

Submission by the Tasmanian Government

Senate Select Committee
Reform of the Australian Federation

October 2010



Tasmania
Explore the possibilities

Introduction

Our federal system of government is at the core of Australia's strength and resilience as a nation. However, challenges to our federal system, and in particular increasing centralism, are undermining its effective operation. It is now more important than ever that we revitalise it so that Australia can fully realise the democratic, social and economic benefits that a well functioning federal system can bring.

The current Inquiry by the Senate Select Committee is therefore timely and the Tasmanian Government welcomes the opportunity to contribute to its wide ranging terms of reference.

The Tasmanian Government is a party to the joint submission made by the Council for Australian Federation (CAF). CAF has an integral role in promoting and harnessing Australia's federal system of government and has commissioned three reports (the Federalist Papers) which make a key contribution to the debate on how to make our federal system work more effectively.

The current submission complements the one made by CAF to the Senate Select Committee and addresses questions or proposals that are of particular interest to the Tasmanian Government. It does not seek to restate all of the issues canvassed in the CAF submission, but focuses on some of the Committee's terms of reference.

Benefits of a federal system¹

Federal systems are recognised for cultivating unity through accommodating diversity and for bringing government closer to the people, particularly in geographically large and diverse countries such as Australia. They allow nations to meet the pressures of globalisation while at the same time accommodating regional difference.

Federalism provides for:

- Checks on power - protects individuals from an overly powerful government and allows greater scrutiny.
- Choice and diversity – citizens have a greater range of choices.
- Customisation of policies and support for local decision-making – policies and services can be tailored to meet the needs of people and communities they directly affect.
- Competition – Interstate comparisons give the states incentive to improve their performance.
- Creativity – Innovation and experimentation within jurisdictions supports competition and can lead to reform nationwide.
- Cooperation – the need to cooperate to achieve reform means that proposals are more measured and better scrutinised.

Although sometimes criticised for leading to 'over government' and inefficiency, comparison of

¹ Information presented in this section is summarised from Scott Bennett, 'The politics of the Australian federal system' Research Brief, Parliamentary Library December 2006 and Anne Twomey and Glenn Withers, *Federalist Paper 1 Australia's Federal Future*, April 2007. Available at <http://www.caf.gov.au/policyinnovation.aspx>

national governments around the world has shown that in fact 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 Moreover, there is evidence that the wider economies of federal countries are more efficient and prosperous.

There are compelling in-principle arguments to support the operation of a federal system in the Australian context as opposed to unitary government. However, it is essential that such a system be structured to operate effectively, with an appropriate balance of powers and clear delineation of roles and responsibilities, along with frameworks and institutions that promote cooperation on areas of overlapping coverage.

Response to the Terms of Reference part (b) (i)-(v)

- (b) explore a possible agenda for national reform and to consider ways it can best be implemented in relation to, but not exclusively, the following matters:**
- (i) the distribution of constitutional powers and responsibilities between the Commonwealth and the states (including territories)**
 - (ii) financial relations between federal, state and local governments**
 - (iii) possible constitutional amendment, including the recognition of local government**
 - (iv) processes, including the Council of Australian Governments, and the referral of powers and procedures for enhancing cooperation between the various levels of Australian government**
 - (v) strategies for strengthening Australia's regions and the delivery of services through regional development committees and regional grant programs.**

A possible agenda for national reform

States and territories have advocated for some time, particularly under the former Howard Government, the need to rebalance the federation. Tensions which have worked against an effectively functioning federation in the past, and in some cases continue into the present, include:

- Centralism – power should not be concentrated in one level of government (and the Prime Minister) in Canberra.
- Power must be shared and preserved by checks and balances.
- Duplication – the roles and responsibilities of the Commonwealth and the states and territories must not be confused, otherwise voters will not know which government should be held accountable and there is an increased risk of buck-passing.
- Opportunistic federalism or ‘aspirational nationalism’ undermine the federal system and are counterproductive to efforts of the Commonwealth and state and territory governments to work together on challenges facing the nation.

² Twomey and Withers 2007, pp 12-13.

- Unilateral policy decisions by the Commonwealth - for example the 2007 announcement by the Prime Minister that the Commonwealth Government would bypass the Tasmanian Government and take direct responsibility for funding the Mersey Hospital, stating the Commonwealth's true role in this case was direct intervention to help the local community.

A robust model of cooperative federalism should provide:

- Greater flexibility for states and territories rather than trying to apply a "one size fits all" program devised by the Commonwealth;
- Reduced administrative burden on state and Commonwealth public servants who are required to implement and report on programs with a Commonwealth funding component.
- A diverse approach to service delivery across states that can lead to policy innovation; and
- More opportunities for state and Commonwealth partnerships in the design of policy.

Twomey and Withers³ identify three reforms that would make the most of the advantages of federalism while reforming its operation to remove or reduce the disadvantages:

- The reallocation of roles between federal and state and territory governments based on the principle of subsidiarity.
- The improvement of mechanisms for intergovernmental cooperation – ensuring that the effectiveness of the Council of Australian Governments (COAG) is not dependent upon personalities and political events.
- The reform of financial relations – the use of specific purpose payments (SPPs) with strict conditions by previous Commonwealth Governments contributed to the public perception of the federal system as fostering duplication and buck-passing; being administratively burdensome; and lacking accountability and coordination.

The Intergovernmental Agreement on Federal Financial Relations (the IGA) agreed by COAG in November 2008 is a new framework for providing Commonwealth funding to states that can help rebalance Commonwealth-State relations. The IGA aims to reform the way that Commonwealth funding is provided to states including improved public accountability and efficiency.

There is concern that the promise of a more simplified and transparent system of Commonwealth payments has not been fully realised. A number of the pre-IGA issues continue to impact on the framing of the new National Partnership agreements and the associated Implementation Plans (discussed in detail in (ii) below).

³ Twomey and Withers (2007), p. 46.

(ii) *Financial Relations*

Vertical Fiscal Imbalance

A great deal of the current state of Australia's Federal Financial Relations can be attributed, directly or indirectly, to the consequences of Vertical Fiscal Imbalance (VFI). Australia has a high level of VFI by world standards. It is estimated that in 2009-10 the Commonwealth Government raised around 72 per cent of total general government revenue, but its own-purpose spending comprised around 55 per cent of total general government outlays. States, on the other hand, raised just 22 per cent of general government revenue in total, but their spending comprised around 38 per cent of national general government outlays⁴.

The expenditure responsibilities and revenue raising capacity of local government, on the other hand, are considered to be broadly in line.

Australia's high incidence of VFI is largely attributable to the Constitution and the changing importance of the various tax bases over time. However, state and Commonwealth policy is also a factor. The proportion of total general government revenue that states currently raise is lower than its full potential. As a result of tax competition, historical development, social equity considerations and past reforms, states (like all governments) do not fully utilise their available revenue bases. Conversely, the Commonwealth's proportion of expenditure is higher than it needs to be because it has chosen to provide selected services in areas outside of its Constitutional responsibility.

VFI has some theoretical benefits – in many cases it is arguably more efficient for a national government to raise certain revenues, and compliance with a national tax regime can be more efficient for businesses that operate in more than one jurisdiction.

However, very high levels of VFI are generally considered undesirable. VFI decreases accountability, since the nexus between a government's revenue raising activity and its provision of services is more distant. It introduces inefficiencies, creating an additional layer of bureaucracy to administer and to oversee grants from one level of government to another.

Ideally, any fundamental reform of federal financial relations in Australia would seek to significantly reduce VFI. This could be achieved through increasing the revenue bases available to states (for example, by transferring some Commonwealth revenue bases to the states, or through national tax reform that might result in better utilisation by states of their existing tax bases), a transfer of expenditure responsibilities from the states to the Commonwealth, or a combination of both.

⁴ Tasmanian Budget Paper No 1 *The Budget 2010-11* (Chapter 9).

However, in order to realise the full benefits of a federation⁵, it would be desirable to ensure that the level of government delivering services to a community remains close to that community – in this case, state governments would be the most appropriate level of government to deliver most services. States are able to provide a mix of services in line with their residents' preferences, which vary from region to region. Consistent with this, Tasmania suggests that it would be generally more efficient and democratic to address VFI by increasing the revenue bases available to states, rather than to transfer current state responsibilities to the Commonwealth.

Horizontal Fiscal Equalisation

The Commonwealth Grants Commission (CGC), the independent body responsible for administering Horizontal Fiscal Equalisation (HFE), has been described as “part of the glue that holds the Australian Federation together”⁶. Without HFE, there would be much greater disparities in the quality of life of Australians living in different states. The CGC process for determining each state's share of GST revenue is transparent, objective and policy-neutral. It does not compensate states for any economic or financial mismanagement, and states cannot directly affect their share of GST revenue.

Moreover, it is important to recognise that only a small part of the GST revenue pool is used to achieve HFE. In 2010-11 for example, it is estimated that less than 8 per cent (\$3.8 billion) of the total GST pool of \$48 billion is to be redistributed to achieve HFE. The remaining 92 per cent of the pool (\$44 billion) is distributed on the basis of state population shares⁷. Tasmania is strongly opposed to any reform of federal financial relations which undermines the HFE process. We consider VFI and HFE to be two very separate issues which should be examined separately in any review.

Intergovernmental Agreement on Federal Financial Relations

The IGA agreed by COAG in November 2008 introduced, among other things, a new framework for providing Commonwealth funding to states.

Under this new framework the Commonwealth has significantly increased the total level of tied funding to states. However, the IGA has not addressed the underlying issue of the misalignment of revenue raising capacity and expenditure responsibilities at each level of government, and so it exposes the states to some uncertainty about their capacity to fund their expenditure responsibilities in the longer term.

⁵ Several of these benefits are presented in Professor Geoffrey de Q. Walker's 'Ten Advantages of a Federal Constitution', which can be found at <http://www.samuelgriffith.org.au/papers/html/volume10/v10chap11.htm>

⁶ Eslake, Saul, 'The Grants Commission is part of the glue that holds the Australian Federation together', accessed from [http://tasmaniantimes.com/images/uploads/Grants_Commission_\(AFR_Mar_2006\).pdf](http://tasmaniantimes.com/images/uploads/Grants_Commission_(AFR_Mar_2006).pdf)

⁷ Based on GST estimates published in the Australian Government Budget 2010-11 *Budget Paper No 3: Australia's Federal Relations*.

The new federal financial relations framework aimed to reform the way that Commonwealth funding is provided to states. At the time the IGA was developed, both levels of government acknowledged that the system of Commonwealth funding lacked public accountability and efficiency. Most Commonwealth funding was provided to states through a large number of SPPs, some of which were very small but nevertheless had high administrative costs and prescriptive requirements.

The new framework was expected to introduce greater public accountability and to increase the focus on achieving outcomes (eg improving numeracy and literacy, reducing homelessness, improving the life expectancy of indigenous people). States were to have greater policy flexibility to use their expertise as service providers to achieve these outcomes, in exchange for increased and clearer outcomes-based public performance accountability. New agreements were to be limited in number and restricted to major projects and reforms of national significance.

These principles promised substantial improvements in federal financial relations, and, ultimately, better outcomes for the Australian community.

After more than one and a half years in operation, the promise of a more simplified and transparent system of Commonwealth payments has not been fully realised. A number of the pre-IGA issues are still present in the new National Partnership (NP) agreements and their subsidiary documents, Implementation Plans (IPs).

It can be argued that only a few of the new NPs and IPs fully comply with the new IGA principles. Rather than focusing on outcomes, many agreements remain focussed on inputs – where and how the money is spent but without much regard for what is actually achieved. In some cases, the agreements remain highly prescriptive and continue the practice of Commonwealth micromanagement over state service delivery.

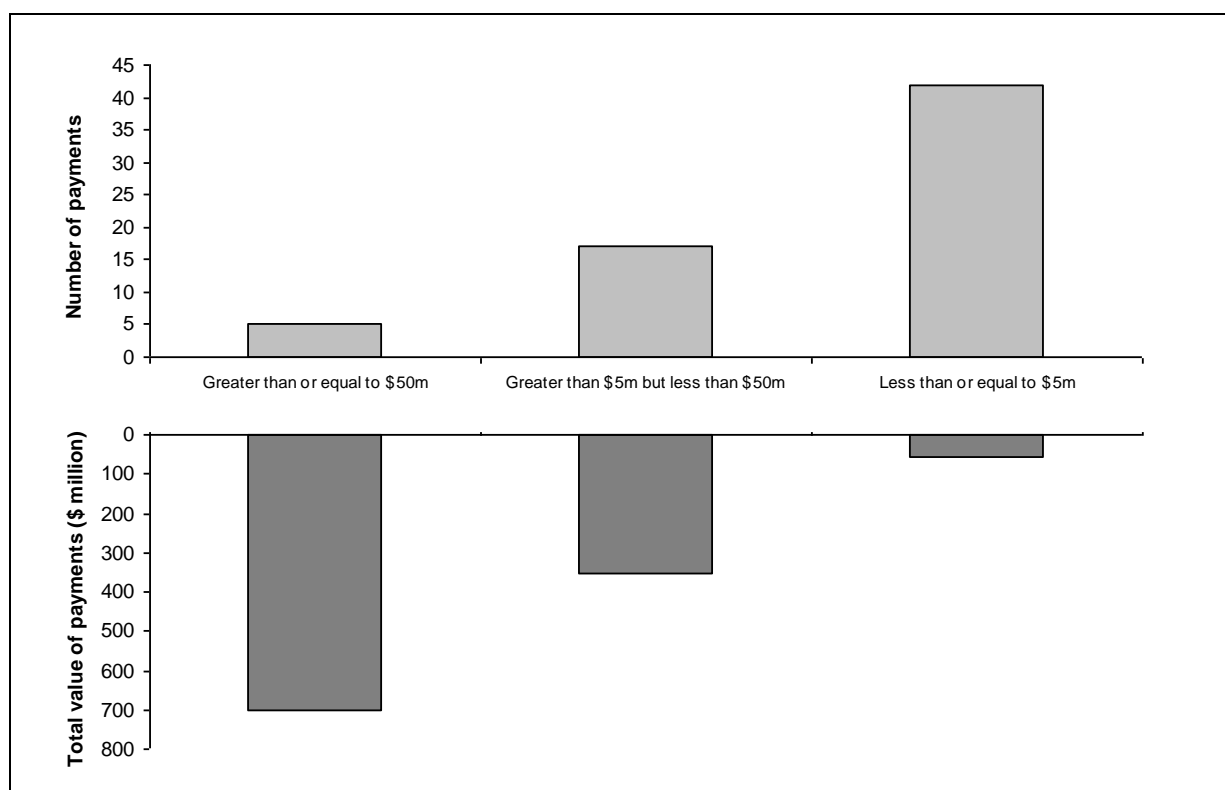
The new framework has not yet fully realised its ambition of reducing the administrative burden on Commonwealth and state departments. The level of oversight and monitoring by the Commonwealth and the reporting requirements placed on states is increasing costs and diverting resources away from service delivery.

Under the IGA, the COAG Reform Council (CRC) has substantially expanded its role in independently assessing and publicly reporting jurisdictional performance. The community is now able to directly compare the performance of governments across key service areas such as health, education and housing in delivering on the outcomes agreed by COAG. This shift to an outcome focus was a key objective of the IGA reforms. The CRC role is now well established, but the emphasis on detailed and prescriptive reporting arrangements remains a feature of many NPs.

Although the number of NP agreements was reasonably small at the time the IGA was agreed, the number has grown substantially. The reform focus for NPs is being undermined and in many cases NPs are being used for small program-level projects.

In Tasmania some 64 payments are expected from the Commonwealth in 2010-11, the vast majority of which are provided under individual agreements. Chart 1 below shows there is a disproportionately large number of small payments compared to the value of those payments. There are 42 payments with an annual value less than or equal to \$5.0 million, including one payment of just \$5 000 per annum. The Chart demonstrates that there remains considerable scope to further rationalise and streamline Commonwealth Government payments to the states in line with the original intent of the IGA reforms.

Chart 1 – Number and annual value of Commonwealth payments to Tasmania, 2010-11



Source: Commonwealth payment estimates are based on those used in Tasmanian Budget Paper No 1 *The Budget 2010-11* (Chapter 9).

Heads of Treasuries (HoTs) are currently undertaking a review of National Agreements, NPs and IPs. The HoTs Review is expected to report on the extent of non-compliance with the IGA, and is likely to include recommended strategies to improve NPs and IPs so that agreements are more consistent with the principles of the IGA. The review is required to report to COAG its findings and recommendations on 31 December 2010.

The VFI is the underlying cause of many of the criticisms of federalism – that it is inefficient and leads to confusion as to roles and responsibilities. The deficiencies in the implementation of the IGA exist to a large extent only because of the Commonwealth's increased involvement in service delivery areas that are primarily a state responsibility, allowed by the imbalances in revenue raising and expenditure across the two spheres of government. It is therefore essential that any reform proposals address the fundamental problem of VFI.

(iii) Local government

Constitutional recognition of local government

While the constitutional recognition of local government nationally may have some symbolic benefits, it remains unclear as to what the objectives of any substantive change would be. The role of local government is well entrenched under Tasmanian legislation. Part IVA of the *Tasmanian Constitution Act 1934* protects the existence of local government and prevents the boundaries of local government areas being altered without a review by the Local Government Board.

At the national level, acknowledgment of the role of the local government within the federation is provided through:

- the Intergovernmental Agreement on cost shifting (2006);
- representation of local government on COAG by the Australian Local Government Association (ALGA);
- ALGA's membership of eight Ministerial Councils and observer status on a further five ⁸; and
- the Commonwealth parliamentary resolution on recognition of local government (2006).

Cooperation between the Tasmanian Government and the local government sector in the State is extensive. The Local Government Division, in the Department of Premier and Cabinet manages a range of initiatives that support cooperation between the two sectors.

The partnership agreements program aims to find better ways of serving Tasmanian communities through intergovernmental collaboration and has led to 51 partnership agreements since its inception in 1999, including bilateral, regional, statewide and tripartite agreements. Councils and government departments are enthusiastic about the program and see it as a useful mechanism for making progress on matters of mutual importance. An additional benefit of the program is that it builds relationships and networks between the sectors, making issues easier to resolve as they arise (through either formal or informal mechanisms).

The Premier's Local Government Council (PLGC) is another formal avenue for collaboration between the State Government and local government. It consists of the Premier, the Minister for Local Government, the President of the Local Government Association of Tasmania and seven elected local government representatives. The PLGC meets three times a year to discuss topical and continuing issues. Through the PLGC and the partnership agreements program, a Statewide Partnership Agreement on Communication and Consultation between the State Government and local government was developed to establish a protocol for communication between the two sectors. The PLGC is currently leading a sector-wide discussion on options for local government reform.

⁸ Commonwealth-State Ministerial Councils Compendium July 2010, http://www.coag.gov.au/ministerial_councils/index.cfm accessed on 2 September 2010.

The State Grants Commission (SGC) within the Department of Treasury and Finance makes recommendations to the Treasurer concerning the distribution of Commonwealth Government financial assistance grants and identified local roads funds to local government under the provisions of the *Commonwealth Local Government (Financial Assistance) Act 1995*. The SGO made recommendations on the distribution of \$62 419 407 in the 2009-10 financial year and these funds are vital to the ongoing viability of local government.

The provision of direct Commonwealth funding to local government is a related issue that requires careful consideration as it has the potential to impact on relationships with and the other two spheres of government, with the risks of:

- wasted resources or duplication by removing the ability of the state government to coordinate funding and plan strategically across regions and councils.
- the Commonwealth Government using direct funding to local government to circumvent a disagreement with the State Government on particular policy issues; and
- direct funding where there may be overlap with or contradiction of state policies.

(iv) Council of Australian Governments processes

It is essential that a federal system is structured to operate effectively, with an appropriate balance of powers and clear delineation of roles and responsibilities, along with institutions that promote cooperation on areas of overlapping coverage and concurrent responsibility.

A federal system should promote both competitive and cooperative federalism as complementary processes which, when operating appropriately, help maximise the benefits of federalism:

- Cooperative federalism is important to achieving the best outcomes in areas of joint responsibility – or where state/territory support is important in achieving an agreed national policy objective; and
- Competitive federalism provides an important driver for innovation, economic development and improvements in service quality and efficiency, by comparison of performance and policy approaches across states and territories.

Federalism in the Australian context differs from most other federations in its high level of shared responsibilities and its substantial vertical fiscal imbalance which has led to a greater Commonwealth involvement in State's responsibilities.

The experience with COAG has demonstrated that federalism works best where there is a collaborative and co-operative working relationship between all governments on issues of mutual national interest. COAG has developed a number of IGAs in areas such as road transport, competition policy, non-bank financial institutions, environmental policy, food standards and mutual recognition. COAG's agreement to National Competition Policy implemented in 1995 was a significant achievement in nationally co-ordinated economic reform.

COAG, when operating effectively, demonstrates how collaborative federalism can yield results. However, at other times when central governments have attempted to dominate the agenda, outcomes have been mixed. A key concern is how the COAG agendas are set. The agenda is determined by the Prime Minister; and issues of importance to the states may not be given adequate time or weight in the agenda. The agenda and agenda papers can be in a state of flux in the lead-up to COAG meetings which does not always enable sufficient time for consideration of the major public policy issues raised. An overly long agenda can also mean there is insufficient time for consideration of issues. Moreover, the COAG collaborative approach to the reform process and future planning does not always flow through to implementation where the Commonwealth often acts unilaterally in relation to core areas of State responsibility and funding arrangements. As noted above, this trend continues to impact on the efficacy of the IGA.

COAG's effectiveness is dependent upon personalities and the contemporary political situation. Typically it is easier to achieve intergovernmental cooperation in less politically controversial areas (eg food regulation as opposed to school curricula) and in those areas where there is no political impetus for the Commonwealth to seek national uniformity.⁹ There is a strong argument for more direct involvement of the states and territories in deciding the COAG agenda.

The Business Council of Australia's *Charter for a New Federalism* (2007) recommended the institutionalisation of COAG to ensure its continuing effectiveness regardless of these influences:

- Regular meetings be held at least twice a year;
- Meetings be scheduled for a full day to give time for the proper consideration of a full range of policy issues;
- Publishing agendas prior to meetings and decisions immediately following meetings; and
- Strengthening the role of COAG and improving its accountability by establishing a jointly-funded/resourced permanent secretariat with a rotating chair.

In 2008, the Victorian Premier, Hon John Brumby MLA, proposed similar reforms to reshape COAG as an enduring institution able to rise above 'the ebb and flow of governments'¹⁰:

- COAG to be underpinned by a new Intergovernmental Agreement – with the role and governance of the COAG Secretariat formalised, including:
 - Regular meetings of COAG;
 - An effective and independent secretariat; and
 - The right for states to place items on the agenda.
- The Premier advocated that the IGA would:
 - Reflect COAG as an equal partnership between all levels of government:
 - Set out COAG's vision and objectives:

⁹ Scott Bennett, 'The politics of the Australian federal system' Research Brief, Parliamentary Library December 2006, p.20.

¹⁰ Brumby J (2008). Address to ANZSOG: Making Federalism Work Conference – <http://www.caf.gov.au/speeches.aspx> accessed on 4/10/2010.

- Have a strong emphasis on joint accountability and direct all Australian governments to meet high performance benchmarks;
- Provide flexibility for COAG to adapt and evolve;
- Make COAG transparent to the community – using plain language that all Australians can understand; and
- Drive the cultural change required to support a mature federalism.

Reform of Ministerial Councils

Currently there are over 40 Ministerial Councils in operation. Following Dr Allan Hawke's review of Ministerial Councils, COAG agreed, in-principle, in April 2010 to reform the Councils. The reforms will enhance cooperative federalism through a reduction in the number of Ministerial Councils; enable the Councils to focus on national strategic priorities and will see new ways for COAG and its Councils to identify and address issues of national significance.

COAG has agreed in principle to reforms that will see current Ministerial Councils rationalised to 11 or fewer Councils overseeing key areas of ongoing importance to both the Commonwealth and the states including health, education and training, community services, infrastructure, police and emergency services, and financial relations. COAG will also convene from time to time Select Councils of Ministers when it requires advice on particular matters within specific timeframes.

Referral of Powers

Tasmania supports the direction taken in the CAF submission – that a referral of power may be appropriate to achieve policy goals in some circumstances, however often there are better ways to harness the benefits of federalism through cooperative mechanisms.

Referral of powers should only be utilised as a 'last resort' option where there is a clearly demonstrated rationale for national uniformity that can only be addressed by ceding legislative powers to the Commonwealth after all other options have been considered and eliminated. The referral of powers increases the centralisation and reduces the opportunities to capitalise on the advantages of cooperative federalism.

Legal mechanisms such as the mirror (or model) legislative schemes or complementary applied laws schemes can be used to support cooperation and achieve harmonisation while retaining some discretion to allow for variability between jurisdictions; enable the states and territories to maintain an active policy role and responsibility for the administration of these statutes. These approaches have the advantage of linking the principle of subsidiarity to the notions of consistency and harmony.¹¹

¹¹ John Wanna, John Phillimore, Alan Fenna and Jeffrey Harwood, *Common Cause: Strengthening Australia's Cooperative Federalism*, Final report to the Council for Australian Federation, May 2009, p.18.

(v) Australia's regions

There is growing recognition that our federal system needs to provide regional communities – rural and urban – with greater capacity for developing and implementing their own solutions to local problems. In Australia, this reflects diversity of regional circumstances and issues and the difficulties faced by central government in responding effectively to regional needs.

Internationally, there has been a significant shift to accommodate regional diversity within unitary countries in Europe and elsewhere. With its existing federal structure, Australia is well placed to respond to the tensions arising from regional diversity, but it will require flexibility on the part of states and the Commonwealth in meeting changing regional needs.

There are new structures and arrangements emerging to address regional service requirements. For example, the National Broadband Network (NBN) has a major focus on redressing inequality of access to high quality internet services in rural regional areas, with most of the early release rollout sites outside of major urban centres.

Under the National Health and Hospitals reforms agreed by COAG in April 2010, there will be a system of Local Health Networks, largely based on regional geographic clusters of hospitals, to deliver public hospital services. Primary health care will also be restructured to have a strong community and regional focus through the establishment of Medicare Locals.

Tasmania already has regional structures for the provision of its health, education, community services and police services that allow delivery to be more flexible and responsive to local needs, while maintaining the equity and efficiency benefits of a statewide system.

At the same time, local government is looking to regional arrangements to drive economic development and efficiencies in service delivery. In Tasmania there are currently three regional local government partnerships – the Northern Tasmanian Development, the Cradle Coast Authority and the Southern Tasmanian Councils Authority.

It should also be noted that Tasmania is commonly treated as a discrete 'region' or as a part of 'regional Australia' in a range of Commonwealth Government programs and initiatives. Inflexible national programs can disadvantage regional Australia where there is too great a focus on the 'mega' population centres.