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ANALYSIS
The trapped dragon:  
A province-by-province analysis of the middle-income trap in China

Bala Ramasamy, Jiarui Zhang, Alan K.M. Au and Matthew Yeung

Abstract

China has been a prime candidate in the study of the middle-income trap (MIT), with inconclusive results. In this article, we pursue the question at a provincial level, and identify those provinces that are, or will be, trapped and those that have escaped. The 10 provinces identified as trapped are: Shanxi, Inner Mongolia, Liaoning, Jilin, Shaan’xi, Qinghai, Xinjiang, Heilongjiang, Gansu and Hebei. Productivity is found to be the most obvious reason behind a trapped province.

Introduction

The slowdown in growth rates among middle-income economies has been widely addressed in the literature. In a 2007 report, *An East Asian renaissance: Ideas for economic growth*, the World Bank formally raised the concept of a ‘middle-income trap’ (Cai, 2012). The middle-income trap (MIT) phenomenon was developed further by Gill and Kharas (2007) to explain the condition when developing countries face a sharp deceleration in growth after a sustained period of increases in per capita income. Research into the best way to identify countries that have fallen into this
trap, as well as ways to avoid or escape it, has intensified. Stagnation in income associated with MIT can pose grave problems for people living in such regions (Bulman et al., 2018), particularly in terms of future sustainable development. The World Commission on Environment and Development defines sustainable development as ‘development that meets the needs of the present generation without compromising the needs of future generations’ (WCED, 1987). Being stuck in the MIT would be undesirable for future generations, since it would lead to long-term income stagnation (Bulman et al., 2018) and hence lowered living standards. Therefore, since economic development and social equity considerations are also embedded in the very notion of sustainable development (Mori & Yamashita, 2015), we argue that more empirical research on the topic of MIT is needed. In this article, we seek to identify Chinese provinces that have managed to escape the MIT, as well as those that are/will be trapped. At the same time, researchers have offered many reasons that explain the MIT, some of which include high income inequality, social conflict, labour disputes and government failure in curbing market monopolies, as well as inappropriate macroeconomic policies such as excess money supply, which leads to hyperinflation or debt crisis (Wang, 2018). In this article, we find that productivity is the most obvious reason behind a trapped province. We contribute to the literature by focusing on the Chinese context, since research on this has been scattered, with many conflicting solutions (Wang, 2018).

Additionally, we justify the importance of this research by noting that, given its size and importance, China has been a prime target for MIT research (Aiyar et al., 2013; Albert et al., 2015; Bailliu et al., 2014; Cai, 2012; Cao et al., 2009; Eichengreen et al., 2012; Glawe & Wagner, 2017; Huang, 2016; Wu, 2014; Zeng & Fang, 2014; Zhang, 2014). The slowing down of its economy from 10.6 per cent growth in 2010 to 6.1 per cent in 2019 spotlighted China’s overall difficulties with growth acceleration. In fact, Premier Li Keqiang himself made reference to the MIT when he delivered the Government Work Report to the National People’s Congress on 5 March 2016 (China Daily, 17 March 2016). So far, however, findings are mixed. Some have argued that China has fallen into the MIT (Cook, 2014; Woo, 2012), while others believe that China will escape or has already escaped the trap (Huang, 2016; Wong, 2016).

We believe that there are two reasons for these mixed findings. First, as pointed out by Glawe and Wagner (2017), there is no universally accepted and unambiguous definition of the MIT. Different definitions will lead to different results. Second, all previous MIT studies look at China as one single entity. The diversity that exists within China is well known. In 2015, for example, Jiangsu province had a per capita GDP of 87,995 yuan while in Gansu province it was 26,165 yuan. Similarly, while the annual economic growth for the whole of China was 6.4 per cent in 2015, Tianjin municipality still clocked a 9.3 per cent growth while Liaoning and Shanxi managed only 3 per cent growth. Thus, while some provinces, particularly...
those in the north and north-east with heavy reliance on natural resources and heavy industries, may be more likely to fall into the MIT, others, such as Tianjin, Beijing, Shanghai and Jiangsu province, may have escaped the MIT. Therefore, to provide a finer-grained analysis of the MIT in China, in this article, we study the phenomenon at the provincial level.

Employing commonly used rules of determining the MIT, we identify each province’s situation, and investigate whether it is likely to be ‘trapped’ or whether it will escape the MIT. Admittedly, to apply some of these rules, a forecast of future provincial per capita GDP is required. While there are various GDP forecast models (for a survey, see Bergheim, 2008), we adopt the simple linear autoregressive integrated moving average (ARIMA) model. We chose not to use structural and non-linear models because of a limited data availability problem at the provincial level. Moreover, as stated by Granger (1989) and later shown by Hess and Iwata (1997) for the case of the US, and Simpson et al. (2001) for the case of the UK, simple linear models are frequently only marginally less precise than forecasts made by complex and non-linear models. Therefore, we admit at the outset that the ARIMA model employed here is used purely for data-mining purposes, with the intention of searching for patterns that could lead to further research into the provincial-level MIT in China.

In the next section, we introduce the four main approaches that have been used to identify the MIT. In section 3, we use these approaches to identify which of China's provinces have been trapped. Finally, we discuss our findings in section 4 and draw some conclusions in section 5.

**Approaches to identifying the MIT**

One of the most controversial problems in identifying countries that are trapped or have escaped is a lack of a clear and widely accepted definition of MIT. Traditionally, the word ‘trap’ is used to describe an economic state of super-stable equilibrium that cannot be changed by normal short-term outside forces. Since the proposition of MIT lacks theoretical foundations, opponents argue that it is ad hoc to simply call those countries that are transitioning slowly from middle-income level to high-income level trapped (Barro, 2016). Indeed, except for a few theoretical studies (e.g. Aoki, 2011; Agénor & Canuto, 2015; Dabús et al., 2016; Hansen & Prescott, 2002) that try to investigate why middle-income countries might be stuck with low growth rates, most other related studies are empirical identifications of whether a country has fallen into the MIT. The latter studies include those by Kharas and Kohli (2011), Eichengreen et al. (2012, 2014), the World Bank (2013), Jankowska et al. (2012), Felipe et al. (2012), Cai (2012), Aiyar et al. (2013), Flaaen et al. (2013), Han and Wei (2015), Arias and Wen (2016), and Glawe and Wagner (2017). These studies find that many Latin American and Asian economies, whose
per capita income levels belong to the somewhat defined ‘middle-income range’, are natural suspects of countries that might have fallen into the MIT. However, due to the lack of theoretical prescription as to what constitutes the MIT, these empirical studies tend to resort to descriptive or quantitative definitions. In what follows, we introduce four definitions of the MIT that have been relatively well acknowledged and used in previous studies. Since some of these definitions are essentially similar, we use the three most representative definitions.

The simplest definition of the MIT is by Felipe et al. (2012) (Definition 1). According to this definition, a country is in the MIT if it stays for more than 28 years in the lower-middle-income range (LMIR) or for more than 14 years in the upper-middle-income range (UMIR), where LMIR stands for the per capita income range between $2,000 and $7,250 per year, and UMIR is per capita income range between $7,250 and $11,750 per year. The income ranges are measured in 2010 USD. By comparing the growth rate of countries in each income group, the authors argue that for a country to avoid falling into the lower-middle-income trap (i.e. to move into the upper-middle-income group), it needs to maintain an average annual growth rate of at least 4.7 per cent; for a country to avoid falling into the upper-middle-income trap (i.e. to move into the high-income group), it needs to maintain an average annual growth rate of at least 3.5 per cent.

Another definition of the MIT is based on the slowdown in economic growth given by Eichengreen et al. (2012) (Definition 2). According to this definition, a middle-income country falls into the MIT if the following three conditions are fulfilled: (1) the seven-year average per capita GDP growth rate was at least 3.5 per cent prior to the slowdown; (2) the difference between the seven-year average growth rate before and after the growth slowdown is greater than 2 per cent, showing a significant drop in growth rates; and (3) the per capita GDP in the year of the growth slowdown is greater than $10,000 (measured by 2005 purchasing power parity (PPP) price, in USD), implying that the country is a middle-income rather than a low-income country. Extending on this idea and focusing on Asian economies, Aiyar et al. (2013) argue that the MIT is a special case of the growth slowdown; that is, a large, sudden and sustained deviation from the previous growth path.

The third definition (Definition 3) uses the Catch-Up Index (CUI) made popular by Woo et al. (2012), Bulman et al. (2014) and Robertson and Ye (2015), among others. This definition measures a country’s per capita GDP relative to that of the US. A country is said to be trapped if its CUI is in the 20–50 per cent range for more than 50 years (Woo et al., 2012). By contrast, Bulman et al. (2014) use 8–36 per cent CUI as the criteria range, while Robertson and Ye (2015) use 10–50 per cent as the criteria range. The differences among the choices of CUI range partly reflect the dispute among economists as to the exact measure of the middle-income range. This problem is addressed in the fourth definition given by the World Bank (2013), where a country is in the MIT if its per capita income was 4.5–45 per cent of
identifying China’s trapped provinces

Although we use these well-adopted definitions of the MIT, our work differs from previous studies because we are the first to study the MIT phenomenon at China’s provincial level. For the past 30 years, the growth performance of China has been significantly higher than in most low-income countries as well as high-income countries. The economic reforms that started in 1978 have transformed China from a predominantly agrarian economy to an urban-based manufacturing growth hub (Pakrashi & Frijters, 2017). China is now the second-largest economy in the world, and is well on its way to becoming the largest. The slowdown in economic growth since 2010, however, has caused many to wonder if China’s growth model is unsustainable and if it would follow some of its Asian neighbours and fall into the MIT (Aiyar et al., 2013; Albert et al., 2015; Bailliu et al., 2014; Cai, 2012; Cao et al., 2009; Eichengreen et al., 2012; Glawe & Wagner, 2017; Huang, 2016; Wu, 2014; Zeng & Fang, 2014; Zhang, 2014).

Glawe and Wagner (2017) use various definitions of the MIT and test whether China has fallen into or will escape the trap. They find that under different definitions, the results vary significantly. They attribute these findings to the fact that there is no widely accepted and theoretically supported definition of MIT, an argument shared by other studies in the field. Other studies mainly believe that China may fall into the MIT if it fails to undertake some fundamental reforms. Zhuang et al. (2012) and Wu (2014) argue that slow growth in productivity and increasing income inequality may cause China to fall into the MIT. Yao (2015) argues that a financial crisis is more likely to happen in middle-income countries, causing them to fall into the MIT and that China is running the risk of a financial crisis. Albert et al. (2015) argue that China needs to rebalance from overinvestment and excessive credit growth to avoid potential crisis and growth slowdown.

As mentioned earlier, all studies of the Chinese economy realise the vast differences that exist between the various provinces in China. Not only are the differences obvious in terms of size, they also vary in terms of annual growth and income per capita, as shown in Table 1. Economic structures also differ. While the north-eastern provinces are the rust belt of the country, with minerals and heavy industry as their prime drivers, the south-eastern provinces’ main drivers are light industries producing mainly consumer goods. While municipalities like Shanghai
and Beijing are financial powerhouses, Yunnan and Sichuan provinces are still relatively agrarian. Thus, considering China as one entity when studying the MIT makes policy prescriptions arising out such studies either meaningless or, at best, too general. It is worthwhile then to consider the MIT at a provincial level to identify provinces that have escaped the MIT, those that are trapped and those that are heading into the trap.

To study the MIT at the provincial level in China is not very different from considering the phenomenon among countries in Central and Eastern Europe (Pruchnik & Zowczak, 2017). Members of the European Union are centralised in some aspects of policy and governance (e.g. monetary policy, foreign policy) while decentralised in other aspects (e.g. fiscal policy). Similarly, while China’s Communist Party is seen as an authoritarian government, there is a high degree of decentralisation when it comes to resource allocation and business activities. Provinces are relatively self-contained and conditions are conducive for regional competition (Feltenstein & Iwata, 2005; Zhang, 2005). In fact, China’s decentralisation policies have been linked to its macroeconomic performance (Cai & Treisman, 2006). Furthermore, China’s *hukou* (household registration) policy, which restricts the movement of labour from one province to another, is yet another reason to consider the MIT at a provincial level in China.

**Table 1. Diversity within China**

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Real GDP per capita (in 2010 USD)</th>
<th>Average GDP growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>1,148</td>
<td>2,036</td>
</tr>
<tr>
<td>Tianjin</td>
<td>1,009</td>
<td>1,532</td>
</tr>
<tr>
<td>Shanghai</td>
<td>2,026</td>
<td>2,597</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>402</td>
<td>927</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>350</td>
<td>940</td>
</tr>
<tr>
<td>Inner Mongolia</td>
<td>268</td>
<td>649</td>
</tr>
<tr>
<td>Fujian</td>
<td>259</td>
<td>775</td>
</tr>
<tr>
<td>Guangdong</td>
<td>358</td>
<td>1,092</td>
</tr>
<tr>
<td>Shandong</td>
<td>299</td>
<td>798</td>
</tr>
<tr>
<td>Chongqing</td>
<td>265</td>
<td>519</td>
</tr>
<tr>
<td>Hubei</td>
<td>318</td>
<td>677</td>
</tr>
<tr>
<td>Jilin</td>
<td>331</td>
<td>767</td>
</tr>
<tr>
<td>Shaan’xi</td>
<td>248</td>
<td>545</td>
</tr>
<tr>
<td>Liaoning</td>
<td>603</td>
<td>1,186</td>
</tr>
<tr>
<td>Ningxia</td>
<td>322</td>
<td>612</td>
</tr>
</tbody>
</table>
Forecasting future GDP per capita and growth

As seen from the various definitions of MIT, there is a need to have a long time series to make meaningful predictions of future growth. For many developing countries that have a short history, forecasting future GDP per capita and GDP growth becomes necessary. This is particularly true for China. Since China is still in the middle-income range, according to many definitions of the MIT, but growing fast, it is necessary to predict if China will be trapped in the future. Take for example the third definition of the MIT: it uses the CUI, which requires a 50-year threshold. Since China’s per capita income relative to the US is currently in the UMIR, we need to predict if and when China will move out from this range. Thus, GDP forecast is needed.

In previous MIT studies that focus on empirical identifications, GDP forecast was not an issue since they would normally use GDP projections from the World Bank, the Organisation for Economic Cooperation and Development, or the International Monetary Fund (Glawe & Wagner, 2017). However, there are no provincial-level GDP projections that are readily available. Estimates need to be made. There are several methodologies that are used to forecast GDP. Both linear models, such as the
ARIMA models and exponential smoothing models and non-linear models appear in the literature. Forecasting for the US, Hess and Iwata (1997) find that although many popular non-linear models can be used to replicate business dynamics and GDP time series, they perform no better than simple ARIMA models. In a similar analysis for the UK, Simpson et al. (2001) show that non-linear models perform relatively poorer than linear models for certain time periods. ARIMA models are quite well accepted for forecasting China’s GDP (Wu et al., 2015; Zhang, 2007; Zhou, 2016). These models have also been used to forecast future provincial GDP (e.g. Guangdong: Hua & Zhao, 2010; Fujian: Zhao & Chen, 2007; Shaan’xi: Wei et al., 2010; Hubei: Zhang, 2015; Chongqing: Xue et al., 2017). Therefore, we use the ARIMA model to forecast each province’s GDP using historical time series of GDP data. Admittedly, the prediction power of the ARIMA model decreases when the period being forecast lengthens. Our forecasted results are based on the assumption that no significant structural reform will be taken within the forecasting period. We acknowledge that this assumption is relatively strong. However, except for Definition 3 of the MIT for several provinces, we do not need to forecast for longer than 20 years. Moreover, some provinces, such as Liaoning, Shanxi and Inner Mongolia, suffered a significant drop in growth rates over the past three years. For these provinces, the ARIMA model cannot provide a sensible forecast (the ARIMA models report negative growth rates). While we do not need any forecast to conclude that these provinces are trapped by the MIT, according to our Definition 2 (growth slowdown), we still use the exponential smoothing technique to forecast their future growth rate and test for other definitions.

The ARIMA model is a generation of the autoregressive moving average (ARMA) model. It is fitted to time series data either to better understand the data or to predict future points in the series. This model is standard in the literature for forecasting GDP and other financial time series (e.g. Wu et al., 2015; Zhang, 2007; Zhou, 2016). Given a time series of data $X_t$, where $t$ is the time index and $X_t$ are real numbers, an ARMA model is given by:

$$X_t - \alpha_1 X_{t-1} - \ldots - \alpha_p X_{t-p} = \varepsilon_t + \theta_1 \varepsilon_{t-1} + \ldots + \theta_q \varepsilon_{t-q}$$

(1)

where $\alpha_i$ ($i=1, 2, \ldots, p$) are the coefficients of the autoregressive part of the model, $\theta_j$ ($j=1, 2, \ldots, q$) are the coefficients of the moving average part, and $\varepsilon_t$-$\varepsilon_{t-q}$ are the i.i.d. error terms. To estimate this model, the time series data must be stationary. Therefore, for non-stationary data (which is usually the case for GDP per capita data), we take first order (or higher order) differencing of the original data. In particular, define:

$$X'_t = X_t - X_{t-1}$$  \hspace{1cm} (first order differencing)

$$X''_t = X'_t - X'_{t-1}$$  \hspace{1cm} (second order differencing)

$$X'''_t = X''_t - X''_{t-1}$$  \hspace{1cm} (third order differencing)
We then first use the augmented Dicky-Fuller test to determine which order differencing will make the original data stationary. Let us suppose it is the $d^{th}$ order. Next, we apply the stationary data to test the optimal ARMA lags $p$ and $q$ in equation (1), using ACF (autocorrelation function) and PACF (partial autocorrelation function) statistics, as well as Akaike information criterion (AIC). Finally, we estimate the obtained ARIMA $(p,d,q)$ model.

Table 2 shows our estimated results for each province, including the optimal parameters $(p,d,q)$, and predicted results for the next five years and beyond.

**Table 2. Forecasted real GDP per capita (in 2010 USD), selected years**

<table>
<thead>
<tr>
<th>Provinces</th>
<th>$(p,d,q)$</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>(1,2,0)</td>
<td>15,356</td>
<td>16,183</td>
<td>17,034</td>
<td>17,903</td>
<td>18,793</td>
<td>27,694</td>
<td>39,473</td>
<td>53,240</td>
</tr>
<tr>
<td>Tianjin</td>
<td>(2,2,1)</td>
<td>14,813</td>
<td>15,131</td>
<td>15,629</td>
<td>16,037</td>
<td>16,479</td>
<td>20,956</td>
<td>26,856</td>
<td>33,737</td>
</tr>
<tr>
<td>Shanghai</td>
<td>(1,2,1)</td>
<td>14,902</td>
<td>15,614</td>
<td>16,327</td>
<td>17,046</td>
<td>17,775</td>
<td>25,017</td>
<td>34,610</td>
<td>45,843</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>(1,2,1)</td>
<td>13,013</td>
<td>13,868</td>
<td>14,748</td>
<td>15,654</td>
<td>16,585</td>
<td>26,161</td>
<td>39,333</td>
<td>55,173</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>(0,2,2)</td>
<td>11,313</td>
<td>11,976</td>
<td>12,657</td>
<td>13,355</td>
<td>14,071</td>
<td>21,301</td>
<td>31,001</td>
<td>41,230</td>
</tr>
<tr>
<td>Inner Mongolia</td>
<td>(1,2,2)</td>
<td>9,724</td>
<td>10,151</td>
<td>10,473</td>
<td>10,807</td>
<td>11,111</td>
<td>21,301</td>
<td>31,001</td>
<td>41,230</td>
</tr>
<tr>
<td>Fujian</td>
<td>(1,2,2)</td>
<td>10,026</td>
<td>10,667</td>
<td>11,327</td>
<td>12,001</td>
<td>12,692</td>
<td>19,613</td>
<td>28,797</td>
<td>39,552</td>
</tr>
<tr>
<td>Guangdong</td>
<td>(1,2,1)</td>
<td>9,765</td>
<td>10,296</td>
<td>10,838</td>
<td>11,390</td>
<td>11,955</td>
<td>17,577</td>
<td>24,972</td>
<td>33,576</td>
</tr>
<tr>
<td>Shandong</td>
<td>(1,2,1)</td>
<td>9,160</td>
<td>9,604</td>
<td>10,064</td>
<td>10,530</td>
<td>11,010</td>
<td>15,786</td>
<td>22,086</td>
<td>29,432</td>
</tr>
<tr>
<td>Chongqing</td>
<td>(1,2,1)</td>
<td>7,992</td>
<td>8,645</td>
<td>9,327</td>
<td>10,032</td>
<td>10,765</td>
<td>18,560</td>
<td>29,748</td>
<td>43,597</td>
</tr>
<tr>
<td>Hubei</td>
<td>(2,2,2)</td>
<td>7,363</td>
<td>7,743</td>
<td>8,126</td>
<td>8,524</td>
<td>8,942</td>
<td>13,271</td>
<td>19,097</td>
<td>26,001</td>
</tr>
<tr>
<td>Jilin</td>
<td>(3,2,3)</td>
<td>7,453</td>
<td>7,774</td>
<td>8,079</td>
<td>8,379</td>
<td>8,672</td>
<td>11,002</td>
<td>14,108</td>
<td>18,092</td>
</tr>
<tr>
<td>Shaan’xi</td>
<td>(2,1,2)</td>
<td>6,896</td>
<td>7,245</td>
<td>7,542</td>
<td>7,803</td>
<td>8,054</td>
<td>10,078</td>
<td>12,808</td>
<td>16,277</td>
</tr>
<tr>
<td>Liaoning</td>
<td>(1,2,1)</td>
<td>6,762</td>
<td>7,013</td>
<td>7,256</td>
<td>7,490</td>
<td>7,713</td>
<td>9,599</td>
<td>12,199</td>
<td>15,503</td>
</tr>
<tr>
<td>Ningxia</td>
<td>(2,2,1)</td>
<td>6,193</td>
<td>6,469</td>
<td>6,747</td>
<td>7,032</td>
<td>7,323</td>
<td>10,220</td>
<td>14,019</td>
<td>18,429</td>
</tr>
<tr>
<td>Hunan</td>
<td>(2,2,2)</td>
<td>6,219</td>
<td>6,578</td>
<td>6,944</td>
<td>7,319</td>
<td>7,704</td>
<td>11,603</td>
<td>16,841</td>
<td>23,034</td>
</tr>
<tr>
<td>Hainan</td>
<td>(1,2,3)</td>
<td>5,798</td>
<td>6,125</td>
<td>6,446</td>
<td>6,783</td>
<td>7,126</td>
<td>10,613</td>
<td>15,322</td>
<td>20,911</td>
</tr>
<tr>
<td>Qinghai</td>
<td>(1,2,2)</td>
<td>5,828</td>
<td>6,058</td>
<td>6,282</td>
<td>6,500</td>
<td>6,710</td>
<td>8,395</td>
<td>10,669</td>
<td>13,559</td>
</tr>
<tr>
<td>Hebei</td>
<td>(2,2,2)</td>
<td>5,315</td>
<td>5,448</td>
<td>5,652</td>
<td>5,929</td>
<td>6,272</td>
<td>9,710</td>
<td>13,406</td>
<td>17,967</td>
</tr>
<tr>
<td>Henan</td>
<td>(3,2,3)</td>
<td>5,719</td>
<td>6,043</td>
<td>6,390</td>
<td>6,776</td>
<td>7,151</td>
<td>11,073</td>
<td>16,474</td>
<td>22,974</td>
</tr>
<tr>
<td>Heilongjiang</td>
<td>(1,2,3)</td>
<td>5,514</td>
<td>5,804</td>
<td>6,043</td>
<td>6,349</td>
<td>6,590</td>
<td>9,477</td>
<td>13,283</td>
<td>17,767</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>(1,2,1)</td>
<td>5,411</td>
<td>5,624</td>
<td>5,833</td>
<td>6,035</td>
<td>6,229</td>
<td>7,795</td>
<td>9,906</td>
<td>12,589</td>
</tr>
<tr>
<td>Jiangxi</td>
<td>(1,2,1)</td>
<td>5,344</td>
<td>5,669</td>
<td>6,007</td>
<td>6,359</td>
<td>6,722</td>
<td>10,479</td>
<td>15,654</td>
<td>21,879</td>
</tr>
<tr>
<td>Sichuan</td>
<td>(2,2,3)</td>
<td>5,207</td>
<td>5,448</td>
<td>5,701</td>
<td>5,976</td>
<td>6,257</td>
<td>9,482</td>
<td>15,050</td>
<td>23,886</td>
</tr>
<tr>
<td>Anhui</td>
<td>(1,2,1)</td>
<td>5,134</td>
<td>5,404</td>
<td>5,691</td>
<td>5,993</td>
<td>6,309</td>
<td>9,635</td>
<td>14,239</td>
<td>19,768</td>
</tr>
<tr>
<td>Guangxi</td>
<td>(1,2,1)</td>
<td>5,116</td>
<td>5,414</td>
<td>5,720</td>
<td>6,036</td>
<td>6,362</td>
<td>9,704</td>
<td>14,292</td>
<td>19,800</td>
</tr>
<tr>
<td>Shanxi</td>
<td>(2,2,0)</td>
<td>4,530</td>
<td>4,709</td>
<td>4,883</td>
<td>5,052</td>
<td>5,215</td>
<td>6,525</td>
<td>8,293</td>
<td>10,539</td>
</tr>
</tbody>
</table>
The second and third columns show the number of years the specified province remains in the lower-middle-income range (LMIR) and upper-middle-income range (UMIR) respectively. Beijing, Tianjin, Shanghai and Jiangsu have escaped from the MIT, since the number of years they are within particular income ranges is less than the maximum (28 years in LMIR; 14 years in UMIR). For the rest of the provinces, we predict whether a province will escape the MIT or be trapped, based on our forecasted growth. For example, we predict that Hebei will escape the MIT because it will move out of the UMIR within 13 years, a year earlier than the MIT definition. On the other hand, Inner Mongolia will be trapped, as our forecast shows that it will remain in the UMIR for 16 years, two years longer than the MIT definition. We conclude that based on Definition 1, Shanxi, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Shaan’xi, Gansu, Qinghai and Xinjiang will be trapped in the MIT.

Table 3. Provincial MIT based on Definition 1

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Years in LMIR</th>
<th>Years in UMIR</th>
<th>Current Status</th>
<th>Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>14 years</td>
<td>11 years</td>
<td>–</td>
<td>Escaped</td>
</tr>
<tr>
<td>Tianjin</td>
<td>13 years</td>
<td>7 years</td>
<td>–</td>
<td>Escaped</td>
</tr>
<tr>
<td>Hebei</td>
<td>21 years*</td>
<td>13 years*</td>
<td>still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Shanxi</td>
<td>31 years*</td>
<td>N.A.</td>
<td>still in LMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Inner Mongolia</td>
<td>9 years</td>
<td>14 years*</td>
<td>Still in UMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Liaoning</td>
<td>22 years*</td>
<td>20 years*</td>
<td>Still in LMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Jilin</td>
<td>15 years</td>
<td>16 years *</td>
<td>Still in UMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Heilongjiang</td>
<td>22 years*</td>
<td>14 years*</td>
<td>Still in LMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Shanghai</td>
<td>22 years</td>
<td>11 years</td>
<td>–</td>
<td>Escaped</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>13 years</td>
<td>6 years</td>
<td>–</td>
<td>Escaped</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>14 years</td>
<td>9 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Anhui</td>
<td>27 years*</td>
<td>11 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Provinces</td>
<td>Years in LMIR</td>
<td>Years in UMIR</td>
<td>Current Status</td>
<td>Prediction</td>
</tr>
<tr>
<td>------------</td>
<td>---------------</td>
<td>---------------</td>
<td>------------------</td>
<td>--------------</td>
</tr>
<tr>
<td>Fujian</td>
<td>15 years</td>
<td>7 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Jiangxi</td>
<td>17 years*</td>
<td>10 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Shandong</td>
<td>13 years</td>
<td>10 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Henan</td>
<td>17 years*</td>
<td>10 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Hubei</td>
<td>13 years</td>
<td>12 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Hunan</td>
<td>16 years*</td>
<td>11 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Guangdong</td>
<td>17 years</td>
<td>9 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Guangxi</td>
<td>17 years*</td>
<td>11 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Hainan</td>
<td>17 years*</td>
<td>11 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Chongqing</td>
<td>12 years</td>
<td>7 year*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Sichuan</td>
<td>18 years*</td>
<td>11 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Guizhou</td>
<td>11 years*</td>
<td>8 years*</td>
<td>Still in UMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Yunnan</td>
<td>20 years*</td>
<td>12 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Tibet</td>
<td>17 years*</td>
<td>10 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Shaan’xi</td>
<td>14 years*</td>
<td>18 years*</td>
<td>Still in UMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Gansu</td>
<td>38 years*</td>
<td>N.A.</td>
<td>Still in LMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Qinghai</td>
<td>19 years*</td>
<td>21 years*</td>
<td>Still in LMIR</td>
<td>Will be trapped</td>
</tr>
<tr>
<td>Ningxia</td>
<td>15 years*</td>
<td>13 years*</td>
<td>Still in LMIR</td>
<td>Will escape</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>24 years*</td>
<td>21 years*</td>
<td>Still in LMIR</td>
<td>Will be trapped</td>
</tr>
</tbody>
</table>

Note: * indicates the number of years in particular income range based on our forecast.
N.A. indicates that per capita income of the province will not surpass the definition of either lower-middle-income range (LMIR) or upper-middle-income range (UMIR) before 2050.
Source: Authors’ summary.

Definition 2, by Eichengreen et al. (2014), identifies the MIT based on the economic growth rates before and after a slowdown period. More specifically, an economy is trapped if:

1. \( g_{t,t-n} > 3.5\% \);
2. \( g_{t,t-n} - g_{t,t+n} > 2\% \);
3. \( \bar{y}_t > \text{USD}\,10,000 \) (based on 2005 PPP price);

where \( g_{t,t-n} \) is the average growth rate between year \( t-n \) and \( t \); \( g_{t,t+n} \) is the average growth rate between year \( t \) and \( t+n \); and \( \bar{y}_t \) is the per capita GDP in year \( t \).

If the above three conditions are fulfilled, the economy experiences a growth slowdown in year \( t \) and falls into the MIT. Eichengreen et al. (2014) define \( n=7 \). For convenience and consistency with other definitions, we transform the 2005 PPP price into 2010 USD price, so that the third condition is now defined as \( \bar{y}_t > \text{USD}\,4,664 \), a level which is roughly equal to the median of the LMIR given in Definition 1 above.
In addition, we impose a fourth condition:

4. \( g_{t, t+n} > 3.5\% \)

This condition implies that after the growth slowdown, the seven-year average growth rate must be lower than 3.5 per cent. If an economy suffers a growth slowdown that is featured by conditions (1)–(3) but still maintains a significantly high growth rate, it is very unlikely that this economy has been trapped by the MIT. In other words, a slowdown by 2 per cent per capita growth from an initially high level (for instance, from 8 to 6 per cent) may still allow a country to maintain rapid convergence to a high-income status (Agénor, 2017; Felipe et al., 2012; Im & Rosenblatt, 2013). Felipe et al. (2012) also emphasise this ‘minimum growth rate’ of 3.5 per cent for a middle-income country to escape from the MIT. Therefore, to make Definition 2 consistent with other definitions of the MIT, we impose condition (4) as well.

Table 4 shows the results of provinces that are trapped based on Definition 2. The second column indicates the year of slowdown based on a seven-year average. The third and fourth columns indicate the average annual economic growth rate before and after the slowdown year for the trapped provinces, respectively. We find that Hebei, Shanxi, Inner Mongolia, Liaoning, Jilin, Shaan’xi, Qinghai and Xinjiang are heading into the MIT in the near future. All other provinces are considered not trapped based on Definition 2.

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Slowdown year</th>
<th>( g_{t,n} )</th>
<th>( g_{t+n} )</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hebei</td>
<td>2015</td>
<td>5.3%</td>
<td>2.8%</td>
<td>trapped</td>
</tr>
<tr>
<td>Shanxi</td>
<td>2014</td>
<td>6.1%</td>
<td>2.9%</td>
<td>trapped</td>
</tr>
<tr>
<td>Inner Mongolia</td>
<td>2013</td>
<td>13.1%</td>
<td>3.2%</td>
<td>trapped</td>
</tr>
<tr>
<td>Liaoning</td>
<td>2010</td>
<td>12%</td>
<td>3.0%</td>
<td>trapped</td>
</tr>
<tr>
<td>Jilin</td>
<td>2016</td>
<td>7.7%</td>
<td>3.49%</td>
<td>trapped</td>
</tr>
<tr>
<td>Shaan’xi</td>
<td>2017</td>
<td>8.0%</td>
<td>3.4%</td>
<td>trapped</td>
</tr>
<tr>
<td>Gansu</td>
<td>2014</td>
<td>9.6%</td>
<td>2.9%</td>
<td>trapped</td>
</tr>
<tr>
<td>Qinghai</td>
<td>2017</td>
<td>7.3%</td>
<td>3.2%</td>
<td>trapped</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>2014</td>
<td>9.0%</td>
<td>3.2%</td>
<td>trapped</td>
</tr>
</tbody>
</table>

Note: Shanxi province experienced the growth slowdown in 2013, but in that year condition (3) is not fulfilled. The per capita income of Shanxi in 2013 is $4,565, marginally below the requirement of condition (3). Since this difference is negligible, we classify Shanxi as in the middle-income range.

Source: Authors’ summary.

Table 5 shows our results for trapped provinces using Definition 3. In our analysis, we use Bulman et al.’s (2014) range which defines an economy as trapped if its CUI: the country’s per capita income \( \epsilon \) (8%, 36%) for over 50 years. As expected, this definition requires forecasting growth rates into the future. We use the ARIMA model, as explained earlier, as well as the exponential smoothing model to improve our
forecasts. Our results in Table 5 show the number of years China’s provinces will be in the middle-income range (column 4). For some provinces, the CUI does not meet the 36 per cent mark by 2050, according to our forecast, but has stayed within the specified range (8 per cent, 36 per cent) for less than 50 years. Therefore, to see whether these provinces will be trapped, we extend these provinces’ forecast until the 36 per cent threshold is met or the 50-year criteria is met. We identify Hebei, Shanxi, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Shaan’xi, Gansu, Qinghai, Ningxia and Xinjiang as trapped provinces.

Table 5. Provincial MIT based on Definition 3

<table>
<thead>
<tr>
<th>Provinces</th>
<th>Year = 8%</th>
<th>Year = 36% (est.)</th>
<th>CUI years</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>1996</td>
<td>2026</td>
<td>31 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Tianjin</td>
<td>1999</td>
<td>2025</td>
<td>27 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Hebei</td>
<td>2009</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Shanxi</td>
<td>2010</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Inner Mongolia</td>
<td>2007</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Liaoning</td>
<td>2006</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Jilin</td>
<td>2009</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Heilongjiang</td>
<td>2010</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Shanghai</td>
<td>1992</td>
<td>2031</td>
<td>40 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>2004</td>
<td>2029</td>
<td>26 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>2002</td>
<td>2039</td>
<td>38 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Anhui</td>
<td>2013</td>
<td>2053</td>
<td>41 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Fujian</td>
<td>2007</td>
<td>2045</td>
<td>39 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Jiangxi</td>
<td>2013</td>
<td>2059</td>
<td>47 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Shandong</td>
<td>2006</td>
<td>2049</td>
<td>44 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Henan</td>
<td>2011</td>
<td>2055</td>
<td>45 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Hubei</td>
<td>2010</td>
<td>2049</td>
<td>40 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Hunan</td>
<td>2011</td>
<td>2052</td>
<td>42 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Guangdong</td>
<td>2003</td>
<td>2044</td>
<td>42 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Guangxi</td>
<td>2013</td>
<td>2055</td>
<td>43 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Hainan</td>
<td>2011</td>
<td>2056</td>
<td>46 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Chongqing</td>
<td>2010</td>
<td>2042</td>
<td>33 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Sichuan</td>
<td>2012</td>
<td>2053</td>
<td>42 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Guizhou</td>
<td>2016</td>
<td>2040</td>
<td>25 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Yunnan</td>
<td>2017</td>
<td>2062</td>
<td>46 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Tibet</td>
<td>2015</td>
<td>2055</td>
<td>41 years</td>
<td>Not trapped</td>
</tr>
<tr>
<td>Shaan’xi</td>
<td>2010</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Gansu</td>
<td>2022</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Qinghai</td>
<td>2011</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Ningxia</td>
<td>2010</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>2011</td>
<td>N.A.</td>
<td>over 50 years</td>
<td>Trapped</td>
</tr>
</tbody>
</table>

Source: Authors’ summary.
Discussion

It is not our intention here to criticise any particular definition of MIT, as each has its own merits and issues. However, based on the three popular definitions from previous literature, we find seven provinces in China that are or will be trapped under all definitions: Shanxi, Inner Mongolia, Liaoning, Jilin, Shaan’xi, Qinghai and Xinjiang. Three other provinces are trapped, based on two of the three definitions—Heilongjiang, Gansu and Hebei—while Ningxia is only identified as trapped under Definition 3. Ignoring Ningxia, we have 10 provinces in China that we can confidently confirm as trapped or heading into the MIT. These provinces are what we term the ‘trapped dragon’, given its obvious shape (see Figure 1). The trapped dragon comprises 10 provinces in the north extending from the east to the west except for Tianjin and Ningxia that are located in the northern area.

Figure 1. The trapped dragon
Source: Authors’ representation.
Regional growth disparity

Since the reform and opening up in 1978, China has maintained rapid economic growth in general. The regional growth disparity, however, has become a well-known concern both in the academic circles as well as in the policymaking space. As predicted by neoclassical growth theory, as a result of a diminishing return from capital investment there exists a ‘b-convergence’ of per capita income between less-developed regions and more-developed regions (Barro & Sala-i-Martin, 1995). However, most empirical studies on China’s regional growth show that such ‘b-convergence’ does not exist (see, for example, Liu et al., 2004; Shen & Ma, 2002; Zhu et al., 2014). In fact, there is evidence to show that regional development can even exhibit patterns of divergence, particularly after 1990 (Dai & Mao, 2015).

Reasons for an absence in absolute growth convergence among different regions in China have been investigated frequently in the literature. The general idea is that several important assumptions for a ‘b-convergence’ are violated in China including distortions in the goods and factor markets (Cai et al., 2002), restrictions in inter-regional labour migration due to the hukou policy (Liu, 2001), preferential treatment among coastal provinces (Dong, 2004) and significant differences in the adoption of technology among provinces (Li & Xu, 2008). Controlling for these factors, a conditional growth convergence might be identified among China’s provinces, with human capital, investment rate and trade dependence acting as important conditions (Cai & Du, 2000). Demurger (2001) also showed that infrastructure development and the ability of local government to raise funds for the public good could act as key differentiating factors to explain the growth gap among provinces. In fact, in the study by Shen and Ma (2002), there is clear evidence of a ‘club convergence’ in China, such that growth convergence can be detected among the eastern coastal region and the western inland region. This observation can be explained by the differences in human capital and market openness between the two regions.

Furthermore, the unequal growth rates in total factor productivity (TFP) also contribute directly to the inter-regional development disparity. As shown by Shiu and Heshmati (2006), the eastern region of China exhibits, on average, higher TFP growth when compared with the western region. There are many factors contributing to such TFP growth differences including foreign and domestic investment in information, communication and technology. Huang et al. (2019) further add that indigenous research and development investment plays a leading role in promoting TFP, while the differences in human capital and technological absorptive capacity explain the differences in TFP growth among provinces. Regional government preferential policies also contribute to TFP disparities. Chen et al. (2019) show that special development zone policies contribute differently to TFP of firms in the coastal and inland regions of China. Although many economic development
zones were created in China’s inland with the hope of reducing growth disparities, most efforts failed to promote productivity growth in the lagged regions resulting in a spatial misallocation of resources.

In sum, previous studies acknowledge the regional growth disparity in China, and identify various factors that cause such disparity. In this study, we categorise China provinces into three: provinces that are in the MIT, provinces that have escaped from the MIT, and provinces that are neither trapped nor escaped the trap.

**Factors behind the trapped dragon**

Having identified the trapped provinces, it is also important to determine why these provinces face such a dilemma. Otsuka et al. (2017) point to erroneous policies and strategies of the government and the private sector in handling a transitional economy. They explain that in an effort to prolong economic growth, the government sometimes will promote and subsidise sunset industries that drag the economy down in the long run. In addition to the growth convergence literature, the MIT literature addresses triggers that result in economies getting caught up in the trap, including weak human capital development (Cherif & Hasanov 2015; Egawa 2013), low TFP (Aiyar et al., 2013; Eichengreen et al., 2014), economic structure—particularly an export structure that is more inclined towards imitative products rather than innovative products (Eichengreen et al., 2014; Flaen et al., 2013; Otsuka et al., 2017)—increasing income inequalities (Bulman et al., 2014), and weak financial sector reforms (Han & Wei, 2015). Glawe and Wagner (2017), in their study of the MIT in China and other developing countries, identify 18 such trigger factors, but they highlight the three most important ones: human capital, export structure and TFP. We consider these three factors now at the provincial level.

We use the share of population that have college education and above as the measure of human capital. Compared to Beijing, Shanghai and other provinces that have escaped the MIT, the human capital of the trapped provinces is significantly lower (see Figure 2). In addition, the share of population that has a college education and above increased faster in Beijing and Shanghai as compared to the trapped provinces. However, it should be noted that the level of human capital in other non-trapped provinces such as Sichuan, Anhui and Guangdong is not significantly higher than our trapped provinces. Therefore, while human capital can partly explain the difference between trapped and escaped provinces, it cannot explain the differences between trapped provinces and provinces that are neither trapped nor have escaped.
Export data at the provincial level is not available. Thus, we resorted to the GDP structure of the provincial economy to provide a general idea of the export structure. We find that the trapped provinces rely much more on secondary industry than escaped provinces (see Table 6). The services sector contributed over 80 per cent of GDP in Beijing in 2015, while secondary industry contributed less than 20 per cent. However, in the trapped provinces, secondary industry can contribute more than 50 per cent of the local GDP (for instance, Shaan’xi). Heavy industries, agriculture and mining make up significant shares of their economies. Table 7 looks at the industrial sector in more detail. We find that mining is a significant sector for Shanxi and Shaan’xi, our representative trapped provinces. Within the mining sector, Shanxi’s main sector is coal mining and petroleum, and petroleum and gas extraction. As for the manufacturing sector, for trapped provinces shown in the table, mining-related sectors like petroleum processing, metal and nonmetal smelting are the dominant ones. Compare this to automobile manufacturing and computers and electronic equipment manufacturing in Shanghai and Beijing, or the light industries like leather or electrical machinery in Fujian and Anhui.
<table>
<thead>
<tr>
<th></th>
<th>Beijing</th>
<th>Shanghai</th>
<th>Fujian</th>
<th>Anhui</th>
<th>Shanxi</th>
<th>Liaoning</th>
<th>Shaan'xi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross regional product (billion RMB)</td>
<td>23,014.59</td>
<td>25,123.45</td>
<td>25,979.82</td>
<td>22,005.63</td>
<td>12,766.49</td>
<td>28,669.02</td>
<td>18,021.86</td>
</tr>
<tr>
<td>Primary industry (%)</td>
<td>0.6</td>
<td>0.4</td>
<td>8.2</td>
<td>11.2</td>
<td>6.1</td>
<td>8.3</td>
<td>8.9</td>
</tr>
<tr>
<td>Secondary industry (%)</td>
<td>19.7</td>
<td>31.8</td>
<td>50.3</td>
<td>49.7</td>
<td>40.7</td>
<td>45.5</td>
<td>50.4</td>
</tr>
<tr>
<td>Tertiary industry (%)</td>
<td>79.7</td>
<td>67.8</td>
<td>41.6</td>
<td>39.1</td>
<td>53.2</td>
<td>46.2</td>
<td>40.7</td>
</tr>
<tr>
<td>Agriculture, forestry, fishery, animal husbandry (%)</td>
<td>0.6</td>
<td>0.5</td>
<td>8.4</td>
<td>11.6</td>
<td>6.5</td>
<td>8.7</td>
<td>9.3</td>
</tr>
<tr>
<td>Industry (%)</td>
<td>16.1</td>
<td>28.5</td>
<td>41.6</td>
<td>42.1</td>
<td>34.1</td>
<td>39.3</td>
<td>40.8</td>
</tr>
<tr>
<td>Construction (%)</td>
<td>4.2</td>
<td>3.4</td>
<td>8.7</td>
<td>7.7</td>
<td>6.6</td>
<td>6.6</td>
<td>9.9</td>
</tr>
<tr>
<td>Wholesale and retail (%)</td>
<td>10.2</td>
<td>15.2</td>
<td>7.9</td>
<td>7.5</td>
<td>8.4</td>
<td>10.4</td>
<td>8.3</td>
</tr>
<tr>
<td>Transport, storage and post (%)</td>
<td>4.3</td>
<td>4.5</td>
<td>6.0</td>
<td>3.6</td>
<td>7.0</td>
<td>5.9</td>
<td>4.0</td>
</tr>
<tr>
<td>Hotels and catering services (%)</td>
<td>1.7</td>
<td>1.5</td>
<td>1.5</td>
<td>1.9</td>
<td>2.7</td>
<td>2.2</td>
<td>2.4</td>
</tr>
<tr>
<td>Financial intermediation (%)</td>
<td>17.1</td>
<td>16.6</td>
<td>6.5</td>
<td>5.6</td>
<td>8.9</td>
<td>6.5</td>
<td>6.0</td>
</tr>
<tr>
<td>Real estate (%)</td>
<td>6.3</td>
<td>6.8</td>
<td>4.1</td>
<td>4.0</td>
<td>5.0</td>
<td>4.1</td>
<td>3.9</td>
</tr>
<tr>
<td>Others (%)</td>
<td>39.5</td>
<td>23.1</td>
<td>15.2</td>
<td>16.0</td>
<td>20.6</td>
<td>16.3</td>
<td>15.5</td>
</tr>
</tbody>
</table>

Table 7. Industrial structure of selected provinces, 2015

<table>
<thead>
<tr>
<th></th>
<th>Beijing</th>
<th>Shanghai</th>
<th>Fujian</th>
<th>Anhui</th>
<th>Shanxi</th>
<th>LiaoNing</th>
<th>Shaan‘xi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross output value of Industry</td>
<td>17,352.46</td>
<td>31,322.64</td>
<td>10,165.33</td>
<td>39,875.66</td>
<td>12,566.97</td>
<td>33,498.56</td>
<td>20,333.97</td>
</tr>
<tr>
<td>Mining (% of total industrial output)</td>
<td>1%</td>
<td>0%</td>
<td>2%</td>
<td>3%</td>
<td>36%</td>
<td>5%</td>
<td>22%</td>
</tr>
<tr>
<td>Coal mining and dressing</td>
<td>0%</td>
<td>0%</td>
<td>31%</td>
<td>47%</td>
<td>93%</td>
<td>15%</td>
<td>49%</td>
</tr>
<tr>
<td>Petroleum and natural gas extraction</td>
<td>0%</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>12%</td>
<td>31%</td>
</tr>
<tr>
<td>Ferrous metals mining and dressing</td>
<td>32%</td>
<td>0%</td>
<td>20%</td>
<td>28%</td>
<td>6%</td>
<td>36%</td>
<td>4%</td>
</tr>
<tr>
<td>Nonferrous metals mining and dressing</td>
<td>0%</td>
<td>0%</td>
<td>11%</td>
<td>7%</td>
<td>0%</td>
<td>12%</td>
<td>10%</td>
</tr>
<tr>
<td>Mining auxiliary activities</td>
<td>68%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>8%</td>
<td>3%</td>
</tr>
<tr>
<td>Other mining industry</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Manufacturing (% of total industrial output)</td>
<td>72%</td>
<td>95%</td>
<td>92%</td>
<td>91%</td>
<td>51%</td>
<td>90%</td>
<td>71%</td>
</tr>
<tr>
<td>Farm products processing</td>
<td>3%</td>
<td>1%</td>
<td>6%</td>
<td>8%</td>
<td>5%</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>Food manufacturing</td>
<td>2%</td>
<td>2%</td>
<td>4%</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>4%</td>
</tr>
<tr>
<td>Wine, beverages and refined tea manufacturing</td>
<td>1%</td>
<td>0%</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>4%</td>
</tr>
<tr>
<td>Tobacco products manufacturing</td>
<td>0%</td>
<td>3%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>2%</td>
</tr>
<tr>
<td>Textile industry</td>
<td>0%</td>
<td>1%</td>
<td>5%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>Textile, wearing apparel and accessories</td>
<td>1%</td>
<td>1%</td>
<td>5%</td>
<td>3%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Leather, fur, feather and related products and footwear</td>
<td>0%</td>
<td>1%</td>
<td>10%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Timber processing, bamboo, cane, palm fibre and straw products</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Furniture manufacturing</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>Paper making and paper products</td>
<td>0%</td>
<td>1%</td>
<td>2%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Printing and record medium reproduction</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>Culture, education, art and crafts, sport and entertainment products</td>
<td>1%</td>
<td>1%</td>
<td>4%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>Petroleum processing, coking and nuclear fuel processing</td>
<td>5%</td>
<td>4%</td>
<td>4%</td>
<td>1%</td>
<td>12%</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>Category</td>
<td>Beijing</td>
<td>Shanghai</td>
<td>Fujian</td>
<td>Anhui</td>
<td>Shanxi</td>
<td>Liaoning</td>
<td>Shaan’xi</td>
</tr>
<tr>
<td>------------------------------------------------------------</td>
<td>---------</td>
<td>----------</td>
<td>--------</td>
<td>-------</td>
<td>--------</td>
<td>----------</td>
<td>----------</td>
</tr>
<tr>
<td>Raw chemical materials and chemical products</td>
<td>3%</td>
<td>8%</td>
<td>3%</td>
<td>6%</td>
<td>8%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Medical and pharmaceutical products</td>
<td>6%</td>
<td>2%</td>
<td>1%</td>
<td>2%</td>
<td>3%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Chemical fibre manufacturing</td>
<td>0%</td>
<td>0%</td>
<td>2%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Rubber and plastic products</td>
<td>1%</td>
<td>3%</td>
<td>4%</td>
<td>4%</td>
<td>1%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Nonmetal mineral products</td>
<td>3%</td>
<td>2%</td>
<td>8%</td>
<td>7%</td>
<td>5%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Smelting and pressing of ferrous metals</td>
<td>1%</td>
<td>4%</td>
<td>3%</td>
<td>5%</td>
<td>27%</td>
<td>11%</td>
<td>7%</td>
</tr>
<tr>
<td>Smelting and pressing of non-ferrous metals</td>
<td>1%</td>
<td>1%</td>
<td>3%</td>
<td>6%</td>
<td>9%</td>
<td>3%</td>
<td>10%</td>
</tr>
<tr>
<td>Metal products</td>
<td>2%</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
<td>2%</td>
<td>4%</td>
<td>2%</td>
</tr>
<tr>
<td>Ordinary machinery manufacturing</td>
<td>4%</td>
<td>8%</td>
<td>3%</td>
<td>6%</td>
<td>2%</td>
<td>8%</td>
<td>4%</td>
</tr>
<tr>
<td>Special purpose equipment manufacturing</td>
<td>4%</td>
<td>3%</td>
<td>2%</td>
<td>4%</td>
<td>3%</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>Automobile manufacturing</td>
<td>31%</td>
<td>18%</td>
<td>3%</td>
<td>7%</td>
<td>1%</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>Railroad, marine, aviation and other transport equip manu.</td>
<td>3%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Electrical machinery and equipment manufacturing</td>
<td>6%</td>
<td>7%</td>
<td>5%</td>
<td>13%</td>
<td>3%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Computers, telecommunication and other electronic equip manu.</td>
<td>17%</td>
<td>18%</td>
<td>8%</td>
<td>6%</td>
<td>10%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Equipments and instruments manufacturing</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Comprehensive utilization of waste resources</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Metal products, machinery and equipment repair</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Production and supply of electricity, heat, gas and water (% of total industrial output)</td>
<td>26%</td>
<td>5%</td>
<td>6%</td>
<td>5%</td>
<td>13%</td>
<td>5%</td>
<td>7%</td>
</tr>
<tr>
<td>Production and supply of electricity and heat</td>
<td>90%</td>
<td>73%</td>
<td>89%</td>
<td>91%</td>
<td>90%</td>
<td>93%</td>
<td>86%</td>
</tr>
<tr>
<td>Production and supply of gas</td>
<td>9%</td>
<td>22%</td>
<td>7%</td>
<td>7%</td>
<td>9%</td>
<td>4%</td>
<td>12%</td>
</tr>
<tr>
<td>Production and supply of water</td>
<td>1%</td>
<td>5%</td>
<td>4%</td>
<td>2%</td>
<td>1%</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>

We also note that the economic structure in trapped provinces like Liaoning is not significantly different from those provinces that are neither trapped nor escaped (such as Fujian and Anhui). Thus, while the economic structure may provide some explanation for the MIT phenomenon, it does not fully explain the reason behind the trapped dragon.

A number of studies have attempted to measure provincial-level TFP in China (Bai & Yin, 2008; Han, 2017; Sun & Xiu, 2017). They use different approaches to estimate the TFP to make cross-provincial comparisons. Han’s (2017) estimations, using the DEA-Malmquist methodology, show that all trapped provinces suffer from an average negative TFP growth between 2004 and 2013 (e.g. Shanxi (–5.4 per cent), Liaoning (–1.9 per cent), Jilin (–1.5 per cent) and etc.), while provinces that are not in the MIT have positive TFP growth rate (e.g. Jiangsu (+4.5 per cent), Guangxi (+4.1 per cent), Beijing (+2.2 per cent), and etc.). Based on the clear distinction in the TFP growth rate, we can conclude that productivity and its growth is an important factor that distinguishes a trapped province from a non-trapped province.

Thus, the general policy implication for the trapped dragon to escape from the MIT is to promote local TFP growth. To do so, the upgrading of industry structure is important, as there is evidence that certain industries outperform others in TFP growth rates (Dai & Mao, 2015; Zhu et al., 2019). Building local human capital and enhancing labour mobility across regions are also recommended policies (Cai & Du, 2000; Huang et al., 2019). In contrast, it should also be noted that some apparently popular policies, such as investments in local infrastructure or establishing special development zones in lagging regions, are found to be inefficient. Infrastructure investments by local government crowd out private capital and reduce the efficiency of such investments (Shi et al., 2017), while special economic development zones fail to promote improvements in local TFP and create spatial resource misallocation (Chen et al., 2019).

**Conclusion**

Previous studies tend to show that China is in or heading towards the MIT (Glawe & Wagner, 2017) while others claim that it has already escaped the trap (Huang, 2016). We argue that, given the economic diversity that exists in China, the MIT needs to be evaluated at the provincial level to be able to provide meaningful insights. While China as a whole is classified by the World Bank as an upper-middle-income country in 2017, municipalities like Beijing, Tianjin and Shanghai have per capita income that is well above the US$12,235 threshold and thus can be classified as high-income. At the same time, provinces like Gansu and Shanxi have average incomes of about US$4,000 and could still be classified as lower-middle-income. We use the three most popular definitions of the MIT and identify 10 provinces that...
are trapped or heading towards the MIT, which we refer to as the trapped dragon: Shanxi, Inner Mongolia, Liaoning, Jilin, Shaan’xi, Qinghai, Xinjiang, Heilongjiang, Gansu and Hebei. It should be noted that these provinces are trapped not because they are ‘poor’, but rather because their economic growth rates have experienced a prolonged slowdown, and a failure to address this malaise could result in these provinces lagging further behind their neighbours. We find low productivity to be an important distinguishing factor between trapped and non-trapped provinces, while weak human capital development and an economic structure that is more biased towards heavy industry and mining could explain the differences between trapped and escaped provinces.

An important policy implication that arises from this study is the need to prescribe different policies to different provinces in China. Clearly, for the trapped provinces, a transformation in economic structure is necessary. For the last three decades, the trapped provinces have focused on heavy industry, mining and agriculture and supported the economic growth and transformation of their neighbours. As the demands for physical infrastructure plateaus (thus, a decrease in demand for heavy industry inputs like iron and steel) and regional economies become more service-oriented, the trapped provinces can no longer continue to rely on their traditional industries as engines of growth. Just like their southern neighbours in the 1980s and 1990s, a shift towards light and more technologically advanced industries is necessary. It is relatively easier to improve productivity in such industries. However, an important prerequisite to attract more productive industries is the availability of human capital. In this regard, the policies pursued by provinces like Jiangsu and Guangdong in the 1980s and 1990s are useful templates for the trapped provinces. More in-depth studies on factors that push provinces into the MIT, on the one hand, and the provincial-specific economic growth models pursued by non-trapped provinces, on the other, will be useful in this regard.

Acknowledgement

The corresponding author would like to thank the Institute of International Business and Governance, established with the partial support of a grant from the Research Grants Council of the Hong Kong Special Administrative Region, China (UGC/IDS16/17), for its support.
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ARGUMENT
The changing nature of community service obligations in the postal sector and the future of Australia Post

Malcolm Abbott and Bruce Cohen¹

Abstract

This article examines the theoretical bases for the existence of community service obligations (CSOs) in postal services in Australia. It assesses the forces that can be expected to affect both their form as well as the capacity of Australia Post to deliver CSOs into the future. It concludes by considering the implications of this assessment for Australia Post’s ownership structure, strategic direction and its relationship with other communications, logistic and financial service providers, as well as with both the federal and state and territory governments.

Introduction

Australia Post² is the oldest government business enterprise operating in Australia, although in recent years the nature of its business has changed dramatically. Traditional mail volumes have declined rapidly as technological change has enabled alternative means of communications, while parcel deliveries have increased as those same technologies have led to substantial growth in internet-based commerce.

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¹ Swinburne University of Technology, mabbott@swin.edu.au.
² Australia Post refers to the Australian Postal Corporation, which is the government business enterprise established under the Australian Postal Corporation Act 1989 (Cth) (APC Act).
Together with the role Australia Post now plays as a deliverer of retail, government and transaction services, there is a question for policymakers as to the efficacy of maintaining the postal-related community service obligations (CSOs) Australia Post has traditionally provided, whether those obligations should be reformed to meet more relevant current and future needs, and, relatedly, are those potential obligations best delivered by a government-owned entity such as Australia Post.

To this end, this article first considers the theoretical bases for the existence of CSOs in postal services. It then details the CSOs Australia Post currently delivers, before considering how changes in market conditions have altered both the need for such obligations and the financial capacity of Australia Post to deliver them. The article then goes on to assess the nature and extent of CSOs likely to be required in the future, and whether they are most appropriately provided by an entity such as Australia Post. The paper concludes by considering the implications of this assessment for Australia Post’s ownership structure and strategic direction—including its relationship with other communications, logistic and financial service providers, as well as with the federal and state and territory governments.

**CSOs in the postal sector: A brief background**

An important part of the justification for public ownership of Australia Post has been the CSOs that the organisation has been required to deliver. CSOs in the postal sector usually take the form of universal service obligations (USOs) (Australian Government Department of Communications, 2014). USOs are requirements imposed on service providers to provide a common minimum service offering to all potential customers, regardless of their location. Such obligations are common in a range of industries, including post, telecommunications and essential service utilities such as electricity and water supply.

CSOs in the form of USOs generally involve cross-subsidisation. Cross-subsidisation is the practice of charging prices to one type of consumers that are higher than that required to cover the costs associated with the service in question so as to artificially lower prices for another group. The formal definition of a cross-subsidy that has been developed in the economic literature comprises two tests that compare a service’s revenues to different cost concepts. A service is a recipient of a cross-subsidy where revenue is less than the direct costs of providing the service. It also might be the beneficiary of a cross-subsidy where revenue is sufficient to cover the direct costs, but less than the sum of direct and attributable costs. In either case, the costs of providing the services is in part paid for from the revenue generated by a different service (Australian Competition and Consumer Commission, 2014, p. 1; Faulhaber, 1975, p. 966).
Although public enterprises might cross-subsidise for political and equity reasons, it is also possible that they might do so for a variety of other objectives, such as to expand the scale of operations, perhaps because the managers of the enterprise benefit personally from expanded scale (Geddes, 1994; Niskanen, 1975; Sappington & Sidak, 2003). It is recognised in the literature that to cross-subsidise it is necessary to have a degree of market power in at least one market segment (Faulhaber, 1975, p. 972; Sidak, 2015, p. 617).

The USOs that operate in the postal sector are generally defined along three dimensions: product range, service quality and pricing constraints (e.g. affordability, uniform pricing) (Ambrosini et al., 2006; Gautier & Poudou, 2014). In turn, service quality may encompass various aspects, including territorial coverage (ubiquity), transit time, accessibility of contact points and delivery frequency (Calzada, 2009). Thus, in the postal sector USOs generally take the form of uniform pricing structures for letters of a similar size and weight, as well as common delivery standards. These minimum service requirements are designed to ensure an affordable, reliable service is available to all members of the community. Without such USOs, the cost structures associated with the provision of the service would result in higher prices, lower standards and/or no services for customers located in areas characterised as more remote, less densely populated or less affluent. The application of uniform pricing for specified mail services is generally accompanied by regulatory imposed monopolies for these services—this approach aimed at underpinning the sustainability of the USOs by establishing exclusivity of service provision, which enables cross-subsidisation between profitable and non-profitable service areas (see Kenny, 2005).³

A range of reasons are posited for the imposition of USOs. A core justification is that the services provided by certain industries are essential to satisfy basic needs (Boldron et al., 2007). According to Boldron et al., this justification is founded on the notion of specific egalitarianism introduced by Tobin (1970):

> that certain specific scarce commodities should be distributed less unequally than the ability to pay for them. Candidates for such sentiments include basic necessities of life, health, and citizenship. (p. 264)

Related to this notion, directed at meeting the needs of individuals who might otherwise suffer disadvantage, is the more collective-oriented justification that a uniform and universal postal network operates a binding force for communities, and as such has the characteristics of a ‘public good’ (Cremer et al., 1998, 2001; Jaag, 2013; Jaag & Trinckner, 2011). In this regard, postal services have historically been integral in meeting the need of enabling the physical communications that underpin

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³ Conversely, the capacity for USOs to be funded by a service provider is reduced where services are generally subject to competition, as this competition will manifest in those areas where profits are achievable (see Chone et al., 2000).
and facilitate community and commercial activity, including the enforcement of property rights—both by establishing a consistent and legally accepted method by which members of the community can be located, as well as the means by which individuals, businesses and the state can communicate and, to varying degrees, transfer both documents and goods.

While such notions may be relied upon to support the direct or indirect provision of certain services as societal necessities, it does not provide a ready explanation for the form in which USOs have been imposed in the postal sector; that is, by way of regulated minimum standards. Relatedly, it does not provide an explanation as to why USOs in that form have traditionally applied to the provision of services such as post and telecommunications, but not for other basic needs such as, say, food or housing. Both the public economics and network economics literatures, however, provide potential explanations for the adoption of USOs in the form of minimum regulated standards, rather than relying on transfer payments and utilisation of market mechanisms to address issues of social disadvantage.

First, in the case of postal services, it is argued that the costs associated with identifying potential recipients for direct transfer payments to subsidise the costs of service may involve such time and expense as to make such an approach less efficient than simply imposing minimum standards, notwithstanding lowering costs overall may result in some overconsumption of services (see Jaag & Trinckner, 2011).

Second, it is suggested that direct subsidies may not be the most efficient solution to meeting individual needs in the case of postal services because they are reliant on networks, which in turn give rise to network externalities (Boldron et al., 2009; Cremer et al., 1998, 2001). At its most fundamental level, postal services are a means for senders to overcome distances to recipients, acting as intermediaries that consolidate mail of different senders, thereby reducing transaction costs through the exploitation of scale, density and scope (Cuomo et al., 2013; Jaag & Trinckner, 2011). As the postal service comprises a network enabling linkages between senders and recipients, expanding coverage can create economies of scale and scope that might not otherwise be achieved. This is because the private benefit to an individual customer may be insufficient to justify a decision on their part to partake in such a service, yet may be justified overall because others who are able to access the postal service enjoy a benefit from the increased coverage (Calzada, 2009; Jaag & Trinckner, 2011; Willig, 1979). In this regard, the benefits of such expanded coverage are not confined to those who are recipients of postal services, but also extended to senders—for example, firms who have expanded potential customer bases than would otherwise be the case. As Boldron et al. (2009) note further, however, the utility of the network externalities are less likely to be as symmetric (i.e. as between senders and recipients) having regard to membership and usage in the postal sector than, say, in the telecommunications sector. Further, postal services networks are different from many other regulated networks in that they are more
heavily dependent on human assets, as compared to other physical infrastructure: in particular, the people involved in the ‘last mile’ delivery aspects of the postal service (Meagli et al., 2011).

While these attributes provide economic justifications for USOs in the form of minimum standards, it should be recognised that such mechanisms may also reflect other, broader policy pressures—for example, a desire for governments to encourage particular regional development policies, which may be assisted by uniform pricing policies that represent a subsidy for individuals in particular locations. Relatively, USOs of this nature may reflect a desire by governments to address political pressures from communities in such locations. The fact that such USOs are often provided by entities that are government-owned monopolies also facilitates requirements of this nature being instituted; as private sector providers in competitive markets would be less willing, or able, to meet such obligations internally. The following section details how the USOs that typically operate in the postal sector have manifested in Australia.

CSOs and Australia Post

Responsibility for the delivery of postal services sits with Australia Post, a publicly owned government business enterprise established and regulated under the Australian Postal Corporations Act 1989 (Cth) (APC Act) (as to the origins of postal services in Australia and the predecessor bodies of Australia Post, see Abbott, 2000, 2019). Pursuant to the APC Act (section 14), Australia Post’s principal function is to supply postal services within Australia, and between Australia and overseas. In fulfilling this function, generally Australia Post has the exclusive right to carry certain letters within Australia, whether the letters originated within or outside Australia. The letters over which Australia Post has the exclusive right to deliver are defined on the basis of weight, size and thickness. The amount that Australia Post is able to charge for the delivery of such letters is subject to regulation and is capped. From 2016 until the end of 2019, the price of basic postage was set at $1.00; this price having increased five times since 2000 (when the price was then 45 cents). This increase in prices in 2016 coincided with changes in delivery standards, which allowed longer time periods for the delivery for basic postal services (i.e. regular letters, as compared

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4 Policy objectives may also militate against the imposition of USOs—for example, environmental policies aimed at reducing carbon emissions may be directed at encouraging reducing reliance on paper-based mail, or reducing the regularity of deliveries (see, for example, Boldron et al., 2011), though it also suggested that the aggregation of activity by postal services reduces adverse environmental outcomes that would otherwise arise if multiple logistic providers operated to deliver last-mile services (see The Urban Institute, 2010).

5 In addition to these commonly accepted policy objectives, other socially beneficial outcomes associated with postal services include safety and security, which incorporates the role played by postal workers as a form of neighbourhood watch (The Urban Institute, 2010).
priority letters) (see further below). In August 2019, Australia Post proposed to raise this basic price to $1.10 in 2020, which was accepted by the Australian Government on the advice of the Australian Competition and Consumer Commission and started on 1 January 2020 (for the change in the nominal and constant $ price of basic postage in Australia from 2000 to 2020, see Figure 1).

Australia Post is also empowered to carry on, outside Australia, any business or activity relating to postal services (section 15, APC Act), as well as any business or activity inside or outside Australia that is incidental to such services, businesses or activities (section 16, APC Act). Among the range of activities that Australia Post undertakes are parcel delivery services, express post services, retail activities and the provision, as an agent, of a range of financial services, including billing transactions services (Australia Post, 2018, p. 1).

As with most postal services operating throughout the world, Australia Post is obliged to provide a range of CSOs. These are specified in the APC Act (section 27), which imposes the requirement on Australia Post to supply a letters service at a uniform rate within Australia for standard postal articles, and in so doing ensure that the service is reasonably accessible to all Australians and meets the social, industrial and commercial needs of the Australian community. The specific nature of these CSOs applicable to Australia Post are further specified in regulation, and insofar as they relate to delivery apply primarily to reserved services letters (for delivery service standards in place prior to measures introduced in response to the COVID-19 pandemic, see Table 1).

### Table 1: Basic stamp price in Australia, nominal and real 2000 to 2020 (cents and 2018 cents)

<table>
<thead>
<tr>
<th>Year</th>
<th>Basic stamp price</th>
<th>Basic stamp price (2018 cents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>45</td>
<td>72</td>
</tr>
<tr>
<td>2001</td>
<td>45</td>
<td>72</td>
</tr>
<tr>
<td>2002</td>
<td>45</td>
<td>67</td>
</tr>
<tr>
<td>2003</td>
<td>50</td>
<td>72</td>
</tr>
<tr>
<td>2004</td>
<td>50</td>
<td>71</td>
</tr>
<tr>
<td>2005</td>
<td>50</td>
<td>69</td>
</tr>
<tr>
<td>2006</td>
<td>50</td>
<td>66</td>
</tr>
<tr>
<td>2007</td>
<td>50</td>
<td>61</td>
</tr>
<tr>
<td>2008</td>
<td>50</td>
<td>62</td>
</tr>
<tr>
<td>2009</td>
<td>55</td>
<td>67</td>
</tr>
<tr>
<td>2010</td>
<td>60</td>
<td>71</td>
</tr>
<tr>
<td>2011</td>
<td>60</td>
<td>69</td>
</tr>
<tr>
<td>2012</td>
<td>60</td>
<td>67</td>
</tr>
<tr>
<td>2013</td>
<td>60</td>
<td>66</td>
</tr>
<tr>
<td>2014</td>
<td>70</td>
<td>75</td>
</tr>
<tr>
<td>2015</td>
<td>70</td>
<td>74</td>
</tr>
<tr>
<td>2016</td>
<td>100</td>
<td>105</td>
</tr>
<tr>
<td>2017</td>
<td>100</td>
<td>102</td>
</tr>
<tr>
<td>2018</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2019</td>
<td>100</td>
<td>98</td>
</tr>
<tr>
<td>2020</td>
<td>110</td>
<td>108</td>
</tr>
</tbody>
</table>

Figure 1. Basic stamp price in Australia, nominal and real 2000 to 2020 (cents and 2018 cents)


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6 See the *Australian Postal Corporation (Performance Standards) Amendment (Speed of Mail Delivery) Regulation 2015* (Cth).
7 Reserved services letters are defined in the APC Act (see section 29: Services reserved to Australia Post etc.; see also section 3 (definition of ‘letter’ and ‘standard postal article’)).
8 As to amendments to regulations affecting delivery standards to deal with immediate issues arising from the COVID-19 pandemic, see the *Australian Postal Corporation (Performance Standards) Amendment (2020 Measures No. 1) Regulations 2020* (Cth).
Table 1. Performance standards applicable as at 7 February 2019

<table>
<thead>
<tr>
<th>Lodgement</th>
<th>Priority</th>
<th>Regular</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000 street posting boxes</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Delivery timetables**

<table>
<thead>
<tr>
<th>If the mail lodgement point is ... and the delivery address is ...</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery within a state</td>
<td>Next business day</td>
<td>3 business days</td>
</tr>
<tr>
<td>in the capital city of a state</td>
<td>within that capital city</td>
<td></td>
</tr>
<tr>
<td>in another city, or a town, in a state</td>
<td>Next business day</td>
<td>3 business days</td>
</tr>
<tr>
<td>within: (a) that city or town; or (b) an adjacent city or town in that state</td>
<td></td>
<td></td>
</tr>
<tr>
<td>in the capital city of a state</td>
<td>in a place within that state other than that capital city</td>
<td>2 business days</td>
</tr>
<tr>
<td>city, or a town, in a state</td>
<td>in a place within that state other than: (a) that city or town; or (b) an adjacent city or town in that state</td>
<td>2 business days</td>
</tr>
<tr>
<td>in a place in a state other than a place mentioned</td>
<td>within that state</td>
<td>2 business days</td>
</tr>
</tbody>
</table>

**Delivery between states**

| in the capital city of a state | within the capital city of another state | 2 business days | 5 business days |
| outside the capital city of a state | within the capital city of another state | 3 business days | 6 business days |
| outside the capital city of a state | outside the capital city of another state | 4 business days | 7 business days |

**On time delivery**

94.0% of reserved services letters

**Access**

4,000 retail outlets

2,500 retail outlets in rural and remote areas

Retail outlets located so that:
- Metropolitan areas—at least 90% of residences are within 2.5 km of an outlet
- Non-metropolitan areas—at least 85% of residences are within 7.5 km of an outlet

**Delivery frequency**

98.0% of delivery points to receive five days a week

99.7% of delivery points to receive deliveries no less than twice a week

Further, the APC Act also imposes obligations on Australia Post with respect to international mail. Arrangements with respect to international mail are also governed by the Universal Postal Union (UPU) treaty arrangements, under which Australia Post is required to deliver inbound international mail on terms no less favourable than those applied to comparable items in the domestic service, increased by the time normally required for customs clearance (Universal Postal Convention Article 20(2): Universal Postal Union, 2017). Remuneration received by Australia Post in relation to all such deliveries are determined according to UPU rules.9

In providing its services, Australia Post is the subject of pricing oversight by the Australian Competition and Consumer Commission. Price notification provisions are contained in Part VIIA of the *Competition and Consumer Act 2010* and apply to declared services. Where Australia Post proposes to increase prices of a declared service it must notify the Australian Competition and Consumer Commission. The commission must then consider the proposal in accordance with the *Competition and Consumer Act 2010* and notify Australia Post whether it objects to the proposed price increase. The commission provides a recommendation to the Minister for Communications, and if the minister does not disapprove of the price increase Australia Post can go ahead with it. The *Postal Services Legislation Amendment Act 2004* also introduced record-keeping rules to enable the commission to assess whether Australia Post has been unfairly competing by using revenue from its reserved services to cross-subsidise the services it provides in competition with other businesses, and to issue an annual report on this matter, although this report was discontinued from 2015/16 (Australian Competition and Consumer Commission, 2020).

### Changing nature of delivery of current USOs and the factors affecting this

While the CSOs required to be met by Australia Post prior to the COVID-19 pandemic have been largely unchanged for the past four years, the nature of services that it is delivering continues to evolve rapidly, in large part due to the combination of technological change and with it the shifting reliance that the community is placing on traditional postal services relative to other services, such as telecommunications and parcel delivery.

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9 Arrangements with respect to remuneration for international deliveries—otherwise known as the terminal dues system—were the subject of an Extraordinary Congress of the UPU in September 2019. The UPU resolved to reform the manner in which remuneration is set to allow member states to self-declare their rates from July 2020 (subject to some exceptions, for example, with respect to countries with low inbound letter-post volumes).
The changing nature of Australia Post’s service delivery profile is illustrated in Figure 2 and Table 2. Figure 2 shows the volume of postal articles carried by Australia Post between 2000 and 2019. As can be seen, there has been a steady decline since this volume peaked in 2008. Table 2 provides data on the overall revenue and expenses of the organisation as well as the relative share of revenue derived from mail, parcel/express services and retail (and other) services since 2006 (columns 7–9). The decline in the volume of mail over time has contributed substantially to the decline in the profitability of the organisation since 2008 (see Figure 3).

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>5203.7</td>
</tr>
<tr>
<td>2001</td>
<td>5258.4</td>
</tr>
<tr>
<td>2002</td>
<td>5281.2</td>
</tr>
<tr>
<td>2003</td>
<td>5261.7</td>
</tr>
<tr>
<td>2004</td>
<td>5307.5</td>
</tr>
<tr>
<td>2005</td>
<td>5363.1</td>
</tr>
<tr>
<td>2006</td>
<td>5418.1</td>
</tr>
<tr>
<td>2007</td>
<td>5515.8</td>
</tr>
<tr>
<td>2008</td>
<td>5609.4</td>
</tr>
<tr>
<td>2009</td>
<td>5323.4</td>
</tr>
<tr>
<td>2010</td>
<td>5145.0</td>
</tr>
<tr>
<td>2011</td>
<td>5038.2</td>
</tr>
<tr>
<td>2012</td>
<td>4843.0</td>
</tr>
<tr>
<td>2013</td>
<td>4580.2</td>
</tr>
<tr>
<td>2014</td>
<td>4570.2</td>
</tr>
<tr>
<td>2015</td>
<td>4314.2</td>
</tr>
<tr>
<td>2016</td>
<td>4023.5</td>
</tr>
<tr>
<td>2017</td>
<td>3634.1</td>
</tr>
<tr>
<td>2018</td>
<td>3342.4</td>
</tr>
</tbody>
</table>

*Figure 2. Australia Post, articles posted in year ended 30 June (million)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit before tax/total assets (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>12.9</td>
</tr>
<tr>
<td>2001</td>
<td>12.6</td>
</tr>
<tr>
<td>2002</td>
<td>12.6</td>
</tr>
<tr>
<td>2003</td>
<td>13.7</td>
</tr>
<tr>
<td>2004</td>
<td>12.9</td>
</tr>
<tr>
<td>2005</td>
<td>11.2</td>
</tr>
<tr>
<td>2006</td>
<td>10.7</td>
</tr>
<tr>
<td>2007</td>
<td>10.2</td>
</tr>
<tr>
<td>2008</td>
<td>10.8</td>
</tr>
<tr>
<td>2009</td>
<td>8.9</td>
</tr>
<tr>
<td>2010</td>
<td>2.6</td>
</tr>
<tr>
<td>2011</td>
<td>8.0</td>
</tr>
<tr>
<td>2012</td>
<td>8.8</td>
</tr>
<tr>
<td>2013</td>
<td>9.2</td>
</tr>
<tr>
<td>2014</td>
<td>2.2</td>
</tr>
<tr>
<td>2015</td>
<td>-6.9</td>
</tr>
<tr>
<td>2016</td>
<td>0.8</td>
</tr>
<tr>
<td>2017</td>
<td>2.3</td>
</tr>
<tr>
<td>2018</td>
<td>2.2</td>
</tr>
<tr>
<td>2019</td>
<td>0.7</td>
</tr>
</tbody>
</table>

*Figure 3. Australia Post rate of return: Profit before tax/total assets, year ended 30 June 2000 to 2019 (per cent)*
Source: Australia Post (2000–2019). See Table 2 (this chapter), Column 4 divided by Column 5.
### Table 2. Australia Post: Key statistics, 2000 to 2019

<table>
<thead>
<tr>
<th>Year ended 30 June</th>
<th>Revenue $m</th>
<th>Expenses $m</th>
<th>Profit before tax $m</th>
<th>Total assets $m</th>
<th>CSOs $m</th>
<th>Mail revenue* $m</th>
<th>Parcels &amp; express* $m</th>
<th>Retail, agency &amp; other* $m</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3,785.8</td>
<td>3,393.9</td>
<td>391.9</td>
<td>3,037.3</td>
<td>81.7</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2001</td>
<td>3,766.4</td>
<td>3,364.3</td>
<td>402.1</td>
<td>3,198.5</td>
<td>86.3</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2002</td>
<td>3,806.6</td>
<td>3,399.4</td>
<td>407.2</td>
<td>3,228.9</td>
<td>87.9</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2003</td>
<td>3,971.9</td>
<td>3,509.9</td>
<td>462.0</td>
<td>3,364.7</td>
<td>90.3</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2004</td>
<td>4,161.1</td>
<td>3,640.0</td>
<td>521.1</td>
<td>4,054.1</td>
<td>79.1</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2005</td>
<td>4,325.9</td>
<td>3,856.1</td>
<td>469.8</td>
<td>4,192.7</td>
<td>81.0</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2006</td>
<td>4,530.1</td>
<td>4,014.5</td>
<td>515.6</td>
<td>4,808.4</td>
<td>87.8</td>
<td>2,634.8</td>
<td>1,095.8</td>
<td>670.6</td>
</tr>
<tr>
<td>2007</td>
<td>4,711.1</td>
<td>4,367.0</td>
<td>561.7</td>
<td>5,490.0</td>
<td>97.3</td>
<td>2,679.0</td>
<td>1,198.9</td>
<td>681.0</td>
</tr>
<tr>
<td>2008</td>
<td>4,959.2</td>
<td>4,367.0</td>
<td>592.2</td>
<td>5,477.0</td>
<td>104.3</td>
<td>2,731.2</td>
<td>1,315.1</td>
<td>713.4</td>
</tr>
<tr>
<td>2009</td>
<td>4,974.5</td>
<td>4,604.4</td>
<td>380.9</td>
<td>4,270.2</td>
<td>113.8</td>
<td>2,750.6</td>
<td>1,348.5</td>
<td>736.2</td>
</tr>
<tr>
<td>2010</td>
<td>4,856.2</td>
<td>4,767.6</td>
<td>103.0</td>
<td>3,915.2</td>
<td>145.7</td>
<td>2,658.1</td>
<td>1,361.7</td>
<td>712.0</td>
</tr>
<tr>
<td>2011</td>
<td>4,986.5</td>
<td>4,674.3</td>
<td>332.0</td>
<td>4,135.1</td>
<td>144.7</td>
<td>2,728.1</td>
<td>1,434.0</td>
<td>708.5</td>
</tr>
<tr>
<td>2012</td>
<td>5,126.2</td>
<td>4,776.3</td>
<td>366.7</td>
<td>4,175.8</td>
<td>165.2</td>
<td>2,312.1</td>
<td>1,822.6</td>
<td>1,342.6</td>
</tr>
<tr>
<td>2013</td>
<td>5,893.2</td>
<td>5,490.3</td>
<td>402.8</td>
<td>4,401.5</td>
<td>177.5</td>
<td>2,207.8</td>
<td>2,658.4</td>
<td>1,370.0</td>
</tr>
<tr>
<td>2014</td>
<td>6,383.3</td>
<td>6,280.3</td>
<td>103.0</td>
<td>4,651.2</td>
<td>205.8</td>
<td>2,110.4</td>
<td>3,094.2</td>
<td>1,465.7</td>
</tr>
<tr>
<td>2015</td>
<td>6,373.8</td>
<td>6,725.9</td>
<td>-352.1</td>
<td>5,094.4</td>
<td>211.6</td>
<td>2,074.9</td>
<td>3,207.0</td>
<td>1,491.1</td>
</tr>
<tr>
<td>2016</td>
<td>6,562.2</td>
<td>6,521.2</td>
<td>41.0</td>
<td>5,043.2</td>
<td>183.6</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>2017</td>
<td>6,807.2</td>
<td>6,681.1</td>
<td>126.1</td>
<td>5,537.3</td>
<td>389.9</td>
<td>2,991.8</td>
<td>2,694.3</td>
<td>962.4</td>
</tr>
<tr>
<td>2018</td>
<td>6,877.0</td>
<td>6,751.3</td>
<td>125.7</td>
<td>5,590.9</td>
<td>403.5</td>
<td>2,903.6</td>
<td>2,913.9</td>
<td>966.9</td>
</tr>
<tr>
<td>2019</td>
<td>6,989.8</td>
<td>6,950.3</td>
<td>41.1</td>
<td>5,536.6</td>
<td>392.2</td>
<td>2,216.3</td>
<td>3,808.8</td>
<td>968.7</td>
</tr>
</tbody>
</table>

Note: *Changes in the divisions of Australia Post make some years not compatible.


The changing nature of Australia Post’s business can be seen from the figures in columns 7, 8 and 9 of Table 2. Since 2006 the proportion of Australia Post’s revenue derived from mail has fallen from 58 per cent in 2006 to 40 per cent in 2019. Over the same period, parcels and express delivery has risen from 24 to 42 per cent, while retail, agency and others has been fairly stable at around 14 to 15 per cent. The changing nature of Australia Post’s revenue reflects both the impact of technology change on its traditional mail business, and also the extent to which it is increasingly reliant on revenue from those parts of its business which are subject to competition (i.e. the parcel business).

In considering the nature of Australia Post’s parcel delivery business, it is necessary to recognise that the geographical reach of Australia Post is such that, in a range of instances, its competitors themselves rely on Australia Post’s delivery services to meet their own customers’ needs. As this article examines further below, this gives
weight to the question of whether, if at all, the extent to which parcel deliveries are reliant on the ubiquity of Australia Post’s coverage provides an ongoing and evolving justification for the maintenance of some form of CSOs in the regulatory structure of Australia’s postal services.

The changing shape of Australia Post’s business, however, also raises broader questions as to the ongoing efficacy of the CSOs that it is required to deliver. As noted above, there has been a significant decline in the traditional mail business, which appears to be continuing and indeed accelerating. In large part, this is a consequence of technological change, which has meant the provision of communications traditionally met by mail is increasingly being delivered through alternative means—that is, via the internet and related telecommunications-based applications—that are both more efficient and convenient. At the same time, as Table 2 illustrates (column 6), the costs associated with Australia Post’s CSOs are rising significantly, while profitability has been declining (see column 4, Table 2, and Figure 3). Hence, as the benefits associated with traditional CSOs are reducing, the capacity of Australia Post to deliver them is falling. To the extent that Australia Post is required to fund the delivery of these CSOs directly, this in turn has the potential to reduce Australia Post’s competitiveness in product markets for which it is required to compete—an effect not sufficiently offset by the revenue and/or profit obtained from the delivery of services reserved solely for provision by Australia Post under legislation.

It is possible that this situation could be alleviated if reform to Australia Post’s business processes are able to achieve efficiencies that lower the cost of delivering services, both generally and specifically with respect to CSOs. In this regard, the changing landscape has prompted significant reform in how Australia Post undertakes its operations, focusing both on operational improvements in the delivery of traditional services as well as facilitating the expansion and productivity of parcel delivery activities. Strategies adopted with respect to enhancing the profitability of its letters service, for example, have included:

- process optimisation, including enterprise agreements that reform labour practices and reduce staffing levels
- process automation and technological innovation, such as new sorting machines at major mail centres to streamline processing
- facilitating the modification of the prescribed performance standards required to be met\textsuperscript{10}
- better utilisation of its delivery network, in particular by integrating letters and parcel delivery through Australia Post’s eCommerce Delivery Team,\textsuperscript{11} and the introduction of more efficient distribution channels (e.g. parcel lockers).

\textsuperscript{10} This is manifested in the introduction of two-tier letter pricing (with less onerous delivery performance standards for regular mail). For further details and discussion of these changes see Australian Government Department of Communications (2015).

\textsuperscript{11} See Australian National Audit Office (2017), Chapter 2.
Such reforms to Australia Post’s operations reflect a more general trend worldwide, which has seen a variety of operational changes as postal organisations have sought to address declining demand and digital disruption. While it is beyond the scope of this article to address such reform efforts in detail, similar to Australia Post this has seen both increases in prices and greater pricing flexibility, changes in service delivery requirements and a variety of operational enhancements, including the utilisation of technology, increased centralisation in some instances (e.g. PostNL; Post Danmark), plant consolidation (e.g. Post Canada, New Zealand Post) and changes in delivery models and delivery channels. While such changes have been directed at improving financial sustainability, the ongoing shifts in demand create ongoing and likely growing pressure on the capacity of postal organisations to deliver their more traditional services, and relatedly fulfil their CSOs.

As such, the changes being experienced in the postal sector create the need to reconsider the nature and scope of the CSOs that apply to postal services—a situation that has received recognition more broadly than just Australia. As Falch and Henten (2018) note, for example, it has been suggested that the EU should initiate a discussion on whether USOs are still meaningful in postal services alone, or rather that consideration be given to a comprehensive redefinition of the USO concept, towards a more general ‘right to communicate’. In the case of Australia, the Australian National Audit Office (2017) similarly suggested that:

> [g]iven the changing composition and narrowing of the user base for regulated letter delivery services, it may be that there are more effective ways of providing support to meet public policy objectives that do not involve using a broad-based CSO. A full examination of the costs and benefits of delivering the CSO would include a detailed consideration of the beneficiaries of the CSOs, the value of those benefits over time, and alternative options for delivering those benefits. This analysis would better inform decisions on whether the CSO remains relevant and fit for purpose, and if not, whether there are alternative policy approaches to adopt. (p. 64)

It is in light of these forces that this paper now considers the potential future nature of CSOs that may relevantly be provided by Australia Post, having particular regard to both the range of technological changes impacting on communications and the shifting community demands for services currently and potentially provided by Australia Post.13

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12 As to examples of similar reforms in other national postal organisations, see for example The Boston Consulting Group (2014) and Copenhagen Economics (2018).
13 According to Jaag and Trinkner (2011), such re-evaluation needs to have regard to five core principles: a focus on outputs (such as delivery times) rather than inputs (such as number of postal outlets), technological neutrality, product neutrality, necessity and viability. In a similar vein, the United States Postal Services (USPS) Office of Inspector General (2014) argued in favour of ensuring clarity of policy goals; recognition that the USO should define the floor and the market ceiling of services to be provided; that USOs should be flexible enough to enable adaptation to changing market conditions over multiple years; that they should be defined in terms of the service received, not how the service is provided; that they need to be financially sustainable while reasonably priced; and finally that any USO requirements should be transparent and measurable.
Considering reform to the CSOs delivered by Australia Post

In considering the potential nature of CSOs that should apply to Australia Post in the future, it is necessary to have regard to who the users, and hence the beneficiaries, of those CSOs might be, and in which capacity they are accessing those services. Historically, user groups intended to benefit from CSOs in the postal sector have been those living in rural/remote places, those with disabilities and reduced mobility, customers who are blind or visually impaired, and those on low income or who are elderly (Deloitte Access Economics, 2018; Industry Commission, 1997). It would be anticipated that these categories continue to represent those groups who should be the target of CSOs applicable to the postal sector.

In terms of the capacity in which such recipients fall, this categorisation may either relate to the type of user group a person falls within—for example, consumers as senders, consumers as receivers, small businesses—or to which postal services might be needed and for what purposes. In this context, for example, traditional mail may have a range of different purposes, including interaction with businesses, managing customer relationships, social interaction, social integration, meeting information needs, interaction between public institutions and citizens, and the delivery of goods. The degree to which changes associated with e-substitution have reduced, or will reduce, the need for CSOs that relate primarily to traditional mail services will then necessarily have regard to the extent to which substitution has occurred, or can be anticipated to occur, with respect to each of these different purposes for which mail is used.

In this regard, social media has made substantial inroads into mail used for social interaction, reducing the need for CSOs for that purpose; at the same time, transactions are increasingly moving towards email-based billing and online applications, including online payments systems. Similarly, digital marketing has manifested as a substitute for direct mail advertising materials, while physical publications such as newspapers and magazines are increasingly deliverable through digital media. Finally, reliance in Australia on traditional mail by government institutions appears also to have changed, albeit at a somewhat slower pace—with some aspects still requiring physical mail delivery (e.g. identification for election purposes), others less so. In this regard, Australia does not appear to have changed as rapidly as some other countries—for example, Denmark, which have sought to move quickly to e-government platforms (see Eggrickx et al., 2018).  

14 In Denmark, the drive for e-government encompassed the rollout of mandated digital mailboxes and a requirement for all interactions to be done, or capable to be done, electronically within specified timeframes (i.e. since 2014) (see Falch & Henten, 2018).
As Figure 2 suggests, digital alternatives have already substantively reduced the volume of traditional mail. Having regard to the CSOs that are delivered through the medium of such mail products, the extent of this e-substitution has the twofold effect of lessening the benefits that stem from the provision of traditional CSOs through the postal service, while at the same time raising the effective unit costs associated them. As such, it creates pressure to either constrain the extent of those CSOs, or to find alternative mechanisms or more efficient means by which they might be provided.

This effect has been noted by the United States Postal Service (USPS), who, in considering how USOs may be reformed to meet changing needs, has reflected that USOs might need to be focused to narrower subsets of the population—referring in particular to those who do not have access to broadband and those who are unwilling to trust or unable to use digital alternatives (for example, a proportion of more elderly customers) (USPS Office of the Inspector General, 2014). On this aspect of access to digital alternatives, it is noted that the rollout of the National Broadband Network (NBN) in Australia can be anticipated to accelerate the pace of change, and hence the decline of traditional mail services. In so doing, it also diminishes the need for traditional CSOs delivered through the postal system, albeit subject to the differences in quality and limitations in reach that may exist under the NBN (Given, 2008).

While digitalisation is reducing the demand for traditional mail services, and hence the benefits associated with traditional CSOs, it is also associated with changing economic behaviours that create a burgeoning need for related services—in particular, parcel delivery services associated with online retailing. As Table 2 illustrates, the growth in online retail has already had a substantive impact on the nature and structure of Australia Post’s business, with parcel revenues almost tripling over the past dozen years (see column 8).

This is turn gives rise to a question in relation to this growth in parcel revenues as to whether the underlying demand for such services is one that should be the subject to some form of formal USO, or indeed the predominant policy outcome that postal USOs aim to address. Such an approach has been supported by Zaiac (2019) in considering how USOs that apply to the USPS should be formalised, and similarly by Hearn (2016) in the context of a potential reconsideration of the European Union’s Postal Directive. In part, this question depends upon the extent to which the changing nature of retailing is likely to impact disproportionately across the community, and in particular how it may impact on rural and remote areas. That online retail will impact on traditional retail activities is already well recognised (Cushman & Wakefield, 2013), and the change is anticipated to be ongoing. Overall, online retail is estimated to be around 10 per cent of all retail in Australia (as of 2019), with growth rates expected to be strong over the next five years.
Compared to other countries this is a relatively high level, although not as high as the United States, the world’s most developed online market, where 13 per cent of all retail was online (Australia Post 2018, 2019).

The effects of ecommerce on retail behaviour in different regions, however, has been less widely canvassed. Within Australia, growth in ecommerce has been strongest in the main regional centres and in the outer suburbs of Australia’s capital cities (Australia Post 2018, 2019). However, as Australia Post (2019) also notes:

> households in remote and very remote Australia that do shop online are doing so more frequently. The rate of purchase is 1.2 times the national average. It is likely households in remote regions depend on online shopping to access a wider range of products, given the distance to their nearest shopping centre. (p. 23)

Differences in the growth in ecommerce by region are further illustrated in Table 3, which details year-on-year online shopping growth by region (overall and by product category). This table shows that whereas remote and very remote Australia have lower than average growth rates in all categories, their relative growth is higher with respect to the ‘Variety stores’ and ‘Homewares & appliances’ categories. This suggests a relatively greater focus on household necessities in remote and very remote regions, as compared more discretionary products such as ‘Fashion’ and ‘Hobbies & recreational goods’.

Table 3. Year-on-year online shopping growth (% 2018)

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Major cities of Australia</th>
<th>Inner regional Australia</th>
<th>Outer regional Australia</th>
<th>Remote Australia</th>
<th>Very remote Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>20.2</td>
<td>20</td>
<td>21.4</td>
<td>19.7</td>
<td>16.3</td>
<td>15.1</td>
</tr>
<tr>
<td>Fashion</td>
<td>20.4</td>
<td>20.3</td>
<td>22.3</td>
<td>19</td>
<td>13.3</td>
<td>10.5</td>
</tr>
<tr>
<td>Variety stores</td>
<td>21.5</td>
<td>20.7</td>
<td>23.3</td>
<td>23.6</td>
<td>21.3</td>
<td>18.6</td>
</tr>
<tr>
<td>Health &amp; beauty</td>
<td>29.4</td>
<td>31.1</td>
<td>27.6</td>
<td>22.4</td>
<td>20.5</td>
<td>11</td>
</tr>
<tr>
<td>Homewares &amp; appliances</td>
<td>11.7</td>
<td>12.8</td>
<td>10.4</td>
<td>8.5</td>
<td>7.3</td>
<td>8.8</td>
</tr>
<tr>
<td>Hobbies &amp; recreational goods</td>
<td>8.5</td>
<td>7.8</td>
<td>10.8</td>
<td>10</td>
<td>6.7</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Source: Australia Post (2018).

The differences in growth rates by region illustrate the multiplicity of forces driving changes in consumer behaviour. The strong growth of online retail in major regional centres and the outer suburbs of the capital cities appears to be reflective both of the demographic structures of those communities (e.g. higher proportions of families, lower-middle income households, etc.), as well as the ready access to, familiarity with and comfort in engagement with ecommerce opportunities. This compares to the factors influencing growth in remote and very remote areas, which are more likely the product of lesser alterative retail options as well as the beneficial cost structures associated with current pricing and delivery arrangements in the postal sector.
More broadly, however, it should be recognised that it appears it is access to a wider range of sellers, with resultant benefits including lower product pricing and a greater diversity of goods available for purchase, rather than postal pricing differences that appears to be driving growth in ecommerce generally. This is reflected in the geographical spread of ecommerce suppliers. In the case of Australia, for instance, China (41 per cent), the United States (21 per cent) and the United Kingdom (14 per cent) make up the bulk of the sources of online retail purchases in Australia (International Post Corporation, 2019).

In considering the extent to which the changing nature of retail may warrant the formal recognition of CSOs more heavily related to parcel deliveries, regard should also be given to the extent to which third-party logistic service providers rely upon the postal sector for last mile delivery. The greater the role of the postal service, the more likely a CSO may be appropriate.

In the United States, for example, the taskforce examining the USPS (United States Government Taskforce on the United States Postal System, 2018, p. 13) found that while the postal service had only a 17 per cent share of competitive end-to-end package delivery revenue in the 2016 financial year (compared to the United Parcel Service’s 40 per cent market share and Federal Express’s 30 per cent market share), the USPS played a greater role in the delivery of lightweight packages to households. Further, the USPS handled much of the ‘last mile’ delivery for the other carriers.

In Australia, while the extent to which third-party carriers rely on Australia Post is opaque, there are commercial arrangements in place between Australia Post and third-party carriers for parcel delivery services, particularly in regions outside metropolitan boundaries that are not covered directly by the third-party carrier delivery networks. This suggests that economic forces militate against multiple delivery services operating across the more remote parts of Australia, or alternatively that Australia Post is delivering parcels to remote regions below cost, which makes competition prohibitive and constitutes a form of informal CSO. If that is the case, then cross-subsidising parcels is unsustainable because although parcel work is expanding there is no monopoly rent to pay for the cross-subsidy. If the cross-subsidy is substantial then it is being paid for by what is left of the reserved letter service monopoly rent, or what would once have been the organisation’s profit. In such circumstances, if the money from the reserved letter services is declining and continues to do so, and if parcel delivery to remote areas continues to grow, something must give. It is unclear that any amount of organisational improvement is going to fix such a problem. If not, then ultimately there would be only two alternatives: higher country delivery prices or instituting a formal CSO arrangement.

While the changing nature of Australia Post’s mail and parcel delivery activities will likely play a key role in decisions regarding the shape and structure of ongoing CSOs, Australia Post is engaged in a range of other activities that may also be
relevant in consideration of future CSOs. One such potential area of activity is in the provision of financial services. As noted above, provision of financial services can form a substantial part of the business activities run by postal services, as is the case in New Zealand, Italy and Japan. Attributes contributing to this role include the geographical spread of post offices, and the implicit protection of being a government-owned institution.

Historically, Australia Post has delved into the provision of financial services, and the nature of such provision in the context of CSOs has also been considered. During the 1990s and 2000s, for example, one factor adding pressure on ensuring the ubiquity of Australia Post services was to ensure the provision of cash and access to financial services to rural and remote communities (see, for example, Parliamentary Joint Committee on Corporations and Financial Services, 2004).

To this end, Australia Post has entered into agency arrangements with a range of financial institutions and has played a front-facing role in facilitating transaction services, in particular bill payment, for both businesses and government. Unlike other postal services around the world (see Falch & Henten, 2018), however, Australia Post has not chosen to enter into the financial services as a direct provider. As it does not currently undertake such a role, and with the development of internet-based banking and a plethora of online payment systems, the pressure for CSOs associated with financial services would appear to have abated considerably, and will likely continue dropping.

Another potential area of activity that supports various aspects of Australia Post’s current CSOs, and which may constitute CSOs in their own right, is a range of government services to be delivered through its outlets. Currently, these relate to both national and state/territory services, in particular ID and document services (such as passport, tax file number and ID applications, as well as police check applications).

In considering whether the current and future provision of such government services may be an appropriate basis for CSOs, a key question is whether there are economies of scope that would underpin the delivery of such services through a joint network, of which the Australia Post retail network may provide the foundation. Cooperation with the state and territory governments would increase the scope for delivery of these types of services and could include such things as motor vehicle registration, licence renewals and so on. It is noted, for example, that some states and territories maintain a network of physical agencies at which a range of government services are provided (e.g. Access Canberra, Service NSW, Service SA, Service Tasmania). However, a likely consequence of expanding Australia Post’s role in the delivery of...
government services—and developing and applying related CSOs—would be to add pressure for its retention as a government-owned entity. Such status is anticipated to be required both to maintain customer trust\textsuperscript{16} and also to support willingness to participate across the various levels of government.

Related to the role that Australia Post’s physical network provides as a basis for re-examining the scope of its role as a provider of CSOs, consideration may also be given to the extent to which government services might be best delivered through alternative mechanisms provided by Australia Post. One possible example of this is the notion of a digital mailbox, which has been introduced in a range of countries as the official location for the receipt of government correspondence.\textsuperscript{17} While Australia Post directed some effort towards introducing a digital mailbox system in Australia, its establishment does not appear to have been particular effective.

\section*{Conclusion}

Historically, the main drivers of mail volumes and reliance on postal services were economic, income and population growth (ERGP, 2016a, 2016b; Hooper et al., 2010). This is no longer the case, with technology and evolving consumer and business behaviours rapidly changing the nature of the market and community in which postal services operate—changes that are likely to have accelerated in response to the COVID-19 pandemic. With these changes comes the need to consider the case for, and potentially a recasting in the nature and manner of, provision of the CSOs which postal services have traditionally provided.

In the case of developing countries, where CSOs have historically not been met to any great degree, this had led to questions as to whether such obligations should not be sought to be imposed—the core argument being that the resources required to meet the needs being satisfied by delivering such USOs could be better utilised on other, more necessary services such as health and education (Kenny, 2005). In contrast, in developed countries such as Australia, the questions are more around the continued relevance of traditional USOs, and the potential changes which may be appropriate.

In considering the future of USOs in the United States, the United States Government’s Task Force on the United States Postal System (2018) noted that, going forward:

\textsuperscript{16} As to Australian’s perceptions of Australia Post, including levels of trust in its brand, and the place of Australia Post as part of the national identity, see Deloitte Access Economics (2018).

\textsuperscript{17} This process has not been without difficulties, with some countries having a low take-up of its use. In Singapore, for instance, the service was abolished in 2017 after operating for five years (\textit{The Straits Times}, 6 April 2017).
the USO must distinguish between the types of mail and packages for which a strong social or macroeconomic rationale arises for government protection in the form of price caps and mandated delivery standards (‘essential services’) versus those types of mail and packages that are commercial in nature, and therefore would not have a basis for government protection.

This article has focused on the CSOs delivered by Australia Post. In Australia, the extent to which physical delivery is required through a postal system is changing rapidly. On the one hand, the relative reliance that the community places on communication in physical form (e.g. letters) is diminishing; on the other, the extent to which the community is becoming reliant on delivery networks for retail products is growing substantially (and, in turn, adversely impacting on the viability of other, more traditional retail outlets).

Together these changes indicate that a reconsideration is required of the nature of the CSOs that should apply to the postal service. In particular, greater consideration should be given to assessing the extent to which market forces alone will enable parcel delivery services to exist at an acceptable standard across the community, or whether intervention is required to ensure parts of the community—particularly those living in rural and remote areas—continue to receive at least the basic level of services considered to be appropriate for all. In the current circumstances in Australia the delivery of parcels to remote regions appears to be cross-subsidised, as evidenced by the lack of service delivery in some places by non–Australia Post carriers. These carriers use the Australia Post service, both because Australia Post likely delivers below cost, and/or below the cost they could otherwise deliver themselves. Internally financing any cross-subsidisation into the future will be problematic, given that the monopoly profits of the Australian Post reserved letter service is being eroded by electronic communication technology. In addition, in itself parcel delivery has no monopoly reserved service component with which to finance this cross-subsidy. At present, cross-subsidisation would in effect be funded by lower profitability for Australia Post, which is currently not making a commercial rate of return. This is unlikely to be a permanent solution, and at some point full cross recovery will be required of parcel delivery to remote regions (i.e. higher prices) or funding either from the government budget or some introduction of a parcel reserved service.

In a similar vein, it would appear, given the physical nature of the postal service network that Australia Post operates, that scope also exists for this to be used to ensure a required level of service provision in relation to government services. In this regard, there appears to be potential for an expanded service delivery role with respect to government services provided at both the federal and state/territory levels. Such an expansion of Australia Post’s role as government service deliverer would, however, likely be associated with consequent pressure for its ongoing retention as a government-owned entity.
References


Tax planning in Australia’s income tax system

Tristram Sainsbury and Robert Breunig

Abstract

Has income tax become voluntary in Australia? It appears that for some, nil or very low tax bills are a real prospect. Those with flexibility over how income is earned and motivation to achieve tax savings can structure their financial affairs to channel income through a mix of companies, trusts, assets, superannuation and family members over time. This article presents some of the simpler strategies available within the Australian tax system and shows how these are available to people across the income distribution. However, a tax system designed to encourage tax planning runs counter to core principles of good tax design of fairness, efficiency and simplicity. It also raises questions about the sustainability of Australia’s tax system. Addressing the structural incentives to engage in tax planning requires a wholesale rethink about the design and role of income in Australia’s tax system.

Introduction

Australia relies heavily on the direct taxation of income to raise government revenue. According to the 2019–20 Mid-Year Economic and Fiscal Outlook, the federal government expected to raise 17 per cent of Australia’s GDP from individual and company taxes in 2019–20 (Frydenberg & Cormann, 2019b). A point made in major Australian tax reviews, as well as in publications from international institutions such

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1 The Australian National University, robert.breunig@anu.edu.au. The authors thank Josh Pooley, David Hansell, Andrew Carter, Shawn Quinton, Paul Beohm, Graeme Davis, Greg Derlacz, Shelby Schofield, Nitin Srivastava, Kristen Sobeck, William Coleman and two anonymous reviewers for helpful comments.
as the International Monetary Fund and the Organisation for Economic Cooperation and Development (OECD), is that Australia’s strong reliance on income taxes for revenue-raising makes us an outlier among the international community. Based on the latest available internationally comparable data (excluding social security taxes), in 2017 Australia raised around 59 per cent of total tax revenue from taxes on income and profits (OECD, 2019b). The corresponding average among OECD countries was 33.2 per cent (OECD, 2019a).

At the same time, Australia’s income tax system design features a range of tax planning and arbitrage opportunities. The opportunities are a result of two ‘structural’ features of the income tax system: different tax rates apply to different tax vehicles, and some taxpayers can defer their tax liabilities to a later point in time. People looking for flexibility or control over their income streams have the choice of a range of trusts, companies, partnerships and self-managed superannuation funds. Combined effectively, tax structuring allows some Australians to achieve highly ‘tax effective’ outcomes, with the most ambitious arrangements carrying the prospect of no tax liability at all.

It is important to recognise that a common feature of such arrangements is their permissibility under Australian law. Further, tax considerations are just one of many reasons people might make use of a superannuation fund, partnership, trust or company. That said, the potential availability of different tax outcomes for the same underlying economic activity represents a form of tax base erosion from Australia’s personal income tax. The widespread use of such opportunities can therefore be considered the domestic Australian version of tax base erosion and profit shifting (also known as BEPS), the well-discussed corporate strategy for reducing corporate tax owed.

It is impossible, looking at the data, to determine how much tax planning is simple for purposes of tax avoidance with no other objective. If it were, the Australian Taxation Office (ATO) could prevent taxpayers from engaging in the behaviour under general compliance rules. What is clear is that the amount of activity of the type that we discuss below is increasing rapidly over time, even as other economic activity is not increasing as quickly. This at least hints at the possibility that use of tax minimisation schemes are more about tax avoidance and less about legitimate economic activity.

In this article, we present an explanation of some of the simpler tax approaches and structures that are available within the Australian taxation system. Even these simple approaches reveal that tax planning can deliver more tax effective outcomes to a wide range of Australians.

We present the examples with three specific goals in mind.
First, their existence makes for a compelling argument to reform Australia’s hybrid income tax system. Low tax rates applying to particular asset classes (housing and superannuation) prompt an overinvestment in these asset classes, while tax rates on personal incomes are higher than they could be. The myriad of options available to taxpayers requires a complex tax code. It is becoming increasingly unlikely that people in similar positions are paying similar amounts of tax. It is also impossible to determine if people who have a greater capacity to pay tax actually pay more tax.

What would be ideal is a level-headed public debate about the relative merits of moving towards a tax system with less incentive to arbitrage—reducing the gap between tax rates on personal, business and savings income—or perhaps accepting the complications that come from a number of different definitions of income, and pursuing reforms that place robust boundaries around them. Such a discussion would need to take place in the wider context of the tax and transfer system in order to maintain the desired level of progressivity of the overall system.

Second, they reveal that the current empirical evidence base around tax planning is sadly lacking. Current distributional analysis of tax burdens generally compares people’s taxes in any given (annual) snapshot, which can provide a fundamentally misleading picture about someone’s true over-time tax burden. The only solution to this dilemma is to build the evidence base by investing in our collective capacity to undertake genuine lifetime distributional analysis.

Third, we want to make an appeal to society to acknowledge that income tax should not be voluntary or temporary in nature. And for that to happen, Australian society needs to buy in to the notion that we collectively can’t afford for specific groups of people to be treated as special in the eyes of the tax system.

We conclude by highlighting how restoring a sense of fairness into the Australian tax system is a significant task that will take coordinated policymaking action.

The elements of tax planning

Important definitions for tax planning in Australia’s hybrid income tax system

In this article we make frequent use of four terms, which we define as follows.

A tax vehicle refers to any of a variety of the types of taxpaying entities that the ATO recognises. The most popular tax vehicles are an individual, a trust, a partnership, a company and a superannuation (super) fund.
A *tax structure* makes use of a combination of tax vehicles in order to legally achieve a different tax outcome than would be realised through a single tax vehicle.

*Tax arbitrage* refers to actions that make use of available tax vehicles and structures to achieve a tax reduction through a lower tax rate. It can be thought of as a specific form of arbitrage; the general concept that concerns the simultaneous buying and selling of an asset (or store of value) in order to take advantage of different prices for the same asset. Tax arbitrage relies on different varieties of tax vehicle paying different tax rates on a marginal dollar of income.

*Tax planning* refers to strategies that combine vehicles, structures and arbitrage to keep tax to a minimum (ATO, 2020). Taxpayers that control how they receive income have two primary incentives to plan. Shifting income from a high-taxing to low-taxing structure delivers an immediate tax saving. Deferring a nominal tax liability into the future increases the tax saving as long as the interest rate on income is positive. The tax saving is even larger if deferral means the income attracts a lower tax rate in the future than it does in the present.

Based on the broadly accepted Schanz-Haig-Simons definition of income, Australia’s income tax system is a ‘hybrid’ between the two ‘pure’ tax approaches that governments can adopt (of ‘comprehensive’ or ‘schedular’ taxation). Australia’s particular interpretation sees most forms of personal income (wages, salaries, interest, dividends and rent) taxed under a global regime at full progressive rates. Corporate income and some capital gains are taxed under the same global regime, but at flat rates. Some capital income receives discounted tax treatment under the global regime, while other capital income (linked to retirement savings) is taxed under its own schedule.

The resulting spectrum of marginal tax rates, as at the 2019–20 financial year, is shown in Figure 1.

---

2 The comprehensive measure of income advocated for by Schanz (1896) and developed by Haig (1921) and Simons (1938) is generally considered by economists to be the best measure of wellbeing. That said, income tax benchmarks typically depart from a ‘pure’ Schanz-Haig-Simons definition in important places. It is common, for example, to evaluate tax expenditures by defining a progressive personal income tax schedule on a nominal, realisation basis as the structural ‘base’ feature of the Australian tax system (e.g. Commonwealth of Australia, 2020).

3 A comprehensive global income tax sees all income aggregated and taxed under a single rate schedule. In contrast, a schedular system sees different income types taxed under different schedules. For example, a schedular dual-income tax system would see labour income taxed at progressive personal rates and capital income taxed at a flat rate.

4 The particular interpretation of income within the Australian tax system (which can be described as a comprehensive income tax base with schedular pockets) means there is no neat distinction between ‘labour’ and ‘capital’ income. For example, personal income taxation incorporates wage and salary incomes, but also dividends, interest, rent and discounted capital gains. And while it captures some forms of capital gains, it won’t capture all capital. Caution is therefore required when interpreting what income taxes imply about the level of taxation on labour and capital sources of income.
Before turning towards the interpretation of this hybrid system, it is important to remember that tax planning is entirely permissible under Australian law.\textsuperscript{5} It is a common feature of most tax systems around the world. People have every right to arrange their financial affairs effectively. Tax is a material consideration for people’s financial affairs. Tax professionals are expected to provide advice that reduces people’s tax liabilities, within the bounds of existing laws.

\textbf{Different ways to interpret the current design of the hybrid Australian income tax system}

Figure 1 shows that Australia’s income tax system is complex. In 2019–20, Australian taxpayers face marginal income tax rates that range from 0 to 47 per cent. The precise rate depends on how much income the taxpayer receives, and whether its designation is as personal income, corporate income, super, capital gain or fringe benefit. For example, someone’s 100,001th dollar in 2019–20 attracts a marginal tax rate of: 47 per cent if a taxable fringe benefit; 39 per cent if taxable personal income; 27.5 per cent if earned by a small business; 19.5 per cent if an individual realised

\textsuperscript{5} Lawful tax planning should be distinguished from tax evasion actions such as deliberately underreporting income or sham contracting, where people try to exploit tax and super systems in ways that are not lawful.
a capital gain on an asset they held for more than 12 months; 15 per cent if it was
the ordinary income of a super fund outside the retirement phase, and 0 per cent
if the income was a capital gain earned on the primary residence, or income of
a super fund during the retirement phase.

Little wonder the majority of Australian taxpayers—71 per cent in the 2016–17
income year (ATO, 2019b)—choose to turn to a tax agent to process their tax affairs
rather than engage directly with the complexity themselves.

Putting the in-your-face complexity to one side, what to make of the tax rates
depends on the perspective of the viewer. For example, one perspective—which we
call the policymaker’s perspective—is that each separate tax rate is a design feature of
the tax system. Each tax rate has been individually justified on particular economic
and/or social grounds. One example is choosing to tax capital at a lower rate than
‘ordinary’ personal income. Another is to make small businesses subject to the lower
tax rate than large businesses. Yet another is creating a tax-free threshold for the
first $18,200 of income individuals earn each year. A further example is exempting
from tax all of the income earned as capital gains (or losses) on the main residence.
A final example is exempting earning through super through the retirement phase,
to encourage Australians to pursue this particular form of saving.

Before we do that, it’s worth considering another perspective—which we call the
tax planner’s perspective—which approaches tax as a ‘minimisation’ problem. For
the aspiring tax planner, Figure 1 reveals that some forms of income result in lower
annual tax bills than others. The tax planner’s challenge is to divide their total
income6 among available tax schedules in a way that gets them to the lowest total tax
bill. By doing so, the tax planner also pays the lowest average rate of tax for that year
across all income sources. They can then turn their attention to thinking beyond
themselves (by minimising the taxes paid by their household) and to thinking
beyond a single income year.

**Basic tax planning**

How can people take advantage of these opportunities? Below we cover some of the
main ‘channels of arbitrage’. Specifically, we provide three illustrative cameo-style
examples of the types of financial arrangements that are of interest to the vast
majority of Australian adults at some point in their lives. The cameos combine
the use of pre-tax wages, property assets, trusts and companies. The arrangements

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6 People will generally be less flexible about the tax rate they pay on income that they need to meet current
consumption needs and more flexible in finding a tax-effective outcome on their discretionary income/savings.
Tax planning decisions are based on achieving a tax-effective rate on total income, across both current and future
consumption choices. We caution against limiting consideration only to the taxation of someone’s savings decisions,
or even more restrictively to just their investment choices.
featured range from the simple and widespread to ‘active’ structures that stream and defer income across multiple tax vehicles over time. Such arrangements are well understood within the tax advice industry, and the advice behind them is pretty easy to access. We do not deal with the types of bespoke ‘best of breed’ tax arrangements that aggressively combine income splitting and tax deferral in sophisticated ways.

**Common and widespread: Salary packaging and the primary residence**

Something many Australians are aware of is that it is possible to reduce taxable income via salary sacrifice. Also known as salary packaging, salary sacrifice allows workers, through an arrangement with their employer, to use pre-tax salary to purchase certain goods or services (through a third party) that they would normally use after-tax income to pay for. For many Australian households, this means that they can purchase items that are important to their lifestyle, in a way that lowers tax. The potential tax savings increase with greater marginal personal tax rates.

The precise opportunities an employee can access depend on what their employer provides. It can include cars and associated running costs, financial loans, health insurance, childcare, electronic devices such as laptops and phones, and contributions to super. On these types of purchases, Example 1 illustrates how salary sacrifice can deliver a sizeable annual tax benefit. Note that the overall benefit an individual will receive is influenced by the terms and fees that the lease company or employer might impose in return for the opportunity.

**Example 1. Salary packaging**

Three single individuals, Bruce, David and Andrea, all work full-time for a company that offers a range of salary sacrificing options. All earn a salary of $100,000 in 2019–20, and receive a 15.4 per cent compulsory contribution into their super funds from their employer. They all plan to take out a loan for a new car, spend $52,000 after tax to maintain their lifestyle, and save the rest.

Bruce likes a simple life. He doesn’t understand how salary sacrifice arrangements work and isn’t interested in finding out. He resents compulsory super and is happy outsourcing his (very simple) tax return to an agent. He maintains his lifestyle (including car) using after-tax money. Bruce’s tax agent tells him that his total tax bill on $100,000 taxable income and $15,400 compulsory super is $26,801 at an average tax rate of 23.2 per cent.

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7 Employers decide to allow salary packaging (and the form of that packaging, including the salary sacrificed covering the associated fringe benefits tax payable by the employer) for a range of commercial reasons, taking into account the fringe benefits tax rules and tax payments involved. Large organisations are more likely to provide access to salary sacrifice arrangements than small businesses.
David has been thinking about his retirement. After a little research, he decides to
salary sacrifice into super. He negotiates with his agency to continue to pay super
on his $100,000 salary while he salary sacrifices $9,600. This brings his total super
collection to $25,000. Otherwise, David funds the same after-tax lifestyle as
Bruce. David’s total income tax bill on $90,400 taxable income and $25,000 total
super is $24,695 at an average tax rate of 21.4 per cent. By taking advantage of one
salary sacrifice opportunity, David pays $2,112 less in income tax than Bruce.

Andrea is highly motivated to lower her tax bill. Like David, she salary sacrifices
$9,600 into super. Andrea also takes advantage of a novated lease arrangement8 in
which a third-party financer buys the car and leases it to Andrea. Andrea funds
a lifestyle equivalent to David and Bruce. Andrea’s total income tax bill on $84,679
taxable income and $25,000 total super is $22,818 at an effective tax rate of
20.8 per cent. By taking advantage of two salary sacrifice opportunities, Andrea
pays $3,989 less in income tax (personal and superannuation) than Bruce.

Table 1.1 Individual salary packaging examples

<table>
<thead>
<tr>
<th>Individual</th>
<th>Bruce</th>
<th>David</th>
<th>Andrea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-tax wage income</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Concessional contribution to super</td>
<td>$15,400 compulsory</td>
<td>$25,000 ($15,400 compulsory + $9,600 salary sacrifice)</td>
<td>$25,000 ($15,400 compulsory + $9,600 salary sacrifice)</td>
</tr>
<tr>
<td>Tax on super contributions (paid by fund)</td>
<td>$2,310</td>
<td>$3,750 ($2,310 compulsory + $1,440 salary sacrifice)</td>
<td>$3,750 ($2,310 compulsory + $1,440 salary sacrifice)</td>
</tr>
<tr>
<td>Salary sacrifice into novated lease for car</td>
<td>$0</td>
<td>$0</td>
<td>$5,721</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$100,000</td>
<td>$90,400</td>
<td>$84,679</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>$24,497</td>
<td>$20,945</td>
<td>$19,068</td>
</tr>
<tr>
<td>After-tax car contribution</td>
<td>$11,721</td>
<td>$11,721</td>
<td>$6,000</td>
</tr>
</tbody>
</table>

Notes: This is a basic scenario for illustrative purposes. Calculations are stylised. Unless otherwise
specified, figures are based on headline personal, corporate and/or super tax rates and thresholds only
without offsets, deductions or levies such as the Medicare levy or low-income tax offset. We’ve assumed
that financing terms available to Bruce, David and Andrea are the same. We also haven’t included ‘bells
and whistles’ that would increase the attractiveness of salary packaging. For example: packaging the
maintenance of the car (such as fuel, service costs) into the arrangement; the lease company claiming
the GST and employee purchasing the car ex-GST; or the employee selling the leased car at a profit in
the future. We also acknowledge that tax is only one consideration when contemplating salary sacrifice
arrangements. For example, a leasing arrangement might reduce a worker’s ability to swap employers.
Similarly, super savings are ‘locked in’ relative to savings outside super.

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8 Novated leasing is a three-way arrangement between a salaried employee, an employer and a finance company.
The employee is responsible for the payments. The financier buys the vehicle and leases it to the employee. The
employer agrees to take the payments from the employee’s salary (as a ‘salary sacrifice’) before income tax is paid.
Often the employer will do this in return for a fee that takes at least a part of the gains, and potentially a significant
share of them.
A comparison of what the different approaches adopted by Bruce, David and Andrea imply for their personal income, consumption, savings and tax rate is included below.

**Table 1.2 Individual personal income, consumption and tax rate examples**

<table>
<thead>
<tr>
<th>Name</th>
<th>Personal income</th>
<th>Consumption</th>
<th>After-tax savings</th>
<th>Average tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Salary</td>
<td>Taxable income</td>
<td>$52,000 + car loan</td>
<td>In super</td>
</tr>
<tr>
<td>Bruce</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$13,090</td>
<td>$24,811</td>
</tr>
<tr>
<td>David</td>
<td>$100,000</td>
<td>$90,400</td>
<td>$21,250</td>
<td>$26,984</td>
</tr>
<tr>
<td>Andrea</td>
<td>$100,000</td>
<td>$84,679</td>
<td>$21,250</td>
<td>$28,861</td>
</tr>
</tbody>
</table>

While the tax saved from salary sacrifice is sizeable, wages and salaries are difficult to use for many tax planning arrangements. This is because such income, typically earned from an individual’s physical exertion, is difficult to allocate among various people for tax purposes. Income derived from dividends, interest, rent and other forms of investment is more flexibly able to be managed. It thus offers significant potential for large tax savings.

The most prominent form of investment in Australia is housing. Some 67 per cent of Australian households own (or their bank owns) a house in 2016 (AIHW, 2019). For many Australians, the family home is the main asset that they own in their life. Housing assets also represent a significant proportion of overall Australian wealth. Capital gains on the primary residence are fully exempt from income tax, unless the primary residence has been rented to generate a financial return for more than six years, in which case the marginal gains beyond six years of rental are subjected to a 50 per cent capital gains tax discount. The capital gains tax exemptions that apply to the primary residence are among the most broadly enjoyed tax effective arrangements in Australia.

These exemptions are exceedingly generous for those fortunate enough to experience them. Example 2 shows how a couple that jointly own a family home that experienced a $1.7 million capital gain over 21 years, and was deployed as a financial asset for just under half of this time, can incur just a 0.9 per cent average tax rate on the overall capital gain when sold.

Capital assets such as housing provide an ancillary benefit that tax planners also value greatly. They provide the flexibility to choose the year in which to incur a tax bill. A tax liability on a capital asset is only incurred when an asset is realised, or sold, rather than when the value accrues (and the economic activity occurs). For example, a house bought in 2010 and sold in 2017 may experience an increase in economic value in each year for eight years. However, under Australian tax law, the capital gain is only incurred with the asset’s sale in 2017. This means that not only are capital gains eligible for discounted tax treatment, the capital owner has complete discretion on when (or if) to realise the gain (or loss) and incur a tax liability.
Example 2. Capital gains on the primary residence

Chris and Todd contributed equally when they bought a house in Melbourne in 1998 for $300,000. This serves as their primary residence for the 21 years between July 1998 and July 2019. They live in the property for the first 11 years from 1998 to 2009. In July 2009, Chris and Todd accept job offers relocating them to Sydney for 10 years. They live in a rental while in Sydney. At the same time they rent out their Melbourne house to produce a (neutrally geared) financial return. Then, in July 2019, they embrace a ‘sea change’ lifestyle. After selling the Melbourne house for $2 million, they buy a $1.5 million apartment in the South Coast of NSW.

In calculating their tax bill, Chris and Todd take advantage of three capital gains tax discounts and exemptions. First, as primary residence, the capital gain for the 11 years that Chris and Todd lived in the house is tax-exempt. Second, thanks to the six-year absence exemption, the first six years of rental are exempt from tax. Chris and Todd therefore only pay tax on the final four years, which is estimated to see a capital gain of $200,000. Third, this gain is eligible for the 50 per cent capital gains discount as the asset has been held for longer than a year. The taxable gain is just $100,000 over the life of the property. And Chris and Todd each realise $50,000 of this gain.

Provided the capital gain is their only personal income in 2019–20, Chris and Todd each pay $7,797 in personal income tax. Their combined $15,594 tax bill works out to be 0.9 per cent of the $1.7 million lifetime capital gain, or 2.2 per cent on the $700,000 gain since July 2009.

Table 2.1. Capital gains tax examples

<table>
<thead>
<tr>
<th>Activity</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td>$300,000</td>
</tr>
<tr>
<td>Capital gain 1998–2009</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Capital gain during six-year absence exemption period</td>
<td>$500,000</td>
</tr>
<tr>
<td>Remaining capital gain</td>
<td>$200,000</td>
</tr>
<tr>
<td>Sale price</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Total capital gain</td>
<td>$1,700,000</td>
</tr>
<tr>
<td>Capital gain that is taxable</td>
<td>$200,000</td>
</tr>
<tr>
<td>Taxable gain after 50% capital gains tax discount is applied</td>
<td>$100,000</td>
</tr>
<tr>
<td>Taxable income upon sale (50% ownership split)</td>
<td>Chris: $50,000 Todd: $50,000</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>Chris: $7,797 Todd: $7,797</td>
</tr>
</tbody>
</table>

Note: Calculations for these examples are stylised. Unless otherwise specified, they are based on headline personal, corporate and/or super tax rates and thresholds only without offsets, deductions or levies such as the Medicare levy or low-income tax offset. The calculations here only concern taxes at the Commonwealth government level and not at the state, territory or local government level.
To put this into context, if Chris or Todd individually realised $1.7 million in wage and salary income in a single year, they would pay $738,097 in tax at an average tax rate of 43.5 per cent. If they instead realised a $1.7 million in capital gain from jointly owned shares—$425,000 in taxable income each after applying the 50 per cent capital gains tax discount—they would pay $164,347 each in tax at an average rate of 38.7 per cent on the $425,000 discounted capital gain, or 19.3 per cent on the $850,000 capital gain.

There are more tax-advantaged alternatives too. For example, if Chris and Todd lived in the property the entire time they owned it, there would be no capital gains tax implications. If they never sold the house and instead gifted it as part of their estate, their children may escape tax. And if Chris and Todd were instead retirees aged over 65, they could contribute up to $300,000 post-tax income from the sale of the house into super. The tax-free ‘downsizer’ contribution would get around many integrity measures governing super, such as non-concessional contribution caps.

The basics of advanced tax structuring:
The streaming and tax deferral benefits of a bucket company and a trust

Using a combination of entities provides taxpayers more flexibility to control when and how they receive income for tax purposes. Example 3 depicts a simple setup involving a couple, a discretionary trust and a ‘bucket’ company over a two-year horizon.

Example 3 Part 1 shows the arrangements in the first year.

Example 3. Part 1. Basic tax structuring using a bucket company and a trust

Year 1: 2019–20

Mike and Angie are both aged 32. They have worked out that they can maintain their current lifestyle on $66,000 after tax per year. Mike operates a consulting practice that provides digital transformation analysis and advice to a range of large Australian firms. He is also trustee of a family trust, which is paid the taxable profit of $148,000 in 2019–20 that the consulting practice generates. The trust has three beneficiaries: Mike, Angie and Family Co., a small ‘bucket’ company that Mike controls. Family Co. is dedicated to managing an investment portfolio and its investment strategy is to only hold cash.

---

9 ‘Bucket company’ is a commonly used term to describe a passive private company set up to be a beneficiary of a trust. The ‘bucket’ element refers to the company sitting below the trust and having money poured into it to reduce tax.
As trustee of the trust, Mike determines that the trust will distribute all $148,000 of its net income to the three beneficiaries: $37,000 to each of Mike and Angie and the remaining $74,000 to Family Co. (If it didn’t, the trust would have to pay the highest marginal tax rate of 47 per cent on retained earnings.)

Table 3.1. Example of tax structuring (Part 1)

<table>
<thead>
<tr>
<th>Activity</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income paid into discretionary trust</td>
<td>$148,000</td>
</tr>
<tr>
<td>Distribution</td>
<td></td>
</tr>
<tr>
<td>Angie</td>
<td>$37,000</td>
</tr>
<tr>
<td>Mike</td>
<td>$37,000</td>
</tr>
<tr>
<td>Family Co.</td>
<td>$74,000</td>
</tr>
<tr>
<td>Retains</td>
<td></td>
</tr>
<tr>
<td>n/A</td>
<td></td>
</tr>
<tr>
<td>n/A</td>
<td></td>
</tr>
<tr>
<td>$53,650</td>
<td></td>
</tr>
<tr>
<td>Tax</td>
<td></td>
</tr>
<tr>
<td>$3,752</td>
<td></td>
</tr>
<tr>
<td>$3,752</td>
<td></td>
</tr>
<tr>
<td>$20,350</td>
<td></td>
</tr>
<tr>
<td>Total tax</td>
<td>$27,854</td>
</tr>
<tr>
<td>Total tax rate</td>
<td>18.8%</td>
</tr>
<tr>
<td>Franking credits generated</td>
<td></td>
</tr>
<tr>
<td>n/A</td>
<td></td>
</tr>
<tr>
<td>$20,350</td>
<td></td>
</tr>
</tbody>
</table>

Note: Calculations for these examples are stylised. Unless otherwise specified, they are based on headline personal, corporate and/or super tax rates and thresholds only without offsets, deductions or levies such as the Medicare levy or low-income tax offset.

Under trust taxation rules, Mike, Angie and Family Co. are assessed on the proportion of trust income that they are ‘presently entitled’ to. In this case, present entitlement is equal to the income received. Mike and Angie each pay tax at their marginal personal income tax rates on their income. Family Co. pays tax on the $74,000 in profit it receives at the 27.5 per cent small business tax rate. Plus, as an Australian resident corporation, it generates a $20,350 franking credit balance—which it considers an asset. The company holds on to the after-tax profits of $53,650 as ‘retained earnings’ as well as the $20,350 in franking credits.

In total, on $148,000 of income in 2019–20, the structure pays $27,854 in tax at an average tax rate of 18.8 per cent. To put this into context, if Mike instead earned $148,000 as a salary, he would receive a tax bill of $42,257 ($14,403 more than the structure) at an average tax rate of 30.4 per cent.

There are three essential steps in the process:

- The couple operates a consulting business. Payments to the business are paid into a discretionary trust which the couple controls.
- The trust distributes enough income to the individuals such that they can meet their desired standard of living, and allocate the rest to the company.
- The company holds its profits as ‘retained earnings’. It pays corporate tax on the profits and generates franking credits (an asset) on this corporate tax.
The immediate gains from setting up a structure are lucrative: $14,403 in first-year tax savings come from paying the small business tax rate rather than the marginal personal tax rate and streaming income across two adult family members. But it is the second year of the hypothetical arrangement that shows the full power of a trust and bucket company structure to deliver low lifetime tax rates. And it highlights the (unintended) role that Australia’s refundable dividend imputation system plays as a tax planning vehicle.

When Australian businesses distribute taxed profits (at a rate of 27.5 per cent for small businesses or 30 per cent for large businesses) to their shareholders, they have the ability to pass on or ‘impute’ the tax by allocating imputation credits to (Australian resident) shareholders. This is called ‘franking’ the distribution, and imputation credits are commonly known as franking credits. Franking credits can be used as tax offsets against marginal tax rates, providing a refundable credit against the tax the recipient would need to pay.

Franking credits are designed to prevent a situation where profits are taxed twice: once when earned by a business and a second time when the business distributes a dividend to a shareholder. A number of countries, including Canada and New Zealand, have ‘one-tier’ systems in place that are designed to ensure that company profits are taxed only once (Martin, 2019). That said, Australia is unique among the OECD in permitting refundable franking credits—which are designed to ensure that the taxable income of companies is taxed at the marginal tax rate of Australian resident individual shareholders when the taxable income is distributed.

Importantly, the role that franking credits play in the Australian tax system has gradually changed since its introduction in 1987. A policy designed to avoid double taxation makes it possible to engineer a zero-tax outcome. The key is to think of franking credits as a ‘tax bank’ in exploiting tax rate differentials. The tax bank involves a deposit and withdrawal stage. The deposit stage stems from the incentive individual taxpayers face to ‘cap’ their marginal tax rate at the corporate rate of 27.5 or 30 per cent, which is cheaper than a top marginal tax rate of 47 per cent (including Medicare levy). And in the process, it costs nothing for the company to generate a franking credit.

The withdrawal stage occurs during the subsequent distribution of the franked dividend to a shareholder. If the shareholder receiving the dividend is a personal income taxpayer or super fund and the income part of a tax-free threshold, they can fully ‘withdraw’ from government the company tax paid. When company tax is paid by one part of a tax structure and then fully refunded to another, then no net tax is received by government on the economic activity performed by the structure. This behaviour is explored further in Sainsbury and Breunig (2020a).
It’s worth acknowledging that the conceptual issue is not with refundable dividend imputation itself. Franked dividends do not need to play the tax bank role. Rather, it’s the different tax treatment of companies, super and personal income. If there were no differential between marginal corporate and marginal personal tax rates, and no tax discount for super, then there would be no incentive to use franking credits in tax arbitrage. The generalised principle is that single taxation at the individual level is conceptually robust when part of a properly designed comprehensive income tax system. But this principle may not apply in a complex hybrid system.

**Example 3. Part 2. Basic tax structuring using a bucket company and a trust**

**Year 2: 2020–21**

In 2020–21, Mike has looked closely at his finances and decided that he and Angie can fund their $66,000 annual lifestyle without him working this year. Compared to Part 1 of this example, Mike makes zero consulting income. He determines that Family Co. will provide a dividend worth all of its retained earnings ($53,650 and franking credit balance of $20,350) to the family trust. As trustee of the family trust, Mike determines that he and Angie are each entitled to half of the dividend and half of the franking credits—$26,825 and $10,175 respectively. Family Co. (despite being a beneficiary) receives no distribution from the trust this year.

Mike and Angie each pay tax on their $37,000 in taxable income at their marginal personal income tax rates. They claim $20,350 collectively in franking credits (which represents tax that has already been paid by their company to the ATO on their behalf) against $7,504 in income tax. The couple has arrived in tax refund city. On $74,000 of realised income, they pay $7,500 in income tax and receive a refund on their dividends of $12,846. Their effective average tax rate falls to 10.1 per cent in year two.

**Table 3.2. Example of tax restructuring (Part 2)**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend from bucket company into discretionary trust</td>
<td>$53,650 + $20,350 in franking credits</td>
</tr>
<tr>
<td>Distribution</td>
<td>Angie</td>
</tr>
<tr>
<td>Tax</td>
<td>$26,825 + $10,175 in franking credits</td>
</tr>
<tr>
<td>Tax rate</td>
<td>10.1%</td>
</tr>
<tr>
<td>Net refund</td>
<td>$12,846</td>
</tr>
</tbody>
</table>

Note: Calculations for these examples are stylised. Unless otherwise specified, they are based on headline personal, corporate and/or super tax rates and thresholds only without offsets, deductions or levies such as the Medicare levy or low-income tax offset.
Mike and Angie have been able to fund the same after-tax lifestyle as in year one, without having to work. In nominal terms, the total tax paid is $15,008 (four payments of $3,752) at an average tax rate of 10.1 per cent. By taking advantage of income splitting, the refundable imputation system, and a trust and bucket company structure, Mike and Angie pay $27,249 less in tax compared to a single income salary of $148,000.

The basic logic of bucket companies and trusts extends to more complex arrangements involving more income and extra family members. Sainsbury and Breunig (2020a) show how the same framework functions for a family of four adults with a combined taxable income of $500,000. In that case, this structure reduces an effective tax rate of 25.2 per cent in the first year to just 6 per cent over the full life of the scheme.

What’s more, Sainsbury and Breunig (2020a) show how, by staying entirely within the tax-free thresholds available for personal taxpayers and in super, a wealthy retired couple can finance a generous $140,000 post-tax lifestyle—of which $42,000 is tax refund—at a negative effective tax rate in the second year of the scheme. Over the course of approximately 10 years of this structure, the couple would be refunded the entire tax bill paid by their company in one year of the arrangement. They have found a way to convert their company tax into a temporary, interest-free loan to government.

In Sainsbury and Breunig (2020a), we document other schemes that can be used, including the combination of a small business and a self-managed superannuation fund and the combination of a trust with a bucket company and distributing income to multiple family members.

Do people respond to tax planning incentives?

Taxpayers are increasingly engaging with the kinds of tax vehicles illustrated in the examples. The most obvious trend since the turn of the century has been the growth in the number of trusts and self-managed super funds (Figure 2). Since 1999–2000, the number of trusts has close to doubled, from approximately 450,000 to 875,000, and the number of self-managed super funds has more than tripled, from approximately 150,000 to 500,000. This compares with a one-third increase in individual tax filers (from 10.1 million to 13.9 million) and two-thirds increase in companies (from 600,000 to 970,000). Part of the growth in trusts and self-managed super funds is coming from the declining interest in partnerships, which are generally more restrictive than trusts.
In addition, there is a relatively extensive academic literature (which is also growing as administrative taxation data becomes more accessible) pointing to taxpayers’ propensity to respond to tax incentives. Academic empirical studies—including international studies such as Feldstein (1999), Saez (2010) and Kleven (2016) as well as Australian-focused studies such as Johnson and Breunig (2016)—observe that the bigger the difference in marginal rates, the greater the tendency for taxpayers to structure their affairs. In addition, there is a higher propensity to respond to incentives by those who derive their income in more flexible forms.

Some estimates have been produced about the tax revenue at stake as a result of specific strategies. For example, in 2019 a team of RMIT researchers identified a number of sophisticated strategies using discretionary trusts, which they estimated to shelter as much as $1.2 billion in tax annually (de Silva et al., 2019).

However, as yet, comprehensive Australia-wide evidence on the extent of tax planning—evidence that combines the number of entities with the total value of tax at stake—is something of a blind spot for research. This is partly due to the challenges in assessing how much tax planning is occurring. The income that tax authorities observe (and audit) is what has occurred after a significant amount of legal tax planning has taken place. The strong assumptions required to arrive at a counterfactual amount of taxable income someone ‘should otherwise be earning’ before they tax plan suggests that such exercises would quickly become assumption and values-driven.

Even if a counterfactual could be robustly determined, measurement would be a challenge. Those embarking on tax planning activities tend to prefer to keep their arrangements private. One of the features of trusts, in particular, has been their anonymity and secrecy, as well as their propensity to be combined in very
complex ways. As a result, getting a complete picture on the amount of income that is directed through trusts, and especially complex structures, remains notoriously difficult. Building on this evidence base is one of the more compelling and pressing areas that warrants further analysis.

**Tax planning and the principles of good tax design**

Individuals benefiting from particular tax planning outcomes are likely to view these as a great development that should be retained. However, a tax system that includes widespread incentives to tax plan is problematic in a number of important respects.

**Less fair**

First, a strong argument can be made that some Australians responding to the incentives while others cannot reduces the fairness of the tax system.

As a range of authors (such as Konow, 2003, and Davis et al., 2019) have argued, notions of fairness are subjective, nebulous and contested. They are based on morals and ethics, with arguments drawn from a number of competing theories and philosophies of distributive justice. They are heavily context-dependent; for example, they are influenced by where ‘you’ are (the tax rate that applies to ‘your’ income) relative to someone else. And there is no single viewpoint as to what is fair. Fairness requires value judgements.

The fundamental ideas that vertical and horizontal equity embody—that those in similar positions are treated similarly, and those more favourably placed are required to pay more—are crucial to public acceptance of the Australian self-assessment system, which relies on people voluntarily reporting and complying with their tax obligations.

Tax planning works to undermine horizontal equity. Australians earning similar amounts of income from similar activities do not pay similar amounts of tax, with the size of discrepancy based on whether (or how much) they structure their affairs. The discrepancy becomes more pronounced for particular types of income.

In undermining horizontal equity, tax planning also undermines vertical equity. If people in the same position are not treated the same, it is impossible to trust that those on higher incomes are actually paying more. To put it another way, a system that is notionally progressive in shape may not be progressive in practice.
The discrepancy between people's capacity to pay and their tax paid becomes more acute when considering that those on higher incomes are likely to have more income to devote to planning, and a stronger motivation to avoid higher tax rates, including the top marginal personal tax rate. The consideration becomes even more stark when considering the cumulative benefits that accrue from planning over many years, and that may ultimately benefit future generations within a single family.

**Less efficient**

Second, the same tax system design feature that acts as an incentive for tax planners—tax rate differentials over time—also works to distort the allocation of Australian national resources. Specifically, the Australian hybrid income tax design imposes efficiency costs on the Australian economy in three ways: through a higher rate, narrower base personal income tax schedule; by fostering a tax advice industry whose presence diverts societal resources away from more productive enterprise; and by biasing tax investors towards low-tax investments.

The Australian tax system is a variant of a high rate, narrow base structure that is in direct opposition to the key learnings from the optimal tax literature (Mankiw et al., 2009). Non-planners are the high rate taxpayers in the system. They generally face the incentives embedded in the statutory personal income tax rate tiers. Tax planners are the low rate taxpayers in the system. For the same economic activity, they can assume a different legal form to achieve a lower tax rate. And because the tax planners are able to realise a lower average tax rate for themselves, tax authorities must impose higher statutory marginal tax rates on the population as a whole for a given revenue-raising objective. It is also worth bearing in mind that at the economy-wide level, tax planners are engaging an industry whose presence diverts societal resources away from more productive enterprise.

If we were to restrict consideration of the efficiency of tax planning decisions only to the subset of people's choices that concern the investment of their savings,\(^\text{10}\) then a tax system design that has neutral impact on taxpayer investment decisions and associated financing decisions may have little impact on the pattern of investment (see, for example, Samuelson, 1964, and King, 1977). If the pattern of investment is minimally affected by income taxation, then for the tax planning cohort the productivity loss, long-term growth effect and adverse efficiency effects might be overstated.

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\(^{10}\) ‘Savings’ here is defined as income that is not required to satisfy current consumption needs. In general, tax planner decisions will be more complex than just how best to invest savings. They can be expected to seek to lower the effective tax rate across all income sources, not just savings, and to seek out opportunities for tax arbitrage without changing economic engagement.
But this highlights a related feature of Australia’s tax structure: the non-neutral tax treatment of different investment options. Some asset classes (such as interest on bank savings) attract marginal personal tax rates, while others (owner-occupied housing and superannuation) have tax-free thresholds. Australians have in aggregate responded to the tax-free status of key investment choices (Sainsbury & Breunig, 2020b). In 2017–18, more than 70 per cent of Australians’ net worth was invested into housing and superannuation (Australian Bureau of Statistics, 2019). Such an asset portfolio suggests that Australia’s tax settings are a prominent part of a broader public policy landscape that is biasing people’s—and firms’—lifetime decisions towards particular domestic asset classes. In the process, the tax system is detracting from the efficient allocation of Australian economic resources.

**More complex**

Third, tax planning can be considered both a feature of and a driver of a complex tax system. As the 2015 *Tax White Paper* acknowledged, Australia’s tax system is complex:

> the complexity of the Australian tax system [which largely reflects the historical foundations of the tax system and the way the changes have been implemented in the past] reduces integrity and transparency, and imposes unnecessary compliance costs on taxpayers, as well as other costs on the Australian economy. (Australian Treasury, 2015, ‘At a glance’ Complexity section)

Tax structures can be technical and require specialist expertise to understand and enact. There is a financial cost both to set up and to maintain such arrangements. Further, the more complex a structure and the more income at stake, the greater risk to taxpayers if the structure were to run afoul of tax authorities. The resulting ‘compliance’ activities impose a financial and emotional toll, and often divert the taxpayer’s focus from other aspects of their life. As a result, taxpayers typically turn to the tax advice industry, and are at least partly motivated to outsource as much of the ‘running afoul of tax authority’ risk as possible to a professional tax planner.

**Less sustainable**

Tax planning also raises questions around the sustainability of the Australian tax system. Figure 3 is a stylised representation of the kind of stylised ‘cost–benefit’ choices that tax administrators and policymakers face. The hypothetical tax system might initially move along a trajectory where government receipts match that which would be expected if all citizens were all paying at their marginal personal tax rates. But over time, as some of the population lower their average tax rates, a wedge opens up between the (theoretically) full collection level and actual collections.
The growth in this wedge will not be a ‘linear’ progression. The wedge can, in general, be anticipated to cumulatively increase over time, as new tax planning opportunities are discovered and tax advisers overcome the fixed costs from developing necessary expertise and road-testing the advice. However, once a robust opportunity is developed, the marginal costs of marketing the advice and otherwise increasing the number who can access it are likely to be low.

Policy settings also often take time to ‘catch up’. The tax planning opportunity is only likely to arrive on the policymaking radar once ‘revenue leakage’ reaches a sufficient level, at which point there will be pressure on governments to fix the hole through a policy change. If the policy response is such that the opportunity is closed off entirely, then the revenue collections might return to the original collection level.

Equally importantly, there is a risk that taxpayers that are not benefiting from tax planning will lose faith in the system and find ways to avoid paying taxes themselves. This might, at some point, include increased action in the informal economy. The risk grows as the number of opportunities for tax minimisation across the economy proliferates.

It’s worth acknowledging that while this is (currently) a vulnerability, Australia continues to reliably collect large sums of money from direct taxation. For example, the 2019–20 Mid-Year Economic and Fiscal Outlook estimated that $231 billion will be collected in 2018–19 from individuals and other withholding taxes (Frydenberg & Cormann, 2019b). But, as Davis et al. (2019) revealed, personal income tax has in recent decades become increasingly concentrated among a narrower band of top earners. In 2016–17, Australia collected 45 per cent of personal income tax revenues annually from approximately 1 million top-earning taxpayers earning at least $125,000 annually and paying an average tax rate of 35 per cent on their taxable income. The composition of the top decile of taxpayers changes over time,
but the membership shares a common incentive to lower their marginal tax rates. So, there are reasons to be alert to the risk that the revenue base could erode. In particular, should the trajectory of Australian revenue collections proceed in the stylised manner depicted in Figure 3, it is reasonable to anticipate some future point at which revenue collections erode.

Where to go from here?

Policymakers could take one of four generic courses of action in response to tax planning:

- **Do nothing.** Persist with the current hybrid income tax approach. Either implicitly or explicitly drop horizontal equity as a fundamental principle guiding the design of the tax system. And accept that public acceptance of the tax system will continue to be questioned.

- **Give everyone access to a ‘no income tax’ outcome.** Instead of taxing income, move the taxation base entirely over to an expenditure tax base, perhaps combined with an estate tax that is set at consumption tax rates and designed to ensure the integrity of the consumption tax regime. This would be a significant shift in composition of revenue collections.

- **Close the incentives to arbitrage.** The general principle would be to directly address the incentives to arbitrage by closing (or significantly reducing) the gap between marginal personal tax rates and the corporate, super and capital gains rates on an enduring basis.

- **Close the opportunities to arbitrage.** The general principle would be regulating additional constraints around the use of common vehicles that ‘work across’ different income types, and considering the prohibition of tax vehicles entirely if more narrow solutions are not pragmatic.

These design options go deep into the basic design of tax. Accordingly, they have, in the (relatively) recent past, been within the remit of major tax reviews in the spirit of the *Review of Australia’s future tax system* (Australian Treasury, 2009) and *Tax by design*, the final report from the Mirrlees Review in the United Kingdom (Mirrlees et al., 2011). This article does not aspire to be a ‘solutions’ paper in the spirit of such weighty reports. We won’t advocate for a particular form of the Australian tax mix here. Instead, we advocate for an informed public policy conversation around which approach to taxation is most appropriate.

We will point out an important further consideration: that while incremental, piecemeal changes to specific sources of tax can contribute positively to Australia’s tax system, adequately addressing tax planning requires ‘big bang’ comprehensive reform that is implemented simultaneously across multiple sources of tax. Consider
the impact of one of the most consequential tax changes (in terms of revenue cost) in the past decade—the seven-year tax personal income tax plan—on marginal tax rates and arbitrage incentives.

On the face of it, reducing marginal personal income tax rates from as high as 47 per cent to as high as 30 per cent (excluding the Medicare levy) for those earning less than $200,000 in a year (estimated in the 2019–20 Budget to cover up to 94 per cent of the taxpaying population (Frydenberg & Cormann, 2019a)) will reduce the discrepancy between marginal personal and corporate tax rates and thereby reduce the initial incentive for salaried employees to set up and operate as a company. However, tax planners will still have incentives to use franking credits to achieve tax refunds. Moreover, for those realising between $50,000 and $200,000, there will be a more prominent incentive to earn income through capital gains rather than through corporate profit making, wage and salary earning.

**Conclusion**

This article has highlighted a range of tax planning opportunities in Australia.

Australia’s tax system contains opportunities for some taxpayers to adopt legal arrangements that enable them to pay less tax than comparable taxpayers, for the same economic activity. Some Australians are able to access these arrangements, with different opportunities appealing to different taxpayers and being of interest at different stages of people’s lives.

We have also revealed that the various parts of Australia’s income tax system are part of an interconnected whole. Appreciating tax planning requires a whole-of-tax-system perspective, with limits inherent in examining just an individual base, an individual element of the system or an individual year in isolation.

It’s not a surprise that taxpayers respond to the incentives they face. However, a tax system designed to encourage tax planning is an affront to the commonly held core principles of good tax design of fairness, efficiency and simplicity. In particular, widespread tax planning points to failure of Australian tax policy to give appropriate weight to horizontal equity considerations.

Conceptually, a taxpayer’s after-tax outcome should be much the same as that of any other broadly equivalent taxpayer, and should be based on the economic activity they undertake rather than the legal fiction they use. To put it another way, taxpayers earning the same income should pay the same amount of tax, irrespective of how they have chosen to structure their affairs.
If Australia remains committed to the principle of horizontal equity, then policymakers and political leaders will need to re-examine the rationale behind every aspect of our personal income tax system, and assess whether they remain appropriate in the modern Australian economy. Such an evaluation will need to take place in the wider context of the tax and transfer system.

References


SYMPOSIUM:

Re-examining Australia’s Federation Episode

On 22 November 2019, a conference ‘Demythologising Australia’s Federation Episode’ took place in Fremantle, with the support of the University of Notre Dame, Australia, and the Mannkal Economic Education Foundation. This symposium is an outcome.
Federation without affirmation: A sketch of a revisionist program of research into ‘1901’

William Coleman¹

Abstract

The Federation in 1901 of six colonies into a Commonwealth of Australia is the most researched episode in Australian political history. But for all its bulk and sophistication, this research remains underdeveloped. The root of the trouble is the ‘affirmative’ premise of almost every page of this history regarding its subject matter, Federation. This article identifies some unexcavated sites in the intensely worked field of Federation history that may supply useful matter for a revisionist history.

Introduction

The Federation in 1901 of six colonies into a Commonwealth of Australia is surely the most researched episode in Australian political history. But for all its bulk and sophistication, this research remains underdeveloped—misshapen, even. The root of the trouble is the ‘affirmative’ premise of this history regarding its subject matter, Federation. To illustrate: the relevant entry in the *Oxford Companion to Australian History* describes Federation as an ‘achievement’, ‘the greatest political achievement in Australian history’ (Davison et al., 2001, p. 245). Achievement is a approbative

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¹ College of Business and Economics, The Australian National University. William.coleman@anu.edu.au. The author is indebted to a referee on several points. The article’s arguments are more extensively developed in *Their Fiery Cross of Union: A Revisionist Retelling of the Creation of the Australian Commonwealth, 1889–1914*, Australian Scholarly Publishing (forthcoming).
term. One well-known dictionary offers as a definition, ‘a great or heroic deed’. Such a characterisation of Federation, in different degrees of intensity, is an implicit premise of just about every page ever written of Federation history.\textsuperscript{2}

A handful of celebratory and ‘memorialising’ chronicles, composed between 1900 and 1950, constitute the foundation of the received history of Australian Federation. In those years of living memory, the most literary of the Federationists—Alfred Deakin, B.R. Wise, John Quick and Robert Garran—\textsuperscript{3} took up the pen to fashion what they hoped would endure as the authorised account of these events. Theirs was a triumphalist story of the valiant struggling against villains, clods and a clown or two. The second phase of Federation history—that crafted by the professional historical investigators of the first generation after the Second World War—did see some greys appear on the palette. But none of this retouching by postwar historians altered an essentially positive outlook of Federation. The third period—say about the time of the Bicentenary until the present—saw a mottling of attitudes. External events deflated enthusiasts. The policy regimen, which was inseparably associated with Federation—tagged as the ‘Australian settlement’, but in fact the ‘Federation settlement’—was after eight decades disowned in the post-1988 period. Perhaps independently but to the same effect, the momentum of professional history continued to grind away at the mythology. But for all the seeming distancing, any frank slight of Federation remains rare. If, to the left, Federation is no longer magnificent, it is still beneficent. And to the right, it is something that only an unpatriotic knocker would want to take down. The centenary of Federation underlined the endurance of the essential consensus. It occasioned a flood of Commonwealth-funded scholarly studies that were perfectly content with an ‘affirmative’ interpretation of the history of Federation.\textsuperscript{4} A plaster cast nobility of ‘1901’, then, remains tolerated, respected and even added to by the past generation. Thus, notwithstanding some well-aimed

\textsuperscript{2} Crisp (1990), Botsman (2000) and Grimshaw (2002) may seem exceptions. But Crisp’s dissatisfaction with Federation is merely that it did not go far enough; it did not produce unification. Botsman’s objection is not to the creation of the Commonwealth, but to its conservation of the imperial tie. The brilliant essays of Martin (2001 and 2003) are perhaps the closest in the literature to a revisionist outlook.

\textsuperscript{3} Deakin (1944), Wise (1913), Quick and Garran (1901), and Garran (1936). Hall (1931) also needs mention, as the one piece of ‘research history’ of the phase. The earliest instance of the received version to appear in print, apart from Quick and Garran, is the potted history of the Federation movement supplied by Bryce in his Constitutions of 1905, which wholly breathes the presumptions of Deakin etc. Perhaps the final chapter of this phase of Federation history is ‘The First Five Prime Ministers of Australia’ by Robert Broinowski (1949), one of the troop of bright young right-hand men of the Federationist cause. In hypothesising that Edmund Barton was named ‘Edmund’ in honour of ‘Sir Edmund Parry’, the paper illustrates the ‘inspirational’ and not very probing flavour of this phase of history. Given that the hero of the Arctic had judged Barton’s father as ‘insolent and insubordinate’ in their brief and bitter encounter, it is unlikely Edmund was named in his honour. And ‘Sir Edmund’ was, in fact, ‘Sir Edward’.

\textsuperscript{4} Not only scholars benefited: ‘Both the Liberal Party and the ALP received grants from the Council for Centenary of Federation projects to mark their respective contributions to Australia’s development during its first century as a nation’ (Nethercote, 2002, p. 13).
stings, John Hirst’s *The Sentimental Nation*—the most significant and balanced single account of 1901—does not baulk at its own sentimental gesture: the work is dedicated to ‘the 422,778 Yes voters who have no other memorial’. 5

Even the best history, then, remains, at bottom, an act of giving thanks for Federation. And in popular, textbook and ‘official’ history, the myth-making of the first generation remains pervasive. Thus kept in general circulation is a ritualistic, commemorative, even legendary history of Australia’s Federation episode.

So for the questioner who asks ‘how can anything new be found in the field Federation, so exhaustively prospected, mined, sieved and sifted?’, there is an answer. What about an account of Federation that is not, at bottom, an exercise in giving thanks for it? There is a new thought.

The papers of this *Agenda* symposium are a gesture towards such an account.

The present paper identifies some unexcavated sites in the intensely worked field of Federation, which may well serve a revisionist history.

**Some deconstruction**

Perhaps the place to embark on a revisionist treatment of history is at the fonts of orthodoxy, and puncture the prestige of some of its texts.

The first is Deakin’s *The Federal Story* (or ‘Federal Fable’ or ‘Federal Fantasy’), first published in 1944. The author was a talented and experienced journalist, and in *Federal Story* he wrote a long editorial in honour of his cause, and philippic against certain miscreants, Lyne and Reid. 6 But, beyond its initial publication, it has been republished twice. This honour is doubtless in part because its literary charm is so great, almost irresistible. But I suspect this honour is traceable to the fact—as with the faithful to sacred scripture—the actual truth or falsehood is not the point; it is inspiring, uplifting, true ‘in spirit’, and that is enough. Granted: to criticise *Federal Story*, seems a bit like fact-checking a poem. But its mythologisations are taken as matter of fact, and it would be a worthy task for this piece of scripture to receive its own taste of biblical criticism.

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5 Mark also Hirst’s rather lame exoneration of the *Immigration Restriction Act 1901*: ‘It is common now to denounce the White Australia policy as racist and nothing more. It is certainly racist, but it also embodied the hopes for Australia as a better world’ (Hirst, 2000, p. 22). I guess many terrible deeds—deeds immensely more evil than the Immigration Restriction Act—have embodied the hopes of their authors for a better world.

6 Deakin claimed Reid ‘never read a book unless it was a sensation novel’, the ultimate damnation, presumably. James R. Tyrell records Reid as a ‘reader’ and ‘regular patron’ of the Sydney Book Club (Tyrell, 1987, p. 67). Deakin’s sulphurous judgement contrasts strangely with the gallant treatment he affords Reid in his anonymous *Morning Chronicle* columns (Deakin, 1968).

7 For example, Deakin’s account of the controversy of May 1900 over appeals to the Privy Council.
A different task awaits for whoever embarks of the massive task of deconstructing Quick and Garran’s 1901 *The Annotated Constitution of the Australian Commonwealth*. This is a tendentious account of Federation and the Constitution, but for all that it was treated as ‘the Bible’ by constitutional lawyers for many years, and was reissued in 1995, 2002 and 2015. It would be a worthy, if arduous, accomplishment to patiently expose the tenacious partisanship of its 1,008 crammed pages.\(^8\) Perhaps more dialectical guile would be called for in laying bare Wise’s *The Making of the Australian Commonwealth* (1913). Rightly distrusted by both his allies and opponents, why should we trust it?

**Myth-busting**

Perhaps the core revisionist remedy is the negative task of demolishing myths.

*‘The distinguished gentlemen’*

One of the vulnerable structures is the overinflated and always gilded representations of the Federation Fathers.

Alfred Deakin’s life has been intensely researched. The composite picture is revelatory, sometimes unnerving, but always fundamentally admiring. Very few have confronted that, for all Deakin’s brilliance and charm, there was something inhuman about him, possessed, as he was, by an all-excluding passion for personal mastery over events and persons.

By contrast to Deakin, George Reid was left by received history in no need of deflation. On the contrary, he needed rescue from the literary bile of Deakin and Wise. And he received it: beginning with Evatt (1945), and followed by Crisp (1990), and Nairn (1973). Reid’s sole and meticulous biographer concurred with the tendency of their conclusions (McMinn, 1989). To all these historians, Reid made Federation possible, and that is true enough. But he was also ‘a great Australian’ (Nairn, 1973, p. 47). This is the question: was Reid a great man, or one faithless to persons and principles? A cloaked, clever, ambitious temporiser? The case against Reid is far from exhausted by the venting by Deakin and Wise of their personal resentments.

It is with Edward Barton that the gap between reality and representation is the greatest. The most accomplished general history of Federation describes Barton ‘calm, devoted, high minded’ with ‘no indication he wanted glory for himself’ (Hirst, 2000, p. 132). A thumbnail refutation of these remarkable affirmations is not possible. The present writer can here only submit that in such words he has

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\(^8\) A compare-and-contrast with Moore’s *The Constitution of the Commonwealth of Australia* (1902) would be a worthy exercise.
FEDERATION WITHOUT AFFIRMATION

zero sense of recognition of the flesh and blood Edmund Barton. More importantly, the present writer would venture that all biographical inquirers into Barton the man have sensed his frailties (see the introductions of Reynolds (1948) and Bolton (2000)). Such inquiries have exposed some of Barton’s weaknesses. But for all that, there is in these biographies a holding back, an exercise of a courteous leniency, in considering Barton. It remains to be acknowledged that Barton was acutely flawed in character, without a noteworthy gift for anything beyond a certain talent for evanescent popularity. Many politicians, it may returned, can be judged the same. But can such a politician be Australia’s ‘noblest son’?

Barton’s only constituency is the celebrants of Federation. Charles Kingston, by contrast, has his own very definite constituency—beginning with The Bulletin, and enduring long into the twentieth century—as a ‘radical’, ‘democrat’ and ‘nationalist’ hero. The ‘radical’ characterisation needs to confront his relatively moderate positioning in the convention. The democrat characterisation needs to ponder his wish to entrench the entire federal constitution by requiring any revision to obtain the approval of at least two-thirds of voters at a referendum. The ‘nationalist’ descriptor is anachronistic, and needs reconciliation with Kingston’s public affirmation, on the eve of Federation, that Australia ‘was prepared to spend its last penny and last man in maintaining’ the British Empire (Daily Telegraph, 30 May 1900). Those warmed by his supposed nationalism might ask to what degree it was part and parcel of his brutal vehemence against Chinese immigration? The veneration needs to confront the plain fact that Kingston was a ‘terrible bully’ to his inferiors (Tennyson, 1978, p. 294), a psychological blight that culminated in his tyrannical administration of the inaugural Customs Tariff Act 1902. The Kingston myth is in need of some truth serum, but has furnished 120 years of adulation, forbearance and a certain averting of eyes from the obvious. The last is especially seen in the fact that no one seems to have registered the overwhelming probability that Kingston’s total mental (and physical) collapse in his 50s was a matter of neurosyphilis.

The recovery of ‘the historical Kingston’ might not only serve truth-telling, it might fill out the story of Federation. In received history, Kingston seems without an important role; Clark was the ideologist, Griffith was the legal counsel, Deakin the strategist, Barton the front man—and Reid the foil. And Kingston? He allegedly drafted the Enabling Acts for the convention in a single night; a feat of virtuosity rather than importance. His leading credit is commonly a very early draft of what ultimately became the Constitution Act of Australia. But the emergence in the last 30 years of Inglis Clark’s significance has dimmed that claim. And the drafts were very much a cut-and-paste from existing statutes and constitutions. Perhaps the truth is Kingston lacked an important role—perhaps Kingston is only memorable being various things (a ‘radical’ etc.), rather than doing various things. A fresh look at Kingston finds a man who, in his prime, had a flexibility in dealing with
majorities, which his browbeating of individuals belies. A fresh look might also find some significance in his unexpected personal friendships with the (presumably ‘un-radical’) free-trader Federationists, Symon and Glynn and Reid, the last of whom ‘liked him immensely’.

Popularity

Part of the myth of the first phase of received history is great popularity of the Federationist cause, at least at its apogee—apparently evinced by a majority voting ‘Yes’ in each of 10 referendums between 1898 and 1900.

But it has long been acknowledged (Crisp, 1949) that, by all reasonable benchmarks, the turnout at the Federation referendums was weak. In only one of those 10 referendums did a majority of those eligible to vote cast a vote for ‘Yes’. And, with respect to the notion of a ‘popular’ mandate more generally, in none of these referendums did the ‘Yes’ vote amount to anything near a majority of adults, not even in Western Australia (WA).

But another criticism of the democratic mandate has not been dealt with. Behind those totals of ‘Yes’ and ‘No’ savoured by Quick and Garran lies an extreme variation, which comprehended great chunks of ‘No’. Thus a majority of Sydney voted ‘No’ both in 1898 and 1899. Australia’s most populous city (narrowly), its largest port (easily), the creative centre of its literary life, the capital of its most economically significant state voted ‘No’, if only just. The received history is close-mouthed on this. It is implicitly recognised in the maps of Parker (1949), and mentioned in single sentences by Bolton (2000, p. 198), Crisp (1990, p. 341), and Hirst (2000, p. 199).

In the mountains of literature on Federation, where else? Gorman’s investigation of ‘Why Sydney voted no’ (this issue) is the first paper to give more than fleeting notice to this discomfiting fact.

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9 Kingston put it this way: he recognised only one master: ‘the majority of the Assembly’ (Morning, 19 September 1900).
10 Reported Yes ballots in WA constituted 50.004(1) per cent of the reported roll. But the abundance of fraudulent enrolments in this referendum leaves this microscopic majority fictitious.
11 The exact margin will depend on how ‘Sydney’ is defined. Using the definition of the ‘Greater Sydney Region’ (Palm Beach–La Perouse–Liverpool–Dural) provided in Clifford et al. (2006), No received 50.3 per cent of the votes validly cast, or 34,667 of 68,968.
12 Federationists, logically enough, considered this fact only discomfiting to Sydney: thus the scolding Sydney sometimes received in the early Commonwealth parliaments for its shameful disloyalty. Brisbane also voted No, but this has received distinct attention. The first page of the first chapter of a history of twentieth-century Queensland squarely notes it (Fitzgerald, 2002).
Motivation

Federation was, after all, meant to secure federation, not unification. But how many were actually moved to create a federal structure? One might be tempted to judge their intentions by the fruits of what they wrought.

By the twenty-first century there can be few federal nations as centralised as Australia. Even in the United Kingdom, Scotland and Northern Ireland have greater independent power than Australian states. (Pomfret, this issue)

Tempting, but not respectful of unintended consequences. Nevertheless, it is hard to detect any genuine federal spirit in the power-mongering of Deakin, the glory-chasing of Parkes or the office-seeking of Barton. You will find frank avowals of unificationism at the Australasian Federal Convention by William Lyne and B.R. Wise. And outside the convention, you will find some nationalism, but as Melleuish (this issue) stresses, nationalism is acutely hostile to federalism. It is true there were delegates to the convention who stuck out for a federal structure, especially South Australians. But it would be worthwhile to inquire how much federal spirit can be found once they threw their personal lot in after 1901. And Griffith. The oft-repeated claim is that the pre-1920 High Court of Griffith was profoundly less centralist than its successor. But that is a relative claim. How much spirit of federalism there was in the Griffith court is thrown into doubt in some of its own judgments, such as its remarkable decision that federal politicians were exempt from state income tax.13 (Were state politicians to be exempt from customs duties?) Historians would do well to review the supposed federalism of the Griffith court, not by the standards of Higgins and Isaacs, but, say, by the discernible expectations of Clark and Moore.

Obviously, there are worthy motivations that are neither federal nor unificationist. Thus Phelps (this issue) strongly argues that, contrary to common presumption, defence was a key motivator. One may retort that if defence was ‘subjectively’ important in the late 1890s, it was not, surely, ‘objectively’ important; and to the extent it was not objectively important, the real motivator of Federationists would be better described as some irrational anxiety about defence. But in distinguishing ‘subjective’ from ‘objective’, we have moved from motivations to functions.

Functionality

Myth-busting can extend to the proposed justifications for Federation.

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13 Deakin v Webb (1904) HCA 57; 1 CLR 585 (3 November 1904).
14 Under Joseph Carruthers, the NSW Government unsuccessfully appealed to the High Court to be exempt from customs (Attorney-General (NSW) v Collector of Customs (NSW) (1904) HCA 28; 5 CLR 818 (23 May 1908)). But Carruthers never claimed that his own purchases of wire netting should be exempt.
One of these is the existence of interstate tariffs prior to Federation. The vexation and scandal of these barriers to intra-Australian trade was, and is, a staple of Federationist rhetoric. And more, there lay a glorious promise in their removal. Thus Andrew Garran, later to be Reid’s man in the Legislative Council, declared ‘The gain if we establish inter-colonial free trade will be enormous. Australia as a whole will enter a fresh epoch’ (New South Wales Parliamentary Debates, 5 June 1890). One may well be sceptical of the epochal implications of their removal. Recall that in the wake of Reid’s *Customs Act 1895*, the rest of Australia could by 1 July 1900 export any good to New South Wales (NSW) perfectly free of tariff, apart from alcohol, tobacco products, tea and opium. And as Lloyd (2015) has revealed, the tariffs of the remaining colonies on imports from Australia were slight. Finally, there is a theoretical naivety in the joy of free traders such as Andrew Garran at the prospect of Victoria, South Australia (SA) etc. removing their tariffs on one another. For while the well-known arguments of the economist, rooted in David Ricardo and W. Stanley Jevons, easily rationalise the proposition that the abolition of tariffs will benefit an economy considered as whole, the very same pattern of argument will conclude that an economy may be harmed by abolishing a tariff on imports from one source but not from all sources (Viner, 2013 [1950] is the classic reference). To illustrate: while SA will certainly benefit from reducing tariffs on hops, whatever their source, SA may be harmed by reducing its tariff on Victoria’s hops alone, while maintaining tariffs on hops imports from the rest of the world. A special case brings out this perhaps recondite-seeming proposition: if Victoria’s hops supply is insufficient to satisfy all of SA’s hops demand, then SA must be harmed by such a tariff concession to Victoria only. For such a concession will not reduce the price of hops in SA, since the price of the still-required imports from the rest of the world still reflect the tariff. And since the price is unreduced, the concession neither benefits the SA consumer nor harms the SA producer. But the concession certainly will reduce SA’s tariff revenue. And it will, certainly, increase Victorian hops producers’ incomes, as they now sell in SA at the high price resulting from the tariff. In effect, SA tariff revenue (say £1,000?) has been spent on offering a subsidy for any Victorian hops exported to SA; an unenticing policy to SA, certainly. And, crucially, Victoria cannot, without harming itself, provide sweeteners in return sufficient for SA to agree to such a concession. For the (de facto) subsidy to the production of Victorian hops, of, say, £1,000, cannot have increased the income to Victorian hops producers by £1,000. The upshot is that the increase in incomes of Victorian hop producers is less than the reduction in SA tariff revenue; or, in other words, the gain to Victoria is less than the loss to SA. Thus Victoria cannot...

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15 An amending Act in December 1898 cancelled for sugar and sugar products the final reduction scheduled by the Act of 1895.

16 A celebrated proposition in the economics of international trade: see Jacob Viner (2013 [1950]).

17 The subsidy, say £1,000, increases production by a certain amount, but that amount must be produced at some loss, disregarding the subsidy—otherwise it would have been produced without the subsidy. Thus the net gain of Victorian hop producers is the £1,000 less that loss.
compensate SA sufficient for it to agree to such a concession, and still be better off itself; and so the two communities, considered in the aggregate, are worse off.\textsuperscript{18} The lesson of this example lessens surprise at the failure of attempts to secure intra-Australian free trade deals—such as that proposed between SA and New Zealand. It is possible that the terms of the mooted agreement were such that if SA was ahead, then New Zealand must be behind, with no possibility of SA being able to compensate … or vice versa.\textsuperscript{19}

A trickier challenge is to bust myths concerning the supposed ‘cultural’ grounds for Federation. The chief of these is ‘nationalism’. In popular Federationist history, this interpretation amounts the anachronistic projection onto the 1890s of attitudes current in Australia a century later. Formal history of Federation, by contrast, has paid close attention to the intense imperial consciousness of Federationists (Meaney, 2001; Souter, 1976)—their Union Jack waving, their \textit{Britannia Rule the Waves} singing, and their recurrent use of Tennyson’s lines:

\begin{quote}
One life, one flag, one fleet, one throne!
Britons, hold your own!
\end{quote}

The political actors who did not share this consciousness (say, Thomas McIlwraith on ‘the right’ and republican orators on ‘the left’) played no role in the Federation movement that gelled from 1895, and actively opposed it. Thus it might be held that Australian Federationists were Imperial Federationists: their fundamental aspiration was to strengthen both the Empire and Australia by establishing Australia as a fully fledged province of a Greater Britain. Did not Parkes, just 10 days after the ‘Tenterfield Oration’, write to Salisbury to propose ‘a great National Council in which all parts of the Empire should be represented on terms of equality’ (quoted in Hyam & Martin, 1975, p. 132)?

And yet it can hardly be said that Australian nationalism was absent or marginal to Federation. The Australian Natives Association, for all its conventional ‘loyalty’, was noisily nationalist and Federationist. The phrase ‘to make a nation’ is no anachronism. As a stated motivation for Federation, it seems to have issued from the lips of Federationists with a frequency comparable to the phrase ‘to consolidate the Empire’.

Complicating the matter is that nationalist and the imperialist sentiments could be felt simultaneously. Thus, at the time of the impasse in London over limiting appeals to Privy Council—a favourite incident in nationalist constructions of Federation—a following letter appeared in the \textit{Evening News} (19 April 1900):

\begin{quote}
\textit{No matter what commodities might be added in some SA–Victoria ‘free trade agreement’, the logic is that at least one of two economies is worse off, and possibly both.}
\end{quote}

\begin{quote}
\textit{In 1895, New Zealand and SA were on the verge of agreement that would admit New Zealand hops to SA, and SA wine to New Zealand, free of duty. But while the legislation was passed by New Zealand, it was abandoned in SA, ‘the natural result of the belief that it would give much to New Zealand but little to SA’ (Pulsford, 1917, p. 144).}
\end{quote}
Sir, — I am one who worked in my own little way to make Australia a nation, but I never dreamt that while assisting to federate Australia I was at the same time helping to sever one of the links which bind Australia to the Empire.

Civis

So what to make of this letter writer? There are at least three logical possibilities.

Perhaps antithetical sentiments (nationalism and empire-ism) simply coexisted in the same breast. Is not some incoherence in political professions almost to be expected?  

Alternatively, perhaps only one of the two sentiments of Civis is genuine, and the other is fake, inauthentic and put on (perhaps even without realising).

Third, one might try reconcile what is apparently contradictory. To that end, distinctions have been advanced between patriotism and nationalism, and between the love of a locality and allegiance to sovereign. How much do these distinctions help? An alternative frontal attack might note that nation may be a colony; and therefore, there exists at least the logical possibility of aspiring to make a colonial nation. A ‘colonial nationalism’, indeed. Logically possible, but, to our ideas, weird, and, to our usages, hardly ‘nationalist’.

The matter remains perplexing (see Ergas in this issue).

**Superiority**

If Federation had a functionality—that is, it constituted a solution—that does not make a sufficient case for it; a sufficient case would require that the solution it provided be superior to any alternative. In service of this requisite, the received history of Federation will often briefly pause to dispose of the Federal Council of Australasia (FCA) as an alternative to Federation.

The case against the FCA is that it was ‘ineffectual’ and ‘born lame’ (Crisp, 1990, pp. 11, 65) and even faintly farcical. Thus Robert Garran clears the board of the FCA with the derisive remark: ‘It passed a few acts about pearl-shell fishing and beche-de-mer fisheries’ (Garran, 1958, p. 85).

This remark is the template for usual treatment of the FCA, and indeed for the total neglect.

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20 Perhaps a strength of Federation is that it accommodated and gratified the existence of inconsistent attractions to both nation and Empire.
Queensland Pearl Shell and Beche-de-mer Fisheries (Extra-territorial) Act 1888: This seemingly laughable piece of legislation from the FCA is in fact an exercise in labour standards, and includes such stipulations as that deaths be reported, that native labourers be ‘carried on ship’s articles’, and that native labourers be paid in the presence of a shipping master.

Other FCA legislation included the Australasian Civil Processes Act 1886, the Federal Garrisons Act 1893, the Australasian Naturalization Act 1897 and the Australasian Testamentary Processes Act 1897, which provided that the orders of the courts of one colony regarding a will would have force in all colonies. The legislation is not contemptible, and served both justice and utility. They do certainly have less ‘sweep’ than that passed by the Commonwealth in the first 12 months of the inauguration of parliament. They lack the sweep of the Pacific Island Labourers Act 1901, which undertook to deport every Kanaka by 31 December 1906; or the strength of the Immigration Restriction Act 1901 (the White Australia Policy), which prohibited the entry into Australia of any one with a contract to perform manual labour, or the Commonwealth Franchise Act 1902, which deemed ‘no aboriginal native of Australia … shall be entitled to have his name placed on an Electoral Roll’.

The evident potential for the Federal Council to pass useful legislation does open a question that Federation historiography, through its contempt, partly closed: why did not NSW join to FCA? Why did Dibbs decline McIlwraith’s exhortation to join; or Reid declare he did not give a ‘fig’ for the Council? No work has been done on this question. The literature on the council is slender; perhaps only two papers over the past century. It appears no PhD thesis exists. And this scholarly neglect is perfectly in accord with the justificationist, if not celebratory, stance of Federationist historiography.

**Contingency, continuity and connections**

Apart from the deconstruction and debunking, what constructively would a revisionist account of Federation do?

A revisionist history commonly draws on different explanatory resources than original history.

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21 A quarantine bill was in process when the Federal Council last met in 1899.
22 The Constitution, at least in theory, placed an inhibition on this prohibition.
23 Trove records no more than an MA thesis (Harris, 1971) and a BA thesis (Anstey, 1971). Crisp’s (1990) wide-ranging bibliography of Federationist literature, which runs up to about 1980, records Harris, but nothing else.
Contingency

An ‘achievement’ is more than a piece of good fortune, or luck. Many observers have felt the realisation of Federation of 1901 was a matter of chance. Thus at the close of 1894, with Barton out of parliament, Griffith sidelined on the bench, Parkes in isolation and NSW Government in the hands of Reid and John Want, the rational likelihood of Federation coming soon must have been low. But within five years the cause was invincible. This bespeaks favourable, but chance (‘unusual’), events. This has been freely recognised, both in recent years and in the first phase. Thus Deakin would refer to a ‘miracle’ (Deakin, 1963, p. 173); the same thought in pejorative terms would have Federation as a ‘freak’. But however the fact is expressed, the contingency puts to sword functionalist grounds (tariffs, railways) or deterministic forces (swellings, rising tides of national sentiment). Eyes would turn to the unusual, unpredictable fluctuations in circumstances, the strange, unaccountable decision.

Continuity

Federationist history is premised on Federation being an ‘achievement’. A critic might see Federation as a misstep, a wrong turn, a blunder, a folly. But an entirely different dissent from affirmative Federation history would see Federation as a non-event. So 1901, rather than being a fork in the road, a rupture, a Year Zero, was, in this view, just more of the same old, same old.

The existence of ‘federation before Federation’ is well recognised; reflected in a style of governance of nineteenth-century Australia amounting to the imitation and cooperation of the six governments, rather than differentiation and competition. It is evinced in numerous intercolonial conferences, and the tendency to borrow legislation from one another. The Federation of 1901, it might seem, was no more than an intensification of this ‘federation before Federation’. Thus the creation of an army of the Commonwealth could be taken as just a culmination of the ‘federalisation’ of the various armed forces that had proceeded during the 1890s. Federationist immigration might illustrate the continuity thesis still more strongly. The White Australia Policy had its concrete origins in the intercolonial conference resolution of 1888 to extend anti-Chinese Acts to all ‘Asiatics’. This resolution was matched in the following decade by increasingly severe legislation culminating in the ‘dictation test’ legislation in NSW, WA and Tasmania of the late 1890s. The Immigration Restriction Act 1901 was, in this continuity interpretation, just a sharpening up and tidying up of a policy already essentially decided upon without Federation. There was, after 1901, a severity in the black letter law and rigour in enforcement that were not to be found before 1901; but, for all that, Federation just hastened Australia down the road it was travelling anyway.
But the continuity thesis is a tall order. Even in the one matter that it well fits—immigration—the severe and sweeping Immigration Restriction Act 1901 evidently reflected a new political game (Norris, 1975); a new politics that had been inaugurated with the creation of a new polity; a new polity that was restricted in scope, and in consequence, endowed with an uncluttered agenda in comparison with colonial legislatures (so crowded with particularist causes), and yet still burdened with an imperative to win elections. In consequence, the new polity yielded an intensification of ‘national’ legislation gratifying ‘valency’ issues. The recasting of defence after 1901 manifests this new kind of politics, and, correspondingly, the inadequacy of the continuity thesis; it is hard to see the 1890s conferencing of brigadier generals and that decade’s harmonisation of weaponry heralding the revolution of defence in the 10 years following 1901. Thus voluntarism—an active principle of pre-1901 armed forces—seemed to reach new heights at the very verge of Federation, and hardly betokened the visions of compulsory mass armies that were so beguiling to all political parties just 10 years later.

Beyond legislation, Federation did seem to amount to a rupture in time for one important particular of the Australian landscape: the Labor Party. The nexus between its remarkable take-off in after 1901 and Federation seems not to have engaged, or even been acknowledged, by the historians of Labor.24 There lies a task undone.

**Connections**

Another salient resource of explanation revisionism is the networks of persons, in contrast to the reliance of unrevised history on impersonal forces (ideas and interests). That such a stress is diminishing (and so revisionist) is plain enough; events—important events—are the product of the machinations of self-serving cliques. The drama, even grandeur, of political ‘waves’, ‘eruptions’ and ‘earthquakes’ is removed.

Federation promises to be a rich field for the study of the power of personal networks. The nerve centre of the movement seems to coincide with a complex of barristers and judges: Barton, O’Connor, Reid, Wise, Griffith, Clark, Deakin, Isaacs, Kingston, Symons (and Glynn). The legal profession at which judges and barristers were the centre was an intense, still small, even intimate, brotherhood, nourished by common education, shared employment, professional bodies, friendships and, of course, briefs passing back and forth continually between them. At the centre of the Australian political fish tank of the 1890s was a highly intelligent, jet-propelling, carnivorous, multi-armed tentacular organism.

24 Thus Hagan and Turner (1991) ascribe the revival of the fortunes of NSW Labor ‘around the turn of the century’ to the NSW Conciliation and Arbitration Act 1901, the recovery of trade unions from the 1890s, the legitimation of the party in Catholic eyes, and the expansion of the wheat belt. Rickard appears to judge Federation of greater significance for the non-Labor side of politics (Rickard, 1976, p. 166).
The seamy side

This is where official history rarely probes, but revisionist history achieves notoriety by doing so. This is the hidden, unattractive but necessary part of any showy garment. Being hidden, the seamy side of Federation is a challenge to record, but traces can be detected.

The money plumbing

This is the funding of Federationist campaigning in NSW and WA (and presumably Queensland) by donors from Victoria and SA. Deakin was certainly a director of these flows. It is possible that, as rumoured, King O’Malley was the palpable duct of some of them. And it is at least plausible that Deakin’s son-in-law, Herbert Brookes, acted as a financial irrigator of the politically parched far reaches of Australia, as he did for Deakin’s Commonwealth Liberal Party 10 years later.

These unsentimental activities have been given most attention by Hirst, who in one dense paragraph reproduces some allegations, and notes some of the extant, if disguised, records of it (2000, p. 260). Obviously, the covert nature of this activity reduces the evidence, but detective work may give a clearer and interesting picture.

Electoral fraud

The ultimate unmentionable in the Federation history is the blighting of the referendums by electoral fraud. Such fraud was a curse of nineteenth-century elections (Nairn, 1967; Walker, 1977), and concerted effort was made with the NSW Parliamentary Elections Act 1893 to stay it. But the equally strenuous efforts of Reid in 1899, and Forrest in 1900, to secure a ‘Yes’ vote produced a relaxation of safeguards. It is a matter of public record that fraud was executed in WA. And it would also seem likely, on the basis of the aberrant size of recorded votes, there was a mound of fraudulent ‘Yes’ votes in the Riverina electorates, and fraudulent ‘No’ votes in Sydney-Lang.

25 Thus Deakin to Symon, 15 July 1898. ‘Dear Mr. Symon: I have just had a verbal request from Sydney to write you to see if your League can in the strictest privacy spare any funds or raise them to assist the fight in the Broken Hill seats …’ (quoted in Wright, 1976; emphasis in original).

26 On the face of it, the 119.9 per cent turnout recorded in Sydney-Lang is a marvel of democratic achievement, which no ballot in our postlapsarian times can hope to touch. But it may be retorted that NSW voters in the 1899 referendum were permitted to cast the vote absentee, and one might impute the outsize turnout to absentee votes. And yet, why should Sydney-Lang exhibit such a mass of visiting electors? The fact that the electorate strongly voted ‘No’ reinforces the thought that Hughes’ Labor machine—strongly opposed to federation—was organising fraudulent ballots. See Hughes (1947).
It would be worthwhile to see if ‘seeming likelihood’ of ballot fraud could be transformed into a more pronounced judgement, one way or another. There is a literature, chiefly concerned with nineteenth-century US referendums, that models turnout statistically, and so allows the testing (and potential rejection) of the hypothesis of turnouts of particular booths being normal, and ‘thus’ being inexplicable only by fraud (Baum, 1991; Baum & Halley, 1994). With the advent of post-1989 democracies, a distinct literature has developed turning on the fact of psychology that the relative frequencies of certain digits of fake returns are not equal to 0.1, as they will (approximately) equal in natural data. Like any statistical test, both approaches will sometimes yield false negatives, and sometimes false positives, but they are not valueless because of that.

Counterfactuals

Counterfactual history by revisionists is subject to the danger of being no more than wish fulfilment fantasy. But ‘used with care’, the speculation over counterfactuals is a legitimate part of the repertoire of revisionist history. With respect to the case of Federation, the use of counterfactuals is partly defensive: to rebut the silly counterfactuals sometimes indulged by received history; thus fancies of passport control and currency exchange at Tweed Heads in the absence of 1901. The mulling of counterfactuals might be additionally useful in exploring the contingency of Federation; and partly in exploring the hypothesis of continuity vs rupture. The formulation of convincing counterfactuals will bring to the table a historicist or social science perspective on Federation, as any counterfactual that is not gratuitous must draw on them. Finally, the cultivation of counterfactuals illustrates in part—at least potentially—the possibility of a better twentieth century, not based on no Federation, but on a better one.

The upshot

A revisionist treatment of history opens up a path for a more constructive inquiry into Federation. If Federation was not ‘an achievement’, what was it?

References


FEDERATION WITHOUT AFFIRMATION


The global context for Federation:
The spread of nationalism and the triumph of the nation-state

Henry Ergas¹

Abstract

Liberal nationalism’s culminating moment, the European revolutions of 1848, ended in utter failure. A movement of intellectuals entirely lacking a popular base, the principle of nationality experienced a far-reaching illiberal turn. By the 1890s the world was awash in deeply illiberal, and often positively repellent, nationalisms. Britain itself, however, seemed an exception. But an almost endless list of new fears had emerged and moved to the centre of her politics. Britain was, in Joseph Chamberlain’s evocative phrase, a ‘weary titan’, staggering ‘under the too vast orb of its fate’. The time predicted by Herman Merivale seemed to have come. As Under-Secretary of State at the Colonial Office from 1847 to 1860, he had foreseen the day when the Empire would have to prove flexible enough to absorb the ‘great Australian Republic which probably is to be’.

The background

All of us alive were born into a world of nation-states. We learned, generally very early on, that the right answer to the question ‘Where are you from?’, particularly when posed overseas, was (say) ‘Australia’, rather than the street address of the hospital at which we were born.

¹ ergas.henry@gmail.com.
By the time we reached adult life, it would have seemed entirely natural to us that being Australian, rather than, say, Austrian, comes with a package of attitudes, expectations, rights and obligations that is common to Australians and not to Austrians.

And we would also have expected that anyone we met would know how to answer the ‘Where are you from?’ question in much the same way as we did, and would have, in his or her mind, a package of attitudes, expectations, rights and obligations that was shared with his or her co-nationals and differed from the mental package of other nationalities.

But none of that would have been the case at the beginning of the eighteenth century. Instead of taking a standard form, polities came in a bewildering array of shapes and sizes, including city-states, principalities, composite monarchies that ruled over geographically separate territories, agrarian military domains, and empires, as well as combinations of some or all of those. While there would have been many ways of answering the ‘Where are you from?’ question, none of them would have invoked the concept of nationality. And although attitudes, expectations, rights and obligations naturally varied greatly from place to place, they were not standardised within national borders in the way they are today.

That was, to some extent, still true when the Commonwealth of Australia was formed in 1901. But even though the triumph of the nation-state as virtually the only form of polity did not come until the end of the First World War—with the collapse of the great land empires and the affirmation by that odd couple, V.I. Lenin and Woodrow Wilson, of that even odder notion, national self-determination—the ascendancy of the nation-state was, by the time of Federation, unmistakable. And integral to that ascendancy was the seemingly irresistible rise of what, in the nineteenth century, was known as the principle of nationality.

That principle, although variously expressed, involved three central elements. The first, which was asserted as an empirical proposition, stated that humanity is divided into nations. The second, which was normative in character, said that nations deserve recognition and respect, allowing their unique attributes to flourish. And the third, which derived an aspiration from the two that preceded it, claimed that nations could only obtain the recognition and respect to which they were entitled if they were autonomous, which usually meant independence and the sovereignty that came with it.

Broadly speaking, nationalism was the translation into the political sphere of the principle of nationality. But nationalism was obviously much more than a political philosophy: it defined an ideal and shaped an outlook on the world; it formed the basis for an urgent call to action; it demanded of its adherents a loyalty and commitment to the cause that could, and in many cases did, involve the sacrifice of life itself.
Nationalism might, in those respects, be viewed as a religion; indeed, the great German political theorist Carl Schmitt considered it to be a secularised version of faith. However, this was a religion that was not founded on any sacred text, lacked any formal structure and never vested authority in any high priests; all it had was a master-concept—the nation—which admitted of a vast range of uses and conceptions. Plastic and polymorphic, its shape evolved over time and space, in ways that have made the search for a unified theory of nationalism a quest for a will-o-the-wisp, invariably leading those who have engaged in it to their doom.

It is, nonetheless, possible to trace, at least in broad outline, the forms it took and the elements that combined as it grew and mutated over the decades leading up to the debate on Australian Federation. How did the principle of nationality develop in the course of the long nineteenth century, which opened with the 'age of revolutions' and ended with the cataclysm of the First World War? What kind of nationalism—or, as will be clear, of nationalisms—defined the broader world in which the debate between those who favoured Federation and those who opposed it occurred? These are the questions that this article, in providing part of the context to the broader assessment of Federation, seeks to address.

In addressing them, it would scarcely be possible to start at the beginning, which would, at a minimum, require us to go back to late medieval Europe; yet there is a great deal of truth in Chaucer's proverb that 'Out of the old fields must spring and grow the new corn'. In this case, the old fields were rich in seeds, and much ploughing had been done, well before our narrative begins toward the end of the eighteenth century.

The idea of a 'nation' had long existed, but it was not at all well-defined; typically, it referred fairly narrowly to political elites, rather than encompassing the people who inhabited a particular territory. However, what had come into progressively sharper focus was the concept of 'the state' as a form of public power separate both from the ruler and the ruled, and which exercised the supreme political authority within a defined territory. By the close of the sixteenth century, that concept lay at the heart of political thinking; and it gained crucial recognition in the settlements, however tenuous they proved to be, of the religious wars that had torn the German lands apart in the aftermath of the Reformation. First the Treaty of Augsburg, in 1555, and then the more important and lasting Treaty of Westphalia in 1648, bundled together state and territory, with the principle of 'cuius regio eius religio'—whosoever the state, his the religion—vesting in the prince of each treaty state the authority to determine whether the principality would or would not retain 'the old religion'. The Westphalian peace thereby gave formal recognition to an interstate system based on territorially defined sovereigns.
The Treaty of Westphalia had many consequences, of which two are worth mentioning here. To begin with, it intensified the focus on the geography of power, and notably on frontiers. Until then, these had usually been very poorly demarcated; now, much greater emphasis was placed on determining exactly where one state ended and another began. Before the mid-sixteenth century, frontiers rarely featured on maps: by 1570, when Abraham Ortelius produced the first modern atlas, about half of its maps located borders, while Joan Blaeu’s magnificent *Theatre du monde ou novel atlas*, which appeared in 1635, marked the frontiers on almost four-fifths. This attention to frontiers was distinctive: Chinese maps, for example, lacked it almost entirely. And it was accompanied by increased concentration on internal delineation as well, with the emergence in that period of the first modern territorial surveys and cadastres.

At the same time, the Westphalian peace, as well as the wars that preceded it, drew attention to crucial questions about states and the relations between them—for instance, how did a polity become a ‘state’? Who decided, and what determined, the rights and obligations that status entailed? Those questions were central to a bevy of Protestant thinkers, whose ability to practice their faith depended on the territorial integrity of the small and perpetually threatened polities that had adopted the new religions of Lutheranism and Calvinism. Central among those thinkers were the Dutch prodigy Hugo Grotius, who wrote in the first half of the sixteenth century, the German scholar Samuel von Pufendorf (1632–94) and the Swiss international lawyer Emer (Emmerich) de Vattel, whose masterpiece, *The Law of Nations*, appeared in 1758; between them, they cemented the notion of international society as a system of states that recognised each other as equals entitled to live in peace.

These ideas were in the air; but they, and many others, were brought into entirely new alignment by two events that—quite understandably—appeared to contemporaries as extraordinary, indeed, revolutionary: the American Declaration of Independence and the French Revolution.

**The American Declaration of Independence**

But before turning to the decision of the American colonists to declare independence, it is helpful to know that historically, the word ‘revolution’, when used in a political context, did not refer to a dramatic new beginning; on the contrary, it meant a restoration, a return to a prior state of affairs.

Thus, the word was first used not when what we would call a revolution broke out in England and Cromwell rose to the first revolutionary dictatorship, but in 1660, after the overthrow of the Rump Parliament and the restoration of the monarchy. The word was used in precisely the same sense in 1688, when the Stuarts were expelled and power was transferred to William and Mary. The ‘Glorious Revolution’,
the event through which the term paradoxically found its place in political and historical language, was not thought of as a revolution in the modern sense at all, but as a restoration of monarchical power to its former righteousness and glory.

There are good reasons to believe that the founders of the United States conceived of what they were doing in much the same way, at least initially. Their original goal was not independence but to free themselves from control by a parliament they thought was dominated by interests inimical to their own; they would, it seems, have been content to be self-governing subjects of the Crown, as they claimed they had been when the colonies were established. But they knew their Vattel, which, as Benjamin Franklin told the editor of *The Law of Nations* in December 1775, ‘has been continually in the hands of our Congress, now sitting’ (Scott, 1916, p. 1a). And it was clear from Vattel that Congress could only legitimately ‘levy war’ and ‘contract alliances’ against Great Britain, as it was determined to do, if it acted on behalf of a sovereign state.

Thomas Paine influentially explained the situation in *Common Sense*, which appeared in January 1776. Only independence according to the ‘custom of Nations’ would permit a mediator to negotiate peace between the United States and Great Britain, as only states could make or secure treaty commitments from each other. Equally, foreign alliances could not be obtained without it. And unless the United States was recognised as an independent state, the Americans would be mere rebels, as George III had declared the colonists to be in August 1775, rather than waging a war. For all of those reasons, Paine concluded, it was essential for a ‘manifesto to be published, and despatched to foreign Courts’; failing that, ‘the custom of all Courts is against us, and will be so, until by an Independance [sic], we take rank with other Nations’ (Paine, 1776).

All that was clearly reflected in the Declaration of Independence’s famous opening sentence, which asserts that the colonists’ goal is to ‘assume among the powers of the earth the separate & equal station to which the laws of nature and of nature’s God entitle them’. And it was that ‘separate & equal’ station—that is, the recognition of the United States as representing sovereign entities—that the British eventually conceded.

The American Revolution was not the first successful secession of a province from an imperial monarchy: ‘the Dutch revolution’ of the late sixteenth century held that honour, as America’s revolutionaries often noted. But there is no doubt that the Declaration of Independence was the first to identify sovereignty with national independence. It successfully claimed for the former colonies the two essential characteristics that form the constitutive principle of states and give them their external shell: *imperium*, that is, final and absolute authority over a political community; and *majestas*, which is the dignity and respect that authority commands.
and which entitles it to be a state among states—endowed, as Vattel put it, with a ‘perfect equality’ to other states, including in its right to be left to the ‘peaceful enjoyment’ of its liberties.

The Declaration itself, and the colonists’ achievement in realising their goal, had an enormous impact. When Britain recognised American sovereignty in 1783, Edmund Burke immediately noted that a momentous event had occurred. ‘A great revolution has happened’, he wrote:

>a revolution made, not by chopping and changing of power in any one of the existing states, but by the appearance of a new state, of a new species, in a new part of the globe. It has made as great a change in all the relations, and balances, and gravitation of power, as the appearance of a new planet would in the system of the solar world.

(Burke, 1852, p. 453)

Overall, the Americans had proved that sovereignty could be acquired through an act of will, thus establishing the bases for a world of nation-states born through deliberate political action. The reverberations did not take long to make themselves felt. The Haitian Declaration of Independence came in 1804; and while it failed, it was followed by the Venezuelan Declaration of Independence in 1811, which copied significant elements of its American counterpart word for word. That set off a chain of declarations of independence throughout Central and South America with the result that by 1844, the entire region was populated by self-formed nation-states. It was also the American Declaration that inspired the Greek War of Independence, which began in 1821 and served as a model for the nationalist movements that, over the course of the nineteenth century, swept the Balkans and central Europe, helping to destroy the great Ottoman and Austro-Hungarian empires. And even the united Māori tribes of the North Island of New Zealand signed a ‘Declaration of the Independence of New Zealand’ in 1835, albeit mainly so as to allow British penetration of the islands before the French could lay claim to them.

The French Revolution

While the American Declaration of Independence unleashed the immense ‘change in all the relations, and balances … of power’ between states that Burke predicted, the tumultuous process that began in France in 1789 dramatically altered the relations and balances of power within states, ultimately redefining the state itself.

To say that is not to ignore the important elements of continuity, which Tocqueville famously stressed, between the changes that were already underway in the Ancien Régime and those that followed its fall; nor is it to deny that many of the states that did not experience anything approaching the French cataclysm were nonetheless in the throes of immense transformations that ultimately reshaped their social and
political life. But what happened in France was the first attempt to consciously shape an entirely new world by tearing down the old order and putting a completely different order in its place. It was, to that extent, the first modern revolution; and it was clearly the modern meaning of the term that François Alexandre Frédéric, duc de la Rochefoucauld-Liancourt, intended when, on the very night of the fall of the Bastille, he warned Louis XVI that ‘Sire, this is not a revolt, it is a revolution’.

The French Revolution was a blood-soaked affair, and its causes, course and consequences remain the subject of intense historical debate. But just as the American Declaration of Independence irreversibly conjoined the notion of sovereignty to that of national independence, so the French Revolution, and the successive constitutions it gave rise to, developed a coherent bundle of concepts that eventually became the backbone of our conception of the nation-state. Four elements of that bundle of concepts are especially relevant: the nation, which was seen as the locus of sovereignty; the citizens, who were its members and comprised ‘the people’; rights and duties, which were the privileges and obligations attached to citizenship; and the state, which was the concrete form through which sovereignty was expressed and which gave the rights and duties of citizens their substance.

Each of those concepts had deep antecedents in European political thought, each acquired new meaning in the course of the revolution and each was to have far-reaching effects. But while they now seem entirely obvious, they have their subtleties, and none more so than that of sovereignty.

We have already encountered that concept as involving the external casing of the state; what makes it an equal in international law to other states that recognise its authority over a defined territory. But France had long enjoyed that protective shell. The concept of sovereignty as it was used in the French Revolution was therefore viewed in very different terms: not as the external recognition of authority but as the ultimate source of the state’s domestic legitimacy.

And at heart of the concept as it was used in the French context was the notion that a fundamental distinction had to be drawn between the sovereign on the one hand and the government or the ruler on the other. That distinction was not a new one: it had already been made by Jean Bodin in the sixteenth century and by Thomas Hobbes a century later. But Jean-Jacques Rousseau placed it at the centre of his work, and made it serve an entirely new end. That Rousseau regarded it as crucial is beyond doubt: he warned readers of The Social Contract that mastering it required careful attention; and in the eighth of his Letters Written from the Mountain, written in 1764 in defence of The Social Contract and of Emile, he declared that:

> Up to the present the democratic Constitution has been poorly examined. All those who have spoken about it either did not know it, or took too little interest in it, or had an interest in presenting it in a false light. None of them have sufficiently distinguished the Sovereign from the Government. (Rousseau, 2001, p. 257; emphasis added)
What he meant, simply put, was that government could not authorise itself; rather, its authority derived from an ultimate source, and it was that source which was the sovereign. As a result, that sovereign was not constrained by whatever arrangements of government happened to be in place; on the contrary, it could alter them as it saw fit. And unless the arrangements were approved by the sovereign, they lacked legitimacy.

It is somewhat paradoxical that the canonical form of this proposition, and of its institutional implications, were elaborated by a French Catholic clergyman, Emmanuel Joseph Sieyès (1748–1836), most commonly known as the abbé Sieyès, who, when he was asked what he had done during the revolution, laconically replied that he had survived. But few of the thinkers caught up in the upheaval had greater or more enduring impact.

Sieyès set out three propositions. The first was that there was a meaningful entity called ‘the nation’, which broadly emerged from the shared history of a community and which was pre-political, in the sense that it existed independently of the political arrangements that prevailed at any time. The second was that the nation so defined was the ultimate source of authority and hence was the sovereign, with the power to constitute the form of government. And the third was that that ‘constituent power’—the power to ‘constitute’ the state—was logically prior to and separate from the ‘constituted power’ (i.e. the government), whose concrete form it determined.

There was, in other words, a difference, which ought to be reflected in institutional terms, between the act of defining, modifying and ratifying a constitution, which necessarily required the approval of the constituent power (i.e. the nation); and the task of legislating within the framework of the constituted power, which could be delegated to representatives.

Sieyès’s notion of a constituent power on the one hand, and a constituted power on the other, eventually provided the conceptual framework for modern constitution-making; no less significantly, it specified a mechanism by which revolutionary change—the transition from one order to another—could, at least in theory, be legitimated. And by tying ultimate sovereignty to ‘the nation’, understood as a historical community, it both made the nation foundational and vested each nation with the authority to determine its own political future.

Of course, the revolution did much more for the cause of nationalism than just elaborate a theory of the nation as a pre-political sovereign. It largely created, and certainly cemented, the idea that the nation had a collective will, and that that will could be determined, separately from the ordinary electoral processes, through referendums—that is, through direct appeals to the people as a whole. It put in place the first laws that defined and circumscribed citizenship, granting it to some while depriving those who were judged to be ‘enemies of the people’ of its rights
and protections. It pioneered mass conscription, creating an army that mirrored and embodied the nation and whose leadership was based on merit, rather than on inherited status. And it developed the panoply of symbols that came to define a nation, including the national anthem, with the *Marseillaise*—which calls on children of the *patrie* to water the nation’s furrows with the blood of the enemy—being undoubtedly the most stirring of its genre.

**Romanticism and the *Volk***

The nation was therefore at the centre both of the French Revolution’s theory and of its practice. The Revolution’s grim denouement might therefore have brought the career of the principle of nationality to an ignominious end. It did no such thing.

That was at least partly because the mayhem that the revolution and then the Napoleonic Empire spread throughout Europe gave new impetus to thinking that was already underway, albeit in embryonic form, when the revolution began. Particularly important was the somewhat inchoate movement later known as Romanticism, which started as a reaction to the Enlightenment’s overwhelming emphasis on reason. To point to the Enlightenment’s emphasis on reason is not to suggest that its great thinkers, most notably Kant, regarded human reason as omniscient; on the contrary, Kant’s program was to derive what could be derived ‘within the limits of reason’, limits that he repeatedly stressed. What is true, however, is that the Enlightenment viewed reason as an innate capacity all humans shared. Because it was everywhere the same, the differences between peoples were inherently transient, and overcoming them was both feasible and desirable.

Assaulting that proposition was the life’s work of Johann Gottfried Herder (1744–1803), who had been Kant’s student. Herder was a complex thinker, whose theories are readily caricatured; but his influence on German culture ran wide and deep, initiating movements that range from the study of folklore (which he famously did in tandem with Goethe, collecting German folksongs in Alsace), to that of linguistics and of the philosophy of history.

The crucial point here is the weight he placed on, and the sophistication he brought to, the notion of a *Volk*. Redolent with meanings, this is not an easy term to translate. In his *Anthropology from a Pragmatic Point of View* (1797), Kant defined the term, with considerable reticence and even greater vagueness, as meaning ‘a multitude of human beings united in a region, in so far as they constitute a whole’ (2006, p. 154; emphasis added). In contrast, Herder, in his *Ideas for the Philosophy of the History of Humanity* (1784/91) portrayed the *Volk* as a natural phenomenon, writing that ‘Nature raises families; the most natural state is therefore also one people, with one national character [which is] as much a plant of nature as a family, only with more
Herder did not mean by that a *Volk* could be found in nature; rather, he meant that it developed organically, much like the growth of a forest.

For Herder, a *Volk* was therefore an entity that had to be defined relationally as the social aggregate that produces a clearly delineated culture and collection of customs. That culture and collection of customs were not the product of intentional human design; rather, they were the manifestation, or working out, of the spirit of the people, or *Volksgeist*. And underpinning the *Volksgeist* was a people’s language, which, having evolved over the centuries, bore the marks of generations of experience and transmitted to each new generation a kind of coded history of the sufferings and joys of the nation.

But Herder did not merely believe that language was the essential attribute of each *Volk*: he approved of the resulting divisions of mankind. The variety of languages cut communities off from each other, forcing them to develop their own unique cultures and protecting them from much of the corruption that arises, Herder believed, from the temptation to slavishly imitate foreigners.

In arguing that case, Herder was no bigot; on the contrary, he made it clear that the diversity of languages and cultures was an integral part of the heritage of mankind—and it is perhaps fitting that he coined the term ‘nationalism’, using it as a pejorative that was synonymous with prejudice and loutishness. Whether Johann Gottlieb Fichte (1762–1814), who translated Herder’s basic notion of cultural distinctiveness into a political program, showed the same broadmindedness is more controversial.

An immensely original and sophisticated philosopher, Fichte was capable of being as incomprehensible as he was brilliant, perhaps inaugurating a great German tradition in that respect. When in 1801 he tried to explain the basic elements of his thought in a tract that was somewhat comically named ‘A Crystal Clear Report to the General Public Concerning the Actual Essence of the Newest Philosophy: An Attempt to Force the Reader to Understand’, he did not succeed in making things any better. But unlike his post-Kantian metaphysics, his contributions to nationalism were all too straightforward, and proved far more dangerous than Fichte, who was a committed humanist, seemed to realise.

Those contributions were crafted in the wake of Fichte’s bitter disappointment at the failure of the French Revolution to live up to its lofty values of liberty, equality and fraternity, and reflected his belief that realising those values was now the historic task of a German ‘nation’. But no such polity existed at the time; Fichte’s goal was to motivate its coming into being.

In doing so, he began by acknowledging the French doctrine that the world has been constructed to accommodate nation-states: ‘Certain parts of the earth’s surface, together with their inhabitants, are visibly destined by nature to form
political entities’ (Fichte, quoted in Reiss, 1955, p. 94). But while he acknowledged that doctrine, he could hardly accept it, as the ‘natural borders’ defined by the Pyrenees, the Alps and the Rhine appeared to give the French a large slice of what he regarded as Germany. So as to adapt the concept of natural borders to the circumstances of a featureless plain in the centre of Europe, he developed Herder’s cultural nationalism into a doctrine of ‘inner frontiers’. ‘Those who speak the same language’, he wrote, ‘are linked together, before human intervention takes a hand, by mere nature with a host of invisible ties; they understand each other and are capable of communicating more and more closely with one another, they belong together, they are by nature one indivisible whole’.

Fichte thereby equated the ‘natural’ nation with the language group. But he went much further than that, asserting that the natural nation not only had a right and obligation to exist, but also to protect itself; moreover, that imperative was especially strong for the Germans, who, being ‘honest, serious, sober’, readily fell victim to foreign intrigue.

Indeed, it was only because ‘foreign cunning easily outmatched German simplicity and credulity’ that Germany was not a united country: having found ‘German valour useful for waging their wars, and German hands useful for seizing loot from their rivals’, the perfidious French had ‘made use of the division of opinions which had arisen in Germany on account of the religious controversies, in order to divide artificially this representative microcosm of the whole of Christian Europe, from being an innate organic unit, into separate independent parts’.

Redressing this did not merely require German unification; it also required that the unified entity form a ‘closed commercial state’. ‘Only the scholar and the creative artist’, he opined, with a bow to academics such as himself, ‘have reason to travel outside the closed state. Foreign trade should no longer be permitted for those who feel merely a leisured curiosity and a desire for diversion to carry their boredom about through all lands’.

**Liberal nationalism**

Fichte’s *Addresses to the German Nation*, which set these ideas out in lectures delivered at the university of Berlin in 1807–08, eventually acquired iconic status as the first and arguably clearest formulation of German cultural or ethnic nationalism. And it is apparent that the lectures expressed a distrust of foreigners, which lent itself both to chauvinism and to the demonisation of ‘the enemy within’. But they had little impact at the time; instead, Herder’s and Fichte’s emphasis on a ‘natural nation’ was taken up by nationalists whose political program was unassailably liberal.
Best known among those liberal nationalists were Adam Mickiewicz in Poland, Lajos Kossuth in Hungary and especially Italy’s Giuseppe Mazzini. Although they were not systematic thinkers, their prolific writings synthesised the marriage between sovereignty and independence that the Americans had achieved, with that of sovereignty, citizenship and rights and duties that had come out of the French Revolution. Great admirers of Britain, their goal was to secure national independence and within its protective shell, construct constitutional regimes based on the rule of law.

These men were intellectuals and political activists, with their activism forcing them to spend much of their lives in exile. Of the three, Mazzini had by far the greatest resonance. Idolised by many, his ‘Young Italy’ movement was imitated by partisans of national independence around the world, and his works were eagerly read in places as remote as Sydney, Bombay and Shanghai.

For Mazzini, national independence and self-determination were crucial to allow each people to achieve its potential; as they did so, they would lay the foundations for a gradual move toward a united world. Although there is no reason to believe that he was familiar with Kant’s famous essay on *Perpetual Peace: A Philosophical Sketch* (1795), he shared its commitment to cosmopolitanism as a moral ideal, declaring in 1847 that ‘We are all cosmopolitans, if by cosmopolitanism we understand the love and brotherhood of all, and the destruction of all barriers which separate the Peoples’ (quoted in Varouxakis, 2018, p. 164). But while that was the ultimate goal, the nation-state was an indispensable stepping-stone.

Perhaps unsurprisingly, these views appealed to no less a liberal than John Stuart Mill, who—although he did not always sympathise with the Italian’s advocacy of revolutionary methods—openly acknowledged his ‘highest admiration for Mazzini’. And the arguments of the liberal nationalists received a strong endorsement in Mill’s major works, most notably his *Considerations on Representative Government* (1861).

Mill defined a nation in terms that were explicitly political. He wrote:

> A portion of mankind may be said to constitute a Nationality if they are united among themselves by common sympathies, which do not exist between them and any others—which make them cooperate with each other more willingly than with other people, desire to be under the same government, and desire that it should be government by themselves or a portion of themselves, exclusively. (Mill, 1963, p. 1759)

He went on to say that ‘where the sentiment of nationality exists in any force, there is a prima facie case for uniting all the members of the nationality under the same government, and a government to themselves apart’. He justified this assertion in the next sentence: ‘This is merely saying that the question of government ought to be decided by the governed’.
The principle of nationality was, in other words, a clause of liberalism itself: ‘It is in general a necessary condition of free institutions, that the boundaries of governments should coincide with those of nationalities’. Obviously, that ‘necessary condition’ did not apply to ‘Nations that are still barbarous’, which ought to be ‘conquered and held in subjection by foreigners’ as that could ‘[carry] them rapidly through several stages of progress’. But they too would ultimately be in a position to merit a government whose boundaries aligned with their nation and so have a self-determining state of their own.

The mid-century turn

These were all worthy sentiments. Unfortunately, high-mindedness has never been a recipe for political success. A movement of intellectuals that entirely lacked a popular base, liberal nationalism’s culminating moment, the European revolutions of 1848 ended in utter failure. And as each of those revolutions collapsed, the principle of nationality experienced a far-reaching illiberal turn.

That sea change reflected the myriad trends that were dramatically reshaping the economic, social and political landscape, and that became ever more pronounced as the century unfolded.

Perhaps the most directly relevant of those trends was the rise of mass politics. Almost everywhere, rapid urbanisation, rising literacy and the development of an inexpensive, mass circulation press disrupted traditional patterns of deference and subordination while bringing ever greater numbers into politics. At the same time, the emergence of new forms of transport and communication undermined the geographical segmentation of political life and increased its pace and intensity. As The Times of London noted in 1859, whereas elections used to drag on for months, ‘now, the phases of the contest succeed each other with startling rapidity’—and even more important, thanks to instantaneous communications:

electors are no longer confined to the communications of their own candidate: they can peruse, contrast and criticize a dozen addresses at a time and deduce perhaps rather a broader moral than any particular candidate intended to convey. (The Times, London, 11 April 1859)

The result was to make the old politics of patronage less viable, provoking a shift toward politics based on parties, promises and programs; however, the promises and programs typically involved an expansion in the activities undertaken by governments, broadening the range of people whose lives were significantly affected by political choices and who, as a consequence, could be mobilised to political ends.
This was not merely a question of ordinary citizens; rather, as governments took on wider responsibilities, the numbers they employed burgeoned, giving rise to a constituency whose livelihoods depended directly on the political process. The move, throughout continental Europe, to armies based on mass conscription further boosted the size of that constituency, not least by creating an expanding stratum of commissioned and non-commissioned officers recruited from the middle class and the petty bourgeoisie that was perpetually entangled in a conflict with the still-powerful component of the officer corps that had aristocratic origins.

While all that would certainly have been enough to point nationalism in new directions, a complex of far-reaching economic and social shocks added fuel to the fires. In particular, as an integrated world economy came into being, what is now often referred to as the first globalisation led to the rapid expansion of international trade, causing massive shifts in the terms of trade, increasing competitive pressures and igniting calls for a return to protectionism.

At the same time, global capital flows also grew greatly, making economies more vulnerable to severe financial crises, which they were incapable of cushioning or correcting.

And last but not least, as population growth accelerated, and the costs and risks of long-distance transport fell, there was a staggering increase in the international movement of people: between 1815 and 1914, some 82 million people migrated of their own free will from their place of origin to a distant point, undermining traditional societies and bringing into contact people with vastly different cultures, languages and expectations (Osterhammel, 2014). Exacerbating the tensions that caused was the fact that the people on the move were not solely European: just from the port of Hong Kong, over 500,000 Chinese left between 1854 and 1880, bound for the already conflict-prone (and at times entirely lawless) mines, goldfields and railroad beds of the countries of recent settlement.

Compounding the pressures those shocks created was a step-rise in the reach and intensity of competition and conflict between states. That was partly due to the scramble for colonies: between them, the European powers controlled 35 per cent of the landmass of the planet in 1800; by 1878 that share had grown to 67 per cent; in 1914, it reached an extraordinary 84 per cent (Nester, 2010). However, it also reflected changes in the nature of warfare that steadily increased its costs, placing enormous pressures on the Russian, Austro-Hungarian and Ottoman empires, which lacked the fiscal capacity to bear the resulting financial burdens. As they responded by increasing the taxes they demanded—inefficiently and ineffectively—from their subject populations, the tensions within those empires became ever more acute, weakening their grip and profoundly destabilising the world system.
But the metamorphosis—or one might say metastasis—of nationalism was not solely the result of the period’s economic and social transformations. Rather, it was also profoundly influenced by far-reaching changes in social thought.

However one characterises them, those changes did not form a tidy package. On the contrary, they bundled together disparate approaches that scarcely sat together easily, and were in some cases facially inconsistent.

There was, for example, a renewed worship of tradition and a longing to restore an entirely mythical past in which communities had supposedly lived in organic harmony, in an idyll suffused by a Herderian glorification of the Volk. Yet there was also a cult of the will that asserted that life was struggle, that the struggle was between competing human groups, and that victory in the unforgiving battle would go to those groups that were most disciplined, most ethnically homogenous and hence most united.

Equally, there was an entirely new emphasis on the irrational, and on both the risks it posed—notably in the form of the mob—and on the scope it created for charismatic leaders to manipulate the masses into motion. Yet, at the same time, there was supreme confidence in the potential scientific methods offered to manage human populations, culling out the degenerate elements and promoting those that were ‘sound’, as well as to more broadly solve social problems and control the course of history.

Perhaps the term that best captures this potpourri is vitalism—the belief that there is a volcanic energy at work in human affairs that is simultaneously ever menacing and ever capable of being harnessed. The point is not that vitalism was a conceptual mess; looked at synoptically, the thinking of every era is. Rather, what matters is that it offered a menu of elements that could be assembled and deployed in varying proportions.

When that possibility was put together with the diversity of circumstances, the result was a proliferation of types of nationalism with greatly differing emphases and social bases. At least four are worth mentioning.

There was, to begin with, reactionary nationalism. This was the nationalism of the cult of tradition, which sought either to preserve or recreate pre-modern hierarchies of rule. Perhaps its most illustrious proponent was Sergius Uvarov, who, in 1833, as the Tsar’s newly appointed minister of education, framed the official state philosophy of Nicholas I in the famous trilogy of ‘Orthodoxy, Autocracy and Nationality’. An urbane and effective apologist for the anti-Enlightenment, Uvarov fought Cartesianism and scepticism with a new ideology that often seems to anticipate modern totalitarianism in its mystical reverence for the leader and its obsession with obedience, submission and loyalty.
No less complex was the nationalism of the modernising autocrats, with Bismarck devising an approach adopted in late nineteenth-century contexts that ranged from that of the great Ottoman sultan, Abdülhamid II (and his worthy twentieth-century successor, Mustafa Kemal Atatürk) at one end of the globe to Ito Hirobumi and the oligarchs of Meiji Restoration Japan at the other. Driven by the determination to rival the great powers, those autocrats typically built coalitions that united elements of the landed or feudal aristocracy with the most dynamic sections of the industrial and commercial bourgeoisie, using economic and political nationalism as the cement that held the coalitions in place.

A quite different social base underpinned what might be termed populist nationalism, which invariably turned its fire primarily on the enemy within. Andrew Jackson was undoubtedly its pioneer, with his appeal to ‘the productive and burden-bearing classes’. That appeal combined a relentless attack on ‘the money power’ of the elites—who he portrayed as a morbid growth on an otherwise healthy and democratic body politic—and an implacable hostility to the American Indians. Mobilising the land-hunger of a population of frontier farmers who required constant new supplies of cheap land to enable their numerous offspring to reproduce their ways, the Jacksonians set the template for a style of politics that galvanised mass constituencies which felt squeezed from above and menaced from below.

Last but by no means least was the separatist nationalism of ethnic minorities, which emerged primarily in the great land empires. Precisely because it was born from an acute resentment of those empires’ dominant cultures, it was perhaps the most virulent of the lot, degenerating—most obviously in Serbia and Macedonia—into murderous violence. Moreover, because it provoked the rise of a counter-nationalism, in which the empires sought to impose and entrench the dominant culture, it triggered a vicious cycle that converted resentment into hatred and violence into savagery. To a considerable extent, a similar pattern played itself out in Ireland, although it was only after the First World War that it reached the pitch the Serbian and Macedonian conflicts had attained by the 1890s.

There were, of course, other nationalisms too; for example, the emergent nationalism of the Indian National Congress. But what these four varieties shared was an intense exclusionary streak. That had, of course, been a factor in the American Revolution and even more so in the French Revolution, with the Jacobins coining the concept, which went on to have an unspeakably grim career, of ‘enemy of the people’. However, what was especially pronounced in the exclusionary streak of the post-1850 nationalisms was that it targeted entire groups, variously defined by religion, ethnicity or race.
Thus, even Bismarck, who was more moderate than most, ordered the deportation of around 30,000 Polish aliens—including some 10,000 Jews—from Prussia, as part of his more general plan to create a German Empire in which German was the sole language and Protestantism the main religion.

A no less striking case is that of Theodore Roosevelt, an ardent reformer who regarded himself as a Progressive. Roosevelt advocated what he considered to be racial hybridity, believing that the world’s most accomplished ‘races’—the British, the Americans and the Australians—drew their strength from the merging together of diverse and complementary racial strains. And he celebrated war because he viewed it as a crucible whose constant stresses and dangers would generate pressures on those ‘races’ to unify into a single, exemplary, race. Yet the crucibles of the ‘New Nationalism’ that Roosevelt championed were invariably racially discriminatory. They always, and deliberately, excluded one or more races—usually blacks, Asians and American Indians—because Roosevelt believed that in the absence of rules that kept those races in their place, ‘indiscriminate mixing’ would inevitably lower the superior race’s intelligence, morals and courage.

Finally, adding to the pattern of exclusion, new and particularly vicious forms of anti-Semitism began to gain mass appeal virtually everywhere, ominously warning of the horrors that were to come.

Overall, the triumphant nationalisms of the era were nationalisms of closure: closure from threatening imports, closure from alien populations, closure from the cultures of the rest of the world.

The British exception?

In short, the world of the 1890s was awash in deeply illiberal, and often positively repulsive, nationalisms. Yet Britain itself seemed an exception.

It and it alone, one might have thought, had heeded the warning of that great liberal, Lord Acton, that the principle of nationality, far from being an ally of liberty, was directly opposed to it. It was, he wrote barely a year after Mill’s Considerations had endorsed the principle, both revolutionary and despotic in character, because it makes ‘a single definite object’, the glory of the nation, ‘the supreme end of the State’, rather than recognising the necessary plurality of objectives in a free country. And in the conclusion of his magnificent response to Mill, Acton set out one of the standing beliefs of classical liberalism:

The co-existence of several nations under the same State is a test, as well as the best security of its freedom. It is also one of the chief instruments of civilisation; and, as such, it is in the natural and providential order, and indicates a state of greater advancement than … national unity. (Dalberg-Acton, 1948, p. 185).
To say those words had moral authority in Victorian Britain is not to ignore the many points of frictions: what was invariably called the ‘Irish question’ in the UK itself; the nagging issue of Québec in Canada; and the rebellious Boers in South Africa. But unlike its continental counterparts, Britain did not face an immediate fiscal crisis; it was therefore never forced—as were the Russian, Austro-Hungarian and Ottoman empires in the second half of the nineteenth century—to intensify revenue extraction from its dependent territories, converting frictions into revolts those empires entirely lacked the resources to manage. Moreover, at home, Britain’s relative prosperity had allowed it to avoid the type of closure that was occurring elsewhere.

But it would be wrong to underestimate the mounting tensions. These were partly internal. The sheer length of Queen Victoria’s reign—from 1837 to 1901—had almost certainly made it easier for many British and even Irish men and women to feel a sense of stability and continuity despite an unparalleled rate of urban, demographic and technological change; but as the Victorian era approached its end, social conflict became significantly more intense, even though it remained less menacing than on the continent.

However, what was most striking and in many respects novel was the anxiety that gripped the elite about their country’s future. The British, it is well known, had been belligerently patriotic, if not positively chauvinistic, in the Napoleonic wars and their immediate aftermath. But as the threats receded, the British patria, which had figured so prominently in the battles between Whigs and Tories in the century to 1820, virtually disappeared as a political issue. Of course, patriotism remained as a generic label for all kinds of national self-reproach, self-approbation and identification. Yet with the exception of Disraeli, the leading politicians neither adopted a nationalistic perspective nor suggested Britain’s pre-eminence, much less its survival, was ever in question. It seemed as if Britannia pre-eminent had inoculated herself against a nineteenth-century epidemic.

But as the decades passed, an almost endless list of new fears emerged and moved to the centre of politics. In a country whose intelligentsia was obsessed with ‘national character’, the belief developed that the admirable amalgam of John Bull and Mr Podsnap was threatened by ‘race suicide’, as rising income levels relaxed the constraints of natural selection and allowed the genetically inferior urban underclass to out-breed its betters. At the same time, free trade no longer seemed to be fair trade, and with Britain’s industries struggling to achieve the economies of scale enjoyed by the great American trusts and the German combines, there was widespread concern about economic decline. And compounding all that was the perception that the Empire, which now stretched from one end of the globe to the others, might be simply impossible to defend.

Britain was, in Joseph Chamberlain’s evocative phrase, a ‘weary titan’, staggering ‘under the too vast orb of its fate’.
No one better synthesised those fears than Sir Charles Dilke, the radical liberal who served as Under-Secretary of State for Foreign Affairs during Gladstone’s second government. In his immensely influential *Problems of Greater Britain*, which was published in 1890, Dilke framed the problem squarely in terms of the ability of the rising colonies to take over the responsibilities that until then had been borne by the mother country. ‘The danger in our paths’, he wrote, is ‘that the enormous forces of European militarism may crush the old country and destroy the integrity of the Empire before the growth of the newer communities, which it contains, has made it too strong for the attack’ (Dilke, 1890, p. 6).

Among the many, often contrasting, views as to how to deal with that danger there were two common themes. The first was that there had to be a quest for what came to be known as ‘national efficiency’ and which ultimately involved everything from eugenics to the promotion of larger, more concentrated industries. The second was that the external casing of the Empire needed to be strengthened by some form of ‘imperial preference’, and its internal arrangements revised in a manner that gave the settler colonies both much greater responsibilities and much greater weight.

Overall, the time seemed to have come that had been predicted by Herman Merivale, who as Under-Secretary of State at the Colonial Office from 1847 to 1860 had shaped the theory underpinning the Empire. Sooner or later, he had said, there would dawn a day when, ‘by the gradual relaxation of the ties of dependence’ between the settler colonies and the mother country, ‘the crown [would] remain, at last, in solitary supremacy, the only common authority recognised by many nations [that are] politically and socially distinct’ (Merivale, 1967, p. 673). And when that day arrived, the Empire would have to prove flexible enough to absorb the ‘great Australian Republic which probably is to be’.

**Conclusions**

The nation-state is one thing; its cult another. But by 1890, the spread of the latter had, for better or worse, helped bring about the triumph of the former: in the century and a bit that separated that date from the American Declaration of Independence, the principle of nationality had only gathered strength, propelling the rise of the nation-state in its wake. The open question was not whether the nation-state would continue its ascendancy but precisely what form it would eventually take in those parts of the world where its victory as the natural way of organising the polity was not yet complete. As far as the dominions were concerned, the ‘National Policy’ that had swept John MacDonald back to the Prime Ministership of Canada in 1878, and that emphasised Canada’s future as an integrated continental power, must have seemed like an attractive option. And in many respects that was the option the Australian colonies adopted in 1901. Were there viable alternatives? Would they have yielded better outcomes?
References


Birthplace of a nation? Why Sydney voted no to Federation

Zachary Gorman

Abstract

While most colonies delivered overwhelming ‘Yes’ majorities in the referendums of 1898–1900, New South Wales twice delivered sizeable ‘No’ minorities. On both occasions the ‘No’ vote centred around the free trade stronghold of Sydney, which determined that she did not want to sacrifice her independence. Up until now this remarkable rejection has received little academic attention. This article argues the main reason why Sydney voted against Federation was because it cut against the main political development of the preceding years—namely Reid’s successful electoral program, which championed free trade, democracy and domestic reform.

Introduction

The referendums of 1898–1900 saw the voters of the six Australian colonies express their democratic will in favour of the Federal Constitution that had emerged first from the Federal Conventions and then from the ‘secret’ Premiers’ Conference. While most colonies delivered overwhelming ‘Yes’ majorities, New South Wales twice delivered sizeable ‘No’ minorities that demonstrated severe doubts and trepidations in the ‘Mother Colony’. On both occasions, the ‘No’ vote centred around the free trade stronghold of Sydney, as Australia’s oldest city, and the capital of what had recently re-emerged as the largest colony, had determined that she did
not want to sacrifice her independence along the proposed lines.\(^2\) Up until now, this remarkable fact has received little academic attention, particularly when it comes to the otherwise successful referendum of 1899. Despite this neglect, the doubts expressed by Sydney are of great historical importance. As the ‘No’ campaign’s greatest victory, the Sydney vote demonstrates the strength of the opposition to Federation and that its accomplishment was by no means inevitable. This piece will argue that one of the main reasons why Sydney voted against Federation was because in its details it cut against the main political development of the preceding years—namely George Reid’s successful electoral program, which championed free trade, democracy and domestic reform. Reid was one of the main drivers behind the accomplishment of Federation, but its success left a significant dent in his political legacy by helping to undermine the New South Wales tariff policy and increasing the overall cost of government.

It is relatively easy to understand why few people have decided to examine the Sydney vote in detail. History is written by the victors and it is difficult to drum up interest in a ‘lost cause’. This was demonstrated by the participants themselves. While ‘Yes’ campaigner Bernhard Wise (1913) wrote a gloating account of Federation’s victory in the face of Reid’s supposed treachery, ‘No’ supporters like Attorney-General Jack Want and prominent Legislative Councillor Dr Normand MacLaurin ‘licked their wounds in silence’ (Crisp, 1990). By continuing this trend, academics risk turning Australian history into a teleology that guides events along a set track. The choice of whether to federate was by no means simple. To New South Wales, the proposal to give up a great deal of sovereignty and place decisions in the hands of representatives of other states, who would be vastly overrepresented in the Senate and even to some degree in the House of Representatives, was no small ask. The purpose of this article is to resurrect and treat as legitimate the arguments of the ‘No’ case. Even someone who holds the traditional positive view of Federation diminishes the practical achievement if they disregard its opponents.

One of the more comprehensive accounts of the referendum campaigns in New South Wales has long been that provided by Quick and Garran in their *Annotated Constitution of the Australian Commonwealth* (1901). While this benefits from an eyewitness view, the authors are perhaps too close to their subject, with Robert Garran having been an active participant in the ‘Yes’ campaign and who wrote an explanation of the constitution that was mailed to every elector before the 1898 poll. John La Nauze (1972) declared that a detailed study of the referendum campaigns was sorely needed, but he did not find the time nor space in *The Making of the Australian Constitution*. More recently, John Hirst (2000) and Helen Irving (1999) have incorporated accounts of the referendums in their Federation works, but both are brief and to some extent coloured by their knowledge of the result. Irving is

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\(^2\) This article uses the 11 city and 28 suburban seats identified by the *Sydney Morning Herald* (SMH), 4 June 1898, to define ‘Sydney’ as an electoral entity.
particularly dismissive of the ‘No’ case, beginning her analysis of the 1898 result by saying ‘the Yes vote was, of course, higher than the No vote’ (1999, p. 79). Rosemary Pringle (1979) filled some of the gap identified by La Nauze through her examination of ‘Public Opinion in the Federal Referendum Campaigns in New South Wales 1898–99’. This provides a critical analysis of the forces arranged on both the ‘Yes’ and the ‘No’ sides, and correctly identifies that the referendums were fought primarily on the terms of the draft constitution bill rather than on Federation as an abstract concept. While admirable, Pringle’s work has some significant limitations when it comes to understanding both the ‘No’ case and why it resonated in Sydney. It only engages with the ‘No’ arguments in a summarised manner and it treats Federation as a separate political issue rather than placing it in its domestic political context. Even ‘The Federation Issue in New South Wales Politics 1891–99’, also written by Pringle (1975), is too Federation-centric to overcome the latter issue.

Other than Pringle, accounts that treat the ‘No’ campaign with any sympathy or depth have tended to come from those approaching the question from the perspective of George Reid or the Labor Party. W.G. McMinn (1989) and L.F. Crisp (1990) have both complimented Reid’s constructive criticism of the 1898 draft, while failing to see much merit in those who thought that the amendments he secured before the 1899 poll were inadequate. Similarly, Bede Nairn (1973) has shone a light on the significant efforts of Labor men to secure a more democratic Federation. Nairn even hints at what is a central argument of this piece, namely that the reason Federation was so controversial in Sydney’s political climate was that it struck against the central characteristics of the popular and reforming Reid government. As he puts it, Reid ‘had done so much to help create the conditions that shaped all these [negative] opinions’ of the Federation bill (1973, p. 178).

The driving principles of the Reid government were democracy in putting the burdens of taxation on the rich and fighting the nominee Upper House, free trade economics that drove tariff reform and Reid’s entire platform, and the rationalisation of government through budget reform and the creation of the Public Service Board (McMinn, 1989). The constitution bill threatened to undermine democracy through the Senate, force high tariffs through the ‘Braddon blot’ and create an irrational government with overlapping responsibilities and unnecessarily high taxation. From a New South Wales perspective at least, few of the supposed practical benefits of Federation could stand up to close scrutiny of the details of how it would work. Instead, the ‘Yes’ campaign had to rely on appeals to emotion, the ‘crimson thread of kinship’ or ‘one people, one destiny’. That they succeeded in creating a climate where even opponents of the bill had to insist that they supported Federation in principle speaks to the overwhelming influence of nationalism in late nineteenth-century Australia (Hirst, 2000). The fledgling nation was caught up in an ideology that was sweeping much of the world (Kemp, 2019).
Background

While it is unnecessary to give a complete recap of the history of Federation leading up to the referendums, it is important to draw out a few points about how the issue had developed in New South Wales. The simplest but most important thing to reiterate is that New South Wales had a successful constitution, healthy democracy, growing population, fertile lands, rich resources and a resilient economy. The 1890s were a time of economic depression, but both the official statistics and popular perception suggested that the colony was in a better position than Victoria, whose protectionist policies had seen a reduction in population growth and aggregate trade even before the crash (Coghlan, 1898). In an alternate timeline the colony could and would have grown into a distinct country in and of itself. There was no clear necessity to federate. The electors enjoyed universal manhood suffrage and the secret ballot, and were used to voting on the future direction of their community. They would have to be convinced that enlarging that community was worthwhile and that by doing so they would not lose control over it.

While leading men like Wentworth had often speculated on the idea, New South Wales had shown itself to be somewhat reluctant to cooperate with her fellow colonies on equal terms (Persse, 1967). The Mother Colony had, after all, controlled at one point all of Eastern Australia, and areas like the Port Phillip district had essentially scorned her in asking for their independence. Joseph Carruthers reflected a common snobbery when he described Federation as an effort to gather up the ‘wandering brood that once owed allegiance to and formed part of the colony’ (Gorman, 2018, p. 143). Pringle identified a sentimental and economic New South Wales ‘nationalism’ that was able to cut across Federation’s more blatant appeal to patriotic emotion. She dubbed New South Wales ‘the most self-conscious of the colonies’, and this was certainly reflected in Parkes’ infamous plan to rename his colony ‘Australia’ (Pringle, 1979, pp. 244–245).

This tendency was severely exacerbated by the fiscal issue. When Victoria erected great tariff barriers against the trade of her neighbours, most of whom retaliated in kind, New South Wales had taken what many saw as a principled stand by upholding comparatively free trade. This was both an economic and ideological policy, inspired by celebrated British politicians like Cobden and Bright, which was sold to the working class as something that reduced the price of necessities like tea and sugar (Kemp, 2019). Though its supporters tried to portray free trade as an anti-parochial stance, New South Wales was not innocent of manipulating the market against her sisters. Geographical reality meant that perhaps no city benefited more from arbitrary colonial boundaries than Sydney. Without these barriers, the farmers and graziers of the Riverina would export their product via Melbourne, Broken Hill’s mineral wealth might have ended up in Adelaide, and the Northern Districts’ sugar plantations would have been marketing in Brisbane (Quick & Garran, 1901).
The Protectionist members of the New South Wales Parliament were predominantly from the country districts where farmers wanted protection from intercolonial competition and landowners were wary of a land tax.

Thanks in part to its economic importance in a mercantile port city, free trade became a defining part of New South Wales and particularly Sydney’s identity. The only elections where the Protectionists secured the largest number of seats were 1891 and 1898, when Federation obscured the fiscal issue, and even then the Free Trade governments survived until Labor voted against them. The centrality of the fiscal issue to Federation was clearly demonstrated when Henry Parkes, the self-styled champion of free trade, stood aloof from the formative Federal Council to protest the tariff policy of its other members.

Ironically it was Parkes who resurrected the Federation issue as a way of distracting a Free Trade Party that had grown frustrated that he would not introduce an ideologically pure free trade tariff. After Parkes delivered his famous Tenterfield speech, much of his cabinet protested that the Premier had failed to consult them beforehand (Martin, 1980). When the National Australasian Convention produced a draft constitution, it was the independent Free Trader George Reid who led the opposition to it. He produced blistering criticisms claiming that the bill threatened free trade, gave an undemocratic Senate too much power over money bills and failed to proscribe a clear model of responsible government (McMinn, 1989). This brought the Federation movement to a standstill, and when Reid soon replaced Parkes as leader of the Free Trade Party, this reflected a choice to prioritise domestic reform over nationalistic visions (Gorman, 2016).

Reid won the 1894 election with a promise to take the burden of what was a relatively small government off the backs of the masses and onto those with significant land and income. McMinn (1989) argues that the direct taxes appealed to the working class and radicals, without alienating a middle-class base that accepted that they were necessary for true free trade to be implemented. The nominee Upper House tried to block his main reforms, teaching Reid through experience that a powerful and obstructionist second chamber could create a constitutional crisis. To force the Legislative Council’s hand, Reid called a snap election for 1895 that produced a campaign replete with democratic rhetoric and a virtual Free Trade–Labor alliance.\(^3\) The result saw Free Trade, Labor and independent Free Trade win all but three of Sydney’s 39 seats, a stunning endorsement of the Reidite program (Green, 2007). Of the three seats the Protectionists did win, two were helped by a split vote among their opponents.

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\(^3\) Free Traders did not contest Labor seats and Labor partially returned the favour (Nairn, 1973).
The government was able to reduce New South Wales’ tariff schedule to one of the shortest in the world and improve public service efficiency, while a strong recovery from the 1890s depression seemed to prove the economic case for free trade. Reid also produced a series of budgetary and administrative innovations that were a matter of personal pride for a man who served as Premier and Treasurer simultaneously (Reid, 1917). By the time of the Federal Conventions, government statistician Timothy Coghlan produced optimistic figures that indicated that by 1941 New South Wales and Queensland were going to grow into the dominant colonies with populations of 8.2 and 7.5 million, while with her limited territory Victoria would inevitably fall to the back of the pack with just 4 million (Official Report of the National Australasian Convention Debates, 1897). The colony’s self-confidence was thus very high.

While continuing to give priority to domestic reforms, Reid underwent a more tempered version of Parkes’ transformation. Apparently convinced that Grover Cleveland’s presidential victory meant that global protectionism was on the wane, Reid agreed to pursue Federation along the democratically elected convention lines proposed by John Quick. One of the main benefits of the convention model was that it took the issue away from the preoccupied parliament, but even then there was a significant delay between Reid adopting the proposals and the elections taking place (Pringle, 1979). Crucially, the Federal Conventions gave each participating colony 10 delegates regardless of population, while even the New South Wales delegation included only three members of the government and no members of the Labor Party that supported the government.

Reid would label the updated draft constitution ‘as fair as could be expected’ to be produced by a convention equalising the colonies, but it by no means represented the concerns and beliefs of Sydney’s leading politicians (Daily Telegraph (DT), 13 May 1898). When the Assembly was asked to express its opinion on the draft constitution, it displayed great hostility by voting 59 to 4 against equal state representation in the Senate (Pringle, 1979). In June 1897, after the convention had begun its work, the government allowed an amendment to the Federal Enabling Bill providing that the referendum to approve the draft constitution would require a minimum of 80,000 ‘Yes’ votes to succeed. Federalists considered this a great betrayal, even though the 80,000 was a compromise from an initial proposal that would have required a majority of registered electors (139,000). Considering the fact that Barton had received over 100,000 votes at the delegate convention and that the decision would bind New South Wales for all time, it is difficult not to see the 80,000 minimum as a triflingly small safeguard.
The 1898 referendum

Forces

Sydney’s political culture had long seen political leagues formed to advocate for particular issues, disseminate literature and organise speakers, and the referendum campaign was no exception. While the pre-existing and professedly non-partisan Federal League had to create an offshoot called the Federal Association to fight the coming political battle, those opposed to the bill had to start from scratch. They created two competing organisations, the Anti-Convention Bill League and the Colonists’ Anti-Convention Bill League.

The former was largely a parliamentary body led by Jack Want, Reid’s Attorney-General who resigned from the ministry to lead the ‘No’ campaign against a federation he thought would sacrifice his colony’s independence and liberty (Finn, 1990). Want was backed by the radical Free Trader and Bulletin founder John Haynes and the rural free trade journalist Edward Millen. As a group, the radical Free Traders were strongly opposed to the convention bill on democratic grounds. Their presence helped to attract some Labor men to the league. However, one of the ‘No’ campaign’s failings was a lack of integration with the Labor Electoral Leagues, despite their opposition to the bill. Though it was started by Free Traders, the league soon reached out to a number of Protectionists led by former premier George Dibbs who supported a radical unification model over mainstream Federation. Its manifesto declared that it stood for the defence of majority against minority rule.

The Colonists’ Anti-Convention Bill League seems to have been the more conservative organisation, founded by rich businessman Thomas Kelly along with others like John Toohey, of brewery fame, most of whom thought that Federation would drive up taxation. There was some overlap between the two groups, but on the whole it hurt the ‘No’ campaign to split its resources unnecessarily. Barton claimed that:

the opponents of this bill—or one wing of them—consist of those who have enough and to spare of the money bags, while the other wing, or some of them, would be only too glad to share the money. (DT, 20 April 1898)

It was a ‘Yes’ campaign claim that since both radicals and conservatives opposed the bill, it must therefore be fairly balanced. Conscious of the weakness of division, the Daily Telegraph (3 May 1898) would push for the groups to merge but their cooperation was not secured until well into the campaign. Pringle (1979) argues that the ‘No’ organisations were weaker than their opponents, whose pre-existing league had built strong networks in the country districts.
Both major parties were split on the referendum question, but the more powerful forces were arguably arranged on the ‘No’ side. For the Protectionists, both the former premier Dibbs and current leader William Lyne were opposed, though they were balanced out by some prominent ex-ministers like R.E. O’Connor. For the Free Traders, only convention delegate Joseph Carruthers and Dugald Thompson were prominent ‘Yes’ men. Most of the parliamentary party was opposed; and despite saying he would vote for the bill, Reid was practically opposed in all important respects. The other ministerial delegate, James Brunker, took some time before entering the fray but when he did he delivered an emphatic ‘No’. For the first referendum Labor was united in its opposition to what it felt was a highly conservative constitution. While Labor supported the federal idea, the party was inherently suspicious of a movement that was often seen as aristocratic, both because it started as a top-down effort and because it was led by Barton, who as Attorney-General had put down the Broken Hill miners’ strike of 1892 (Pringle, 1979). There were also concerns that Labor’s model of union-based electoral organisation, still only a few years old, would be less effective at a national level.

The real strength of the ‘Yes’ campaign was in the media. So many editors got caught up in the patriotic fervour that the newspapers that opposed the bill can be listed on one hand. They included the Labor-affiliated *Worker*, the Protectionist *Star* and the *Sunday Times*, while in the country Millen’s *Western Herald and Darling River Advocate* was virtually a lone voice in opposition to the bill (Irving, 1999). The *Daily Telegraph* had initially supported Federation, but it was utterly opposed to the convention bill on both fiscal and democratic grounds. It did not help that the Federal Conventions had rejected the advice of the *Telegraph*’s financial correspondent R.L. Nash, much to the chagrin of editor Lachlan Brient (Pringle, 1979). It says much about Sydney’s political culture that both of its major newspapers were expressly pro–free trade, but the *Sydney Morning Herald* was more willing to overlook the threat Federation posed to its economic ideology. While it was no more biased than its opposition, the *Telegraph* employed all sorts of innovative techniques to win over readers. These included bold headlines, short propaganda articles reproduced in multiple issues, and a special edition printed to reach every elector in the colony.

**Arguments**

Without doubt the two largest issues of the campaign were the limitations the bill placed on majority rule and the financial provisions. It was only in 1893 that plural voting had been abolished in New South Wales and a Senate that gave equal representation to states regardless of population threatened to overturn decades of reform that had finally secured equal voting strength for every man. As it stood, there would be 12 senators representing 2,500,000 people and 18 representing 500,000 (*Evening News*, 4 April 1898). The proponents of the bill argued that Federation would only be possible with equal representation because otherwise the small states
would refuse to join. This was countered by those that suggested the small states had a financial imperative to federate, and pointed to Germany, Canada and Switzerland for examples of federations where the constituent provinces were not entitled to equal representation. There was even a suggestion that the three largest colonies should federate on a more democratic basis and then the smaller colonies could join if they so wished (DT, 22 April 1898).

It was clear that the Senate was modelled on the US Constitution, and this was controversial in itself. The *Telegraph* (6 April 1898) quoted Walter Bagehot on the American Senate having ‘no self-evidence’ and being the product of circumstance; there was no need for a Senate provided the federal government’s powers were limited and it was only deciding on issues that were truly national. The United States was the exception rather than the rule and given that the country had quite recently endured a bloody civil war over states’ rights it was hardly a model exception. James Bryce was quoted to show that the Senate had always been the bulwark of slavery, and its very presence fed into the states’ rights narrative. From the opposite perspective, the civil war was also used as an argument against the indissoluble union. Once New South Wales voted ‘Yes’, the only way out would be through unimaginable violence.

There were many ‘No’ advocates who could accept a Senate with equal representation, provided they secured several defences of majority rule. The first had to do with money bills. Westminster tradition had long accepted that the popular House should have control over taxation and appropriation, and since taxes were to be collected per capita rather than per state, democrats argued that those providing the money needed to have control over how it was spent. The constitution accepted this proposition by declaring that only the House of Representatives could initiate and amend money bills, but the Senate was left with the power to block money bills and suggest amendments. The ‘No’ side argued that the power to block would be as good as the power to initiate or amend because the Senate could create a stalemate until the government was forced to back down and its members were secure, because only half faced election at a time. This threatened to undermine the principles of responsible government, because a ministry might very well need a majority in both Houses just to ensure that public servants were paid. It also opened the door for Brunker and others to cry ‘no taxation without representation’ (*Sunday Times* (ST), 29 May 1898).

In order to overcome a situation where the Senate acted obstinately, it had been New South Wales delegates who introduced a deadlock provision allowing for a double dissolution and then a joint sitting where a three-fifths majority would succeed (Quick & Garran, 1901). While, with Queensland absent from the Federal Conventions, New South Wales and Victorian representatives would have three-fifths against the three smaller states, this provision still gave far too much weight to the
smaller states, particularly with the constitutional minimum of five members of the House of Representatives. It was also pointed out that the deadlock mechanism was far too slow to deal with the pressing consequences of a deadlock over money bills.

Labor thought that its platform plank of ‘initiative and referendum’ could overcome some of these limitations by taking questions directly to the people (Nairn, 1973), but without Labor delegates the convention had not adopted this. Instead they introduced a referendum mechanism for constitutional change that was quite rigid and went completely against the evolutionary nature of the much-lauded and unwritten British Constitution. Not only did the referendum require a majority in a majority of states, again seen as undemocratic, but the 1898 draft required that a referendum proposal would have to pass both Houses. There truly was no getting past an obstructionist Senate.

New South Wales had long feared joining a Federation because her sister colonies all employed protectionist tariffs to some extent. It was therefore highly controversial when the ‘Braddon blot’ seemed to decide the fiscal issue before a federal parliament even sat. The fundamental problem, which has continued to poison Federation ever since its inception, is the entanglement of federal and state finances. Nationhood and intercolonial free trade required that the federal government take over customs, but every state except New South Wales relied on tariff revenue to avert bankruptcy. The solution proposed by Tasmanian delegate Edward Braddon was to give three-quarters of all customs revenue back to the states. This seemed to guarantee a high tariff, and in the convention it was opposed by most of the New South Wales delegates, including Barton (Quick & Garran, 1901).

Two of the major arguments against it were that it would require the federal government to levy four times the amount of taxation required by its expenditure, and that it seemed to imply that the federal government would have to look after the financial interests of the states. Once the latter principle was accepted it opened the door to calculations on how high tariffs would have to be to keep the states solvent once the services given over to the federal government were factored in (DT, 27 May 1898). Different states had different financial needs, but the argument went that the tariff would either have to be set to a level that would accommodate the most ‘necessitous State’ (DT, 31 May 1898), which was Tasmania, or that the tariff would be set according to the average state and the more needy would have to be bailed out in some other fashion. No matter what, it was clear that New South Wales would have to deal with a vast increase in customs taxation that might jeopardise her prosperity.

New South Wales would theoretically get this money back in the form of the three-quarters, though this was only guaranteed during the ‘booking keeping period’ of the first five years. After that it appeared that the federal government could allocate it to any state and given the financial needs of others it seemed that a form of horizontal
fiscal equalisation was inevitable. The idea of New South Wales bankrolling her sisters was easy to attack, but even if she got back her three-quarters there were other problems. The money could not simply be given back to those who paid it, but would have to be spent. Many feared that the money would see a large increase in wasteful government spending. The money could be used to abolish other taxes, but the idea of getting rid of Reid’s land and income taxes and funding government through burdens that fell on the masses would be an utter betrayal of the working class and everything the premier stood for. Reid himself replied to the idea with ‘what have I been fighting for with others for four years?’, a line that would be quoted against him at the next referendum (DT, 9 June 1899). Carruthers, who at first tried to ignore political reality by arguing that Braddon would force federal governments to avoid tariffs because they only received one-quarter of the revenue, came up with the idea of using the money to subsidise railway fares. The Telegraph (25 May 1898) had a field day with this, reporting

as a sincere politician, it consequently devolves upon Mr Carruthers to propose the immediate abolition of free trade in New South Wales, with the view of putting a customs tax calculated to yield more than a million pounds over the requirements of government, in order that we may be provided with the boon of cheap fares to Hurstville and other suburbs [which happened to lie in his electorate of St George].

To compensate for the loss of overall free trade, ‘Yes’ pointed out that New South Wales would have guaranteed intercolonial free trade; ‘No’ argued that this was a hollow gift (DT, 17 May 1898). The colony did vastly more trade with the rest of the world than it did with her sisters, relied on excess import ships to keep exports competitive, and the main colony she did trade with, Queensland, was not even going to be in the Federation at this stage (Kemp, 2019). ‘No’ also maintained that intercolonial free trade was undermined by the bounties provision, which ensured that any ‘grant or agreement’ made before 30 June 1898 would have to be paid out by the federal government. Victoria subsidised a number of products including beet-sugar, wine and coal, and the fact that the Commonwealth would pay for this allowed ‘No’ to argue that the New South Wales taxpayer would foot the bill for an attack on themselves (DT, 2 June 1899). Since the clause guaranteed ‘agreements’ made before 30 June, the 3 June referendum date allowed ‘No’ to run a scare campaign that Victoria would enter into a series of agreements after the referendum and leave the federal government to foot the bill (DT, 10 May 1898).

One of the ‘No’ campaign’s most difficult tasks was to combat the emotional power of the ‘Yes’ campaign’s appeal to nationalism. Most insisted that they were for Federation but opposed to the ‘lawyers’ bill’ as it currently stood. Their argument was that ‘No’ would not mean an end to Federation, but an improved Federation thanks to New South Wales exercising her bargaining power. She was going to provide as much as 45 per cent of the money, so the other colonies would be forced to wait for her. A.B. Piddington told the Women’s Suffrage League that ‘New South
Wales was mistress of the situation; the key to federation hung at her girdle, and there could be no federation without her' (DT, 21 April 1898). Frequently, ‘No’ appealed to people to be guided by their heads not their hearts, imploring ‘men of all classes and political creeds, who are not to be led into disregard of menacing actualities by any amount of oratorical vaporing concerning splendid possibilities of the future’ (DT, 5 April 1898). At the end of the campaign the Telegraphe (2 June 1898) vented its frustration:

The Conventionist poet who claimed a lien on the Southern Cross will have to forego his celestial mortgage, and the fact that this is a ‘sunny land’ will be quietly relegated to the oratorical dust-heap.

Despite the pressure to maintain an overall pro-federal position, there were those who fought the ‘No’ campaign as a defence of local sovereignty. Want was one of the brasher speakers on this front, telling a Marrickville audience ‘if love of country and a desire for the welfare of its inhabitants were provincialism, then he would proudly be regarded as one, and was content to bear the name’ (DT, 1 June 1898). Legislative councillor Louis Heydon argued that ‘Yes’ were underestimating the size of New South Wales, which was bigger than any of the great nations of Europe and could house over 50 million people by the year 2000 (DT, 11 April 1898). Even in an ideal federation, New South Wales would have less control over her affairs than she had previously; this is why it was so important that on paper the constitution seemed to give only limited powers to the federal government. It was one of the few things that Reid fully approved of (McMinn, 1989). The issue would have no doubt been far greater had the electors known how things would pan out.

**Key moments**

Coming right at the beginning of the campaign, Reid’s ‘Yes-No’ speech was certainly a defining moment, but it was not necessarily the telling factor that betrayed federalists like Wise would have us believe. Given reasons of space, it is probably not worth dwelling too long on the one aspect of the referendum campaigns that has received detailed attention. With his trademark oratorical skill, Reid made a series of cutting critiques of the draft constitution before concluding almost glumly that he was still going to vote for it. His criticisms focused on the relationship between the two Houses and the effects of the Braddon blot, as well as the sleeper issues of New South Wales possibly losing control over her rivers and the failure to set the site of the federal capital in New South Wales.

It may be tempting to engage in speculation over how the referendum would have gone without ‘Yes-No’, but it is difficult to imagine Reid not doing what he did. As has been argued, the convention bill cut against almost everything he stood for. It is often forgotten that even the lukewarm support ‘Yes-No’ gave Federation provoked such a backlash that Reid had to cancel a proposed sitting of parliament.
because he was likely to be defeated in the Legislative Assembly. The Telegraph (1 April 1898) treated the move as an ‘act of constitutional violence’. Free Trade backbencher James Ashton said an earthquake would have surprised him less than the prorogation. Perhaps responding to this pressure, throughout the campaign Reid became ever more critical of the bill to the point where ‘Yes’ completely scorned him. L.F. Crisp (1990, p. 16) has argued that Reid’s ‘speeches provided the bullets which other people fired for the purpose of killing’ the bill. To a large proportion of his free trade and working-class supporters, Reid’s most inexplicable betrayal was not ‘Yes-No’, but the fact that he turned from this position into such a resolute supporter of the ‘Yes’ campaign after securing a number of concessions that never really solved the fundamental problems that he identified.

A twist that had equal impact on the campaign was the sudden politicisation of Coghlan the government statistician. Appointed to his position at a young age, Coghlan had been something of a prodigy, producing a guide to the ‘seven Colonies of Australasia’, a triumphant book on the Wealth and Progress of N.S.W., and an innovative statistical register (Knight, 1961). Coghlan’s famed reputation had seen him asked to provide key advice to the finance committee of the Federal Conventions, and he would later be offered the position of federal government statistician (Hicks, 1981). The finance committee’s conclusions had tended to favour the figures provided by strong pro-federalist Edward Pulsford, who naturally thought Federation would cost less than the sober bureaucrat had argued (DT, 6 April 1898). In the heat of the campaign Barton callously tried to pick holes in the figures Coghlan had offered the convention in order to downplay as much as possible the costs of Federation. This prompted Coghlan to come out in public and defend his reputation, arguing that if anything the figures he offered were conservative and underestimated the amount that would need to be spent on defence (DT, 22 April 1898). The whole issue blew up into a wide-ranging debate over both the costs of the federal government and the tariff that would be required under the conditions of the Braddon blot.

Eventually a combination of Free Trade MPs such as Want and Sydney Smith, along with the Colonists’ League, convinced Reid to launch an inquiry into these financial issues. The three-person committee was chaired by the neutral manager of the Bank of New South Wales, John French, with Bruce Smith representing the ‘Yes’ side and Dr MacLaurin representing the ‘No’ side. It eventually produced a report that suggested the direct costs of Federation would be somewhat contained but that the tariff itself might be up to a million pounds higher than predicted by Pulsford and vastly higher than Barton’s gross underestimation (DT, 1 April 1898). Both sides claimed vindication, but the focus on costs undoubtedly played into the ‘No’ campaign’s hands. The ‘Yes’ campaign used the report to claim that Federation would only cost 3s 6d per person, or as Wise famously put it, little more than registering a dog (Crisp, 1990). This figure was, however, based only on the immediate costs of
the federal government after factoring in transferred services, and did not account for the increased tariff that could not be given back to the people who paid it. Once that was factored in, the report suggested that the cost would be 22s 6d, which ‘No’ was then able to depict as an absolute minimum while also highlighting the fact that everyone’s calculations had also included a doubling of postage rates.

Results and assessment

The colony-wide result saw 71,595 ‘Yes’ votes to 66,228 ‘No’, thus failing to reach the 80,000 number. Dibbs pointed out that Barton had lost tens of thousands of votes since the delegate elections and called for him to resign as head of the federal movement (ST, 5 June 1898). Overall there was a noticeably low turnout, which some blamed on the fact that, unlike in the delegate elections, electors were only allowed to vote in their electorate. The election was on a Friday and was declared a public holiday, so others suggested that people had gone away on vacation rather than voting. The Telegraph (4 April 1898) argued that a significant number of ‘No’ voters took advantage of the 80,000 minimum, which meant anyone who did not vote was essentially helping ‘No’. If this was the case then it was a problem the paper had helped to produce; ‘No’ voters probably read the Telegraph whose writers seemed so assured of victory that they hardly drummed up an incentive to vote.

In Sydney, the city saw a majority of 677 for ‘No’, and the suburbs 2,961, making a total of 3,638 (DT, 21 June 1899). The fact that the ‘No’ arguments had cut through can clearly be seen in the Sydney Morning Herald (2 June 1898), whose last-minute pitch to voters the day before the referendum spent a good deal of time refuting ‘No’ before providing any reason to vote ‘Yes’. They began almost comically by pointing out that Reid was voting ‘Yes’ before suggesting that the constitution was amendable, the joint sitting ensured majority rule, and that it would only cost 3s 6d per person. Only then did they get to nationalistic catchphrases like ‘federation will build up a national Australian spirit’, ‘union is strength’ and ‘vote for a ‘White Australia’. A number of MPs found that their electorates had voted against their wishes. One of the most notable was Carruthers, whose safe Free Trade seat of St George registered a ‘No’ majority of 435 from 1,789 votes, the 1,112 ‘No’ voters being the most of any electorate (Sydney Morning Herald (SMH), 4 June 1898). Three electorates had more than 1,000 ‘Nos’, while the top ‘Yes’ vote was 860 in South Balmain. Reid’s electorate polled a ‘Yes’ majority of 126.

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4 Including Canterbury which the SMH classified as part of Sydney but the DT did not.
The secret Premiers’ Conference

When the results came in, many disappointed ‘Yes’ campaigners wanted to amend the enabling bill to retrospectively remove the 80,000 minimum. This was soon dropped as it was politically untenable compared to Reid’s tactic of seeking concessions to make the draft constitution more acceptable to New South Wales (Quick & Garran, 1901). Reid approached the other premiers about this but, thanks in part to the secret lobbying of Barton, they refused to meet with him until after the election, which was due shortly (Hirst, 2000). That election saw a transformation of the major parties. The Protectionists replaced Lyne with Barton, agreed to temporarily drop the fiscal issue, and renamed themselves the ‘National Federalists’. Reid oversaw a similar transformation, labelling the Free Traders the ‘Liberal and Federal Party’ and trying to differentiate from his opponents on the basis of seeking greater concessions than the more compromising Barton. A small majority in a low-turnout referendum had, remarkably, convinced both fiscal parties to compromise their identities in order to chase votes.

The election results saw Reid hold on with Labor support despite losing several seats. Since both parties were projecting themselves as Federation parties it is virtually impossible to explain what the results reflected. Clearly people who voted ‘No’ would have an incentive to back Reid as the less ardent federalist, but Protectionists would have found this a hard pill to swallow.⁵ Notably, Labor gained as many seats as it lost, so the firmer ‘No’ stance did not appear to be an electoral handicap. Several ardently federalist Free Traders sought seats as members of Barton’s party, but most were unsuccessful (Loveday et al., 1977). As this was also the first election since the introduction of Reid’s land and income taxes, a backlash among the wealthier classes seems to have cut through the other issues.⁶ What is plain is that all the clarity Reid’s free trade agenda had provided New South Wales politics with had evaporated.

After the election, Reid had a series of suggested amendments to the draft constitution approved by parliament and then took them to a conference with the other premiers, including Queensland. The concessions secured were that the capital site be in New South Wales but at least 100 miles from Sydney, an absolute majority could succeed in joint sittings, the Braddon clause was limited to 10 years, state boundaries could not be altered without the consent of the people of the state and referendums only required the approval of one House of Parliament. Requests to remove the ‘reasonable’ limitation in the rivers clause or further limit the Senate’s power over money bills were rebuffed.

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5 Pringle (1979) argues that Protectionists hated Reid more than they hated the bill.
6 Hirst (2000) suggests the taxes were the main reason Reid lost seats.
Reid then introduced an enabling bill for a new referendum, this time skewed in favour of ‘Yes’ through the lack of a minimum vote and the ability of electors to vote in any electorate, the latter increasing the possibility of voter fraud. It remained a matter of fierce contention. The Legislative Council had to be swamped with new members in order to pass the enabling bill, while the Labor Party had to endure an internal debate over whether to vote for the enabling bill despite what were considered to be inadequate changes to the draft constitution (Nairn, 1973). Labor concluded that it was resolutely opposed to the updated bill, but James McGowen successfully maintained that the issue should be put to the people.

The 1899 referendum

Forces

Organisationally, there was little difference between the referendum of 1899 and its predecessor. Both the Anti-Constitution Bill League and the Colonists’ League had maintained their operations, and despite the previous year’s efforts to secure cooperation they remained separate entities. Jack Want had resigned his leadership of the Anti-Constitution Bill League in order to retake his position in the Reid Ministry and was replaced by Dibbs. The real change was in the position of the parliamentary parties. In the election, Reid had made Federation a party issue and he was therefore able to call on members to fall into line at the behest of party solidarity. In 1898, this would have been impossible, even if Reid had tried, but the referendum result and Reid’s subsequent ownership of the negotiations had shifted the circumstances. The Free Traders had once had a considerable problem with party discipline, but Reid and Carruthers had gone to great lengths to instil a more unified culture and they were now far ahead of the Protectionists in this area (Gorman, 2018). The addition of Reid gave ‘Yes’ the colony’s best platform speaker. Demonstrating his trademark political savvy, he turned the screws on his opponents by pointing out their contradictory positions. MacLaurin and the Telegraph (16 June 1899) supported a stronger form of Federation than that of the convention bill, so Reid was able to paint himself as the champion of New South Wales autonomy by contrast. Want remained strongly opposed to the Federation bill, but he took an ill-timed trip to Egypt and his only real contribution to the campaign would be via telegram.

Having adopted Barton as their leader, the Protectionists were somewhat restrained, although many of those who had opposed the bill last time were out in force again. The most intriguing figure was Lyne. He at first stayed silent, perhaps in the interests of his party, but after the Telegraph called him out on his absence, he led a vigorous late charge for the ‘No’ campaign. It seems that at first he thought the success of ‘Yes’ was a forgone conclusion, but as opposition stiffened he may have hoped that
a ‘No’ result could have propelled him back to the leadership of the opposition and even the premiership. Labor took a far more active role in the ‘No’ campaign this time around, led by Billy Hughes and William Holman, who had both tried to stop their party supporting the enabling bill (Nairn, 1973). Many of the most devastating critiques were given by Labor men as champions of democracy, but William John Ferguson and Richard Sleath, two members from far western electorates concerned about the safety of their seats, decided to break with caucus discipline and campaign for ‘Yes’, leading to their expulsion.

The only newspaper to change its position was the Star, which fell in line behind Barton’s leadership. The Telegraph seemed to thrive on the fact that it was taking on the world, and if anything its writers fought a more spirited campaign than the last time. They took great delight in quoting the previous constitutional criticisms of Reid and other backsliders against their current positions, even doing the same with extracts of Barton debating contentious clauses during the Federal Conventions. They made it into a regular section called ‘in the witness box’, where the politicians were effectively cross-examined by themselves. The paper dubbed the updated constitution the ‘Secret Conference Bill’ and regularly drew out the fact that one of Reid’s main attacks on the 1891 bill was that it was drafted behind closed doors (Pringle, 1975). They also seized on Barton justifying his support for both versions of the bill by claiming it was substantially the same, reprinting this quote in multiple editions to undermine Reid’s claim to have improved it.

A new strength of the ‘Yes’ campaign was the endorsement of a number of influential churchmen (Pringle, 1975). While the churches as institutions avoided giving an official position, individual clergy were given a free rein to express their opinion.

Though they had already been heard in the first campaign, women were even more vocal in 1899 on both the ‘Yes’ and ‘No’ sides. A Miss Hickman told a meeting of 200 women under the auspices of the Colonists’ League that ‘women felt most keenly the defect in the Constitution which prevented them from recording their opinions at the ballot-box’. Nevertheless, ‘the opinions expressed by thinking women in public meetings would have due weight with all thinking men’ (DT, 9 June 1899). They tended to argue from a democratic point of view and were quite wary of a parliament that would sit so far away from its people. Referring to Wise’s quip on the costs of Federation, feminist Belle Golding pointed out that a mongrel dog could be put down but they would be stuck with a flawed Federation for all time.

Arguments

The 1899 referendum was if anything fought more fiercely than its predecessor, but since many of the arguments were simply a replay of 1898 there is little point repeating them. The new dimension was the debate as to whether Reid’s amendments fixed the problems onto which the referendum campaign had shone
a light. ‘No’ maintained that they absolutely did not and that in some cases they had made things worse. Starting with the capital site, the 100-mile limit was considered an attack on Sydney, which now knew for certain that it would not be the national capital. MacLaurin asked:

what has Sydney done to Mr. Reid that he should seek to affix such a stigma to a city which, most people think, has treated him with the greatest consideration and kindness? (DT, 16 February 1899)

The Telegraph (7 May 1899) produced a detailed map demonstrating the 100-mile radius, and showing how it covered from Newcastle to Nowra and crossed through Bathurst. When it was left up to parliament, there was some hope that Queensland could have helped secure the honour for Australia’s first city, but now that was out the window. Instead, not only was there the 100-mile limit but also a guarantee that parliament would sit in Melbourne in the meantime. This meant that the city would have all the financial benefits of government departments, its politicians would have an easier time attending parliament and that its Protectionist newspapers would dominate the press gallery. Moreover, there was not even a mechanism that would force the capital to move on from Melbourne by a certain date; theoretically, it could be there for a century if no other capital site had been settled upon (DT, 22 April 1899).

On the issue of the financial clauses, Reid’s failure was almost self-evident. The 10-year limitation on the Braddon blot was little more than an evasion, too far in the distance to detract from the problems Reid himself had identified with the clause. Worse still, the price of the time limit was the introduction of section 96, which allowed the Commonwealth to make grants to the states ‘with attached conditions’. This was attacked as proof that New South Wales was expected to dig into her pockets to bail out the other states’ financial needs. Reid found himself in the awkward position of having to downplay his strong criticisms of the previous year. Having committed to not removing his land and income taxes, the premier proposed using the three-quarters surplus on farm subsidies and pensions, a populist move the Telegraph (10 May 1899) took as further proof of the wastefulness of Federation. It said he wanted people ‘taxed for their own good’ like a typical Protectionist.

Because Braddon remained, all the financial debates of the last year were largely repeated, though the nature of the repetition meant that people were less engaged, at significant damage to ‘No’. To enliven the debate, ‘No’ turned to attacking the idea that Australia would be grossly over-governed by its seven parliaments and that Federation would add needlessly to the overall costs of government. Lyne added together all of Australia’s MPs to get 750 and suggested that if Westminster had the same level of representation it would have to seat 8,000 (DT, 3 June 1899).
If the finances were just as bad, the central question became: was the bill any more democratic? ‘Yes’ had two amendments to point to. The first was that referendums would only require the support of one House to get off the ground. This was easy to dismiss as the ‘double majority’ would ensure that any referendum question that cut against the interests of the smaller states would be defeated anyway. The focus thus turned to the absolute majority. At first even ‘No’ seemed to concede that this was a slight improvement, but later there were attacks on the fact that an absolute majority, similar to the 80,000 minimum, would take an absence as a ‘No’ vote. Considering that this was an era when MP absences were high and the distances involved in a federal parliament would likely exacerbate this, many feared that the absolute majority would often be unachievable. Hughes argued that ‘the difference between a three-fifths majority and an absolute majority was much the same as that between one ton of coal and two tons falling on your head’ (DT, 31 March 1899). Holman went to great lengths to explain the procedure of a double dissolution and demonstrate that the absolute majority had done nothing to overcome the fact that the deadlock provisions could not be used in money bill situations (ST, 21 May 1899). The Senate still had a right of veto over the government, as 1975 would show.

The amendment to protect state boundaries took away a scare campaign on the annexation of the Riverina and other areas, but this was a clause that benefited all states, so it was hardly a concession to New South Wales. Lyne argued that the other premiers had run rings around Reid and that at the very least he could have secured the capital without equivocation (ST, 12 February 1899). To his opponents, Reid had completely failed in his attempt to haggle and the fact that he tried to save face by pretending otherwise was the source of much scorn. Those expecting the premier to repeat his nuanced stance of 1898 felt betrayed by his partisanship: towards the end of the campaign he was burned in effigy outside the Glengarry Castle Hotel in Darlington as the ‘strangler of majority rule’ (DT, 13 June 1899).

More and more, the ‘No’ campaign tried to counter the emotional appeal of ‘Yes’ with their own appeal to the people to protect their rights and those of their children. A mass meeting of the Political Labor League was told that equality at the ballot box had been the central goal of democratic reform since the Chartist movement (DT, 14 June 1899). McGowen explained to a meeting at Newtown that:

> to accept the present bill would be not only to diminish their own privileges, but to destroy the rights and liberties of future generations; and on these grounds he appealed to the working men of New South Wales to show that they understood their own interests, and were determined to pass as a heritage to their children the freedom now enjoyed, by voting against the bill. (DT, 5 June 1899)

The appeal to emotion was part of a more concerted effort to undermine the ‘Yes’ arguments in favour of Federation. Holman led a critique of the military necessity of Federation, pointing out that Australia would still be reliant on the Royal Navy
and that Tasmania was hardly going to bolster New South Wales’ military divisions in any meaningful way (DT, 16 June 1899). It was also pointed out that the only way that defence would improve through Federation was if there was an increase in spending, but the ‘Yes’ campaign had been adamant this would not be the case. Though for the most part it stayed away from issues of race, while ‘Yes’ claimed to be the champions of ‘white Australia’, in its desperate last push ‘No’ made some opportunistic and unfortunate use of racial bogies. These included that Federation with Queensland might flood the rest of Australia with the Pacific islanders of the sugar-cane farms and also that the federal government’s takeover and development of the Northern Territory would not only mean unnecessary expenditure but also the use of labourers more suited to tropical climates.

Key moments

The most controversial moment of the 1899 campaign was the Public Service Board’s decision to issue an edict prohibiting public servants from participating in the Federation debate. The Sunday Times (1 June 1899) described this as an ‘un-British’ and sinister import from the United States. The Telegraph denounced the attack on free speech where,

more than a tenth of the electors of the colony have the iron hand of bossism clapped across their mouths, so that while the Premier and his new allies go about deluding the people not one of them may utter a word. (12 May 1899)

While the prohibition applied to all public servants, it was clearly directed against Coghlan. As one of the most senior public servants, Coghlan was actually a commissioner of the supposedly independent board but he caved in to political pressure in not opposing the prohibition. The Telegraph led a campaign repeatedly criticising the ‘muzzling’ of Coghlan while speakers like Lyne often brought up the issue. A defensive Reid insisted that Coghlan was available to offer his expert advice to both ‘Yes’ and ‘No’ MPs in private, but the premier refused to back down in the face of mounting pressure.

Things got worse when the government allowed Major-General French to deliver a pro-Federation appeal, demonstrating selective enforcement in favour of the ‘Yes’ campaign (DT, 14 June 1899). The depoliticising of public servants was made all the more perverse when ‘Yes’ tried to deliberately court their votes, making speeches claiming that Federation would create new job opportunities or increase wages. Barton suggested that a legislature made up of ex-ministers would be more appreciative of public servants and ironically tried to woo them with the fact that federal employees would be freed from the strictures of Reid’s Public Service Board (DT, 15 May 1899). ‘No’ countered with the claim that public servants in transferred departments would have to reapply for their jobs, many of which might be relocated.
to Melbourne as the temporary capital. It was also pointed out that Victoria paid her public servants less, and that in the push for economy that even ‘Yes’ was advocating the lower pay rates were likely to become the standard (1 June 1899).

Despite the negative press, Reid’s decision successfully undermined the ‘No’ campaign to a significant extent. The *Telegraph* tried reprinting Coghlan’s statements from the previous year with the headline ‘when the “muzzle” was off’, but because his calculations had not included Queensland they were out of date and ineffective. Dr MacLaurin did his best to pick up the slack, delivering a series of devastating speeches on the costs of Federation. However, the fact that he was both a known partisan and a member of a Legislative Council, which was associated with hard-line conservatism, meant that his views were less likely to be heeded by disinterested voters.

The other key moment was when Queensland passed an enabling bill ensuring that it was going to hold a referendum on Federation (Quick & Garran, 1901). Reid had long courted Queensland, believing that their shared regional interests would be an important counterbalance to the southern states. As a ‘medium’-sized colony and as one presumed to have great potential for growth, her absence was sorely missed during the small state victories of the Federal Conventions. The parliamentary debate on the enabling bill was going on simultaneously with the referendum, and its outcome was a great boon to ‘Yes’.

**Results, assessment and conclusion**

The result of the 1899 referendum was 107,420 ‘Yes’ and 82,741 ‘No’. There had been a large increase in voter turnout, which was due to a number of causes. First, the voting regulations that allowed electors to vote outside of their electorate. Second, the increased effectiveness of both the ‘Yes’ and ‘No’ organisations and the fact that people inclined towards ‘No’ could no longer rely on the 80,000 minimum. Finally, there was the sense that the Federation issue was coming to a head. The *Telegraph* and other ‘No’ campaigners tried to insist that an adverse vote would not mean the end of Federation but the possibility of a Federation on better terms. This was effective in 1898, but with a second round of negotiations having now occurred, it was clear that a vote of ‘No’ would set back Federation for at least a decade. It had essentially become an issue of take it or leave it.

The Sydney vote saw a majority of 479 ‘Yes’ in the city and 843 ‘No’ in the suburbs, making a slim 364 margin against overall (DT, 21 June 1899). The ability to vote in any electorate seems to have had the biggest impact in the city, where several electorates had voter turnouts well above the numbers registered on their electoral rolls. The *Telegraph* (21 June 1899) suggested that if a significant proportion of

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7 Including Canterbury, which the SMH classified as part of Sydney but the DT did not.
these extra voters represented people travelling from the country districts, who were statistically more likely to vote ‘Yes’, the majority for ‘Yes’ in these electorates may not be an accurate guide to local feeling.

While there had been a noticeable swing to ‘Yes’, the fact that Sydney registered another ‘No’ majority is simply remarkable. Virtually everything was stacked against ‘No’, which had to face off against the government, the opposition, the majority of the press, churchmen, the levers of government like the Public Service Board and the momentum of Federation. In the ‘No’ corner was an incongruent assortment of unpopular Legislative Councillors, contrarian Protectionists and the Labor Party. Considering the unpopularity of the first two groups in the city of Sydney as demonstrated by the 1895 election result, almost all of the burden of prosecuting the ‘No’ case fell to Labor and the *Telegraph*. It must be remembered that Labor was still very much a junior party compared to the Free Traders, who had a virtual stranglehold on the city’s middle-class voters. The results showed that a significant proportion of these voters rebelled against the dictates of the Free Trade Party, and instead voted for what was sold as democracy, lower taxation and inexpensive government. These issues were the ones that had won Reid the 1894 and 1895 elections, and they dominated the debate in both referendums.

Those free trade supporters who voted against Federation were to have their fears confirmed. The federal parliament did raise large tariffs, first for revenue then in the name of protection. The Braddon clause, combined with an economic downturn, did lead to a large rise in New South Wales government spending, which even the fiscally conservative governments of Carruthers and Charles Wade were unable to fully reverse (Gorman, 2018). Carruthers himself came to personify the frustrations of the free trade–sympathising people of New South Wales with Federation, threatening secession just a few years into the new arrangement. The concerns about democracy remain a matter of perspective. The representatives of the smaller states have tended to vote along party rather than state lines, but this does nothing to diminish the fact that the strength of a Tasmanian elector’s Senate vote is far greater than that of someone from New South Wales.

Reid’s domestic legislative agenda thus did not survive Federation. Ardent Federationists like Wise and Deakin went to great lengths to paint Reid as the villain, but given the perilous political situation he had to navigate he should arguably be their hero. In contrast to the traditional story, Reid’s real sacrifice was of the interests of the people who had supported him the longest. He would lose the premiership in September 1899 in large part because he had alienated both sides of the Federation question. In many respects Reid secured Federation ‘at any price’.

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8 Labor only bothered to run candidates in 12 of what Nairn (1973) identifies as 40 Sydney seats in 1898.
References


Was Federation motivated by federalism?

Greg Melleuish

Abstract

Australia is a federation that does not really believe in federalism. Whenever matters pertaining to the workings of federalism appear, comments made in the press or online advocate the abolition of the states and the creation of a central national government. It is assumed that state governments are venal, incompetent and inherently inferior to the Commonwealth Government. How do we explain this peculiar phenomenon?

Introduction

Australia has a very peculiar political system in that it is a federation that does not really believe in federalism. Certainly, there are advocates of states’ rights, more than often found in Western Australia, but it is rare to find anyone who believes in the virtues of federalism as an institutional means of governing the country. Whenever matters pertaining to the workings of federalism appear in the press or online, comments made under such articles advocate the abolition of the states and the creation of a central national government. It is assumed that state governments are venal, incompetent and inherently inferior to the Commonwealth Government. How do we explain this peculiar phenomenon?

1 The University of Wollongong, gmelleuish@gmail.com.
Federalism is an unusual form of political order sitting between the small, self-governing community and the large, territorial state or empire. It seeks to reconcile these two forms of political entity, thereby, at least in theory, bringing together the advantages of local self-government and the economic, political and military capacity that only a large political entity can possess. Federalism has its ancestry in places such as ancient Greece and medieval Germany, where small political entities came together in leagues so as to pursue common interests while at the same time keeping control of their own affairs. Over time, these leagues tended to be absorbed into empires and larger territorial units, such as happened with the Roman Empire in the case of ancient Greece, and in modern Germany.

Federalism is similar to the idea of mixed government in that both advocate a form of government in which power is shared rather than being concentrated in a single source. In this regard, a federal system sits uneasily with an idea of a single sovereign entity sitting at the apex of the political system. In fact, the problem with the idea of sovereignty is that it seeks a precise or scientific notion to the problem of the organisation of political power, when, of course, the situation in the real world is always much more complex and power is diffused. This was the case in medieval Europe, where there were multiple sources of authority. It is only really with Bodin, who disliked mixed government, that the idea emerged that there was only a single source of authority in a polity (de Benoist, 2018, pp. 104–106).

This scientific desire culminated in Thomas Hobbes’ *Leviathan*, where, in a sense, politics is solved by geometry, by bringing together a collection of amorphous individuals into single collective that requires a single source of authority (Hobbes, 1991). In a similar fashion, the French Declaration of the Rights of Man creates a similar binary model of individual and nation (or state). The key clause is

3. The sources of all sovereignty resides essentially in the nation; no body, no individual can exercise authority that does not proceed from it in plain terms.\(^2\)

The opposite position can be found in Johannes Althusius’ *Politica*, in which he argues in favour of what he terms federalism by which he means the idea that a political community is composed of a number of groups or associations (Althusius, 1995). In many ways, the role of associations may be crucial for the success or otherwise of a federal system of government. It is what Alexis de Tocqueville, an anti-Jacobin, saw as the distinctive feature of American democracy (see Jaume, 2013, pp. 21–64). It was also what J.D. Lang emphasised in his account of America (Lang, 1840).

This division of sovereignty leaves open the possibility that one of the elements sharing that sovereignty will eventually come to dominate and impose itself on the others. In the case of the mixed constitution of England, this issue was resolved by vesting sovereignty in parliament, which was ‘mixed’ in that it represented the
monarch, the lords and the commons. In this way the unitary nature of sovereignty was reconciled with its ‘mixed’ elements, although it can be argued that the consequence was the creation of a unified sovereign entity.

This explains the argument of the advocate of Australian federalism, John West, writing in 1854. West argued that the many small associations of English society acted as a brake on the power of the central English government. West believed that such associations were weak in the Australian colonies and he proposed that a federal system could create the checks and balances required in such circumstances (West, 2001, p. 26). This raises the issue of the extent to which artificial constructions can be substituted for organic associations.

The idea that civil associations were weak in the Australian colonies can be contested. In their recent history of Evangelicals in Australia, Piggin and Linder point to the importance of churches as forms of civil association in the colonies, and that members of churches were central to establishing other forms of civil associations, such as mutual societies (Piggin & Linder, 2018). In the latter part of the nineteenth century, one can also see the development of other forms of association such as trade unions (Gollan, 1960, esp. Chapters 4, 5, 6). There can be no doubt that the third quarter of the nineteenth century was the heyday of voluntary associations in Australia; along with mutual societies and friendly societies, there were also mechanics’ institutions established for the purpose of self-education (Nadel, 1957, pp. 111–160).

On the other hand, the transportation of convicts meant that convicts were effectively ‘dumped’ into a society where they had few, perhaps no, connections, although some convicts could bring family out to the colonies, as happened when my great-great-grandmother joined my great-great-grandfather in the early 1820s.

Nevertheless, the fact that so much of the incoming population came as individuals rather than families, as was also the case with the gold rushes, meant that associations in the colony were not organic and needed to be created out of a collection of strangers. It is extremely important that, in New South Wales and Victoria, a centralised government preceded local government (Hirst, 1988, pp. 243–265). A degree of local initiative existed but there was also a very strong incentive to look to the government of a colony to do things, as happened in the key areas of education and railways.

The colonial governments can be understood as newly minted artificial constructions trying very hard to pretend that they embodied the organic qualities of British government. In a similar way, the Federation movement, despite the rhetoric about the crimson thread of kinship, can be understood as an exercise in constructing an artificial political structure. The delegates at the various conventions were imbued
strongly with the idea of an organically evolving British Constitution but recognised that they were bringing a constructed entity into being (Chavura & Melleuish, 2015, pp. 512–528).

Federal political structures, understood as artificially created institutions, have a certain instability. Sir Robert Menzies famously stated that either the central government or the states will come to dominate (Menzies, 1967, p. 2). The apportionment of power between them brings a very real tension into being. There is also a distinction between a confederation and a federation, with a confederation involving much looser bonds among its members. In the case of the Australian Federation, it is clear that the bonds were meant to be relatively strong and permanent as indicated by the preamble’s reference to an ‘indissoluble union under the crown’.

Moreover, the English tradition of government evolved over time towards centralism; parliament was sovereign and the ultimate source of authority. The Australian colonies inherited a form of polity, ‘responsible’ or ‘party’ government that was quite different to that which the American colonies had adapted from Britain in the 1780s. The British version of ‘responsible government’ was essentially aristocratic; parties were a little like aristocratic clubs who shared power.

Two points are particularly relevant here:

• The norm for British settler communities by the middle of the nineteenth century was for the imperial power to encourage local self-rule within the wider imperial framework (Ward, 1976). Australia, like America and Canada, was settled both at different times and in different places, and under a variety of circumstances. South Australia was always a free colony while most of the others had convicts at some stage. The most powerful tendency in the mid-nineteenth century was towards separating out the colonies rather than bringing them together. The ideal of an empire of small self-governing communities was pushed in Australia by figures such as J.D. Lang as part of his vision of creating an Australia composed of yeoman republics (see Melleuish, 1999, pp. 22–23). There was great enthusiasm for the idea that the colonisation of Australia should follow the model of the ancient Greeks. Colonies would model themselves on their place of origin but be independent of them. They would run their own affairs, but still be linked to ‘home’ by ties of kinship and affection.

• When it came to the issue of the form of government that the colonies would adopt, the evolution of what would become the Westminster system was moving away from an eighteenth-century concern with the need to restrict the power of government and to root out corrupt practices, and towards a model of government that tended to centralise power. Responsible government, as it developed in the Australian colonies in the second half of the nineteenth century, took on strong centralist tendencies. Power was concentrated in the various governments who could then use it for purposes of economic development. Local critics such as
William Forster bemoaned the way in which responsible government failed to provide much in the way of checks and balances to resist the power of the executive (Melleuish, 2014, pp. 90–94).

A degree of concentration of political power made sense in a political entity that had economic development as its major objective. Railways needed to be built and there was insufficient private capital to do so. Primary education required that governments build schools. Colonial governments built railways and opened schools out of financial necessity, but the results were extremely centralised systems. The nature of colonial governments matters, because that is where the men who drew up the Commonwealth Constitution learned their political trade.

If one goes back to the 1850s, there was still a strong ideal in the colonies of ‘mixed government’ (Melleuish, 2014, pp. 65–87). By mixed government is meant the idea that the concentration of power is something to be avoided and that power should be distributed among a variety of groups in a political community. This is why John West advocated federalism in the 1850s as a means of recreating mixed government by splitting power between local and central governments. West was particularly concerned about the possible despotic excesses of democracy in small communities; he hoped that a federal structure would divide power and prevent either level of government from being too dominant. West was worried that small democratic communities would enact selfish legislation that would harm minorities, such as the Chinese, or seek to benefit themselves at the expense of others, such as in the case of protective tariffs. Unchecked democratic majorities simply could not be trusted to act in a just fashion (West, 2001, pp. 22–25). In the absence of traditional British social structures within colonial society, that which had not been provided by nature would need to be supplied by artifice. The model is mechanistic, but perhaps this was inescapable given the peculiar circumstances of the Australian colonies.

When the British Government granted responsible government to the Australian colonies in the 1850s, it was also concerned that the various colonies would adopt an array of policies that might place some of them at odds with other colonies. This concern was not without foundation, given the level of conflict that existed in the United States. The colonists were encouraged to adopt some sort of federal structure, although there was no model of what such a structure would look like. In a similar vein, West understood the value of federalism in terms of political theory but was hazy regarding its institutional design.

From an imperial point of view, the value of federalism lay in the expectation that it would create a measure of uniformity; diversity, especially in crucial policies, was not a desirable thing. What is interesting is the degree of conformity in the models of responsible government adopted by the various Australian colonies. They were all bicameral. They all adopted a relatively broad franchise, if not universal manhood suffrage, for the lower house, and an upper house that was designed to resist democratic excess (Melleuish, 2007, pp. 112–114).
Federalism, from the imperial perspective, was clearly seen as desirable because it would allow for some sort of coordination among the various colonies. There was an absence of coordination when the colonies were free to do as they chose; for example, in the absence of any central authority, each colony developed its own policy on tariffs. Over time, it appeared that the legislative consistency of the various British communities would fracture. For example, my great-grandfather married his deceased wife’s sister in Sydney at a time when such marriages were still illegal in Britain.

Federalism made sense on what are essentially utilitarian grounds. The British Empire grew in a remarkably unsystematic fashion and the imperial authorities came to accept that the various settler societies composed of peoples from the British Isles should run their own affairs, at least within certain limits. The imperial authorities desired a degree of uniformity but knew that it could not be imposed on its overseas colonies. Encouraging federal structures seemed like a reasonable way to proceed, in that it would encourage a degree of commonality among the political, social and economic practices of ‘Greater Britain’ (Belich, 2009, pp. 456–478).

Of course, having attained responsible government, the various Australian colonies showed little desire to come together. The next 40 years, it can be argued, established the foundations of the way in which politics would function in Australia. Initially, there was a strange mixture of utopianism and anxiety (Melleuish, 1994, pp. 114–133), which was compounded by teething pains as people with very little political experience attempted to run a parliamentary system.

By the 1870s, a decade of considerable prosperity, the colonists had established what would become their political traditions within the framework of working systems of responsible government. As J.M. Ward has argued in the case of New South Wales, this led to a more relaxed and conservative approach to political matters, combined with a desire for material development (Ward, 2001, pp. 1–36). As this was the political tradition and experience that was defining for those who drew up the Commonwealth Constitution, it was far more important for them than any theoretical understanding of federalism.

For earlier figures such as John Dunmore Lang, the whole point of the colonial enterprise was to establish a series of small self-governing entities that would be democratic in nature. They would be like Greek colonies in the sense that what bound them together would be ties of affinity and shared values. It should be noted that the 1850s were a highpoint of a faith in free trade and its capacity to transform the world so that universal peace and the brotherhood of man would reign.

The men who came to draw up the Commonwealth Constitution came from colonies that had entrenched a centralised form of representative government in the form of ‘responsible government’. As discussed, New South Wales and Victoria
had not developed strong systems of local government. After 1859, the desire for separation appeared to have largely abated; there would be no new colonies created. The railways, owned by the various colonial governments, invariably led back to the capital that dominated the colony. In particular, Melbourne dominated Victoria and Adelaide basically was South Australia.

The advocates of Federation were men who aspired to distinction and a status appropriate to their standing in the community. West had argued that one of the advantages of a federal sphere was that it would create a type of government and legislative body that would enable men of distinction to debate and discuss higher issues of politics founded on principle (West, 2001, p. 41). Local assemblies concerned themselves with much more material and mundane matters.

The quest for distinction in colonial Australia manifested itself in the desire of colonial politicians to acquire the word ‘Sir’ before their names, such as Sir ’Enry Parkes. They wanted their Britishness affirmed by being awarded the sorts of honours to which all those of British stock aspired (Hirst, 1988, pp. 105–118). Equally, those colonies that had once been home to convicts craved respectability. There were still former convicts around when Federation took place, including one of my great-great-grandfathers.

One key factor is that by the 1880s the strategic environment in which Australia was placed had changed significantly. The British navy, which had guaranteed the universal peace of the era of the free trade world of the 1850s, was being increasingly challenged to maintain that order. As Clinton Fernandes argues, there was ‘strong popular support’ in the Australian colonies for the use of force by the British Empire (Fernandes, 2018, p. 19).

What can be said is that the move towards Federation in the late 1880s occurred in a very different environment from that of the late 1840s and 1850s. The optimism and utopianism of mid-century was slowly leached away as the European world moved into the darker waters of the fin de siècle. There was a growing focus within the West on decay and degeneration.

The increasingly pessimistic mood of the 1890s is caught by the Bulletin and C.H. Pearson’s National Life and Character. Pearson believed that liberalism had, in a sense, exhausted itself, and was being replaced by what he termed ‘state socialism’ (Docker, 1990, pp. 167–171; Pearson, 1893). One can also not underestimate the influence of the ever-pessimistic David Syme in Victoria, his gloomy view of human nature and his advocacy that the state constrain and regulate human actions (Melleuish, 2014, pp. 107–123).

The mood of the 1890s, the decade in which Federation occurred, was quite different to that of the 1850s when the idea of Federation was first considered. The bush was tethered to the world after 40 years of railway building, and it was also the case that
the railways, along with the education system, created the first large bureaucracies in the Australian colonies. George Reid both introduced a radical free trade regime in New South Wales and sought public service reform to create a more uniform bureaucracy. Colonial democracy in its green years had had a somewhat amateur air to it and politicians exercised great personal influence over government and the way in which it operated. The era of the individual liberal politician was being replaced by one in which political parties and public service bureaucrats became more important.

The men who created Federation were the products of this changing world. By the 1890s the Australian colonies were being increasingly integrated into the British imperial order. The second half of the nineteenth century saw not only the construction of the railways but also the telegraph, the growth of steamship travel, all of which conquered the earlier ‘tyranny of distance’ (Kern, 2003). This ‘new world order’ was matched by the emergence of ‘progressivists’ in Australia (Roe, 1985).

The Australian colonies had developed their own distinctive versions of ‘responsible government’ that were driven by an impulse to centralise. They now lived in a world that was less ‘relaxed and comfortable’ than had been the case 40 years earlier. Older political ideas, in particular those relating to ‘mixed government’ that recognised the need to create a system of checks and balances to restrict concentration of power, had largely faded into history.

One element of this new political mood was the adoption of the ‘pledge’ and the delegate model of democracy by the fledgling Labor Party, a move designed to discipline its members. David Syme, it should be noted, was another great supporter of the idea that members of parliament were no more than agents of the people who had elected them and should act under instructions (Melleuish, 2014, p. 118). Of course, the men who drew up the Commonwealth Constitution were liberals to a man. But among them were a significant number of ‘new liberals’, such as the Oxford-educated Bernhard Wise, as well as the Deakinites, students of C.H. Pearson and protégés of David Syme.

There is also the man who lit the Federation fuse, Sir Henry Parkes, at the fag end of his career, in a move that was clearly motivated by a desire to establish a legacy for himself. In his famous speech of 1889, Parkes dwells on the ‘crimson thread of kinship’, on Australia as a nation and on the need to bring an Australian people into being. Parkes was a man who sought distinction. He was also not a political figure who understood the importance of limiting and dividing political power. In his Tenterfield speech, Parkes rejects the idea of a loose arrangement amongst the colonies:
Some colonial statesmen had said that this might be done by means of the Federal Council; but this Federal Council had no power to do anything of the sort, as it had no executive function; and, moreover, was not an elective body, but merely a body appointed by the Governments of the various colonies; and, did not, therefore, carry with it the support of the people. (Parkes, 1889)

Parkes also cites defence as a key reason for Federation. By the late nineteenth century, the dream of a peaceful world and the brotherhood of man, exemplified by the Great Exhibition of 1851 and the various colonial exhibitions of the 1870s and 1880s, was looking more and more illusory. Here is George Reid (1879, p. 7) in his entry for the 1879 Sydney Exhibition poetry competition:

And thus another lesson to mankind is taught,
Of amity by such co-operation wrought;
For here the fiercest competition for the prize,
The rival ardour to the general good allies.
This harmony of force was early understood,
By that first 'mong princes—ALBERT THE GOOD;
Bright harbinger of the restored, primeval plan,
That seeks the freedom yet the brotherhood of man!

The free trade ideals that had inspired Reid’s utopianism had largely evaporated by the early 1890s. The world had become a more dangerous place.

This is not to say that higher ideals had been banished from the colonial world. The creation of a federated Australia was a noble cause. It would bring into being a new nation, a nation that was both Australian and British. I wonder what the Irish Catholics among my ancestors thought of the anti-Catholic Parkes’ depiction of them as British. The Federation movement, it should be pointed out, was largely a Protestant enterprise.

Federation was an aspect of the growing cooperation and coordination of the various parts of the British Empire, although it is sobering to appreciate that it occurred as Australian troops were involved in a war against a part of that Empire that wished to secede. There is a logic in imperial development, as can be seen quite clearly in the case of Rome, whereby what begins as fairly loose rule over time becomes increasingly tight. Of course, Australians willingly supported the Empire, even as they sought jealously to protect their interests within that Empire.

To a large extent, the majority of Australians accepted that Parkes was correct and that they were building an Australian nation that was fundamentally British in nature. It is not untrue to say that the men who drew up the Commonwealth Constitution had a love affair with the British Constitution and saw it as the pinnacle of political perfection (Chavura & Melleuish, 2015). This raised some interesting issues. How was it possible to replicate the British Constitution in the Australian context especially given the fact that there is no single formal document?
At the same time, following British precedence, those drawing up the constitution were reluctant to specify too closely the shape of that constitution in written terms. They feared that a written constitution would be too rigid and not able to evolve. Despite this reluctance, they had to draw up a written constitution. The delegates did not like theory; as one would expect of a group largely composed of common law lawyers, they considered themselves to be practical men. Even someone who we tend to think of as a liberal radical, Alfred Deakin, often sounds like a good Burkean conservative on constitutional matters (Chavura & Melleuish, 2015).

In many ways, this cast of mind was a positive thing; the constitutional drafters avoided highfalutin statements about the values that the constitution would embody. They did not insert a Bill of Rights; they were very suspicious when it came to putting anything to do with religion in the document (Ely, 1976). What we get instead largely are the sorts of implicit values of late-nineteenth colonial liberal lawyers and politicians who had been moulded by the practices of responsible government.

The whole point of the exercise was to create a federal constitution that was acceptable to all those colonies wishing to come together. They were practical men seeking a workable outcome. Their primary interest was getting the mechanics correct and ensuring that their goal of a federated Australia was achieved. The constitution was focused on creating a workable federal system; the workings of parliament are only discussed insofar as they are impacted by the new federal structure. They did not need to discuss responsible government; they knew how it worked.

This approach had a number of consequences. One is that many of the key clauses of the constitution became the subject of horsetrading among the representatives of the various colonies. There was a division between the large colonies and the small ones. The Billites were more concerned with achieving the glory of an implemented constitution than with writing a good constitution (see Gorman & Melleuish, 2018).

This is not to say that some of the key players, such as Barton and Griffiths, were centralists. Their subsequent careers as High Court judges proves otherwise. There was no real expectation that they were bringing into being a powerful Commonwealth government that would overshadow the states. Rather, it can be argued that the process of constitution-making allowed for the creation of a government that contained the potential, provided for by the constitution, to become centralising and powerful.

What does this all mean?

I would like to give a few suggestions:

- The coming of Federation did nothing to slow down the centralising tendencies inherent in the system of responsible government that formed the real foundation of Australian politics. The state governments continued to develop as they had
in the second half of the nineteenth century. Once the opportunity arose, as it did during the First World War, Australian governments were able to exploit the centralising elements within the constitution, such as the defence powers, to begin their own centralisation.

- What this means is that the political instincts of the Australian people, and of the political culture that they created, are centralist. They are not jealous protectors of their local liberties and defenders of their communities. How could they be, when local government only became a serious matter after Federation? Sovereignty never extended to local self-governing communities but was claimed by state, Commonwealth and Empire (the Commonwealth did not become a sovereign entity in 1901). Australians were predisposed to hand over the running of things to governments who took decisions on their behalf. They wanted governments to do things for them, just as Commonwealth governments expected Britain to do things for it, especially in defence matters.

There was the occasional obstacle to this process. The Australian people elected a Labor government in 1910 and that government failed in two referendums in 1911 and 1913 to increase Commonwealth powers. This became part of a pattern whereby Commonwealth governments found it almost impossible to use referendums to extend their powers. In this regard it is interesting that both the 1913 referendums and the subsequent 1919 referendums had 49 per cent of the vote and the support of three states. It was a closely run thing.\(^3\)

Although the Australian people have been reluctant to change the constitution through formal mechanisms, they have not resisted the long-term move towards the accumulation of power by the Commonwealth Government. One of the key ways in which that has occurred has been through High Court interpretation of the constitution, which, from quite an early stage, favoured the increase of Commonwealth power. While both Barton and Griffith, key players in drawing up the constitution, favoured the states, the introduction of new High Court justices in 1910, who had played no role in the constitutional conventions, meant that constitutional interpretation moved towards common law principles and literal interpretation and, in the long term, this meant increased Commonwealth power (Sawer, 1956, p. 106).

This process was accelerated by the use of the defence powers, which were only temporary, during the First World War. Geoffrey Sawer argues:

> Thus judicial doctrine in this period markedly favoured the expansion of Commonwealth power and in particular gave the defence power a scope which could, for practical purposes, turn the Constitution, at least during grave and large-scale wars, from a federal to a unitary one. (Sawer, 1956, p. 106)

\(^3\) The figures for all these referendums can be found on Wikipedia.
With the retirement of both Barton and Griffiths in 1920, the direction of the High Court was consolidated by the *Engineers* case. Of course, the use by the Commonwealth Government of the defence power once again during the Second World War allowed for an increase in Commonwealth power. Moreover, as Sir Robert Menzies argued, it habituated the Australian people to look to the Commonwealth Government as the relevant authority, even in matters that were state government responsibilities (Menzies, 1967, p. 68).

Financial power was gradually accrued by the Commonwealth. On all these matters, Sir Robert Menzies’ *Central Power in the Australian Commonwealth* is still worth reading (Menzies, 1967, pp. 74–92). Slowly, but surely, the capacity to raise taxation was largely vested in the Commonwealth Government. The states gave up their right to raise income tax during the Second World War. The High Court prohibited them from imposing a sales tax. The Australian federal system slipped into an increasingly worsening condition of vertical fiscal imbalance.

Following our argument regarding developments in the West in the late nineteenth and early twentieth centuries, one could argue that centralisation and the consolidation of Commonwealth power was an inevitable feature of twentieth-century Australian political, social and economic development. The intriguing thing is that this process encountered so little resistance and was, leaving aside the failed referendums, widely embraced by both the political elite and the Australian people. The principal argument presented in this article is that one reason it happened so easily was that Australian political culture was moulded by the traditions of responsible government and the desire to follow the British Westminster system as much as possible. This is, and remains, a tradition that favours centralisation. Put another way: ‘nation’ has always trumped the federal compact.

It can be argued that some sort of union among the various Australian colonies would have occurred at some stage or other. Alternative history is not all that popular in Australia but in the 1940s G.V. Portus argued that even if David Syme had never owned *The Age*, protectionism would have triumphed in Australia (Portus, 1944, pp. 115–123). Taking a similar approach to Federation, what matters, under such an argument, is the timing of the federal union. The later that it occurred, the more centralist the constitution was likely to have been; the earlier, the looser the bonds tying together the various colonies would have been. Australia may have become a ‘confederation’ rather than a federation if the colonies had come together about the same time as Canada. It may have become a unitary state if the Labor Party was predominant.

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4 *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd*, (1920) 28 CLR 129; HCA 54 (31 August 1920).
Having said all of this, it is worth reflecting that the centralist tradition in Australian politics has its real origins in the various colonial governments. They were centralist because that was the dominant feature of responsible government. An Australian continent dotted with quasi-independent entities would still be a continent home to polities founded on the principle of ‘responsible government’ administering centralised education and health systems. In this regard, and following on from John West, it may well have been the case that a principled federalism would have been able to infuse the politics of Australia with a much greater concern for limiting the power of governments. But that would have meant a belief in the principles of federalism among the wider population and much stronger local associations. In the final analysis, the coming of Federation did little to prevent the long-term ‘centralising’ tendencies in Australian political life. The Commonwealh Government that came into being in 1901 was still fundamentally another version of responsible government. The real issue was, and remains, the sort of political culture that came into being in the 1850s and developed in the second half of the nineteenth century and formed the way in which those who drew up the Commonwealth Constitution, and became the political class of the new Commonwealth, thought and acted. It placed an imprint on Australian political practice that has remained with us until the present day.

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Federation: Liberalism triumphant? Or liberalism thwarted?

Peter Phelps

Abstract

The most egregious myth about Federation is that it was all about domestic issues, particularly economic issues, and that defence and foreign policy played little or no part in the impetus towards Federation. The argument runs that because little time was spent debating issues of defence and foreign affairs in the constitutional conventions, and much more time was spent on economic and fiscal matters, the latter must have been the most important drivers of Federation. The argument is unjustified in the face of the evidence. Defence and external affairs are the key to understanding the push for Federation.

Introduction

The Federation of the Australian colonies did not have the ‘heroic’ quality of a war of liberation, nor did it consciously adopt an ideological panegyric about ‘rights’, nor did it rely for its raison d’être on something like the ‘European experiment’ of a single customs union. As such, it has been seen by Alomes and Jones (1991) as a second-rate coming of independence—a stunted nationalism. Horne (1977, p. 154) lamented about a nation that engaged in ‘a desultory debate for 20 years’ and produced ‘a terse and extraordinarily interesting’ constitution. White (1984, p. 111) goes further: ‘Federation represented less the birth of a nation … than a readjustment of colonial relations, a somewhat shabby deal among the colonies based on deep suspicions and self-interested manoeuvring’. However, this article argues that the process of making the constitution was a remarkable exercise in assertive national liberalism, with the final document—if not its political implementation over subsequent decades—being a high point of Australian liberal thought.
Part of the reason for the disparagement of the process and product of the Constitutional Conventions arises from a lack of overt explanation for Federation from the conventioneers themselves. As Ward (2001, p. 58) wrote:

The Convention debates … offer no neat, convincing demonstrations of why the colonies federated. Indeed, the debates were more often concerned with what colonies might lose or gain by federation, or with the likely political reactions to the proposed Constitution than with the question ‘Why federate?’

The responses usually fall into the popular hindsight of ‘it was just inevitable’; or ‘it was an expression of a new cultural nationalism’ (Ward, 1966, p. 240); or the argument that capital was seeking to protect itself from the rise of socialism and trade unionism (McQueen, 1970).

It is beyond the scope of this article to go into any great detail, but the weight of evidence (Broinowski, 1992; Craven, 2001; Coulthard-Clark, 1988; Jordan, 2013; Kemp, 2019; Lehane, 2013; Meaney, 1976) is that Australian security—defence, external affairs and immigration—was the key driver in the initial push for Federation. The leaders of the Australasian colonies themselves indicated as much in the priorities listed to encourage the move towards closer association (Intercolonial Convention, 1883, p. 4):

It is desirable that a Federal Australasian Council should be created for the purpose of dealing with the following matters:

1. The Marine Defences of Australia, beyond territorial limits
2. Matters affecting the relations of Australasia with the Islands of the Pacific
3. The prevention of the influx of Criminals
4. The regulation of Quarantine
5. Other such matters of general Australasian interest …

Sir Henry Parkes’s ‘Tenterfield Speech’, so often seen as the spark for the ultimate move toward Federation, was made in response to a report that called for greater defence cooperation between the colonies—but he took its logical implications a step further, advocating full political federation (Alomes & Jones, 1991).

If Australian colonial leaders felt themselves compelled to move towards unification because of fears from external threats, they used the opportunity to attempt to create a new and liberal polity for the nation to come. But to examine the various responses to what the drafters thought a ‘liberal’ Federation would look like, we first need to address the problem of definition: what do we mean by ‘liberal’ and ‘liberalism’ in the Australian context?
On one side you have people who historians have described, variously, as ‘Classical Liberal’, ‘Free-Trader’, ‘Conservative’, ‘Old Liberal’ and ‘Liberal’. On the other side, you have people described as ‘New Liberal’, ‘Protectionist’, ‘Colonial Liberal’, ‘Deakinite Liberal’ and, confusingly, also ‘Liberal’. So what is the difference?

On the first side were those who thought ‘liberalism’ meant a limited role for government, supported free trade and opposed protective tariffs. On the other side were those who supported greater state intervention in the economy, usually through the mechanisms of government welfare and higher tariffs on imported goods. For the purposes of this article, it is the former definition of ‘liberalism’—that is ‘classical liberalism’, or those who favour development of individuality, support free trade and oppose the expansion of government power—that will be used as the touchstone for assessing the liberality of the Federation movement, and for the eventual constitution it produced.

Alfred Deakin himself lay down the philosophical boundaries between the two groups, even as he was obfuscating their nomenclature (in Melleuish, 2001, p. 31):

A Colonial Liberal is one who favours State interference with liberty and industry at the pleasure and in the interests of the majority, while those who stand up for the free play of individual choice and energy are classed as Conservatives.

Another of the Federation Fathers, Samuel Griffith, said (in Joyce, 1984, pp. 110, 150): ‘The comfort of the individual must yield to the good of the public … It is only the State … that can enforce the rule of Freedom.’ And Edmund Barton, Australia’s first prime minister, told an audience in Maitland, New South Wales (NSW), in January 1901, just before he was about to take up office (in Gordon, 1976, p. 162):

A policy of free-trade would be impossible and would in any case be insane … I am a protectionist as are nearly all my colleagues … I am a protectionist and I will endeavour to protect … the productions of our own soil.

Our industries have grown up under protection and the Government will not be a party to any policy that would be their destruction … The first tariff will be thoroughly liberal and at the same time of a purely Australian character.

This lexicographic problem is not helped by writers like Roberts (2001) who contend that ‘as an ideology and a worldview [Australian liberalism] occupies the middle ground between conservatism and socialism’. Ward likewise misidentifies George Reid as a ‘New Liberal’ when he was unquestionably what should be called a ‘classical liberal’—his lifelong antipathy to Deakin’s economic policies being an obvious point of difference. Nor is there evidence to support Ward’s assertion (2001, p. 56) that ‘liberalism and conservatism had been virtually indistinguishable’ in colonial politics. Ward (2001) states that the ‘New Liberals’ or ‘Deakinites’ clearly believed that governments had a duty to intervene in fiscal, industrial and social
policy in order to keep societies prosperous and secure, yet later himself falls into the Deakinite mistake of calling classical liberals ‘conservatives’. Similarly, Craven (2001, p. 53) says that the Federation Fathers ‘all fell within the range of what would today be referred to as liberal opinion’—but that is only true to the extent that ‘liberalism’ has been debased in its meaning by Deakin and his political heirs.

Nor is it simply an issue of Left vs Right. It must be remembered that, at that time, issues of religious sectarianism and economic protectionism, not capitalism vs socialism, were the major points of cleavage in Australian society. The divisions between Catholics, Anglicans and other Protestant denominations (not to mention Jews) were entrenched and bitterly contested across all spectrums of society, and would continue to be so even after Federation (Nairn, 1986). The arguments over free trade and tariffs between the colonies—what Victorian premier James Service called ‘the lion in the path’ to Federation—occupied the spotlight of Australian political controversy (Kemp, 2019, p. 489). That is not to say that the framers were unaware of ‘class’ issues, but the absence of an aristocracy-by-birth and a widespread underclass, as in Britain, meant that Australian colonial leaders were more able than Gladstone to give effect to the latter’s ideal ‘to create an area where rationality and the general interest could be enforced and the class will rebuked’ (Vincent, 1972, p. 248). Thus, Ward is incorrect to say that federation was seen by classical liberals as a means for ‘the colonies to minimise the creeping menace of socialism’ (2001, p. 66). Rather, the political battles that stood in the way of Federation were largely about ‘the fiscal issue’—taxes, tariffs and state intervention.

The economic background to Federation

This split between ‘classical liberals’ and ‘Deakinites’ was mirrored, geographically, by the split between political opinion in NSW and Victoria. Victoria’s serendipitous but short-lived gold rush (and its inflationary consequences), combined with a lack of free land, spurred the growth of domestic manufacturing. The nineteenth-century meme of ‘Father Sydney; Master Melbourne’ had some validity: by 1890, Victoria had the highest rate of industrialisation, the richest trade and the greatest wealth per capita of any Australian colony (Ward, 2001).

The largest employment in secondary industry in Victoria was in clothing/textiles, breweries, sawmills, tanneries, iron foundries, brickworks, potteries and engineering establishments—but, in 1861, the average number of employees in Victorian factories was only six people (Ward, 2001). Even by the 1880s, this figure had only increased to an average of 16 workers (Kemp, 2019). There was no way that these native industries could viably compete with goods from Liverpool, or Birmingham, or Manchester—much less the United States or the growing manufacturing power of Japan. Tariff walls seemed the logical solution, after the gold boom left the
colony’s economic wellbeing dependent on the continued proliferation of small, inefficient firms. David Syme, editor of *The Age*, led the vanguard and he used his paper as a bully pulpit from which he attacked *laissez-faire* economics and competitive individualism. He leaned towards what he called ‘State Socialism’ and believed ‘the parental authority is the basis of authority in the state’. Syme was a key influence on a young journalist and lawyer named Alfred Deakin (Melleuish, 2001; Ward, 2001). The power of Syme, arguably the first of the great activist, Australian media moguls, as an advocate for government intervention and tariffs cannot be understated.

While Victoria was moving down the path of protection and regulation, north of the Murray River it was the golden era for free trade liberalism. As Ward (2001, p. 42) notes:

> Liberalism was triumphant in NSW. Everyone with a political voice to use knew that it could be used. No one with a future to make … had cause to fear that society would withhold opportunity. Land law amendments were being made … there was education for all who sought it. The economy was expansive. Men and women still migrated … in hope, not despair. The belief that the colonies allowed everyone a sure prospect of full personal development to the limit of his or her abilities had become entrenched. If the system failed in particular cases, that was attributed to human folly or gross misfortune, not to lack of opportunity in a colony where, it was thought, nature’s law of individual freedom had been enshrined.

Founded on agricultural and mining exports, and with a smaller domestic manufacturing industry that had had to survive without substantial tariff walls, NSW was almost monolithic in its support for free markets and free trade. NSW premier George Reid was the key political figure, following on from the free-trade principles of Sir Henry Parkes, and he instituted a series of administrative and tax reforms that saw NSW recover from the depression of the early 1890s in a better position than the other colonies (Melleuish, 2001). NSW was the centre for ‘classical liberal’ thought, and Reid’s government, as Melleuish (2001, p. 31) notes, ‘contained genuine theorists who opposed the extension of the powers of the state, and developed a coherent and modern theory of liberalism’. Bruce Smith was one of these. As early as 1887, he wrote (Smith, 2005, pp. 143, 162):

> Without freedom, it is obvious that man could not choose the time, place, means or method of obtaining the requirements of life; and … the more crowded a community becomes, the greater the necessity for freedom to the individual.

> If I am right in laying down, as the fundamental principle of Liberalism, that each individual should have secured to him the most absolute liberty … then it follows that the state should take no steps to curtail the liberty of any class, even though that other class happen to be much larger or more influential politically.
Such language was redolent of the liberal drawing rooms of Victorian England, and indicated the deep level of cross-fertilisation of ideas between liberals in the colonies and the Mother Country. But, equally, there is a timelessness to his plea, which would also find a place in a libertarian conference of the twenty-first century. Indeed, were he able to express such views today, Smith might well be termed, by those on the Left, as a ‘Neo-Liberal’.

Yet, as Melleuish (2001, p. 29) points out, a linguistic paradox developed: ‘Free trade liberals found themselves saddled with the description “conservatives” while the Victorian Protectionists, who were basically statists, appropriated the term “liberal”’.

So was Federation a triumph of classical liberalism?

It is important to note that the Federation movements were not unitary. While there was consensus on defence, immigration and external affairs, there was a battle waged between Free Traders and Protectionists concerning the role of the state in social and economic affairs. Even the newly emergent Labor Party, in 1891, found itself divided on these matters, necessitating the introduction of a binding pledge to ‘solidarity’ voting, after the Party split over whether to support a Free Trader or a Protectionist for the premiership of NSW (Dyrenfurth & Bongiorno, 2011). Ward (2001, p. 50) contends that it was merely an opportunistic coalition of interests, in the troubled 1890s, to bring about Federation, but this view appears too harsh. It is better to say that the Federation Fathers were determined to protect the security of continental Australia and, having reached that threshold decision, were determined to try make the ‘shotgun marriage’ of the colonies work in the more contentious areas of fiscal arrangements and the extent of centralised powers.

The very name chosen for the new nation, the Commonwealth of Australia, is significant. Canada used the term ‘Federal Dominion’. Sir Henry Parkes had earlier indicated a preference that the new nation be called ‘The British States of Australiá’ (Parkes, in The West Australian, 21 February 1884). Ward (2001) suggests that ‘commonwealth’ might be a nod to the United States, with the publication of a prominent political tract The American Commonwealth some three years before. These claims are unconvincing. The Federation Fathers were all steeped in the Whig history of Britain and the centrality of the English Civil War—portrayed as a gallant struggle by the people and parliament over tyranny and in defence of liberty. The new nation would be the ideal polity, a government responsible to the people and committed to the ‘common weal’ (Hancock, 1947, p. 95). Curran and Ward (2010, p. 265) contend that ‘the use of the term reflected a sense of national idealism and the idea of a free community dedicated to the advancement of the common good’. Robert Garran, a Father of Federation and the most respected and prolific early
interpreter of the constitution, held a deep interest in British constitutional history stretching back to the Plantagenet kings, and used ‘Commonwealth’ as the consistent leitmotiv in the titles of his three major publications (Milner, 2013, p. 125).

Indeed, the structure of the new nation was a litany of earlier Whig interests: a written constitution, as distinct from the Westminster system; parliamentary supremacy, with the Executive needing to obtain supply from both Houses; the separation of powers, with a clear delineation of judicial and executive power; an enumeration of all the legislative powers to be held by the government; a democratic vote, where the words ‘directly chosen by the people’ were embedded in the document; and a parliamentary representational structure that inevitably required the extension of that franchise, if each state wished to maintain or extend its relative power in the new federal parliament.

Federalism itself was not merely a political necessity brought about by colonial jealousies, but continued the notion of the dilution of power so as to prevent centralised tyranny. It was a recognition of the benefits of devolution and localisation of power, and it is unsurprising to note that the great Referendum failures since 1901 have been those that sought to increase central power. The drafters were not utopians. They foresaw that states could seek economic advantage for their polity, at the expense of others, and so adopted the quite remarkable provision of section 101 for the creation of an Inter-State Commission (ISC).

The ISC was created to prohibit the making of laws and regulations derogating from absolute freedom of trade between the states. It was not merely to ensure the end of internal tariffs and customs posts at borders, but also the manipulation of government-owned rail and river use through parochial government fiat. Support for this measure was so great that its remit was extended to trade and commerce generally between the states. This wide reach was largely the result of Reid, who not only worried about protectionist states, but also feared a federal government usurpation of trade transport and commerce generally. His hope was for an institution with dominant powers, but one that would be ‘free from all political prejudices and unnecessary control’ (Bell, 2009, p. 61).

While the enumerated legislative powers set for the federal government were, in many instances, machinery provisions, there are key liberal ideals also expressed here. In line with the ISC, there was a requirement for non-discriminatory taxes and bounties, and ‘the acquisition of property on just terms’. This latter clause, s. 51(xxxi), is remarkable—‘just terms’ makes it clear that outright expropriation is prohibited but, more so, that any proposed compensation would not be ‘take it or leave it’, but would be justiciable. None of the Australian colonies had any such constitutional requirement for their own citizens, and even the United States Constitution contained no comparable provision, despite unjust taking of property—through the quartering of British troops—being one of the grievances
laid against King George III by the American colonists. But the Australians went further and made the apparently unnecessary reiteration that any such acquisition could only be done ‘for any purpose in respect of which the Parliament has power to make laws’. This view fits absolutely within the intellectual tradition of British liberalism. Gladstone believed that only ‘intellectual or moral aberration could account for such schemes as land nationalisation’, and asked rhetorically of his own government (Vincent, 1972, p. 251):

Do you [the government] mean to pay for it [land], or do you not? If you mean to pay for it, it is folly: if you don’t mean to pay for it, it is robbery.

Also flowing out of the English liberal tradition was the prohibition on the ‘establishment’ of any religion. From the 1850s onwards, the Liberation Society and other Nonconformist groups ‘were extremely successful in making the [British] Liberal Party feel the weight of Nonconformist views on questions of religious equality’. They not merely motivated large numbers of people to cast votes for supportive liberals, but provided the intellectual rigour in favour of Disestablishment, which became a touchstone for their electoral support (Vincent, 1972, p. 104). In Australia, the problems of sectarianism were never far from the surface of political life, exacerbated by the fact that 80 per cent of Roman Catholics were of Irish origin, and thus the political troubles acquired a religious dimension with ‘hostility, aggression, and exaggerated suspicion towards those not the same belief as themselves’ (Ward, 2001, p. 19). But with no established church in the Australian colonies, their arguments were not met with the same Tory concerns about power, privilege and property—and thus the principle of non-establishment was swiftly enshrined in the Constitution. Even if the various denominations could not get on with each other, at least there would be no legal avenue for state coercion.

Moreover, in continuation of the liberal tradition, there are individual sections within the Constitution that seek to guarantee trial by jury (s. 80) on indictable offences against Commonwealth law, a prohibition on discrimination against residents of other states (s. 117), and the aforementioned free trade within the Commonwealth (s. 92), which was not merely to be ‘free’ but uses the seemingly redundant, but nonetheless emphatic, term ‘absolutely free’.

But there were notes of illiberalism too. Four powers that were granted to the new federal government stand out in this regard. First was the inclusion of the banking and insurance powers (ss. 51(xiii) and (xiv)). In the latter case, insurance was included because of an unfounded fear from protectionists of American competition driving out domestic insurers. In the end, however, the ‘free market’ worked better than ‘protectionism’: after US insurers did enter the Australian market, they swiftly departed when they discovered that their actuarial figures were wrong, having failed to account for the fact that Australians lived longer than their US contemporaries (Ward, 2001).
The second problem was the inclusion of a federal arbitration and conciliation power. This amendment to the draft constitution had failed twice previously, but was barely accepted in 1898 on the back of parochial concerns from the Western Australian delegation (Kemp, 2019). Third, there was the inclusion of a power over aged and invalid pensions. One supporter for this proposal, Bernhard Wise, said ‘it would not be used for a Century’, but was included because it was thought that it would win votes for Federation (Ward, 2001, p. 120). Finally, there were powers to handle marriage and divorce, which, like all of the above, were supposed to be deferential to existing state laws.

Craven contends that the final product was, by and large, a victory for the Free Traders, and the evidence suggests that this assessment is correct: the Australia Constitution as envisaged was a classically liberal document. But Craven (2001, p. 59) also notes: ‘Paradoxically, the external federal tariff, adopted immediately after federation and which was to endure for so long, represented the application of opposite tendencies’. How did this happen? Because the first decade of Australian political life—the Federation Decade—was, for classical liberals, a disaster.

The Federation Decade

In the very first session of the Commonwealth Parliament, the Victorian Protectionist Henry Bournes Higgins persuaded the House of Representatives to pass a motion calling on the states to transfer to the federal government ‘full power to make laws for Australia, as to wages and hours and conditions of work’ (Commonwealth of Australia, 1901). He was an unabashed Deakinite and his motion set the tone for this formative era of Australian politics. Higgins would later be appointed to the Commonwealth Conciliation and Arbitration Court (and later the High Court), where he would write the judgment in the 1907 *Harvester Case*, which would vastly expand federal government powers. As Kemp (2019, p. 377) rightly notes, the inclusion of the power of conciliation and arbitration, in s. 51, while meant by the drafters to ameliorate the effect of parochial unionism,

> was to provide a doorway through which Australian unionism, and the Labor Party, walked into an unexpectedly inviting field of action, and ensured that the philosophy of systemically embedded conflict would soon come to exercise and influence on the new nation’s affairs.

Things were no better on the issue of protective tariffs. Barton was also determined to back protectionism at the expense of free trade. The *Customs Tariff Act 1902* set the initial rates, and Lloyd (2015) has estimated that it increased the average rate of customs duty on dutiable imports from outside the Commonwealth by

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1 *Ex Parte H.V. McKay* (1907) 2 CAR 1.
about 34 per cent. Despite this, Protectionists remained dissatisfied and, in 1905, when Deakin formed government, he gave notice of his desire to raise the levels of protection even further. Combining with a Labor Party that now also supported higher tariffs, ostensibly to protect Australian workers’ jobs and conditions of employment, they passed the *Customs Tariff Act 1908*, which cemented Australia into high levels of protection for manufactured goods. It represented the triumph, in both parliament and Australian public discourse, of protectionism over free trade. The average rate of duty on dutiable imports increased from 26.2 per cent in 1907 to 30.6 per cent in 1908. By the early 1930s, the average rate was over 70 per cent, and Australia would not see a return to pre-Federation tariff levels until the late 1990s (Lloyd, 2008).

By 1909 there was a federal aged pension. By 1910 there was also a federal invalid pension, in direct refutation of Wise’s stated belief that those powers would not be used for a hundred years. And by the early 1960s, the state marriage and divorce laws were all subsumed by Federal Liberal Attorney-General Garfield Barwick’s *Matrimonial Causes Act 1959* and *Marriage Act 1961* (Barwick, 1995).

How could this have happened? In the first decade after Federation, Deakin was prime minister for almost 60 per cent of the time, and this was despite support for the Protectionists continuing to fall at each election. The numbers are striking: at the 1901 Federal Election, Protectionists held 31 seats, Free Traders 28 seats and Labor 14 seats. At the 1903 election, the numbers were 26, 23 and 25 respectively. And by 1906 the Protectionists only held 16 seats, compared with 27 for the Free Traders and 26 for Labor (Marsh, 2001).

Until the ‘Fusion’ of the Protectionist and Free Trade parties in 1909, Deakin and the other Protectionists were continually dependent on Labor support. In chronological order, the Australian governments in that first decade of nationhood were:

- Protectionist backed by Labor
- Protectionist backed by Labor
- Protectionist backed by Labor
- Labor backed by Protectionist
- Free-Trade (Reid) backed by Protectionist (for only 10 months)
- Protectionist backed by Labor
- Protectionist backed by Labor
- Labor backed by Protectionist.

Exploratory discussions on more durable linkages between Labor and Protectionists were held in 1904, and again as late as 1908—just a year before the Fusion between the Free Traders and the Protectionists (Marsh, 2001). In other words, Deakin clearly saw greater possibilities for a permanent relationship between Labor and
Protectionists, and expended more energy attempting to get a lasting partnership with them, rather than with the party with which he would ultimately make the Fusion deal.

As Gorman (2018) notes, Deakin was not a socialist, but he was naïve about its potential dangers, believing that, at worst, ‘socialism’ could only be carried out at the level of state government, given the (supposed) limited responsibilities of the federal government. Nevertheless, Deakin still wanted the power of the state to be used to guarantee minimum wage rates; old-age pensions; free compulsory state education; the redistribution of wealth by taxation; and ‘some legislation to cut the impact upon men and women of capitalist enterprise concerned with profit’ and, thus, Deakin ‘continued to regard Labor and [Protectionists] as natural allies’ (Ward, 2001, p. 74).

Contrast this policy position with George Reid, the Free Trade leader, who like Joseph Carruthers saw that socialism, not protectionism, was the political enemy of the future (Gorman, 2018). Reid lays the issue out squarely in his 1906 election speech, while at the same time taking a firm swipe at Deakin:

The Labor-Socialist leagues are doing one good thing for Australian politics – they are striving to get rid of the system of three parties just as strenuously as we are … They believe their party has a future. We know the [Deakin] Government has only a past. Unless you, ladies and gentlemen, respond either to the appeal of the [Free Trade] Opposition or the appeal of the Socialists, you will be the real authors of another miserable period of intrigue.

What is the appeal the shattered Deakin Administration makes for a continuance of its humiliating career? What great, inspiring cry comes from Ballarat? Nothing but a wail over a distress which does not exist, in order to fill the pockets of a few men who already have enough out of the taxpayers. (Sydney Morning Herald, 24 October 1906)

By the time Deakin understood the threat from socialism, and sought Fusion with the Free Traders, it was too late—the ‘Australian Settlement’, as Kelly (1992) described it, was locked into place. The ‘Settlement’ consisted of the ‘White Australia’ policy, protective tariffs on imported manufactures, compulsory conciliation and arbitration of industrial disputes, and federal government expansion into social welfare. With Fusion, Deakin not only required the excision of Reid’s influence, he cemented the ideological baggage of protectionism within the new party. When the British Economic Mission came to Australia in 1929, it ‘reported in both sorrow and anger the protectionist propensities of the Australians, waring that no lasting progress could occur under such conditions’ (Millar, 1980, p. 92). Yet Deakin remains an avatar of popular ‘Australian Liberalism’, while people like Reid, Smith and Carruthers all fell out of the pantheon of liberal heroes as ‘the policy of free trade and minimal interventionism … suffered a bad press’ (Staley & Nethercote, 2001). As Melleuish (2001, p. 35) wrote:
Reid’s advocacy of ‘anti-socialism’ was the foundation for Fusion, and yet the Liberal Party thereby created was defined intellectually largely by Deakin’s statism. For the next 60 years, classical liberalism was not really central to Australian Liberalism; Australian Liberalism in these years was mainly a combination of Deakinite statism, populism, and conservatism.

Conclusion

So did Australian Federation represent liberalism triumphant or thwarted? The Constitution is a profoundly liberal document—both in its democratic construction and, with some exceptions, in its final form. But there is also no doubt that, even in the lifetime of the participants of the Constitutional Conventions, their expectations of what the federal government should look like, and what it actually did look like, were wildly different. Certainly, the polity envisaged by the framers did not live up to the reality of the politics, as the federal government expanded its power at almost the first available opportunity, and has continued to do so ever since. A mixture of judicial and political activism, the collapse of the ISC (at the hands of a centralist High Court of Australia), and the precarious nature of federal–state fiscal relations all had strongly illiberal tendencies for the new federation. Carruthers spent a great deal of time and effort in his declining years, inside and outside the NSW Legislative Council, fighting against that expansion of federal government power (Gorman, 2018). If blame is to be laid—and that is a big ‘if’ without falling into the arrogance of hindsight—it must be laid with those who believed that classical liberalism would remain unchallenged in perpetuity.

In that regard, it is instructive to note the absence in the Australian Constitution of a comparable clause to that found in the Tenth Amendment of the US Constitution:

The powers not delegated to the United States by the Constitution, nor prohibited to it by the States, are reserved to the States respectively, or to the people.

It is arguable that a clause of this nature in the Australian Constitution would have, even if not ending the centralist and expansive tendencies of the federal government, at least substantially slowed them down. But Australia’s Federation Fathers were far more complacent than their American brethren, and they misread the temptations of federal power—and none more so than Deakin himself. They believed that there was no need to set formal constitutional constraints on the power of the federal government, as the Americans had chosen to do, because everyone within their circle, to a greater or lesser degree, accepted the liberal norms about the limits of federal government power. In their world view, the states would do what the states did in 1895, and the federal government would limit itself to only those things which the states could not do. It was not to be so—but that does not detract from the classical liberal motivations of those involved, nor the classical liberal spirit within which Australia’s foundational document was created.
References


Australia’s Federation episode in international context

Richard Pomfret

Abstract

By the twenty-first century there can be few federal nations as centralised as Australia. The Canadian provinces have been much more successful than Australian states in retaining their power of taxation and their autonomy in areas such as education or health. Why has this happened when the Canadian constitution was explicitly aimed at limiting states’ rights and the Australian constitution was intended to avoid the centralisation of the Canadian Constitution?

There is no fully convincing explanation of the divergence.

Introduction

Australian Federation was preceded by several experiences of nation-state creation in the nineteenth century, much of which was explicitly accompanied by debate over the merits of federal versus unitary states and of variations in federal structures. Australian Federation followed the US Constitution and Canadian Confederation, and to a degree presaged the European Union, in the explicit attempt to create a federal institution among previously separate entities, with political and economic rules set out in a formal agreement. There are also similarities to Italian and German

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1 University of Adelaide, richard.pomfret@adelaide.edu.au. This article benefited from discussion with William Coleman, Peter Phelps, Zac Gorman, Greg Melleuish and Henry Ergas. I am also grateful to Glenn Withers for constructive comments on an earlier draft, to Peter Abelson for sharing work in progress on his local government experiences in Mosman, New South Wales, and to an anonymous referee for helpful comments.
unification in the nineteenth century, although these created nations under the leadership of the King of Piedmont-Sardinia and King of Prussia. In each case, economic and monetary union was a concomitant of political union.

The two big examples of nation creation in nineteenth-century Europe were German and Italian unification. Both were responses to nationalist aspirations and in both cases the lead actor was aware of the benefits of federalism over imposition of a unitary state; in a large country with substantial regional variation, many public functions can be best addressed by decentralised policymakers. However, the outcomes were different, with German federalism lasting, despite challenges in the 1920s and 1930s, to today’s Federal Republic of Germany, while Italy has had a centralised state that is only starting to be seriously decentralised in the twenty-first century. The different outcomes are best explained by the capacity of subnational units to self-govern, which was uniformly high for the times in Germany but varied substantially in Italy. A similar gap in competences helps to explain why new nations since the mid-twentieth century have tended toward centralisation even when the founding constitution created a federal state.

But for Australia, as with the US and Canada, the argument about competences does not resonate. After the introduction of responsible government in 1848, the British colonies in North America and Australasia led the world in socially inclusive political reform. However, the Australian and Canadian experiences differed in that the Canadian constitution incorporated greater centralisation while Australia’s was more respectful of state rights. Paradoxically, the practice of federalism has been exactly the reverse as Australia became one of the most centralised federations in the world while Canadian provinces operated with significant independent powers in the century and a half after Confederation. The second section analyses why this happened. The third section draws some conclusions.

Germany and Italy

German integration was led by the Zollverein (customs union) established under Prussian leadership between 1828 and 1834. Was the Zollverein a first step towards German unification or were Prussia’s motives economic, and only became political decades later?² Dumke (1976, 1994) emphasises the financial benefits of customs union among states with small populations and relatively long land borders at a time when trade taxes were an important source of public revenue. The Zollverein had no internal customs borders, a common external tariff and revenue redistribution. Its secretariat was small; customs posts remained national and tariff decisions were

² Treitschke (1872) is a classic statement of the first position, while Taylor (1946) and Kitchen (1978) emphasise the evolution of motives. The standard English textbook by Henderson (1984) had a narrative of response to external events.
taken by a congress of states. The *Zollverein* treaties constrained public monopolies and producer taxes, harmonised weights and measures, and regulated currency acceptability. The *Zollverein* was followed by closer union in the 1870s, driven by Prussian military victories (and the era of nationalism), in very broad terms presaging the EU route through the European Coal and Steel Community and customs union in the 1950s and 1960s to deeper integration and closer union after 1986.

Italian unification followed a different path. It was essentially top-down, led by Piedmont with other parts of the peninsula being freed from foreign rule or papal control, rather than a union of independent states. Irresistible nationalist pressure for Italian unification led to a unitary state, albeit with strong traditions of local government. In the 1947 constitution, three regions (Trentino-Alto Adige, Friuli Venezia Giulia and Valle d’Aosta) were recognised to have distinct linguistic components, and the islands of Sicily and Sardinia had special status, but the other 15 regions were not recognised until the 1970s. The regions only gained greater autonomy after the 2001 revision of the constitution gave them control of functions that did not require a national level of administration.\(^3\)

Ziblatt explains the unitary/federal divide not by the goals of the leading power but by the capacity of other units. In Italy, outside of Piedmont, absolute rulers had been restored after the 1848 revolutions with limited civil society support and poor administrative capacity, in contrast to the more modern and competent administrations of German states:

> federalism is possible only if state building is carried out in a context in which the pre-existing units of a potential federation are highly institutionalized and are deeply embedded in their societies—and hence are capable of governance. (Ziblatt, 2004, p. 71)

Ziblatt quotes extensively from the correspondence of Bismarck and Cavour to show that both leaders would have preferred a federal system rather than trying to impose a unitary nation-state. However, in the void left by the overthrow of foreign or religious rule in Italy, a federal system among units of unequal administrative competence was impossible.

The unitary versus federal choice has varied since unification. In Germany the Social Democrats in the Weimar Republic and the National Socialists of the Third Reich promoted greater central power in order to push their agendas of change in the 1920s and 1930s and the German Democratic Republic (East Germany) had a unitary system from 1949 to 1990, but since 1949 the Federal Republic has explicitly left significant powers with the states. In Italy, centralisation was strengthened under

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\(^3\) Only foreign policy, immigration, defence and the design of the welfare state were left with the central authorities (Zamagni, 2018, p. 48).
Mussolini, and the timing of the decentralisation of the early twenty-first century is consistent with the thesis of Ziblatt (2004, 2006), in that education levels and other civil society indicators in the less-developed regions had improved significantly.

Canada and Australia

The paths to nationhood in Canada and Australia were influenced by similar debates over the balance between central and provincial power but the debates took place in meetings among the constituent units, treated more or less as equals. Some (Upper and Lower Canada or New South Wales and Victoria) were clearly more equal than others, but no single colony would dominate the nation-building as Prussia or Piedmont did. Unlike in the US, the constitutions would not be of republics; in both Australia and Canada it was accepted that the British monarch would remain the head of state, but the sovereign was far away and would increasingly become a symbolic head of state rather than the national leader like the German Emperor or King of Italy.

In both Canada and Australia, military defence was an argument for unification under the British imperial umbrella. The British North American colonies had relied on the British army to repel invasion by the US in the War of 1812, and there was an ongoing threat of forcible or peaceful annexation. The US purchase of Alaska in 1867 emphasised the vulnerability of a nation that stretched to the Pacific after British Columbia joined Canada in 1871. For Australia, the Royal Navy was crucial for defence as tensions between Britain and Russia mounted in the second half of the nineteenth century and as Germany became more militarily threatening from its island colonies. However, this aspect had little impact on debates over the nature of federalism in British North America or Australasia.

The issue of whether the federating units were capable of self-government was moot insofar as all of the North American and Australasian colonies had effective self-government on the Westminster model, and in some respects (e.g. universal male suffrage and representation of women) were in the vanguard of nineteenth-century political reform. New Zealand’s withdrawal from the Australasian Federation in part reflected concerns that its more advanced approach to race, labour and social

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4 James Polk won the 1844 US presidential election against all expectations with the slogan ‘Fifty-four forty or fight!’ (i.e. that the northern border of the US Oregon territory would be Russian Alaska), although once in office he backed down from declaring war on Britain. The 49th parallel was established as the US–Canada border to the Pacific Ocean in 1872 after arbitration.

5 Australia’s Federation debates also took place before a background of racial concerns, especially fears of being swamped by Chinese immigrants or worries about Japan’s growing military and naval power in the 1890s. Novels about the yellow peril were popular and most influential of all was the quasi-scientific 1893 book National Life and Character by Henry Pearson, who warned that without preventative action the white races would be pushed aside by the more numerous inferior races, and saw Australia as the front line of defence. The first federal Act of Parliament was the Racial Exclusion Act.
relations would be compromised in an Australasian federation (Irving, 2013, p. 264). A stronger contrast is to British colonies achieving independence in the twentieth century, some of which had federalist constitutions or motives but lacked administrative capability in less-developed regions (see e.g. De Alwis (2020) on Sri Lanka).

**Canada**

Central to debates bringing together the British North American colonies in Canadian Confederation in 1867 was a concern with avoiding perceived American errors. The idea that the US Constitution was basically flawed is easy to understand given the timing of the Québec Conference in 1864, when the US Civil War was still raging. The general criticism was that the US Constitution gave too much power to the states, which in many senses considered themselves sovereign. In particular, the principle that powers not explicitly granted to the national government remained state powers was considered to be flawed. Canadian leaders like John A. McDonald insisted that the national government must be more powerful and residual powers must accrue to the federal government and not to the provinces.

The drafters of the Canadian constitution also resisted US federalism in the design of the Senate. Although numbers were related to Canada’s composition (24 each for Ontario, Québec and the Maritimes, with the latter’s allocation divided 10 each for New Brunswick and Nova Scotia and 4 for Prince Edward Island), delegates were appointed and their role was conceived more as oversight along the lines of the British House of Lords than state delegates with real power as in the US Senate.

However, against this centralising view had to be balanced the concerns of the Québécois, who feared being swamped in a sea of Anglo-Protestantism. In particular, Québec insisted on retaining powers over education and health, which were crucial pillars of Catholic influence (although nowhere near as important in 1867 as they would become later). The Québec delegates resisted any feature of the British North America Act that could lead to future subjugation of Québec’s power over education and health. In 1980 and in 1995, the government of Québec held referendums on loosening the association with Canada, to what they called ‘sovereignty-association’ and Anglophones tended to call secession. On both occasions, the proposal was defeated: 60 per cent against, 40 per cent in favour in 1980 and 50.6 per cent against, 49.4 per cent in favour in 1995.

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6 Fairburn (1970, pp. 142–143) argued that recent experience of the abolition of provincial governments, which many associated with economic calamity, contributed to New Zealanders’ wariness of the potential for centralisation in an Australasian federation.

7 The importance of state capacity is also emphasised by Brustt and Campos (2019) in the context of EU enlargement in 2004 and 2007 to include some countries with weaker state capacity.
Apart from the original and more recent derogations to Québec, the framers of the Canadian Constitution were concerned to limit provincial sovereignty and ensure that residual rights accrued to the national government. However, it did not always work out as expected. When powerful provincial leaders rejected the role of a glorified local government official and stood up to the national government, they had authority. Smith identified ‘various and compelling reasons’ in the literature:

- the strength and persistence of the autonomist tradition in Quebec,
- the internal dynamic of the political and bureaucratic institutions that comprise and sustain modern provincial administrations,
- and the role of the Judicial Committee of the Privy Council in developing constitutional doctrines favourable to provincial claims.

(Smith, 1988, p. 462)

Ironically, the decision not to follow the US model of elected senators sitting in an upper house with real powers may have created the vacuum in which elected provincial leaders could exercise greater authority than US state governors.

Lecours (2019) argues that Canada’s overall ‘federal balance’ has remained largely stable since 1867. There has been decentralisation in some areas; in early years in the fiscal realm and a few policy fields—for example, finance and securities as well as employment relations, and more recently in areas such as agriculture, citizenship and immigration, and natural resources—but also centralisation in areas such as social welfare and language. The overall slight decentralist path of the Canadian federation occurred primarily through non-constitutional means, with court decisions playing a significant early role. More fundamental reasons why Canada has not centralised are the territorial diversity of the country, primarily but not exclusively nationalism in Québec, along with the original centralised nature of the British North America Act.

Australia

The Australasian fathers of Federation were aware of the Canadian experience and the example of Canadian Confederation was ‘rejected, unequivocally, as too centralist and insufficiently federal’ (Irving, 2013, p. 253). Foreign policy would follow the British lead. Economies of scale in defence and in administration were centralising.

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8 Québec operates its own pension plan, while the other nine provinces are covered by the Canada Pension Plan, and Québec retains extensive authority over employment and immigration issues within its borders, matters that are handled by the federal government in all the other provinces.

9 The British North America Act was an Act of the UK Parliament. The constitution was ‘repatriated’ and renamed in 1982 as the Constitution Act 1867.
factors. Federation would involve customs union, and trade policy would clearly be a central government competence; the tariff was the main topic of debate between free-trade New South Wales and protectionist Victoria.\textsuperscript{10}

For South Australia, running the Northern Territory, for which it had taken responsibility in 1863, was causing problems. Attempts to create settlements had no success until 1869, when George Goyder, the Surveyor-General of South Australia, established a settlement of 135 men and women at Port Darwin. Construction of the Overland Telegraph led to more exploration of the interior and the discovery of gold at Pine Creek in the 1880s, but in general the territory was viewed as a burden in Adelaide, while the Overland Telegraph benefited all of the Southeast Australian colonies.

Post and telegraph services were an early example of centralisation. The six colonial postal services were replaced by a national post office with impressive buildings in state capitals. Measures, such as the Wireless Telegraphy Act 1905, which placed under government control the entire electromagnetic spectrum that had previously been in the public domain, reflected the centralising control of the federal government. On 1 January 1911, a decade after Federation, the Northern Territory was separated from South Australia and transferred to Commonwealth control as a result of the Northern Territory Surrender Act 1908 in South Australia and the federal Northern Territory Acceptance Act 1910.

Despite these measures and High Court decisions that supported central competence rather than states' rights, the central government was often criticised in the early decades for not doing enough. After the 1914–18 war, for example, the major task of reabsorbing demobilised soldiers was at cost to the states, when many people argued that resettlement of returning soldiers should have been a Commonwealth responsibility. Nevertheless, court decisions starting with the 1920 Engineers case\textsuperscript{11} continually broadened central government powers by rejecting restrictions on specific powers and deeming considerations of federal–state balance to be legally irrelevant.

The extent to which the Commonwealth would become a centralised state was underestimated. Most importantly, the Commonwealth assumed control over the main revenue sources, leaving the states with limited and diminishing powers. Initially the Commonwealth returned at least three-quarters of duties to the state where they were levied, but this proportion gradually shrivelled and in the First World War the Commonwealth kept all, as well as introducing a national income tax. A High Court decision in 1942 confirmed the Commonwealth Government's monopoly of the income tax. Today, the central government receives over four-fifths

\textsuperscript{10} Cashin (1995, n. 21), drawing on Wood (1968), Chan (1969) and Fairburn (1970), argues that one reason why New Zealand did not join the Federation was that only 14 per cent of its exports went to Australian colonies in 1890, and most of that was to free-trade New South Wales, so that a customs union including the more protectionist Australian colonies could lead to significant trade diversion.

\textsuperscript{11} Amalgamated Society of Engineers v Adelaide Steamship Co Ltd, (1920) 28 CLR 129; HCA 54 (31 August 1920).
of all public revenues, about half of which it redistributes to the states, usually tied to conditions of expenditure.\textsuperscript{12} Thus, even in areas of state competence and formal administration authority, the states have very limited control over policies.\textsuperscript{13}

The High Court continued to rule in favour of central authority rather than state rights. In a 1983 Tasmanian dam case, for example, the court confirmed the primacy of international obligations as a means for the Commonwealth government to assert its powers over states; the state government was prevented from building a dam on a river protected by the World Heritage Convention that had been signed by Australia.

Despite the difficulties of making an economic evaluation of the costs and benefits of Federation and the fact that this has become a non-issue as most Australians have accepted national identity, it is useful to recall that the referendums on Federation were closely fought and the benefits have been seriously questioned. The South Australian state parliament set up a Royal Commission to examine the financial effects of Federation for South Australia in 1927 and the Royal Commission’s conclusion was unambiguous:

There can be little doubt that for South Australia Federation has proved a failure. The advantages gained have been slight, while the disadvantages have been material.

(Committee on the Financial Effect of Federation on South Australia, 1927)

Particularly in Western Australia, secession has been a recurring issue.

Several decisions taken by Australia in the decade after Federation would not be in the country’s long-term economic interest. The \textit{Immigration Restriction Act 1901}, by introducing a dictation test in a European language, set the new country on a White Australia Policy for two-thirds of a century, which would reinforce isolationism and generate suspicion of non-Europeans in a globalising world. The political machinations of the first decade led to the Australian compromise of protectionism plus labour market regulation (with a ‘living wage’ legally justified by the 1907 Harvester Judgement). Australia’s slide into protectionism, with one of the world’s highest tariff rates (Anderson & Garnaut, 1987; Lloyd, 2008 and 2012) meant that Australia missed the opportunity to develop on the basis of a globally competitive manufacturing sector, or at least delayed the process by decades.\textsuperscript{14}

\textsuperscript{12} The states account for just under half of public expenditures, and on average depend on transfers from the central government for half of their funds. About half of these transfers involve redistribution of the goods and sales tax (GST) as untied grants to the states and the other half of the transfers are tied grants to the states for specified programs in health, education, housing, infrastructure etc. However, even untied grants may be subject to observing rules set by the central government.

\textsuperscript{13} These limits continue to shrink. In recent decades, \textit{inter alia}, disability insurance has been determined at the federal level and funds for road maintenance have become dependent on states observing national speed limit structures.

\textsuperscript{14} Canada showed in the 1940s that a protectionist policy could be reversed. During the 1950s and 1960s, however, Australia demanded exceptional status within the World Trade Organization’s General Agreement on Tariffs and Trade, identifying its economic situation with poor commodity exporters rather than with other rich primary product exporters such as Canada (Pomfret, 2000).
A key aspect of Australian centralisation has been the concentration of tax power. This is not irreversible, for similar reasons to Bismarck’s preference for federalism over a Prussian-dominated unitary German state. On two occasions, Australian central governments have come close to allowing states to levy income taxes. Malcolm Fraser was blocked in 1977 by lack of support from leaders of Western Australia and New South Wales. Malcolm Turnbull also considered state income taxes in 2016 but ran into difficulties with unrelated intra-party politics, as well as opposition from leaders of several states who were unwilling to accept the tax reform in return for assuming full responsibility over education. In sum, once overwhelming central control over tax revenue and limited independence of state governments had been established in the first half of the 1900s, it was difficult to create consensus for change by convincing all state governments to accept greater control over revenues and greater responsibility over decentralised policy areas.

The weakness of Australian states has implications for local government. Local governments in all countries provide local public goods and regulations and some welfare services; typically, they are the closest part of government to most citizens and the desirability of effective local government is widely recognised under the subsidiarity principle. The Australian Constitution does not recognise a third level of government; local governments are the creation of state government legislation and ‘local governments overwhelmingly serve at the pleasure of the state legislatures’ (Grant & Drew, 2017, pp. 183–184). Legislation in most Australian states empowers local government to do whatever is necessary for the wellbeing of the local population but withholds the means for independent action. The functions of local government vary due to differences in governance frameworks and geographical differences, but in all states the scope of local governments’ activities has increased since the 1980s well beyond traditional roads, rubbish and rates, and at the same time the power of local governments relative to state governments has been eroded in all states.

In parallel to their own declining authority relative to the central government, state governments increasingly micromanage local government activity and amalgamate local authorities to make them more efficient implementers of state policies (and to distance them further from the citizens that they represent).

Mayors of Australian cities have limited powers compared to mayors of North American or most European cities. South Australia is the extreme case: given the demographic preponderance of the Adelaide metropolitan area and minimal territory covered by Adelaide City Council (ACC), the state government takes over

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15 The confusion of competence over education was highlighted in the March 2020 COVID-19 crisis when the federal government and the governments of New South Wales and Victoria held different views on the need for school closure.

16 The principle that public policy decisions should be made and implemented by the most decentralised competent level of government, operating as close as possible to the citizens affected by the decisions, is explicit in Article 5 of the Treaty of the European Union.

17 Abelson (2020) reports that New South Wales local governments now perform over 100 different services.
virtually all decision-making about the CBD, North Adelaide and the parklands (i.e. the ACC territory). One consequence is that it is easy to be elected to ACC (the last candidate to cross the line in 2018 had 298 first preferences and 516 votes at election), but the elections, including for Mayor, do not attract strong candidates. ACC meetings are characterised by low-quality debate and *ad hominem* bickering, which reinforces the state government’s claim that it should take over decision-making, despite the mismatch between the mandate of a government elected over a geographically large state and the wishes of city residents on local matters.

### The British dominions

The similarities of Canadian and Australian federalism were highlighted in the twentieth century by their status as dominions within the British Empire, and later the Commonwealth. To what extent can lessons be drawn from the other dominions? Unfortunately, the answer is very little. Responsible government was a thread from the 1839 Durham Report to the confirmation of dominion status in the 1931 Statute of Westminster, but its influence on the design of federalism or unitary governments was limited. By 1931 there were six dominions, but for varying reasons New Zealand, South Africa, the Irish Free State and Newfoundland never engaged in serious constitutional debate over how responsible government should be exercised in a federal state.

Largely for historical reasons, the dominions of New Zealand and South Africa were unitary states. The Colony of New Zealand became the Dominion of New Zealand on 26 September 1907; this involved no formal constitution (legislative practices are based on precedent and unwritten conventions) and no change from the unitary state in which regions and local government were created by the authority of the central government. The Union of South Africa was referred to as a dominion upon its creation in 1910 following the *South Africa Act 1909* that unified the Boer republics of Transvaal and Orange Free State with the Cape Colony and Natal. The Act was intended to forestall any independence by the republics that had been defeated in the Boer War rather than to create a union of equals. South Africa became a republic and left the Commonwealth in 1961.

Dominion status was never popular in the Irish Free State, where it was seen as a face-saving measure by UK governments unwilling to countenance a republic in Ireland. Successive Irish governments undermined the constitutional links with Britain until they were severed completely in 1949.

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18 The estimated 2019 population of South Australia was 1.67 million and of metropolitan Adelaide 1.35 million. The City of Adelaide had around 25,000 residents.

19 All subnational government has only the powers conferred upon it by Parliament and these powers were fewer in New Zealand than in other dominions, e.g. the central government controls police and education.
Newfoundland was a colony of the United Kingdom until December 1931, when full autonomy was granted by the UK Parliament. However, the government of Newfoundland requested that application of dominion status be delayed, and self-government (and its status as a dominion) was suspended from 1934 until Newfoundland became a province of Canada in 1949. The reluctance to accept the rights and responsibilities of self-government has parallels to some Australian states’ reluctance to accept income-tax-raising powers when offered in 1977 or 2016.

In sum, the concept of dominions as self-governing units under the British monarchy was a fleeting idea with limited real coverage. Canada and Australia considered themselves the senior dominions. The other four dominions exhibited no similarity in constitutional arrangements or political practice. The term gradually went out of usage in the second half of the twentieth century. The dominion experience underlines the lesson from the German/Italian comparison that the scope for comparative study of Australian federalism is limited by the small number of potential federations with the state capacity to make federalism work.20

Conclusions

By the twenty-first century there can be few federal nations as centralised as Australia. Even in the United Kingdom, Scotland and Northern Ireland have greater independent power than Australian states. The Canadian provinces have been much more successful than Australian states in retaining their power of taxation and their autonomy in areas such as education or health. Why has this happened when the Canadian Constitution was explicitly aimed at limiting states’ rights and the Australian Constitution was intended to avoid the centralisation of the Canadian Constitution?

The magnitude of the Australia–Canada divergence is clear from Fenna (2019), the Australian counterpart to Lecours (2019) in a project to measure the degree of centralisation in federal systems. In this project, the degree of centralisation in 22 areas is measured on a scale from 7 (totally decentralised) to 1 (totally centralised). Canada’s average score has changed little, from 3.8 in 1870 to 3.9 in 2010. Australia’s average score fell from 5.0 in 1910 to 2.8 in 2010—that is, from a more decentralised starting point, the Australian system had become considerably more centralised than Canada’s in 2010.

There is no fully convincing explanation of the divergence. Court decisions have played a role in both countries, but in different directions, which implies that, rather than separation of powers with an independent high court, the courts’ rulings reflect

20 Bruszt and Campos (2019) contains a review of the limited economics literature on economic integration and state capacity.
the opinions of the politicians who appoint them or the views of the community or some other influence. In Australia, the central government’s power to appoint the High Court (technically through advice to the Governor-General) has produced a strong central bias in judicial interpretation, despite nominal consultation of state governments.

Québec exceptionalism has always been a force for provincial rights. Many commentators, including Lecours (2019), argue more generally that territorial diversity explains Canada’s decentralisation, with particular focus on the resource-rich western provinces’ discontent about how much they contribute to the federal budget and the extent to which their interests are misunderstood by policymakers back east. However, this description could equally capture disillusion in Western Australia or Queensland over fiscal arrangements and policymaking in Canberra. The existence of poorer regions (the Atlantic provinces in Canada, South Australia and Tasmania in Australia) and sparsely populated regions (northern Canada and the Northern Territory) is also remarkably similar. Regional affinities and accents are less differentiated in Australia than in Canada, but that seems a weak basis for explanation of the degree of centralisation.

Debates over the optimum size of nations and the appropriate level of centralisation in political and economic unions have revived in the twenty-first century. Alesina et al. (2000), and in more detail in Alesina and Spolaore (2003), argued that a more liberal international trade regime has been associated with an increase in the number of countries, as the economic benefits of size (notably for national security) are reduced, while Rodrik (2000) foresaw globalisation as a force for increased integration in the twenty-first century. Rodrik also predicted that these processes would cause discontent and revolt. Partly in response to the challenge of anti-integrationists, the European Union has explicitly included commitments to subsidiarity in its program since 1986 to create a single market. The experiences of Australian and Canadian federalism suggest that EU leaders will need to match statements of intent with continuous vigilance if they are serious in seeking optimum devolution of economic decision-making.

21 The issue of judicial oversight and, more fundamentally, who appoints the judges has emerged as a current issue not just in federal states such as the US, where appointment of Supreme Court judges became rancorous in the 2010s. Leaders as diverse as Donald Trump, Boris Johnson, Vladimir Putin and Recep Tayyip Erdoğan, whose authority is based on personal popularity with voters, have sought to restrict judicial powers that might limit their own untrammelled authority as the embodiment of the popular will.

22 A referee suggested that the difference between Canada’s linear geography, in which most Canadians live within 50 km of the US along an 8,891 km land border, and the circular location of Australia’s five main cities explains Australia’s more inward-looking federalism and stronger inter-state integration. However, geographical similarities also exist; both national capitals are situated between the two largest states/provinces and roughly equidistant (200–400 km) from the two largest cities, while the most distant capitals are similarly far from the national capital (flying distance Victoria–Ottawa is 3,577 km and Perth–Canberra 3,086 km).
Australian federalism since Federation has distinctive features, most of which stem from the extreme centralisation of revenue collection and policymaking that evolved over the twentieth century. This has proved difficult to roll back even when the federal government has proposed reverting some revenue-raising powers to the states in return for the states accepting greater independence and responsibility in specified policy areas. A consequence has been that, as local policymaking has expanded in scope in recent decades, state governments have exerted ever stronger influence over local decisions to the extent that local governments’ authority and responsiveness to their residents’ wishes have been seriously undermined. These two consequences were not intended at Federation and are in contrast to public administration developments in North American and European countries.

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