

How Healthy is Australian Federalism?*

Geoff Gallop

In today's lecture I will summarise the various issues we take up in examining Australian federalism, look at the politics of the federal idea throughout Australian history, noting how the Commonwealth has been the consistent winner, state my own position that federalism is a good idea whose benefits are clearly established by the evidence, look to how the states have tried to rescue their position in recent years through the embrace of the National Reform Agenda and co-operative federalism, provide an overview of the tensions that remain in the system established by the Rudd/Gillard Government, make a case for addressing vertical fiscal imbalance (VFI) through income tax sharing, and conclude, despairingly, that this is unlikely, leaving Australia, at its best, with a second best system.

There are so many issues related to a discussion of Australian federalism it's hard to know where to begin. In saying this I'm always reminded of the story told by Gary Sturgess about a United Nations committee commissioning international studies on the elephant:

There were a variety of contributions. Each nation giving its own unique insights and expertise. Germany submitted a paper on the training and discipline of elephants. France questioned the existence of elephants. United Kingdom submitted a paper on the role of the elephant in colonial expansion. There were two papers from the US, one from the east coast ('Taking over elephants—economies of scale and synergetic benefits') and one from the west coast ('The joy of elephants'). And Australia submitted a paper, 'Elephants—Federal or State responsibility'.¹

Indeed when discussing federalism in Australia this issue of Commonwealth and state roles and responsibilities usually comes first. What does the Constitution say and how has that changed over the years either through referenda or interpretation by the High Court? In recent years the notion that we have a Convention to consider roles and responsibilities has been mooted but not realised in practice.

* This paper was presented as a lecture in the Senate Occasional Lecture Series at Parliament House, Canberra, on 25 February 2011.

¹ Gary Sturgess, 'The progress towards Commonwealth/state rationalisation', *Royal Australian Institute of Public Administration National Newsletter*, vol. 1, no.2, June 1991, p. 12.

Linked to such a discussion is the question of intergovernmental relations and how they are managed, including in relation to overseas treaties and trade agreements. Under this heading is an assessment of the role and functioning of the range of institutions set up to facilitate co-operation between the levels of government, most importantly, but not only, the Council of Australian Governments (COAG).

Thirdly there is the matter of Commonwealth–state financial relations and the taxing powers of each level of government. In Australia this takes debate into the territory of vertical fiscal imbalance, the situation where the revenue-raising powers and expenditure responsibilities of each level of government are mismatched. A distinguishing feature of our federation is the very high level of VFI, with the Commonwealth in the dominant position.

Fourthly there has been substantial analysis of the governmental institutions that reflect the commitment to federalism, most notably the High Court, the Senate and of course the states themselves. Contrasting the way the constitutionally protected states and the federally constituted territories operate assists us in understanding the difference between a federal system and a unitary one with regions.

Inevitably any discussion of proposals for significant change, such as the republic or a bill or charter of rights, is caught up in an argument about these institutions, most particularly the states.

Fifthly we examine how each of these issues come together to create an Australian model. Is it a case of ‘managerial’ federalism, ‘intelligent’ federalism, ‘opportunistic’ federalism or ‘co-operative’ federalism? On the other hand some say we should recognise it for what it is, a case of ‘creeping centralism’.

In discussing this issue there is usually a prescriptive as well as a descriptive element, in particular analysis of the public policy implications of different ways to distribute powers, raise taxes, co-operate in matters of mutual concern and manage differences when there is disagreement.

It is at this point that ideology enters the equation. Federalism is a subject about which politicians and commentators have a view—for or against, change or no change? Such views aren’t necessarily evidence-based but are often a mixture of pride and prejudice. In other words is the advocate speaking from Canberra or from the states? Is the advocate a state or federal politician? Is the advocate a state or Commonwealth public servant? We all have pride in what we do and the institutions we serve and this can blind us to the bigger picture.

This leads me to a sixth and final way in which the issue can be analysed. What is the politics of federalism in Australia? Who are the participants in the debate? What power and influence do they have in determining outcomes? How do they mobilise and shape opinion? What is the attitude of the public to these matters—do they care who delivers services or is it just a case of the outcomes? As John Howard put it in a speech on 20 August 2007:

So much of the debate about Commonwealth—State relations concerns the respective roles of the two levels of government, as if an appropriate balance between the two were an end in itself. To me, that misses the point. We should be neither centralists, nor slavish adherents to states rights. We should be focused on outcomes, not systems.²

These matters are important for reformers because they help in determining what may or may not be possible by way of change. At any time there are forces working either for change or against change. They win or lose not just on the basis of their political strength and argument but also on how politics plays out in the circumstances that prevail. For example Labor's proposals to build a co-operative federalism put to the people at the 2007 election may not have been so well received if John Howard's authority had not been so badly dented by complacency on climate change and aggressiveness on industrial relations.

When looking at the politics of Australian federalism from the vantage point of twentieth-century history it is clear that the Commonwealth rather than the states has been the winner. Not only is it the case that a mixture of wartime necessity and constitutional interpretation have pushed the balance of power in the direction of the Commonwealth, there has always been an ideological current favouring centralisation as better for economic planning, economic efficiency and good public policy. Not surprisingly such a view has strong roots in Canberra and has often been associated with the assumed requirements of national sovereignty in a competitive world.

In earlier times it was also linked with a democratic socialist view that the will of the majority should prevail when confronted with the checks and balances we associate with liberalism, such as upper houses and the High Court or with conservatism, such as a propertied franchise or malapportionment. In this mix federalism was seen as an enemy of the creation of a united nation with one set of laws applying to all, noting of course that it took some time before 'all' actually meant that and not just the white population.

² John Howard, Address to the Millennium Forum, Four Seasons Hotel, Sydney, 20 August 2007, <http://pandora.nla.gov.au/pan/10052/20070823-1732/www.pm.gov.au/media/Speech/2007/Speech24507.html>.

In more recent times it has been linked to a conservative view that uniformity is better for business and our more mobile population. So too is centralisation seen as better to protect our geographical and cultural borders against minorities intent on undermining traditional Australian values with their postmodern curricula and libertarian attitudes.

Whilst this development of the right-wing side of Australian politics has opened up space for Labor to embrace federalism there remains a strong residue of centralism within the federal caucus. This is partly a case of position (that is to say being in the Commonwealth Parliament) but also of ideology (that is to say being committed to a 'streamlined' system of regulation for the nation).

On how state Labor has responded to this new institution I will have something to say later in my lecture.

The first point I wish to make today, then, is that there has always been a heavily values-based opposition to the federal principle within Australian politics, firstly from the left and more recently from the right. Taking turns they have lined up with the federal bureaucracy to seek more power for the Commonwealth. This mixture of ideology and brute power, particularly over finance, has proved very effective in outflanking and when necessary overriding the states and territories. Both Labor and Liberal governments at the Commonwealth level have been involved in this power shift.

It was the Commonwealth seeking power to exclude state-based conciliation and arbitration and consolidate Work Choices that precipitated the challenge by New South Wales and the other states in the High Court. This resulted in a very expansive definition of the corporations power in s.51(xx) of the Constitution .

Try as they might the states were unable to convince the court that there were clear limits to the exercise of this power. Only Kirby and Callinan JJ pointed to the need to read the Constitution as a whole and to be mindful of preserving a balance between the two levels of government. One would have thought that this was the intention of those who framed the Constitution but, as has so often been the case, each head of power in the Constitution has been accorded full scope on the basis of its language rather than any theory of 'balanced government'.

The Commonwealth knows, then, that it can push the boundaries in its law-making functions. Whatever the political colouring of the Commonwealth government of the day it is being tempted to do this and urged to do it by a public service proud of its status and openly contemptuous of the 'lower' levels of government. Usually it starts

out as an aspiration for a ‘national’ solution involving all levels of government but more often than not finishes up as a Commonwealth-controlled program.

Having said this now let me draw your attention to the recently published analysis of Australian federalism by Anne Twomey and Glenn Withers, *Australia’s Federal Future*.³ In a methodical and empirical way they demonstrate the economic, social and political benefits of a federal system of government. Of the debates about federalism in Australia they have this to say in their covering letter to the Council of the Australian Federation:

It became apparent to us in writing this report that Australian attitudes towards federalism are out of step with those in the rest of the world. In Australia, it is often asserted that federalism is an old fashioned, cumbersome and inefficient system. Yet internationally, federalism is regarded as a modern, flexible and efficient structure that is ideal for meeting the needs of local communities while responding to the pressures of globalisation. The difference between these two views is stark.

In this report we have used political, legal and economic analysis and international comparisons to highlight that, far from being a burden, Australia’s federal system provides us with many economic and social benefits. For example, federalism:

- divides and limits power, protecting the individual;
- gives Australians a wider range of choices and allows policies and services to be tailored to meet the needs of communities; and
- spurs all Australian governments to be more innovative and responsive.

Compared to centralised, unitary governments, federal nations such as Australia have:

- more efficient governments; and
- higher rates of economic growth and higher per capita GDP.

These benefits deliver significant economic and social advantages to all Australians. However, increasing centralisation in Australia threatens these benefits.

³ A. Twomey and G. Withers, *Australia’s Federal Future: Delivering Growth and Prosperity*, 2007, www.dpc.vic.gov.au/.

The truth about government is that no one level can be expected to get it right all the time. There are good and bad Commonwealth governments, good and bad state and territory governments and good and bad local governments.

Somehow or other a range of commentators seem to think that increasing the power of the Commonwealth will automatically mean a lesser involvement of vested interests in decision-making. Unfortunately, however, it is not the case that rationality resides in a particular level of government. All levels of government are subject to political pressure on issues like economic and environmental reform. This is clearly demonstrated in the debate currently going on within the Commonwealth over the meaning of the words in the Murray–Darling legislation.

In recent times we have seen failures in public administration, some very serious, in all levels of government. At the same time we have seen innovation and reform, some coming from above and some from below. Much of this has come from state governments. In a recently published speech Helen Silver, Secretary of the Department of Premier and Cabinet in Victoria has listed the following examples:

- case-mix funding for public hospitals (Victoria)
- state-based greenhouse gas certification and abatement (NSW)
- early anti-discrimination legislation (SA)
- health care call centres (WA)

About such innovation she notes:

There are tremendous benefits to be gained from vigorous policy competition between the states and territories, as proven strategies in one jurisdiction are taken up in others.⁴

More controversial, and not yet universalised, are the charters of rights in the ACT and Victoria and the Medically Supervised Injecting Centre in NSW. They sit in contrast to the euthanasia legislation in the Northern Territory and the civil partnerships legislation in the Australian Capital Territory. These were territories whose work could be easily overturned by the Commonwealth.

This leads me to my second point for the day. Even though the position of the states has weakened constitutionally and financially they still play an important role in Australian politics. They provide important services and advocate for the communities

⁴ Helen Silver, 'Getting the best out of federalism—the role of the Productivity Commission and the limits of national approaches', *Australian Journal of Public Administration*, vol. 69, no. 3, September 2010, p. 327.

within their boundaries and, however limited it may be, they still have important tax-raising powers. They are facilitators of development within a national and global context. Note, too, that they allow for displays of difference, perhaps best illustrated by the absence of poker machines in hotels and clubs throughout Western Australia.

We still have a complex system of power relations unlike those that apply in a unitary system. A very good illustration of this complexity comes from the National Reform Agenda, for which a good deal of the political and intellectual work was done by Victoria during the premiership of Steve Bracks, backed up as he was then by Terry Moran, head of Premier and Cabinet.

In many ways we could see this proposal as a pragmatic but principled response by the states to the depressing reality of ‘creeping centralism’. I say pragmatic because there was a recognition that vertical fiscal imbalance was a nut too hard to crack. It was to be a partnership approach to governance and financing directed to promoting competition and participation in the interests of productivity.

In proposing this approach Victoria had drawn on the experience of the National Competition Policy of the 1990s. This had seen the Commonwealth and the states agree on the changes required to improve productivity. However, each state was left free to determine the rate and range of change. Should their performance be assessed as acceptable by the National Competition Council they would receive payments from the Commonwealth. This mixture of national purpose, state delivery and Commonwealth incentives produced significant reform.

As Australia entered the new century it had become clear that the economic challenge was also a social challenge, particularly in health, education and social welfare generally. A healthier, more skilled and better motivated population was needed to bring about further productivity improvement. Given that both Commonwealth and state governments had responsibilities in these areas it was clear that a new partnership would be required.

About the new financial and operational arrangements which have emerged from the Council of Australian Governments to facilitate this partnership let me say a member of things.

Firstly, that the ‘model’ is very coherent in construction and intellectually sound in conception. Outcomes are distinguished from outputs, roles and responsibilities are to be agreed, performance indicators and benchmarks set to judge performance and the COAG Reform Council (CRC) created to monitor and assess that performance. At the heart of this model is the idea that agreement over objectives doesn’t have to mean

uniformity over the means to achieve them. Indeed the whole idea of the program was to move away from the input controlled Special Purpose Payments to a system that allowed for local flexibility. What mattered was whether the outcomes were being achieved not how that was to be done. From this emerged the new national agreements in education, skills and workforce development, health care, disability services, affordable housing and Indigenous reform.

The states loved it—guaranteed revenue, devolution of responsibility and transparency to drive performance by way of the public reporting of results across the nation. Added to this was a new system of National Partnership Payments (NPPs) to facilitate or reward reforms of national importance.

This leads to my second observation about the system that has emerged following the election of 2007. The NPPs are paid to the states to deliver discrete projects or outputs. They are to have a limited time horizon and in respect of reward payments they are only to be paid following a favourable assessment of performance by the CRC. In relation to facilitation payments they are only paid if certain things are done, deemed to be reforms of national significance.

There are a massive number of such partnership agreements, ranging from preventative health to early childhood education, to homelessness and productivity places. Also in the mix is the NPP to deliver a seamless national economy which builds on the competition agenda of the 1990s. It contains 36 streams of regulation and competition reform.

In assessing what all this means for Australian federalism we need to go below the surface and look at the real dynamics at play. Despite an aspiration to see a change in the culture of inter-governmental relations, required to make this co-operative system work, the players at both levels are reverting to type. For its part the Commonwealth is finding it hard to accept the notion of federal balance and the diversity it brings and the states can't resist the temptation to take the money at any cost, despite misgivings about what is being required when it is spent. Once again highly restrictive requirements and controls are emerging in relation to the NPPs.

Even in the health and education agreements the Commonwealth has moved beyond an outcome agenda to an output agenda with its push for hospital networks and a national curriculum. The very distinction between national agreements on outcomes and local delivery of outputs is being whittled away in the name of 'implementation'.

The concept of subsidiarity which requires decisions to be handled by the least centralised authority and not handed up to a higher level unless the task cannot be

properly undertaken from below, such as the defence of the nation, is as alien to the Commonwealth as socialism has become for the Labor Party. Nor is it necessarily understood by the states and if understood, often breached in dealings with localities and sacrificed in the search for money from the Commonwealth.

We saw how some of these stresses and strains are playing out in the recent revision of the health agreement. Only deft footwork by Julia Gillard rescued the package. Note, however, that it is still an agreement which is yet to be finalised and there is sure to be more conflict over the detail.

However, what the health issue demonstrated was the potential that still exists for the states to push their agenda, should they so decide. They do have power in the system. The federal Labor government couldn't afford continuing conflict with the states, particularly over the future of the GST.

Whilst it is clear, then, that co-operative federalism along the lines developed in recent years is the best way forward for the states it remains doubtful whether it can be fully institutionalised in a way that protects their long-term interests and autonomy. Attitudes and values within the Commonwealth may have moderated but it is hard to see that they have fundamentally changed. Unless they do co-operative federalism will be a good idea that didn't realise its potential to renew federalism in Australia.

The reality here is that VFI continues to exert its influence. Resources mean power, power leads to temptation and more often than not temptation leads to coercion and control. The only known remedy to this illness comes from checks and balances and a more equal distribution of resources. Is this possible in Australia today?

As I noted earlier the states still have power and influence, even if limited and declining compared to other nations. They do provide a check and important balance to the system. The model of co-operative federalism could work if a genuine effort at addressing VFI was added to the equation and tax-raising powers more evenly spread.

The distribution of the GST to the states and territories was never going to be a successful resolution of this matter. In the first place it is a Commonwealth tax and as we saw last year the temptation to claw some of the money back from the states is strong. In the second place it replaced a range of state taxes which were not as efficient or growth sensitive but nevertheless they did raise revenue for state governments.

The only lasting solution to this state of affairs would be to allow the states back into the field of income tax. For this to occur the Commonwealth would need to cut

income taxes across the board, thus making room for the states to apply their own rate. The tax would still be administered and collected by the Commonwealth.

Should such an issue be put on the table it would require a further examination of Commonwealth and state roles and responsibilities. Note also that it would open up a discussion of further tax reform and simplification at the state level, something the business community have been advocating for some time.

In saying all of this, however, I am reminded of what I concluded earlier in the lecture about the politics of federalism. Why would the Commonwealth agree to such changes and give up power in the process? For this to happen they would need to be convinced that it is a good thing. Even if some on both sides of politics in Canberra saw that it was they would meet strong opposition from colleagues. Remember the headline for an article by Mike Skeketee in the *Sydney Morning Herald* on Saturday 16 November 1991: 'Keating Wrecks Chances of a Saner Federation'. He was referring to Paul Keating's scuttling of the then attempts by Australian governments to better fit taxing and spending powers throughout the levels of government. He did this by campaigning on behalf of Commonwealth power within the Labor Caucus. It would be safe to assume similar conflict would occur today if a prime minister advocated radical change that returned financial power to the states.

For their part the states could—and should—advocate for such a change. However, they have no means under our constitutional arrangements to make it happen. As Darryl Kerrigan said in *The Castle*: 'Tell 'em they're dreaming!'

Australia seems destined to have a federal system that at its best is second best. Our responsibilities in such a situation are to make that second best system work as best as we can. That means the states being more forceful in pursuing their interests and the Commonwealth more understanding of complexity and the benefits of diversity. Is that going to be possible in the adversarial system that has developed in our nation?



Question — We have in Australia over 300 local governments. Why hasn't local government been able to find its voice here in the Senate so that the Senate can fulfil its destiny of being the voice of Australia?

Geoff Gallop — Well I think its destiny was to be the voice of the states, of course. I think the problem with such a proposal in taking power away from the people to elect both houses of Parliament is it would lack the democratic credentials to be advocated in our current system. If, on the other hand, the Senate changed its nature to be more like a House of Lords without a lot of power over finance or legislation, a checking but not an ultimate decision-making power, you might consider things like that. But under the current system where we have proportional representation for the Senate I think that encourages smaller parties, independents and minorities and gives them a chance to influence the outcomes through our system. I prefer proportional representation as a way to do that rather than incorporating institutions into the electoral system.

Question — You are a Western Australian and you were their chief for a number of years. We all know that all Western Australians are secessionists, so is your talk a preparation for a declaration of independence and have you come up with a name for your new country yet?

Geoff Gallop — Once upon a time I used to dream about the Democratic Socialist Republic of Western Australia but talk about chances of something happening—that certainly wouldn't! I favour federalism as opposed to secession and subsidiarity also means that issues that can't be addressed at a local level ought to be addressed at a national level and defence is a good case study. As my good friend Kim Beazley said to me 'if those secessionists really want to carry through they are going to have to work out how much money they are going to have to spend on defence'. Now I think we ought to advocate for federalism and as I always use to say 'I am an Australian first, a West Australian and born and bred in Geraldton—and we've got to try and merge all those interests together through good systems of local government, good systems of state government and a good federal government. So I prefer federalism. There is a secessionist movement current in Western Australia although it's really not that strong and I think it's the muscle flexing within the federation that we're going to see and have seen in the past rather than a move towards secession. Let's face it, they voted for secession in the 1930s and then West Australians put in power a party that was against it. So as my mentor, John Wheeldon, said to me when I went into politics, 'Geoff, never assume rationality in politics'.

Question — Australia, or at least the component of the Australian federation, is fairly culturally homogeneous and that contrasts to Canada or Switzerland where you've got cantons or provinces that are quite distinctive. What effect do you think that's had on the imbalance or the creation of the imbalance in our federation?

Geoff Gallop — Well I think from an analytical point of view there is no doubt that Canadian federalism is much stronger in the culture because of Quebec. No question about that and you mention Switzerland which is the federal dream in a sense. So it's had an impact but I wouldn't exaggerate it because I think what we see is that political systems create their own cultures. I'm quite proud of the fact that Western Australia does not have poker machines and it's strongly supported in the community and it just makes a difference. I'm not so sure about daylight saving and trading hours or the Potato Marketing Board, for that matter, but nevertheless I think these are differences. NSW has gone out there with its drug policy—medically supervised injecting centres; Victoria and the ACT have gone out there with their charters of rights. We create a dynamic as well as reflect a dynamic and I think yes, Canadian federalism is a lot healthier than Australian federalism. That being said, I don't think we should exaggerate the impact that cultural uniformity has as a precondition and driving force for centralisation.

Question — The Commonwealth Grants Commission has come out today with an update on the distribution of the GST revenue between the states and in the inevitable way of these things there is a league table of winners and losers out of the current round and the losers this time seem to be Victoria and the winners are Western Australia and Queensland. I was just wondering about this sort of approach to managing the GST revenue take and the institution of the Grants Commission itself to handle this. What do you make of that process?

Geoff Gallop — The Grants Commission has played a key role in Australian—obviously under different names in earlier times—but it has brought an equalising influence to Australian politics. It's never easy to find a formula that's precise. That will, for example, be able to reflect the fact that in Western Australia, even though there's revenue coming in, there are also great demands on infrastructure to back up that growth that's occurring. Or that in Sydney there is Western Sydney, which is huge and has great needs associated with it. We certainly put forward a proposal from Western Australia that we needed to take more account of our infrastructure needs. The Commonwealth has come along some way to that with its infrastructure fund and to say that we will support the states and if they put forward proposals that are nationally significant we will back them up. But in the end a lot of those funds become like all of these things—subject to trying to get a little bit here and a little bit there so everyone's happy rather than really looking at what would be nationally significant.

So the GST distribution process through the Grants Commission is not perfect but I do think we need one. The principle I agree with. In recent years it has tended to work against Western Australia because of the royalty growth that has been there. There's

some correction now going on. I think the real issue is sharing taxes and the proposal that was put forward in the last years of the Hawke Government to create some space so that the rate could be set by each state, that would give them real growth revenue and I think that their ability to blame the Commonwealth would be radically reduced in that situation. We need to try to equalise our opportunities throughout the country. The formula is always subject to a lot of debate. It was certainly our view when I was in government that it didn't quite reflect the infrastructure demands in a place like Western Australia, but the real issue for states would be this income tax sharing. As I said it is very hard to get that up.