

Where To for Australian Federalism?

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Jonathan Pincus, Wolfgang Kasper,
Cliff Walsh, and Ken Baxter

Edited by Robert Carling



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Papers presented at the 'Fixing Federalism' round-table,
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**Edited with a preface and overview
by Robert Carling**

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Preface

In May 2008, the Centre for Independent Studies (CIS) hosted a round-table discussion of issues on the reform of Australia's federal system of government. The CIS invited several participants to lead the discussion on selected topics. Their papers are published in this volume, along with an overview of the themes and a scene-setting piece by Robert Carling, the event's organiser.

This work continues the CIS's involvement in issues related to Australian federalism over many years. The round-table was held at this time in view of the heightened public interest in the reform of federalism since the 2007 federal election.

Approximately twenty participants, drawn from academic, government, and business backgrounds, attended the round-table. The authors of the papers published here are experts in federalism, and have a mixture of academic and practical experience in the area.

Contributors

Ken Baxter	Director, TFG International; Former Secretary, Department of Premier and Cabinet, Victoria; and Former Director-General, Premier's Department, New South Wales
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Jonathan Pincus	Visiting Professor, School of Economics, University of Adelaide; and Visiting Researcher, Productivity Commission
Cheryl Saunders AO	Professor of Law, University of Melbourne
Cliff Walsh	Emeritus Professor, School of Economics, University of Adelaide; and Former Director, Federalism Research Centre, Australian National University

Overview

One of the key planks in Labor's platform for the 2007 federal election was the reform of federalism. Since then, the newly elected government has begun implementing its vision of reform through the Council of Australian Governments (COAG) and other intergovernmental fora.

It was against that background that the Centre for Independent Studies (CIS), which has contributed to the debate on federalism over many years, convened a round-table discussion of experts on 5 May 2008. Coincidentally, the CIS round-table closely followed the government's 2020 Summit, at which reform of federalism emerged as one of the salient themes. In that sense, the CIS event proved to be timely.

The CIS round-table did not produce a single blueprint for change in federalism, nor was it expected to. Rather, its purpose was to bring together a range of views on the nature of the problems with Australian federalism, identify suitable remedies, and in the process comment on the scope and adequacy of the Rudd government's planned reforms.

The invited round-table discussion leaders produced the papers that follow in this volume. This overview does not substitute for those papers, but provides a summary of their flavour and themes.

A federal structure is the right one for Australia

One often hears calls for the actual or de facto abolition of the states and local government, and for their replacement by a single tier of regional government. The round-table found no support for such a reshaping of the federation. There was general acceptance of the current structure, although that acceptance ranged from Ken Baxter's somewhat grudging support for it as the 'least worst' option to Wolfgang Kasper's defence of federalism based on its ideals and principles.

Acceptance of the current structure was not merely based on a pragmatic view that constitutional change to abolish the states would be unachievable in practice, but more importantly on a philosophical exposition of the benefits of a federal structure. Kasper sees a federal structure as central to the protection of civil and economic liberty, by virtue of its dispersing governmental power. Cliff Walsh sees the key strength of a federal system compared with a unitary system as being that it enhances ‘citizen empowerment.’ In a similar vein, most speakers saw benefit in a federal structure because of its greater responsiveness to local preferences and capacity for innovation in service delivery.

But federalism is not functioning as it should

While defending Australia’s three-tier structure of government, all contributors saw room for improvement in the way the system functions. In Kasper’s view, the rules and institutions of Australian federalism have evolved in such a way that they do not satisfy the conditions for a successful constitutional system of competitive federalism. Cheryl Saunders regards the system as being ‘not broken’ and Jonathan Pincus describes it as being in ‘rough good health,’ but both see a clear need for improvement.

So, what is the nature of the improvements called for?

What should be the roles and responsibilities of each level of government?

Clarifying the roles and responsibilities of the three tiers of government in the federation is often suggested as a starting point for restructuring federalism. The purpose would be to clarify which functions should be exclusive and which (if any) should be shared; which tier of government the exclusive functions are best assigned to; and within the shared functions, what the roles of each tier should be. In this context, one of Kasper’s constitutional rules for competitive federalism is that ‘each task of government must be assigned exclusively to one level of government.’

Others, however, accept at least a degree of duplication and overlap. To Pincus, vertical competition (that is, between the federal, state, and local tiers of government) is beneficial, and competition on this dimension is inconsistent with a neat separation of responsibilities and

with the avoidance of overlap. Likewise, Walsh sees it as a reality of federal systems that they ‘will not result in, or sustain, a neat and tidy (unambiguous) allocation of roles and responsibilities.’ Nor should they, in Walsh’s view, because vertical competition is beneficial.

Cooperative and competitive federalism

The Rudd government has labelled its version of federalism ‘cooperative.’ While few participants in the round-table were willing to question such a motherhood concept as ‘cooperation,’ there was a general view that intergovernmental competition, both horizontal (between governments in the same tier) and vertical (between the tiers), also has an indispensable role to play in an effective federation. There is such a thing as too much cooperation, and too much of it is inconsistent with federalism.

In Walsh’s words, for example, ‘the case for cooperation needs to be made on an issue-by-issue basis: competition should be the default option in the interests of “the people.”’ Kasper goes further, viewing cooperative federalism as ‘another step on the slide to more centralism,’ and one that will ‘contribute to a further deterioration of public services and to further confusing the citizens about who to hold responsible.’

Uniformity, harmonisation, and coordination

In practical terms, cooperative federalism amounts to the commonwealth and the states working in harmony to achieve greater uniformity, consistency, and coordination in policies and regulation across the states. The business community has been particularly vocal in calling for greater cooperation in these terms to create a ‘seamless’ national economy and to reduce the cost of doing business.

The round-table revealed support for this position only up to a point. Baxter is supportive, reflecting his direct experience of the imperfections in state government service delivery and regulation together with the economic efficiency costs of unwarranted interstate differences. Saunders accepts that the lack of uniformity in some areas outside commonwealth constitutional control represents one problem with federalism, but cautions that each policy area needs to be examined on its merits to determine whether uniformity or differentiation is the best approach. Pincus emphasises the benefits of horizontal competition, which can only accrue if there are limits to uniformity and harmonisation.

Kasper argues that uniformity equates to the exercise of cartel power by governments, which is contrary to business interests.

Achieving national reform through federalism

Several contributors commented on how greater uniformity in government regulation—to the extent it is desirable—and other national reforms requiring intergovernmental agreement could be achieved within the federation. Baxter proposes various changes to intergovernmental processes such as ministerial councils, which he believes should be abolished in their current form. Saunders and Walsh see current processes for the development and implementation of intergovernmental agreements as lacking in accountability and transparency. They suggest changes that would minimise these problems. Saunders argues that constitutional amendment could have a greater role to play than is commonly thought. In her view, this avenue has been unduly discounted as a mechanism for effecting changes to achieve uniformity of laws where justified.

Fiscal federalism

No discussion of federalism would be complete without attention to the fiscal aspects—commonwealth grants, vertical fiscal imbalance (VFI), and horizontal fiscal equalisation (HFE)—although changes in these areas are not prominent in the Rudd government's version of federalism reform. These aspects were explored at the CIS round-table, and most contributors expressed varying degrees of unease about the current arrangements.

Vertical fiscal imbalance

Another of Kasper's constitutional rules for competitive federalism is that 'each government should be responsible for raising the revenue needed to discharge its assigned and self-chosen tasks.' This means there would be no vertical or horizontal fiscal transfers, in sharp contrast to the current arrangements whereby commonwealth grants make up more than 40% of state and local revenue, and their distribution follows the principle of HFE. Kasper calls for the GST to be made explicitly a state tax to overcome VFI. Walsh also identifies VFI as a continuing problem that has not been solved by allocating GST revenue to the

states. He explains why substantial fiscal independence of the states is important to the vitality and workability of federal systems. However, now that the GST revenue has been assigned to the states, any pressure that was present for a reduction in VFI has diminished. In Walsh's view, the states have increased their dependence on commonwealth grants over time by failing to use their own broad tax bases (payroll and land) as effectively as they could.

Pincus, by contrast, does not see VFI as a problem as long as it is held in check. He believes that Australia has 'achieved a reasonable balance between centralisation of tax collection and interstate tax competition' while it is also appropriate that government spending is less centralised than taxation. He argues that despite the high degree of VFI that exists in Australia, the states still have significant tax and spending flexibility at the margin, which is what matters most.

Specific purpose payments

The one aspect of fiscal federalism that has featured in the Rudd government's reforms is tied grants, known as Specific Purpose Payments (SPPs). Round-table contributors generally endorsed changes that will consolidate the large number of existing SPPs and make them more performance-based and less prescriptive. Pincus, however, warned that the overuse of SPPs poses a 'severe threat' to the effective operation of Australian federalism by converting the states into service agents of the commonwealth.

Horizontal equalisation

As with VFI, participants aired contrasting views of HFE. Kasper rejects any role for horizontal (or vertical) transfers within a system of truly competitive federalism. Walsh accepts the case for HFE in principle, but believes there needs to be a fully independent inquiry to redefine the objectives and design a simpler and more transparent system to achieve them.

Conclusion

The diversity of views expressed at the round-table makes it difficult to arrive at a single conclusion. It is clear, however, that while there was a good deal of support for what the Rudd government is attempting to do to change the working of federalism, views were also expressed that the government's reforms are in some respects incomplete in their scope, misdirected, or even misconceived.

Setting the Scene

Robert Carling

Senior Fellow

The Centre for Independent Studies

Reform of Australian federalism—or at least discussion of it—has gathered momentum of late, but it is hard not to think that we’ve been at this juncture before without achieving much, or at least anything positive.

Anyone who is familiar with the history of Australian federalism will remember such milestones as Malcolm Fraser’s ‘New Federalism’ in 1976, the push for reform led by Bob Hawke, Nick Greiner, and Wayne Goss in the early 1990s, and even the Howard government’s ‘A New Tax System,’ implemented in 2000, which had as one of its objectives correcting flaws in fiscal federalism. And now we have Kevin Rudd’s ‘cooperative federalism’—whatever that term means.

Yet, on each of the past occasions I have recalled, ‘reform’ led to more of the same: federalism was eroded in the sense that our system of government became more centralised; vertical fiscal imbalance became more pronounced over time; and the commonwealth became more involved in what were traditionally state areas of responsibility, through specific purpose payments.

Will the outcome be any different this time? *Should* it be any different this time? The second question prompts me to observe that while we have strong representation from the school of true believers in federalism here today, we do recognise that there is also a school that favours more centralisation, or at least a diminished role for the states if not their abolition. No doubt we will get an exchange of views on such fundamental issues here today.

To set the scene, the way I see the current debate on federalism, there are four driving forces for change.

The first is the public's dissatisfaction with the states' performance in delivering services. This dissatisfaction is especially apparent in New South Wales, and especially in relation to the performance of public hospitals, but it is also evident on a broader front, in other states and in other fields of service delivery. Kevin Rudd has tapped into this public mood and is using COAG to pressure the states to lift their game. In health, he is holding over the states' heads the threat of a commonwealth takeover of public hospitals through constitutional amendment.

But there has been very little analysis of the underlying causes of state underperformance. There seems to be an assumption that it is due to the federal division of powers, and an assumption that the commonwealth would do better than the states, but these are little *more* than assumptions. In the prevailing climate of public opinion on these matters, making the case for federalism becomes heavy going for the true believers, but it is all the more important that the case be made.

The second driving force for change is the business lobby's hunger for reform of state taxation and for deregulation and greater uniformity in state regulation. This is the source of calls for abolition or harmonisation of various state taxes and for a 'seamless national market.' The business lobby has a case: some state taxes are prime candidates for abolition or restructuring, there is scope for harmonisation in the way some taxes are applied, and there is a case for less regulation and more coordination in the regulation that remains. But the business lobby tends to overstate its case, paying lip service to the benefits of a federal system while prescribing policies that go in the opposite direction by throwing a blanket of uniformity and harmonisation over interstate differences.

The third driving force is the pursuit of a national reform agenda aimed at improving productivity growth and labour-force participation. This, in a sense, is the sequel to the National Competition Policy, which was applied successfully in the 1995–2005 period. The national reform agenda has its origins in the so-called 'three *P*'s' (population, productivity, and labour-force participation) analysis of long-term fiscal challenges by the federal treasury in its intergenerational reports of 2002 and 2007. The 'three *P*'s' view of the world was championed by Peter Costello, and the Victorian state government was instrumental in developing a related policy framework for COAG to consider.

However, this policy framework was making heavy weather under the Howard government. The national reform agenda has been given a new lease of life under the Rudd government, and probably more than anything else defines 'cooperative federalism.' In brief, this agenda consists of agreed commonwealth and state policy objectives and measures in health, education, infrastructure, and other areas to boost productivity growth and labour-force participation, backed up by commonwealth 'national partnership payments' to the states.

Before coming to the fourth and final driving force, I will make the observation that while each of the first three forces has some intrinsic merit and points to a policy issue that needs to be addressed, they could also take us in the direction of greater uniformity and centralisation and in that sense lead to 'reforms' of federalism that weaken it rather than strengthen it. Popular opinion seems to be running against state autonomy; the business agenda favours greater uniformity; and the national reform agenda may also unduly diminish the competitive dimension of federalism.

Missing is the voice of those who believe that the Australian system of government has drifted too far from its federal roots. This is what I call the fourth force for change. Proponents of this view want reform to be based on an acceptance of the fundamental advantages of a federal system and the division of powers that goes with it; an examination from first principles of the optimal allocation of expenditure and revenue-raising powers to the federal, state, and local tiers of government; how the tiers should be funded (the mix of tax and grant revenue); the problems raised by vertical fiscal imbalance; the role (if any) for horizontal equalisation; and so on. Consideration of these fundamental structural features of federalism counterbalances the centralising tendencies inherent in the other forces.

Clearly, the various forces for change are not all pulling in the same direction. How these tensions are resolved will determine the nature of the reforms that emerge from the current debate.

The Constitutional, Legal, and Institutional Foundations of Australian Federalism

Cheryl Saunders

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In any federation, there may be a variety of reasons why a federal form of government is used. In Australia, the most obvious reasons include history, geography, democratic potential, and opportunities for policy innovation and experimentation. Federalism also is important in Australia as one of the few institutional checks and balances. If federalism were abandoned, or even seriously weakened, it would have implications for Australian government as a whole.

There appears presently to be widespread agreement that Australian federalism does not work as well as it should, although the rhetoric that it is ‘broken’ and therefore must be ‘fixed’ goes too far. The challenge, therefore, is to consider what the problems are, what changes are needed, and how they might be given effect. My premise in the remarks that follow is that a federal form of government is appropriate for Australia, so that a move to a unitary system is not a solution to whatever difficulties we face.

In some respects, moreover, the particular present structure of the Australian federation suits the needs of the country and its people reasonably well. Australia has a relatively small number of centralised states spread over a very large landmass. All provide representative democracy through a broadly similar system of parliamentary responsible government. Power is allocated between the various orders of government for federal purposes in a way that assumes and complements democratic institutions. Each order of government has legislative, executive, and judicial power within its own areas of authority. Each

has corresponding institutions, through which the chain of democratic accountability runs.

This design assumes what we know is no longer true, that orders of government within a federation can operate in relative isolation from each other. Nevertheless, the combination of a small number of states with parliamentary responsible government also gives Australia a greater capacity for intergovernmental cooperation than is possible in some other federations. The structure of the Australian federation thus facilitates policy harmonisation and other forms of interaction between governments, without change to the formal allocation of federal power. Harmonisation, in turn, is widely perceived as a good in a country with a small population, at a considerable distance from major world markets, in which the component states and territories are relatively homogeneous.

These characteristics of Australian federalism have disadvantages as well. The lines of democratic accountability are muddled by inter-governmental arrangements in ways that affect both the commonwealth and the states. The greater efficiency in the operation of the federation that a small number of centralised states and territories offer is achieved at the expense of more responsive, localised democracy. The passion for harmonisation through cooperation dictates policy direction, undervaluing innovation and diversity and undermining the states as a significant order of government. And the passion, in any event, is hard to satisfy by these means. One of the most vocal criticisms of Australian federalism in its current form is its inability to deliver uniformity quickly enough and deeply enough across an ever-expanding range of policy areas.

Alternative federal structures

Two major alternatives to the Australian federal structure are suggested from time to time, each of which would create more difficulties than it would resolve.

The first proposes the replacement of the present states and territories with a larger number of regions. Usually, it is envisaged that such regions would replace local government as well, leaving Australia with two tiers of government, improbable as this may seem in a landmass of this size and configuration.¹ Despite the frequency with which this

alternative is put forward, it is inherently ambiguous, complicating serious consideration of it. For some, the proposal involves creating a unitary system of government in Australia with power devolved by the centre to the regions, as a more powerful form of local government. For others the proposal involves the opposite: deepening the federation, by creating more units exercising power in their own right at the sub-national level of government.

For me at least, the former is unacceptable because of the extent to which it concentrates power. If it were to be adopted, it would require reconsideration of Australian checks and balances, with wider implications for the system of government as a whole. On the face of it, the latter would further disperse power, causing significantly greater policy fragmentation than at present. As this is unlikely to be acceptable either, it can be expected that the regions would be much weaker than the present states in terms of both power and institutions. In consequence, paradoxically, this approach to regionalism also would be centralising in effect.

A second alternative is to restructure the Australian federation along the lines of the German federal model. This would involve two major changes to the present Australian federal design. For the most part, power would be divided between the commonwealth and the states horizontally rather than vertically. In other words, most policy would be made through legislation at the commonwealth level, but most legislation would be given effect, or executed, at the level of the states, where it could also be adapted to local conditions. Similar arrangements would apply in relation to financial resources: most taxation would be centrally raised, but the Constitution would guide the distribution between the commonwealth and the states and between the states themselves. The role and composition of the Senate would be changed to oil the wheels of these new arrangements. In place of directly elected senators, the Senate would comprise representatives of state governments, so as to give the states a direct say in the legislation that, in due course, they would administer.

I have often thought that, in many respects, the German federal model would have suited Australia well. It implies such an upheaval in the system of government, however, that it is almost certainly

unacceptable here. The separation of constitutional responsibility for making and implementing legislation runs counter to the assumptions of Westminster responsible government, as it operates in Australia. The Australian senate already has a useful role as a house of review in a parliament otherwise dominated by two tightly organised political parties. It is noteworthy also that in Germany itself recent changes to the federal structure are designed to reduce the power of the *Bundesrat*, in which the state governments are represented, and to delineate the federal division of powers more clearly along vertical lines.

Improving Australian federalism

If alternative federal structures are not viable in Australia, it follows that federalism reform should take place within the broad contours of the system that we presently have, in the light of problems that are shown to exist, and in a way that complements the system of government as a whole. At the risk of oversimplification, I suggest that the problems to be resolved are likely to fall into two categories.

One category of problems comprises concern about the lack of uniformity, harmonisation, or coordination in some areas presently outside commonwealth constitutional power, with consequential costs in time, money, and general inconvenience to those whose interests are affected. Areas in which these problems exist include those associated with the national market, but are not necessarily confined to them.

A second category of problems comprises concern about the quality and capacity of state and local governments. To the extent that this concern is justified, an original underlying cause may be the fiscal imbalance, now exacerbated by confused expectations about what states can and should achieve and how they should be held to account. These problems have costs as well. In particular, they detract from our ability or at least from our willingness to realise the benefits of federalism in terms of more localised democracy, experimentation, and diversity.

In what follows, I will concentrate on the first of these categories of problems, which presently attracts the most attention in public debate. I note, however, that the second is equally important and deserves more attention than it gets.

Much of the recent criticism of the lack of coordination in Australian federalism reflects genuine difficulties that Australians have with the

way in which government impinges on them. There has been some work done on this already, from the perspective of the business community.² More is needed, to identify the areas of genuine difficulty and the appropriate solutions with a degree of precision. It may be that the ‘expert commission’ proposed by the 2020 Summit would be a useful mechanism for this purpose.

Questions that need to be asked include the following:

- In what areas of regulation and service delivery is full and deep uniformity needed?
- In what areas is a lesser degree of uniformity, which we might call policy harmonisation, required?
- In what areas can perceived problems be met by reciprocity along the intended lines of mutual recognition?³
- In what areas can inconvenience to people be minimised by collaboration between governments to simplify administration, by enabling a single application to be made for a service or creating a one-stop shop?
- What areas should be handled by state and local governments alone, subject to the usual accountability mechanisms that operate within each jurisdiction, in the interests of more localised decision-making, diversity, innovation, and, potentially efficiency?

Once a decision is made about the effects that are sought from the exercise of power by governments, there is a question about how to achieve the necessary changes. In the interests of simplicity, I will focus here only on changes that require greater uniformity, although the exercise of redrawing the federal boundaries of power is likely to require changes of other kinds as well.

Mechanisms for desirable forms of uniformity

There are three principal mechanisms available for the purpose of providing uniform laws in areas where they do not presently exist.

The first is commonwealth legislation, based on existing commonwealth powers. I do not suggest here a more creative use of commonwealth power of the kind found, for example, in the *Water Act 2007* or the *WorkChoices* legislation. Commonwealth

statutes based on a smorgasbord of powers as in the *Water Act*, or on the corporations power as in *WorkChoices*, are patchy and uncertain in their scope and complex to the point of raising questions from the perspective of the rule of law. For a range of odd, historical reasons, however, the commonwealth's power to make laws for 'trade and commerce among the States,' in section 51(i) of the Constitution, has been narrowly interpreted and lightly used. It may be time to try to resuscitate that power by using it strategically and seeking to persuade the High Court to accept its expanded scope.

A second mechanism for achieving uniformity of law is intergovernmental cooperation. Cooperation in Australia comes in a variety of forms, including the use of section 96 conditional grants as incentives to coordinated action by the states, references of power to the commonwealth by the states in accordance with section 51(xxxvii) of the Constitution, and complex intergovernmental schemes. The network of intergovernmental arrangements is supported by a range of about forty ministerial councils, with COAG as the peak body, and an unknown but large number of intergovernmental agreements, some of which qualify the operation of legislation in practice if not in law. Collectively, these arrangements have achieved significant uniformity of legislation and administration in areas beyond the easy reach of commonwealth power. Notoriously, however, they are affected by a range of problems: accountability and transparency, effectiveness, and most recently, doubts about constitutional validity.

Intergovernmental arrangements present two types of challenges for accountability, each of which affects one of the most basic principles on which the Australian system of government relies. First, many such arrangements affect the political accountability of executive governments to their parliaments, at both commonwealth and state levels. Secondly, many such arrangements affect the legal accountability of public decision-makers to courts and other independent review mechanisms. Accountability and transparency thus are problems in their own right. If these problems were resolved or ameliorated, however, the effectiveness of intergovernmental arrangements almost certainly would be enhanced as well, and in the process, the constitutional questions might be avoided.

Many examples might be given of the ways in which problems of accountability arise. The following identifies some of the most obvious.

The proceedings of ministerial councils on which the effectiveness of much cooperation depends have all the usual characteristics of executive meetings. For obvious reasons, meetings are held in camera. The inevitable shortfall in transparency is exacerbated by the intergovernmental character of the bodies, which fall outside the normal accountability chain and for which no single parliament has responsibility. In fact, steps have been taken in recent years to release more information about the decisions of ministerial councils and to provide a measure of accountability for performance within the ministerial council system itself. These arrangements are still somewhat patchy, however, and the COAG website, on which available information appears, is still off the beaten track of sources about government and law.⁴ As a result, it is difficult to follow policy initiatives that involve a ministerial council process, and impossible to sheet responsibility home for failure to reach agreement where cooperation is necessary or appropriate. The bland communiqué from the Environment Protection and Heritage Council on 17 April 2008, following its failure to reach agreement on the reduction of plastic bag use, is a clear illustration of the difficulty.⁵

Secondly, no jurisdiction keeps reliable track of intergovernmental agreements, even though they are often a form of soft law. There are almost certainly hundreds of such agreements, but the COAG site presently lists only ten as ‘current.’⁶ Agreements typically are not scheduled to legislation to which they relate, even where, as under the mutual recognition legislation, the agreement throws light on how the legislation is expected to work. By way of instructive contrast, the ComLaw website provides access to explanatory memoranda that accompany bills into Parliament; the commonwealth now has a sophisticated system for the scrutiny and publication of all forms of delegated legislation, under the *Legislative Instruments Act 2003*; and an extensive database on treaties to which Australia is a party is now available on the Australian Legal Information Institute (AustLII) site.⁷

Thirdly, the accountability of the commonwealth government to Parliament for intergovernmental and other spending schemes has,

if anything, diminished over time. *Appropriation Act (No 2) 2007–8*, for example, gives ministers a blanket authority to attach conditions to grants to the states under the act, and provides no mechanism for scrutinising its exercise. The commonwealth parliament has never recognised the decision to attach conditions to grants as an exercise of delegated legislative power, despite the stipulation in section 96 of the Constitution that grants are to be made ‘on such terms and conditions as the Parliament thinks fit.’ To compound the problem, in *Combet* the High Court diminished the accountability of government to Parliament for the exercise of the general spending power, by refusing to attach any ‘degree of specificity’ to the purposes for which moneys are appropriated.⁸

One final example concerns accountability for intergovernmental schemes. One particular scheme secures a deep level of uniformity in both law and administration in the following ways. State parliaments adopt a commonwealth law that on its face applies only in the ACT, as amended from time to time in accordance with decisions by a ministerial council. State parliaments transfer state authority to administer that law, within the state, to a regulatory body established by the commonwealth. Through this ‘legislative conflation,’ as Owen Dixon described it when the forerunner of these schemes appeared, state parliaments lose control of both legislative and executive power over the area in question without either clearly being acquired by the commonwealth.⁹ It is now settled that the adoption technique is constitutionally valid, whatever problems of principle it may raise. Doubt has, however, been expressed by the High Court about the extent to which state executive power may be exercised by commonwealth agencies, halting the proliferation of schemes of this kind and encouraging greater use of the reference power.¹⁰

Intergovernmental cooperation without the pitfalls

It would be possible to develop approaches to intergovernmental cooperation that would minimise, if not entirely avoid, these difficulties. An essential starting point is to accept accountability and transparency as fundamental principles to be taken into account in designing all arrangements. In addition, the arrangements themselves must be structured in a way that matches the rest of the system of government as far as possible.

To this end, I do not favour an amendment to the Constitution to confirm the capacity of commonwealth bodies to exercise state executive power in order to overcome the doubts raised about types of intergovernmental arrangements that rely on this technique. The muddled amalgam of power that results would compound accountability problems and contribute to the further deterioration of state institutions. On the other hand, references of power by the states to the commonwealth fit the wider system of government very well. They enable the commonwealth to exercise power over a referred matter in the same way as in relation to any other commonwealth responsibility, subject to the provisions of the agreement typically attached to each reference, which should be scheduled to the referring act. To the extent that there are features of the present reference power that deter its use by the states, these should be identified and rectified, by constitutional amendment if necessary. Alternatively or in addition, the Constitution should be amended to provide a clear and consistent framework for arrangements that require joint action, including the establishment of a national regulator.

Again, a process is needed to develop this blueprint. This might be added to the terms of reference of the expert commission recommended by the 2020 Summit, as long as the commission itself is adequate to the task. In addition, however, there is a need for an independent agency to support cooperation on an ongoing basis. The recommendations of the summit on this point were somewhat less persuasive, to the extent that they envisaged that a 'national co-operation commission' would 'register, monitor and resolve disputes concerning intergovernmental agreements.' In some areas this brief is too narrow, and in others it is too wide. It would be desirable for such a body to have oversight of ministerial council papers and projects as well as intergovernmental agreements. On the other hand, it is probably undesirable for the body to have a dispute resolution function in addition to playing a role in supporting and systematising intergovernmental arrangements. The dispute resolution function is different and could compromise the integrity of the cooperation commission in the eyes of one or more jurisdictions. Moreover, if intergovernmental arrangements are sufficiently transparent, there is no reason why the disputes could not

adequately be resolved in the usual ways, through the political process or by the courts. Attention to the possibility of the latter would have the additional advantage of sharpening the drafting of intergovernmental agreements and causing them to be taken more seriously on all sides.

The third and final mechanism for effecting the necessary changes to achieve uniformity of law in particular areas is amendment of the Constitution itself. For decades, this has been discounted as a solution to problems about the scope of commonwealth power—wrongly, in my view. In any event, it can be argued to be wrong in principle to effect major and effectively permanent changes to the federal distribution of powers without formal constitutional change.

It remains true, however, that the record of success at referendum to change the commonwealth constitution in Australia is bad and getting worse. It may be that the fault lies with the unilateral and top-down process that has typically been used and, sometimes, with the proposals for change that are put. If this is correct, it is desirable to involve the Australian voters at an earlier stage than usual in the deliberative process, dry though the subject matter of federalism is considered to be. In this regard also, the recommendations of the 2020 Summit are useful. They propose a convention to consider the proposals about change emanating from the expert commission. Whether a convention is the right deliberative mechanism remains to be seen. I am inclined to think that in this instance it is, as long as its proceedings are sufficiently publicised, its thinking is adequately explained, and the process is not too rushed.

Conclusion

In many ways, Australian federalism is at an important turning point. Federalism lies at the heart of the Australian constitutional system. It provides the rationale for the written Constitution. It is one of the checks and balances in the exercise of public power. Inevitably, however, the division of power that is a defining feature of any federal arrangement has changed over the years since the federation was established, in 1901. In Australia's case, the change has been effected through unilateral commonwealth action confirmed by judicial review and through a variety of cooperative arrangements. Throughout this period, the text of the Constitution has been largely impervious to change, generally

and in relation to the federal division of powers in particular.

In the first decade of the twenty-first century, there appears to be both elite and public dissatisfaction with the consequences of this evolutionary process. The causes of the dissatisfaction almost certainly differ, complicating effective resolution. Nevertheless, at least in the short term, the response is likely to be a dramatic increase in coordination and harmonisation of government action, largely through intergovernmental schemes. Whatever the other benefits of this response, it will exacerbate the familiar problems of accountability and transparency to which such schemes already give rise. These problems have implications for the system of government as a whole. To counter them, it is necessary now to provide a more structured and principled framework for public decision-making by these means, in recognition of its significance in Australia.

It may be, however, that the time has come for a more focussed debate about the design and future of Australian federalism, so as to identify and clarify genuine problems and to tailor solutions to them. The 2020 Summit proposed one mechanism for this purpose, involving a three-stage process. The process itself calls for a combination of expert advice and public deliberation and is unexceptionable to this extent. Its terms of reference would need to be sufficiently broad, however, to take account of the interdependence of federalism and the rest of the system of government. It would, in effect, be a major exercise in constitutional review.

Endnotes

- ¹ Proposals of this kind surfaced again at the 2020 Summit. See, for example, one idea that was raised in the governance stream: ‘People feel they are over-governed and that having three levels of government is too much. This means we should abolish local government and have only two levels of government. There would then be a need to create more states (as many as 40) to take over the role of current local government.’ Australian Government, ‘The Future of Australian Governance,’ in *Australia 2020: Australia 2020 Summit Final Report* (Canberra: Department of the Prime Minister and Cabinet, 2008), www.australia2020.gov.au/docs/final_report/2020_summit_report_9_governance.doc, 303–351.
- ² For example, BCA (Business Council of Australia), *Reshaping Australia’s Federation: A New Contract for Federal–State Relations* (Melbourne: BCA, 2006).
- ³ See Commonwealth of Australia, *User’s Guide to the Mutual Recognition Agreement (MRA)* and *Trans-Tasman Mutual Recognition Agreement (TTMRA)* (2006), www.coag.gov.au/mutual_recognition/index.cfm#users.
- ⁴ COAG (Council of Australian Governments), *Council of Australian Governments*, www.coag.gov.au (accessed 1 July 2008).
- ⁵ Environment Protection and Heritage Council, ‘Ministers Seek Sustainable Solutions’ (17 April 2008), www.ephc.gov.au/pdf/EPHC/Comm_17_04_08.pdf.
- ⁶ COAG, *Council of Australian Governments*.
- ⁷ Australian Government, Attorney-General’s Department, *ComLaw*, www.comlaw.gov.au; Australian Legal Information Institute, ‘Australian Treaties Library,’ www.austlii.edu.au/au/other/dfat.
- ⁸ *Combet v Commonwealth* (2005) 224 CLR 494, 557.
- ⁹ *Australian Iron & Steel v Dobb* (1958) 98 CLR 586, 596.
- ¹⁰ *R v Hughes* (2000) 202 CLR 535.

In Defence of the Status Quo

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Thanks to CIS for this opportunity to present my views on Australian federalism.

My thesis is that Australian federalism is in rough good health. Australia has achieved a reasonable balance between centralisation and decentralisation of government functions, and a reasonable balance between cooperation and competition between governments. I have argued this case in more detail in a paper for the Committee for Economic Development of Australia (CEDA).¹

However, there is room for improvement and there are threats to face.

The newly elected commonwealth government has made reform of federalism a central part of its agenda, to ‘put an end to the blame game,’ and to ‘nurture a spirit of cooperation.’ I discuss that broader agenda in my CEDA paper, and sing the praises of cooperation and welcome the re-energising of the Council of Australian Governments (COAG) as the vehicle for cooperative federalism.

However, I would not like Australia to lose all elements of intergovernmental competition. I will devote my efforts today to presenting and defending competition.

Intergovernmental competition in services and regulation

Many of you would agree that competition in business and the professions is generally to the social good. But it took six or seven decades for that notion to be accepted by Australian elites and politicians. The

* The views expressed here are the author’s own, and not necessarily those of either institution

first *Trade Practices Act* was in 1964, and was significantly strengthened by Lionel Murphy's rewriting a decade later. Although the first effort to bring import tariffs down substantially was in the 1970s, it was not until the 1980s that the path was taken towards the virtual elimination of import tariffs. Bank competition was vastly boosted in the 1980s. The first widespread push for competition in public utilities and in the professions was made in the 1980s and 1990s.

In view of the relatively recent acceptance of the idea that market competition is a Good Thing, I do not expect today to convince all the doubters amongst you that intergovernmental competition is, on balance, a force for economic and social good. But I will try.

I will start with examples of areas where the commonwealth is competing with the states and territories.

Since the election, Mr Rudd has moved to implement Labor's electoral promises, including reductions in the waiting lists for elective surgery.

This is an example of vertical competition between the commonwealth and the states and territories.² It is competition for the support of voters in areas of service delivery traditionally regarded as being the responsibility of the states—the states own and run public hospitals.

The states, however, have not succeeded in delivering waiting lists that are acceptable to many voters, and so the Rudd government stepped in.

A further example requires some background. The Business Council of Australia (BCA) has called on all governments to agree on a single set of business rules and regulations across Australia, to assist the 32,000 business firms that operate in more than one state and to produce a seamless national economy.

If such an agreement does not occur, the BCA's fallback position is vertical competition between governments—that is, for the federal government itself to create national business schemes in key areas and allow companies to opt out of the state and territory systems.

A third example—the previous federal government directly funded non-state schools in competition with the state schools.

In fact, federal involvement is extremely widespread in areas previously the prerogative of the states. In many instances, I would

prefer that the feds kept out, especially when the federal intervention takes the form of setting narrow performance standards for the states rather than directly encouraging structural reform.

But unfortunately, the performance of some state governments in various areas has not been splendid, and vertical competition from the commonwealth puts pressure on them to perform better.

A common complaint is that vertical competition leads to a blurring of responsibilities. It is not always clear who is responsible for the supply of public hospital services—the state or the feds? And it is less clear now that the commonwealth has made itself responsible, in some way, for reducing the length of waiting lists.

But, I must ask, who is responsible for the supply of supermarket groceries? Coles or Woolies?

Very few people would argue that Australia would be better served by a monopoly grocery chain than by competition. However, many believe that Australia would be better served by a clear and unassailable assignment of governmental responsibilities within the federation—that is, by monopoly government. Such a clear assignment means the end of vertical competitive federalism, an end to the blurring of responsibilities, and an end to overlap and duplication.

In contrast, I argue that just as competition between firms safeguards consumers against high prices and shoddy goods and services, so competition between governments can safeguard citizens against bad service delivery and bad government, and encourage good government.

We are familiar with electoral competition between political parties. Periodically, the governments in power in Canberra and in each state or territory ‘go to the people.’ Federalism reinforces the strength of party-political electoral competition by pitting the central government against the states and territories, individually or collectively, and by pitting one state government against another.

Discussions of federalism often disparage the existence of ‘overlap and duplication’ between the commonwealth and the states and territories. Certainly, overlap and duplication imposes costs. However, I make two points. First, overlap can be a sign that vertical competition is operating. Second, the overlap that arises from intergovernmental competition

may be worth the cost if the competitive process sufficiently enhances governmental responsiveness to citizens' preferences, for example by promoting improvements to service delivery.

Competitive processes and a rationally planned monopoly produce different results. There is overlap, even duplication, between what Coles does and what Woolies does. The rational licensing of suppliers and supply points can avoid wasteful duplication of facilities, and has often been the preferred way for established firms to handicap or suppress the competition.

Similarly, one apparently sure way of removing intergovernmental overlap and duplication, and of securing clear lines of governmental responsibility, is to assign full responsibility for the specified matters to one level of government.

Easier said than done—so long as the states exist and have significant functions, then a cashed-up federal government will always be tempted to obtrude into the affairs of the states for an electoral advantage, or in the national interest as it sees it. And issues of national or electoral importance do not always fit neatly into predetermined or preassigned categories of responsibility.

I take this to be the significance of the High Court's quoting Justice O'Connor in *Befair*:

It must always be remembered that we are interpreting a Constitution in broad terms, intended to apply to the varying conditions which the development of our community must involve.³

There are other ways to remove overlap and duplication, and to eliminate any blurring of governmental responsibilities. These are:

- abolish the states,
- or reduce them to mere service delivery agencies for commonwealth programs,
- or constrain the states with narrowly-defined commonwealth targets for service delivery for every state programs to the extent that the states lose the capacity to set their own priorities and to innovate.

Would the actual or effective elimination of the states be a good idea? According to Anne Twomey and Glenn Withers, federalism annually adds about \$4,500 to \$7,500 a head to the income of Australians, compared with straight abolition of the states. These are net gains, not gross, and they are much larger than the BCA's estimate of the gross costs of federalism, which is a mere \$450 per head.⁴ Net gains of \$4,500 to \$7,500 from federalism are comparable in size to the gross gains that the Productivity Commission has estimated will flow from the next big thing in intergovernmental cooperation in Australia, which is COAG's National Reform Agenda.

If Australia eliminated the states, actually or effectively, then the only remaining form of intergovernmental competition would be horizontal competition between the Australian government and foreign governments.

Horizontal competition exists whenever a citizen can move from one state, or from one country, to another. Migration is easier between states within a federation than between countries.

Under Premier Bjelke-Petersen, Queensland reduced death duties in order to attract retirees from other states. It worked. Other states followed suit, and eventually death duties were eliminated in all states. The mere threat of mobility can put pressure on governments to perform. Eliminate the states, or force them into uniformity, and one form of competition has been removed.

Horizontal competition led to uniformity across the states in the instance I have just given. There are no death duties now in any state. However, when people complain about horizontal competition it is mostly about the *lack* of uniformity in the policies and practices across the states. Recall the BCA's objective of achieving a single set of business rules and regulations across Australia instead of eight.

Differences in inputs and outcomes are intrinsic to or inherent in the very nature of the competitive process itself—one firm or state tries something different from what it has been doing, or different from what other firms or states are doing—and if it works others may follow, at least to some extent.

There is a deeper point to be kept in mind. People often assume that a national regime will select or improve upon the best aspects of

the state regimes. But in the process of arriving at a national regime, the highest or the lowest state standard may prevail.

For example, nationally uniform occupational health and safety laws that the BCA wants may include features now present in only one or two states—for example, New South Wales’ industrial manslaughter laws—which firms outside those states would find very burdensome. They may prefer the present diversity to that kind of uniformity. Or, again, a uniform national curriculum for public schools may not incorporate features that some parents previously rejoiced were present in their own state’s public school curriculum.

I must not exaggerate the case. Undoubtedly, some of the diversity found across the states is the result of the resistance of entrenched bureaucratic and other interests, or the result of sheer inertia, and could be eliminated to the general advantage.

But a competitive process and a rationally planned monopoly produce different results. Competition is messy and the results can appear irrational, unplanned, and far from ideal. A monopoly is neat and rationally planned and otherwise fine, if you own it or if you can trust it to act in the public interest. In this regard I am a sceptic, and prefer messy competition to rational monopoly, including in government.

Tax competition and vertical fiscal imbalance

So far, I have been concerned mostly with intergovernmental competition in service delivery and regulation, of which I generally approve.

The tax story is more complicated—it is harder to weigh up the advantages of interstate tax competition against the disadvantages. That caveat in mind, I nonetheless think that Australia has achieved a reasonable balance between centralisation of tax collections and tax competition between the states. To explore these claims requires a short excursion into tax theory.

Taxes induce avoidance or evasion. That is, taxes change the behaviour of the taxpayer, who responds by acting otherwise than they would have acted in the absence of the tax or if the tax were lower.

Sometimes, the very purpose of a tax is to change behaviour—for example, a tax on carbon emissions is imposed in order to reduce carbon emissions. But for most taxes, their purpose is to generate tax revenue, and then the induced changes in behaviour represent an economic

burden on the community over and above the tax revenue collected. An income tax is not imposed in order to reduce incomes—any such reduction is a cost of income tax, not a benefit.

Or, to take another example, a firm may move interstate in order to avoid a heavier payroll tax burden even if, in the absence of payroll taxes, the firm would be more profitable—that is, more efficient—in the state of origin. The loss of pretax profitability and productivity is a loss to the Australian community. On grounds of economic efficiency it is better to impose the smallest possible costs of avoidance per dollar of tax collected.

Although there is no escaping death itself, death duties can be evaded or avoided by various moves, including gifts made before death. Because these reactions involve relatively small costs, many economists believe that death duties are a reasonably efficient form of taxation, and should be included in the tax mix. However, interstate competition eliminated death duties and the commonwealth did not rush to fill the gap in the tax system.

The arguments about interstate tax competition are set out in more detail in my CEDA paper, where I also refer to the destructive effects of too much interstate tax competition in the US. Australia has avoided some of the worst outcomes of tax competition by the centralisation of the income tax in 1942 and recently the GST, and through the centralisation of the responsibility for social welfare in 1946.

So, in particular, payroll tax rates would be higher if the states received much smaller commonwealth grants (or none) and were forced much more onto their own resources to fund the expenditures that they make today. Interstate differences in the rates of payroll tax would then have more influence on the decision-making of firms than they do today.

But there is a consequence. The centralisation of the income tax and GST means that the commonwealth collects over 80% of all tax revenues, although it is responsible for about 60% of public spending. Wisely, in my opinion, Australia has a pattern of government spending that is less centralised than its taxation.

The surplus of commonwealth taxes over commonwealth spending is largely sent to the states as grants, which fund about half of state government spending. They comprise GST grants, which are currently

free of conditions, and Specific Purpose Payments, or SPPs, which come with commonwealth conditions attached.

Many people believe that the states are careless about spending commonwealth grants. Famously, Joh Bjelke-Petersen is alleged to have said that the only good tax was a commonwealth tax: the commonwealth bears the odium, and the states get to spend the money, presumably profligately.

However, it is important to note that despite the huge commonwealth grants to the states, a state government bears 100% of the costs of any additional spending that it makes on its own account, and a state saves 100% of any reduction in its own spending (absent a punitive clause in an SPP).

If margins matter for behaviour, as they usually do in economics, then states have strong incentives not to waste federal general revenue grants. Instead of spending on services that are of comparatively low value to its constituents, there is always the option of state tax relief. (In South Australia, the election held after the State Bank fiasco was fought explicitly along the lines of ‘increase state taxes or cut state services.’)

I do not rest my case in favour of some degree of vertical imbalance, on economic theory alone. In 2001, New South Wales and Victoria asked Ross Garnaut and Vince FitzGerald to inquire into fiscal equalisation. They in turn commissioned sophisticated quantitative modelling work from the Centre of Policy Studies at Monash University, which indicated that states do not waste federal grants—or, at least, they waste them no more than they waste their own tax revenues.⁵

Specific Purpose Payments (SPPs)

A severe threat to the effective operation of Australian federalism is an excessive use of Specific Purpose Payments, which tend to convert the states into mere agents of the commonwealth. These grants total about \$30 billion, or 40% of all grants.

The COAG meeting of 26 March 2008 announced that there would be a New Reform Framework (and I quote sentences out of order):

On the recommendations of Treasurers, COAG agreed on the key elements of a path breaking new Intergovernmental Agreement on Commonwealth–State

financial arrangements, which will be finalised by the end of 2008 following extensive work by Treasurers and COAG Working Groups to settle outputs, outcomes, reforms, performance indicators and funding arrangements ... Sweeping reforms to the architecture for Commonwealth–State funding arrangements will enable the States to deploy Commonwealth specific purpose payments (SPPs) more effectively and creatively, enhance public accountability and sharpen the incentives for reform through new National Partnerships (NP) agreements.

Some SPP grants will simply be rolled into general revenue payments to the states.⁶ But the main action is that the government intends to reduce the almost ninety SPPs to five—covering health care, housing, schooling, and early childhood development, vocational training, and disability and community services. Payments would be made only when the states achieved policy goals previously agreed with the commonwealth.

If the difficulty in achieving a new Australian Health Care Agreement is any guide, then some of the negotiations will be vigorous.

These five new SPPs will cover a sizeable portion of state spending and, to the extent that the commonwealth uses them to impose narrowly-defined performance indicators—like the length of surgery waiting lists—they will limit the capacity of states to respond to their own electorates in these areas. And the commonwealth is apparently keeping open the possibility of involving itself in areas other than these five.

In addition, a new form of conditional grant is proposed, to be called National Partnership Payments, partly to be paid upfront, but mostly on achievements under the National Reform Agenda. I understand this to be the updated version of the incentive scheme that operated under the National Competition Policy, and which proved to be very effective in lubricating significant policy reform.

Conclusion

In this talk, I have explored the benefits of intergovernmental competition, especially outside the tax area. Competition is messy, and

leads to overlap and duplication, and to a blurring of governmental responsibilities. Despite these costs, I have argued that vertical competition and horizontal competition are both worth preserving.

The main threat to competitive federalism lies in the use of Specific Purpose Payments, SPPs, under whatever name, to convert the states into service agents of the commonwealth.

I never mentioned states' rights, since I hold them unimportant. What is important is the right of the Australian people to enjoy good government. Competitive federalism and cooperative federalism—they both help in achieving that goal.

Endnotes

- ¹ Jonathan Pincus, 'Six Myths about Federal–State Financial Relations,' *Australian Chief Executive* (February 2008), ceda.com.au/public/research/federal/six_myths_federal_state.html, 36–47.
- ² In a 2007 speech, the Secretary to the Treasury, Ken Henry, is reported to have criticised 'the model of "aspirational nationalism" enunciated by the former prime minister John Howard' and its 'startlingly new concept of vertical competitive federalism.' *Canberra Times* (6 May 2008), 6. The concept of vertical competitive federalism is discussed in Productivity Commission, 'Productive Reform in a Federal System,' chap. 1 in *Annual Report 2004–05* (Melbourne: Productivity Commission, 2005), www.pc.gov.au/annualreports/annualreport0405/annualreport0405.pdf.
- ³ *Befair Pty Limited v Western Australia* [2008] HCA 11 (27 March 2008), www.austlii.edu.au/au/cases/cth/HCA/2008/11.html.
- ⁴ Anne Twomey and Glenn Withers, *Australia's Federal Future: Delivering Growth and Prosperity*, Federalist Paper 1 (April 2007), www.crawford.anu.edu.au/pdf/staff/glenn_withers/federalist_paper.pdf.
- ⁵ Peter B. Dixon, Mark R. Picton, and Maureen T. Rimmer, 'Effects of Changes in Commonwealth Grants to the States: An Applied General Equilibrium Analysis' (2002), web.archive.org/web/20040705164416/http://www.reviewcommstatefunding.com.au/library/CoPS_EfficiencyPaper.pdf.
- ⁶ Recent government documents relating to SPPs do not seem to have been made available outside government except to selected journalists, so I rely on a press report: Lenore Taylor, 'Overhaul of Federal–State Funding Rules,' *Australian Financial Review* (21 February 2008), 1.

Reviving the Spirit of Federalism

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If one reviews how the federalist idea (ideal!) has fared around the world over the past two decades, one is likely to arrive at two conclusions:

1. Communities that practice the concept that *legislative*, *executive*, and *judiciary* powers ought, as far as possible, to be dispersed among self-responsible regional entities have better protected the civil and economic liberties of citizens (democracy and prosperity).
2. There has been a tendency around the world towards less subsidiarity and more centralisation. At best, pseudo-federal arrangements are put in place. Most notable are the progressive, and widely resented, de-democratisation of governance in the EU and the abandonment of the federal idea in Putin's Russia.

This is not a perplexing puzzle, unless one subscribes to the naive view that agents of collective action voluntarily pursue the people's common good, such as their freedom, security, or prosperity. In reality, politicians and bureaucrats—like everyone else—pursue their own interests and try to shirk responsibilities. Centralisation means more distance from the informed and demanding public, hence a more comfortable job, even if it is at the expense of the common good. It serves the interest of politicians and bureaucrats. Who wants to be controlled effectively by the electorate and, above all, who wants to compete with other politicians and bureaucrats?

It is therefore up to the citizens to defend the federalist ideal. No one else will do this for them.

Competitive federalism

Proper federalism (as distinct from pseudo-federalism) means that as many functions of government as is feasible are devolved to state and local governments *and* that the various authorities have the responsibility for their own tasks (within a certain, transparent constitutional framework).

To give substance to the concept of subsidiarity, the following constitutional rules have to be obeyed:

- *Exclusivity*. Each task of government must be assigned exclusively to one level of government (no duplication; no scope for shirking political responsibility). This is only possible if big blocs of government action are assigned to particular levels of government. For example, all health services could be the responsibility of the states, all foreign policy the task of the central government. Finer divisions of tasks only produce instability, confusion, and political conflict, as witnessed for example in the vertical competition in public-sector health between the commonwealth and the states.
- *Rule of origin*. The sale of a product that is sold legally anywhere in the federation must be automatically allowed throughout the federation (free trade; non-discrimination according to origin).
- *Fiscal equivalence*. Each government must be responsible for raising the taxes, fees, or borrowings needed to discharge its assigned and its self-chosen tasks (banning of vertical and horizontal fiscal transfers in the interest of fiscal responsibility; no welfare handouts for incompetently run states).
- *Most-favoured citizen treatment*. If a state government offers a preferment (such as a subsidy) to one citizen or enterprise, it must offer the same to all comparable comers. This amounts to a ban on subsidy wars.

These rules define a constitutional system called 'competitive federalism.'¹

Competitive federalism works well if we understand it not only as a system of devolving government tasks to lower-level government authorities, but if the system is also open to privatisation. As technologies

of measurement and accounting change, and as scale economies change, it is quite likely that there is advantage in devolving many erstwhile tasks of collective action to competing private operators. That option should always remain on the table to induce the agents of public policy to perform on behalf of the principals, namely the citizens.

Such an arrangement means, for example, that state governments, when faced with emerging problems, are encouraged to experiment and compete with finding novel administrative solutions. Such competition enhances the 'discovery potential' of a society in creating 'institutional capital,' such as useful rules and arrangements. They also oblige governments to support the producers and the jobs, when these have to compete internationally and nationally, rather than acting as self-serving rulers. At a time of great uncertainty and change (globalisation, shifting political and economic pecking orders, new technologies), the communities with the most agile and supportive administrative setup will be the winners. By contrast, defensive power cartels (cooperative federations) will drag communities down, as happened in late antiquity with centralist Rome; 400–500 years ago with the inward-looking, centralist Ming dynasty in China; the rigidifying, centralising Ottoman empire 100–200 years ago; or, since the 1970s, the increasingly Brussels-centred European Union.

I understand why big business often demands uniform regulations throughout Australia, even the abolition of states. But what we, the citizens, want is expedient and supportive regulation, not necessarily uniformity. Competition between jurisdictions serves the objective of citizen- and business-friendly institutional capital, whereas uniformity (monopoly) can quickly lead to the opposite. I would expect business leaders to be a bit more foresighted.

A self-responsible federalist setup also means that producer-supporting administrations reap the reward of economic growth in the form of a growing tax base. Fiscal equivalence thus educates governments in cultivating their revenue base, hence in favouring economic growth.

Competitive federalism is desirable above all from the viewpoint of the citizens' freedom, because political agents, who are obliged to compete with each other and who have to live with the consequences of earlier political decisions, are more likely to pursue what the citizens

want. This is an empirical question, but one that is amply borne out by history.

The evidence has, however, never stopped those self-seeking elites who live off government from believing that—though we are all self-seeking knaves—people turn into white knights in shining armour once they work in government.

This is the reason why genuine liberals around the world have always favoured federalist arrangements.

Nowadays, there is the additional argument that—thanks to globalisation—collective agencies have to compete globally, whether they are aware of it or not, and whether they want to or not. The competitive spirit is best acquired within the federation.

Australia's debased federalism

Australia does not have a system of genuine federalism. Over time, since 1901, the system has become more and more centralised.

Vertical and horizontal transfers—such as the gross and habitual violation of the principle of fiscal equivalence (let alone state interference in local government)—are one of the few surviving elements of the stifling, socialist 'Australian Settlement' of the early 1900s. They are based on the collectivist notion that Canberra must somehow ensure that state governments provide egalitarian levels of service, irrespective of how well or poorly the individual states are run. Badly governed states, which producers and citizens abandon, become respected mendicant states whose failures get rewarded through federal–state financial transfers. This socialist notion undermines all motivation to improve poor administrative practices and puts a premium on bureaucratic hostility to economic growth and administrative improvement.

The High Court has often connived with the Canberra powerbrokers to undermine the role of the states. Successive federal administrations of either political party have seized tasks of government, which the original Constitution assigned to the states. All too often, state governments have shirked responsibilities and connived in shifting tasks to the commonwealth or agreeing to duplication (breach of the exclusivity principle).

There have been improvements with regard to the rule of origin—states now find it, for example, more difficult to buy preferentially in

their own jurisdiction. The ‘National Competition Policy’ also went some way to curbing the likelihood of subsidy wars.

The introduction of a massive federal tax, the GST, coupled with a ‘social justice’ driven federal–state financial redistribution system, was a retrograde step from the standpoint of competitive federalism. It made the states even less responsible for their own actions. Howard’s relentless seizing of erstwhile state functions was another retrograde step. Traditionally, the Liberal Party used to favour federalism as an integral part of its platform, but this seems no longer the case. This is not surprising, since the Liberal Party has abandoned many other policies in support of individualism and self-responsibility, such as the deregulation of labour markets or resistance to the costly collectivist ‘climate push.’

The ALP has, since the 1920s, tried to abolish the States, most notably through the Coombs Royal Commission under the Whitlam government. Now, the proposal is on the table again: to replace states with a regional federal bureaucracy.

The currently fashionable notion of ‘cooperative federalism’ is just another step on the slide to more centralism and a further violation of the principle of exclusivity. Cooperative federalism is no more than a polite word for the cartel of taxing governments; it will contribute to a further deterioration of public services and to further confusing the citizens about who to hold responsible for administrative failures.

Matters will deteriorate and the burdens of ineffective government will grow, if we, the citizens, do not understand (and demand a revival of) the principles of ‘competitive federalism.’

Reviving the federal spirit

Practical steps to revive competitive federalism would include:

- Make the GST explicitly a state tax, which accrues to the jurisdiction where the sales take place and whose rules and rates state governments can vary. This does not mean that GST must be collected by different state treasuries.
- Confine federal–state transfers in practice and, better still, by explicit constitutional limitations.
- Proscribe overlapping federal and state responsibilities, thus

returning to the original concept of the commonwealth constitution. There should, for instance, be no commonwealth education or health department once it is decided that these areas are state matters. Tackling duplication could serve as the basis for massive public-sector reforms and could be the beginning of a smaller public sector, one more in line with the Asia-Pacific countries with which Australian workers and businesses compete—and not the failing European welfare states!

- Recognise local government constitutionally as a separate level of government with certain responsibilities and revenues of its own, rather than corrupt branches of state departments of local government, where failing local councils are readily replaced by administrators—self-seeking party cronies.²

Let a thousand administrative flowers bloom and let's move from 1910 to 2010 by jettisoning the last collectivist remnant of the untenable Deakinite Settlement! A go-getting, productive, and internationally competitive Australia will be the reward.

Endnotes

- ¹ I have written extensively about these matters in, for example, Wolfgang Kasper, *Competitive Federalism: Promoting Freedom and Prosperity* (Perth: Institute of Public Affairs, States' Policy Unit, 1995); *Competitive Federalism Revisited: Bidding Wars, or Getting the Fundamentals Right?* (Perth: Institute for Public Affairs States' Policy Unit, 1996); and 'Competitive Federalism for the Era of Globalization,' in *Voluntary versus Coercive Orders*, ed. G. Radnitzky and H. Bouillon (Aldershot: Avebury, 1997).
- ² Wolfgang Kasper 'Local Autonomy—Healthy Local Democracy,' in Independent Inquiry into Financial Sustainability of NSW Local Government, *Interim Report*, vol. 2 (Sydney: Local Government Inquiry, 2006), www.lgsa-plus.net.au/resources/documents/kasper-local-autonomy-healthy-local-democracy_2005.pdf.

Fixing Fiscal Federalism

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Going only as far back as the Whitlam government's so-called new federalism (it was, in reality, an attempt at a new centralism), each successive Australian prime minister has proposed and to a degree implemented changes to the nature and content of intergovernmental relations or intergovernmental arrangements. Although not always dubbed new federalisms, they all involved attempts to achieve significant 'structural' changes.

From the viewpoint of learning about how, and how not, to attempt to 'fix federalism,' it would be an interesting and valuable exercise to critically review what was the intent, content and consequences of each of these initiatives. That isn't the task I've been asked to undertake here, but some of what I have to say will be shaped by my perceptions of what has been attempted before and what influenced the outcomes. Learning about how federalism really works by studying how the system reacted to reform initiatives has a lot more going for it than behaving as if the lessons of the past are of little contemporary relevance. One general observation doesn't require much detailed study to become obvious: federal systems are resistant to attempts to *impose* changes on them—most often for good reason.

The role I've been allocated is to discuss what changes in fiscal arrangements in Australia's federal system would be desirable as a contribution to fixing federalism more broadly. This is a world full of acronyms that create a vacuum in the minds of all but those deeply embedded in the operation of, or study of, federal fiscal arrangements. In particular, there are SPPs, VFI, HFE, and the CGC. Even spelling out what the acronyms stand for isn't much help to most: the terms Specific Purpose Payment, Vertical Fiscal Imbalance, Horizontal

Fiscal Equalisation, and the Commonwealth Grants Commission likely still are a mystery to all but aficionados. I'll attempt to explain what they mean, how they're appropriately interpreted, and what, if anything, about them is relevant to attempting to reform Australia's federal system.

However, I begin with a discussion of aspects of federal reform more broadly, built around key features of the Rudd government's attempts to create what Treasurer Wayne Swan has referred to as 'modern federalism.' My central purpose in doing so is, first, to insist that federal reform should be about what will benefit 'the people'—citizen-voters—including what ensures their democratic participation in reform processes; and, second, to suggest that reforms that aren't unquestionably for and ultimately by the people aren't likely to stick.

In what follows, I'll use the term *states* to include the mainland territories since, nowadays, they receive state-like treatment in fiscal and most (though not all) other respects.

Content, context, and consequences

Robert Carling, in an article in the Autumn 2008 edition of the CIS's journal, *Policy*, suggested that 'Conferring with the states has never before been high on a new federal government's to-do list.' I could quibble around the edges about this: for example, new commonwealth governments have often pre-negotiated with state governments about aspects of their relationships or arrangements (Fraser's tax sharing is a case in point), and this potentially can be as important as post-election conferral. However, I think Robert was substantially right.

Understanding why this is the case is important to understanding the nature, and likely consequences, of the Rudd reform initiatives. One contextual point often overlooked is that Kevin Rudd, as then-head of the Queensland (Goss) government's cabinet office, was an important driver of the Greiner–Goss–Hawke new federalism initiative in the early 1990s. Gary Sturgess, head of Nick Greiner's cabinet office, was the source of the intellectual backbone of the initiative, but Kevin Rudd was a powerful ally from the other side of politics and a quick learner. While the early 1990s' initiative didn't deliver all that was hoped for, it was the base on which the mid-1990s' National Competition Reforms were built, and the force underpinning it was the (political) payoff from

enhancing people's well-being.

But, perhaps more importantly, the Rudd government's federalism initiatives reflect the fact that many of the new government's election commitments require cooperation from the states if they're to be delivered. Think not only of climate change and water reform initiatives, but also of health and hospitals, infrastructure, education, housing, competition and business regulation, and reforms especially targeted at Indigenous Australians. The state premiers have been co-opted into delivering the Rudd government's commitments, including through promises of both compensation for costs to their states of meeting those commitments, and a broader range of National Partnership Payments (NPPs) dependent on making progress on meeting 'mutually agreed' objectives.

There are a number of remarkable features of the Rudd government's new (or modern) federalism, none more so than setting up working groups chaired by commonwealth ministers but otherwise composed of officials. How this experiment will work out will be interesting to see, but it clearly illustrates how much the commonwealth is controlling the agenda. On this account, and others concerning financial arrangements, 'modern federalism' looks distinctly like 'commonwealth federalism.'

From a broader perspective, there are two central themes being presented as core motivators, or *modus operandi*, of federalism Rudd-style: an emphasis on cooperation and an end to waste and duplication (or 'the blame game'). Each deserves some comment.

Of cooperative and not-so-cooperative federalism

It would be verging on the insane to suggest that intergovernmental cooperation to tackle issues of national significance is undesirable. Clearly, it often can be highly beneficial. In recent times, cooperative approaches to all that goes into creating a seamless, internationally competitive, national economy has required cooperation and coordination, or at least harmonisation, between the states and between them and the commonwealth. Considerable progress has been made over the last couple of decades, though it remains something of a work still in progress.

However, to borrow a term much used in discussions about the decision-making processes of the European Union, there is a potentially

significant 'democratic deficit' involved in the development and implementation of intergovernmental agreements, and even more so in management of them. There is generally no transparency in the processes used to form intergovernmental agreements: they are deals done behind closed doors, with much of the shape and content driven by bureaucrats; the outcomes are invariably determined by the lowest (highest achievable) common denominator among first ministers; and their subsequent implementation again is essentially in the hands of bureaucrats (intergovernmental managers, so to speak).

There might be 'stakeholder consultations' along the way, but so-called stakeholders typically are lobby (interest) groups. The average citizen-voter is dealt out of the process—and so, too, are other state or commonwealth parliamentary members, even ministers, and especially backbench members of the governing party. 'A done deal is a done deal,' they are told.

The general point, I guess, is that intergovernmental cooperation, while sometimes highly desirable and productive, isn't invariably 'a good thing' from the perspective of applying democratic principles. Indeed, one of the key virtues of federal systems of government is that they supercharge political competition, not cooperation for its own sake. They do so by adding inter-jurisdictional political competition to the inter-party competition for political consent and support that's familiar to and supported by all. That is, governments are driven to compete with one another as well as with opposition parties, interest groups, and so on, in federal systems to win political consent and support. The competition they face is both horizontal (with other states) and vertical (with the national government).

A consequence of all this inter-jurisdictional competition is that intergovernmental relationships often appear to be combative and disharmonious, and sometimes downright rancorous. But this doesn't mean they aren't productive, especially from the viewpoint of the citizen-voters whose consent and support governments compete for. Nor does it mean that intergovernmental cooperation is likely to be a rare event.

By the same token, cooperative federalism, while often desirable, should be viewed with the right degree of suspicion. It is *potentially* productive but also potentially 'anti-democratic.' Certainly, as an overarching organising principle for intergovernmental relations it has

no appeal: cooperation potentially facilitates governments behaving in ways similar to private sector cartels, deflecting citizen-voter preferences and denying them the use of their governments, at all levels, to pursue their perceived needs. The case for cooperation needs to be made on an issue-by-issue basis: competition should be the default option in the interests of ‘the people.’

Tidying up roles and responsibilities

In addition to extolling the claimed virtues of intergovernmental cooperation, a familiar catch-cry of those intent on reforming the federation is that we need to reduce duplication and overlap, which are argued to be wasteful of taxpayers’ money. Indeed, Wayne Swan’s depiction of the virtues of the Rudd government’s so-called modern federalism included reference to a need to end ‘waste and duplication’ and said that ‘the new financial architecture will make roles and responsibilities unambiguous.’

If the treasurer literally meant ‘unambiguous,’ he presumably was pointing to a neater and tidier delineation of roles and responsibilities between the commonwealth and the states. Joint tasks by definition require joint inputs and joint activities, and the boundaries of responsibility and accountability for outcomes are at best blurred and at worst incapable of being even approximately identified.

So here we appear to have an exquisite incoherence: cooperation is good because it blends resources and comparative advantages in delivering desired policy outcomes, but it’s bad because it blurs lines of accountability and responsibility—ultimately to citizen-voters. At what point is neatness and tidiness—a structured, ‘rational’ allocation of roles and responsibilities between spheres of government—trumped by the benefits of cooperatively promoting objectives?

In my view, it is simply a reality of federal systems that they will not result in or sustain a neat and tidy (unambiguous) allocation of roles and responsibilities and accountabilities, if that’s what you want to achieve. I believe that, over time, federal systems most often do result in rational ‘allocations’ of roles, but that allocation rarely looks neat and tidy. Trying to fix federalism by trying to re-sort roles and responsibilities is ultimately likely to be futile, and its intent is arguably antidemocratic in any event.

National governments and state governments compete with one another to occupy policy spaces in order to win political consent and support. Who wins depends on who's best—most efficient and effective—in delivering the desired policy outcomes. The result is a win for the people (and businesses as intermediaries): they get outcomes at least cost, or more effective outcomes for any given cost. But the outcomes are likely to involve governments sorting themselves by activities, not functions per se. The commonwealth's dominance of revenue-raising might appear to give it a big competitive edge, but I'll argue later that the apparent degree of dominance is in fact as much a result of choices made by the states as of the commonwealth asserting its financial muscle. Similarly, while High Court interpretations of what limits there are on the commonwealth's use of its heads of power in section 51 of the Constitution have been expansive since the Engineers Case way back, the commonwealth's capacity to sustainably use its ostensible powers isn't unlimited: the states and the people have the power to fight back, by withdrawing political consent (as they did recently over WorkChoices).

The upshot of all this is likely to be very messy and I'd be surprised if anyone in the political sphere thought it really could or would be otherwise. Politics is a messy business. It is more so when jurisdictions overlap, but that's a consequence of having a political system more responsive to citizen-voters—one that gives them multiple entry points to express their needs and preferences.

All that said, and with it as background, I turn now to specifically *fiscal* issues.

Fiscal issues

Tied grants

A common argument about how fiscal issues affect intergovernmental relations and arrangements is that the commonwealth government's power under section 96 of the Australian Constitution to provide grants to the states 'on such terms and conditions as the Parliament sees fit' has empowered the commonwealth to exert considerable influence, if not control, over the states' exercise of their autonomous powers (everything over which the commonwealth does not have direct constitutional power).

The principal focus of concern has been the use by the commonwealth of tied grants, usually referred to in Australian context as Specific Purpose Payments (SPPs)—grants provided to the states on condition that they use them to promote objectives determined by the commonwealth, as the ‘donor,’ in areas such as hospitals, schools, universities, roads, housing and, through the states, for local governments. In fact, the section 96 grants power has been used even more widely than this: the commonwealth’s general purpose (untied) grants to the states—nowadays hypothecation of GST revenues to the states—have long been conditional on the states not re-entering the income tax field, despite their constitutional capacity to do so if they chose.

Clearly, section 96 of the Constitution gives the commonwealth considerable fiscal power, to the extent that the commonwealth is willing to raise revenues greater than those it needs strictly for its own purposes. That it has been willing to raise more tax revenue than it needs for its narrowly defined own-purposes suggests that ‘the will-of-the-people’ has been that it should do so.

Quite what to make of this observation is hard to know. As a matter of principle, it would appear obvious to argue that governments should be allowed to get on with doing the business which the Constitution explicitly or implicitly allocates to them without interference; and, correspondingly, that they should have access to sufficient revenues to allow them to do so. But there are lots of ambiguities associated with such a statement of principle.

To give my discussion some concreteness and focus, there are two somewhat separable questions worth asking. The first is, are SPPs a desirable feature of intergovernmental relations? The second is, are the proposed Rudd/Swan reforms to them a step in the right direction? My answer to both questions is a *qualified* yes.

The grants power given to the commonwealth by the Australian Constitution is offered strong support, *in principle*, by the economic analysis of functional federalism. Where there are positive spillover benefits arising from the actions of one state that it can’t capture directly, or by negotiation or cooperation with other States, a case exists for the central government to provide incentives—grants tied to redressing the externalities. For example, if state A’s investment in education and

training produces benefits, some of which states B to Z can capture (by people educated in state A moving to them) without compensating state A, there'll be too little investment in education and training in state A, and similarly for all other states. A commonwealth grant tied to achieving higher levels of investment in education and training by all states would increase national well-being.

Similar cases exist in many other contexts, such as the levels of investment in highways that connect the state capitals (and elsewhere)—an area in which nowadays the commonwealth fully funds investment in what are essentially state-owned roads—or where irrigation and water-use practices in parts of a river system have downstream (and even wider) consequences. The general point is that there are substantial interdependencies between states in many areas in which the states are functionally responsible, and a system of *tied* grants is a desirable and appropriate way to 'internalise' the interdependencies.

There also are national equity objectives in relation to service delivery, for the attainment of which the commonwealth makes Specific Purpose Payments to the states. The standout case is in relation to public hospitals, where the commonwealth contributes to the costs of running them on condition that the states not charge for public beds and treatment. But similar things could be said of commonwealth funding for state schools, for example.

Also, to return to my emphasis on citizen empowerment and participation, people are citizen-voters at local, state, and national levels, and will search between them to get their preferences met. It is often said that people don't care much which sphere of government meets their preferences, as long as one does. This gets us back to the inherent messiness of federal systems of government: whatever the constitutional allocation of functions, political pressure and the search by political parties for political support will often drive governments into one another's territory, and to preclude governments from responding, if it were possible to do so, would be to disempower the people. That said, the search by political parties for political consent can result in what appear to be extremely dubious proposals (for example, former prime minister Howard's proposed requirements that schools have flagpoles and fly the Australian flag as a condition for continued school funding)

as well as in clearly beneficial proposals (the Rudd government's funding of computers in schools and funding for reducing waiting lists in public hospitals).

Doubtless, over time, some conditions associated with SPPs persist long after becoming anachronistic or even downright counterproductive. If you're going to have SPPs, it would seem unambiguously the case that making them performance-based rather than prescriptive is much to be preferred—including because doing so requires that their objectives be clearly identified and more open to critical scrutiny. The Rudd government's proposals for reforming SPPs include mechanisms for ongoing scrutiny of both the performance of the states against agreed outcomes and the relevance of grants and conditions attached to them through the COAG Reform Council.

This is a direction of reform that the states, among others, have been pressing for for some time—at least intermittently—though their far more persistent theme has, not surprisingly, been about the adequacy of the grants for achieving their agreed purposes.

Let's be under no illusion, however: despite the new groupings of SPPs into five or six block grants, the agreements, including performance measures, will ultimately be driven by commonwealth objectives. And, despite claims to the contrary, they will at least from time to time be a source of irritation and possibly open conflict and buck-passing. A new spirit of intergovernmental cooperation there may be for now, but intergovernmental *competition* won't thereby be suppressed in the longer term. Ultimately, the only objectives the commonwealth and state governments unquestionably share is the desire to get reelected, and that will eventually put them at odds with one another even if they are of the same political persuasion.

It is important to note, too, that the Rudd government's proposals will increase rather than reduce the range of SPPs. There are to be so-called National Partnership Payments to the states, conditional on them supporting achievement of the government's election commitments and on implementation of the new National Reform Agenda. Clearly the days of extensive SPPs are far from numbered: neither the commonwealth nor, importantly, the states, have substantial incentives to want to reduce their scale or scope, much as they might say otherwise.

Untied grants

So much for tied grants. What about the untied (‘general purpose’) component of commonwealth grants to the states, nowadays comprising the GST revenues fully hypothecated to the states?

A couple of preliminary points are in order. First, the Rudd government hasn’t yet had anything to say about them *directly*—not least, I suspect, because though they’d like more, the states have been content with having a guaranteed income stream rather than having to turn up annually, begging bowls in hand. They might be a little less enthusiastic if the recent slowdown in consumption expenditure persists, of course. Second, though they are untied grants—and grants they are, not states’ own-source revenues in any meaningful sense—they are conditional. Since around 2000, they have been overtly so—conditional on the states eliminating and not reintroducing a raft of inefficient taxes. But since World War II, they’ve always been conditional on the states not re-entering the income tax field. Moreover, just because a grant looks unconditional doesn’t mean that it is free from implicit conditionality.

These (at least nominally) untied grants, at around \$42 billion, constitute around 28% of state revenues. Their existence is said to reflect a high degree of vertical fiscal imbalance (VFI) between the commonwealth and the states. That is, the commonwealth is able to raise (nowadays through the GST) substantially more tax revenue than it needs for its own purposes so as to make these untied grants to the states, while the states are highly dependent on the grants to fund their own-purpose outlays.

The first thing to note about this is that I haven’t included SPPs in my depiction of VFI. While, at 15% of state revenue, they might be large compared to tied grants in other federations, they, in effect, represent commonwealth own-purpose expenditure; they’d not likely go away entirely, if at all, in the event that the commonwealth gave the states access to additional revenue sources; and they are a feature of fiscal relations in all federations, even where state-level governments have pretty much unfettered access to tax bases not available to the Australian states. It’s possible, but not certain, that the commonwealth can apply more pressure on the states to accept tied grants than can central governments in other federations. But there appear to be

few cases in which the states would reject commonwealth SPPs even if they were able to raise more revenue from their own sources: why would you bite a hand prepared to feed you, albeit with some modest strings attached?

Also, it could be argued that a component of the untied grants—GST revenue—is in fact a pool of money to fund fiscal equalisation transfers between the states. In 2007–08, the transfers from New South Wales, Victoria, and Western Australia to the other states, compared to what GST revenue they would have received if they had received an equal per capita share, amounts to about \$3.3 billion. Deducting this from total GST revenues leaves around \$39 billion. This still represents a little over 25% of total state revenue, and only \$9 billion less than the states raise from their own tax bases.

It has been suggested by some that the total hypothecation of GST revenue to the states ‘fixed’ the VFI issue. This is because it has given the states a guaranteed, reasonably buoyant source of revenue instead of having to rely on the former Financial Assistance Grants, the amounts of which lay entirely at the commonwealth’s discretion. Certainly, compared to the old system it replaced, there are distinct advantages to this new deal. It has given the states greater predictability about future untied revenue transfers from the commonwealth, and it is an arrangement that would be politically difficult for the commonwealth to undo, at least absent an even better, equally secure arrangement viewed from the states’ perspective. Moreover, it was also accompanied by (conditional on) the states eliminating a raft of inefficient and distorting taxes and not reintroducing them: the extra revenue from the GST has more than compensated the states for doing so.

However, it’s something of a furphy to suggest that the GST deal has fixed VFI: the essential fact of the matter is that it remains a commonwealth tax. In fact, it has to be, as a matter of constitutional interpretation. The High Court has repeatedly rejected the argument that the commonwealth’s exclusive power to impose duties of excise shouldn’t be taken to preclude the states from imposing broad-based taxes on goods. So, at least in a technical sense, there’s no less VFI now than there was before the GST revenues were hypothecated: the states have no power to choose what rates are set or what the base consists

of—only the commonwealth can exercise those powers. It might not be a bad tax to hand over to the states as an ‘own source’ of revenue, but it simply isn’t possible to do so.

The question I’ve yet to address is whether VFI really matters and is inevitably as substantial as it appears to be in any event. Before doing so, I should point out that if it *is* considered that VFI is a problem, one way to fix it would be for the states to hand over (‘refer’) some of their functions to the commonwealth. After all, it might be said, the commonwealth is already funding large parts of state education, hospitals, and roads, for example.

However, there’s a big difference between contributing to the *funding* of state services and actually *delivering* them. The commonwealth has no capacity—or, at least, no comparative advantage—in service delivery, especially on the scale that would be required to run a national schools systems or a national public hospitals system. And for it to do so would result in a loss of the advantages of interstate competition in encouraging, over time, efficiency and innovation in service delivery and the diffusion of successful innovations. The states might not always run their services well, but it’s not obvious that the commonwealth would do any better—likely the opposite, in fact.

In light of all this, Prime Minister Rudd’s threat to take over public hospitals unless the states lift their game fills me with trepidation. I assume that he doesn’t expect to have to do so. But if he did, it would amount to trying to fix federalism by undermining it!

That brings me back to the question of whether VFI as currently manifested in Australia really is a problem and how to fix it if it is.

At the level of principle, I consider there to be good reasons for believing that VFI is a problem, given its extent in Australia’s federal fiscal arrangements. Although perhaps not as compelling as the catch-cry of the American War of Independence—‘No Taxation Without Representation’—it seems to me that the converse of that democratic principle also has some claim to be an important principle. That is, in a matter of speaking, that there ought to be ‘No Representation Without Taxation.’ By this I mean to say that governments that spend money on delivering services to their constituents (citizen-voters) ought to be directly responsible for raising the required revenue to the greatest

extent possible, so that they can be held directly accountable.

In all federal systems, this principle is offended against to some degree, with central governments typically making both tied and untied grants to state-level governments. It is not possible to draw a clear line beyond which reliance on grants at the state level is undesirable. This is so especially if, as I do, you treat tied grants as involving national governments buying services from the states and being willing to wear the political consequences of raising the additional revenue needed to do so. But untied grants, which in effect balance state budgets, are another matter—and certainly so when they are of the significance that they are in Australia. That the states should be substantially fiscally as well as constitutionally independent is important to the vitality and workability of federal systems.

At a more technical level, an argument I've used in the past I now concede to be less clear-cut than I previously suggested. This concerns whether state decision-making is distorted as a result of receiving *untied* grants (tied grants are another matter). Clearly, once commonwealth grants are determined, a state government that wanted to increase spending would have to raise the additional revenue from its own sources: its residents would be aware of the costs to them and the government would risk losing political support if its taxpaying citizen-voters didn't regard it as money to be well spent. What *would* be distorting, however, would be if they were compelled to raise the additional revenue from narrow-based, inefficient taxes for lack of access to a broader-based, less distorting tax.

Although I'll have more to say in a moment about that last point, just to wrap up my discussion of whether VFI is an important issue, I think there is an important principle to be applied, and this alone would justify regarding a high degree of VFI with concern. Whether and how distorting of government decision-making a significant degree of VFI might be isn't as clear-cut. At the very least, however, such grants risk an avoidable degree of blurring of accountabilities—notwithstanding that the citizen-voters who are the beneficiaries of untied grants to the states also fund them through their commonwealth taxes.

Finally, if VFI is in fact a problem, there is the question of how best it might be fixed. The standard answer—one I've frequently given

myself—is that the states should be ceded access to a broad revenue base, with freedom to choose what tax rates they apply to it. Since the GST can never be a states' tax, the obvious answer would be to allow them back into the personal (but not company) income tax field. This could conveniently be done by allowing the states to piggyback on the commonwealth's income tax collections: that is, the commonwealth determines the base and sets its preferred rate schedule, and the states, each independently, choose a flat rate of tax to be collected for them from their residents on incomes above the tax-free threshold. The commonwealth would reduce its personal income tax collections commensurate with a corresponding reduction in untied grants to the states.

There are many details that would have to be worked through, but it would be feasible to apply some such scheme. Indeed, in most federations, state-level governments have a degree of independent access to the income tax base. (In Germany they don't; rather, they receive a constitutionally fixed share of federally collected income tax revenues. But then they do have access to sales taxes and the like, which the Australian states don't.)

That said, I have also frequently pointed out that the ostensible degree of fiscal dependence of the states on the commonwealth is, at least to some degree, a choice the states have made. The most immediately obvious sense in which that is so is their natural preference for the commonwealth to raise the revenue and for them to do the spending out of (part of) it. Note how quiet the states have gone about their fiscal dependence, which always was somewhat ritualistic, since the GST deal.

However, there's another sense in which the states have exercised a choice about their ostensible degree of dependence. From their own tax bases, they have *chosen* to raise *only* \$49 billion compared to the \$42 billion they receive from the commonwealth's GST. They could choose to narrow the gap of their own volition.

The conventional response to this observation (especially from the states) is that their tax bases are narrow and distorting and it would be undesirable to work them any harder than they already have to. But this simply isn't so for all of the tax bases available to them. In particular, the payroll tax base and the land tax base are potentially very broad.

Land tax is one of the most efficient forms of tax, particularly when applied to the value of the land *per se* rather than to capital improved value. The states have chosen to apply it to a narrow base (for example, usually only second homes, though sometimes also to higher-valued owner-occupied dwellings, in the case of residential land). At the very least, they could progressively reduce their heavy reliance on stamp duties on property transfers (which is an inefficient form of taxation) by expanding the land tax base—even if initially at concessional rates on newly included land.

Payroll tax, while apparently an unpopular tax (with business), also has a potentially much broader base than it is effectively applied to now by removing the exemption for small businesses, even if, again, a concessional rate is initially applied to those businesses newly included in the base. The antagonism towards payroll tax is substantially misplaced. It looks (ideally applied) very much like a pay-as-you-earn (PAYE) income tax but with the employer, rather than employee, legally liable for its payment. As with the personal income tax, those legally liable will attempt to shift it, for example through wage-bargaining processes. The outcomes in terms of final incidence, and impacts on employment, seem to me unlikely to be very different between PAYE income tax and a payroll tax.

In short, while there are reasons for regarding the degree of VFI evident in Australia's fiscal arrangements as undesirable, the states could go some way to reducing it themselves by fixing up some of the tax bases available to and used by them. Perversely, the GST deal, while having led to the removal of some inefficient state taxes, has possibly given the states greater leeway to further narrow their payroll tax bases and reduce the tax rate they apply. That isn't to say the GST deal was an inherently bad one, but it possibly has had some unintended, unfortunate consequences.

Fiscal equalisation

Among those who, outside government, understand what it's all about—and they are relatively few—Australia's system for achieving horizontal fiscal equalisation (HFE) is regarded as unnecessarily complex, if not bizarre. That how it operates is incapable of being understood by most is also regarded as a decided weakness—transparency is essential

for accountability—and it is claimed that the way it works distorts states' decisions about how to raise revenue and what to spend it on in an attempt to 'game' the system. Some insiders share some of these concerns.

It surely won't have gone unnoticed that the outcomes of the system are politically contested, too. Successive New South Wales treasurers have been very vocal in claiming that it is unfair and unreasonable that they receive nearly \$2 billion less annually in GST revenues than they would if the revenues were distributed between the states and territories on an equal per capita basis (NSW will receive around \$12 billion in GST revenue during 2007–08, rather than the roughly \$14 billion it believes it's entitled to). A particular focus of the angst of NSW and Victoria, until recently, was that Queensland and, at an earlier stage, Western Australia, both perceived to be relatively rich, were beneficiaries of 'transfers' from NSW and Victoria. Western Australia flipped over to being a donor state a few years ago and, in fact, in the 2008–09 financial year, alone among all the states, is projected to actually receive less in GST grant revenue than it received in the 2007–08 financial year, as a result of its surging own-source revenue. Moreover, Queensland will switch from having been a (modest) recipient state in the 2007–08 financial year to being a (modest) donor state in the 2008–09 financial year, for similar reasons.

Evidently, HFE is currently the most contentious part of Australia's federal fiscal arrangements among observers and insiders alike. It might appear to be a bit odd that this is so, given that the total dollar value of the transfers from 'rich' states to 'poor' states is currently about \$3.3 billion within a total pool of tied and untied grants from the commonwealth to the states of \$64 billion. But then, within a pretty much predetermined total grants pool, the struggle over shares becomes the main game. (In annual treasurers' conferences, then commonwealth treasurer Peter Costello's response to the complaints of New South Wales and Victoria was to say that if all the states together presented him with a unanimous proposal for different shares, he'd implement their agreement!)

I think it would be fair to say that among economic and other analysts, if not among all the main protagonists, the underlining rationale for a system of fiscal equalisation has substantial support. The overarching

objective of the system is to ensure that if there are differences between the states in per capita tax burdens or expenditure levels, or both, they are the results of decisions made through democratic processes, not the results of different states having different fiscal capacities. It is important to emphasise that the objective is to equalise fiscal *capacities*, not fiscal *outcomes*. To try to equalise outcomes would be distinctly anti-federalist.

One rationale offered for fiscal capacity equalisation suggests that there is a sense of equal rights associated with national citizenship. In unitary systems, this is embodied in the fact that central governments deliver broadly equal services in all regions of the country, funded out of national taxes raised according to people's ability to pay, wherever they live. There is de facto equalisation across regions in the sense that regions with people who have lower capacities to pay tax, on average, pay less tax but receive similar benefits to those available in other regions. But note that what's equalised is *outcomes*, in terms of services made available. In federal systems, the sense of equal rights to services is married with a right to nonetheless choose diverse outcomes across regions (states), by equalising the states' fiscal capacities to achieve similar outcomes but allowing outcomes to differ if that's what people choose.

At a more technical but nonetheless important level, the economic rationale for fiscal equalisation relates to incentives that people otherwise might have to make inefficient location decisions. From a national perspective, it is best if people choose to locate where their skills can be used most productively. However, if, for example, one state provides similar services to the others, but has the capacity to do so at lower tax burdens per capita, at least some people might be induced to move there even though their employment would be less productive. They'd receive lower private incomes but sufficiently higher 'fiscal benefits' to make the move worthwhile.

So, overall, fiscal equalisation reflects notions of fairness (contrary to the suggestions of some state treasurers and premiers) and can help to ensure efficient location decisions. Although these propositions aren't universally supported by commentators (in the media especially), they are by most serious analysts. What is also widely agreed, however, is that the way in which the extent of fiscal transfers appropriate to achieve fiscal equalisation is determined is seriously open to questions.

The assessments are undertaken by the Commonwealth Grants Commission (CGC), a commonwealth statutory body which makes recommendations to the commonwealth about how the GST revenues should be distributed between the states so as to achieve fiscal capacity equalisation. Broadly speaking, it assesses the relative per capita capacities of the states to raise revenue from each of their revenue sources separately and their relative per capita expenditure needs for every recurrent state expenditure category. It's a complex process with huge information demands and ties up substantial resources not only in the CGC itself, but also in all state treasuries. There is a regular pattern of major reviews of how the methodology is being applied during which each of the states devotes considerable time and effort to analysing, and arguing for, changes that would be favourable to them.

The complexity, the opaqueness and the time-intensity of the process, and the possibility of the system being 'gamed,' among other things, have led to repeated calls for a rethink and redesign of the methodology. It is relatively easy to think of how the revenue-raising capacity side of the calculations could be simplified: for example, by using state average per capita incomes as an indicator of general revenue-raising capacity plus, importantly, the per capita capacity of each state to raise revenue from mining royalties, since that is likely to be the biggest difference between the states. However, to simplify the expenditure needs side of the equation is much less obvious. Factors such as remoteness, and the particular expenditure needs related to Indigenous communities, would seem likely to be of some consequence that can't be overlooked. Taking the expenditure side out altogether doesn't appear desirable.

The previous government asked the CGC to come up with a simpler system. I agree wholeheartedly with Jonathan Pincus's view that it would be far preferable that there be a fully independent inquiry asked to redefine the objectives of fiscal equalisation and to design as simple and transparent a system as possible to help achieve them. This would not *eliminate* the contentiousness of fiscal equalisation—matters distributional will always generate some heat—but likely would reduce it if there was clarity and broad agreement about its objectives and simplicity and transparency in the processes for achieving the objectives.

Concluding remarks

I have traversed essentially political as well as fiscal issues in my discussion. I have done so, to reiterate my earlier point, because I see processes and practices proposed by many—and being used currently—for federal reform as involving a significant risk of disempowering citizen-voters. The key strength of a federal system compared to a unitary system of government is that it enhances citizen empowerment: trying to fix federalism through means that exclude or reduce citizen participation has no appeal to me. A political system that gives citizens multiple points to exert their ‘will’ results in considerable messiness in outcomes, but is, most often, a sign of its healthiness.

So far as fiscal issues are concerned, I would make three points by way of summing up.

First, I do not regard SPPs with the degree of antipathy many do. I see them, for the most part, as the commonwealth purchasing outcomes for its national constituency in areas controlled by states, having to impose higher levels of taxation on its constituents to enable it to do so. Moreover, there are few SPPs that appear to me to be distorting the capacity of the states to respond to the preferences of their constituents. That said, the reforms currently underway will test the alignment of national and state-level preferences and objectives and give the states greater capacity to choose how to deliver intertwined objectives.

Second, the hypothecation of GST revenues to the states has removed, at least for the time being, one of the points at which conflict previously existed in commonwealth–state relations and has resulted in elimination of a number of inefficient taxes previously applied by the states. I’d have preferred it to have been done through allowing the states back into the personal (but not company) income tax field, albeit in a managed way, but that’s probably been made less likely than it ever was as a consequence of the GST deal. Moreover, while I consider VFI to be a significant issue, at least from the perspective of applying sound democratic principles to the design of federal fiscal arrangements, the states have some capacity to reduce it themselves by broadening, and using more substantially, some of the tax bases available to them—most notably land and payroll taxes.

Third, and finally, the application of processes for achieving fiscal equalisation is currently the most contested part of commonwealth–state fiscal arrangements, among the states and independent experts alike. Since it involves a distributional issue, it will always be somewhat contested by donor states, but an independent review of its objectives and of how to achieve them in a simple, transparent way is one ‘fix’ of fiscal federalism that would be highly desirable.

Federalism and the Pursuit of National Reform

Ken Baxter

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Victorian Department of Premier and Cabinet

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As far as I have been able to establish, I am the only person since Federation to serve as the head of the premier's department in two states and also to have worked for the commonwealth. Also, I have been involved directly with major property rights issues involving conjoint commonwealth and states' legislation, and have seen the policy and administrative issues of working within the current system.

Over the last thirty-four years, as part of contemplating what the future of the Australian political system might and should look like for the next one hundred years, I have spent considerable time investigating and analysing the structures and outcomes of various federal systems and the national unitary governments and the systems that support them.

The conclusion is that 'federalism' is the least worst political system in countries the geographical size of Australia, India, Canada, the USA, and possibly also in Germany, although geography is less a constraint than history in that country.

However, one of the things that has always puzzled me is why our New Zealand brethren, who attended the original constitutional conventions, have been more prepared to undertake radical reform. Lange and Douglas might have been driven by the TINA ('there is no alternative') principle, but that was not the driver for MMP (the mixed member proportional electoral system).

Prima facie, there is considerable political, administrative and commercial merit in dealing with international affairs, defence, and tax

collection and reimbursement nationally, and for the delivery of physical and social services to be left to the states and local governments, and for there to be a degree of competition between the states. This is an important consideration in discussing the achievement of reform in the Australian federal system.

There are numerous premises and assumptions inherent in the propositions about the efficacy of the Australian federal system—some are political, some are administrative, and others are geographic and demographic. One of the key premises is that the pre-colonial borders determined prior to Federation and incorporated in the Australian Constitution are appropriate, logical, and the least inefficient way of structuring a political system and delivering services to its people.

Another is the appropriateness of the allocation of specific powers to the commonwealth in the Constitution, the sharing of powers between the commonwealth and the states' governments (and in some cases, local government) and the accumulation of residual powers, obligations, and functions by the states.

Another is the ability and capacity of the commonwealth, states, and local government bureaucracies to efficiently and effectively carry out their roles and responsibilities, which include devising and implementing policies that meet the demands of modern Australian communities. In my mind, this matter is far more important than people think—both in terms of creating real competition and fulfilling accountabilities to taxpayers.

As an example, the capability and efficiency of the NSW public service has declined significantly while its numbers have increased substantially. Thus, the capacity to compete with other states with far more efficient bureaucracies is constrained.

From time to time since 1901, Australian governments have recognised that reforms or changes (or both) were required to policies, systems, and services.

Regrettably, in one way, some of the major reforms arose because of World Wars I and II. The best examples are the consolidation of the income taxing powers in the hands of the commonwealth, putting on a national basis many of the states-based agricultural marketing schemes and many of the broader regulatory arrangements.

However, the agricultural marketing schemes illustrate the constraints that are imposed by the existing division of powers. It took forty years to reform the egg industry, fifty years for the dairy industry, the wheat marketing sector is still clomping through reform (largely activated by a goodly dose of bribery and corruption) and Western Australia still sports a potato marketing board!

Another recent example, leaving aside the real as against the symbolic impact of banning plastic shopping bags, is the incapacity of the commonwealth and the states to reach an agreement on how citizens should carry home their groceries. The incompleteness of the policy debate about this arcane issue and an absence of the real cost-benefit analysis of the proposal illustrates why ministerial councils should be abolished. It amply indicates the difficulties of securing national reforms or changes—on a policy, political, and administrative basis.

In the late 1980s and early 1990s, a group of politicians from across party lines and divided between the commonwealth and the states recognised that Australia was, and remains, a single nation and should be treated as such in an international context. They saw creating Australia as a single national entity in the eyes of the world as one of a number of measures required to enable Australia to improve productivity and compete internationally.

The politicians were supported by senior bureaucrats in the commonwealth public service and a number in some of the states—including Kevin Rudd, who was the then head of the cabinet office in Queensland under Premier Wayne Goss.

It needs to be observed that in all the states, and some sections of the commonwealth, there were ministerial and bureaucratic ‘mafias’ that resisted vigorously any change, let alone significant reform—health, housing, transport, law, and education were the most notable. The degree of progressive, forward-looking policy in these areas was minuscule. Some of these areas continue to be issues of serious national concern, such as health, transport, and housing.

The torpor was reinforced by the system of ministerial councils and the then Specific Purpose Payment (SPP) arrangements—many of which were outside the annual budget processes. In many cases the greatest contribution of the ministerial councils was to the Australian

and New Zealand tourist industry. In the middle of the year, they met north of the Tropic of Capricorn and in summer months in places like Hobart and Queenstown.

As much as I hate to admit it, two of the most recent and necessary reforms have been achieved not by the development of sectoral policy, but by Treasury-driven imperatives.

The first was the introduction of the goods and services tax.

The second is the very recent change to the system of Specific Purpose Payments *and* the introduction of competition-policy-type incentive payments *after* conditions have been complied with by the states.

If the prime minister and his government have the courage and accumulate the skills to put in place a real, effective, performance-based system related to outcomes as against outputs, it will secure far more real reform than by new legislation or controls by regulations and administrative fiat.

Over the last twenty-five years, there have been some significant changes that would be regarded as reforms. One of those was the introduction of National Competition Policy in the mid-1990s. This involved significant changes to the *Trade Practices Act* that had been introduced by Sir Garfield Barwick when he was Attorney General and then strengthened by Lionel Murphy.

The competition policy reforms arose from politically bipartisan pressures initiated largely by premiers Greiner and Goss and prime ministers Hawke and Keating.

These reforms were strongly supported by some of the senior bureaucrats at the time—both in the commonwealth and the states. However, at lower levels of both tiers of the bureaucracies the reforms were not well understood, and in many cases vested interests used that lack of understanding to stall or railroad reforms—in relation to mutual recognition over a very broad spectrum of issues, for instance.

Some of those reforms have been very powerful. They have not only dealt with specific areas of the economy. They have affected the economy as a whole in a positive way, the major impact being the implementation of the notion that Australia is a national market.

However, some of those so-called reforms have been largely in name only—mutual recognition, single rail gauges and everything that

should accompany them, workers' compensation, etcetera—and we are still arguing about national workers' compensation and occupational health and safety arrangements, let alone the mutual recognition of hairdressers!

Many of what might be regarded as 'second tier' reforms have faltered because vested interest groups such as professional associations, trade unions, and elements of the states' bureaucracies have either 'gone slow in their implementation' or have continued to oppose them.

It is pleasing to see that the new federal government has indicated a commitment to cooperative federalism, assuming that the existing structure of government cannot be significantly changed and thus accepting the necessity of making the current system work a great deal better than it is working at the moment.

It comes also at a time when some sections of the commercial sector have returned to arguing that monopolies or duopolies or cartel-type operations should be supported or condoned because of the alleged benefits to shareholders and the economy. Telstra and Qantas are the most prominent exponents. Interestingly, both are former government-owned businesses!

It is to be hoped that the new government remembers that the drivers for the reforms of the mid-1990s were not based on making the system work per se, but rather that:

1. The interests of four to five million shareholders did not equal those of twenty million consumers.
2. The major way to improve Australia's international economic competitiveness was to increase and to continue to increase productivity.
3. The costs of society's overheads—both public and private sector—needed to be contained.
4. The Australian society and its economy had to be as open and as flexible as possible to attract new investment and attract new technology, and use it in a way that would improve the ordinary Australian's standard of living.
5. The conditions needed to be created and sustained that prevent us retreating to a series of duopolistic, rent-seeking dinosaurs that

would again stall our economic growth.

6. Possibilities created by rapidly growing Asian economies would be quickly translated into opportunities for Australia.

The revival of the Council of Australian Governments (COAG) following the election of the Labor government and the years during which it had faltered under the previous government is a positive step. For all its faults, COAG is far better than the old system of premiers' conferences, loan councils, and meetings of commonwealth and states' treasurers.

Apart from the financial measures that flow from the changed arrangements for the SPPs, there need to be some major changes to the COAG structures and processes if the breadth and nature of national reform is to be accelerated.

Some of these changes are:

1. The twenty-seven ministerial councils need to be replaced by five groups reflecting the streams of payments flowing from the new arrangements with the SPPs.
2. The five groups should be chaired by federal ministers and supported by either a senior federal or state bureaucrat—as has been done with the current Housing Taskforce Group, where Tanya Plibersek is the chair and Evan Rolley, the secretary of the Tasmanian department of premier and cabinet, is the senior bureaucrat heading a small official taskforce.
3. The notion of 'competition policy' type incentive payments should apply to all the streams of SPPs by the commonwealth to the states.
4. As has been done with GFS accounting, the commonwealth and the states should agree a standard set of *rigorous*, credible performance criteria that regularly measure results, not outputs, and make sure they are implemented.
5. The commonwealth should institute a review of parts of the commonwealth public service to ensure it has the capability, capacity, financial resources, and management information supporting IT systems that will enable the commonwealth and

states to analyse and publish credible performance data. As an example, I would not be confident that the commonwealth department of health has the capability, resources, and systems to rigorously analyse the states' health performance data.

6. There needs to be an urgent revision of the Australian Constitution, with special attention to section 51(i)–(xxxix), and possibly chapter IV dealing with finance and trade.

It might also be appropriate to revisit chapters V and VI in relation to the states and new states! Short of having the sort of courage the New Zealanders have demonstrated, I suppose I reach the view that we have the least bad political system and we would be hard pressed to design and implement something better.

Where To for Australian Federalism?

Reform of Australia's federal system was one of the key parts of the Australian Labor Party's 2007 election platform. The Rudd government has since begun implementing its vision of reform through the Council of Australian Governments and other fora.

In May 2008, the Centre for Independent Studies convened a round-table discussion of experts on federalism from academic, government, and business backgrounds. This CIS Policy Forum publication collects the six presentations made by the round-table's discussion leaders, edited with a preface and overview by Robert Carling.

These papers all give their general support to Australia's current structure of government, but see room for improvement in the way the system functions. They present diverse views—on the balance of cooperation and competition between the states,

Robert Carling is a senior fellow at the Centre for Independent Studies.

Cheryl Saunders is a professor of law at the University of Melbourne.

Jonathan Pincus is a visiting professor in the School of Economics at the University of Adelaide and a visiting researcher at the Productivity Commission.

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