

# Can we reinvigorate the Australian Federation? How?

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# When our two major levels of government work in partnership, our Federation can function well

- ▲ **The standout period for cooperative Federalism was the Hawke/Keating term of government**
  - ▲ Producing (for example) the National Competition Policy, the east coast power grid, a national rail agreement, a measure of harmonised regulation and consumer standards
  - ▲ And mutual recognition of many policies, occupations etc
  
- ▲ **More recent examples:**
  - ▲ IGA on Reform of C'W–State Financial Relations (1999), National Reform Agenda (2008)
  - ▲ IGA on Federal Financial Relations (2011), NDIS Agreement.



# Notwithstanding those successes, the post-WWII drive to centralise power in Canberra has made the Federation increasingly unbalanced

- ▲ It has increasingly blurred the division of roles and responsibilities and created much overlap and duplication
- ▲ It has blurred both political and administrative accountability and incurred significant inefficiency and shortcomings in service delivery
- ▲ The C'W, despite its far greater command over revenues, tends to push its financial problems onto the States – as it seeks to do in the recent Budget
  - ▲ And the States, too, are not above a little cost-shifting to the C'W, *if* they can find opportunities, or to Local Government.



# How did this come about?

- ▲ The fundamental root of the problem is the ***vertical fiscal imbalance (VFI)***
  - ▲ The C'W has come to control over 70% of tax revenues
  - ▲ Whereas expenditure responsibilities are split roughly 50/50
- ▲ This has come about through the extraordinarily wide definition of 'excise' that has resulted from a series of High Court Decisions – denying the States access to nearly all major indirect tax bases
- ▲ And more so by the refusal by the C'W after WWII to allow the States to resume levying personal income tax, which they had pioneered
  - ▲ This was enforced by C'W use of its grants power under s96 to deny the States exercise of their clear constitutional power to levy that tax – this enforcement again sanctioned by the High Court!
  - ▲ And many State politicians have been happy to see the C'W raise most taxes.



# How did this come about (cont'd)?

- ▲ So State politicians have been complicit – happy to let the C'W take responsibility for raising most tax revenues. They willingly gave up a range of theirs for the proceeds of the C'W GST
  - ▲ This actually *worsened* the VFI, although in practice it left the States a little better off
  - ▲ The State taxes forgone were (in general) inefficient, regressive, and mostly not good 'growth taxes'
  
- ▲ Clearly, looking ahead, the pool of resources available to both levels of government needs to be increased, and it will be
  - ▲ Including by broadening the GST base or increasing the rate, or ideally both – of course with compensation to those most affected (especially pensioners and low income working families).



# The direct consequence: proliferation of C'W payments and involvement in areas of State responsibility

- ▲ As reported by the National Commission of Audit (NCoA), as at 1 July 2013 there were 144 agreements in place under the 2011 Intergovernmental Agreement on Federal Financial Relations (IGA-FFR)
  - ▲ Each tying payments to priorities and conditions set by the C'W
  - ▲ Most involving excessive red tape and reporting requirements
  
- ▲ Ten years ago, there were fewer than 100 – still too many – and the proliferation since has been despite in principle agreements on the need to broad-band them, reduce their number and link payments to agreed *outcomes*, or at least, *outputs*
  - ▲ As distinct from *inputs* (e.g. matching requirements) or extraneous requirements of a political character (e.g. schools having to fly flags).



# Why does the C'W use its financial muscle to seek greater involvement in core services?

- ▲ The centralist drive reflects a desire by C'W politicians – and bureaucrats – to drive policy, and be seen to do so, in ‘bread and butter’ areas which are constitutionally the States’ responsibility but are of core importance to the community — and the voters
  - ▲ Notably health and education
- ▲ **There are some legitimate grounds for a (limited) C'W role**
  - ▲ E.g. a desire to ensure all Australians, wherever they live, can access core services (e.g. health care) of at least some nationwide minimum standard, or to achieve a degree of national consistency. And to take a lead in charting broad national policy directions
- ▲ **But also (of course) politics, not just policy, is a driver**
  - ▲ An increasing desire by C'W politicians to deliver benefits to particular groups in the community and be seen by them as *the* sole source of those benefits, i.e. to ‘tag’ them as Federally provided.



# What's the problem with national partnership agreements delivering dollars to core service areas like health and education?

- ▲ **True, these deliver extra funds to areas like health care**
  - ▲ They can also, in the best cases, provide a national policy lead without imposing uniform delivery mechanisms
  - ▲ While allowing a constructive degree of competition among States to spur innovation in service delivery approaches
  - ▲ Which others can then adopt.



# What's the problem with national partnership agreements delivering dollars to core service areas like health and education? (cont'd)

- ▲ **But the C'W, particularly the C'W bureaucracies involved, have increasingly sought to control, prescribe and micro-manage, often down to very detailed operational levels, and thus:**
  - ▲ While agreements should be aimed at achieving agreed *outcomes*, instead they are often in practice focused on bureaucratic processes and controls
  - ▲ They are often very burdensome to comply with (e.g. requiring highly detailed reporting, and may include requirements extraneous to good service delivery)
  - ▲ Often they create tension between levels of government rather than promoting cooperation, and they bloat bureaucracy at both levels
  - ▲ They typically lack incentives or frameworks for pursuing efficiency, and they blur political and administrative accountability.



# There have been periods of successful cooperative federalism in the past: *What can we learn?*

- ▲ As noted earlier, the standout period of cooperative Federalism in recent times was during Hawke/Keating term of government, producing a range of key reforms
- ▲ For more examples see Ken Wiltshire's excellent chapter in the 2013 CEDA volume  
*Australia Adjusting: Optimising National Prosperity*
- ▲ As Ken says, power *sharing* was key to the successes achieved in the past, along with recognition that only C'W–State *partnership*, **not** unilateral C'W exercise of power, could achieve the desired outcomes.



# The lessons for reform from past successes

- ▲ Forget the occasionally heard proposals that we should get rid of the States and adopt a unitary form of government (with some kind of regional underlay)
  - ▲ It won't happen. So accept that we will remain a Federation – in essence a system where sovereignty is divided, but partnership is possible
- ▲ Hence, the States must be treated as the sovereigns that they are, with clearly defined sovereign areas of jurisdiction
  - ▲ Accepting this as the starting point in negotiation over roles and responsibilities in policy making and administration
- ▲ Other ingredients: commitment to rational, evidence-based policy in the national interest, with purely political considerations marginalised; leadership and demonstration of trust; open communication
- ▲ And commitment to *sharing* of resources, including revenues, responsibilities and expertise, to achieve efficient outcomes.



## Some reform *principles*

- ▲ It is to be hoped that the present C'W Government's review of the Federation (via a White Paper) approaches its task on the basis of key principles implied by those lessons from past successes.
- ▲ Reforms to the Federation (presumably via a new IGA rather than constitutional amendment) must be based on:
  - ▲ Mutual recognition of sovereignty
  - ▲ National interest
  - ▲ Subsidiarity
  - ▲ Efficiency
  - ▲ Accountability
- ▲ Based on those, there is substantial scope to reduce overlap and duplication, identify the areas where both major levels of government do need to be involved and to cooperate, and to clearly define respective roles and responsibilities in those areas.



# Areas where joint involvement of both levels of government appears inevitable

- ▲ The most obvious are:
  - ▲ Health
  - ▲ Transport and transport infrastructure (at least on inter-state/ national routes)
  - ▲ Other major infrastructure (e.g. power grids, rail networks, broadband)
  - ▲ The environment, including climate related issues, major river systems
- ▲ There are instructive models overseas for determining respective roles in these areas
  - ▲ In the US, Canada, post-war Germany (see Ken's paper) and the suggestions in the report of the Australian Advisory Committee on Intergovernmental Relations.



# How should agreement on roles in shared areas be approached?

A reformed Federation would incorporate a new model of partnership agreements which would strongly embody:

- ▲ A strategic outcomes focus with agreed outcome objectives and
- ▲ Arrangements designed as a true partnership model, with mutually balanced obligations and contributions
- ▲ Subsidiarity determining the level at which each role is exercised, and sharp clarity about who is responsible and accountable for what
- ▲ Emphasis on efficiency, flexibility, and minimal administrative burdens
- ▲ A major focus on dynamic improvement, stimulated by diversity and a degree of competition across States in policy design and in delivery solutions.



# What are ideal roles for the levels of government?

## **COMMONWEALTH**

- ▲ Leadership on broad national policy directions
- ▲ Leadership on minimum national standards that should be met everywhere (e.g. in health care)
- ▲ Leadership in achieving national consistency where important (especially in business regulation)
- ▲ Provision of funding

## **STATES**

- ▲ Tailoring to local needs
- ▲ Coordination of delivery
- ▲ Policy and delivery innovation

## **LOCAL**

- ▲ Delivery
- ▲ Delivery innovation.



# No reform will last without tackling the cause of the march to centralism: the VFI

- ▲ The Budget's squeeze on future C'W contributions to health (especially hospital) and education funding via the States is apparently designed to encourage the States to press for an increase in the GST (broader base and/or higher rate).
- ▲ The NCoA proposal for the States to again share the personal income tax base is not new, but it is a very good one
  - ▲ It is the only constitutionally relatively secure way to reduce the VFI substantially and to protect the new balance for the future. As well as extending/raising the GST, it should be in the debate.
- ▲ More GST revenue will help resource the States, although it will *increase the VFI* – it adverse effects exacerbated by the distortions of our extreme horizontal fiscal equalisation (HFE) system (a topic for another day).



# No reform will last without tackling the cause of the march to centralism: the VFI (cont'd)

- ▲ Various ways of doing it, e.g. as follows (each assuming that the C'W 'makes room', so total income tax doesn't rise. ATO still administers):
  - ▲ State to receive flat % (say 10%) of each resident's above-threshold income
  - ▲ or simply a % of total income tax paid by each resident
  - ▲ plus scope for the State to surcharge/discount on its own responsibility
- ▲ State politicians would thus have to take responsibility and political accountability for raising their own revenue (at the margin)
  - ▲ And should also better manage and improve yield from their own existing tax bases, notably the best one: payrolls
- ▲ C'W would reduce grants (and extent of involvement in many areas) – and even take back some (or perhaps all?) of the GST proceeds, to the extent of net additional funds States achieve from the income tax.