WHAT SHOULD WE DO WITH THE STATES?

COMMENTARY

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A INTRODUCTION

1. It is an honour to be asked to comment on David Jackson QC's paper this evening.

2. As Mr Jackson points out, Australian federalism has many elements. The federation came into being when the six colonies agreed to be united into a federal commonwealth under the Constitution. The origin of the Constitution in a negotiated agreement contributes to many of its important characteristics, not least of which is the integral role played by the States within the federal system. The States are so essential they must be considered key participants in any proposal for its reform. As Mr Jackson's paper makes clear, the States are here to stay. It is a pipe dream to think they might simply be abolished.

B. THE SENATE

3. And yet, it is widely thought that Australia's federal system is in need of reform. Several features of the system contribute to this belief. The first, to which Mr Jackson draws attention, is the failure of the Senate to represent the interests of the States. Quick and Garran thought the Senate was the chamber in which the States would be represented to protect their constitutional rights and defend their particular interests.[1] Quick and Garran are an indispensable first point of reference for understanding the meaning of the Constitution as intended by the founders. However, they were participants in the debate, and cannot be relied upon always to present the views of the founders accurately and impartially.[2] I don't question their impartiality on this particular point but I do question the completeness of their account.

4. There were two federal conventions held in the 1890s, the first in 1891 and the second in 1897-8. Delegates to the first convention were nominated by the colonial legislatures, and it is no coincidence the first convention proposed a Senate consisting of senators nominated by the State parliaments. By contrast, delegates to the second convention were directly elected by the voters (in four of the five colonies[3]) and they accordingly proposed a Senate that was directly elected by the people of the States. At both conventions an overwhelming majority supported equal representation of the States in the Senate, but the big difference was that the

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[1] John Quick and Robert Randolph Garran, *The Annotated Constitution of the Australian Commonwealth* (Angus and Robertson, 1901) 414.

[2] I discuss Quick and Garran's particular conception of federalism in Nicholas Aroney, *The Constitution of a Federal Commonwealth: The Making and Meaning of the Australian Constitution* (Cambridge University Press, 2009) 3-6, 119-128.

[3] Queensland did not attend the second convention. The Parliament of Western Australia chose to nominate its delegates.

first convention made the senators delegates of the legislatures, whereas the second convention made them representatives of the people.

5. When it was said (in the 1890s) that the Senate would represent the interests of the States, it needs to be recalled that for much of the time it was assumed senators would be delegates of the State legislatures. While not nominated by the State governments (as in Germany today),[4] such a system would have enabled State political leaders through the parliaments to nominate senators expected to act in accordance with State government interests. If such a system had prevailed, there is every likelihood the Senate would have represented the States much more tangibly than has proven the case. The decision to make the Senate directly elected by the people made this much less likely, and many of the founders foresaw this.[5]

6. An important exchange between Samuel Griffith and Alfred Deakin at the first convention laid bare the point of difference. Deakin supported direct election of senators by the people and he rejected the alternative proposition, advanced by Griffith, that the Senate should 'represent the states'. Deakin observed:

> I cannot conceive of an entity called the state apart from the people whose interests it embodies; nor can I conceive anything within the state which can claim an equal authority with the final verdict … of the majority of its citizens. If the hon. Gentleman has any metaphysical entity in his mind which can be placed above this, I shall be glad to learn its nature.[6]

7. Griffith did not attempt to describe any such metaphysical entity, but rather said that the States were to be understood as 'aggregations of their own people' and that 'the majorities of the separate States might be of a different opinion from the majority of the people of Australia, taken as one!'[7] Edmund Barton developed this idea by pointing out it would be 'possible for the representative principle to be … instituted … in two chambers just as well as in one.'[8] One chamber would represent the people of the Commonwealth, while the other would represent the people organised as States. As Charles Kingston later put it, 'while the

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[4] Donald Kommers, *The Constitutional Jurisprudence of the Federal Republic of Germany* (Duke University Press, 2nd ed, 1997) 96.

[5] In fact, John Quick's proposal that there be a second Convention directly elected by the voters (which would produce a constitution that would be submitted to the voters in a referendum) made the direct election of the Senate almost inevitable. See *Official Report of the Federation Conference Held in the Court-House, Corowa, on Monday 31st July, and Tuesday, 1st August, 1893* (Corowa: James C. Leslie, 1893), 27. On the possible role of Henry D'Esterre Taylor in first suggesting this procedure, see Alfred Deakin, *The Federal Story: The Inner History of the Federal Cause* (Melbourne University Press, 1944), 57-9. See also Quick and Garran, *Annotated Constitution*, 154, 160.

[6] *Convention Debates, Sydney* (1891), 74-5.

[7] *Convention Debates, Sydney* (1891), 78.

[8] *Convention Debates, Sydney* (1891), 91. See also *Convention Debates, Sydney* (1891), 63 (Thomas McIlwraith).

electors are the same, the electorates are different.'[9] '[U]nder a system of two chambers', he said, 'both voices ought to be heard – the voice of the nation and the voice of the States'.[10]

8. Kingston was speaking metaphorically when he referred to these two 'voices'. However, his application of the metaphor to *both* the 'nation' and the 'states' suggests we might just as well ask whether the House of Representatives has adequately represented the interests of the 'nation' as whether the Senate has adequately represented the 'states'.[11] Identifying such a 'voice', or 'interest' – of either the Commonwealth or the States – is always going to be elusive, and politically contested. What Kingston and his colleagues hoped for when they insisted on the bicameral design of the Parliament was that it would recognise the two constituencies which the two houses ought to represent. They were aware that to speak of some ascertainable 'voice' or 'interest' was to speak metaphorically, and that deliberation within the Parliament would involve a contest of many different opinions.

9. As such, the framers anticipated the Senate would not simply represent the interests of the 'States' as such. Thus, John Macrossan and Alfred Deakin were able to foresee, even as early as 1891, that party politics would shape the practical functioning of the Senate.[12] John Downer put it more idealistically when he pointed out that so long as the States were guaranteed equal representation in the Senate:

> state rights will come very little into these matters, and the results will be highly satisfactory, because we shall know that we really have become so much one people that these smaller considerations never occur to anybody at all.[13]

10. Downer suggested a successful Senate would be marked by such a sense of unity and national purpose that senators would not often or even usually vote in defence of 'States' rights'. John Hackett's observation was to similar effect. He argued the 'main function of the Senate' would be:

> to cement these isolated communities together, to make a dismembered Australia into a single nation, … to convert the popular will into the federal will … to give full voice to the wishes of the populace, but, at the same time, to take care before that voice issues forth as the voice of

[9] *Convention Debates, Sydney* (1891), 159. See also *Convention Debates, Sydney* (1891), 111 (Richard Baker).
[10] *Convention Debates, Sydney* (1897) 285.
[11] Philip O'Meara and Anna Faithful, 'Increasing Accountability at the Heart of the Federation' in Paul Kildea, Andrew Lynch and George Williams (eds), *Tomorrow's Federation: Reforming Australian Government* (Federation Press, 2012) 92, 95, point out that the kinds of matters routinely referred to as being in the 'national interest' are often as much the concern of the states as they are of the Commonwealth.
[12] *Convention Debates, Sydney* (1891) 434; *Convention Debates, Sydney* (1897) 584.
[13] *Convention Debates, Sydney* (1897) 269. See also *Convention Debates, Adelaide* (1897) 539, 646, 665.

> Australia that it shall be clothed with all the rights and duties of the federal will.[14]

11. On this view, equality of representation in the Senate ensured the people of each State were properly represented as 'a people', freeing them to engage in national debate in a non-parochial manner, knowing they were entitled to that equal share of representation which befits an independent polity, and could make use of this if their sectional interests were ever seriously in jeopardy.[15] In this sense, equal representation in the Senate would serve to unify rather than divide the nation, while at the same time recognising that, in essence, what was being created was a 'federal commonwealth' (or a 'commonwealth of commonwealths', as James Bryce put it)[16] and not simply a unitary state.[17]

C. COMMONWEALTH LEGISLATIVE POWERS

12. Mr Jackson is eminently qualified to explain how the shift of the High Court's approach to interpreting federal legislative powers in the *Engineers* case[18] has led to an inexorable expansion of Commonwealth power. He makes the very important point that not only has the legislative power of the Commonwealth grown, but this has had a knock-on effect for its executive power and the jurisdiction of federal courts, for as Commonwealth legislative power grows, so too does the power and jurisdiction of the federal government and courts.

D. MONEY

13. This year, we are contemplating the reform of the federation (yet again, you might say.) The Commonwealth government has initiated two coordinated White Paper processes, one focused on reform of the federation and the other focused on reform of the taxation system. The two issues are inextricably linked because the malaise of Australian federalism is closely associated with the decline of both the capacity and the willingness of the States to accept responsibility for raising their own taxation. Australia suffers from exceptionally high vertical fiscal imbalance.[19] This means the Commonwealth raises taxation far in excess of its own needs, and distributes the excess to the States. The States are dependent upon

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[14] *Convention Debates, Sydney* (1891) 280.
[15] As has happened very occasionally: see Campbell Sharman, 'The Australian Senate as a States House' (1977) 12(2) *Politics* 64, 70.
[16] Aroney, above n , 78-87.
[17] Much more could be said here about the practical operation of the Senate and its relation to federalism. These wider points are canvassed in Nicholas Aroney, Peter Gerangelos, James Stellios and Sarah Murray, *The Constitution of the Commonwealth of Australia: History, Principle and Interpretation* (Cambridge University Press, forthcoming 2015) ch 2.
[18] *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd* (1920) 28 CLR 129.
[19] *Issues Paper 5*, 26-34.

Commonwealth for more than 40 per cent of their budgetary needs, and this creates the buck-passing syndrome with which we are all familiar. The States blame the Commonwealth for insufficient revenue to perform their functions adequately; the Commonwealth blames the States for ineffective and inefficient provision of services; and citizens don't know who to blame, and generally end up blaming both.[20]

14. The Rudd government tried to fix the 'blame game' through reforms to the way in which federal funding is distributed and States are made accountable for its expenditure. But the accountability system seems, in practice, to have made the States more accountable to the Commonwealth than to the citizens.[21] The Commonwealth wields the whip hand over the States essentially because the States are dependent upon it for money.

15. While the confusion of responsibilities between the Commonwealth and the States is a major factor, the blame game will not come to an end until the States become directly responsible to their people for the efficiency and effectiveness with which they administer the revenues they receive from the people through taxation. The line of proper fiscal accountability is partially broken in our system because the State governments are not fully accountable to their people for the balance they strike between the taxes they impose and the services they provide.

16. If each State were made fiscally responsible to its people the benefits would not only be democratic. Such a system would provide greater incentives to States to innovate and compete.

17. Some fear this would lead to a 'race to the bottom' as each State seeks to reduce its regulatory and tax burden to encourage corporate investment and immigration of wealthy citizens. But there is another 'race' to be worried about. That is the tendency of governments to over-legislate and over-regulate. As Murray Gleeson has shown, a whole host of threats to the rule of law, civil liberties and democratic accountability accompany the incessant stream

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[20] Brian Galligan has observed: 'Vertical fiscal imbalance leaves the Commonwealth awash with money for which it has no need or policy purpose, inducing it to invent novel programs and generally expand Commonwealth spending for political and bureaucratic purposes. The large Commonwealth Departments of Education and Health are monuments to this tendency. Moreover, when times are tough, rather than prune its own expenditure, the Commonwealth is prone to cut grants to the States in vital policy areas of State jurisdiction for which it has no direct political responsibility. State grants tend to be used as a balancing item in Commonwealth budgets and an obvious source of savings.' Brian Galligan, 'Federal Renewal, Tax Reform and the States' (1998) 10 *Proceedings of the Tenth Conference of the Samuel Griffith Society* .

[21] See Alan Fenna, 'Commonwealth Fiscal Power and Australian Federalism' (2008) 31(2) *University of New South Wales Law Journal* 50; Nicholas Aroney, 'Reinvigorating Australian Federalism' in Michael White and Aladin Rahemtula (eds), *Supreme Court History Program Yearbook 2009* (Supreme Court Library Queensland, 2010) 75; Geoff Anderson and Andrew Parkin, 'Federalism: A Fork in the Road?' in Chris Aulich and Mark Evans (eds), *The Rudd Government: Australian Commonwealth Administration 2007-2010* (ANU E Press, 2010) 292.

of legislation and regulation produced by our parliaments and governments.[22] Given citizen and business mobility between jurisdictions, horizontal competition between States provides incentives to governments to avoid excessive legislation, regulation and taxation.[23] A balance has to be struck between decentralised competition and centralised cooperation.[24]

18. Others fear that by requiring the States to stand on their own feet, States with less capacity to raise revenue and provide adequate services will fall behind the other States. However, Australia has one of the most complex equalisation systems in the world to prevent this from happening. Despite the excessive complications in our current equalisation system, it may be argued some form of horizontal equalisation is needed.[25] But one does not need to have vertical fiscal imbalance to have horizontal equalisation.[26]

19. At present, our system distributes the revenue from a Commonwealth tax – the GST – among the States, and there is a lot of debate about the disproportionate impact of the formula on States such as Western Australia. But my point here is that the GST system contributes substantially to vertical fiscal imbalance. This is because the GST is used not only to help those States and Territories (such as the South Australia, Tasmania and Northern Territory) which need financial support, but also to make very substantial grants to the larger, wealthier States.[27] In other words, we have a system of middle-class and upper-class welfare in our federal system. States which do not need any financial assistance are nonetheless dependent upon Commonwealth grants. But it is possible to have horizontal fiscal equalisation without middle-class welfare. Equalisation can be used to support the more needy States without making the other States excessively dependent upon the Commonwealth.

20. In this context, Mr Jackson's suggestion that we revisit s 90 of the Constitution is worth considering. The constitutional transfer to the States of power to levy excise duties could be taken as a reform measure in itself, or be part of a more encompassing reform. On its own, it would provide the States with access to a broad-based, efficient tax which they could use to

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[22] Murray Gleeson, 'The Growth of Legislation and Regulation' (Paper presented at the International Conference on Regulation Reform, Management and Scrutiny of Legislation, Sydney, 9 July 2001).
[23] Charles M. Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64(5) *Journal of Political Econonomy* 416.
[24] Anne Twomey and Glenn Withers, *Australia's Federal Future: Delivering Growth and Prosperity* (Council for the Australian Federation, 2007) 13.
[25] For a strong counter-argument, see Henry Ergas and Jonathan Pincus, *Reflections on Fiscal Equalisation in Australia*, Submission to the GST Distribution Review (Commonwealth of Australia, 2012).
[26] John Brumby, Bruce Carter and Nick Greiner, *GST Distribution Review: Final Report* (Commonwealth of Australia, October 2012) ch 12; Tony Shepherd et al, *Towards Responsible Government: The Report of the National Commission of Audit, Phase One* (Commonwealth of Australia, 2014) ch 6.
[27] *Reform of the Federation White Paper: A Federation for Our Future: Issues Paper 5* (Commonwealth of Australia, September 2014) 31.

become fiscally more self-sufficient. Lest the overall tax burden be disproportionately increased, however, it would have to be accompanied by a reduction in Commonwealth taxation. The amendment of s 90 could be part of a package through which the GST became a State tax.

21. At least two issues would then arise. First, there may be efficiencies if a tax like the GST, even if transformed into a State-controlled tax, was to be administered by the Commonwealth.[28] Secondly, it would be relevant to ask whether re-entry of the States into the field of personal income tax might be a better option, such as through a 'piggybacking' arrangement whereby the Commonwealth lowers its income tax rates to allow room for the States to levy their own income tax surcharges at rates to be set by each State.[29] This second route would not require a constitutional amendment, as the only thing standing in the way of income tax reform is political will on the part of the Commonwealth and the States.[30]

22. These are, of course, questions for economists as well as lawyers, so I won't trespass any further. The important thing, to my mind, is that we find a way to reorganise the taxation system so the States are made more directly responsible for raising revenues they need to provide the government services their citizens expect.

CONCLUSION

23. This brings me to my last comment. Australians are said to be a pragmatic people. We are not very interested in theories or grand statements of political principle. But when it comes to the reform of our federation, principles and theories cannot be avoided. The framers of the Constitution knew this. They began their deliberations with a set of resolutions which set out general principles and features of the federation they wished to see created. While they

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[28] There are also issues about the roles s 90 currently plays in securing other important goals of the federation. By preventing the states from imposing customs duties s 90 enables the Commonwealth to adopt a national approach to trade policy, particularly as it relates to the importation of goods into Australia. This needs to remain a federal responsibility. By preventing the states from imposing excise duties s 90 removes a means by which the states might otherwise have been able to interfere with Commonwealth trade policy, noting the Commonwealth's jurisdiction over trade with other countries (s 51(i)) and the principle of freedom of interstate trade (s 92). Section 92, as currently interpreted, prevents the states from imposing protectionist burdens on interstate trade. If s 90 were to be amended to allow the states to impose excise duties, s 92 would still operate to prevent them from imposing discriminatory duties that have a protectionist effect as regards interstate trade. Thought would need to be given to whether this would need to be extended to prevent interference with Commonwealth trade policy so as to maintain, for example, a policy of free trade with other countries.

[29] Shepherd et al, above n , 70-71. Such an option was proposed by the Fraser government in the 1970s but without any reduction in Commonwealth taxes, and was therefore refused by the states.

[30] *Victoria and New South Wales v Commonwealth* (1957) 99 CLR 575 (Dixon CJ, McTiernan, Kitto and Taylor JJ; Williams, Webb and Fullagar JJ dissenting), upholding the uniform tax scheme except for s 221 of the *Income Tax Assessment Act 1942*, which required taxpayers to pay Commonwealth taxes before paying state taxes.

sometimes disagreed about what these principles would mean in practice, they recognised the need to secure broad consensus about the principles that would guide their deliberations. They were pragmatic, but they were also principled. While they knew the devil would be in the detail, they tried to put principles first.

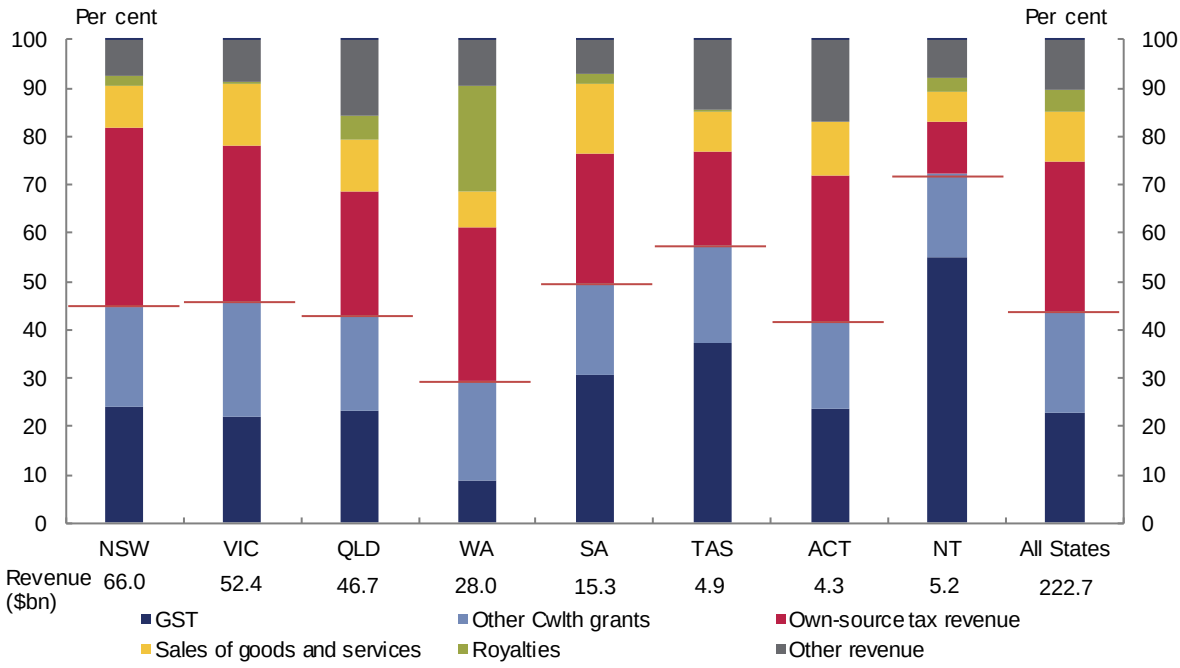
24. The White Paper process seems to be committed to the same way of proceeding. It is explicit about the guiding principles of the reform – subsidiarity, efficiency and effectiveness – and it alludes to the relevant theoretical frameworks – legal, political and economic – which help us understand the operation of our federal system and the possibilities for its reform.

25. But Australian pragmatism is also there to be seen. It is manifest in the way the Issues Papers move so very quickly from 'principles' to seeking 'practical' solutions to our problems. But, as I have argued elsewhere,[31] if we move too hurriedly to pragmatic questions our deliberations are likely to descend into self-interested debates about 'who' is to get 'what'. The risk is that for all this effort, we may get 'change', but not 'reform'. And then: the more things change, the more they will stay the same.[32]

26. Thank you.

[31] Nicholas Aroney, 'Federalism and Subsidiarity: Principles and Processes in the Reform of the Australian Federation' (Paper presented at the Attorney-General's Department Constitutional Law Symposium, Canberra, 1 May 2015), available at <http://ssrn.com/abstract=2604783>.
[32] Jean-Baptiste Alphonse Karr (1808-1890): 'Plus ca charge, plus c'est la meme chose.'

Figure 3.4: Revenue source by State and Territory; the level of VFI is beneath the red line[33]



2013-14 data. Source: State budgets, ABS. cat. no. 5512.0 and Commonwealth Final Budget Outcome 2013-14.

[33] *Reform of the Federation White Paper: A Federation for Our Future: Issues Paper 5* (Commonwealth of Australia, September 2014) 31.