

FEDERATION? Better together in collaboration or happier apart in competition

Ken Smith, Dean and CEO
ANZSOG

WA PSC/CEO's Luncheon, Perth
Wednesday 26 July 2017

Structure of Presentation

- Why the states are here to stay
- Benefits of a Federal system – competition and collaboration.
- How did we get here ?– A short history of Commonwealth expansion.
- Cost of Commonwealth Overreach
- Vertical Fiscal Imbalance – the flaw at the heart of our federation.
- What’s the way forward?
- Q and A and Commentary

FEDERALISM IS OUR ONLY REALISTIC OPTION

- Any plan to abolish the states is totally unrealistic.
- A country of Australia's size and diversity would still need regions and local governments
- Federalism is not inherently inefficient, or outmoded.
- Federalism recognizes our states face different issues internally and externally both in Australia and Globally

WA and Queensland's similarities

- WA and Qld are similar in many respects:
- Both feel remote from the centres of power – the Syd/Melb/Canberra triangle
- Both feel misunderstood, and that they contribute more than is recognized .
- Not a coincidence that both face similar financial challenges , after a period of rapid population growth and the slowing of their once in a generation mining booms.
- Current system fails to recognize the pressures faced by fast-growing states with remote and decentralized populations.

THE ADVANTAGES OF FEDERALISM

We often ignore the advantages of a federal structure. Here are a few overlooked benefits – that academics Glenn Withers and Anne Twomey in *Federalist Paper 1: Australia's Federal Future (2007)*, describe as the “Six Cs”

- Checks on power
- Choice in voting options
- Customization of policies
- Co-operation
- Competition between jurisdictions.
- Creativity.

MORE EFFICIENT, ECONOMICALLY STRONGER

- In the last 50 years, federations have consistently out-performed unitary states in economic terms. The more decentralised the federation, the better the performance.
- Withers and Twomey (found that despite having an extra layer of government, federations have proportionately fewer public servants and lower public spending than unitary states.
- The total workforce employed in the entire Australian public sector has declined over 30 years from 25% per cent to 16%.

FEDERALISM'S CONTEMPORARY RELEVANCE

- Opponents sometimes refer to it as something from the 'horse and buggy' era – which has outlived its usefulness in the modern era.
- But federalism remains the best way of reconciling the greater pressure to bring government closer to the people, with the supra-national demands of globalisation.
- Subsidiarity and place management are not outmoded concepts.
- Every developed nation has at least two, usually three levels of administration.

WHAT'S HAPPENING IN EUROPE

If you look beyond the hype around Brexit – Western Europe is devolving power to more local levels.

- In France, a unitary state, powers over higher education, industrial policy and regional infrastructure were transferred to the regions in 2003 – plus taxation powers.
- In 2006 Germany passed major constitutional reforms, described by the Bavarian Premier as the ‘mother of all reforms’. Sole responsibility for certain matters, such as education to the states
- In Italy, another unitary state, fiscal reforms in the last two decades have given the Italian regions greater power to impose taxes and access a fixed share of national taxes, ending use of tied grants.
- In the United Kingdom, significant powers were devolved upon Scotland and Wales in 1999, including the establishment of associated legislatures and the “northern powerhouse” of cities.

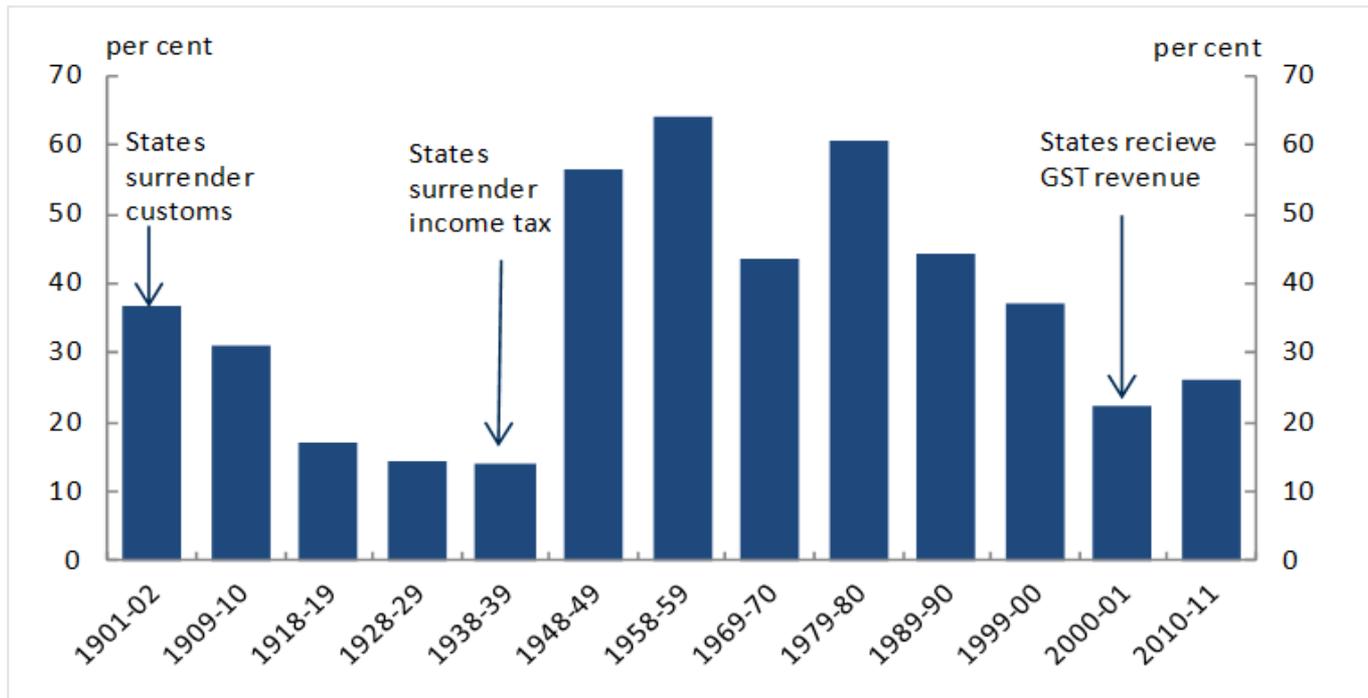
NEED FOR COLLABORATION AND COMPETITION

- A successful Federation is based on both competition and collaboration.
- It should be based on a relationship of equals between the states and federal government – not one where states are seen as subservient service delivery agencies.
- Competition allows states to compete by exploring different ways, learning from each other, and ‘ratcheting up’ to the best model.

HOW DID WE GET HERE?

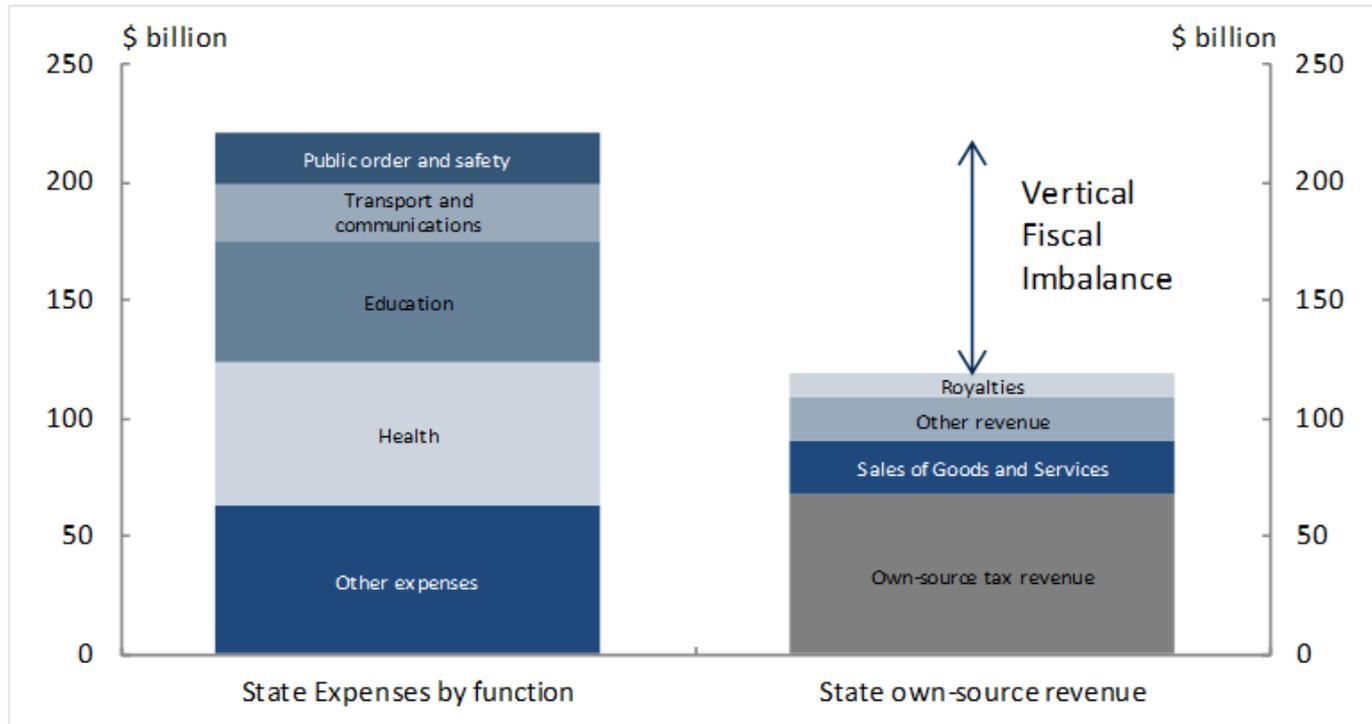
- The current imbalance, and the over-reach of the Commonwealth, is not what our Constitution intended.
- It was well accepted in the first half of the 20th Century that the Commonwealth had limited spending powers.
- Only way it could spend money outside of the subject matters granted to it by the Constitution was to make grants to the states under section 96 of the Constitution.

A BRIEF HISTORY OF VFI



Source: National Commission of Audit, 2014

THE SIZE OF THE VFI GAP



- Source: 2013-14 State Budgets; Australian Government, 2013b (Collected in the National Commission of Audit Report)

OPPORTUNISTIC FEDERALISM

- Commonwealth's fiscal dominance leads to sporadic, unco-ordinated interventions based on the politics of the day.
- For example the school chaplains program and take over and failed attempt to run one hospital in Tasmania.
- This is accompanied by the use of the financial powers to coerce, rather than work with, the states.
- Questions of which level of government is best suited to a task are ignored – as the level with the funding calls the shots.

Commonwealth's financial dominance distorts our federation

- Commonwealth sees funding provided to the states as 'their money' and believe state sovereignty and accountability is subordinate to its own agenda.
- The Commonwealth has unilaterally given itself the right to spend on almost any issue, without taking full responsibility.
- How do we rebalance our federation so we can take better advantage of its potential benefits?

COMMONWEALTH OVER-REACH NOW EMBEDDED

- *“From the 1970s into the 2000s, the Commonwealth built up a massive edifice of spending based upon little more than an aspirational view of the extent of its executive power and the hope that no court would be willing to knock it down.”* – Professor Anne Twomey, CEDA Report, p.72

Regardless of their political stripes no post-Whitlam government has tried to stop this shift of power.

STATES HAVE LARGELY BEEN SILENT ON THE TAKEOVER

- We are now left with what former NSW Premier Nick Greiner described as: ‘the present multi-faceted, wasteful, ineffective shambles that passes for Federalism”.
- No State Government has put its hand up for more fiscal responsibility.
- As Joh Bjelke-Petersen said in response to Malcolm Fraser’s plan to give states more control over income tax: *“The only good tax is a Commonwealth tax”*

VFI: THE FEDERATION'S FATAL FLAW

- Federation has evolved so that Commonwealth takes in revenue, while states have service delivery responsibility
- *“The worst of all possible worlds. The states don’t have the fiscal freedom to deliver the potential benefits of federation, and the Commonwealth does not have the capacity for effective central exercise of government.”* — Professor Ross Garnaut, quoted in CEDA Report p.38
- Changing GST distribution is not the sole answer – complexities in setting the scope and rates.

THE 1980s AND 1990s

- Hawke had more of a partnership approach and accepted many functions would be shared.
- the Commonwealth's greater revenue and policy capacity meant it could directly fund reforms such as Medicare
- Other initiatives included the significant National Competition Policy, a national electricity grid, food labelling and rail freight.
- Under the Howard Government, despite the introduction of the GST, the centralising impulse continued – for example shifting Industrial Relations responsibilities to the Commonwealth.

THE LAST DECADE – A LOST DECADE?

- In the last decade the major reforms delivered by this kind of co-operative federalism have stalled
- Both Labor and Coalition governments at Commonwealth level have taken different, largely failed, approaches.
- Both sides have not challenged Commonwealth dominance, or the distortions of VFI. Reforming financial relations seen as too hard.
- We need a new compact.

RUDD'S CO-OPERATIVE FEDERALISM

- Then PM, Kevin Rudd tried a more 'co-operative federalism' based on joint funding of key areas.
- He floated a Commonwealth takeover of the health system. Quarantined the states' GST revenue to pay for these reforms; Wanted Commonwealth to be the 'dominant funder' of public hospitals.
- This reform relied on using Commonwealth funding as an incentive and, despite best intentions reinforced VFI and Commonwealth control of inputs.
- Rudd reforms replaced some tied grants with NPPs – which instead of settling the 'blame game' reinvented previous duplications and control.

ABBOTT AND TURNBULL

- As PM, Tony Abbott, was an early advocate of the Commonwealth takeover of the health system, before announcing via the 2014 Budget that “the states were responsible for public hospitals and schools and would have to take on more responsibility for those areas of government.

THE ABANDONED WHITE PAPER

- Abbott subsequently announced a federation White Paper in 2014 to look at: *'clarifying roles and responsibilities so that state and federal governments are, as far as possible 'sovereign in their own sphere'*
- The 2015 Green Paper canvassed a range of options, from a federal takeover of key service delivery areas to giving states a fixed share of income tax revenue.
- In 2016 new Prime Minister Malcolm Turnbull abandoned the White Paper process.
- He chose the carpark of the Penrith Panthers Rugby League Club to announce that he would present a proposal to allow the states a share of income tax – and the power to raise or lower rates.
- When States rejected the proposal a few weeks later it was quietly abandoned.

HIGH COURT'S NEW APPROACH

- While progress stalled politically – the High Court has begun a major shift in its approach.
- In a series of cases brought by individual taxpayers from 2009 to 2014, the High Court made it clear that:
 - The Commonwealth can only undertake direct spending upon matters within its allocated legislative powers.
 - For the most part, actually needs to legislate so that there is parliamentary authorisation of the expenditure of public money.
- Commonwealth can still make tied grants.

ITS PUBLIC MONEY NOT COMMONWEALTH MONEY

In the Williams case, which examined the legality of the School Chaplains program, the Commonwealth argued that it could spend money on anything, as long as it was the subject of a valid appropriation, or could have been the subject of a validly enacted law.

The High Court rejected both arguments. In doing so, it relied upon three essential factors:

- 1. The principles of federalism;
- 2. The requirement that the executive be accountable to the Parliament; and
- 3. The fact that the Commonwealth was spending ‘public money’ rather than its own money

COMMONWEALTH CAN'T SPEND JUST FOR POLITICAL ADVANTAGE

“The third point that the High Court made is that the Commonwealth is not spending its own money. Rather, it is spending public money, and must therefore be more accountable. This point can’t be stressed enough. It is not money that may be used to maximise the political and electoral advantage of the Commonwealth Government (whichever party happens to be in office). It is money raised from the public for the purpose of providing government services and infrastructure to the public at both the Commonwealth and state level.” -

Professor Anne Twomey’s analysis of the Williams decision (CEDA Report, p.77)

HOW DO WE MAKE THE FEDERATION WORK BETTER?

- System that effectively deals the problem of Vertical Fiscal Imbalance (VFI).
- Restore authority and accountability to states
- Allows the Commonwealth to focus on its core areas of responsibility domestically and internationally.
- Allows us to unlock the potential of a federation – that provides enables the benefits of both competition and collaboration.
- States also need to deal more effectively with the important principle of subsidiarity

WE HAVE BECOME 'BLAND HOMOGENISERS'

“As a nation we have become bland homogenizers and turned our backs on the benefits of diversity inherent to a modern federation. We strive to fit all our states and regions into a one-size-fits-all national policy approach. In the process we ignore the changing settlement patterns and demographics that show the emerging regional differences across the nation.”

Jennifer Menzies – Inaugural Secretary of the Council for Australian Federation (quoted in CEDA’s “A Federation of the 21st Century p.65)

WHAT SHOULD BE THE COMMONWEALTH'S ROLE?

- Commonwealth has some clear responsibilities: defence, immigration, foreign affairs and trade, pensions and welfare.
- It is not a “Swiss Army” knife that can do anything.
- In the Pink Batts program, the Commonwealth ran implementation despite states having all the expertise in the related safety and consumer issues.
- In general Federal Government does not do direct service delivery well (let’s talk, Aged Care).
- As the previous Treasurer Joe Hockey said: *“Canberra is a long way from the services...we are not good at it.”*

STATES MUST PUSH THEIR CASE

- We have now have some High Court decisions to support a more mature form of of federalism.
- Who is going to make the arguments for returning finances and control to the states?
- History tells us it won't be the Commonwealth. States need to step up and shape the debate.

CONCLUSION

- States are best placed to address many of the key policy and service delivery functions in Australia. They need to be more case and place responsive.
- The federation would be better served if the Commonwealth reduced its role, and states had the financial independence and accountability – either through fixed access to untied funds, or specific tax sources.
- Any attempt to clarify roles of government, or reduce duplication, must begin with fixing the problem of VFI. If we don't any fix will be temporary.

CONCLUSION PART 2

- Maintaining equity between states can still be achieved, with an ongoing role for the federal government to ensure availability and access to quality services across the nation.
- But this should be done, not by controlling inputs, but having an independent capacity to monitor outcomes and data to drive improvements.
- State Govts need to embrace greater responsibility for raising revenue and be accountable to their communities . It is in our long-term interest to do so.

anzsog.edu.au

 twitter.com/anzsog

 facebook.com/anzsog

 youtube.com/user/theanzsog

 linkedin.com/company/the-australia-and-new-zealand-school-of-government-anzsog

