GOVERNANCE TRANSITIONS IN FEDERATIONS: AGENDAS FOR CHANGE IN INDIA AND AUSTRALIA

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Abstract

This paper makes a comparative analysis of strategic issues in federal governance in India and Australia. Despite large differences in history, context and scale the two countries share overlapping agendas for change in federal arrangements. Both are about the hard task of promoting collaboration and managing intergovernmental competition in uncertain times. The paper is exploratory. It draws on the extensive literature on federalism in both countries to examine agendas and processes of change. It focuses in particular on the path to economic liberalisation in both countries and the impacts of liberalisation on the management of intergovernmental relations. In doing so it examines drivers of change, blocking points and evolving arenas for negotiation. Of particular interest are the shared struggles to negotiate coordinated national policies (especially for economic management), maintain momentum for reform, and enlist the cooperation of state governments for national projects while managing the temptation to cut the policy space and resources that would enable state governments to take valued local initiatives. The paper proposes that the extent of the shared themes encourages further comparative analysis.

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INTRODUCTION

This paper makes a comparative analysis of strategic issues in federal governance in India and Australia. Despite large differences in history, context and scale the two countries share overlapping agendas for change in federal arrangements. Indian agendas often foreshadow major challenges to principles, structures and processes but change is gradual. Australian agendas tend to focus on how to make more effective use of the well developed institutional frameworks now available. However, both are about the hard task of promoting collaboration and managing intergovernmental competition in uncertain times.

In both countries agendas for change flow from two linked sources. First is the continuing impact on public policy and management of initiatives in economic liberalisation in the 1980s and 1990s. Second are the ongoing challenges of managing intergovernmental relations in a federal system. Shared themes include: proposals that are substantial, fluid and contested; federal financial arrangements that heavily favour national governments; negotiation with multiple institutions and interests as a prerequisite for effective intergovernmental cooperation; and impacts of economic globalisation that enhance policy and management scope at the centre and put pressure on the scope of state governments (Rao and Singh 2007, Bagchi 2008, Keddie and Smith 2009).

Comparison is assisted by shared experience. India and Australia are both federations with systems of responsible cabinet government. Their federal compacts share explicit reference to earlier federal experience in the US and Canada. Comparison is assisted also by the explicit role of bargaining between levels of government and a preoccupation with fiscal relationships (Singh and Vasishtha, Rao and Singh 2007, Singh and Srinivasan 2008, Grewal and Sheehan).

As Grewal and Sheehan state:

federal constitutions are incomplete contracts and, in being so, provide opportunities for governments to compete with one another over policies. Thus, there is an inherent rationale for intergovernmental competition for wider legislative competence in every federal constitution.

Grewal and Sheehan argue further that, no matter how detailed a federal constitution (and the constitution of India is very detailed), the assignment of powers evolves over time; federal arrangements are shaped not only by exogenous forces but also by intergovernmental competition and cooperation; and fiscal relations are determined less by distinctions between conditional and unconditional transfers and more by the ‘overall financial dominance of one level of government over another’. For these reasons federal systems are always in transition.

Comparison is encouraged further by previous studies, both official and academic.

India’s establishment of Finance Commissions, appointed every five years to manage federal/state financial relations, followed an official mission in 1946 to Australia (Kapur, Nehru, Copland and Rickard). Members of the Twelfth Finance Commission closely examined fiscal federalism in Canada and Australia (Rangarajan and Srivastava 2004a, 2004b). Later work by the same authors also used Australian material (Rangarajan and Srivastava 2008). Also, research on federal financial relations in Australia has been enriched since the 1970s by Professor BS Grewal, whose studies of federalism began in India. Further, both India and Australia are included in recent studies in comparative federalism (Hueglin and Fenna), an international conference on federalism in India and Australia in 1996 observed a shared capacity for evolution (Copland and Rickard) and India and Australia are included in a recent volume on federalism in Asia (He, Galligan and Inoguchi).
Finally comparison is encouraged by the impacts and official response in both countries in 2009 to the global financial crisis. In both countries central governments launched economic stimulus packages which not only reinforced the influence of the centre but also cut funds available for discretionary intergovernmental transfers. Neither country experienced problems of debt fuelled consumption and regulatory failure in banking and finance, as in the US and some parts of Europe. But the crisis gave both a powerful shock. If in India and Australia the crisis did not create new problems it gave many existing ones new force.

The paper is exploratory. It draws on the extensive literature on federalism in both countries to examine agendas and processes of change. Its uses ‘structured, focused comparison’ (George and Bennett). It focuses in particular on the path to economic liberalisation in both countries and the impacts of liberalisation on the management of intergovernmental relations. In doing so it examines drivers of change, blocking points and evolving arenas for negotiation.

It accepts that the dynamics of the complex patterns of policy and management flowing from federal arrangements resist easy explanation. It looks therefore for strategic interactions. Following Kingdon (1995) and Seldon (1996) it proposes that critical sets of interactions include those between ideas, advocates, interests, institutions and events. None of these factors provides convincing explanations on its own. However in conjunction they can be persuasive. For example, ideas may lie fallow for years before an opportunity to apply them arises. Similarly, events may foster or foreclose opportunities to apply new ideas. Further, interaction between factors can lead to reciprocal change. For example, institutional resistance to particular ideas may, following an appropriate opportunity, lead to new directions in which both ideas and institutions are modified. Such a framework is used explicitly by recent studies of economic management in India (Jenkins 2003, Kapur, Mukherji 2004a). Compatible frameworks are used also to explain economic liberalisation in Australia (Argy, Brennan and Pincus).

The paper is organised as follows: for each country a summary of key federal arrangements is followed by examination of its path to economic liberalisation and impacts on the management of intergovernmental relations. This is followed by a comparison of agendas for change. Of particular interest are the shared struggles to negotiate coordinated national policies (especially for economic management), maintain momentum for reform, and enlist the cooperation of state governments for national projects while managing the temptation to cut the policy space and resources that would enable state governments to take valued local initiatives. These are very familiar themes. But recent Indian and Australian experience puts them into sharp relief. The paper proposes that the extent of the shared themes encourages further comparative analysis.

Federal Arrangements and Agendas in India

Federal arrangements in India have evolved under strong forces that push in different directions. The Indian union began as a ‘holding together’ federation. Following the tragedy of partition and incorporation of the princely states the drafters of the constitution made extensive use of the colonial Government of India Act 1935, designed to ensure a strong centre. The states have no separate constitutions, the centre can amend state boundaries and create new states, state Governors are in effect agents of the Prime Minister, under President’s Rule Governors can take direct control of state administrations, and amendments to the constitution, despite intentions to the contrary, can be made readily. Arrangements for fiscal transfers to the states, allocated in the constitution to successive Finance Commissions, expanded to include decisions of the Planning Commission, grants from central ministries, and the custom of providing top ups to states in fiscal difficulty. Creation of a substantial network of central state owned enterprises and nationalisation of banks added also to central influence.

However pronounced unitary tendencies jostle with forces for decentralisation. Central policy leadership is subject to multiple challenges. Court decisions have discouraged imposition of President’s Rule. An institutionalised system of national and state planning battles with short
term political bargains. The dominance of the Congress Party at the centre and in most of the states has gradually eroded. Related decentralising forces include: internal social and economic diversity (28 states, 7 Union territories, 26 scheduled languages), the prevalence of coalition governments at the centre, the emergence of parties representing regional interests and underprivileged groups many of which hold office at state level, the participation at any one time of some of such parties in central coalitions, and decentralisation of powers to layers of local government. Emboldened by the relaxation of central regulation in 1991 state governments took opportunities to impose their own restrictions. However the tasks of promoting an effective national market, managing international economic relations, coping with fiscal indiscipline at state level, and a tendency for the toughest electoral conflicts to be played out at state rather than federal level, gave new bite to central influence. An example illustrates the sharpness of with which such contradictions apply: in the early 2000s increases in the political power of state governments were matched by increases in their fiscal dependence on the centre (Bardhan 2003).

Contradictory forces are managed through explicit bargaining and discussion (Singh and Srinivasan 2008). Forums for such interaction are both formal and informal. An Inter-State Council, created in 1990, provides a limited overall forum. Formally constituted committees, for example of finance ministers, are often used to reach collective agreements on specific matters. However, much important business is conducted through informal and ad hoc arrangements. A key question among informed observers is whether, in view of the range of matters demanding intergovernmental negotiation, such arrangements are sufficient.

Paths to Economic Liberalisation

In India the transition to a more market based economy followed a history of smothered initiatives. The transition began at the centre, focused first on relaxing central restrictions and drew bipartisan support at the national level. Pragmatic, incremental initiatives, taken after assembling support from diverse stakeholders, slowly accumulated (Mukherji 2009). Higher and sustained economic growth took place. However, the sectoral coverage of initiatives left many gaps. Further, and critically, they were not supported by explicit strategies for coordination with the states.

Critiques of India’s planned economy began early. In 1948 socialists split from the Congress Party because its policies were not socialist enough. Similarly, others left Congress because it was building a licence-quota-permit raj. Balance of payments crises in 1957, 1966, 1973 and 1981 led to short-lived and ‘erratic spurts of liberalization’ followed by ‘a return to import-substitution and increased regulation’ (Sridharan). Following the death of Jawaharlal Nehru in 1964 his successor Lal Bahadur Shastri took unexpected initiatives in deregulation. But Shastri’s own death in 1966 brought these to an end. It has been argued that, in any case, the ‘majority of Indian business, intellectuals, and political elite’ would have provided Shastri with little support (Mukherji 2009. See also Kale). More small steps took place at the start of Indira Gandhi’s emergency in 1975, became more focused in the early 1980s and gathered pace under Rajiv Gandhi before faltering after election setbacks in 1987 (Kale). However developments under Rajiv Gandhi left important legacies. These included: some industrial deregulation, corporatisation of parts of the telecommunications industry, a government fostered and forward looking industry association (Confederation of Indian Industry), software sector exports, research in central agencies—Prime Minister’s Office, Ministry of Commerce and Industry and Ministry of Finance—on economic liberalisation, and close study of economic growth in East and South East Asia, particularly Malaysia. Such legacies led to growing awareness by successive leaders that economic management could be done differently (Mukherji 2009. See also Panagariya 2009).

In 1991 these trends provided domestic support for a change of direction and continuing reform. The need to seek IMF assistance to handle another balance of payments crisis provided an opportunity to change. Political leadership, dramatic diagnosis of the problems, credible proposals for change, and the acquiescence of industry leaders enabled the central government
to take the opportunity. Prime Minister PV Narasimha Rao backed the tough decisions proposed by Minister of Finance Manmohan Singh and formulated by senior civil servants (Panagariya 2009). The Confederation of Indian Industry provided support from within industry. In Mukherji’s (2009:91) analysis:

Manmohan Singh had the support of an excellent technocratic team whose research and policy experience during the 1980s generated a sophisticated blueprint for reform. Singh stated in no uncertain terms in his Budget speech in 1991 that the underlying problem was the unsustainability of government spending in the presence of low levels of productivity. The budget deficit had contributed to the balance of payments deficit and led to investor pessimism.

One of the civil servants (Mukherji 2009:91) often associated most closely with the change, Montek Singh Ahluwalia, in 2004 appointed Deputy Chairman of the Planning Commission and a former head of the Ministry of Finance, emphasised that the new directions had continued domestic support (Ahluwalia 2004:271-2):

[T]he reforms were basically homegrown, and a genuine domestic response to developments in the rest of the world, including especially in South East Asia where the benefits of more open economies was evident. It is important to note that Indian reforms did not come to an end once the immediate crisis was over. This reflects the fact that there was an autonomous internal process of reform that had been taking place and indeed gaining momentum.

The process was highly interactive. Cumulative combinations of ideas, advocates, interests and events drove the dramatic change that the liberalisation decisions of 1991 came to represent.

However the ‘autonomous internal process’ on which continuing reform depended had notable limits. One of these was gradualism. Political support did not extend to detailed, prompt and clear implementation. As Montek Singh Ahluwalia explained (Ahluwalia 2004:270):

[G]radualism...took the form of first signaling the broad directions of reforms, which has usually been very clear, but leaving the detailed implementation to a more opportunistic process whereby the reforms are implemented at a pace that is politically feasible. The absence of a specified time table leads to a lack of clarity about how fast the change is going to take place and this has often slowed down the process of adjustment since the actors involved are often not very clear about what policy changes are likely to happen and when.

Closely linked to gradualism of this kind was institutional asymmetry of support for liberalisation. Within the civil service some key agencies in the central government had much to lose. At state level political leaders and civil servants gathered support from disaffected interests by imposing state level restrictions. While the ‘quality of institutions’ has been praised as ‘India’s underrated strength’ (Rodrik and Subramaniam 2004:1593) the task of negotiating centrally desired reforms with the states emerged quickly as a major task for which even the most talented of leaders had no ready answers. Paradoxically, liberalisation led to an Indian state which could more easily negotiate with international agencies like the World Bank than ‘marshal the internal coordination needed at all levels of government to consolidate the new economic policies favored by the national leadership’ (Kirk 2005).

Impacts on Intergovernmental Relations

Following the reforms of 1991 relationships managed previously within political and bureaucratic arenas controlled by the centre became manifest. Competition by the states with each other and with the centre took place in plainer view. As Aseema Sinha (2004) has argued, economic liberalisation led to a dual process: abolition of central controls made existing state level controls much more visible; reregulation by state officials enhanced state roles in investment
policy. Different states adopted different strategies for economic development, including strategies for attracting foreign investment. International agencies such as the World Bank began dealing direct with specific states, with the centre facilitating loans after terms had been negotiated. Economic disparities between states increased. Control of necessary market supporting regulatory functions tended to drift to the states.

This did not halt regulatory reform. However initiatives often involved protracted negotiations or reform by stealth (Jenkins 2004). Where the central government had constitutional power, for example in telecommunications, negotiations took place within the governing coalition and within the civil service. But where the central government shared power with the states, as in the power sector, difficult negotiations for national regulatory arrangements needed an external stimulus from the World Bank (Mukherji 2004a). Further, in the case of labour policy, as Jenkins (2004) has argued, low key attempts at reform tended to undermine the very institutions needed to manage the change.

More generally the long lists of issues still demanding reform (Ahluwalia, Bardhan 2003 and 2009, Panagariya) depend also on the cooperation of the states. While many states have undertaken reform programs the impacts are uneven and detailed analysis has just begun (Howes et al). The centre is enjoined regularly to take the lead in further reform but the obstacles discussed above to explicit and systematic initiatives remain. Three positive points are that: successive waves of implemented reform are rarely undone; there is an emerging coalition of urban and more prosperous rural interests in favour of reform; and links between the state and capital are close. However, as Mukherji (2004b) has argued: ‘India could be evolving both in a developmental and predatory fashion at the same time…’. In 2004 high profile reform oriented state governments in Karnataka and Andhra Pradesh suffered defeat. Disparities between states continue to throw up problems; many regional political interests not only oppose reform but see winning office as an opportunity for rent seeking; and successful states resent revenue redistribution to poorer states. At the centre the Congress led coalition government formed in 2004 held back from ostentatious reform. However its re-election in 2009 with less restrictive coalition partners provided it with opportunities to be less reticent.

Agendas for Change in Intergovernmental Relations

How federalism in India evolves is critical to prospects for continuing reform and sustained growth. The range of ideas for new directions is large. Many of these ideas are about improved management of intergovernmental relations. To illustrate the issues involved four broad categories of agendas are discussed.

The first is about the range of relationships with which the central and state governments are now involved. Instead of hierarchy, one-party dominance and insulation from external economic forces, central and state governments are involved in burgeoning networks of consultation and negotiation with each other, with industry and with community groups. Jenkins (2003) has described this as ‘the thickening of the Indian polity’s institutional structure’ and argued that it is ‘creating the basis for more imaginative compromises’. However questions that need to be resolved go to the changed role of the state, the management of economic relations in which international and local interests collide, the building of market supporting regulatory institutions, and the equitable distribution of opportunities and rewards of economic growth. Such issues lead to further questions about the quality of arrangements for governance and public management; the distribution of capabilities between the centre and the states; and the distribution of capabilities between states. Linking economic reform to improved governance arrangements and effective public management is regarded by many commentators as essential. As barely a week passes without the Prime Minister or other senior ministers publicly asking the states to collaborate on matters that bear on the strategic questions listed above this suggestion gains urgency. The shaping of institutions for consultation, negotiation and implementation itself becomes an agenda item.
The second category of agendas is thus about the management of intergovernmental relations. Consistent with strategies of gradualism the range and scope of intergovernmental forums has extended incrementally. The list includes: National Development Council (Prime Minister, Chief Ministers and selected central ministers), Inter-State Council (Prime Minister, Chief Ministers and selected central ministers) meetings of Chief Ministers, meetings of central and state ministers, ‘empowered’ committees of ministers, and task groups of officials. The National Development Council negotiates the recommendations of the Planning Commission. These influence a large part of what each level of government does. But they do not cover the whole range of government activities. The Inter-State Council resulted from a constitutional review, is regarded as having unfulfilled potential and remains advisory. The bodies with the most forceful role on tough issues are ‘empowered’ committees of ministers. An ‘empowered’ committee of ministers of finance brokered an agreement to rationalise taxes affecting interstate trade by collecting a value added tax; a similar committee is negotiating arrangements for a goods and services tax. In view of continuing debates about directions and implementation of reform whether the most effective way to resolve issues is through ad hoc referral to one of the available forums is an open question. Proposals for creation of new forums in which propositions from both levels of government can be tested are beginning to emerge. The first approach is more compatible with strategies of gradualism and reform by stealth. The second approach may become attractive if both levels of government come to share a commitment to further reform.

The third category of agendas is about fiscal federalism. This category contains the most developed proposals. The chief problems are about the shrinking fiscal space for state governments, the intermixing roles of central and state governments, and the multiple channels for fiscal transfers to the states. Specific problems include: single year budgets, difficulties in relating budget and plan expenditures, little commitment to budgets, structural deficits, parking of deficits with government owned banks, top ups and bail outs for state deficits, fudging of compliance with fiscal responsibility legislation, growing central expenditure in areas of joint or state responsibility, growing use of conditional grants, lack of market discipline on borrowing, and the overlapping responsibilities of the Planning Commission and Finance Commissions.

Many of these issues are included in the terms of reference of a commission on centre-state relations appointed in 2007 which is yet to report. They may also be addressed by the Thirteenth Finance Commission which submitted its report to the President on 30 December 2009 (since adopted by the government). In the meantime public analysis by scholars and local and international officials provides a menu of options ready to match with new opportunities for change. M Govinda Rao and Nirvikar Singh set out the strategic significance of fiscal federalism (2005:385): ‘fiscal federal reforms may ultimately aid the recognition and political acceptability of broader institutional reforms in India’s federal system.’ They also argued that change is feasible through a collaborative approach (2005:384): ‘India has been able to change the status quo in many aspects of the economy, and we have argued...that federal reform necessitates an explicit building of supporting coalitions across levels of government.’ They nominated three chief areas for reform: a simpler, more transparent, incentive compatible and better targeted fiscal transfer system; tax reforms to improve efficiency of collection, reduce allocative distortions, and improve equity; and effective decentralisation of spending authority. A World Bank team (Ravishankar, Zahir and Kaul: 61) argued that the states could increase their own revenues through reform of tax policies and administration. They argued further that the centre could increase incentives for the states by strengthening market based discipline for state borrowings and replacing annual targets for deficit reduction by monitoring actual end of year stocks of debt and liabilities. M Govinda Rao (2009a:84) proposed a substantial list of measures including: increasing central revenues by a spectrum 3G auction and ‘seriously initiating’ a program of divestment/disinvestment; strengthening collection of direct taxes; and in collaboration with the states finalising arrangements to introduce a dual Goods and Services Tax. These proposals probed three areas of political and institutional sensitivity: the reluctance of governments, central and state, to privatise state owned enterprises (corporatisation and allowing private investors to take up a small proportion of equity are preferred); the difficulties of maintaining a balance between central and state abilities to raise revenue; and the capabilities
of the civil service to enforce existing laws and implement new initiatives. The re-elected central government is proceeding with disinvestment proposals with great caution. Proposals for a GST are yet to be finalised. Outstanding issues include a draft constitutional amendment providing the central finance minister with leadership of a proposed Union Finance Ministers’ Council to set rates of GST (Economic and Political Weekly), raising fears of central dominance, and difficulties in finalising administrative arrangements, including IT systems, to collect the tax (Rao 2009b).

On fiscal administration generally, Rao sounded an overall note of caution (2009a:85):

[F]iscal discipline is not a function of the finance ministry alone; it has to be owned by the government and all spending departments should be a part of implementation.

A further persistent theme is the need to review relations between the central agencies concerned with finance: the Planning Commission, Ministry of Finance, and Finance Commission. In 2005 Singh and Srinivasan (2008:37) proposed strengthening the Finance Commission as a fiscal monitor; later they proposed that the Inter-State Commission constitute itself as a Fiscal Review Council to review the medium and long term fiscal policies of the states and the centre. In 2007 Amaresh Bagchi (2007) argued for a thorough review of relationships between the Planning Commission and the Ministry of Finance, the introduction of multi-year budgeting and a review of arrangements for fiscal transfers to the states. The range of proposals makes it clear that agendas on fiscal federalism relate at many levels with other agendas. There is a consistent search for opportunities to make significant structural changes; in turn it is hoped that such changes will create further opportunities for change.

The fourth category of agendas is about minorities and their search for representation. Unlike the previous agendas they are unequivocally agendas from below. They are illustrated by renewed claims for the reorganisation of states. In 1956 and against the wishes of Prime Minister Nehru the states were reorganised on linguistic lines. More recently minorities sharing the language of existing states have argued for separate states of their own. Their grounds are backwardness and deprivation. After agitations the former Bharatiya Janata Party coalition created three new states. In 2010, after a period of complex interparty deals, the Congress faced sometimes violent agitations from the Telengana region of Andhra Pradesh, including self immolation. The pragmatism of the government’s response led to demands for the formulation of principles to apply to new state claims and for a second states reorganisation commission. However, it has been argued that applicable principles are in short supply. Singh (2007) argues that given the complexity of Indian society ‘no reorganization of states can produce an internally homogeneous and administratively and financially viable set of states in all cases.’

The diverse and developing range of agendas suggests that the most significant agendas about directions in the management of intergovernmental relations have yet to crystallise. Indeed one observer states bluntly (Sharma) that ‘the most difficult reforms are yet to be achieved’. In the meantime strategies of gradualism grapple with crosscutting trends towards centralisation and decentralisation, neither of which provides satisfaction. Perhaps the most significant trend is the extension of the range of forums in which central and state governments can negotiate their roles. Building incentives to enrich the outcomes of such negotiations may become one of the most important emerging agendas.

FEDERAL ARRANGEMENTS AND AGENDAS IN AUSTRALIA

Federal arrangements in Australia have evolved under strong forces for centralisation. The Australian commonwealth began as a ‘coming together’ federation. After several rounds of inter-colonial conferences six small, self governing British settler colonies formed what they thought would be a limited federal government. A seventh colony, New Zealand, decided not to join. The main reasons for coming together were to facilitate inter-state trade and a common defence. Within existing boundaries the states maintained their own constitutions, parliaments,
courts and public services. Governors appointed by the monarch on the recommendation of state executives were until the 1970s usually retired British military leaders. Powers not specifically assigned to the federal government remained with the states; surplus federal funds were to be returned to the states. Constitutional amendments could be made only by referendum requiring a majority of voters in a majority of states.

Against the expectations of most of its founders Australian federation has become noted for relentless trends to centralisation. The manner of assignment of powers led to a high proportion of shared and contested functions. Precedence in the exercise of concurrent powers lay with the federal government. Federal policy pre-eminence derived from three factors: federal financial power, negotiated transfers of power by the states, and favourable constitutional interpretations by the High Court (Garnaut and Fitzgerald, Madden, Sheehan and Grewal, Galligan). The High Court ruled that an Inter-State Commission provided for in the constitution usurped judicial power. An agreement with the states, confirmed by a rare constitutional amendment, enabled the federal government to control state borrowing. During the 1939-45 war the federal government negotiated the transfer of state income taxation powers, a transfer made permanent by the High Court in 1959. In later cases the court upheld broad application in the federal government’s favour of the external affairs power, removed important residual state-controlled taxing powers, and expanded the corporations’ power to support federal government action wherever a corporation was involved (Garnaut and Fitzgerald, Twomey and Withers). Federal dominance of taxation provided the federal government with substantial influence through its ability to make special purpose grants to the states. Invariably, revenue sharing with the states was arranged on federal terms. Although the Commonwealth Grants Commission provided a high degree of fiscal equalisation between states, vertical fiscal imbalance remained pronounced. A goods and services tax introduced by the federal government in 2000 with revenue assigned to the states provided limited relief. Ambiguities in the arrangements enabled the then federal government to claim that the states had not reduced regulatory burdens as agreed or provided efficient services for which they were well funded (Parkin and Anderson, Wilkins).

Three factors modify these patterns. First, a large number of government activities depend on joint action. For this reason Australia has evolved a formal process for intergovernmental negotiation through the Council of Australian Governments (COAG) which includes the prime minister, state premiers and territory chief ministers and a representative of local government. Second, the federal public service is stronger in policy skills than in operational management. Third, state governments have become increasingly sensitive to the local impacts of international trends and begun to frame dissenting views in the language of national interest and international opportunities. They have also upgraded the policy skills in their public services. Further they have set up their own forum—the Council for the Australian Federation (CAF).

Federal influence is thus substantial but not complete. This leads to a dilemma: increasingly issues formally within state responsibilities seem to demand a national approach. Indeed where the federal government concentrates its efforts it can often determine outcomes. But too many effective but resisted interventions mobilise widening circles of opposition. An outstanding question is whether in view of the attractiveness of national approaches to policy and management the mechanisms for intergovernmental negotiation can provide an alternative path to effective solutions. Whether the states continue to play an independent role in the development of national policy or end up collaborating in their progressive marginalisation remains contested.

Paths to Economic Liberalisation

In Australia the path to economic liberalisation began with realisation that economic changes in the rest of the world made long settled policies of domestic protection and regulation insupportable. It involved strategic rethinking about Australia’s external economic relations by government leaders and their public service advisers. Necessary changes took place through
negotiations in a number of arenas in which key players included a federal Labor government, a mixture of Labor and non Labor state governments, business and trade unions. Economic analysis by public service and university economists underpinned processes of negotiation. At the federal level the Liberal Party in opposition broadly supported the changes. However implementation forced widespread and often unwelcome adjustments that precipitated strong political dissent.

The program of economic liberalisation began in the 1980s. In the face of economic reverses and political opposition, earlier initiatives in the 1960s to cut import restrictions and in the 1970s to cut tariffs petered out. However by the 1980s significant external factors forced a rethinking of long running policies (Brennan and Pincus: 81). These included:

- The long term secular decline in the world price of most of the commodities in which Australia has traditionally held a comparative advantage and on which Australian relative wealth in 1901 was based
- The increase in the relative significance of human to physical capital
- The reduced transportation costs in product markets
- Increased competitiveness in world markets for almost all goods and services
- Increased mobility in labour markets (both domestically and internationally) and greater competitiveness in international capital markets.

Thinking among economists favoured major change (Argy:44):

- Inflation needed to be kept low as a matter of ‘high’ priority
- And independent central bank was an important way of taming inflation
- A floating exchange rate offered the best way of reconciling the conflict between monetary goals and fixed exchange rates
- Keynesian policies of fiscal fine tuning needed to be used more sparingly and selectively.

Necessary changes entailed macro and micro economic reform. Key changes included (Argy:40):

- Reforms to open up the public sector to competition (deregulation, outsourcing and privatisation)
- Measures to expose private markets to greater competition (freer international trade, fewer barriers across Australian state borders and deregulation)
- Workplace reform
- A shift to more market-based techniques of economic intervention, with less use of regulations, controls, protective barriers or cross-subsidisation of public services and more use of market incentives, such as subsidies or tax concessions, or at least market-neutral devices such as direct budgetary payments.

The changes entailed a critical shift in the institutional focus of regulation. Labour market regulation, since the early years of the 20th century a distinctive feature of the regulatory framework, yielded its central place to competition policy (Braithwaite 2002:102).

Argy argues that two forces drove the changes (2002:44): the force of ideas current among the policy elite; and strong leadership by the Prime Minister Bob Hawke and Treasurer Paul Keating. Brennan and Pincus take a more path dependent view. They argue (2002:78 and 81) that external changes demanded a policy shift, that ‘the message, rather than the messengers, was the decisive factor’ and that the changes were ‘the optimal response’ to external change. However they do not discuss at length how domestic actors and institutions mediated external forces and made the implications of such forces their own. As an examination of the interaction between the federal and state governments shows, the formulation and implementation of measures to support liberalisation demanded the identification of many specific opportunities.
and the negotiation of just as many blocking points. The path to learning the lessons of ideas and external events demanded skilled advocates, adaptable institutions and strategies for securing the acquiescence of well organised interests.

During the 1980s the federal government took a large number of initiatives, including negotiation of an accord with the Australian Council of Trade Unions to restrict growth in real wage rates, floating the exchange rate, holding summits on taxation and housing, corporatising state owned enterprises and devolving management responsibilities within the public service. However to promote a national market, redesign arrangements for regulation of business and promote competition it needed the cooperation of the states. The process of drawing in the states began after a more than usually acrimonious heads of government meeting in 1990.

John Bannon (2001), at that time Premier of South Australia, offers an insider’s perspective. To avoid another conflict-ridden heads of government meeting Prime Minister Hawke proposed a special Premier’s Conference to discuss cooperative arrangements. He foreshadowed a broad agenda of reform including reduction of duplication of functions between levels of government and a rebalancing of federal state financial arrangements. The initiative had the support of five Labor premiers and the one Liberal premier. The new forum, which became the Council of Australian Governments, made a good start. It offered a chance for premiers to interact on a more equal basis with the prime minister and to discuss potentially common issues away from the heavily ritualised conflicts over finance at the Premiers’ Conference. However the supportive state Liberal government lost ground at an early election and Treasurer Paul Keating initiated a leadership challenge against Prime Minister Hawke.

Problems of organising further meetings led to the state premiers holding discussions on their own. At the meeting the premiers agreed on a statement of principles for managing the federal system. They agreed also on ‘mutual recognition of standards and the elimination of impediments to a national market of goods and services’ (Bannon: 245). When Paul Keating ultimately succeeded Bob Hawke as Prime Minister the agenda for discussion changed (rebalancing financial relations with the states disappeared) but the impetus for economic reform continued.

In 1996 when the federal Liberal-National coalition led by John Howard came to office it continued much of the reform agenda. However it also drew support from many who felt disadvantaged by the Hawke and Keating changes. It managed this contradictory approach by making separate appeals to economic liberalism and conservative nationalism. Key differences with the previous government were that the Howard government sidelined the union movement, introduced a goods and services tax (although Treasurer Keating had considered a similar reform before being over ruled by the prime minister), and passed legislation to deregulate the labour market (Work Choices). Prime Minister Howard was ambivalent about negotiating reform through the Council of Australian Governments and, in the interests of pursuing nation-wide policy approaches, towards the end of his government began a flurry of initiatives to intervene directly in fields administered by the states.

Robyn Hollander (2008) has argued that Howard’s approach arose from ‘his support for the principle of small government and his commitment to building a national market.’ He attached little value to regional identification and the direct delivery of services by state governments. In the interests of economic liberalism and conservative nationalism federalism lost priority. However many of the Howard government’s interventions in state domains came to grief. Despite its success in winning court backing for Work Choices the policy mobilised political opposition that played a significant role in the government’s defeat.

Throughout the initial steps towards economic liberalisation the role of the federal government took most prominence. However during the Hawke and Keating initiatives the collaboration of the states was essential. Further, the states took an active part in formulating the national reform agenda. In the face of the Howard government’s centralist approach and its lack of interest in further collaborative reform the states developed their own agenda for further national
Impacts on Intergovernmental Relations

Policies of economic liberalisation confirmed the federal government’s financial dominance. They also drew the states into a network of agreements on taking a national approach not only to economic policy but also in other fields in which a national approach became attractive. One way of rationalising federal initiatives was to reformulate relations with the states as that between principal and agents. Robyn Hollander’s examination of the development and application of National Competition Policy (2006:44) suggests a template for further federal initiatives:

The NCP approach, based on broad principles, meticulous monitoring and substantial financial carrots rewarded only after performance has enabled the commonwealth to pull the states into line in a way which tied grants did not.

Two other ways of pursuing federal initiatives were identified. One was to organise services to citizens through competitive tendering between states, private providers or non government organisations; the other was to bypass the states altogether by providing funding direct to end users who could then choose their own providers (Wilkins). While no government has fully deployed the latter two approaches, the Howard government experimented with them and they remain available, if only at this stage as bargaining points in difficult negotiations with the states.

On taking office in November 2007 Prime Minister Rudd promised to ‘fix the federation’. As a former senior official of a state government who staffed the officers of senior ministers and his own Department of the Prime Minister and Cabinet (he appointed a new head who previously led the Department of Premier and Cabinet in Victoria) with recruits from state public services, the prime minister had an unusually intimate knowledge of state strategies and incentives. The approach taken by his government combined the performance management strategy outlined by Hollander with vigorous consultation and negotiation. Interaction included four interwoven strands: offers of funds in return for performance, consolidation of special purpose payments in return for more strategic reporting on performance, threats of national takeovers in case of poor performance, and vigorous pursuit of intergovernmental agreements through the Council of Australian Governments.

However the Rudd government has also experienced blunt reminders of the limits to federal control. A proposal continued from the previous government to adopt a national approach to management of the major east coast river system foundered on the resistance of Victoria. Its attempts to drive an ‘education revolution’ by providing computers to every school student became enmeshed in wrangling with state education agencies. Moves towards federal funding of hospitals entailed hard bargaining and commitment of additional federal funds. Perhaps most seriously an attempt to meet environmental aims while also stimulating the economy in response to the global financial crisis by subsidising the installation of ceiling insulation in homes throughout the country exposed the weakness of the operational skills of federal agencies.

While states have tried hard to cooperate with the Rudd government, with the exception of the examples given above, they have been mindful to watch out for electoral punishment of too eager collaboration by their own electorates. In the 1990s one state government closely identified with reform received a strong rebuke and two more lost office.
Agendas for Change in Intergovernmental Relations

Agenda for change focus on ways of taking a national approach to a wide range of policy issues and on managing intergovernmental relations. Demands for national approaches are often coupled with sophisticated proposals for constitutional change. On one matter, management of state health systems, Prime Minister Rudd promised a constitutional referendum if states did not agree to a national approach. However, as is the case with most other proposals for constitutional change, the force of the prime minister’s promise weakened as the time for necessary action approached. It is widely accepted that the gift of amending the constitution continues to lie with judicial processes rather than with citizens and political leaders.

Demands for national approaches and suggestions for improving intergovernmental relations are closely linked. As the current federal government has discovered the hard way, taking direct operational control through a federal government agency risks outrunning the skills of federal ministers and their public servants. Means of facilitating agreements with the states may prove more effective. The development of COAG under the current federal government has extended the mode for conducting intensive intergovernmental negotiations. The current activities of the Council for the Australian Federation focus on making intergovernmental agreements the preferred mode for formulating and implementing national policies. Intergovernmental agreements also provide a path for rationalisation of functions and services between levels of government. As the federal government takes an interest in local matters and state governments take an interest in international matters ideas about appropriate assignment of functions are likely to change. Revising assignments through successive intergovernmental agreements offers a pragmatic way forward. Once the prospect of an intergovernmental agreement becomes attractive the political language of takeovers and king hits gives way to the less exciting mutual adjustments negotiated by teams of ministers and public servants. As major reform of federal fiscal relations remains a remote prospect learning to improve the management of intergovernmental relations encapsulates many of the most feasible current agendas for reform. Further, the ability of the states to organise through COAG and CAF may provide a counterweight to the federal government’s fiscal power. As John Bannon (2001:248) argued about state initiatives in the early 1990s to continue to formulate reforms in the absence of the federal government:

[T]he swift demonstration by the states that they had political if not financial clout may have got the process back on the rails—and again would not have been possible without the confidence and solidarity that the new processes of COAG and leaders meetings had brought.

CONCLUSION

Despite the many differences between federal arrangements in India and Australia the stories of the impact in the two countries of economic liberalisation touch at many points. Four stand out. First, in both cases external stimuli provided the opportunity for radical rethinking of economic management. In the face of adverse events ideas for change prospered. Second, in both cases processes of change were driven by domestic forces. These were led by coalitions of committed political and public service leaders. Third, outcomes of change had to be negotiated in the context of continuing fiscal dominance by federal levels of government. Fourth, in view of often deep seated resistance, programs of change were pragmatic. They also had to be tailored to enlist the support of influential interests, in India business groups and in Australia trade unions.

The stories also diverge. First, in India a proliferation of intergovernmental forums has yet to crystallise around a set of arrangements agreed to by both levels of government. However in Australia, in cases where neither level of government has exclusive powers, intergovernmental forums and intergovernmental agreements have emerged as the most effective means for managing change. They also mitigate to some extent the fiscal dominance of the federal
government. Second, in India economic liberalisation allowed state governments to capture regulatory space vacated by the centre. However in Australia negotiations between levels of government bound the states to a national regime of regulation. Third, in India large scale privatisation has not proved feasible whereas in Australia the federal and several state governments have privatised the largest state owned enterprises. Fourth, Indian proposals for a dual goods and services tax may go some way to addressing problems of vertical fiscal imbalance whereas in Australia a similar tax has left many problems unresolved.

If each country could learn one thing from the other it is suggested that India could examine Australia’s methods for handling intergovernmental relations and Australia could reflect on the adverse impacts of the introverted policies of a dominant central government in India when tempted by the prospects of federal takeovers. In doing so both could explore further the notion of federal constitutions as incomplete contracts and the ability of the parties to federal compacts to negotiate imaginative transitions. Should they do this Oliver Williamson, who developed the idea of incomplete contracting, would not be surprised. As he argued (1999:9):

[M]any economic agents have the capacities both to learn and to look ahead, perceive hazards and factor these back into the contractual relations, and thereafter to devise responsive institutions. In effect limited but intended rationality is translated into incomplete but farsighted contracting.
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