

Federalism

PRINCIPLES

A strong federal system of government is of significant importance to all Australians and Australian businesses.

Of particular importance is the relationship between the Commonwealth, States and Territories and their respective roles and responsibilities in policy development and service delivery.

The competitiveness of business both nationally and internationally relies on the efficient functioning of all tiers of government.

The main principles that should underpin the federal system and apportionment of responsibilities include:

Nationhood

Policy areas that have significant effect beyond the boundary of any one State (ie they have large externalities) should be the responsibility of the Commonwealth government, with State and Territory governments providing support for Commonwealth responsibility for such matters.

Subsidiarity

Where possible, the responsibility for a particular function should reside with the level of government most accessible, responsive and accountable to its citizens (this is called the principle of subsidiarity). Where a policy does not have significant effect beyond the boundary of any one State, it can safely be delegated to the state (or local) level.

Based on the two above principles, some examples of functions that should be provided at a national level include defence, foreign affairs, trade, monetary policy and immigration. Other functions such as education, health, law & order and environment can be provided by a mix of jurisdictions with standards set at higher levels of government and implementation undertaken by lower levels.

Transparency

The individual roles and responsibilities of each level of government must be made clear and understandable and there should be clear systems for coordination between governments.

Efficiency

Intergovernmental relations should promote economic efficiency, particularly by promoting the use of markets and the private sector.

Accountability

Intergovernmental relations should promote democratic accountability of government.

Flexibility

Intergovernmental relations should allow flexibility to respond to changing circumstances.

POLICY OBJECTIVES

Australia needs to reform the roles and responsibilities of the Commonwealth, State and Territory governments for a number of reasons, including:

- The increasing national focus of business, showing the significant costs of national inconsistency;
- Increased globalisation, which is forcing Australia to become more internationally competitive;
- Looming fiscal pressures, particularly from an ageing population; and
- A tax system that is becoming increasingly uncompetitive against our trading partners.

A federal system of government has many advantages, including:

- dispersion of power;
- giving increased control and responsibility to local communities;
- encouraging competition between jurisdictions;
- allowing services to be tailored to local communities; and
- encouraging policy innovation.

However, potential disadvantages of federations include:

- increased costs due to duplication;
- national inconsistency, increasing costs on national businesses;
- reductions in economies of scale;
- lack of accounting for externalities (or spillover effects between jurisdictions);
- inefficient cost shifting; and
- fragmentation.

These disadvantages must be reduced to improve Australia's wellbeing.

The current system can be improved by:

- Delineating Commonwealth, State and Territory responsibilities more clearly.
- Maximising the private sector role in service delivery. This addresses one of the main problems with the current federal system – too many services are being government provided.
- Eliminating overlaps, inconsistencies and duplication between each level of Government, particularly where these arise flowing from shared responsibilities.

- Reforming the institutional framework that coordinates federal and State policy positions, to improve efficiency and produce more timely outcomes.
- Implementing the new national reform agenda that focuses on collaboration as well as competition and includes a financial reward mechanism for States and Territories that achieve agreed outcomes.
- Addressing the widening vertical fiscal imbalance between the Commonwealth and the States (this occurs where the expenditures of States are much greater than their taxing powers). As part of this, the system for distributing funds between states should be reviewed.

THE POLICY FRAMEWORK

Institutional changes are needed to deliver an improved and more efficient federal system.

Reducing the size of Government

Many of the problems of the current federal system in Australia are caused by governments being involved in too many areas of the economy. Reducing the size of government will reduce the problems of the current system because it would reduce the problems caused by poor allocation of responsibilities between governments. If a function is allocated to the private sector, the allocation between governments becomes irrelevant.

Reducing the size of Government would have additional advantages, including increasing economic efficiency and growth and releasing funds for fundamental tax reform.

Council of Australian Governments (COAG)

The Council of Australian Governments (COAG) is the peak inter-governmental body in Australia. The members of COAG are the State and Territory Chief Ministers and the President of the Australian Local Government Association (ALGA). COAG plays a vital role in determining, agreeing and implementing new reform agendas. To achieve continuing reform, leadership from the highest levels is required.

To enhance this role, COAG agreed in 2006 to the creation of a permanent, non-statutory body; the COAG Reform Council (CRC) the aim of which was to coordinate and monitor reform of federal arrangements.

Four years on and the specific responsibilities of the CRC, as defined on its website, are to:

- monitor, assess and publicly report on the performance of the Commonwealth and States and Territories in achieving the outcomes and performance benchmarks specified in the six *National Agreements*. The council provides annual reports to COAG which:
 - publish the performance data and provide a comparative analysis of the performance of governments in meeting the agreement's objectives;

- highlight examples of good practice and performance so that, over time, innovative reforms or methods of service delivery may be adopted by other jurisdictions (from second year of reporting)
- reflect the contribution of both levels of government to achieving performance benchmarks and to achieving continuous improvement against the outcomes, outputs and performance indicators (from second year of reporting).
- report to COAG on the performance of governments under various National Partnerships.
- assess performance of the Commonwealth and the Basin States under five bilateral Water Management Partnerships as part of the *Agreement on Murray-Darling Basin Reform*.
- advise COAG on the *aggregate pace of activity* in progressing COAG's agreed reform agenda
- advise COAG on options to improve COAG's *performance reporting framework* for National Agreements and National Partnerships
- review the consistency of capital city strategic planning systems with the new national criteria during 2010 and 2011
- report on any other matters specifically referred unanimously by COAG.

In addition to the aims of the CRC as described above, ACCI believes that the council should have the ability to:

- advise COAG on reform priorities; and,
- set benchmarks and standards for jurisdictions not just monitor, assess and report on the achievements of benchmarks, as stated above.

Despite the heavy reform agenda undertaken by COAG in the past few years there are still key areas which still require further reform. They include, but are not limited to:

- Industrial Relations; and,
- Taxation.

Allocation of money to States & Local Government

In Australia, states and local government receive significant funding from the Commonwealth Government. In fact, the Commonwealth Government raises about three quarters of all tax revenues collected while the states are responsible for about half of government expenditure.

Over 40% of states' general government revenue comes from Commonwealth grants. This disparity between the taxing and spending powers between the States and the Commonwealth constitutes vertical fiscal imbalance.

ACCI believes that there are several problems created by this imbalance which require concerted and co-operative action by the Commonwealth and the States to reverse or at least re-align. They are:

- **Weakening of Accountability:** a separation between the two authorities that raise and spend the revenue (the Commonwealth Government and the State Government) leads to a weakening of accountability and inefficiencies in the delivery of state services as State Governments do not bear the political ill will of raising the taxes to pay for the services. For example, the Commonwealth Government is responsible for GST but it is the State Governments that benefit by receiving all of the revenue raised through this tax. For each dollar spent by state governments, they raise only 60c.
- **Reliance on inefficient taxes:** the States are forced to rely on inefficient taxes such as stamp duty and payroll tax in order to raise revenue as their ability to impose more efficient taxes is restricted.
- **Limits incentive for states to cut taxes:** the taxes that states can impose are inefficient and regressive but their reduced revenue raising capacity gives them very little incentive to reduce taxes.

ACCI strongly advocates wholesale reform of the most inefficient remaining state taxes. In particular ACCI recommends:

- The abolition of all taxes included in the 1999 GST agreement, including stamp duties on business conveyances;
- The reform of fire service levies so that they are based on property values and apply to all property; and,
- Major reductions in payroll taxes as a step towards their eventual abolition.

There is a risk that major state tax reform will increase the imbalance between the taxing powers of the State and Federal Governments. ACCI argues that State Governments should also undertake significant spending reductions to minimise this problem. In particular, the allocation of functions to the private sector, where the delivery of services can be much more efficient, is recommended as this makes issues of federalism much less relevant.

However, if this imbalance remains a concern, then the allocation of some taxing powers from the Federal to State Governments may be worth examining, but only on the basis that this does not increase the total tax burden.