is a principle that potentially is unfederalist, if not anti-federalist, in its implications. In fact, we suspect that both of these are true simultaneously.

If it sounds as if we are throwing down a gauntlet, we are.

- We see truly federal systems of government as inherently flexible in the way responsibilities, policies and programs are shared, shaped and reshaped between spheres (levels) of government: that is, we see coordinate federalism (Wheare 1946) as unfederal. We regard the capacity of governments, at any level, to invade the territory of another level as a fundamental strength of federal systems. This capacity reflects the responsiveness of federal systems to multi-stop shopping by voters/citizens, enabling them to get their preferences registered. Coordinate federalism is a constitutional (and in our view, unworkable) concept in which different governments perform clearly defined functions within their jurisdiction. It ignores the fact that federalism is a multi-government process in which jurisdictions are shared: a coordinate federal system would be simply incapable of responding to the different needs of its citizens in ways which are consistent with the organising principle of federalism.
- We interpret the principle of subsidiarity as a flawed attempt to make the division of functions (policies and programs) between spheres of government clear-cut, neat and tidy, resistant to change and resistant to the overlap and duplication which characterises federal systems. The flaw is that subsidiarity

is capable of being interpreted and reinterpreted to suit virtually any view of the appropriate division of responsibilities that anyone holds. Whether this is a good or a bad thing depends on whether the flexibility in interpretation translates into flexibility in defining and shaping roles and functions—or alternatively, is construed merely to support different coordinate arrangements.

- We see the European Union as likely to be, for the long foreseeable future, pre-federal—or, more precisely, confederal—in its institutional and political structures: that is, we see the policy drivers and revenue providers at Union level predominantly being the governments of the constituent member states, rather than a central (federal) level of government with its own legislative and revenue-raising competencies, notwithstanding the existence of a European Parliament.

Each and all of these propositions or hypotheses is open to challenge. But if we are right, or even only half right, the lessons which Europe has to learn from truly federal nations may be limited, and possibly less significant than those that federal nations (and transitional economies) have to learn from Europe on the adaptation of internal economies to a more competitive external (internationally competitive) environment.

Subsidiarity, as defined above, involves the 'optimal' devolution of government functions. What this implies, in practice, is less than clear. The absence (or presence) of significant cross-border influences (spillovers) is often cited as the basis for judging whether one level of government or another should be responsible for a particular function. The problem is that virtually everything regional and national governments do can be construed as having cross-border effects.

Breton and Scott (1978), in their work on optimal constitutions, considered how a constituent assembly (under different assumptions about its *modus operandi*) would make decisions about the distribution of functions between levels of government, recognising both these spillovers (and the coordination costs to which they give rise) and the costs to citizens/voters of signalling their preferences for policies and programs under different public sector organisational structures. While their analysis provides clues about how the subsidiarity principle could be made operational—given its constitutional content—really begs the ultimate question of what relationship there is, or ought to be, between constitutional design and federal outcomes. It is this issue, more than anything, which underlies the following discussion on subsidiarity from the perspective of Australia's federal experiences.

A brief overview of the Australian federal system is followed by an examination of the lessons for Europe that flow from considering Australia's federal experiences and evaluating how the subsidiarity principle relates to them. The conclusion emphasises the portability of these principles and the value of comparative analysis for both developing and less developed countries.

The Australian Federal System

Australia is a classic, mature federation (Walsh 1992). The six original sovereign States¹ (then colonies) agreed jointly to create a national (federal) democratically and directly elected sphere of government (known as the Commonwealth). They agreed to cede certain powers to this new national government, and to share others with it, as specified in a constitution, approved by popular referendum in all member States. The Commonwealth Constitution both encompassed and preserved existing regional constitutions, and guaranteed their continuing existence (Fletcher and Walsh 1993a).

The Commonwealth Parliament established by the constitution consists of a lower house (House of Representatives) elected nationwide from single member constituencies of essentially equal population size, and an upper house (Senate) consisting of equal numbers of Senators (currently twelve) from each of the original States irrespective of population size—plus, nowadays, two from each of the two mainland 'federal' Territories² (which are self-governing, and in most fiscal and other intergovernmental respects receive State-like treatment). The third tier, local governments (of which there are more than 900), receive no formal recognition in the Commonwealth Constitution.

Constitutional powers

The Australian Constitution, which came into effect on 1 January 1901, gives the Commonwealth few exclusive powers, the principal exceptions being over customs and excise duties, coining of money and initiation of referenda for constitutional change. It defines a large number of powers which the Commonwealth can exercise concurrently with the States, and in which its laws prevail in the event of conflict, including taxation, defence, foreign affairs, social welfare benefits and pensions, postal and communication services, quarantine measures, banking and insurance, matrimonial causes and copyright, patents and trademarks. The Commonwealth has established substantial legislative and administrative authority around all of these powers, although it does not always fully 'occupy the field'.

The States retained residual (exclusive) legislative responsibility for most areas of law and order, education, health and hospitals, land, housing and urban development, regulation of intrastate commerce and industry, agriculture, development of natural resources, rail and road transport, provision of water, gas and electricity, and control of local government. Through Section 96 of the constitution, however, the Commonwealth can make grants of assistance to the States on such terms and conditions as the (Commonwealth) parliament sees fit, providing it with a significant capacity to influence State policymaking and administrative arrangements. This power has been used increasingly, particularly over the post-war period.

Local government is a State Constitutional structure, subject to alteration at the will of State legislatures. Unlike in other federations, local government in Australia does not have any significant policy or administrative role in education, police or health services: it remains primarily the supplier of local infrastructure and services to residents (such as roads, drainage and garbage collection).

Outlays

The Commonwealth's 'own-purpose' outlays (that is, excluding transfers to the States and local government) amount to about 50 per cent of total public sector outlays, and are concentrated primarily in social security, welfare and health benefits and defence.

The State public sectors' own-purpose outlays represent about 45 per cent of total government outlays, predominantly for education, health (hospitals), transport, housing and community amenities, and public order and safety.

The local government sector is a comparatively small sector (by international standards), responsible for only 5 per cent of total public sector outlays, principally for road construction and maintenance, and for sewerage, drainage and sanitation services to households, but including, also, some aspects of human services, especially in relation to health, the aged and children.

Taxation

Despite the fact that all taxation powers, except over duties of customs and excise, constitutionally are accessible to the States as well as to the Commonwealth, since World War II, the Commonwealth has become highly revenue dominant, currently collecting 76 per cent of total taxation revenues despite the fact that its spending represents only 50 per cent of public sector outlays. The States, on the other hand, collect only 20 per cent of total taxation revenues while being responsible for 45 per cent of total public sector outlays. Taxation arrangements in Australia are more like those of unitary countries than those of other mature federations.

The principal reason for the Commonwealth's dominance of taxation lies in the fact that it acquired a monopoly over income taxation in 1942, ostensibly as a temporary war-time measure, but retained the monopoly after the war by making its grants to the states conditional on their not reintroducing income taxes. Although, legally, the states have the power to reintroduce income taxes, the 'fiscal politics' of their doing so has proved an insuperable barrier.

A further constraint on the States' power to levy taxes has been the High Court's wide interpretation of the Commonwealth's exclusive power over 'excises'. This interpretation in effect prevents the States from levying any tax directly on the

production and sales of goods. The Commonwealth, thus, has predominant power over both income taxes and broadly-based indirect taxes.

The States raise tax revenues primarily through payroll taxes, stamp duties on financial transactions and conveyancing, taxes on motor vehicles and business franchise taxes, licence fees on the sellers of alcohol, tobacco and petroleum products, together with a host of smaller taxes. Municipal rates are the principal domain of the local government sector. (See Fletcher and Walsh, 1993b for more details on the fiscal structure.)

Borrowing

Moreover, from 1927 (when the Commonwealth and the States entered a, subsequently constitutionally entrenched, *Financial Agreement*) until quite recently, State borrowing for general government purposes has been undertaken on their behalf by the Commonwealth, and it still is subject to control as to its level and distribution through the Australian Loan Council. Borrowings by Commonwealth and State trading enterprises and local authorities were incorporated into Loan Council decisionmaking through a voluntary 'gentlemen's agreement' in 1936.

The operations of the Loan Council and associated voluntary agreements have undergone significant change over recent years, but the Commonwealth's capacity to exercise overall control over State and local-sector borrowings through its dominance of tax revenues, and the dependence of the States on Commonwealth grants, remains undiminished.

Intergovernment grants

The flip-side to the Commonwealth's tax revenue dominance is the high degree of dependence of the States on grants (determined unilaterally by the Commonwealth) to fund their outlays. Averaged across all States, net Commonwealth financial assistance funds about 38 per cent of State outlays, while State taxes fund only 32 per cent.

Equally significantly, since 1990/91, despite comparatively large general-purpose transfers, a little over half of the Commonwealth's assistance has been in the form of 'specific purpose payments' (tied grants). Education, hospitals, roads and housing account for the bulk (about 80 per cent) of tied grants.

Few tied grants nowadays have stringent 'matching' requirements (housing being a notable exception), but the Commonwealth-State agreements and arrangements which surround them create often complex administrative interactions. Moreover, a vast network of 'Ministerial Councils'—comprised of relevant Commonwealth and State ministers—and associated committees of officials has been formed in an attempt

to regulate and coordinate Commonwealth and State interests within and across 'functional' areas. At last count, there were 41 such Ministerial Councils actively in existence.

While the distribution of the available total pool of general revenue assistance between the States and Territories is formally determined at annual Intergovernmental Conferences, an independent statutory body, the Commonwealth Grants Commission (CGC), makes recommendations on the relative shares that would be appropriate to enable all States and Territories to provide similar levels of services if they were to apply similar levels of tax effort.³ The CGC's approach represents the most comprehensive 'fiscal capacity equalisation' procedure among federal systems, assessing expenditure needs as well as revenue raising disabilities.

Premiers' conferences

The peak council of intergovernmental relations in Australia is the so-called Premiers' Conference—an anachronistic name, reflecting its pre-federation origins. Premiers' Conferences, in fact, are meetings of what Canadians would refer to as First Ministers and are comprised of the Prime Minister (as chair), plus the six State Premiers, and the Chief Ministers of the two mainland Territory governments.

During most of the post-war period, Premiers' Conferences were held once a year, principally to formalise financial arrangements concerning the level and distribution of Commonwealth general purpose grants. Special Premiers' Conferences also were called for this purpose, but only when cross-jurisdictional issues of high political salience required political leaders to meet. In recent years, however, there has been at least one additional meeting of political leaders, referred to as the Council of Australian Governments (COAG), at which local government usually also is represented through the President of its national association. This flowed from a remarkable, cooperative push towards a new federalism, initiated by former Prime Minister Bob Hawke (Fletcher and Walsh 1992).

The principal agenda items for COAG have been the promotion of microeconomic reform among state-controlled business enterprises (in the interests of promoting national efficiency and competitiveness), and attempts to rationalise the roles and functions of the various spheres of government. In pursuing these issues, Australia's political leaders at times have borrowed significantly from European Union models and ideas. For example, a new Commonwealth-State agreement providing for mutual recognition of product standards, occupational licensing and professional qualifications across States has been introduced. Interestingly, as discussed later, at the end of the first frenetic burst of meetings and official reports associated with the then Prime Minister's new federalism initiative, the Australian states also proposed a version of

the subsidiarity principle. It was advanced as one of a number of principles that they argued should be used to guide a rationalisation of the roles and functions of the different spheres of government to reduce the extent of what they saw as wasteful overlap and duplication in program administration and service delivery (Communiqué 1991, Fletcher and Walsh 1992).

Subsidiarity: lessons from the federal experience

It will be evident from the preceding discussion that Australia's federal system shares few common features with Europe's Union. This is hardly surprising since, even post-Maastricht, the European Union remains very much pre-federal, largely confederal, in nature, with a form of Economic Union its principal (but nonetheless remarkable) achievement to date.

Even where there is an apparent similarity, for example, a heavy reliance on intergovernmental Ministerial Councils, the formal appearances hide deep differences. The European Union's rotating Presidency is more than a mere gesture towards the shared powers and responsibilities of the member States and the central governing body, as it would be in Australia if a similar rotation of the chair for COAG meetings were adopted. But the European Commission's reliance on contributions from member States, possibly above all else, tells the story of structural differences loudly and eloquently.

This is not, in any way, to belittle the European Union's great political achievements. Through a remarkable, pragmatic, evolutionary process, Europe has created a set of institutional and political arrangements which overcome the instability problems that have plagued other, previous attempts at establishing sustainable economic unions (customs unions or free trade areas, for example) from which the rest of the world may learn, including NAFTA and the, as yet nascent, APEC (Asia-Pacific Economic Cooperation). Established mature federations also are picking up aspects of Europe's structures and ideas as they grapple with the question of how to make their internal markets more national in structure and international in outlook.

As already indicated, moreover, Australia's State and Territory governments have signalled that they see Europe's recently rediscovered subsidiarity principle, among others, as relevant and useful to their attempts to rationalise the roles and responsibilities of the States and the Commonwealth in relation to service delivery. At this point, however, a strong caveat must be entered. It is strongly suspected that subsidiarity, even if it can be given sustainable operational content, is a principle that may be relevant to confederal systems, but could be unduly constraining, if not dangerous, in truly federal systems.

Subsidiarity and federalism

Broadly speaking, articulation of the subsidiarity principle in Europe is a strategic attempt to demonstrate the ability of the European Union to respond to its regional communities in much the same way as the organising principle of federalism (Commission 1993). Responsiveness is the essence of federalism and, in a similar vein, subsidiarity has become a principle which is presented as being able to

- blunt the forces of centralisation by encouraging economic coordination among member states of the European Union
- signal the importance and necessity of introducing pan-governmental standards
- control the type of policies selectively that powerful coalitions of bureaucracies and governments can put into effect.

As a concept, subsidiarity touches on some of the characteristics of unity which are familiar to the Australian federalist. But there are many fundamental differences between the two. Differences are most notable within the constitutional framework of government (laws and political culture), the intergovernment negotiating process and the institutions through which governments register the needs of their regional communities (parliaments and the allocation of resources).

Walsh argued that pre-federation-type unions lack a 'central fiscal process by which primary income transfers occur automatically' (Walsh 1992:32). He argued that economic problems can arise when pre-federal conglomerates are put under pressure to endorse standards which are not necessarily compatible with their regional constituents. As demonstrated in this paper, institutional integration and economic legitimacy are based on the incorporation of regional government preferences in the overall governing process. Almost all policy functions 'overlap' into different jurisdictions and most government activities are shared.

Unlike federalism, modern legal concepts of subsidiarity are focused on the legitimising of decentralisation, as a way of separating the jurisdiction of one government from that of another—at least in principle. Decentralisation principles, even in federations, frequently are adopted at the national government level: in Australia, they suit the strategic microeconomic reform agenda of the Commonwealth government which attempts to use sub-national jurisdictions as a management tool to achieve reforms which, in turn, hold sub-national governments more accountable.

There are political implications of federalism, however, which conflict with decentralisation. Elazar (1987) has argued this point forcefully. In simple terms, difficulties stem from the lack of constitutional authority of one government to decentralise the powers of another government. In theory, federalism usually implies that different governments respect (in principle) the powers of other governments.

Whether European Union member governments will recognise the authority of other governments as superior is quite a different matter. Our impression is that once member states gain access to the public policy process, they will be able to improve their individual response to national and transnational events and, hopefully, increase their influence in key areas, such as fiscal inequalities, environmental disasters, infrastructure problems and so on (CEPR 1993).

From most accounts, the subsidiarity principle is ambiguous enough to be adopted as a guide to government but, in essence, subsidiarity lacks the protective guarantees accorded member states within a federation. Its strengths lie in its ability to be used as an integrating factor in the European Union, but only in policy areas which are actually outside the Union's exclusive jurisdiction. Subsidiarity establishes guidelines, as described below.

Subsidiarity and federalism: ideas and ideals

First, subsidiarity is supposed to be a guide to the future economic management of the European Union. Second, it represents a concern with the constitutions and laws that contribute to the overall governing regime. Our impression is that if the organisation of power can be concentrated into the institutional framework of the European Union's economic and legal arrangements, other important elements of government and administration will follow. European Union member states have a strong, historical preoccupation with the virtues of local democracy at the level of the community, possibly as protection against the centralising tendencies of national governments (Commission 1993, Dankert and Kooyman 1989, Walsh 1992).⁴

Early interpretations of subsidiarity also supported notions of the interventionist state. Now, in western liberal industrial economies, institutions are attempting to limit and direct intervention. Plans for centralisation and decentralisation⁵ are more concerned with which level of government performs specific functions. Given that government infrastructure develops in response to conflicting pressures, this may or may not lead to a change in the role of government overall.

In Australia, for example, the laws governing the role of government are defined as much by political and economic circumstances in the States as by national government fiscal policy. Fiscal policy is highly centralised in Australia. This reinforces traditional assumptions concerning 'national efficiency' and 'national standards'. In other words, it highlights the importance of looking at the details of relationships between local authority and centralised powers—particularly in view of the decentralisation principles that governments use to encourage the process of administration and economic reform. This has important implications for developing countries.

Thus, the federal process in Australia is capable of accommodating centralising and decentralising forces simultaneously. This is despite a centralised revenue system. In fact, the extent to which the national government centralises authority through the use of its taxation power is more than offset by a strong federal constitutional system whereby State authority encompasses most major policy functions. Each State had progressed towards its own constitutional arrangements well before the close of the 19th century (Lumb 1991). By the time of federation, State constitutionalism had the potential for enormous influence over two of the main products of federalism: centralisation and decentralisation.

Fairness and equity

The authority of the Australian federal democracy is embedded in the constitutional system. Commonwealth and State constitutions provide a solid framework for fiscal federalism, reinforced by democratic support from the population in all regions of the country. Importantly for this popular democratic support for federalism, Australia organises its fiscal resources by applying principles of equity to the distribution of grants. The Commonwealth government derives a large degree of its authority from its acquired uniform tax power and, as a consequence, State powers are placed under constant stress. But equalisation arrangements help restore the balance, by entrenching fairness and equity, nationhood and common citizenship.

Equalisation

The Australian system of general revenue transfers from the Commonwealth to the States and Territories, even though largely determined by the Commonwealth, restores a level of political dignity to regional governments eroded by the Commonwealth's revenue raising authority. The system of fiscal equalisation associated with the distribution of those grants ensures that the poorer regions have the capacity to provide levels of service which reflect the common citizenship aspirations that go along with federation: differences in levels or patterns of services, accordingly, reflect differences in political preferences among regions, not differences in access to resources. Equalisation is a critical element in the combination of factors that contribute to national unity.

Once the States acquire Commonwealth grants, and depending on the nature of the grant, they are relatively free to spend but, in terms of revenue independence, they are expenditure servants of the national government. The potential for fiscal instability created by the vertical fiscal imbalance (caused by the Commonwealth's uniform tax powers) is subsequently overcome, to a large extent, through the process of fiscal equalisation. In principle, fiscal equalisation guarantees a fair degree of horizontal equity in the distribution of Commonwealth general purpose revenue: horizontal equity provides a basis for interregional unity.⁵

Resource disparities affect the wellbeing of regional communities and this makes it more difficult to obtain consensus between different governments. Bearing in mind that the Commonwealth's taxing powers give it the capacity to determine unilaterally all grants to the States, fiscal equalisation takes on great significance.

The role of inter-regional transfers has been recognised in Europe, even if their form is different in nature and extent from Australian transfers. According to the EMU report, equalisation is 'an expression of solidarity' (Commission 1993:1). The report goes on to say that 'interregional solidarity should be expressed through central public finances, that is, resources should flow from richer regions of the union to poorer ones' (Commission 1993:5). As the report points out, this type of public finance equalisation is very different from the type of tax sharing and general and specific purpose transfers which take place between governments in a federal system, but it has, in part, a similar underlying rationale.

The relationship between political stability and regional economic disparities is recognised by economic experts in their assessment of *Community Public Finance in the Perspective of EMU* (Commission 1993). In their view, equalisation is a recognition of

the strong linkage between the political process in its various facets and Community responsibilities for spending and revenue raising.

They go on to say that

deepening and widening of the Community will bring to a head the question of whether it is willing to adopt more direct democracy, and a European Government in a long-term perspective (Commission 1993:v).

Equalisation of resources enables governments to have a significant impact on the lives of their citizens.⁶ In Australia, distribution criteria are applied to the bulk of State funds and, to facilitate consensus, the process requires a concentrated input from sub-national governments.

Government responsibility for fairness and equity is based on political obligation, with the consequence that there are virtually no limits to the number of different interpretations. When the Commonwealth government wants the States to agree to national standards, it has the advantage of using the plans for distribution of expenditure as leverage to push its own economic agenda. But, it is common for the States to oppose both Commonwealth policies and to disagree with each other over 'uniform' standards and different regional interpretations of the equity principle.

Some of these problems are common in other federal systems, also. In relation to Canada, for example, Boadway and Hobson (1993) suggest that federal standards are marked, first, by the inability of governments to agree to a uniform process and, second, by the ability of government to reconcile their differences through the adoption of national uniform standards. The following discussion explains how this process works in relation to federal reform in Australia.

The process for defining principles

In focussing, to this point, on imbalances in fiscal powers and the stabilising influence of fiscal equalisation in Australia's federal system, the capacity of Australia's federal structure to accommodate substantial reshaping of roles and functions of the various spheres of government over time is implicitly acknowledged. Some current State governments, such as the Court government in Western Australia, believe that the reshaping process has been excessively centralising. But on balance there seems little doubt that, for the most part, the capacity for reshaping has been to the benefit of Australia's citizen-voters. Intergovernmental policy competition often has resulted in the innovative development of policies and programs responsive to people's needs (Gerritson 1990).

It is an open question whether a subsidiarity principle embedded in the Constitution would have made any difference. It might have (even though, in itself non-justiciable) by requiring the High Court to recognise a federal balance principle that has been absent from its considerations for many years. But whether this would have resulted in better federal outcomes for the Australian people still would be a moot point. Roles and functions might have remained more fixed than was politically and socially desirable.

The fact is, however, that such a principle operative does not exist, and roles and functions have been shaped and reshaped according to political pressures and preferences. The cumulation of layers of overlap and intermingling of policies and program management that has resulted has, however, evoked responses from the States—responses which, interestingly, have seen them borrow the subsidiarity principle as a principle for guiding a process of federal reform. The process itself, however, was started by the Commonwealth as part of its search for ways of circumventing the constraints its reform processes faced as a result of State jurisdictional boundaries.

Over the past decade or so, both Mr Hawke and his successor, Prime Minister Paul Keating, have flagged an explicit change within the federal process. This usually inspires the Premiers also to earmark their place in the federalism reform agenda, particularly in relation to the allocation of funds and constitutional power. Western Australia, for example, has recently completed an audit of Commonwealth powers (Court 1994) and, for regional economic purposes, the South Australian government appointed a commission to audit state assets: the commission recommended significant public sector reforms in a report released in May 1994. (One of the authors of this paper was appointed as a commissioner to the Audit Commission.)

From the Commonwealth's perspective, federal reform questions generally are framed in broad strategic terms to suit current political circumstances and its own

political and economic priorities. They may be articulated in terms of an interpretation of federal principles, but, if so, the principles used typically will be opportunistic. The Commonwealth's approach is likely to be highly pragmatic—appealing in recent years to national efficiency and international competitiveness as essential drivers of federal-state reforms.

State responses also are likely to be pragmatic and attached to important broad federal principles. Typically, this has involved invoking appeal to the 'States rights' and the need to keep decisions close to the people. In an interesting departure from (or variant of) the usual response, at what turned out to be the end of a recent new federalism reform process, marked by more cooperation and intergovernmental decisionmaking than most new federalism policies, Australia's States and Territories presented to the Commonwealth a set of principles. These, they argued, would guide decisionmaking aimed at rationalising the roles and functions of the various spheres of government. For further discussion of these principles see Fletcher and Walsh (1992).

To a significant extent, the statement of principles compiled by the States and Territories reflected their frustration with the *ad hoc* pragmatic way Commonwealth politicians and administrators tended to approach reform of Commonwealth-State arrangements. For example, the reforms tend to reflect the managerialist elements of the Commonwealth government's own efficiency agenda often at the expense of the needs or demands of the regional communities which the States and Territories are supposed to represent. The reforms also contained elements which are explicitly hostile to the sharing of jurisdictions that is the hallmark of federal systems. Nonetheless, they are worth setting out in brief (see Communiqué 1991 for full details).

- The Australian Nation principle emphasised the virtues of collectivity, nationhood, unity and a single economic market, but also stressed the virtues of cooperation within a polity capable of tolerating institutional diversity, constitutional integration and economic equality.
- The subsidiarity principle was designed to defend the roles of state governments in regulation, and in the provision of core public sector services: subsidiarity was to be an accompaniment to the 'Australian Nation' principle, with governments recognising 'the capacity for choice and differences within a national framework'.
- The principle of structural efficiency emphasised the need for reform of intergovernmental relations to complement microeconomic reform in the private sector and sought also to address the perennial question of the structure of federal finances. Losing financial powers to the Commonwealth is seen by the States as the most significant cost of federation: the Commonwealth interprets this principle in terms reminiscent of a centralised unitary system where, unlike arrangements in the federal system, sub-national governments are, constitutionally, fully dependent on the national government (Walsh 1991).

- The accountability principle emphasised the need to make the roles and responsibilities of the various governments clearer and more transparent: the problem with this principle is that it advocates clear jurisdictions, is hostile to shared functions and, in the long run, probably constrains the natural competitive nature of sub-national governments.

New federalism defined

After Mr Keating became Prime Minister in 1991, the spirit of new federalism which gave rise to the States' statement of these principles went into decline. Mr Keating reinstated federal reform across the board but the more traditional centralising nature of his policy reforms put interpretations of Commonwealth and State relations outside of what was considered, by some, to be inherently 'good' for the future of Australian federalism: his 'One Nation' policy statement in 1993 abandoned the reform of financial arrangements which earlier had been promised to the States, and federal reform languished for 12 months or so before emerging in a revised form in early 1994.

One important principle to emerge from the 1994 February meeting of COAG was 'competition'. The Prime Minister and Premiers agreed to focus on developing this 'principle' through the restructuring of an existing organisation to be renamed the Australian Competition Commission.

The Competition Commission should not be confused with competitive federalism. Unlike Breton's (1987, 1991) theory of competitive federalism, State and Territory governments in Australia lack the fiscal independence necessary to increase their resource base. The Australian Competition Commission, and the policy changes of which it is part, is designed explicitly to reduce State powers to grant and protect the monopoly position of their business enterprises or to enter into arrangements and agreements which protect anti-competitive conduct (for example, with respect to state marketing authorities for agricultural products). In short, it represents a head-on challenge to the capacity of States to protect their regional economies and their regional institutions from the full forces of competition, in the interests of promoting national efficiency and competitiveness.

The *quid pro quo* being offered, in principle, is compensation to the States for their loss of monopoly rents. Fundamental reform of financial arrangements to allow the States to more directly share in the tax revenue benefits of greater competition and growth, however, is not contemplated. Once again, the Commonwealth appears to be seeking to reduce States powers in the so-called national interest.

The Communiqué (COAG 1994) recognises that, despite policy similarities between the administrative/policy functions of States and the Commonwealth, State and

Territory policies may have quite a different set of clients to those of the Commonwealth. According to the Communiqué

the Commonwealth's interest will most often be at the area of broad, jointly agreed, strategic goals, involving program planning and a concern for achievement of program performance and outcomes for clients (COAG 1994:13).

This is overtly administrative and reads more like the corporate plan of a central government in a unitary system than the set of political goals of a government whose authority is sustained by its uniform tax powers and yet limited by a strong federal culture. The Communiqué continues its managerialist line by outlining a uniform path of decentralisation for the sub-national governments as follows.

The States would share an interest in these matters and generally would have primary responsibility for program implementation and management. The Council also noted the view by the States that the Commonwealth involvement in operational management should be reduced to the greatest possible extent, consistent with ensuring that agreed national objectives are met (COAG 1994:13).

In this instance, an outsider could be forgiven for mistaking the Australian federal principle for 'subsidiarity' but this probably is due as much to perceptions of the need for 'management' of political conflict as to the Commonwealth's apparent corporatisation of government functions.

The centralising taxation powers of the Commonwealth give that government an advantage in the national decisionmaking process. But, this centralising financial power also, to some extent, leaves the Commonwealth in a politically incomplete position. The sharing of power is what gives the Australian system its constitutional virtues: political incompleteness forms the basis of the federal principle. However, notwithstanding the virtues of the system, governments are stony-hearted and it is clearly obvious that the Commonwealth sees itself as a financial monitor. Because computations of tied and specific grants are directly influenced by the Commonwealth running of its own agenda in the States, it uses 'management' language to strength its position. This was apparent across all areas of government that received attention at the February COAG meeting.⁷ As is usual, a prime objective of the COAG meeting was to define 'roles and responsibilities' and to 'eliminate overlap and duplication'.

Consensus and consent

Elazar (1987) has written extensively on the organising capacity of the federal principle. Federalism encourages the legitimacy of public forums for use by different communities either to endorse, or convey their consent, to government policymaking activity. Politically, this strengthens rather than weakens the position of the various governments

within the federation when the focus on shared policy functions is sharpened, for example, in relation to health policy, the social justice system or financial transactions.

The continuation of constitutional authority, recognition of sovereign institutions and the maintenance of economic stability are functions that take place in a process that thrives on a large amount of intergovernmental consensus. The reasons for this degree of consensus can be found in the registered needs of the different regional communities.

Consensus is organised into the system at every level: in terms of representation, for example, Australia is part majority rule and part consensus democracy.⁸ At the parliamentary level, where this combination is most observable, consensus democracy is institutionalised into the national parliament through the second chamber, the Senate. Unlike the upper chamber of the Westminster Parliament, the Australian Senate was designed to represent the States. In principle, the Senate is the national embodiment of federalism. It ensures the entrenchment of regions as equal partners to the federation.⁹ Also, most of the State parliaments are bicameral: the two mainland Territories and Queensland are unicameral.

Against this background, subsidiarity would appear somewhat shaky, except that, as with the process in other liberal systems, democracy is a paradox and, in Australia, judicial interpretations have forced policies into the path of centralisation. Many questions remain, particularly those that concern sub-national fiscal sovereignty.

Although the Australian States compete with each other for resources, there is little evidence to suggest that they unite against the Commonwealth except for partisan purposes.¹⁰ But, in relation to the Commonwealth's international status within the region, nothing in Australia comes close to the relationship linking members of the European Union. The States do have a role in the extent to which Australia ratifies its international treaty obligations but there is nothing to indicate that this influences their relationship with each other within the federal system.

The federalising process is an important consideration on a number of fronts, particularly for countries (such as Germany), which already operate a federated set of institutional arrangements. According to Sturm and Jeffrey (1992) the centralising process which shapes German federalism has the potential to alter further the intergovernmental balance between national and sub-national governments after European integration. Whether or not this is seen as a 'good' outcome depends on the key purpose of intergovernmental relations. Interestingly, but not surprisingly, on the basis of Sturm and Jeffrey's (1992) argument, the Lander (German States), at odds

with each other over resource allocation and, consequently, over equalisation issues, could conceivably unite against the direction of national monetary policy as their authority is increasingly eroded by the federal government's desire for a strong sovereign influence in European Union policy.

Regional support for government is derived from the direct endorsement by local constituents. Governments attempt to profit economically (and electorally) by promoting their regional strengths directly or by comparing the 'virtues' of their region with the 'disadvantages' of other regions. At this level, communities in federal democracies are supposed to have access to a great range of government institutions through which to place pressure on the national government to correct disadvantages. The Australian federal compact was believed to be the key to national unity mainly because, during the federation debates, it was a commonly held belief that federalism would only work if it received endorsement from all of the regional communities (Western Australia 1934). Consequently, constitutional recognition of the rights of sub-national communities underpins the economic concerns of both State and national governments.

For example, centralised monetary policy has the potential to affect regional political culture and, basically, political and economic stability cannot be achieved without local community endorsement. By most accounts, the architects of European Union know this, but for the sake of future security, they want to ensure that central governments in the European Union carry the 'burden of proof' for centralised power (Commission, 1993). Hence, the framers of the European Union will place constraints on their own powers. The nation state is free to control its own sovereignty and, at this stage, under normal peace-time circumstances, nation states have not agreed to recognise, as constitutionally superior, an outside replacement.

In a domestic context, rarely, if ever, does one government defer power to another without some form of resistance. Power is conceded with reluctance and national agreements are usually bound together by a set of principles which all parties acknowledge. Intergovernment agreements in Australia symbolise the difficulties inherent in reconciling differences between the respective governments. And, notwithstanding that the national government has a significant role in revenue raising, policy implementation in most areas of government falls within the jurisdiction of the States. State legislatures have a major role in formulating and enacting State laws in line with the political and economic concerns of the regional communities. In the following section some of the connections that legitimise and reinforce the links between regional political cultures and federalism are explained.

The legitimacy of regional political culture

Whatever the subtleties of regional differences in Australia, within the overall national framework different regional preferences become apparent when State legislators enact regional laws. Because of the nature of the constitution, the Commonwealth government has concurrent powers with those of the States and, for many purposes, laws operate in combination, in different political configurations. Across the country, State differences are apparent in policy areas which concern local governments, housing policies, land policies and, more recently, native title legislation.

Even when regional disparities are relatively difficult to measure, regional assumptions attract interpretations of the law and this can be strong enough to differentiate one region from another. Regional differences may be equally strong in unitary systems but, unlike regional governments in a federal system, regional governments which are governed from a central constitution do not have the same degree of legal security guaranteed (such as the Italian regional governments): they remain vulnerable to obliteration by an unfriendly or irresponsible powerful central government.

Laws are part of the connection between communities and governments: in principle, they indicate the community's desire for control or regulation. They indicate, also, governments' desire for power. Laws in Australia are, to varying degrees, sandwiched between national and sub-national governments: they are framed by either the Commonwealth constitution, State constitutions, or both. According to Finn's (1987) account of colonial legal development, laws in colonial Australia were Australianised from their very inception. In other words, despite their British roots, the interpretation of laws in Australia registered some of the assumptions of the colonials who enacted them. Ideally, interpretations incorporate the economic and political values of different communities in the country.

For the purpose of explaining how the organisation of authority affects the constituent governments in a federal system, it is clear also that legislation enacted by sub-national governments, together with entrenched regional administrative behaviour, has an impact on the way governments deliver services to their local communities. Similarly, in Europe, according to the Centre for Economic Policy Research, 'in principle, Community laws are implemented by the member states accordingly' (CEPR 1993:19).

The allocation of roles and responsibilities would be likely to be more clearly observable in a system that has been operating for a while than in the design of a 'new' system. For example, prior to federation in Australia, the regional colonial governments had their own administrative structures and when powers were 'allocated' to the newly-formed Commonwealth government in 1901, outside of tariffs,

customs and defence, there was little that could be allocated independent of the States. Nineteenth-century laws provided the bulk of Australia's legislative regime and State government publications indicate that many old laws remain on the books.

Conclusion

The organising principle of government varies from country to country, according to the constitutional framework. Governments, however well-intentioned, are constantly under pressure to maximise their authority. This is a key factor in the context of economic reform and, more often than not, in their desire to maximise efficiency, governments are generally enthusiastic for reform to take effect uniformly. As this paper has explained, uniformity needs to be responsive, particularly in systems where central government reforms override local policy preferences or where regional communities are experiencing the effects of economic transition. Federalism of the Australian variety provides a solution to governments which might otherwise find it difficult, if not impossible, to risk submerging their political and economic preferences within parameters established by other governments. Whether or not this holds true for other federal-style countries remains to be seen.

As this paper has illustrated, in Australia—aside from the Commonwealth's constitutional motives for attempting to control State and Territory expenditures—all of the intergovernment reform processes are supported by regional interpretations of the federal principle. The difference between this, and the type of 'decentralisation' motives attached to the concept of subsidiarity, can be found within a formal constitutional system which guarantees the existence of the European Union member states.

Basically, federalism represents a preoccupation with constraining powerful central government. It represents also, a preoccupation with the distribution of equity: the States frequently disagree among themselves over interpretations of the equity principle. Interpretations of equity and other such issues arise as a result of diversity. The Commonwealth government defines diversity as a 'cost' of federation and attempts to overcome diversity by encouraging the States to agree to national standards. Generally, the Commonwealth employs the distribution of expenditure as leverage.

The underlying message and central challenge of our paper to the European Union and its institutional designers is to demand that they more clearly articulate both their ultimate vision for the European Union as a political compact and their vision of the path, over time, by which the Union is to get there. If Europe ultimately is to be a fully

federal system of governance, with a constitutionally entrenched central government which has independent revenue raising and spending powers, then the subsidiarity principle, even if it could be operationalised, could be argued to be either irrelevant, or potentially dangerous, or both.

Subsidiarity is a principle capable of being all things to all people. While it undoubtedly has been rediscovered in recent times, principally to reassure nervous member states that the European Union is not about centralising power in Brussels or elsewhere, it is capable of re-interpretation (for example, via the prevalence of cross-border effects of member states' policies and actions) to be much more centralising in its effect. It is hard to see how the subsidiarity principle, therefore, could be used other than to help define the initial division of powers and responsibilities in a European constitution. Included as a principle in the constitution, even with some guidance as to its intended interpretation, subsidiarity surely would be a non-justiciable concept and, while not on that account totally irrelevant to constitutional interpretation and evolution, it might be less relevant to constitutional interpretation than to changing ideological predispositions about the appropriate roles and functions of different spheres of government.

This, it should be said, is not an altogether unhappy conclusion. Attempting to set roles and functions in concrete not only is futile, in general, but also positively dangerous. While federations, in earlier times, might have been relatively coordinate in their operation, increasing complexity, mobility and interdependence, combined with a (post cold-war of Eastern Europe) resurgence of an emphasis on cultural and/or regional identity, is creating a need, a demand, for a more cooperative or coordinative style (as well as form) of governance. In this context, subsidiarity may have a role to play as a guide to intergovernmental negotiation about the evolution, or redesign, of roles and functions, but not as a constitutional principle *per se*.

If Europe wants, and expects, to be truly federal, this argument about the role of the subsidiarity principle would seem to be compelling. As Elazar (1987) has repeatedly emphasised, federal systems of government, in essence, are systems of non-centralisation of power. Constitutions share, as well as divide, powers and responsibilities and, over time, the roles of different spheres change. These changes occur, as Breton (1987, 1991) particularly emphasises, because political competition between, as well as within, spheres of government is likely to lead to what conventionally has been seen as overlap and duplication, some of it, apparently, centralising in appearance.

If Europe, on the other hand, sees a long future of confederal-style union, subsidiarity, again, may have little more than a role of providing initial assurances of

non-centralising intentions. Given the role of member states in approving and funding the central (confederal) government, an operationalised subsidiarity rule may have more force than in a truly federal context. In the end, however, the methods used to operationalise subsidiarity would seem to be far from ideology-proof—it is, and will likely remain, a principle for all ideological seasons.

Notes

- 1 New South Wales, Victoria, Queensland, Western Australia, South Australia and Tasmania in descending order of current population size. New South Wales has more than 30 per cent of the national population and Tasmania less than 3 per cent.
- 2 The Northern Territory and the Australian Capital Territory.
- 3 The CGC initially was established in 1933 to recommend 'special grants' to the financially weaker states, but since the early 1980s has been given the role of recommending the general 'relativities' that should apply to the distribution of a pool consisting of Financial Assistance Grants (general revenue grants), and part of Hospital Funding Grants.
- 4 For an informative historical account and legal interpretation of subsidiarity leading to the European Union, see Cass (1992).
- 5 Boadway and Shah argue that fiscal federalism revolves around 'horizontal equity' in Canada (Boadway and Shah 1993:4).
- 6 Walsh (1992) refers to equalisation as the 'glue' which holds the federation together.
- 7 Resource policy is a key policy item on the COAG agenda including intergovernmental cooperation for the development of the natural gas industry, electricity regulation, national standards, water resources and attempts to reform a significant raft of government functions in general.
- 8 Lijphart's (1984) analysis of liberal democracies explains this type of classification in detail.
- 9 The lower house, the House of Representatives, represents majority rule.
- 10 This may require some qualification if we included the relationship between the States and the Commonwealth in the context of the Senate.

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Rodney V. Cole and Maree Tait (eds)

ISBN 0817-8038

Vol. 9, No. 1 June 1994

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