



Council for the Australian
Federation

Senate Select Committee on the
Reform of the Australian Federation

SUBMISSION

Submission

The Council for the Australian Federation (CAF) welcomes the Committee's broad-ranging interest in reform of the federation, noting the Senate's unique role in Australia's constitution.

This CAF submission (on behalf of all States and Territories, with the exception of Western Australia) will address the terms of reference in turn, while focusing particularly on:

1. the public benefits of our federal structure for all Australians
2. the problems caused by vertical fiscal imbalance
3. the practical value of further developing existing cooperative mechanisms, such as the Council of Australian Governments (COAG) and the 2008 Intergovernmental Agreement on Federal Financial Relations (IGA FFR)
4. the need for any proposal for constitutional change to be supported by thorough, robust analysis of the perceived underlying problems and the likely costs and benefits of purported solutions.

As noted throughout this submission, our federal system delivers many benefits to all Australians. It is essential that any reform proposal aim to enhance the benefits of our federal structure, rather than undermine existing federal architecture.

Background – the Council for the Australian Federation

CAF was established in October 2006 to support and enhance Australia's federal system by providing an intergovernmental forum for State and Territory leaders in Australia. Under the founding agreement, First Ministers agreed to create CAF "as part of their plan to protect, maintain and revitalise the Australian federation and build a more collaborative, cooperative and effective federal system".

CAF is currently chaired by the Premier of NSW, the Hon. Kristina Keneally MP. In October 2010, the chairing role will be assumed by the Hon. Paul Henderson MLA, Chief Minister of the Northern Territory. The CAF Chairing jurisdiction rotates annually.

CAF supports the work of the Committee and notes the importance of encouraging and facilitating public dialogue on this important issue. Since its establishment, CAF has commissioned three independent reports on federalism, which comprise the *Federalist Paper* series. While CAF does not necessarily support all the recommendations in these reports, they make an important contribution to the question of reforming the Australian Federation:

- *Federalist Paper 1* (April 2007): *Australia's Federal Future* by Glenn Withers and Anne Twomey, highlighted the opportunities for growth and prosperity within the federal framework and identified areas for reform in Commonwealth-State relations (see **Attachment A**).
- *Federalist Paper 2* (September 2008): *The Future of Schooling in Australia*, outlined an eight-point action plan to improve the quality of education across Australia (see **Attachment B**).
- *Federalist Paper 3* (May 2009): *Common Cause - Strengthening Australia's Cooperative Federalism* by Professors John Wanna (Australian and New Zealand School of Government), John Phillipmore and Alan Fenna, and Dr Jeffrey Harwood (John Curtin Institute of Public Policy), proposes a framework for practical reform to make federalism work more effectively (see **Attachment C**).

CAF would also draw the Committee's attention to the Federalism Repository on its website.¹ We encourage the Committee to make use of this repository in conducting its inquiry. A federalism reference list is also attached for your convenience (**Attachment D**).

Through CAF, State and Territory governments have initiated significant reform and championed new, positive thinking about the prospects for cooperative federalism in Australia. CAF has continuing potential as an instrument of innovation and positive change in Australia's federal system.

Recognising the benefits to all Australians of our federal inheritance

Underlying the Terms of Reference for this inquiry is a fundamental question about the very nature of the Australian Federation. It is therefore important that the Committee keep in mind the concrete benefits that our federal structure provides to the Australian public, some of which are not always acknowledged.

Federalism is often misconstrued as a costly and inefficient system of government. In fact, Australia's federal structure provides for a number of significant benefits that in fact outweigh these perceived costs:

- The customisation of policies to meet local needs
- Incentives to innovate and experiment in policy and service delivery
- Supporting choice and diversity
- Competition and comparison that supports continuous improvement
- Greater scrutiny of national policies as a result of the need to achieve cooperation
- Protection for the individual by checking the concentration of power.

Importantly, the benefits of federalism do not preclude the development of national approaches to common problems. In addition, the federal structure allows for new ideas to be pioneered by one jurisdiction and, if successful, to be adopted by others.

¹ http://www.caf.gov.au/federalism_repository.aspx

A federal system enables a geographically large and diverse country such as Australia to maintain national unity and meet the pressures of globalisation while at the same time accommodating regional difference.

Comparison of national governments around the world has shown that federations have smaller public sectors than centralised or unitary systems and that public spending as a share of GDP is 13 per cent higher on average in unitary states.²

Key issues and priorities for the reform of relations between the three levels of government within the Australian federation

CAF recognises a growing consensus across politics, business and the community of the need for a clarification of roles in the federal system. This enhances responsibility, provides clarity to those who use particular services and reduces problems of cost-shifting and blame-shifting.³

In considering the best way to achieve an effective allocation of roles and responsibilities, it is important to have regard to the principle of subsidiarity. This principle holds that the most effective and efficient allocation of roles is achieved where policy and service delivery responsibilities rest with the lowest sphere of government practicable.

This principle is especially important in Australia's federal system, as we increasingly move towards a system of concurrent federalism – where multiple levels of government will have a role to play in key areas, such as health or education. While there are inherent complexities to such a structure, a federal model remains the best system to deliver a range of benefits to the Australian people.

It is also important to keep in mind that effective federalism requires a supporting architecture consisting of the following three interrelated components:⁴

- Principles to guide cooperative federalism
- Supporting legal and institutional arrangements
- Appropriate cultural practices and attitudes.

Through the Intergovernmental Agreement on Federal Financial Relations (IGA FFR) there has been welcome progress in better delineating roles and responsibilities across a range of shared policy areas. This is an important case study of how institutional and cultural change can be achieved through cooperative federalism and incremental reform – rather than requiring a significant change to our underlying federal architecture. As outlined further below, a key future priority is the practical challenges

² Twomey A, Withers G, 2007, *Federalist Paper 1: Australia's Federal Future*, Report for the Council for the Australian Federation (April), pp 12-13. Available at <http://www.caf.gov.au/policyinnovation.aspx>

³ Twomey A, Withers G, 2007, *Federalist Paper 1: Australia's Federal Future*, Report for the Council for the Australian Federation (April), p. 46. Available at <http://www.caf.gov.au/policyinnovation.aspx>

⁴ Wanna J, et al, 2008, *Federalist Paper 3: Common Cause – Strengthening Australia's Cooperative Federalism*. Final Report to the Council for the Australian Federation.

of working to maximise the shared benefits of this framework and address the vertical fiscal imbalance between the Commonwealth and the States and Territories.

A possible agenda for national reform and ways it can best be implemented

As noted above, national reform can take many forms, and does not necessarily require significant change to our underlying federal architecture. In working together to improve the well-being of all Australians, COAG's reform agenda is broad and ambitious – as it should be.

Ongoing refinement of national priorities and strategic directions will require cooperation and partnership across all spheres of government. Communicating COAG's relative priorities is also critical to effective stakeholder engagement and timely implementation.

The principles of the IGA FFR provide a sound basis for the negotiation and implementation of national reforms. In particular, this framework recognises that States and Territories have primary responsibility for service delivery, the effectiveness and efficiency of which is best improved by a commitment to genuinely cooperative working arrangements.

The distribution of constitutional powers and responsibilities between the Commonwealth and the states (including territories); and financial relations between Australian governments

One of the great lessons of Australian constitutional history is that the division of roles and responsibilities needs to be supported by enduring mechanisms for fiscal sustainability. Currently, there is a mismatch of spending responsibilities and revenue-raising capacities between the national and State governments, which produces a need for large financial transfers between levels of government – a vertical fiscal imbalance (VFI).

As observed in *Federalist Paper 1*:

*Most complaints about the operation of the federal system concerning duplication, buck-passing, excessive administrative burdens, lack of accountability and lack of coordination can be traced back to the use of specific purpose payments (SPPs) by the Commonwealth Government.*⁵

The IGA FFR agreed in November 2008 provides a solid and realistic platform from which improvements can be made in the delivery of services to the Australian public and upon which further reforms can be based to make Australian federalism work better.

Reform of fiscal federalism need not stop with reform of SPPs, but should address more broadly the level of VFI. While some level of VFI is not unusual in a federation, its extent in Australia is the most extreme of any federation in the industrial world.⁶

⁵ Twomey & Withers, 2007: 47

⁶ Twomey & Withers, 2007: 37

As identified in CAF's joint State and Territory submission⁷ to the Henry Tax Review (*Australia's Future Tax System*), an excessive degree of VFI is undesirable, because it can:

- **weaken government accountability to the public** by breaking the nexus between a government's decisions on the level of service provision and the revenue raised to fund it. For every dollar spent by state governments, less than 60 cents is raised directly for those purposes.
- **reduce transparency** regarding who is responsible for which government services, allowing governments to avoid responsibility by shifting blame for funding and operational shortfalls to other spheres of government. Health policy has been a prime example where different spheres of government responsibility, for funding, operating and regulating across different areas of the health care system, has resulted in public confusion and opportunity for blame-shifting.
- **create inefficiencies**, including through bureaucratic overlap, duplication and excess and the cost of administering grants between governments.
- **misallocate resources**, including the inadequate or inappropriate funding of services.
- **slow the responsiveness of governments** to the needs of their communities.

While federalism is often criticised for being inefficient and leading to confusion as to roles and responsibilities, it is evident that the VFI is the root cause of many of these criticisms. It is therefore essential that any reform proposal address the underlying problem of VFI. Otherwise, reform risks not only being ineffective, but undermining the integrity of our federal system.

The IGA FFR was a significant reform to financial relations between Federal and State Governments and it provides a practical framework for clarifying ongoing roles and responsibilities between levels of government. A key national priority should be to ensure that this reform is properly implemented prior to considering other far-ranging reform options such as constitutional reform.

Possible constitutional amendments, including the recognition of local government

Constitutional reform is difficult, expensive and can create greater uncertainty. A better approach is to work within our existing constitutional framework to improve the operation of our federal system (such as through the IGA FFR). Constitutional reform should be a last resort, where there is no reasonable alternative or other options have failed. It needs to be remembered that constitutional reform is just one avenue to assist in a rebalancing of the powers of the Commonwealth and the States.

CAF recommends that any proposal for constitutional change should be focused on limited, targeted amendments that have clear utility in enabling improved cooperation between the Commonwealth and States and Territories, rather than wider changes to

⁷ Council for the Australian Federation 2010, *Australia's Future Tax System – A State Perspective*. Available at <http://www.caf.gov.au/meetings.aspx>

powers and responsibilities that threaten to generate greater uncertainty and complexity within the Australian Federation.

In general terms, any proposals for constitutional change require thorough, robust analysis of the perceived underlying problems and the likely costs and benefits of purported solutions. Any reform proposal should aim to harness the benefits of our federal structure, rather than risk undermining it.

CAF recognises the important role that local governments play within the Federation and notes that they are currently recognised in many State Constitutions. Consistent with the core benefits of Australia's federal structure, the 560 councils across the country are currently governed by a variety of State-level regimes. This diversity promotes tailored policy, service delivery and regulatory models and supports the development of best practice across the country. The same is true for State-level regional development policy.

Consideration of constitutional amendments to recognise local government should recognise the diversity of local government arrangements, the extent of existing recognition within State Constitutions and the availability of other means to provide certainty for Commonwealth flows of funds to local government. CAF notes that the *Pape* case⁸ is often cited as having caused increased uncertainty in the context of local governments and federal financial relations. This uncertainty should not be overstated, as the Commonwealth continues to be able (at a minimum) to expend federal funds wherever it has a specific legislative power, or provide funding to (or through) the States.

Processes, including the Council of Australian Governments (COAG)

CAF supports the strengthening of institutions such as COAG to promote cooperative federalism. While COAG has proved an important mechanism for achieving cooperative reforms, it lacks an institutional basis, which is needed to support ongoing reform. As a result, the effectiveness of COAG is often dependent on the personalities and priorities of the leaders of the day.⁹ In 2006, the Business Council of Australia (BCA) recommended “the institutionalisation of COAG to ensure its continuing effectiveness regardless of these influences”.¹⁰

CAF supports the development of an Intergovernmental Agreement to underpin the operation of COAG, so that it may become a more enduring institution that rises above the ebb and flow of governments. Such a mechanism should enshrine principles that:

- reflect that COAG is an equal partnership between all spheres of government, including the agenda setting of COAG
- set out COAG's vision and objectives, including reform priorities
- have a strong emphasis on joint accountability

⁸ Bryan Reginald Pape V The Commissioner of Taxation of the Commonwealth of Australia & ANOR [2009] HCA 23

⁹ Twomey & Withers, 2007: 47

¹⁰ Business Council of Australia, 2006, *Reshaping Australia's Federation: A New Contract for Federal-State Relations*, Melbourne, BCA. www.bca.com.au/Content/100802.aspx

- provide flexibility for COAG to adapt and evolve
- make COAG transparent to the community and stakeholders by better communicating its decisions.

Referral of powers and procedures for enhancing cooperation between the various levels of Australian Governments

CAF supports mechanisms to enhance cooperation between various levels of Australian Governments, noting that a referral of powers is not necessarily the best mechanism to achieve this. While a referral of power is appropriate to achieve policy goals in some circumstances, in many cases there are better ways to harness the benefits of federalism through other cooperative mechanisms. These include harmonised schemes, for instance, the development of harmonised occupational health and safety laws and the Australian Consumer Law.

In addition, there are a range of existing and recently established intergovernmental institutions whose purposes vary from regulation, to research, policy development, standard setting and management of commercial enterprises. The continued development of innovative intergovernmental institutional arrangements presents an opportunity to enhance cooperation between various levels of Australian governments. However, the success of these arrangements will depend on appropriate governance arrangements being in place.

When establishing new or reviewing existing intergovernmental bodies, the governments involved must have reference to clear governance principles, including that they are appropriately accountable to all participating governments. Moreover, the benefits of genuine cooperation will be best harnessed when the fiscal power imbalance between State and Federal governments in Australia does not infect the genuine ownership of intergovernmental bodies.

Strategies for strengthening Australia's regions and the delivery of services through regional development committees and regional grant programs

State and Territory leaders recognise the importance of strengthening Australia's regions and protecting their sustainability, particularly for remote regions. While all governments have initiatives underway (from major economic stimulus programs to smaller capacity-building programs in local areas) there are still significant opportunities to be captured.

It is important that all three spheres of government work collaboratively to meet the individual needs of these communities and enhance the capacity and sustainability of Australia's diverse regions.

In developing strategies for strengthening Australia's regions, acknowledging regional differences, from State (or Territory) to State and region to region is vital. No one model will fit every region. An approach that caters for regional differences and varying governance arrangements, such as regional development organisations and State-based regional development funding, across Australia is crucial.

All three spheres of government should be involved for regional service delivery to be successful. State, Territory and local governments have extensive experience and

networks in regional Australia and already provide a significant contribution to strengthening Australia's regions.

The recent establishment of Regional Development Australia committees is a case in point. Where these committees are established and operate with the involvement and cooperation of both Commonwealth and State and Territory spheres of government, the network is more likely to lead to closer alignment and integration of regional development activities for the benefit of Australia's regions.

Regional development committees that include business and industry, community and local government leaders, with the support of Commonwealth and State and Territory governments are well placed to provide strategic advice to government on regional development planning and priorities. Regional grant programs that respond to regional development priorities as agreed by the three spheres of government can have a role in strengthening regional Australia.

Regional Development Australia is beginning to transition from a development phase to the implementation of regional plans. Once this is underway, we will be in a better position to further consider other options for delivery of services in Australian regions.

Attachments

- A. Federalist Paper 1
- B. Federalist Paper 2
- C. Federalist Paper 3
- D. Reference List