INTRODUCTION

What explains patterns of centralization and decentralization in federations? Accounts often pit those who stress structural factors as the demographic make-up of the polity, against others who emphasize critical junctures and temporally rooted explanations familiar to historical institutionalists. Each on its own, however, cannot sufficiently account for change in federations. To explain change more fully, in this article we bridge these intellectual terrains to recognize the interactive effects that institutions and agents have with underlying structural factors that together propel the evolution of federal systems.

In this integration, we bring to the forefront two variables that have been somewhat overlooked in contemporary structuralist and institutionalist accounts. First are political economy variables and second are political parties. Put succinctly, we argue that political economy variables shape the nature of the active party system, which in turn influences the degree of centralization and decentralization in a federation. To advance this theory, due to their contrasting trajectories of federal evolution, Australia and Canada take centre stage. As argued by Bruce Hodgins (1989: 19) and his collaborators:

The British North America (BNA) Act of 1867 provided for a more centralized form of federalism than the Commonwealth of Australia Constitutions Act passed in 1901 and yet over time, despite the expectations
of the founding fathers, Canada has tended to *move erratically* towards a much more decentralist operation of government, while Australia has shifted in the opposite direction.

Where Australia moved uniformly towards centralization through a series of staggered steps, Canada experienced intermittent periods of centralization and decentralization before coalescing into a decentralized federation, presenting an interesting puzzle for us to explain. These different endpoints, at odds with the two countries’ beginnings, present an interesting puzzle in need of explanation.

A number of metrics can be deployed to measure the degree of centralization and decentralization. Here we focus on the allocation of taxation authority in the fiscal architecture. The allocation of taxation authority lies at the heart of all federal systems as it determines the relative revenue raising capacities of the various governments, establishes the degree of autonomy and independence that can be exercised by the respective governments, and directly impacts these governments’ ability to act in their respective spheres of competencies (Boadway and Shah 2009).

Our argument is that the root of these distinct centralization-decentralization trajectories lies in variations in the two countries’ respective economic systems. Australia’s model of economic development was more conducive to the creation of a strong left party at the national level that favoured centralization. In the meantime, Canada’s regionalized economic development model created a favourable environment for the emergence of regionally-based party systems, while somewhat impeding the rise of a powerful leftist party at the national level that consistently advocated in favour of centralization. Combined together, these conditions in Canada generated the fluctuations
between centralization and decentralization and the subsequent disparities in the degree of fiscal autonomy enjoyed by the Australian States relative to the Canadian provinces.

We advance this argument in five parts. The article opens with a snapshot of the puzzle and a critique of the different approaches that have been used to explain it. The second section presents our theoretical framework. Section three outlines the influence of political economy on the party systems before section four details the role that these party systems had on the allocation of taxation authority in Australia and Canada. We conclude with a discussion of our findings.

I – The Puzzle

The designers of federations face a multitude of choices as they endeavor to create a central government that is simultaneously strong and limited while striking a balance between centrifugal and centripetal forces. Of all the decision points, crafting the fiscal architecture carries considerable weight in the balance of power, and federations differ widely in the ways in which they have chosen to apportion revenue-raising responsibilities (Watts 1999).

Looking at Australia and Canada, we find these two countries fall on opposite ends of the centralized-decentralized continuum. Today, Australian States have no direct access to income, corporate or general sales taxes and rely extensively on grants from the Commonwealth government. The Canadian provinces, in contrast, can access essentially the same taxes as the federal government, from personal income taxes and corporate taxes to social insurance and sales taxes (Boadway and Shah: 2009: 157). Australian States thus enjoy little fiscal autonomy from the Commonwealth while the Canadian
provinces can determine an impressive proportion of their own fiscal destinies: “The capacity of the Canadian provinces to pay for their expenditure responsibilities from their own revenue sources is greater than that of their counterparts in most other federal systems” (Bakvis et. al. 2009: 140). How can we account for these dramatic differences?

The first explanation would ask us to consider the original configuration of the fiscal architectures. If Australian States saw their fiscal autonomy circumscribed while Canadian provinces enjoyed expansive fiscal independence, the current conditions would be neither unexpected nor interesting. An examination of the initial accords, however, demonstrates that States and provinces in both federations had access to similar taxation authority. It thus seems that: “knowledge of the formal legal framework for the assignment of fiscal power . . . does not appear to be a useful basis for predicting the actual, contemporary assignment of either tax or expenditure responsibilities” (Winer 2002: 96).

We could also consider the societal attributes of the two federations. Jan Erk, for example, has argued that over time federations gradually evolve so that they come to be congruent with the underlying socio-linguistic structure of a federal polity (Erk 2008). Those with territorially based linguistic heterogeneity tend to decentralize, while linguistically homogenous ones centralize. Australia’s centralized fiscal arrangements have thus emerged due to its relatively homogenous population and mono-national identity while Canada’s fiscal architecture gradually evolved to become more congruent with its bilingual and multi-national polity.

Probing into Canada’s history, however, we uncover facts that lead us to nuance the narrative. Some of the earliest and staunchest defenders of provincial rights came
from the Anglophone provinces and certain premiers were later fierce defenders of provincial autonomy (Russell 2010: 26). While Quebec was undeniably the most stalwart opponent of federal incursions, it consistently had a number of important allies in other provinces. The history of federalism in Canada thus cannot be reduced to a simple fight between a federal government and nine predominantly Anglophone provinces promoting greater centralization and a Quebec government impeding such development (Simeon and Robinson 1990).

Finally, differences could be the result of court decisions. A common argument in Canada is that the Judicial Committee of the Privy Council contributed to the decentralization of Canada's federal union while in Australia, analysts pin centralization on the High Court of Australia. Certain scholars have nevertheless challenged the emphasis on courts. Alan Cairns (1971: 319), for one, argued: "it is impossible to believe that a few elderly men in London deciding two or three constitutional cases a year precipitated, sustained and caused the development of Canada in a federalist direction that the country would not otherwise have taken." While the courts have undoubtedly played a role, there are two important limits to this perspective.

First, as argued by Patrick Monahan (quoted in Baier 2006: 162), "it is always possible to do indirectly what you cannot do directly." Court decisions do not preclude the emergence of political bargains and adjustments. The 1984 decision of the Supreme Court of Canada that offshore oil was a federal responsibility, for example, did not prevent Conservative Mulroney government and the province of Newfoundland negotiating an agreement that granted control to the province over this resource. Second, such a perspective depicts courts as isolated from debates in the political sphere, when
they are in fact not immune from such pressures. Reflecting on the Australian case, as Gerald Baier (2006: 53) opined: "the High Court's balanced centralism was always a pressure release for the more overt centralism coming from the political process, particularly during period of Labor Party Rule.” Consequently, court rulings are not the lone explanatory variable. How then can we account for the contrasting patterns in these two federations?

II – Theoretical Framework

While one cannot deny the importance of language and national identity, not all debates in federations are driven by cultural variables. Also relevant are economic conditions and, in particular, the often-unequal geographical distribution of wealth and resources and the different models of economic development deployed by a country. As Richard Simeon (1989: PAGE) once declared:

> to fully explain change we are driven to revive our interest in societal forces and in political economy. It is these forces - domestic and international - which provide much of the energy and raw material which elites mobilize. It is impossible to understand major shifts in the federal system without exploring such factors as global economic forces as they interact with the regionally differentiated domestic economy and territorially defined institutions (...). Nor can we understand federalism without looking at changes in the domestic society and economy (...).

In his book with Ian Robinson (1990: 15), Simeon contended that in a country like Canada, with significant regional diversity in resources, “changing global terms of
trade also shift the terms of trade- and hence the source of political conflict- within the Canadian federal system”. Using the example of the 1970s energy crisis, which pitted workers and capitalists in one region against those in others, the authors argued that regional economic conflict limited the ability of the central government to develop durable “national” solutions, and thereby contributed to a period of decentralization. Current debates between Alberta and Ontario over the strength of the Canadian dollar as a result of Alberta’s oil exports confirm that such an analysis remains relevant today (Bimenyimana and Valée 2012).

Material economic conditions offer a starting point, but economic ideas as manifested in models of economic development are also important. Discussing changes in the federal system in the inter-war period, Mallory (1954: 41) suggested that such ideas contributed to the evolution of Canadian federalism:

Thus a change in the structure of economic theory-from whose assumptions policy is derived- accompanied by a drastic change in economic behaviour and in the nature of the economy, had combined to cut the ground almost completely from under the Canadian federal system. (…) Canadians were forced to find new ends in common, and having found them, to adapt the means – the political constitution- so that those ends could be served.

By highlighting the importance of ideas, Mallory advanced an approach that combined the Innisian perspective on the significance of economic resources with the role of ideas that figures prominently in contemporary works on political economy and historical institutionalism (see: Blyth 2002; Bradford 1998).
Attuned to the problem of determinism that often bedevils structural accounts, Simeon and Mallory recognized the importance of agency via political actors. Changing economic conditions transform into the “energy and raw material which elites mobilize” (Simeon 1989) while changes in the economic structure influenced the workings of the party system (Mallory 1954). Reflecting on Canada, Mallory determined that national economic policies could not hide the highly regionalized nature of the economy and provincial governments thus began to play a greater role in economic affairs. Provincial politicians entered into direct relations with business leaders, strengthening provincial parties relative to their federal counterparts. Ultimately, this “change in the party machine [was] one of the most important causes of the shift in the centre of power in the federal system away from the Dominion and towards increasing provincial autonomy” (1954:43).

Mallory’s work anticipated William Riker’s contribution to the study of federalism. For Riker (1964): “the proximate cause of variants in the degree of centralization (or decentralization) in the constitutional structure of a federation is the variation in degree of party centralization.” (Ibid., 129). He believed that if the same, strongly disciplined parties existed at the national and state levels, it would undermine the independent action of the constituent members contributing over time to greater centralization. However, Riker’s approach is ill-suited to explain Australia. In Australia, the degree of centralization of the federal system – including the fiscal architecture – is much greater than the degree of centralization of the party system (Sharman 1994). Consequently, while the structure of party systems plays a role, we need to add a further ingredient to understand the impact of political parties.
A complementary approach considers the ideologies of political parties represented in the system and builds on an important body of literature that has found a strong correlation between the presence and strength of left parties and high levels of state intervention.\textsuperscript{1} Left-wing political parties moreover did not only promote greater public spending. Indeed, as W.A. Robson (1953: 52) argued in the case of Britain, a central characteristic of Labour was its focus on centralization and territorial equality:

One reason is probably an extreme emphasis on equality: if socialists regard the provision of more or better services in one area than another as indefensible anomalies, (…) they have ceased to believe in local government as regards these services.

The influence of left-wing parties can be felt in two ways. First, if elected to govern, such parties can use the opportunity to pass major reforms that can become a lasting legacy in federations. Second, even when out of office, left-wing parties can influence the discourse and ideological currents that flow throughout the party system elevating the salience of socialist ideas, perhaps encouraging other parties to adopt them. This insight draws from the consequences of party competition associated with the work of Anthony Downs (1957). By assuming that voters would support the party closest to their ideal point, Downs located a median voter and predicted that the parties would converge to that voter’s ideal until there were just enough differences between the two parties so that the voter would not be indifferent between the two.

To understand differences in party systems, salient socio-economic cleavages must be considered. The best known-articulation of the relationship between cleavages
and party systems remains Lipset and Rokkan’s (1967) study of the impact of four key cleavages in the development of modern democracies. Mobilized cleavages, in turn, must be connected to the patterns of economic production, or what might be referred to as “varieties of capitalism” (Hall and Soskice 2001), which create different party systems that promote distinct socio-economic interests. Contemporary studies further stress that party systems evolve, and that changes in the party system can lead to the introduction of new ideas and new power dynamics that promote more centralized or decentralized forms of governance over time (Maier 1997). What then was it about the Australia economy that led, contrary to Canada, to a relatively well-organized left party making a strong case for centralization and forcing other parties to adapt? It is this question that we tackle in the next section of this chapter.

III – Political Economy and the Party Systems in Australia and Canada

In the second half of the 19th century, the economies of Australia and Canada had much in common. Both were staples-reliant, peripheral economies that provided raw materials for more industrialized countries. Today, both countries have been classified as typical liberal market economies and/or liberal welfare states meaning they provide a limited role for the state in economic and social affairs (Hall and Soskice 2001). These similarities nevertheless hide major differences not only between the two cases, but also in their approaches to economic production and social protection over time. These distinct approaches had important repercussions on the creation and evolution of their respective party systems.
In Australia, economic development focused on resources (wool and gold) that were not concentrated in one specific region. Communications were facilitated by cheap coastal transportation between port cities and the level of urbanization was much higher than in Canada. There were (and still are) less regional differences in Australia, both in terms of resource endowments and distribution of wealth. Due to its early economic success, moreover, Australia was a prime destination for immigrants from the British Isles. The British influx heavily influenced the Australian system of industrial organization, leaving a lasting imprint on the Antipodean state. The country followed the British approach to skills formation, largely limiting public investment in formal education, and focusing instead on workplace training and apprenticeship. The country experienced a rapid unionization of its workforce and, by the end of the 19th century, had one of the highest rates of unionization. Combined together, these conditions encouraged the emergence of Labour parties before the ratification of the federal agreement.

Pre-federation Australia was neither economically integrated nor guided by a strong consensus about the best model for economic development or the value of federation itself. An economic crisis in the 1890s nevertheless led two factions that had long fought – the free traders and the protectionists – to compromise and accept the establishment of a federal system. Federation, for free traders, meant the end of trade barriers among the formal colonies, while for protectionists it meant a common external tariff, which was to be the main source of government revenue (Norris 1978: 191).

The growing strength of the labour movement, the federal settlement, as well as the economic crisis of the previous decade led to the development of Australia's unique approach to economic production and social protection, which combined high wages for
workers and tariffs to protect industries that made the new federation an early welfare
pioneer defying its contemporary classification as a liberal welfare state (Castles, 1996). This model of economic development remained in place until the 1980s and had a considerable impact on Australia’s party system.

Having secured high wages, unions could look beyond the industrial arena and invest significant resources in the political arena through the Australian Labor Party, which tended to advocate for increased social programs while deriding federalism and decentralization (Huo, 2006: 176). In return, the growing strength of the ALP and declining importance of the protectionist/free trade debate led parties of the right to either join forces (leading to the creation of the Liberal Party), or to form coalitions against Labour (the Liberal-Country Party coalition, in which the Liberal Party represented urban liberal and conservative voters, and the Country Party represented conservative rural voters). High levels of ideological polarization thus marked the Australian party system.

The ALP had a dual objective of nation-building and economic justice. The 1905 convention of the federal ALP presented the party’s key objectives:

a) The cultivation of an Australian sentiment based upon the maintenance of racial purity and the development in Australia of an enlightened and self-reliant community;

b) The securing of the full results of their industry to all producers by the collective ownerships of the monopolies and the extension of the industrial and economic function of the State and the Municipality.\(^3\)

The growing national and social discourse of the ALP helped radicalize the Commonwealth legislature. As argued by Norris, “[a more radicalize legislature] put
conservatism on the defensive, made progressive social measures- emanating from whatever source- more likely, and increased the prospects of success” (1978: 273). Yet, it would be a mistake to see the Liberal Party’s support for centralization as only a reaction to the rise of the ALP. While the Liberal Party rejected the abolition of the federal system proposed by the ALP, it nevertheless continued to favor a centralization of the federal system, due to the popularity of "socially liberal" ideas. As such, parties on both the left and the right of the political spectrum favoured a more centralized federation.

Canadian patterns of economic development led to a significantly different party system. Famously demonstrated by Harold Innis, the major staples at the heart of Canada’s economic development were regionally concentrated and their development sequential over time, with each period of development bringing a new wave of immigration from new countries. This pattern of regionalized development continues in Canada today and the contrast between the two federations is striking. According to a report completed by the Commonwealth Grants Commission (2009: 84), while economic circumstances as measured by GDP are similar between Australian and Canada, “regional differences are greater in Canada . . . Average GDP per capita in the Australian States varies from 85 to 137 per cent of the national average. In Canada, it varies from 71 to 161 per cent of the average.” Regionalized economic development, however, is not the only point of difference between the two federations.

Canada was also less urbanized than Australia, a factor that hindered the development of a working-class conscience. When it finally appeared, the working-class was regionally, ethnically and linguistically fragmented. The regional nature of the Canadian political economy, in tandem with the linguistic conflict, thus contributed to the
emergence of regional and provincially based political parties. In some cases, these regional movements expressed demand for greater federal interventions and centralization as evidenced by the rise in Saskatchewan of the socialist Cooperative Commonwealth Federation (CCF). But, as argued by Young (1997: 220), "outside the wheat belt the CCF could not count on the same support because nowhere else was there as large or as homogenous a group which shared similar economic and social conditions, attitudes, and geography”. As a result, no credible socialist parties emerged nationally in Canada until the 20th century.

Rather than labour, Canada’s party system focused its attention on the needs of the business class: “The most significant characteristic of the two parties which have held power at the national level in Canada is the fact that they share the same conservative values” (Porter 1965: 373). What is more, the different regional economic interests and the heterogeneous character of its population made it necessary for the Liberal and Conservative parties to balance a number of interests, engaging in what has come to be known in Canada as brokerage politics (Jenson and Brodie, 1988). Unlike the ALP, these parties were not characterized by their commitment to any specific ideology, which meant that the party system was not “locked into” the same pattern of interest aggregation generating markedly different party systems over time (Haddow 2008: 232; Patten 2007). It also meant that parties built coalitions based on regional support, pitting the interests of one area of the country against another.

Whereas Australia’s model of economic development stayed in place for most of the 20th century, Canada experienced different “national policies” that simultaneously shaped and were shaped in turn by Canada’s evolving party system (Smiley 1975;
Bradford 1989). The first national policy was premised on the colonization of the west and the development of an East-West economy. Protectionist measures favoured the interests of the more industrialized provinces such as Ontario and Quebec at the expense of the Western Provinces fostering considerable regional resentment. The resentment fuelled the creation of regional parties at the provincial level that pressed for a renewed approach to economic management (Mallory 1954: 42). And so, with the two world wars and the rising popularity of Keynesian ideas of economic development articulated by the emergent CCF, the national party system tilted in favour of centralization.

The second national policy that emerged, while less-protectionist, nevertheless afforded a more active role for the federal government as it set about fashioning the scaffolding of what would become the Canadian welfare state. Such centralization, however, would not endure as the uneasy consensus that supported federal intervention gradually eroded from the 1970s onwards. The federal government’s response to the oil crisis re-ignited regional tensions, subsequently spurring the creation of new parties that advocated neo-liberal remedies. At the same time, the rise of secessionist feelings in Quebec fueled calls for provincial autonomy (Carty et.al. 2000). Put together, these forces pushed for a more decentralized model of economic development. As demonstrated in the next section, whereas in Australia the presence of a strong left contributed to centralization, alterations in Canada’s party system led to oscillations between centralization and decentralization in the fiscal architecture.
IV. Party Systems and Taxation Authority in Australia and Canada

Australia

At federation, Australian States retained control of land and income taxes, whereas the Commonwealth gained control over customs and excise taxes. However, this allocation of taxation authority created a major fiscal imbalance since most resources came from customs and excise. To resolve this situation, the Commonwealth adopted the Braddon Clause whereby for the first ten years after federation, the federal government retained one quarter of customs and excise revenues with the remainder distributed to the States, in addition to any surpluses that the Commonwealth received that went beyond its expenditures (Reinhart and Steel, 2006: 6). Within a few short years, it became quickly apparent that this fiscal arrangement would nevertheless cede greater control to the Commonwealth at the expense of State fiscal autonomy.

Measures adopted to increase the fiscal capacity of the Commonwealth were defended on the grounds of a “national agenda” as articulated by the burgeoning ALP. Indeed, the Commonwealth’s taxation policy cannot be dissociated from the ambitious agenda pursued by the ALP in the early years of the federation. These expenditures by the national government, however, translated into lower revenues for the States since they decreased Commonwealth surpluses, and thus also decreased transfers to the States. Moreover, in light of the popularity of a proposed national pension plan by the ALP, the Commonwealth legislature adopted the Surplus Revenue Act in 1908, largely to finance the plan adopted later that year following the election of the first ALP minority government. Rather than automatically transferring surplus funds to the States, the Act provided that these revenues would be consolidated into the Commonwealth Trust Funds...
and controlled by federal decision-makers (Smith, 2001: 24). The first ALP majority government, elected in 1910, continued to increase social spending on pensions and baby bonuses while increasing taxation revenues through the Commonwealth land tax. Firmly on a centralizing trajectory, some members of the ALP, including Andrew Fisher leader of the ALP in the early 20th century, went even further calling for the transfer of complete legislative authority to the national parliament with or without the abolition of State legislatures (McMullin, 1991: 79-80).

Following the expiration of the Braddon clause, over the next thirty years the Commonwealth adopted different measures to ensure that States would have adequate revenues, ranging from per capita transfers to fixed payments. Unfortunately, these efforts proved insufficient and States were forced to institute income taxes. Due to the fact that the Commonwealth had been occupying that tax field since 1915, this created significant resentment from poorer States that had less revenue raising capacity and had to tax their citizens at higher rates than did wealthier states. During the 1920s and 1930s, considerable efforts were thus made to harmonize Commonwealth and State taxation. In general, the smaller States came to support centralized taxation, as they would benefit while the larger ones registered some unease with the plan (Smith, 2001: 28). Nevertheless, any reticence was overcome as centralized income taxation was also supported by a large section of the ALP, which increasingly perceived territorial disparities as contributing to inequality and inefficiency (McMullin, 1991: 220).

In 1942, a Labor-led government gave the Commonwealth an effective monopoly over income taxation when it passed the *Income Tax Act* and the *States Grants (Income Tax Reimbursement) Act*. Under the terms of the legislation, the first act levied uniform
income taxes across the country while the second act called for the Commonwealth to reimburse the States an equivalent amount on the condition that they permanently vacate the tax space. While a State could continue to impose its income tax, it would pay a double price, having to impose an increased burden on its citizens and loosing federal government grants (Reinhart and Steel, 2006: 8).

While adopted by an ALP government who favored greater centralization and uniformity, it must be stressed that there was an all-party consensus on the initiative as federal politicians from across the ideological spectrum were committed to centralizing the fiscal architecture at the time. As argued by McClean (2004: 24), “in the bipartisan welfarist climate of the 1950s and 1960s nobody except the State governments opposed the income tax power staying at Commonwealth level.” While some States challenged centralization, members of the ALP at the state level impeded the battle against the Commonwealth. “ALP advocates of state rights had a hard time when unificationist tendencies were entrenched not only in many Labor minds but in the party platform as well” (McMullin 1991: 220). To demonstrate, during the 1942 party conference, the members of the New South Wales Labour Party rejected Premier William McKell’s proposal to contest the tax scheme in the courts.

After the war, the Labor government decided to maintain control over income taxation. For Prime Minister Ben Chifley, central control over progressive taxation was akin to redistribution from wealthier States to poorer States (quoted in Smith, 2001: 35). States twice challenged the constitutionality of the Act, but in both cases the High Court found that the legislation was legitimate, as it was deemed to be non-compelling since States could essentially opt out. The High Court argued that control over taxation was a
political question. According to Chief Justice Latham (quoted in Baier, 2006: 52): “The determination of the propriety of any such policy must rest with the Commonwealth and parliament and ultimately with the people. The remedy for alleged abuse of power […] is to be found in the political arena and not in the courts.”

Key to the political maintenance of Commonwealth control over income tax was that it was used to finance new popular social programs. Using revenues from the uniform income tax and a payroll tax, in 1943, the Labor government had created the National Welfare Fund. It substantially increased taxation rates, especially on low-income earners, to develop a national system of income security that included unemployment benefits, widow’s pensions, and child endowment funded at the expense of revenues for the States (Smith, 2001: 35). As argued by Francis Castles (2005: 76), while war provided the impetus for the centralization of income taxes, “it was popular sentiment favouring welfare reform that underpinned these changes and made them, effectively, irreversible.” It was also made possible by an egalitarian philosophy, promoted by the Labour Party, which valued uniformity above diversity (Commonwealth Grant Commission, 2008: 82). Indeed, the ALP discourse had profound consequences on public opinion. In 1941, a poll conducted found that 60% of Australians believed that States should be abolished, while only 22% favoured their retention (McMullin, 1991: 229). Such public feeling thus revealed a favorable climate for greater centralization.

This is not to say that no proposals were subsequently put forward to diminish the level of centralization. Such an opportunity for change arose in 1975 Commonwealth election. During the campaign, the Liberal-National Party coalition advocated a rebalancing of revenue-raising responsibilities, arguing against what they referred to as
“centralist authority control . . . [and] undue concentration of power” (Mathews and Grewal 1995: 14). The platform further specified that under a L-NP Coalition government, the States would be given a specified share of personal income tax revenues to increase their budgetary flexibility and autonomy inculcating degrees of fiscal decentralization into the Australian federation.

Upon gaining office, the new conservative government introduced legislation that allowed the states to either impose a surcharge on a given percentage of personal income tax or to grant a rebate, thus tentatively affording the states greater fiscal independence from the Commonwealth government. In practice, however, this initiative failed to induce any meaningful decentralization as none of the states took advantage of the opportunity. The reason for this failure was straightforward: “the Commonwealth did not make tax room available by reducing its own tax rate” (Mathews and Grewal 1995: 17). It seemed that once the Commonwealth had occupied the room and laid claim to the fiscal resources, even the conservative coalition lacked the necessary willpower to voluntarily diminish their fiscal clout.

Ultimately, two important reforms have been adopted, in areas other than income tax to deal with the significant vertical fiscal imbalance in Australia. In 1971, payroll taxes were transferred to the States. And in 2000, a number of State taxes were abolished or phased out and replaced by a goods and service tax collected by the Commonwealth but subsequently transferred to the States. None of those measures, however, has significantly challenged the centralization of taxation in Australia. Having detailed this trajectory of centralization in Australia, what dynamics appeared in the evolution of the Canadian federation?
Canada

During the early years of the Canadian federation, it was the provinces not the federal government that saw their fiscal prowess ascend (Winer 2002). Provincial expenditures between 1896 and 1913 ballooned and they needed to access a series of lucrative revenue sources. Many provinces thus began to levy direct taxes to cover expenditures creating personal income tax systems, real and personal property taxation, corporate taxes and succession duties. Put together, these activities strengthened the independent fiscal capacity of the provinces, generating 26 per cent of total provincial revenues. But there were regionalized implications of these developments. Such taxes only yielded 9 per cent of provincial revenues in the Prairies and 8 per cent in the Maritimes but more than double as high of the average in Ontario and Quebec (Rowell Sirois 1963: 106).

Somewhat counterbalancing the decentralizing momentum, during World War I, the federal government started levying taxes on personal income and corporate profits. Financing the war thus provided the immediate stimulus for centralization further buoyed by certain emergent nationalistic sentiments in English Canada. The Conservative Party, led by Prime Minister Sir Robert Borden, indicated that personal and corporate income taxes were temporary measures to increase federal coffers. Following the war, however, regional and other salient cleavages reappeared with a vengeance, hindering the emergence of a clear consensus on a common economic policy (Mallory 1954: 42). And so, under the leadership of the Liberal Party, Ottawa began to scale back its rate of taxation freeing up some space for the provinces to reclaim. This marked the first instance of the pattern of centralization followed by decentralization in the Canadian fiscal architecture.
Dynamics in the prevailing party system played a key role in these policy decisions that unfolded from Confederation up to WWII. Whereas Australia already had a strong left-wing tradition operating at both the state and Commonwealth levels, such parties had not materialized in Canada. Instead, political contests played out largely between the Conservatives and the Liberals who shared certain predilections and generally eschewed policies that reflected socially inspired ideas. In lieu of direct state provision, for example, capitalists carried out much of Canada’s infrastructure development where even Canada’s railway was not built by the state: “the half-hearted policy of building it piecemeal as a public work was discarded and in 1880 a group of capitalists agreed to undertake an all-Canadian railway to the Pacific as a private enterprise” (Rowell-Sirois 1963: 68). This propensity to turn to the private sector reflected the prevailing ideological currents shared in common between the two dominant parties. Where the ALP pursued policies that made Australia a welfare pioneer, the Liberals pursued a “negative policy, avoiding new obligations and striving to cut down existing ones” (Rowell Sirois 1963: 146), further confirming the absence of an influential left-wing voice in the Canadian party system.

While the Conservatives and Liberals demonstrated common ideological predilections, one key point of difference revolved around the preferred balance of powers in the federation. During this first party system, it was the further right-leaning Conservatives that favoured a strong central government while the Liberals advocated for provincial rights (Dawson 1948: 506). Hence, Conservative Prime Minister Sir Robert Borden entered into the arena of direct taxation, somewhat centralizing the fiscal
architecture, while the Liberal government voluntarily reduced its rates ushering in a decentralizing dynamic.

Circumstances nevertheless changed in the 1940s, when Canada embarked on a more determined pathway toward fiscal centralization. Once again, the onset of a war acted as a critical juncture where World War II saw the federal government assume a dominant position in taxation (Winer 2002: 100). The need to finance the war created a window of opportunity for federal politicians to get the provinces to give up their personal and corporate income tax systems in exchange for tax rental payments. Although war was the immediate trigger, the ascendance of federal prominence was reflective of changing material and ideological factors that stretched back to the 1920s.

From the federal perspective, the percentage of Dominion revenues from indirect taxes fell from 90 percent in 1913 to less than 40 percent by 1946 creating an untenable situation that needed to be rectified. From the provincial perspective, between 1920 and 1940, a sizable imbalance emerged between provinces’ expenditures and their capacity to cover costs. This problem was particularly acute in the smaller, poorer, provinces that could not provide their citizens with services of a comparable quality as in other parts of the country. Added to which, the Great Depression had “revealed Canada’s vulnerability to adverse economic circumstances” (Smiley 1975: 45) and further legitimized the idea of centralizing the fiscal architecture of the country.

Changing conditions in the party system also played a meaningful role. Federally, leaders of the Liberal Party had begun to integrate new ideas on state action. “Mackenzie King’s views”, wrote Joseph Wearing (1997: 180), “reflected the new positive liberalism of T.H. Greene and L.T. Hobhouse in seeing the necessity for state intervention as a
means of enhancing the individual liberty of society’s weakest members.” However, as many observers of the Liberal Party have argued, “these steps to the left [were] taken more with a spirit of opportunism than from a basic orientation to social progress and change” (Porter 1965: 373; see also Wearing 1997). What pushed the Liberal Party, a party that had long been the defender of provincial interests, to the left and to adopt a more centralist position?

By the 1940s, populist and progressive parties had emerged on provincial stages and broke into the national arena. While these parties did not coalesce either politically or intellectually, they challenged the prevailing approaches to “federalism, capitalism, the financial institutions, and the monetary system” (Bradford 1998: 28). In particular, parties like the CCF “became an instrument of social change and a progressive force not only in the one province but in the country as a whole where it became a pace-setter in reform legislation” (Porter 1965: 368). During the latter stages of World War II, polls showed the CCF enjoyed a stunning surge in support that inspired Mackenzie King to move leftward (Young 1997: 223). It therefore seems that while the CCF lacked the necessary pragmatism to cope with the variety of attitudes and interests flowing throughout the Canadian population and to secure a majority in the House of Commons (Young 1997: 221), the party and its ideals managed to encourage centralization in the Canadian federation.

This post-war period marked the pinnacle of fiscal centralization in Canada when, in 1955, Ottawa levied approximately 70 percent of all taxes (Bakvis et. al., 2009: 142). With its newfound fiscal clout, Ottawa began to fashion the scaffolding of what became the Canadian welfare state. The reaction of the premiers to this pattern of centralization,
however, “was mixed reflecting the varying economic interests of the provinces, different views about the nature of the federation, and partisan party political considerations” (Lazar 2010: 115). The smaller, economically weaker Anglophone provinces tended to welcome centralization, whereas the larger, economically stronger provinces, in tandem with Quebec, tended to oppose Ottawa’s interventions. The case of Quebec is particularly salient here. When headed by the Godbout government, which was institutionally connected to the federal Liberals, Quebec had agreed to temporarily transfer taxation authority to Ottawa. When led by Duplessis’ Union Nationale, which was not dependent on any federal party, Quebec’s acquiescence to centralization disappeared and the province decided to re-institute its own income tax scheme. Perhaps inspired by Quebec’s innovativeness, Ontario later pressed for a new deal in the tax rental agreements, demanding 50 percent of all the major tax sources and subsequently re-introducing their own corporate tax system in 1957 (Winer 2002: 100). Put together, this contributed to an agenda for decentralization in the Canadian federation.

Centralized fiscal relations thus failed to endure, and shifts in the party system once again played a role. Federally, the centralist-leaning Liberals lost control of the House of Commons in 1957, when the Progressive Conservative government of John Diefenbaker took office. Canadian politics shifted to the right as the CCF saw their support fall to a single Saskatchewan seat. The new prime minister from Western Canada had campaigned on an explicitly decentralist platform: “We believe there can be no national unity in this nation until there is a realization that Federal-Provincial matters have handcuffed the provinces of this nation.” Particularly sensitive to the interests of the western provinces, he further opined: “We believe that the Federal system is today being
challenged by the centralization complex of the St. Laurent Government, and that a healthy division and balance of revenues, as between the Federal and Provincial Governments, must be assured” (Diefenbaker, 1957: np).

Prime Minister Diefenbaker thus ushered in a renewed discourse of decentralization onto the Canadian national stage. After operating for 20 years, the tax rental system was dramatically altered when the Progressive Conservatives introduced in new regime whereby the federal government instituted tax abatements and block grants. Instead of collecting 100 percent of the standard taxes, the federal government left room so that the provinces begin collecting their own taxes. Under the new regime, moreover, provinces could either collect these taxes themselves or have the federal government shoulder the administrative costs. The tide of centralization had thus somewhat abated in favour of provincial autonomy, reflecting the shifts in the party system fostered by the regionalized nature of Canada’s political economy.

The undulating pattern of centralization and decentralization persisted through the 1960s and 1970s, propelled by the shifting electoral fortunes of left-wing parties and the salience of certain economic ideas – particularly Keynes – on the federal parties. The Liberal Party chose to distinguish “itself from Diefenbaker’s Conservatives by becoming the more aggressive champion of social policy expansion” (Simeon and Robinson 1990: 162). The 1970s nevertheless acted as a watershed in Canada’s fiscal architecture when the federal government, now headed by the Trudeau Liberals, gradually lowered its rates of personal and corporate taxes, freeing up further space for the provinces to levy their own taxes directly. Since that point in time, the “proportion of provincial expenditures
financed by own-source revenues has been gradually increasing . . . because provinces have been occupying more and more of the tax room” (Boadway 2007: 111).

In economic terms, rising deficits had forced the federal government to scale back its fiscal support of the welfare state, thus transferring the burden to the provinces. Political events also intervened shifting Canada towards decentralization. In the early 1970s, the minority Liberals had to rely on the support of the NDP to continue governing. When the Liberals first announced their intention to reduce corporate tax rates, the NDP voted against the budget triggering the 1974 election. Following the election, the Party’s share of seats in the House of Commons dropped from 31 to 16. Returned to office with a majority and a mandate to reduce corporate taxes, the Liberals “were freed from the need to maintain NDP support for their policies” (Simeon and Robinson 1990: 219). Furthermore, the rise and salience of the nationalist movement in Quebec was a determined force against centralization throughout the 1980s and 1990s.

Finally, further conflict regarding energy policy generated tough bargaining with the western provinces, and subsequently encouraged the Liberals to consider decentralizing strategies. The creation of the Reform Party in the late 1980s, moreover, ushered in a new political discourse inspired by neoliberalism and the reduction of state intervention, delegitimizing the idea of government programs pulling the other parties toward the right: “The Reform party’s major achievement is arguably to have pulled political discourse and policy debate substantially to the right over the past decade” (Laycock 2002: 140). Put together, these factors and forces spawned a dramatic realignment in the Canadian party system that continues to privilege decentralization.
CONCLUSION

This paper sought to address a straightforward puzzle: Why did Australia, initially designed as a decentralized federation, evolve incrementally into a centralized federation while Canada, structured as a centralized federation, transformed unevenly over time into a decentralized federation? More specifically, why do Canadian provinces have access to a far wider array of taxation authority when compared to their Australian counterparts? Conventional accounts would have asked us consider the original allocation of authority, characteristics of the polity (mono-national/lingual or multinational/lingual), or decisions of the courts. We have argued that, individually, none of these institutional or structural explanations sufficiently accounts for the interesting and unexpected patterns of evolution in these two federations.

The unique and diverging patterns of federal evolution in taxation authority instead can be explained by combining structural and institutional variables with the choices of actors to appreciate the interactive effects of structure and agency as they influence the workings of federal systems. Australia, with its less regionalized political economy and largely stable model of economic development, had conditions that were conducive to the emergence of influential left-wing parties at both the national and state levels. Canada, with its highly regionalized political economy and unstable models of economic development, only experienced intermittent periods of influential left-wing parties at the national and provincial levels. Given that left-wing parties tend to favour centralization over decentralization, the distinctive and divergent trajectories of Australia and Canada’s allocation taxation authority can be explained.
Thinking beyond the confines of these two cases, we have argued that the importance of economic structures and party systems must be re-integrated into the study of federalism. Political economy, as both the economic conditions that characterize a state and the manifestation of ideas of economic development, molds the party system. As the intervening variable “between background social conditions and the specific nature of the federal bargain” (Riker 1964: 136), political parties and party systems play a meaningful role in determining the degree of centralization or decentralization in a federation. Furthermore, while stable, neither of these variables is immutable and changes in either can impact the prevailing dynamics. Some economic structures appear more conducive to the emergence of certain configurations of party systems. We further pinpointed the importance of the ideologies that political parties articulate at particular points in time. Specifically, left-wing parties articulate a discourse of social justice and equality while promoting investments in social programs, which together generates a propensity to favour centralization over decentralization in federal systems.

Admittedly, while additional research is needed to confirm these hypotheses we nevertheless believe that our analysis of the Australian and Canadian cases demonstrates the importance of considering the interaction between party systems and economic structures to explain the evolution of federal states. Bridging these analytical terrains helps us to break the shackles that have accompanied the struggle to articulate mono-causal explanations that, while elegant, fail to capture the complex and complicated dynamics that unfold during the evolution of federal systems.
References


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1 On the left impact on social policy-making, see Esping-Andersen (1990). On the impact of the left on economic policy-making, see Boix (1998).
Australia had a positive net immigration balance during the period between 1881 and 1900, while Canada had a negative balance. See data in C.B. Shedvin, “Staples and Regions of Pax Britannica,” *Economic Historic Review* 43, no. 4 (1990): 540.