

COOPERATIVE FEDERALISM; EXAMPLES FOR AUSTRALIA FROM ABROAD

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I. INTRODUCTION

This is a talk about two kinds of federalisms in two senses. The first duality is the two kinds of federalism in constitutional theory – what I shall call constitutional federalism and cooperative federalism. I will briefly outline the costs and benefits of both. I recognize that our primary focus here is cooperative federalism but the problems that need to be solved in cooperative federalism are thrown into bold relief by understanding some of the virtues of constitutional federalism.

The second duality will be American and Australian federalism. I will necessarily talk more about American federalism, because that is what I know. But I will also try to use the American experience (and to a much more limited extent the German and Canadian experience) to suggest the practical steps that can be undertaken to ameliorate the greatest defects of cooperative federalism in Australia. These defects include cooperative federalism's tendency to blur lines of accountability, to permit federal dominance of policy, to lead to excessive spending, and to lessen competition among the states.

At the heart of my talk will be a list of some possible reforms to improve cooperative federalism. Some are structural in that the reforms cut across all programs and try to create a general discipline that improves cooperative federalism as a whole. Others are programmatic in that they are likely to improve some kinds of programs, but not all programs. While I believe problems of accountability and competition in cooperative federalism cannot be dissolved or eradicated, these reforms may help temper difficulties inherent in its structure.

II. Constitutional Federalism

A. *The Structure*

Constitutional federalism involves clear separation of responsibilities of federal and state government. The content of constitutional federalism is based on decisions about which government is best at producing the relevant public good. In the original United States constitution, for instance, responsibility for defense and interstate commerce was given to federal government; morals matters (such as police, prisons, and regulation of family) and intrastate commerce were given to the states. The notion behind this division is that the federal government would keep open avenues of trade and migration among the states, but that the states would be

responsible for matters that more directly affected their own citizens than citizens in other states.

Constitutional federalism should not be confused with states' rights. The distribution of responsibilities among state and federal governments is for the advantage of the people, not the states.

B. *Advantages*

1) *Satisfaction of diverse preferences.* If state governments produce local public goods and services, these bundles of good and services can differ from place to place, satisfying different preferences of different citizens in different localities. The reality of this rationale for constitutional federalism was vividly brought home to me when I lectured on federalism at the University of Idaho a few years ago. Before the lecture my hosts auctioned off a magnum shotgun for the benefit of their worthy organization. The gun, let alone the raffle, would have been illegal in Chicago where I teach, but continental republics, like the United States and Australia, should have a government structure that comports with their expanse and variety.

2) *Market for Governance.* By permitting state governments to produce public goods, federalism creates competition among states. Citizens can vote with their feet for efficient services.¹ Foot voting has many advantages over ballot voting. Individuals have little incentive to be informed in ballot voting, because the chance that an individual's vote will be decisive is less than the chance of his being hit by lightning on the way to the polls. In contrast, individuals have incentives to be informed in foot voting, because they directly benefit from the better goods and services in the localities in which they move. As a result, governments which are subject to foot voting are likely to perform better than those which are subject to only ballot voting.

In my view the market for governance is the most powerful advantage of constitutional federalism. The advantages of foot voting in societies like the United States and Australia are even more powerful than at our respective Foundings, because both our societies are more mobile today, allowing more effective choice among state jurisdictions for citizens.

3) *Production of information.* Different policies in different jurisdictions create information which can be evaluated by citizens and social scientists. This advantage is also of growing importance in our age where ever greater power of computation facilitates useful empirical analysis. The rise of the empiricism in the social sciences allows careful studies of what policies work through comparisons of results in different jurisdictions.

¹ See John O. McGinnis & Ilya Somin, *Federalism v. States' Rights: A Defense of Judicial Review in a Judicial System*, 99 N.W. L. REV. 89, 107-110 (2004).

4) *Relatively clear lines of accountability.* Because federal and state governments have clear and unique responsibilities, citizens have a relatively easy time evaluating performance and holding politicians accountable. An economist would observe that constitutional federalism decreases the agency costs of government, because citizens can more easily monitor officials who have clear and well defined responsibilities.

I should note in passing that intergovernmental immunities in my view are not necessarily a proper part of constitutional federalism. If an area is properly within the federal government's responsibilities, the federal government in theory can properly regulate operations in the area even if by doing so the federal government infringes on state operations, like regulating state employees. This reflects a fundamental premise of constitutional federalism: the distribution of power is for the benefit of the people, not governments or their officials.

C. *Disadvantages*

1) *Difficulty of optimally distributing powers.* It is difficult to create a clean and permanent separation between state and federal responsibilities. The world changes and with these changes different distributions may become optimal. If the Constitution creates a flexible standard, however, to address this problem, it creates even more problems of democratic legitimacy discussed below.

2) *Risk of Disunion.* Different states can potentially create such different cultures as to generate disunion. Northern and Southern states in the United States before the civil war are a prime example because their profound differences over slavery helped cause the civil war. As I understand it Australia had something of this issue when its Western states tried to secede in the 1930s. But in my view this concern is muted today in both the United States and Australia, where mass communications draw all people of a nation together.

3) *Need for Strong Judicial Review.* Because divisions between states and federal government are not self-policing, there is a need for a strong form of judicial review, which empowers judges and may create issues of democratic legitimacy. Many academics in the United States have seized on this point to argue that the political branches themselves should police the boundary lines between state and federal governments. The difficulty, in my view, is that federal and state politicians lack the incentives to create or maintain the boundaries that are optimal for the people, and the people are unlike to pay enough attention to a structural issue like federalism to force them to do so.

III. *Cooperative federalism*

A. *Structure.* Cooperative federalism has no clear division between state and federal responsibilities, or, in perhaps the more usual occurrence, the federal government has essentially a plenary scope of power, but states are circumscribed in entering realms reserved for the federal government, like foreign policy. In either case there are large overlapping areas of responsibilities where both state and federal governments can act separately as well as jointly. These joint enterprises are generally

called cooperative federalism and constitute much of modern government in the United States.

B. *Advantages*

1) *Flexibility*. Under the cooperative federalism model, because the federal government has plenary responsibility, there is no need for a permanent division of power. Thus, the federal government can take responsibility for area that is optimal at any particular time and, in theory, create an optimal division for states and federal responsibilities. For instance, today the federal government in the United States is able to create any effective division it wants, because it is now able to regulate almost any area. Moreover, because of the Supremacy Clause of our Constitution it can sweep away any state regulation inconsistent with federal law. The federal government is not required to regulate, of course, and its failure to act itself provides regulatory space to the states.

2) *Separation of the Funding and Provision of Services*. As described below, one other advantage of cooperative federalism is the ability to separate the government that funds the services from the government that provides the services. In this division, the federal government provides the funds and the states provide the services.² In a federal republic, states may vary considerably in their wealth and federal programs can be designed to equalize resources in a particular area, effectively redistributing money from one state to another for some public purpose. Nevertheless, it may still be more efficient for the federal government in effect to buy the services from the state rather than to provide the services itself. The states can then compete on their provision of services and tailor them to their citizens' needs.

3) *Potentially Cooperative*. Federal and state governments can work together in areas of shared responsibilities, perhaps making use of one another's personnel.

C. *Disadvantages*

1) *Lessening of competition among states*. Because the federal government establishes the ground rules it can establish relatively uniform rules, thus diminishing competition among states to make the most effective rules. Interest groups often do not want competition and thus will lobby for uniform rules that will choke it off. As a result, the federal government may often permit less diversity among states than would be the case under constitutional federalism. In the United States on occasion, even the states themselves have manipulated the federal government into more uniform rules to avoid competition among themselves. This is in effect a state cartel – the opposite of the competition generated by constitutional federalism.

2) *Lack of accountability*. Citizens are unclear which government is responsible for which function and thus have a harder time holding governments

² See Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Sovereignty" Doesn't*, [96 MICH. L. REV. 813, 893-900 \(1998\)](#).

accountable, weakening incentives to provide cost-effective services. In contrast to constitutional federalism, an economist would say that cooperative federalism raises the agency costs of government.

3) *Federal Dominance*. Although the programs are styled as cooperative—the federal government can dictate terms

4) *Loss of experimentation*. Because federal government is ultimately in charge there is less experimentation and thus fewer differences in programs for social scientists and citizens to evaluate.

5) *Excessive Spending*. As I will discuss below, competitive federalism, at least in the United States, often leads to excessive spending. If money is raised at the federal level, but states have some authority to determine how much money is spent, there will be pressure for overspending, because states pay only a small fraction of the additional cost they incur. It is a tragedy of the commons where states gain incentives to overfish the federal budget.

IV. THE CURRENT FEDERALISM FRAMEWORK IN THE UNITED STATES

A. Historical Transformation from Constitutional to Cooperative Federalism

The American nation began with the constitutional federalism model and has largely shifted to cooperative federalism. The shift was accomplished in the 1940s in the New Deal, the period of comprehensive reform in American government that followed the Great Depression. The decline of constitutional federalism—the market for governance among the states-- paralleled the greater enthusiasm for centralized government and the relative loss of enthusiasm for markets.

B. Slight Revival of Constitutional Federalism

The United States has experienced a slight revival of constitutional federalism. A decade ago, in *United States v. Lopez*³ the Supreme Court was confronted with the question of whether the federal government could ban the carrying of guns 1000 yards from a school. The Court invalidated the federal regulation, holding that the federal government cannot regulate non-economic matters that do not affect more than one state. The extent of this revival is unclear and uncertain given subsequent cases.

C. The Continuing Importance of Cooperative Federalism

But mostly in the United States today, the federal government continues to have essentially plenary power over public policy matters. In some areas, it chooses to exercise this power through schemes of cooperative federalism. In the United States there are two distinct kinds of cooperative federalism.

³ 514 U.S. 549 (1995).

1. *Fiscal Federalism*. The first are programs which we may label fiscal federalism.⁴ Here the federal government provides money for a program on the condition that the states perform certain functions. Sometimes the requirement is for the states to provide money of their own as well as services. Thus, in funding the Medicaid system, which is our system of taxpayer-funded public health care for poor citizens, the federal government pays for a certain amount of service and the states do as well. In such programs of fiscal cooperative federalism, the government also generally imposes requirements on how the states can structure their own programs. Such conditions are part of the Medicaid system, for instance, where federal government requires the states to provide certain benefits to poorer citizens as part of the package of services.

It should be noted that the states are not required to participate in most fiscal cooperative programs, like Medicaid, but the financial incentives are such that all of them do. The “voluntary” nature of the program combined with funding so substantial that the program is “an offer the state can’t refuse” is characteristic of fiscal cooperative federalism -- American style.

The theory behind this kind of cooperative federalism is that the federal government should contribute largely to the funding so as to equalize funding among the states, but it should in effect buy the services from the states, because the states, being closer to the people, can deliver services more efficiently.

2. *Regulatory Federalism*. A second kind of cooperative federalism is what one might label “pure regulatory federalism.”⁵ In these programs, the federal government provides a federal agency with the authority to regulate a particular area. But it will forbear if the state comes up with a regulatory plan that the federal government deems acceptable. For instance, the federal legislation may require abatement of a certain pollutant and delegate to the Environmental Protection Agency (“EPA”) the authority to establish a regulatory plan to accomplish this goal. But in a cooperative federalism scheme the federal legislation also gives the states the first opportunity to design the regulatory plans affecting their citizens so long as these plans meet with EPA’s approval.

The basic theory behind regulatory cooperative federalism is that the federal government should set national standards because spillovers from activity in one state affect another. Yet states should have the opportunity to frame the specific regulations because this permits them to experiment and to tailor regulations to their own particular circumstances. Federal approval of these regulations in turn assures that they are adequate for the federal purpose.

V. Structural Solutions to problems of Cooperative Federalism in United States and Their Applicability to Australia

⁴ Hills, *supra* note 2, at 865-866.

⁵ *Id.* at 867-866.

I have tried to lay out the theory of federalism, both constitutional and cooperative, and to describe the basic kinds of cooperative federalism in the United States. I now turn to practical lessons from the United States that might advance federalism in Australia. Because so little is left of constitutional federalism in the United States, I focus my attention to cooperative federalism.

I first look at structural solutions to advance accountability and competition in cooperative federalism and then at programmatic ones. By structural solutions I mean cross-cutting principles that have general applicability to all programs of cooperative federalism. I think the structural approach possesses certain advantages in improving cooperative federalism. Trying to build in safeguards program by program may tend to fall victim to a problematic dynamic inherent in cooperative federalism. Politicians do not necessarily welcome accountability and interest groups rarely welcome competition. Thus, if cooperative federalism improvements are left to the details of particular programs, they may well be neglected. Only by raising these concerns to a level of structure is a Party likely to get credit for its position, and only if the structure is available to discipline day to day politics are accountability and competition likely to be advanced.

A. Taxing Power

The first structural reform suggested by the United States experience seems to me to restore taxing powers to the states in Australia. Because the states in Australia, unlike the United States, have lost their income taxing powers, the scope for state action seems even more reduced than in the United States. To an outsider, the tax structure in Australia does not seem to be in keeping with a federal system. Moreover, the lack of revenue raising ability in the states may make states even more unhealthily dependant on the federal government in schemes of cooperative federalism than they would in a system where they could at least raise revenue.

Without revenue, states will not be able to undertake innovative parts of a scheme without getting money from the federal government. Moreover, it will give them little choice but to petition the federal government for more funds. Their inability to tax may paradoxically contribute to growth of government overall, because states will continually seek to get more from the federal government in cooperative federalism programs than their citizens pay in. Thus, one bit of advice from America would be to work out a way of giving the states more revenue raising power.

B. Judicial Reforms

The Supreme Court has throughout American history been the arbitrator of the relative powers of the federal and state governments. As mentioned above, the pendulum has swung greatly to the federal side, with very few restrictions on the power of the federal government. Now the judicial focus has shifted largely from the question from the *scope* of federal power to the *manner* in which the federal government can exercise its authority. Thus, the Court today is not so much regulating constitutional federalism as working out the background principles of cooperative federalism. Its current jurisprudence should be relevant to cooperative federalism in Australia.

1) *Attempts to Mitigate Problems of Accountability.* The Supreme Court has attempted to mitigate the worst problems of accountability in *New York v. United States* and *Printz v. United States*. In *New York v. United States*,⁶ Congress had ordered the New York legislature to pass a state law taking title to radioactive waste. The Court struck this down, saying that the federal government could not “commandeer” state legislatures. The Supreme Court essentially reasoned that the risk of confusing lines of accountability became too great, if state law were a direct product of federal law. Each set of officials—state and federal-- could blame the other for the controversial policy, because each could point to the other’s law as being responsible.

In *Printz v. United States*,⁷ Congress had required state officials to do background checks on people buying guns. There the Court prohibited the federal government from conscripting state officials into the enforcement of federal law. Two possible policy rationales for this case suggest themselves. One is again the confusion of accountability: if state officials enforce a law, citizens are likely to think the law is state rather than federal. The second is opposition to off budget spending. By getting state officials to enforce the law, Congress is avoiding the hard choices on enforcement spending.

As I understand Australian jurisprudence, the Commonwealth is not allowed to order states to pass state laws to accomplish federal objectives—the practice that the United States Supreme Court has banned in *New York v. United States* as part of its ‘anti-commandeering’ principle. In contrast, my impression is that the Commonwealth can make use of state officials without their consent to help enforce Commonwealth law, a practice our Supreme Court has also banned. This latter practice blurs lines of accountability and imposes unfunded cost on states. On the other hand, states may like the practice because it gives them some discretion in how federal law is enforced. In any event, the Australian High Court quite rightly is unlikely to follow the United States Supreme Court and overturn settled constitutional doctrine.

2) *Rules of Statutory Construction to permit states more say in design of programs of cooperative Federalism.* The Supreme Court has adopted a so-called clear statement rule requiring that obligations on states to be clearly stated or they will not be enforced. The concern motivating this rule is that Congress can slip in ambiguous and opaque obligations in legislation without fair notice to the states. The rationale behind the rule is that the requirement of clarity will give state officials’ notice to mobilize political opposition to burdensome or unfair obligations, thus giving some structural protections against federal dominance. In Australia the *Acts Interpretation Act* might be amended to reflect this principle.

B. *Legislative Reforms: Prohibitions of unfunded mandates.*

Under Cooperative Federalism Congress can pass statutes prohibiting federal legislation directing the states to take expensive actions without providing the requisite funds. There was widespread support for such a rule in the 1990s and the

⁶ 505 U.S. 144 (1992).

⁷ 521 U.S. 898 (1997).

Republican Congress in fact passed the so-called Unfunded Mandates Act of 1995. In the United States such constraints on the form of legislation can be enforced through points of order that individual legislators can raise against the legislation. Unfortunately, the Unfunded Mandates Act has many loopholes and has not been widely regarded as very successful.

But in principle such an act could be a very sound reform. It would require the federal government to fully pay for the services it is buying from the states. If the federal government exercises authority in an area, it is a matter of national provision, and thus it should pay for the services that states provide on the theory that they can do so more efficiently. Of course, the federal government should be able to provide incentives, including monetary incentives, for the states to act efficiently, as I will discuss below, but it should not have the authority to order the states to provide services without payment. That kind of authority makes the federal government a kind of dictator in a command and control economy in which states are mere serfs.

I think some kind of unfunded mandate act may be the most important structural constraint on cooperative federalism that a national government could impose on itself. In the Parliamentary system, like that of Australia, where the Government of the day controls, at least, the lower house of Parliament, such a legislative measure might be successful.

D. Executive Reforms.

In the United States system the executive branch can promote the values of federalism as well. President Reagan promulgated a Federalism executive order which has been continued by all subsequent Presidents with relatively minor variations.⁸ For instance, it requires that federal agencies grant states maximum flexibility in complying with the federal mandates. It also attempts to make sure that any federal requirement that an agency imposes related to a federal grant be used to fulfill the objective of the grant. This provision of the order can be seen as way of preventing agencies from imposing unfunded mandates on the states.

While in Australia there is not the sharp separation of powers between the executive and legislature that exists in the United States, there may still be a role for a new cabinet to play in advancing federalism values. In the United States, the national bureaucracy is indifferent or hostile to federalism values. It is not too much to say that federal agency bureaucrats regard themselves as the elite, and their state counterparts, at best, as less sophisticated country cousins, or at worst, as rubes. As a result, the national bureaucracy is hardly likely to pay much attention to values of federalism unless pressed. And the bureaucracy will not be pressed, unless there are standing orders from the government's highest democratic authority for all agencies to take these values into account.

⁸ Exec. Order No. 12,612, 3 C.F.R. 252 (1987), revoked by Exec. Order No. 13,132, 3 C.F.R. 206 (1999), reprinted in 5 U.S.C. 601 (2000).

Thus, it might well be useful for a future Australian government on coming to power to issue federalism guidelines to accomplish similar objective to the federalism executive order in the United States. In particular, the order could make clear that the federal government should not establish uniform regulations, where there was not substantial interest in uniformity, and instead encourage regulatory competition among the states in programs of cooperative federalism.

VI. Programmatic Ideas from American on Cooperative Federalism

Let me now turn to a number of practical programmatic strategies that the United States has actually undertaken in the area of cooperative federalism or have been suggested and assess whether they would improve the accountability and competition, the most important objectives in my view of any federalism scheme, and lessen the threat of excessive spending, a characteristic danger of fiscal cooperative federalism.

A. Block grants.

The Reagan administration attempted a so-called New Federalism initiative, which replaced federal grants for individual programs with block grants—i.e. subventions of money given to states and not tied to any particular program. I have been told that this program is similar to that proposed by the current Australian government. The advantage of such a scheme is that it permits states maximum flexibility to spend money on the objectives they want. This flexibility potentially increases competition among states and permits satisfaction of diverse preferences. On the other hand, it might be thought to diminish accountability, because states are essentially able to spend free money on whatever they want. As a result, it also in some tension with limited government because it leads to greater spending than if spending were more closely tied to the raising of taxes.

One other point emerges from the American experience: block grants seem peculiarly vulnerable to elimination in fiscal downturn turns. Because the programs block grants support are not well defined, interest groups are less likely to support block grants than more targeted programs.

B. Substantial Flexibility within a program.

Somewhat akin to block grants are federal programs that provide resources in particular areas with few strings attached. The most recent example is the United States is a program for children's health care-- the State Children Health Care Program or SCHIP program.

As described by supporters, SCHIP is a shining example of cooperative federalism: "SCHIP represents an ideal administrative experiment in federalism on two levels. First, it provides the states the choice between three administrative structures for providing health insurance to low-income, needy children: Medicaid [the medical care program in the United States for poor citizens] expansion, a new "stand-alone" or separate program, and a combination of Medicaid expansion and the stand-alone option. The experiment also allows for variation in eligibility standards,

the design of benefits packages, and the state financial contribution to the program. Secondly, SCHIP creates a new, cooperative, and more equal relationship between federal and state governments. The federal government provides the basic policy framework and the primary source of financing and allows the states to make the administrative decisions.”⁹

It is certainly true that SCHIP has permitted state experimentation with eligibility levels and benefit packages. But like block grants, the no-strings-attached approach may lead to problems of accountability and incentives for greater spending. Some states, like my own state of Illinois, have sought to use SCHIP to cover children from families two or three times the poverty line. It seems doubtful that they could get support for such an expansion of government from state taxpayers for citizens who are hardly poor if the states actually had to pay all the costs of a very expensive program themselves. Moreover, this kind of expansion has represented an attempt to move toward universal health care through the backdoor—an objective obviously opposed to the current administration and not yet approved by the federal legislature.

As a result, I am not sure I could recommend this kind of approach to a party favoring limited and accountable government, but certainly it is standard in the cooperative federalism literature in the United States to call maximum flexibility for the states even when the federal government is paying all or most of the costs. Perhaps one way to limit this approach’s tendency to excessive government is to make states pay for a greater proportion of the services they provide beyond the minimum required by the federal government. Indeed, one could imagine a structure requiring the states to pay a greater and greater percentage the more they exceeded a certain threshold of service.

C. Empowering Citizens as accountability monitors and spurs to competition.

Perhaps a more successful idea of competitive federalism has been a particular provision in the Bush administration’s No Child Left Behind Act. As you may know this Act was an attempt by the federal government to improve the standards of education in the United States. The basic notion was that the federal government would provide resources for the states and in return the states would submit to testing. One provision in the No Child Left Behind act made the resources “portable:” the idea was that money would follow children rather than be directed toward schools directly. Thus, if a child left a school because it performed badly that school would lose money. Unfortunately, most of the portability provisions were limited to disadvantaged or “special needs” children.

Such a portability concept helps advance both accountability and competition.¹⁰ Schools within states that do better by children get more money, and the choices of students and their parents impose accountability on schools.

I should note that this advantage derives not so much from any structure intrinsic to competitive federalism, but from following a sound substantive policy. National imposition of a school choice or voucher scheme would accomplish the same

⁹ *The State Children Health Care Program: An Administrative Experiment in Federalism*: Robert F. Rich, et al., 2004 ILL L. REV. 107, 108. .

¹⁰ See Michael S. Greve, *Against Cooperative Federalism*, 70 MISS. L. J. 557, 605 (2000).

goals. But given that the latter decision is not politically possible, it is true that such a portability provision in a federal education bill uses a substantive idea of classical liberalism—greater choice in schools—to impose greater accountability and competition in a cooperative federalism education scheme. One could imagine similar schemes in other programs, like the provision of health services.

I should also note that interest groups are likely to be arrayed against such competitive notions. For instance, teachers' unions opposed these portability schemes, because they would bring pressure on schools and teachers to perform. As a result, there is some question whether federal governments will succeed in making them central to cooperative federalism schemes.

D. Permitting states to use grants to cut taxes

It has been suggested in the United States that when the federal government gives grants to states, the federal government should permit the states to use the grants to cut taxes.¹¹ This proviso, which to my knowledge, has not actually been put into any federal law in the United States has some advantages. It creates more opportunities for competition—this time along the axis of taxes. It provides a way of using grants that does not increase the size of governments. Finally, it may impose a little more accountability on states, because the citizens may monitor their states' use of "free money" more closely, if they know that the alternative to spending is a tax cut for them.

In the Australian context, this kind of initiative would work better if the states were also given greater revenue raising abilities and could use grants to offset the taxes they raised. Once again one wonders whether it would be possible to institute such a scheme. As a general rule, interest groups press for new programs, but not tax reductions.

E. Creating Competition through prizes rather than grants. One way to create more competition among state in cooperative federalism is for the federal government to offer essentially a prize for states that meet an objective in the most cost-effective or otherwise best way. Recently, for instance, Congress provided funds to the federal Transportation Department for cities that found new ways to reduce congestion and pollution. New York City would have won if its state legislature had been able to agree to a congestion pricing plan. It did not and Chicago won, gaining funds for its innovative public transit plan. These types of "prize" programs will promote clear competition best if they have clear rules and do not depend on bureaucratic discretion.

I should note that this type of prize program is relatively rare in the American context, probably because legislators elected by particular localities are loath to vote for a program in which their locality may lose out. A parliament in Australia with its greater party discipline may have more success in implementing such programs. There is a rich economic literature on when private actors and philanthropists should use prizes rather than grants to stimulate innovation and experimentation. Basically, the literature suggests that when the goal can be well defined ex ante, prizes work

¹¹ *Id.* at 206.

often better than grants. This literature would be a useful guide to employing them in the context of cooperative federalism as well. One could also imagine “prizes” within grants, where states are given incentives to meet benchmarks and the like.

F. *Cooperative Regulatory Federalism*

I want to say a little more about cooperative regulatory federalism, both because I understand that this is not prevalent in Australia and yet is relatively common in the United States, but also because it seems to me one of the most promising kinds of cooperative federalism. As I mentioned, cooperative federalism of the regulatory kind comes when Congress delegates authority to an agency to regulate but permits the agency to decline to apply its regulations in a particular state if that state regulates and enforces those regulations in a manner that meets with the federal agency’s approval. Most regulatory federalism comes in the environmental area in the United States, but there is no reason in theory why it is necessarily so limited.

Successful cooperative federalism in the regulatory area must meet two conditions in my view. First, there must be substantial externalities or spillovers from one state to another. If a matter has primarily intrastate effects, it is not the business of the federal government. Second, if the costs of regulation are substantial, the federal government should reimburse the states, although the federal government might want to provide incentives for the states not to spend excessively. Regulatory federalism should not be an excuse to slough off costs on the states. But if these two conditions are met, regulatory federalism could be successful, because it makes use of the states’ greater local knowledge and yet makes sure that they cannot pass on the costs of non-regulation to other states in the union.

Most criticism of cooperative regulatory federalism has come from those who believe that the federal government simply cannot monitor the performance of state regulators. Even if the regulations may be good on paper, they may be deficient in practice.¹² And the federal government cannot ascertain whether this is the case without investing time and effort that rivals the effort that the federal government would undertake for direct regulation. Moreover, the reason federal involvement is needed in the first place is that states have the incentives to underregulate in the area, because some of the costs of underregulation are borne by other states. Thus, one might expect that states will systematically underenforce state regulations that are sound in principle.

In favor of cooperative federalism is the observation that the environment has substantially improved in the United States during the pendency of cooperative federalism in the environmental area. But some critics attribute that improvement wholly to direct federal regulation of polluting sources. I do not know of good empirical work to settle this question.

But this analysis suggests that regulatory federalism will work best when the federal government can easily measure the outputs (i.e. the results) of state regulation rather than have to monitor the inputs of that regulation. Fortunately, technology here

¹² See, e.g., Richard B. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L. J. 1196 (1977)

again may be helpful in making measurement of matters like pollution easier. Then the federal government can make its decision on whether to defer to the states based on objective measures.

VII. Other Nations

I am not a comparativist myself and thus I have largely relied on the American experience to provide ideas of how cooperative federalism can be improved. What I know of two other countries—Germany and Canada—speak more to the dangers of excessive cooperative federalism rather than provide helpful examples of how it can work better.

In Germany the Constitution mandates cooperative federalism in two important ways. First, it mandates a sharing out of revenues among the Lander—the German equivalent of states. Second, it expressly authorizes and encourages state enforcement of federal laws, thus giving more power to state official and bureaucrats. The legislative structure also reinforces cooperative federalism—the upper house is made up of representatives of Lander. It is as if an American state official sat in the Senate.

At least according to Michael Greve, the keenest observer of German constitutionalism in the United States, the results have been very unhappy.¹³ Because lines of authority between the state and federal governments are so blurred, citizens have trouble holding anyone accountable. Because taxes are not collected by the government providing the services, taxes have tended to rise inexorably. An ever larger tax take also keeps the peace between the federal and state governments while impoverishing their citizens.

The current German coalition government agrees. It has introduced and passed some reforms that attempt to disentangle some state and federal authorities and make clear the division between state and federal responsibilities. Thus, I am afraid that the lessons of Germany for cooperative federalism are largely negative. Above all, the German experience warns that it is important to create structures that militate against cooperative federalism's natural tendency to create more spending and confusion in lines of accountability. It certainly suggests that it may be perilous for Australia to undertake more ambitious programs of cooperative federalism before it sorts out the authority of states to raise revenues independently.

Canadian federalism as a general matter is somewhat friendlier to the autonomy of states than either Australia or the United States. I attribute this largely to the presence of Quebec. One needs stronger guarantees of federalism if one is going to protect a distinctive culture that dominates a substantial locality. I believe that this influence has been good for constitutional federalism, reserving more areas to provinces in Canada than are reserved for the states in the United States.

The relevance for our subject of cooperative federalism, however, is that the federal government has fewer exclusive responsibilities, thus opening up areas for cooperative federalism that are unknown in the United States. For instance, Canada

¹³ *Id.* at 569-573.

has cooperative federalism in some immigration matters, whereas in United States immigration is wholly a federal responsibility. In particular, Quebec has undertaken substantial immigration responsibilities.

In my view, this aspect of Canadian federalism also illustrates a danger. Federalism is not about giving more rights to states, but splitting up responsibilities in a way that maximizes benefits to the people as a whole. The question of immigration ultimately bears on the nature of the entire nation, as, once in a state, immigrants can move freely around. Thus, in thinking about cooperative federalism, it remains important to preserve clear and undiluted federal responsibility in areas of distinctively national concern.

Conclusion

Thus, I believe there are a few lessons for cooperative federalism in America that may be useful to Australia. I would be less than candid, if I thought they were likely to dissolve the deep structural problems I have noted in cooperative federalism. While both the legislature and the executive in the United States have announced initiatives, like the Unfunded Mandates Act, and the Federalism Executive order, I know of no scholar who has suggested that their enforcement has yet had very substantial effect in advancing accountability and curbing federal dominance in cooperative federalism. The reasons are those I have already outlined: it is not clear that politicians on a day to day basis have a huge interest in accountability, and federal politicians who are dominant in the cooperative federalism have few incentives to curb their dominance, particularly because interest groups rarely like competition among the states. Competition may reduce away interest groups' exactions on the government treasury and destabilize the regulations that give their members an easy life.

My own view is that this probably leaves us with trying to create structures that will constrain interest groups and make the federal government act more efficiently, including in its use of cooperative federalism. It should be noted that globalization creates many of the conditions of competition that were so healthy for the states in the nineteenth century and imposes them on national governments today. Competition, that is the free flow of goods, and to a lesser extent people, among the developed nations of the world, puts pressure on national governments to adopt good policies. And people still feel an attachment to the nation state that prevents their leaders from blurring accountability and reducing competition by delegating power to international bodies. Thus, oddly enough the policy with the greatest likelihood of improving cooperative federalism in the twenty first century may not be local but international—support for free trade and open capital markets together with support for national sovereignty on all regulatory and other matters that are of national concern and not the proper concern of the international community.