SEVEN COMPELLING REASONS TO VOTE AGAINST THE LOCAL GOVERNMENT PROPOSAL

Suri Ratnapala, Professor of Public Law, the University of Queensland

The people of Australia will be asked in the near future to vote at a General Election to choose a new Parliament and government. They will also be asked to vote on a proposal to give constitutional recognition to local government bodies. The government hopes to achieve this aim by a simple amendment of s 96 of the Constitution. The proposed change has been presented as a harmless, modest and beneficial change to the Constitution that merely formalises existing funding arrangements between the Commonwealth governments and local government bodies. It is said to be designed for the welfare of local communities. My view, however, is that the proposal if approved at the referendum will be bad for the Federation, bad for the states, bad for local communities and bad for the national economy.

The proposed amendment, if approved, will amend s 96 of the Constitution by inserting words that empower the Commonwealth to make direct financial grants to local bodies on conditions determined by the federal government. It is an echo of Gough Whitlam's grand design for regional government directed from Canberra. The supporters of the amendment say that it does not constitutionally guarantee the existence, shape or form of local government bodies but leaves those matters to the judgment of state legislatures. This, as I argue presently, is not true.

There are **seven** compelling reasons to oppose the referendum proposal. First though, let us be clear about the present scope of s 96 and the change that is sought to be made by the proposed amendment.

Section 96 as it stands today reads:

> **96.** During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides, the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.

This section, on the face of it, was an innocuous provision. It enabled the Commonwealth to grant financial assistance to the states on conditions that Parliament determines. The states had the power to reject these grants if the proposed conditions were unacceptable. Although the conditions must be determined by Parliament, the High Court has allowed Parliament to delegate that power to a minister. (*Deputy Commissioner of Taxation (NSW) v Moran* (1939) 61 CLR 735) Therefore, it is not always Parliament that determines conditions in practice but the federal executive.

Given the federal nature of the Constitution and the limits of the Commonwealth's legislative powers, it was inconceivable that the authors of the Constitution intended by s 96 to create a new source of federal power that is virtually unlimited. The conditions that the founders intended to attach to grants under s 96 were financial conditions that enable the Commonwealth to use State agencies to achieve objects that fall within Commonwealth power. However, as the eminent constitutional lawyer P H Lane has said, the High Court has interpreted s 96 in ways that allow the Commonwealth to 'invade traditional State domains and dictate State policy'. (Lane 1986, 548)

This expansion of federal power was engineered in two stages. First, in 1926, the High Court ruled in *Victoria v Commonwealth* (1926) 38 CLR 339 that the power in section 96 was not limited to the achievement of objects within the enumerated areas of federal power. It meant that the Commonwealth could make grants to States on conditions that allowed it to regulate public policy in fields from which it was excluded by the Constitution. This ruling by itself was not catastrophic as the States could still refuse to yield their authority by not agreeing to conditions that the Commonwealth proposed. The Commonwealth has no ***legal*** power to compel the states to accept

the grants or agree to its conditions. However, the High Court's interpretation of s 96 has allowed the Commonwealth to gain a ***virtual*** power to compel the States to accept its terms.

In the second stage, following the end of World War II, the Commonwealth succeeded in gaining a monopoly of the power to impose income tax to the exclusion of the states. This was done by legislation that provided for grants to be made to states on the condition that the states do not exercise their undeniable legislative power to impose state income tax. In 1957, the High Court approved this arrangement and thereby further widened the federal power under s 96. (*Victoria v Commonwealth (Second Uniform Tax Case)* (1957) 99 CLR 399) The Commonwealth already had a constitutional monopoly of customs and excise duties under s 90, which meant that the States have no capacity to impose sales or consumption taxes. The combined monopoly of sales, customs and income taxes makes the Commonwealth of Australia one of the most fiscally imbalanced federations in the democratic world. The High Court by its interpretation of s 96 has reduced the States to financial dependency.

Section 96, the way it has been judicially construed, has become a powerful weapon in the Commonwealth armoury in its hundred year campaign to reduce the States to irrelevance. The proposed constitutional amendment seeks to make this weapon even more potent. The amendment, if approved at the referendum, will allow the Commonwealth to make conditional grants to any local government body formed by a law of a State, on such terms and as the Parliament thinks fit. Section 96, if amended as proposed will read:

> 96. During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides, the Parliament may grant financial assistance to any State, **or to any local government body formed by a law of a State**, on such terms and conditions as the Parliament thinks fit.

As I said before, Parliament's discretion, according to the High Court, can be exercised by a federal minister. This means that the Commonwealth executive can by-pass the State governments and State legislatures in critical areas of policy. Let me now explain my reasons for opposing this amendment.

Reason 1: Federalism is a worthy ideal to be defended against the proposed amendment

There are pragmatic, moral and economic reasons for a nation to choose a federal form of government. The first and pragmatic reason is that a federal system is a device that prevents the concentration of power in the hands of one central government. Where power is dispersed as in a federation, the likelihood of one political party or faction imposing its will in an oppressive manner is greatly diminished. James Madison, the political philosopher sometimes called the Father of the US Constitution, and that nation's fourth President explained the pragmatic reason as follows:

> This policy of supplying, by opposite and rival interests, the defect of better motives might be traced through the whole system of human affairs, private as well as public. We see it particularly displayed in all the subordinate distributions of power, where the constant aim is to divide and arrange the several offices in such a manner as that each may be a check on the other - **that private interest of every individual may be a sentinel over the public rights.** These inventions of prudence cannot be less requisite in the distribution of the supreme powers of the State. (Madison 1982, 263)

The second and moral reason is that political decisions must be made by persons accountable to those who are most affected by the decisions. This is the philosophical principle of subsidiarity, according to which, local matters must be decided locally and not by some remote central government. It means, for example, that decisions which especially affect the lives of Queenslanders

should be taken by people responsible to the Queensland electorate and likewise in the case of every other State. Similarly, the residents of Toowoomba should be able to have a special voice in determining matters that exclusively affect them. The principle of local government serves this end. However, the ideal of subsidiarity demands that physical configuration of regions for local administration and the constitution, powers and procedures of the local government bodies should be determined by the people of the State through their elected parliament and not by a remote central government. The power to intervene in local governance that the proposed amendment seeks to invest in the federal government subverts the principle of subsidiarity and is a direct attack on the federal design of the Constitution.

The third, economic reason is that a well-designed federal scheme is more economically efficient than unitary forms of government. This is the theory of fiscal federalism which I will address presently.

The proponents of this amendment claim that it only formalises the long standing practice of direct federal funding of local government. However, constitutional propriety of this practice was thrown into serious doubt by the recent decision in the *Williams Case*. (*Williams v Commonwealth* [2012] HCA 23; (2012) 86 ALJR 71) This decision makes it clear that the Commonwealth has no *general* power to fund activities except under the authority of valid laws or valid grants under s 96. Since the Commonwealth has no legislative power to make laws for local government which is the preserve of state legislative power, it may, at present only fund local councils through the State governments under conditions acceptable to State governments. This is the constitutional position after *Williams v Commonwealth*. The real object of this amendment therefore is to remove this constitutional obstacle so that the federal government may in the course of time become the master of local government.

Reason 2: The amendment will interfere with the power of state parliaments to make arrangements for the local administration of the state.

The proposed amendment, despite the protestations of its proponents has the potential to entrench local government in the Australian Constitution in a manner that will diminish the states' power of oversight and legal control. Consider the following hypothetical scenario.

The territorial limits of the Toowoomba Regional Council, its constitution and powers are determined by State legislation (currently the *Local Government Act 2009* as amended by the *Local Government and Other Legislation Amendment Act 2012*). Imagine that under the power created by the proposed amendment to s 96, the Commonwealth government offers a very large grant to the Toowoomba Regional Council on the condition that it carries out certain federally determined policies within its area of authority. The conditions may relate to practically any subject. There could be, for example, a condition that requires the Council to pass by-laws that prevent land owners within the Council area from managing or cutting down trees on their properties without the approval of a Commonwealth officer. Imagine that the Council, for whatever reason, accepts this condition as an offer too good to refuse. If in the future, the Queensland parliament wishes to reconstitute the Toowoomba Regional Council, or modify its powers, there can be a conflict between state law and the conditions imposed on the Council under s 96. This conflict will have to be resolved in the end by the High Court. The Court might hold in favour of the state but it is not beyond the realm of possibility that the justices may decide that the Council's legislative power, or for that matter, its territorial jurisdiction, cannot be changed while the conditions are in force. If this happens, the capacity of the Queensland Parliament to determine local government arrangements for the State will be seriously weakened.

Reason 3: The amendment will erode the legislative power of State Parliaments

Section 96 as it stands is a means by which the legislative power of a State parliament may be reduced. The Commonwealth by its overwhelming financial power can induce a state legislature to change the state law on any subject. This is plain from the High Court's decision in the *Second Uniform Tax Case*. At least, at present, the elected state government has, in theory and law if not in practice, the capacity to reject the demands of the Commonwealth by refusing to accept the grant. If the proposed amendment becomes law, the elected government will have no capacity to reject conditions attached to federal grants to local bodies. The decision of a local authority to accept conditions under s 96 will be binding on the state parliament. These conditions will override all State laws that are in conflict with them. The state parliament will not be able to make any laws that conflict with the conditions accepted by the local council.

The will of the people of the state will then be defeated by a local council acting in concert with the federal government.

Reason 4: The amendment allows the Commonwealth government to interference with state policy

The Australian Constitution divides political power between the Commonwealth and the states. The Constitution limits the federal legislative power to specific subjects and leaves other areas to the jurisdiction of the States. The Constitution therefore divides responsibility for economic and social policy between the Commonwealth and the states. It is true that the Constitution grants the Commonwealth extensive powers to manage the national economy. However, the Constitution also envisages the separate and independent existence of the States. As Chief Justice Latham said in the *Melbourne Corporation Case*, the states are not in the position of subjects of the Commonwealth. (*Melbourne Corporation v Commonwealth* (1947) 74 CLR 31, 55) 'The Constitution', the Chief Justice said, 'is based upon and provides for the continued co-existence of Commonwealth and States as separate governments, each independent of the other within its own sphere'. ((1947) 74 CLR 31, 55) A state's legal existence is meaningless unless it has economic existence. The populations, resources, agriculture, industry and commerce of local government regions are integral to the state's economy. States must be able to prioritise their economic objectives and choose their economic strategies. It is important to remember that in a state like Queensland, a local government area will cover an extensive territory encompassing townships, farmlands and wilderness areas. To the extent that the federal government gains control of the economies of the regional units, the State loses control of the state economy. At present, and in the past, the Commonwealth has been inhibited from exerting too much direct control of local government because of constitutional uncertainties. If the proposed amendment becomes law, the Commonwealth's temptation to defeat trump policies by controlling local bodies will naturally grow.

Reason 5: The proposed amendment weakens fiscal federalism

Fiscal federalism means the decentralisation of the power to regulate economic activity. Fiscal federalism invites contrast with centralised command and control systems. There are persuasive studies in international economic literature that show the superiority of fiscal federalism over unitary economic systems. (Tiebout 1956, Oates 1999, Weingast 1995, Hayek 1939/1948, Brennan and Buchanan 1980; Sorens 2011)

Sorens correctly identifies four aspects of an ideal form of fiscal federalism.

1. State governments enjoy policy autonomy, i.e. exclusive authority to decide a subset of economic policy.
2. States have to fund their spending largely out of their own tax revenue.

3. There is a common market within the federation to ensure free flow of goods, capital, and labour among the states.
4. The division of powers is constitutionally guaranteed and the central government cannot change it at its will. (Sorens 2011, 208)

There are three principal reasons why a nation should promote fiscal federalism. First, it increases fiscal responsibility of government. Second, by devolving power, it promotes more informed economic laws and policy. Third, it generates jurisdictional competition leading to better institutions nationwide.

The aspects 1 and 2 noted above capture the revenue and spending sides of government. The capacity of a government, whether central or provincial, depends on its power to raise revenue (mainly by taxation) and the power to spend. Empirical studies show that government tends to be smaller and more efficient where the states are responsible for both revenue raising and public spending. Then, the capacity of a state to spend beyond its means is limited by its capacity to raise revenue. People of the state become more empowered to demand either better public goods or lesser tax burdens or both of these. The desirable system of fiscal federalism is where the powers of taxing and spending are in the same hands. In Australia, the states' powers of independent revenue-raising have been diminished since federation. The connection between revenue and spending responsibilities has been fractured by High Court approved federal legislation and the s 96 conditional grant mechanism. Consequently, state governments have to go cap in hand each year to plead for a share of federal tax revenue. Economists call this situation vertical fiscal imbalance. In Australia, taxation power is more centralised than in other federations. Even formally non-federal countries such as Sweden and Japan have greater decentralisation of taxation power. (Sorens 2011, 213)

The proposed amendment will worsen this fiscal imbalance. The amendment creates a new source of spending and regulatory power. It allows the Commonwealth to undertake new activities within state jurisdiction without state government agreement. It would be a constitutional game changer. The new spending power is likely to lead to higher federal spending, to larger budget deficits and therefore to higher taxes and debt. This at least is what history suggests.

The second reason for fiscal federalism is that it leads to more informed and responsive governance. Economic policy to the extent that it can promote prosperity must be informed by relevant local knowledge. As the Austrian School of economics has argued, no central planner is capable of commanding all knowledge specific to time and place. This is true of central as well as regional governments. Hence the idea of central planning is wholly misconceived – a fact repeatedly demonstrated by the histories of failed socialist states. (Mises 1949; Hayek 1945, Kirzner 1997) However, as between a central government and a state government, the local economy is likely to be served better by a state government that is elected by and responsible to the people of the state.

The third advantage of fiscal federalism is the jurisdictional competition that it promotes by encouraging arbitrage. Individuals and capital are drawn to states with less regulatory burdens, lower taxes, and open, incorrupt and efficient administration. This competition tends to improve the overall performance of the national economy. It is not surprising that the most prosperous of the larger industrialised nations are federations or else unitary systems that have substantially decentralised fiscal and revenue powers.

The proposed amendment weakens these advantages by further centralising spending and regulatory authority and by diminishing the capacity of the states to determine economic policy that is fundamental to their existence as viable units within the federation.

Reason 6: The proposed amendment does not improve local government

Local government is important for good governance. There are some public goods that are especially the concern of local communities. The functions of local government bodies differ from state to state and from country to country. At a minimum, local government has responsibility to create and maintain local infrastructure and public spaces, to provide certain essential public services such as sanitation and to engage in urban planning. In the past, local authorities in Australia provided public utilities such as electricity, town water and gas. In some countries, local bodies administer public schools and local health services. In some countries such as the US and Italy they maintain police forces. The territorial size and powers of local authorities are variable. More than one local authority may administer a local community in relation to different functions. There used to be town councils and county councils performing different functions in the same community. In the United States there are school boards that administer public education and hospital boards that manage public hospitals. These are all specialised local government bodies. The size, functions and powers of the various local authorities are determined having regard to geography, economic and administrative efficiency and historical, geographical and cultural factors. These are matters are best left to state parliaments whose members bear closer connections with and electoral responsibility to local residents.

As I have previously shown, if the proposed amendment is enacted, the powers and functions of local bodies can be altered by the federal government without reference to the state governments. A local body by agreeing to federal conditions in exchange for federal largesse can avoid its obligations under state law and gain new regulatory powers. Moreover, the local body through this stratagem may undermine the state parliament's supervisory power over it. This cannot be good for the local communities whose last resort against a corrupt or incompetent local body is an appeal to the state government and state parliament.

The proposed amendment, as I argued previously also fractures the accountability between the local government and the local community of rate payers it is meant to serve. The principle way in which this responsibility is maintained is by the financial dependence of local government bodies on the revenue raised from the local community by way of rates and charges for services. This accountability can be defeated by the proposed extension of federal power under s 96. Consider this example. The local community does not like the federal government's policy on vegetation management within its local area. The local council however, for idealistic or corrupt reasons agrees to implement the federal policy in return for the grant. The local community may turn out the local administration at the next local election. But the new local authority will still be bound by the federally imposed conditions unless it is able to renegotiate the terms of the grant with the Commonwealth government.

Reason 7: The amendment will allow the Commonwealth to subvert the Australian Constitution

Section 96, as its stands has been used in the past to avoid prohibitions set out in the Constitution. In the past, the Commonwealth used s 96 grants to avoid paying compensation for private property acquired for its use. Section 51(xxxi) permits the acquisition of private or State property only on just terms, meaning that reasonable compensation must be paid to the owners from whom property is taken by the Commonwealth. The states, unfortunately, are not bound by the s 51(xxxi). The Commonwealth has avoided the just terms requirement by making the states acquire private property without paying just compensation in exchange for grants made under s 96. In 1951, the High Court refused to condemn this subterfuge. (*Pye v Renshaw* (1951) 84 CLR 58) Recently, however, a majority of the High Court rectified this gross error and held that s 96 grants which require a state to acquire private property on its behalf without just compensation are not

constitutionally valid. (*ICM Agriculture Pty Ltd v The Commonwealth* (2009) 240 CLR 140, 170, 238).Yet, the Commonwealth, with the approval of the High Court, has been able to avoid other constitutional prohibitions. Consider this remarkable example.

The Constitution as it was written down prohibits discrimination between states or parts of states. This is a fundamental feature of the federation. I refer in particular to two provisions of s 51.

> **51.**The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to: -
>
> **(ii.)** Taxation; but so as not to discriminate between States or parts of States:
>
> **(iii.)** Bounties on the production or export of goods, but so that such bounties shall be uniform throughout the Commonwealth:

These two provisions were intended to prohibit the Commonwealth from discriminating between states or regions of states in imposing taxes or in providing assistance to trade and industry. The Commonwealth cannot, for example, impose by law a higher income tax on Queenslanders than on the residents in other states. The Commonwealth, likewise, cannot by law subsidise only the farmers of a selected state. The Commonwealth also cannot discriminate between regions within one state. However, the High Court has allowed the Commonwealth to discriminate among states in subsidising industry by the stratagem of distributing funds, not by a law made under its legislative powers, but by making different payments under the s 96 grants power. (*Moran v Deputy Commissioner of Taxation (NSW)* (1940) 63 CLR 338, (PC); *Commonwealth v Morton* (1968) 117 CLR 383)

Section 96, as it stands today, allows grants only to the states. However, once this section is amended, the Commonwealth can make conditional grants to parts of state. This means that, according to the High Court's reading of s 96, the grants powers can be used to discriminate not only between states but also between regions of a state. The government in power in Canberra will have an additional legal capacity to favour one region as against another. In the context of Queensland, this means that the Commonwealth can favour or punish particular regional councils as against others. The major political parties may rejoice for they can, in government, use this new power to impose its will on recalcitrant states, or worse, buy votes in critical electorates at elections. But I ask you, what would it do to democracy, or to political morality, or to sound economic policy?

A final thought

The proposed amendment may look innocent but, for the reasons that I have explained, is a calculated assault on the fundamental structure of the Australian Constitution. The Australian federation is a system of vertically divided power in which the Commonwealth and the states have their assured spheres of governance. The federal-state balance that the delegates of the Colonies painstakingly worked out has, since federation, been reweighted in favour of the centre by the High Court's endorsement of the Commonwealth's expansive legislative claims. Even so, there remain significant constitutional limits to the Commonwealth's powers. It may only legislate on specified areas. It can only spend public money for the purposes identified with its legislative sphere. Its so-called nationhood power is limited to situations of national emergency. Importantly, it can make grants of public funds under s 96, as it stands, only to the states and only on conditions that the states are at legal liberty to reject. However, as I have explained, the proposed amendment if enacted will further erode the remaining capacity of the states to manage their own affairs and will further threaten their legal, political and economic existence. If enacted, it will cause irreparable harm to the Australian polity and economy.

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