

Australia's federation:

How it is broken and
why it has to be fixed

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Institute of Public Affairs
February 2008



Introduction

Two separate but complementary comments in a 2006 parliamentary library research brief, provide a neat summary of the history and contemporary positions on the issue of federalism:

The Australian federal system, which came into existence in 1901, has generally worked satisfactorily...¹

There is a general consensus, therefore, that the Australian federal system does not work as well as it might ...²

Any review of the Australian federation should start by reviewing whether federalism remains an appropriate system of governance for the nation, before considering the recent history of the federal arrangements and prospects for future improvements.

Federalism in principle and Australia's states in practice

There are regular calls for the abolition of the Australian states. There are three main reasons why these are ill-conceived.

The first is that it would seem odd for Australia to move away from federalism at the very time when the model seems to be becoming more popular in other parts of the world. As Hueglin and Fenna explain in *Comparative Federalism: A Systematic Inquiry*:

... more than half of the world's space and nearly half of its population are governed by some form of federation. While some of the classic federations may be showing signs of intergovernmental fatigue, there has been an outburst of federalization elsewhere.³

Further, studies have shown that 'over the past 50 years, federations have outstripped unitary systems in economic performance'.⁴

The second is that despite claims that their boundaries are anachronistic, or artificial, the Australian states do have real contemporary relevance. While any drawn boundary is in one sense inherently artificial, the differences between Australia's states are, in fact, very real and would certainly be far more real than those between any replacement regional areas. While there has been a huge increase in interstate commerce since 1901 the capital cities are still, in both an economic and cultural sense, the centre of their states. Goods tend to move towards intrastate transport hubs and people gravitate towards their own capitals for higher education, specialist health and for cultural and sporting activities.

The third reason why calls for abolition of the states are ill-conceived is what could be called the democratic reason. Whenever the people of Australia have been asked to express a view through the electoral process,

they have supported the retention of the states' powers. All 17 constitutional amendment proposals to increase Commonwealth economic power have been defeated, as have four non-economic ones. Similarly, Australians have twice refused to grant local government a formal place in the constitution. In fact, if we exempt the referenda that proposed structural change in our federal system from the list, almost half the others have passed.

It is hard to avoid the conclusion that former Queensland Premier Peter Beattie was correct with his practical assessment that 'no referendum on the abolition of the states will succeed within the next 50 years'.⁵

Proponents of state government abolition can cite a couple of surveys done earlier this decade, which suggested that citizens in some Australian states would prefer a two-tier model, without the states. However, it needs to be recognised that the sample sizes of the surveys were small and they may also have reflected the frustrations of the time with performance of particular state governments.⁶

It is perfectly reasonable that people should think that we are over-governed in Australia. Perhaps it is also a natural reaction if one of three tiers needs to be abolished for the middle one to be the obvious candidate. This is a similar phenomenon to the one that seems to grip large segments of the business community. In the lead-up to last year's election the Business Council of Australia and the peak body for companies building infrastructure, Infrastructure Partnerships Australia, both released papers arguing for a stronger Commonwealth role in a range of areas. A recent article in *BRW* highlighted how short sighted this approach could be and pointed to the risks that the federal government is just as likely to wield power unwisely as wisely.⁷

Business groups generally embraced the High Court ruling against the states challenge to the Work Choices legislation. But as former ACTU Secretary, Bill Kelty noted in the aftermath of the election:

There will be one lasting contribution of the Coalition government and that is to provide unambiguous national power in dealing with the key issues of water, industrial relations, indigenous health and ultimately, public hospitals. Future governments can now use that power constructively and consensually.⁸

The Howard government: coercing the states

Liberal Party historian, Gerard Henderson, made clear that John Howard was 'a Liberal with a difference' when it came to his attitude to the federation. Whereas Robert Menzies, Harold Holt, Billy McMahon and Malcolm Fraser were all federalists, the only previous Liberal Prime Minister with an attitude to the federation as centralist as

Howard's was John Gorton and, as Henderson explained, his 1971 downfall was 'partly due to the poisonous relationship he had developed with coalition premiers'.⁹

Nevertheless, even those federal Liberal governments under the stewardship of avowed federalists have sometimes acted in a centralist manner. The Menzies government increased commonwealth involvement in a range of areas such as education through the funding of science labs and libraries from 1963 onwards, and health with the introduction of commonwealth subsidies to private health insurance in the early 1950s. Under Holt, the federal government's centralising tendencies were sufficient for the Victorian Liberal Party state council to consider a motion condemning the growing Commonwealth role.¹⁰

The Fraser government attempted a more genuine piece of reform of the federation than any other modern Australian Liberal government. Its 'new federalism' accepted the legitimate role of the states, however, it foundered in large part due to the states being legitimately wary of how their 'guaranteed' share of the revenue could be altered by future federal governments.

In contrast, the Howard government set a new benchmark for centralism for non-Labor governments in Australia. Howard was unapologetic about the federal government taking action when he believed it was required commenting that he had 'little time for state parochialism' and denied that he had ever been one to genuflect uncritically at the altar of states' rights'.¹¹ Other Howard government ministers, such as Tony Abbott also reflected on how their attitude to federalism had changed over their time in government.

There were two aspects to the Howard government's significant alteration of the federal-state relationship. The first was to introduce the GST as a major funding mechanism for the states. The second was a whole series of actions, many very small in themselves, but which were noteworthy for their collective rationale that they were being undertaken to rectify real or perceived specific state government shortcomings. This phenomenon has tended to attract the title 'opportunistic federalism'.

The new tax system, including the GST, was announced, negotiated and introduced when there were still state and territory Liberal governments. It is interesting to speculate whether the desire to give the states a 'growth tax' would have been as strong if they had all been Labor at the time. Similarly, it is hard to believe that the opportunistic centralism of the latter years of the Howard government would have been as pronounced a strategy if not for the fact that from February, 2002 until November 2007 it was the only Liberal government in the nation. The fact that this period coincided with the increased confidence in its own electoral popularity that the Howard government gained by its comeback win in the 2001 federal election was perhaps also a contributing factor.

Of course, there was no inherent reason to include federal-state relations as an element in the introduction of the GST. Richard Eccleston has commented:

The least anticipated aspect of the package was the proposal to restructure fiscal federalism by allocating all of the GST revenue to the States via the Grants Commission in lieu of their general purpose grants, provided that they abolish nine existing State-based indirect taxes.¹²

This is not the venue for a discussion of the merits of the new indirect tax per se, but in terms of the states and territories it presented them with a huge financial windfall. The economist Mike Nahan wrote that:

In the main, the States have squandered their reform bonus. While there is variation among the individual States in terms of fiscal performance, through a combination of sloppy budgeting, failure to control public service wages, and a propensity to throw money at problems, they have, in aggregate, consumed their reform bonus without undertaking reform or investing in infrastructure.¹³

It was perhaps only natural when many critics were pointing out the failings of state Labor governments, the federal government would see an opportunity to attack the Labor brand. Oddly, it tried to combine these attacks with a position also maintaining that the GST was a state tax and should not be included on the federal books.

Also contributing to the growing federal interest in state areas of responsibility was a campaigning paradigm that placed huge emphasis on exploiting local issues. Federal coalition MPs were told by strategists not to 'pass the buck' and to use state, and even local, issues to demonstrate their own credentials as a grass roots local member.¹⁴

MPs not only responded to problems raised by constituents, but also through the use of mechanisms such as questionnaires at railway stations found out about perceptions of crime on public transport, knowing full well that both public transport and policing were state responsibilities. This fact, in many ways, added to the perceived attraction as it meant that federal MPs could hardly be criticised for the problem having arisen, while they could claim credit for attempting its rectification.

Huge increases in MPs' printing and postage budgets exacerbated this tendency to blur the traditional lines of responsibility. Newsletters and brochures tend to be full of pictures of MPs presenting grants to local sporting clubs and environmental groups, or announcing federal funds for a black spot on a local road. Campaigning strategists quickly realised that specific local material was more likely to be read than general policy information, so the simple need for content actually overrode states' rights.

Most of these projects were small enough to only gain local attention, but sometimes there were big enough sums of money involved, or radical enough policy implications to attract national attention. A classic example was when the federal government offered \$40 million and a takeover plan for the Mersey Hospital in Devonport. While the people of Devonport were understandably upset by the loss of services at the local hospital, it certainly appears as if the decision of the Tasmanian government to rationalise services in north western Tasmania was a logical one, given the availability of medical professionals and funds.

Undoubtedly, the use of state issues had been made more attractive for the federal coalition from 2002 when the last non-Labor state government was voted from office. There seemed to be little downside in attacking their Labor replacements. However, even in the short-term there were.

By its piecemeal involvement in a variety of state issues the Howard government achieved the counterproductive outcome of making people feel that the Commonwealth was equally culpable for the failings of the state governments in areas like hospitals, roads and ports. This was backed up by research on the 2006 Queensland state election which showed that a significant number of voters blamed the federal government for failing to fix the state's hospitals apparently 'believing that there are enough funds at a federal level to fix everything'.¹⁵

Many people pointed out how odd it was in the lead-up to last November's federal election that so many of the issues being debated were in fact state issues. Tim Colebatch observed in *The Age*, in the final week of the campaign, that 'almost the entire election has been fought out on state government turf'.¹⁶ After the election one Labor candidate somewhat crudely said of his Liberal opponent using state issues in the campaign—'They thought people were stupider than what they really are'.¹⁷

One by-product of the actions of the Howard government was to create real problems for state Liberal oppositions to define their roles. The federal government was effectively delivering a message to voters disaffected with state government performance that the appropriate method of redress was not at the ballot box, but through Commonwealth intervention.

However, perhaps the most serious consequence that the Howard government's attitude towards the states had was to build up an enormous duplication in bureaucracy. This duplication was a significant factor in the growth of almost 50 per cent in the federal bureaucracy from 1998 to 2007.

The Rudd government: cooperating or coercing?

In some ways, federalism is an easier issue for Labor than for its opponents. It does not have to deal with an avowedly federalist tradition, nor does it have the philosophical commitment to small government which motivates at least some elements of the Liberal Party.

Thirty years ago progressive opinion, from Gough Whitlam down, was united in its view that Australia would be a much better place if the states were abolished and the powers of the Senate were dramatically reduced. The traditional progressive, or left, position on Australia's federation was described by Brian Galligan in 1989 as 'an influential body of expert opinion' which propagated a view that 'colours much of the post-war commentary on Australian constitutional politics'.¹⁸ The general position of this expert opinion was to lament the conservatism of the Australian people in refusing to amend the constitution when presented with progressive referenda. Geoffrey Sawer explained this attitude:

The Australian labour movement, and the Australian Labor Party (ALP) which emerged from that movement, have never been enthusiastic about federalism as a form of government. Like most political movements and parties, the ALP has been more interested in social aims and policies than in the structure of government by which they are to be achieved.¹⁹

While Whitlam himself has maintained a degree of consistency, the latter years of the Howard government saw much of the same body of progressive opinion lamenting the government's Senate majority and arguing for the traditionally conservative idea of a check on its power. Similarly, with Labor governments in power in all states and territories, supporters of the states were certainly more numerous on the left than they had been in the days of Joh Bjelke-Petersen or Charles Court. The issue which underscored both of these views was Work Choices, which was only passed due to the government no longer being frustrated by the 'states' house' and then survived a High Court challenge from the states.

Trying to predict the actions of an incoming government based on previous speeches and policy announcements is always problematic. The fact that in the area of federalism the Hawke and Keating governments are mainly remembered for the reforms of the early 1990s which led to the setting-up of COAG and the introduction of competition policy underscores this point. No one was predicting that in March 1983.

In 2005, Kevin Rudd delivered a paper entitled 'The Case for Cooperative Federalism',²⁰ a sentiment that seems to have been maintained in most of his public ut-

terances. The promotion of the concept of cooperation continued in the early days of the new government when it was claimed that the Commonwealth providing an additional \$150 million to the states to cut hospital waiting lists was some sort of federalist break-through. It was, of course, nothing of the sort. Providing some extra money was hardly likely to meet opposition.

What undoubtedly would arouse controversy is Rudd's statement that he will take over running all the country's 750 public hospitals if state and territory governments have not agreed to a national reform plan by the middle of 2009. He has said that such a move would be designed to 'end the blame game between Canberra and the states on health and hospitals'. This is hardly what most would consider 'cooperative federalism'. Anyone who believed that having all governments of the same political persuasion would solve the nation's problems has already had the Victorian government's on-going refusal to sign up to the national water plan to add to the many historical examples of uncooperative federalism.

It has been reported that the Prime Minister recently told his Cabinet colleagues that the setting up of Infrastructure Australia 'could be the most important move in commonwealth-state relations since Federation'.²¹ If accurate, this comment reflects both hyperbole and over-optimism.

While clearly many of the state governments have been too busy blowing their budget windfalls on spending on recurrent programs, and the bureaucrats to administer them, it is unclear that the Commonwealth will make wiser infrastructure choices. One can see the prospect of many more Goodna bypass type debates coming up where there is conflict between the Commonwealth and a particular state about the best way to deal with problems. Then there will be the conflicting priorities between states. The howls of protest from the Western Australians who felt that the Howard government did not provide them with a sufficient proportion of Auslink roads funding will only increase as, under the Rudd government, the Commonwealth determines priorities in an expanded number of infrastructure areas.

There appears little cause for optimism that there will be any reversal in the trend towards greater Commonwealth interference in areas of state responsibility under the newly elected government. When Rudd said at his campaign launch that 'The buck stops with me' it was hardly a promising moment for a federation in which both Commonwealth and the states shoulder their share of the responsibility. A rare positive was the announcement by the incoming administration that henceforth the GST would be counted as a federal tax, ending the previous charade.

The way forward: cohabiting with the states

The first component of the way forward is to recognise the benefits of federalism and to cut out any ideas of abolishing states and accept that they have a fundamental place in the Australian system of governance. This requires a particular vigilance as the threat to Australia's federation is most likely a form of *de facto* abolition that would see the states' powers incrementally taken away by Commonwealth action, backed by the rulings of the High Court.

The second fundamental issue is vertical fiscal imbalance (VFI). As a recent overview of the world's federal systems noted:

Australia represents the most acute case of VFI, with the Commonwealth controlling all major tax sources and engaging in massive annual transfers to the states.²²

Obviously, it is a fundamental problem with Australia's federation that the Commonwealth raises 82 per cent of the tax revenue, but is only responsible for 36 per cent of the spending. There is always going to be a huge difficulty when those figures are so divergent.

In recent years one of the more comprehensive and sensible reform proposals for addressing VFI was compiled by Robert Carling of the Centre for Independent Studies in 2006. He proposed a state income tax of around 10 per cent offset by a similar reduction in commonwealth income tax and a range of other offsetting tax measures. He argued that 'over time state income taxes would vary, but with competition limiting any upward drift'.²³ A more modest set of worthwhile proposals were contained in Anne Twomey's 2007 paper 'Australian Federalism: Options for Reform'.²⁴

The Institute of Public Affairs has established a States Policy Unit, directed by RMIT Economics Professor, Sinclair Davidson, which, in 2008 and beyond, will be undertaking a major program to develop reform options for fiscal federalism.

An ongoing frustration is that more common than proposals to fix VFI are proposals which would exacerbate it.

On the revenue side, the most commonly criticised types of tax are all ones levied by state governments—payroll tax, stamp duty and gaming taxes, particularly on poker machines. Lower unemployment has somewhat reduced the profile of the first of these as a tax on employment, but rising property prices have added weight to calls for stamp duty reductions. The opponents of poker machines claim that the main reason why reduction in their numbers is not achievable is because the states are addicted to gaming revenue.

When it comes to expenditure, the combination of

VFI and the prosperous economy meant that in its later years the Howard government was awash with funds. This not only led to the voters considering that this provided them with the greater responsibility in fixing problems in areas of joint responsibility, but also led to various calls for them to commence providing funds in areas which had not previously been considered areas of state responsibility at all. A classic example of this is the ever-increasing demands from a diverse group including the bus and rail industries, local government bodies, environmentalists and some media commentators to gain direct Commonwealth funding of urban transit.

Proponents of federal involvement argue that Australia is one of the few OECD countries where the national government does not put taxpayers' money into urban mass transit. This ignores the fact that a lot of these countries have more unitary government structures than Australia's federation. It is also argued that federal funding of urban public transport is required to provide equity because the Commonwealth already funds urban roads. For many years, Commonwealth involvement in both rail and road was on interstate routes. However, in recent years under both 'Auslink' and 'Roads to Recovery', a significant proportion of federal funds have also gone into urban roads. Whatever one thinks of federal roads funding, there is an important distinction between roads and public transport. It is only in the latter that government has a role in providing services as well as infrastructure. Just as the nation's health system is currently bedevilled by duplication and buck-passing, a joint federal-state funded, and state-operated, urban public transport model is a recipe for major problems. One can imagine both federal and state governments clamouring to fund sexy new rail extensions in marginal seats, while the need to fund less glamorous, but more urgent, signalling upgrades and other key maintenance would probably be ignored.

To add to the confusion many local governments, as well as lobbying for federal funding, are also claiming a policy role for themselves in public transport.

Citizens looking for easy-to-understand accountability must be shuddering at the prospect of the three tiers of government all arguing over levels of funding and priorities and blaming each other for poor performance. Instead, what Australia needs is a more clearly delineated federation, not one where every level of government buys into every area. A good start will be to keep urban public transport as a state government responsibility.

Urban transport also demonstrates another advantage that states provide—an opportunity to assess the costs and benefits of different policy approaches. The differences between the Victorian public transport privatisation, the massive public investment in Western Australia and the more traditional approaches in other states can be

compared. In most states there would be more funding available for additional public transport infrastructure if only the respective state governments would reform the operational and maintenance side of their systems. The Lemma government continues to rule out contracting out rail maintenance services in NSW, instead bowing to the will of Unions NSW to maintain current inefficient practices. In Queensland, the split-up of QR is a small step in the right direction, but more radical reform is required. Only in Victoria, with the combination of efficiency gains under the Kennett government and subsequent private operation, can one say that there is not significant fat in the operational public transport budget. The *BRW* article referred to earlier contains a list of other policy innovations that the states have generated.²⁵

In asserting the ongoing value of the role of the states, there is no reason to preclude a reassessment of which areas are the responsibility of which tiers of government. However, whatever the split up, it is crucial that the federal government accepts that if something is deemed a state area, the Commonwealth cedes any form of interfering or oversight role.

If the Australian federation is to be improved all involved need to appreciate that what is required is not coercion of the states by the Commonwealth, nor is it co-operation with both parties having a finger in every pie. What is required is a system of cohabitation by equal parties that guarantees the states and territories explicit responsibility for key areas.

The coercion of the states, if there is to be any, should come from the voters in the states. The cooperation should be limited to avoid a particularly unnecessary growth in the size of government.

The cohabitation will only work if the Commonwealth accepts that they have equal partners in the running of the nation and if the states accept the responsibility of that role.

The current volume of material being produced on federalism is indicative of the fact that the problems, many of which have been steadily accumulating over the 107 years since federation, are serious, and do need to be addressed. In that 107 year period the relationship between the Commonwealth and the states has been altered radically.

However, far more dramatic has been the change in the nature of the size and scope of government activities at all levels. While the power of state governments viz a viz the commonwealth may have been eroded, the power they wield over their citizens has increased dramatically.

Consideration of the appropriate responsibilities for particular tiers of government should also necessitate an evaluation of whether activities are appropriate responsibilities for any tier of government.

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