CHAMBER OF COMMERCE
AND INDUSTRY
WESTERN AUSTRALIA

Federalism in Australia:
A Discussion Paper

Business Leader Series
Prepared by the Chamber of Commerce and Industry of Western Australia

April 2007

Contents

CHAMBER OF COMMERCE AND INDUSTRY WESTERN AUSTRALIA

Overview

About CCI

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

Context

The Coalition party's victory in the November 2004 Commonwealth election delivered to the government control of the Senate as well as the House of Representatives for the first time since 1981, providing the Commonwealth Government with considerable scope to implement its policy agenda within its own jurisdiction.

At the same time, Labor has been in control of all of the State governments, which has heightened political rivalry and ideological conflict between the Commonwealth and State Governments.

These recent changes in the political landscape take place against a background of increasing stress on the constitutional theory and political practice of government in the Australian federation. Three issues, in particular, have been persistent and remain unresolved:

- First, the question of vertical fiscal imbalance, by which the Commonwealth is responsible for raising the bulk of Government revenues collected in Australia, while the States are responsible for most service delivery.
- Second, the issue of the horizontal redistribution of funds between states, with the validity and appropriateness of the horizontal fiscal equalisation process increasingly challenged by those state that are net losers from the process.
- Third, the practical processes of resolving interstate conflicts over policy and resources, of delivering essential services and funding infrastructure, and of providing appropriate regulation for a modern, globalised economy have become more complex and more pressing.

These last issues in particular have prompted CCI to compile this discussion paper in order to re-examine some of the fundamental issues about how Australia's federation works. It is striking that, in the recent review of the impact of competition policy produced by the Productivity Commission[1], the key areas identified as needing further reform are overwhelmingly ones that cut across government jurisdictions, either because they are activities for which state governments have prime responsibility but a policy response affecting more than one state is required (such as water and electricity) or where there is an overlap or duplication of funding responsibilities, service delivery, and policy development between the Commonwealth and the States (such as industrial relations and health).

Further evidence of the stresses on current arrangements comes from attacks by the combined Premiers on the changes to intergovernmental arrangements for resolving policy issues that cut across jurisdictions in areas such as health policy, education and the environment[2]. From water rights to the provision of infrastructure such as ports; from industrial relations reform to the funding of universities or the setting of school curricula, the issue of which layer of government has the ability and the authority to set policy is a recurring theme that clouds, and sometimes overwhelms, the question of what the best policy actually is.

This discussion paper starts by outlining a history of federalism in Australia, as well as some of the key challenges facing Australia's federation going forward.

This will be followed by what CCI believes to be the five key principles that should shape and inform reform of government relations and a renewed agenda for political and economic reform in Australia. The final section will then look into more detail some of the key issues in relation to Australia's federation.

Executive Summary

Australia is one of a relatively small number of countries worldwide with Federal constitutions. Australia's constitution was accepted by referenda in each of the Australian colonies, and it was created as a Federation 1 January 1901.

A federal system was adopted because it struck a balance between the local responsiveness and regional autonomy that had been enjoyed by the separate colonies, and the benefits of co ordination, consistency and an international presence that national government conferred. Under Australia's federal constitution, the Commonwealth and the State Governments share sovereignty.

In the past hundred years there has been repeated conflict between the states and Commonwealth over jurisdictional boundaries, and in general an increase in the power of the central government relative to the States.

However, the effect of the Commonwealth's fiscal powers has been a significant force shaping the evolution of the federation. Under the constitution, the Commonwealth has had sole rights to levy customs and excise taxes, and during World War Two the States ceded their income taxing rights to the Commonwealth too, leaving them with a range of fairly narrow and distorting taxes and charges to provide own-source revenue. As a consequence, the states have been reliant on substantial transfers from the Commonwealth to fund their activities for most of the federation.

Local governments on the other hand are established solely under State legislation, and not under the Australian Constitution. By forming local authorities, the States are able to delegate various functions and responsibilities to these bodies. As a result, this has added another layer of complexity in relation to Australia's federation.

Looking to the future, there are some key challenges which Australia faces, including the ageing of the population (which will substantially increase demands for services such as health and aged care while significantly reducing the potential labour supply relative to the population) and globalisation (which will require countries to respond efficiently, flexibly and innovatively to global economic pressures).

CCI believes that there is a need to revisit the allocation of responsibilities within the federation more systematically and rationally, with a view to simplifying the system, improving its efficiency and transparency and eliminating duplication and overlap.

CCI believes that there is a need to revisit the allocation of responsibilities within the federation more systematically and rationally, with a view to simplifying the system, improving its efficiency and transparency and eliminating duplication and overlap. This would require both state and Commonwealth governments to commit to a genuine review of functions and responsibilities, including a commitment to withdraw from areas deemed to be more appropriately sited in the jurisdiction of another layer of government. It also requires that funding adequacy and autonomy be addressed.

A starting point for such reform might be an independent review of jurisdictional boundaries and their efficiency by a body at arms-length from Government, perhaps modelled on the Productivity Commission or National Competition Council. Its first role would be to recommend new and clearly defined allocations of policy, spending and revenue raising responsibilities for funding, policy determination, and policy implementation.

Such a review of functions should be guided by five key principles:

- **Subsidiarity**, which requires that that power should be exercised at the lowest level that produces efficient results;
- **Competitive federalism**, which emphasises the benefits of diversity, experimentation and a degree of rivalry between the States' policies and practices;
- **Cooperative federalism**, which identifies the benefits of a cooperative, consistent and co-ordinated policy approach on some issues, especially those which have effects beyond the jurisdiction of the government with authority to legislate on the issue, or where there are significant benefits from a unified approach;
- **Financial adequacy**, which requires that governments have secure access to the funds necessary to implement their programs, which in turn demands that the drawbacks of vertical fiscal imbalance be addressed; and
- **Appropriate redistribution**, which demands an appropriate means of distributing funds between jurisdictions, and requires a fresh look at the objectives and processes of horizontal fiscal equalisation.

Probably the key issue from which the Federalism debate centres, concerns the financial relations between the Commonwealth and the states.

In Australia, the Commonwealth government raises about three quarters of all tax revenues collected, but the States are responsible for about half of government expenditure. As a result, over 40 per cent of States' general government revenue comes from Commonwealth grants. This disparity between revenue raising and expenditure at different levels of government constitutes vertical fiscal imbalance.

The key problem with vertical fiscal imbalance is that it undermines the autonomy of the financially dependent government. Political authority is vulnerable without autonomy, which includes the financial capacity to deliver the goods and services that constitutional authority empowers the government to provide.

There are a number of ways in which greater fiscal balance could be achieved. A centralist approach could be to transfer expenditure responsibility to the Commonwealth or by the Commonwealth providing the States a greater share of its tax revenues. However, each of these has its complications. A better reform process would also see the extent of vertical fiscal imbalance reduced.

If tax reform is in future to achieve a lesser degree of vertical fiscal imbalance without transferring spending powers from the States to the Commonwealth, it must allow States to increase their own-source revenues.

Another key aspect of Commonwealth-State financial relations is the process of horizontal fiscal equalisation process, which is typically a great source of tension and debate as to what the appropriate distribution of GST revenues should be.

The key weaknesses of the current equalisation process is that it equalises opportunities to indulge in spending that is wasteful or even damaging, and that it introduces incentives to distort spending and taxes to maximise grant revenue. Such concerns could be addressed by reformulating the 'standard' budget so that it is no longer the average of actual expenditures.

That said, some of the tension surrounding the horizontal fiscal equalisation process might be eased if the States were less reliant on the Commonwealth for revenue.

Another area of concern in relation to Commonwealth-State financial relations is the increasing use by the Commonwealth of Specific Purpose Payments, which have allowed the Commonwealth to set its policy agenda on the State. These payments have also become increasingly prescriptive through matching conditions that prescribe how much a State must spend from its own sources and condition as to how (and when) services are to be delivered and how the service delivery agency or projects are to be managed.

Commonwealth Government intervention in such a manner can have a significant negative impact on State Government budget flexibility. These issues highlight the need for the Commonwealth-State agreements to focus on common outcome based objectives rather than prescriptive financial and other requirements.

Another key issue concerning the federalism is in relation to infrastructure provision – and more specifically the Commonwealth's responsibilities in the provision of key economic and social infrastructure.

CCI believes that the Commonwealth Government should carry a greater share of the responsibility for providing the infrastructure necessary for industrial development, because it collects the main tax benefits from such projects.

Another issue with the current method of accounting for infrastructure investment under horizontal fiscal equalisation is its treatment of depreciation and valuation of capital stock. The formula used to determine states' relative capital expenditure needs should be amended to give greater recognition to the problems caused by population growth, and should seek to base depreciation estimates on a more realistic assessment of the value of capital stock than one derived from depreciated historic cost.

While the Commonwealth and its agencies have had a relatively small role in the direct provision of infrastructure, its indirect role remains significant, as it is responsible for the taxation regime affecting companies that can have a significant effect on companies' decisions on whether and how to invest. The Commonwealth also engages in investment attraction activities such as the provision of subsidies and incentives for developers of major projects, and provides special purpose payments to the states for the provision of particular infrastructure investments.

The Commonwealth should review its business assistance programs to create a more transparent and predictable evaluation process and to provide support in cases where there is a demonstrable market failure and where net community benefits are likely to be maximised, such as common user infrastructure. There should also be a joint review between the Commonwealth and states aimed at achieving better consistency and co-ordination of assistance programs between jurisdictions.

Reducing overlapping and inconsistent regulation in Australia through cooperative federalism is a significant reform objective. Increasing mobility and flow of Australian businesses and workers has raised concerns about separate, overlapping and conflicting regulation between state jurisdictions. This ad hoc regime increases the costs of complying with regulation without any associated increase or change in economic activity. Simplifying regulation will go toward reducing the cumulative burden faced by business in terms of reducing overlapping and inconsistent requirements. State based regulation, which has the same objective yet different regulations should be investigated for possible alignment and simplification.

One of the greatest achievements of cooperative federalism in recent years in Australia has been competition policy reform through National Competition Policy. As part of that reform, the states cooperated to introduce a single national framework for corporations law in Australia so that each State had identical regulations covering companies and securities and some other regulations governing food standards, transport and financial institutions.

There is still much to be done in relation to competition policy, and CCI has been calling for a renewed focus to ensure Australia can achieve higher living standards and be well placed to address some future challenges – including global competitive pressures as a result of continued global integration, and the pressures resulting from the reduction in labour supply from the ageing of the population, which without offsetting increases in productive capacity will constrain future growth potential.

CCI has welcomed the February 2006 agreement by the Council of Australian Governments (COAG) towards a new *National Reform Agenda*. It is hoped that this new agreement will help to further boost competition, productivity and efficient functioning of markets in the key areas of transport, energy, infrastructure regulation and planning and climate change.

There are also a range of other tensions in relation to federation, and indeed they have become a recurring issue in a surprisingly large proportion of Australia's political concerns and controversies – ranging from water rights to the provision of essential services such as electricity or infrastructure such as ports; from industrial relations reform to the funding of universities or the setting of school curricula. The issue of which layer of government has the ability and the authority to set policy is a recurring theme that clouds, and sometimes overwhelms, the question of what the best policy actually is.

The issue of which layer of government has the ability and the authority to set policy is a recurring theme that clouds, and sometimes overwhelms, the question of what the best policy actually is.

However, these recent clashes are only the latest chapter in a saga of conflict between the States and the Commonwealth that has be running since Federation. Its fuel comes from the pursuit of power and the clash of ideologies, from social, economic and technological changes that force governments to develop policy responses to issues the founding fathers could not possibly have anticipated, and from periodic High Court rulings on the distribution of authorities that regularly shift the goalposts for political players.

These clashes take the form of turf wars more often than reasoned debates of the proper allocation of responsibilities between jurisdictions. By and large, the Commonwealth wins more of these clashes than it loses. This is partly because its greater financial clout allows it to use financial strings or incentives to influence the states, or simply to by-pass them and implement its own agenda; and partly because the changing political, social and economic climate means that some issues are more sensibly resolved at a national than a state level.

What this discussion paper helps to highlight is the need for the allocation of responsibilities within the federation to be reviewed systematically and rationally, with a view to simplifying the system, improving its efficiency and transparency and eliminating duplication and overlap. This would require both state and Commonwealth governments to commit to a genuine review of functions and responsibilities, including a commitment to withdraw from areas deemed to be more appropriately sited in the jurisdiction of another layer of government. It also requires that funding adequacy and autonomy be addressed.

CHAMBER OF COMMERCE
AND INDUSTRY
WESTERN AUSTRALIA

Unless there is a genuine commitment to the reform of Commonwealth-State financial relations, it is unlikely that the federalism debate will go away.

This would best be achieved through an independent review of jurisdictional boundaries and their efficiency by a body at arms-length from Government, perhaps modelled on the Productivity Commission or National Competition Council. Its first role would be to recommend new and clearly defined allocations of policy, spending and revenue raising responsibilities for funding, policy determination, and policy implementation.

From CCI's perspective, the key issue surrounds the uneven distribution of financial powers between the Commonwealth and the States. Unless there is a genuine commitment to the reform of Commonwealth-State financial relations, it is unlikely that the federalism debate will go away.

In the absence of a commitment to reforming Commonwealth-State financial relations, there still exists opportunities for reform through the examination of discrete issues. To illustrate this, CCI undertook to examine the issue of public housing. This examination identified an opportunity for reform through the adoption of a model whereby the Commonwealth provides all of its funding by way of cash grants or income assistance for rental accommodation, and where the States are responsible for designing policies aimed at ensuring there is enough public or private sector housing stock for recipients of assistance to access.

This was a reform that was originally proposed by COAG in 1995, and would have done away with the Commonwealth-State Housing Agreements, and in the process eliminated a range of inefficiencies and delays caused by duplicate administration. Further, such a reform would go some way to eliminating the perverse incentives that exist through the present funding structure of matching grants. Under the present funding arrangements, the incentives to provide services at least cost are reduced because State Governments do not receive financial benefit from cost savings but rather are rewarded by spending more money on housing provision.

Federalism in Australia

Introduction

Australia is one of a relatively small number of countries worldwide with Federal constitutions. These countries generally have the characteristics of being relatively large geographically and/or having marked regional divergences in population characteristics. Federations worldwide include the USA, Canada, Brazil, South Africa, Russia, India, Mexico, Germany and Switzerland. There are 25 countries with federal political systems, and their citizens comprise 40 per cent of the world's population[3].

In addition, other federal-type political structures have emerged in recent years, such as the partial devolution of power within the United Kingdom, and the evolving political structures of the European Union.

Globalisation, trans-national issues such as human rights and the environment, technological changes such as the internet, improvements in transport and human mobility all mean that there is pressure for consistency and compatibility in the political, economic and technological processes we encounter – systems and rules apply to increasing numbers of people, and in this regard decision-making is moving upwards to higher levels of authority governing larger numbers of people.

At the same time, these same developments are also empowering individuals, businesses and groups to make independent decisions and choices about the way they live and operate. There is a trend away from uniformity and top-down authority evident in economic, cultural and political life, an emphasis on local, regional, ethnic, and personal autonomy and self determination, and the rediscovery and reassertion of distinctiveness and identity.

This polarisation can reflect in tensions between the layers of government in a federal system, but federal government can also provide the flexibility and adaptability to re-distribute responsibilities between jurisdictions as technology, circumstances and changing values dictate.

A Brief History of the Australian Federation

Australia's constitution was accepted by referenda in each of the Australian colonies, and it was created as a Federation 1 January 1901.

A federal system was adopted because it struck a balance between the local responsiveness and regional autonomy that had been enjoyed by the separate colonies, and the benefits of co-ordination, consistency and an international presence that national government conferred. Under Australia's federal constitution, the Commonwealth and the State Governments share sovereignty.

From the start, the drafters of the constitution envisaged that some matters would need to be dealt with by a national government, but relatively few powers were explicitly or exclusively granted to the Commonwealth, while jurisdiction over most areas was reserved to the States. The Commonwealth is responsible for issues that cut across State borders (Section 92) and for international and external affairs. However, the extent of the Commonwealth's powers was not clearly delimited, and there is also a fair degree of overlap between the responsibilities and powers of the two levels of government. This meant that both conflict and the need for cooperation between layers of government featured from the beginning of Federation. Where there is inconsistency or conflict between State and Commonwealth law, the latter prevails (Section 109).

The Constitution established an Inter-State Commission which was intended to be "a quasi judicial body with powers to adjudicate questions arising in relation to interstate trade and commerce"[4], but this has not operated for most of the past 100 years. Other means have been used to manage jurisdictional conflict.

The composition of the Senate was designed to offset the tendency for the more populous states to dominate the House of Representatives. It has substantial powers in its own right, and each State gets equal representation regardless of population.

In the past hundred years, there has been repeated conflict between the states and Commonwealth over jurisdictional boundaries, and in general an increase in the power of the central government relative to the States. The Parliament of Victoria's Federal-State Relations Committee identified two key causes of this centralisation – "…the open-ended nature of the powers given to the Commonwealth by the Constitution, and the nature of the financial relations between the Commonwealth and the States." [5] It is probably fair to add that the increasing complexity and international engagement of Australia's economy and society over the hundred years since federation have also meant that many powers envisaged originally as state responsibilities are more effectively operated at national level.

However, the effect of the Commonwealth's fiscal powers has been a significant force shaping the evolution of the federation. Under the constitution, the Commonwealth has had sole rights to levy customs and excise taxes, and controversially this has been interpreted by the High Court in such a way that it is presumed to debar the states from raising sales taxes (indeed, their selective excises were overturned in the Ha and Hammond cases in 1997).

During World War Two the States ceded their income taxing rights to the Commonwealth too, leaving them with a range of fairly narrow and distorting taxes and charges – such as stamp duty, land tax, royalties and (later) payroll tax – to provide own-source revenue. As a consequence, the states have been reliant on substantial transfers from the Commonwealth to fund their activities for most of the federation.

This is not a situation which the states have resisted particularly strenuously, for it means that they win the political benefits of spending on essential and other services without the political pain of raising the taxes to pay for them. But it has created a raft of associated problems that have cumulatively acted to strain the federation. There is also a similar issue of vertical fiscal imbalance between state and local governments, with local governments almost completely limited to property taxes for own-source revenue, and reliant on (mainly state government) grants to finance services. The implications and consequences of vertical fiscal imbalance are discussed in more detail on page 24.

Section 94 of the Constitution provides that any surplus Commonwealth revenue should be returned to the States. But by diverting such revenues into trust funds, the Commonwealth has ensured that there has technically been no such surplus since 1908. Instead, the distribution of money to the States has been undertaken under section 96, which gives the Commonwealth discretion to distribute grants to the States as it likes.

In the 1980s to the mid 1990s, a key source of tension within the federation was the uses and abuses of the Commonwealth's external affairs power to make Treaties. As described by Gallighan (2000):

> *The … Labor Government and its forceful Minister for Foreign Affairs, Senator Gareth Evans, had used the untrammelled treaty making power with little concern for parliamentary scrutiny or public accountability. The practice of bulk tabling of treaties in Parliament at six-monthly intervals in batches of between 30 and 50 treaties had developed. In about two-thirds of the cases, Australia had already ratified or acceded to the treaties before tabling and was obliged to comply under international law. Such contempt for Parliament, combined with concern about the High Court's open-ended interpretation of the external affairs power that favoured the Commonwealth over the states, caused a political backlash.*

There were three political concerns with this process – the loss of State Government powers to the Commonwealth, the loss of Commonwealth Parliamentary powers and oversight to the executive, and the ceding of national sovereignty to international bodies.

These concerns led to a Senate committee investigation which recommended greater public scrutiny and public accountability, leading in 1996 to a range of reforms to make the treaty- making process more accountable. It included the establishment of a Parliamentary Joint Standing Committee on Treaties and a Treaties Council under the auspices of Council of Australian Governments; tabling of a Treaties at least 15 sitting days before they come into force; and public access to treaty making information via the Internet.

While these reforms greatly improved the accountability of the process, the basic tension still remains – as issues such as greenhouse policy are increasingly determined in multinational negotiations, the role of the Australian Parliament may diminish, while the States become largely irrelevant.

Role of Local Government

Local government in the States is established solely under State Legislation. By forming local authorities, the States are able to delegate various functions and responsibilities to these bodies. State local government legislation specifies the structure, functions and powers of local authorities and it is within the power of the State government to amend that legislation at any time. Local government is therefore clearly a part of, and subordinate to, the State government[6].

Local government in the States is established solely under State Legislation. By forming local authorities, the States are able to delegate various functions and responsibilities to these bodies.

Since local government is essentially an extension of the State, there is no mention of local government in the Australian Constitution. Many of the provisions in the Constitution which regulate the relationship between the Commonwealth and the States therefore also extend to local government.

The most significant activity undertaken by local government in all States is the provision of roads. Almost as significant, is the provision of cultural and recreational facilities, parks, ovals, swimming pools, libraries, as well as planning and building approval processes.

Local governments are far less reliant on Commonwealth and State government funding than the States are in relation to Commonwealth funding. In 2005-06, less than 10 per cent of all local government revenue ($23.1 billion) was provided by the Commonwealth and State government through the provision of local government grants.

Most of the payments from the Commonwealth to local government are untied payments that are passed through the States, but the Commonwealth also provides specific purpose payments direct to local governments. State grants for local governments mainly comprise funding for roads.

The Challenges Ahead

Population Ageing

Arguably one of the biggest challenges facing Australia in the coming decades is the ageing of the population — as a consequence of falling fertility and, more importantly, of increasing life expectancy. The ageing phenomenon is not unique to Australia and brings important benefits. However, it will substantially increase demands for services such as health and aged care while significantly reducing the potential labour supply relative to the population. Projections by the Productivity Commission suggest that, in the absence of policy responses, this will in turn cut per capita income growth by as much as a half by the mid-2020s compared to its 2003-04 growth rate.[7]

The most significant sources of potential stress on government budgets are health and aged care, with the former contributing most to the expected increase in government outlays.

The most significant sources of potential stress on government budgets are health and aged care, with the former contributing most to the expected increase in government outlays. Health care costs are projected to rise by about 4.5 percentage points of GDP by 2044-45, with ageing accounting for nearly one-half of the increase, or some $40 billion of extra spending according to the Productivity Commission.

Overall, the fiscal gap associated with spending and revenue trends, in the absence of policy responses, is projected to be around 6.5 per cent of GDP by 2044 45, with ageing accounting for almost 90 per cent of the gap. On past trends, much of the fiscal burden could be expected to be borne by the Australian Government, but there are significant potential burdens faced by State and Territory governments.

A range of policy measures will be required to reduce the fiscal pressures of ageing or to finance the fiscal gap. More cost-effective delivery of government services, especially health care, would alleviate a major source of fiscal pressure at its source. While some policy measures can be effectively pursued on a jurisdictional basis, many will require collective and coordinated action across jurisdictions. For example, many potential reforms in the health and aged care areas require a multi-jurisdictional approach.

Economic and Social Integration

Another aspect of globalisation that is placing stresses on Federation is the changing nature of business and economic relations. These have led to reviews and revisions of the distribution of roles and responsibilities for economic policies between the levels of government. Technology and trade have combined to make the world a much more integrated and interconnected place.

For all their self-promotion, State Governments have far less control over the factors that affect their states economies' than they had even 40 years ago, let alone at the time of federation, when the world was less integrated or "globalised" than it is today.

State governments nonetheless regularly mislead their constituents into thinking that they have far more influence than they really do over the economic performances of their states. Some of this is relatively harmless political rhetoric, but the need to appear relevant and offer benefits to the electorate can induce State Governments into tinkering in economic processes in ways that hinder state and national economic growth.

Moreover, international investors are looking increasingly to national governments to deal with major economic blockages, and expect national governments to address inefficiencies in their countries physical and regulatory infrastructure, with little patience with the niceties of internal jurisdictional boundaries. Similarly, Australian businesses that once traded mainly intrastate are now looking increasingly to interstate and overseas markets, and also looking for the transparency and lower compliance costs that come with a unified national system of regulations. This has been the impetus behind business support for simplified and unified systems of regulation in areas such as industrial relations, taxation administration and workers' compensation.

In a number of areas, it is increasingly being recognised that while the Constitution gives the Commonwealth jurisdiction over international and interstate but not intrastate trade, in reality a single national regulatory regime is sensible and desirable in a number of areas, particularly in relation to business regulation and corporations law.

However, the pressure of globalisation on the Federation is not all one way. The economic pressure to institute reforms such as reducing tariffs and non-tariff trade barriers, floating the exchange rate, deregulation of the finance sector and other industries, and the adoption of internationally-agreed standards on business investment and intellectual property, have all seen the Commonwealth cede at least some control of the grounds of its core constitutional economic powers.

The increasing integration of the world's economies will heighten competitive pressures on Australia, and our living standards will, to a large extent, be shaped by how well we respond. Countries unable to respond efficiently, flexibly and innovatively to changing patterns of demand, technological change, increasing mobility of capital and labour and shifts in underlying comparative advantage, risk seeing their standards of living fall[8].

According to the Productivity Commission (2005a), an obvious area for policy focus is to further reduce the barriers to the movement of goods and people within Australia that are attributable to unwarranted variations in institutional or regulatory frameworks. Key areas cited by the Productivity Commission (2005a) include the better integration of our economic infrastructure, notably in the areas of energy, water and freight transport – all of which will require collective action by governments.

Principles

There are very different views on the politics of federations. At one extreme, there are the states' righters – those who believe the Commonwealth can do no right, and that all authority should reside with state governments, and as little as possible with the Commonwealth.

At the other extreme, there are centralists, who believe that the Federation is messy and inefficient and parochial, and that the states should be abolished.

Between these two extremes are conviction and pragmatic federalists. Conviction Federalists, who share with the states' righters an instinct to prefer the authority of the states to the Commonwealth, but they do so from the belief in the benefits of a federal system, and a respect for the Constitution which clearly anticipated that this is the way things should be ordered. They recognise the need for, and benefits from, a central government, but prefer that its functions be few in number and limited in scope.

Pragmatic Federalists are less concerned for the constitutional niceties of who has responsibility for what, and more focussed on the configuration of jurisdictions that leads to the best outcome for the community. They recognise both the benefits and the inefficiencies of a federal system, and the need for a robust Constitution to protect each layer of government from the other, but also that our changing economic, technological and social systems sometimes require a reordering of roles and responsibilities.

There are some key principles which should be used to help ease some of the tensions in the Federation, and make it work more effectively. They are: (1) subsidiarity; (2) competitive federalism; (3) cooperative federalism; (4) financial adequacy; and (5) appropriate redistribution. Each of these principles is discussed in detail below.

Subsidiarity

Subsidiarity suggests that matters should be handled by the lowest competent authority[9].

Subsidiarity suggests that matters should be handled by the lowest competent authority[9]. In the context of governmental jurisdictions, it requires that political authority should be exercised by those agencies closest to the citizens affected by their decisions. So state government, and only state government, should make policies whose effects are felt only by the state's residents, but international agencies are needed to negotiate and enforce multilateral agreements on free trade or greenhouse gas emissions[10], which have significant effects on the citizens of many countries.

The concept of subsidiarity is a key underlying principle of federal political systems, but it also has broader implications and applications than managing the boundaries of government jurisdictions. It means that government should not interfere in the activities of individuals, families, businesses and civil society except in areas where these are not capable of effective self-management, or where their activities might spill over to affect others.

The term also has overtones of assistance and support (the word derives from the Latin subsidium, meaning aid), so that the role of the higher-level authorities is to assist or facilitate the lower in the achievement of their objectives, not to direct or to compel. So while it recognises the necessity and reality of political hierarchy, subsidiarity has (in theory at least) an inverted hierarchy of priorities, with the higher levels at the service of the lower. In practice, of course, things may not work out that way.

The principle of subsidiarity is enshrined in the Constitution, which reserves to the States all powers not explicitly granted to the Commonwealth, and gives the Commonwealth responsibility mainly for activities that require a national approach or which cut across state boundaries.

It is also integrated into mainstream political thought, although in ways which cut across party lines to some degree.

For example, its emphasis on the rights and freedom of individuals, on constraining the power of the state, and its preference for voluntary and local over the coerced and centralised are all consistent with the values and ideas of "small-l liberalism" [11].

Australian conservatives are comfortable with its dispersion of power among multiple levels of government. But it is not compatible with those conservative values which seek to use state power to moderate the pace of social, economic and cultural change, or to impose conformity to social values and moral standards.

From the opposite end of the political spectrum, traditional socialist views which are hostile to business and free enterprise and emphasise the need for state direction and control to deliver social progress are generally not compatible with the principles of subsidiarity.

The Policy Dimensions of Subsidiarity

CCI's own political philosophy is best characterised as "small-l liberalism", a view laid out in detail in its 2001 publication *In Support of Free Enterprise*, which argued that "…the state which governs least is the state which governs best…"[12] But as a lobby group, CCI must engage with governments, political parties, community, business, labour and other groups that hold different values and philosophies. Subsidiarity provides a possible basis for agreement and common policy action with these diverse groups, even when we agree to differ on some philosophical points.

As well as reinforcing federalism, limited government and free enterprise, subsidiarity is consistent with other key policy principles adopted by CCI.

Notwithstanding its general preference for free enterprise, CCI recognises that there is a case for government intervention in markets if, and only if, there is a demonstrated case of market failure. The market failure justification for intervention parallels subsidiarity's principle that a higher authority may interfere in the jurisdiction of the lower if, and only if, the lower is not competent to deliver efficient outcomes.

The particular form of market failure known as an externality (when costs or benefits associated with the activities of a person or business which do not accrue to that person or business) is conceptually similar to subsidiarity's requirement that a higher authority may intervene in the activities of a lower where the lower's actions have consequences beyond its jurisdiction or competence.

Subsidiarity provides a basis for the principle of beneficiary pays. Unless there are wider social or economic benefits or concerns associated with a project, activity or transaction, the costs of providing it should be carried by the people who will benefit from it. For purely private benefits, this requires that only users pay. Where there is a social or external dimension to the activity there may be a case for moving beyond user pays, but subsidiarity also suggests the limits beyond which that extension should not be pushed – for example, Western Australians but not Tasmanians should be required to contribute taxes for the construction of the Mandurah railway, as it is Western Australians as a community which will benefit and not Tasmanians.

The Erosion of Subsidiarity

In recent years, an increasing number of activities that were envisaged as states' responsibilities when Australia's Constitution was drafted have come under the influence and control of the Commonwealth Government.

This centralisation of power does not necessarily contradict the principle of subsidiarity. The changing nature of our economy, technology and society means that many issues now require a national response that might once have been capable of management at state level.

There is, however, widespread concern that this centralisation has gone beyond what is needed to respond to changing political necessities and competencies, and that Australia's federal system and political processes are poorer as a result. Some key examples of these claims are discussed in detail elsewhere in this paper, but two in particular are worth examining specifically in the context of subsidiarity – namely competence and scope.

Competence

Subsidiarity requires that power is exercised at the lowest "competent" authority. In legal terminology "competent" means being qualified or having the legal capacity to act, and this is the sense of the word used in defining subsidiarity.

But the broader meanings of "competent" (adequate and capable), are also relevant to the practical application of subsidiarity as a political principle.

Running an administration capable of dealing with the diverse and complex demands on modern government requires significant financial resources. The fact that state and local governments in Australia do not have the capacity to raise sufficient funds to support their activities has been an ongoing source of political friction which has undermined the robustness of the federal system. This issue of vertical fiscal imbalance is explored in more detail on page 24.

A properly functioning and accountable democracy also requires capable and wellinformed politicians (both government and opposition), media, academia and bureaucracy. Local governments and state governments with small populations may find it difficult to muster the human capital they need to function effectively, or may not be subject to effective external and political oversight and scrutiny.

The unspoken implication behind many interventions by higher level governments in the affairs of lower jurisdictions is that the lower were incompetent and made the wrong decisions. Indeed, the belief that lower tiers of government are simply not capable of governing effectively is a recurring theme in inter-jurisdictional tensions.

In 2005, Prime Minister John Howard[13] argued that that "… the major source of discontent with Australia's federal system today turns on the underwhelming performance of State governments following the introduction of the GST", and that "All the Commonwealth asks now is that the States make a determined effort to meet their responsibilities and obligations." He concluded that "… while ever the States fail to meet their core responsibilities there will be inevitable tensions in our federal system." The assumption is that failure is almost invariably on the part of the States; and the veiled implication seems to be that, is when the states fail to meet their "responsibilities and obligations", the Commonwealth must, however reluctantly, intervene.

While this problem of capability can be real, in practice challenges to agencies' actions arise at least as often because of disagreement with the outcome of their decision-making, which can lead the dissenter to assume that it was a product of ineptitude or improper process. More often still, people and organisations tend to "jurisdiction shop", supporting the exercise of power by the layer of government whose policies suit them best, with little or no interest in which is the proper layer of government to exercise authority over that particular issue. For example, a person opposing logging of old growth forests may be a centralist or federalist depending on whether the State or Commonwealth government is proposing the most extensive limits on logging.

More often still, people and organisations tend to "jurisdiction shop", supporting the exercise of power by the layer of government whose policies suit them best, with little or no interest in which is the proper layer of government to exercise authority over that particular issue.

Scope

Another key issue concerns the scope or boundaries of the area in which a person or authority has the freedom to act. In Australia, this issue has proven controversial in two opposite contexts – the centralisation of authority, and movement of power upwards though the jurisdictional hierarchy in a manner that is sometimes controversial (for example, the Commonwealth Government's use of its external affairs authority to make laws constraining the activities of the states); and, more broadly, the extent to which a person or party must be affected by the decisions of an agency before they are entitled to a say in how its decisions are made.

People feel entitled to influence a much wider range of agencies and decision makers, and at much greater remove, than was once the case. They have more opportunities to monitor, publicise and respond to business behaviour through the media, the internet, and via interest and pressure groups. Not only are people more informed about the activities of governments, businesses and non-government organisations, they are more willing and able to influence and penalise that behaviour, as consumers, investors, voters and litigants.

In one example, the US activist group People for the Ethical Treatment of Animals (PETA) persuaded retailers Abercrombie and Fitch to stop stocking Australian wool products in protest at practices in the Australian sheep industry, particularly mulesing and live sheep exports[14].

Businesses are particularly affected by this change in political culture. Most larger businesses routinely consider stakeholder interests in their decision making, and some speak of a "social licence to operate" as reflecting the informal but important requirements of acceptable business behaviour, which go well beyond compliance with formal regulations and licences.

This raises the important question of the point at which a person's concern at another's activities becomes an interest that entitles them to exercise some authority over that person's activities, and how far that authority should extend.

In a world where everyone's actions have consequences for others, the most efficient way to maximise welfare gains and minimise losses is to place the burden of carrying the cost of activity with negative spillovers on the agent whose costs are lowest.

This suggests that passion does not constitute permission to coerce. In a parallel way, to equate strong feeling with entitlement to determine how others are allowed to act in the political arena is a recipe for power without accountability or responsibility.

Indeed, one of the problems with the (otherwise generally welcome) way in which modern society amplifies the influence of motivated individuals and groups, is that it shifts decision-making power away from those who suffer the consequences. The decision of Abercrombie and Fitch to accede to the demands of PETA and stop stocking Australian wool products probably cost it little or nothing and may even have been perceived as a public relations bonus. The consequences for Australian wool growers or the Australian economy generally would have been given scant consideration in its decision.

A central tenet of subsidiarity is that an agent has authority and autonomy to act within their own sphere of competency. Its aim is to protect the individual from "tyranny by passionate majorities"[15], not to promote it.

Competitive Federalism

The fact that other states might be providing a better balance of taxes and services or delivering services more effectively provides a basis for rivalry and competition between government.

Competitive federalism suggests that a major stimulus for reform might derive from the differences between governments' taxation and regulatory frameworks, policy approaches and the efficiency of their trading enterprises.

The fact that other states might be providing a better balance of taxes and services or delivering services more effectively provides a basis for rivalry and competition between government.

When jurisdictions compete, they innovate. The best examples are imitated by others. Equally important, the worst examples are avoided, as was the case with Victoria's disastrous fiscal policies of the late 1980s and early 1990s, and WA's governance failures of the 1980s, which provided a demonstration effect of what to avoid in other jurisdictions. Diversity encourages experimentation, and provides examples against which to judge the experiments.

Finally, different communities' tastes, values and preferences differ, and competitive federalism encourages governments to identify and cater to those differences.

Paradoxically, the National Competition Policy reforms in Australia over the past decade may actually have served to reduce competition in this respect, as they have tended to emphasise the benefits of national consistency and uniformity in regulatory regimes in facilitating competition between businesses, but have neglected the potential benefits of competition between governments and regulators. In CCI's first response to the Hilmer Report (in 1995), it argued that:

> *"Perhaps the most disappointing aspect of the Hilmer Report is that it gives no consideration to the benefits to be gained from competition over the regulatory framework itself, rather than within that framework."*

While innovation arises because of differences between governments' activities, in the longer term competitive federalism is likely to lead to quite a high degree of consistency between States' taxation, fiscal and regulatory stances. This is because they should converge as each adopts the best practice. This is achieved through a process that is essentially competitive rather than prescriptive.

Admittedly, such competition can be destructive. Perhaps the most egregious example is the competition between state governments to outbid each other's subsidies on order to attract footloose or rent-seeking businesses. State treasuries are also nervous of being dragged into a downward bidding war on taxes, in which they have no choice but to match a competing jurisdiction's tax cuts even though it undermines their own revenue bases. Queensland's abolition of death duties and stamp duty on shares are sometimes cited as examples of undesirable competition. Whether their taxpayers view this as undesirable is another matter.

In WA, with its poor record of implementing National Competition Policy reforms, the top-down and coerced approach to trying to induce competition reform has not worked. However, examples are now emerging to show that competitive federalism – the evident benefits enjoyed by consumers in jurisdictions where reform has been more widespread – can be a more effective inducement to disregard pressure of vested interests to implement reform that is in the community's interest. The 2006 liquor licensing reforms and recent renewed interest in deregulation of trading hours in Western Australia have been driven in large by concerns that some Australian cities are more vibrant and interesting places to live, work and visit.

Cooperative Federalism

While competition can be an impetus for better government, there are cases which suit a cooperative rather than a competitive process between jurisdictions. Cooperation can lead to simpler and more consistent regulations, improving transparency and reducing business compliance costs. It can allow cross-border issues to be managed without recourse to the centralised direction that can ride roughshod over local and regional concerns; and address issues which geographically limited in scope but cross state borders, and which do not need an Australia-wide approach. Cooperation can also lead to sharing of research and experience, pooling of resources and sharing of costs.

National decisions need not be made by the Commonwealth Government alone. While the outcome of cooperation might be a single consistent system across jurisdictions, it can nonetheless be better than a single uniform centralised system. For example, cooperation allows the possibility of divergence in future, should that prove desirable; it allows for a more rigorous consideration of competing and distinct interests, and it allows some room for local variations – policies and regulations can be consistent and compatible without being identical.

Cooperative federalism is especially applicable to those issues:

- which have effects beyond the jurisdiction of the government with authority to legislate on the issue;
- where there are broadly similar issues in several jurisdictions; and/or
- where there are significant benefits (such as efficiencies) from a unified approach.

One of the greatest achievements of cooperative federalism in recent years in Australia is (somewhat paradoxically) National Competition Policy. As part of that reform, the states cooperated to introduce a single national framework for corporations law in Australia.

Currently something approaching cooperative federalism is being tried in the areas of water and electricity. There are dangers in this for WA, however, as the definition of "national" in both cases seems to extend only to the eastern edge of the Nullarbor, and there is a risk that a national regime is designed which does not take account of WA's very different priorities, needs and circumstances in these industries.

It is hoped that the recent agreement by the Council of Australian Governments (COAG) to the new *National Reform Agenda* will build on the reforms started as part of NCP. However, the agenda is broader than NCP to the extent that it will also include human capital and regulatory reform, along with competition reform.

How Cooperative Federalism Works

A variety of means can be used to apply cooperative policy approaches.

The most centralised approach to implementing common policy is the referral of powers. State parliaments can vest power to legislate over some matter within their own constitutional jurisdiction with the Commonwealth under Section 51 (xxxvii) of the Constitution, which states:

> *Matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments of any State or States, but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law.*

This power has been used fairly infrequently, with recent examples including corporations law, terrorism and de facto relationships.

Another approach is to adopt template or mirror legislation. In the case of NCP, for example, the States agreed to adopt a template law (based on Commonwealth legislation), so that each has identical regulations covering companies and securities and some other regulations governing food standards, transport and financial institutions.

Cooperation need not require singular or identical legislation. States can agree to adopt broadly similar approaches. With NCP, the States and Commonwealth agreed to a range of complementary reforms within their own jurisdictions, including reviews of anti-competitive regulations. In return for implementing the full raft of reforms, the States were to receive payments from the Commonwealth. The National Competition Council was given the role of assessing the extent to which governments complied with their agreed undertakings under the reform process, and making recommendations to the Commonwealth Treasurer on whether the states had implemented their agreed reforms and were therefore entitled to competition payments.

The results of this process were patchy and at times disappointing, especially in Western Australia, where the government had the worst record of the State Governments in implementing competition policy reforms[16]. However, the Commonwealth's record in implementing its own reform agenda was even worse – there in nothing to suggest that a more centralised approach would lead to a better outcome.

Complementary legislation has also been use in Australia to implement separate but consistent regimes of environmental protection, disability services and vocational training.

Financial Adequacy

A key consideration in the assignment of functions is the principle of fiscal equivalence, which requires each level of government to finance its assigned functions with funds it raises itself.

Applying this principle, it could be argued that where the subsidiarity principle supports the allocation of a function to a lower level of government, then both the necessary expenditure and taxing powers should also be delegated to that level of government. Such assignment promotes accountability by placing a constraint on the extent to which the political agenda can deviate from the preference of citizens.

Since Federation, the Commonwealth has been very successful in gaining access to the major sources of taxation, resulting in an inequality between the financial responsibilities and the available financial resources of the Commonwealth and the States. This is what is termed *vertical fiscal imbalance* and requires a system of intergovernmental transfers to correct the imbalance.

Today, the Commonwealth government raises about three quarters of all tax revenues collected, but the states are responsible for about half of government expenditure. As a result, around 40 per cent of states' general government revenue comes from Commonwealth grants. Compared with other Federations, Australian States have a high degree of financial dependence on the central government.

Today, the Commonwealth government raises about three quarters of all tax revenues collected, but the states are responsible for about half of government expenditure.

There are a wide range of considerations that impinge on the desirable allocation of expenditure and taxing functions between governments[17]. Potential advantages include:

- administrative advantages for both governments and taxpayers in having the major taxes collected and administered by only one level of government;
- the facilitation of policies aimed at achieving national economic stability and growth;
- the existence of adequate scope for the Commonwealth to provide grants producing a strong horizontal equalisation effect across the States;
- the facilitation of interpersonal horizontal equity through relatively uniform taxation and social welfare payments throughout the nation;
- the ability to take a more "national" approach to resource allocation and the setting of standards; and
- reduced scope for destructive "tax competition" amongst the States.

On the other hand, the disadvantages include:

- a loss of diversity and responsiveness to regional and local needs and preferences;
- the divorcement of revenue raising and expenditure decisions at each level of government may lead to fiscal inefficiencies – such as from imposed priorities not reflecting preferences, the lack of direct accountability to taxpayer expenditure decisions, "buck passing" amongst the various levels of government, and the waste of resources inherent in the grant negotiation process;
- the uncertainty on the part of the States as to future levels of funding, especially if the funding is ad hoc;
- the States have to resort to raising revenue from "nuisance" taxes, which are inefficient, inequitable and associated with high administration and compliance costs;
- there may be reduced scope for "constructive" tax competition between the States; and
- the political power of the States is diminished through the financial power of the Commonwealth.

It is difficult to determine the optimal assignment of revenue sources and expenditure responsibilities. Complete vertical balance is not realistic or desirable if the Commonwealth is to continue to provide some mechanism for fiscal equalisation between the states.

All federal systems undertake some income transfers between their various levels of government. However, the degree of vertical imbalance in Australia is much greater than in other democratic federations around the world.

The states' own-source revenues as a percentage of total government revenues have fallen in a series of steps since federation. Virtually all have been associated with the States losing taxing powers. An exception being the transfer of payroll tax to the States in 1971 and the introduction of franchise fees from the 1970s, both of which were success stories for the States, although they lost their franchise fee revenues in 1997.

The GST notionally increased the States' fiscal independence, which has continually been reinforced by the Commonwealth Government. In a recent speech on federalism, John Howard commented that:

> *"Those who argue that the Government has embraced centralism are suffering from a severe case of historical myopia. Our decision five years ago to grant every last dollar of the GST to States and Territories was the greatest vote of confidence in the federal system in the Liberal Party's history."* [18]

All federal systems undertake some income transfers between their various levels of government. However, the degree of vertical imbalance in Australia is much greater than in other democratic federations around the world.

The problem with this view is that the GST is not a tax the states control – they have no influence over its incidence or level, and limited influence over its distribution. The GST is a transfer from the Commonwealth to the states and therefore increases vertical fiscal imbalance, a process likely to worsen over time. More problematic is the possibility that the Commonwealth will use its control over the level and distribution of GST funds to become progressively more powerful in the intergovernmental relationship. The fiscal history of the federation gives little ground for optimism that the Commonwealth will hand over this money indefinitely without seeking any political influence on, or advantage through, how it distributed or spent.

We saw the first signs of political interference in 2005, when the Commonwealth threatened to cut WA's share of grants if it failed to fall into line with the others states and implement agreed abolish a number of stamp duties (as part of the GST Agreement between the Commonwealth and the States). While the WA Government argued that the agreement only required it to "review" the need to keep those taxes, it was clearly the intent at the time of the agreement that those taxes would be abolished if GST revenue growth was strong enough (which it clearly has been). Of more concern, however, was the prospect of the Commonwealth using its control of the GST revenues to increase its influence on the States' fiscal policies.

This is related to the third concern about recent trends in inter-governmental fiscal relations, namely the Commonwealth's increasing use of its spending powers to influence what the States do with their money. Through tied grants, the Commonwealth attaches conditions to the money it transfers, reducing or eliminating the states freedom to determine policy or establish priorities in service delivery. Service delivery is effectively contracted out to the states.

This trend is evident in the growing proportion of States' grants in the form of Specific Purpose Payments tied to particular uses, rather than general funds to be used as the states choose.

The Commonwealth is also making increased use of matching funding, providing money for projects only if the States chip in as well.

Appropriate Redistribution

Appropriate redistribution suggests that citizens in different States should have access to equal standards of government services. This is based on the principle of "horizontal fiscal equalisation" (HFE), which is defined as:

> *State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standards[19].*

The States have different capacities to raise revenue and different spending "needs". For example, Western Australia has a relatively large capacity to raise revenue from the mining industry compared with Tasmania, and a State with a young population needs to spend relatively more on primary education.

To provide the States with equal capacity to provide services, States with below average revenue-raising capacity or above average spending needs receive a larger share of funding. HFE thus redistributes resources from States with the capacity to provide above-average services to the other States.

GST revenue grants are allocated across the States according to the recommendations of the Commonwealth Grants Commission (CGC), using the principle of HFE. Consequently, the amount of GST a State receives differs from the amount it would receive if GST were distributed on an equal per capita basis.

When calculating spending needs and revenue-raising capacity, the CGC takes account of factors that a State cannot control. How a State raises revenue and spends it reflects policy choices. If the distribution of GST were based on actual spending and revenue, a State could (say) tax less to increase its share of GST revenue. The CGC therefore seeks to make its assessments of revenue-raising capacity and spending needs "policy-neutral" – meaning that a State will receive a larger share of GST revenue if it can demonstrate that it is unable to provide services at the national average level for reasons that are beyond its control. The CGC also takes account of "revenue raising effort", which compares each State's actual revenue with its assessed capacity.

There has been significant tension over the method by which the CGC redistributes GST grants to the States, especially by those States that are net losers from the process, namely New South Wales, Victoria, and, until recently, Western Australia. These concerns are outlined in the next section of the discussion paper.

It should be noted, however, that some of the tension surrounding HFE might be eased if the States were less reliant on the Commonwealth for revenue. The substantial vertical fiscal imbalance is a feature of Australia's Federation, and until this issue is addressed, concerns over the HFE process will continue.

Key Issues in the Federalism Debate

The issues concerning Australia's Federation have received significant attention in recent times as a result of the Federal Coalition Party gaining control of the Senate as well as the House of Representatives for the first time since 1981. This has provided the Commonwealth Government with considerable scope to implement its policy agenda within its own jurisdiction.

At the same time, Labor continues to control of all of the State governments, introducing the possibility of heightened political rivalry and ideological conflict between the Commonwealth and State Governments.

These recent changes in the political landscape take place against a background of increasing stress on the constitutional theory and political practice of government in the Australian federation.

These recent changes in the political landscape take place against a background of increasing stress on the constitutional theory and political practice of government in the Australian federation. Three issues, in particular, have been persistent and remain unresolved:

- First, the question of vertical fiscal imbalance, by which the Commonwealth is responsible for raising the bulk of Government revenues collected in Australia, while the States are responsible for most service delivery.
- Second, the issue of the horizontal redistribution of funds between states, with the validity and appropriateness of the horizontal fiscal equalisation process increasingly challenged by those state that are net losers from the process.
- Third, the practical processes of resolving interstate conflicts over policy and resources, of delivering essential services and funding infrastructure, and of providing appropriate regulation for a modern, globalised economy have become more complex and more pressing.

These issues are further investigated below.

Commonwealth-State Financial Relations

Vertical Fiscal Imbalance

In Australia, the Commonwealth government raises about three quarters of all tax revenues collected, but the States are responsible for about half of government expenditure. As a result, over 40 per cent of States' general government revenue comes from Commonwealth grants. This disparity between revenue raising and expenditure at different levels of government constitutes vertical fiscal imbalance.

The key problem with vertical fiscal imbalance is that it undermines the autonomy of the financially dependent government. Political authority is vulnerable without autonomy, which includes the financial capacity to deliver the goods and services that constitutional authority empowers the government to provide.

Other problems include:

- Separation of revenue raising authority from expenditure authority weakens accountability – in particular it is claimed to have encouraged inefficiencies in the delivery of State services, as States do not bear the political odium of raising the money they spend. For each dollar spent by State governments, they need to raise only 60 cents.

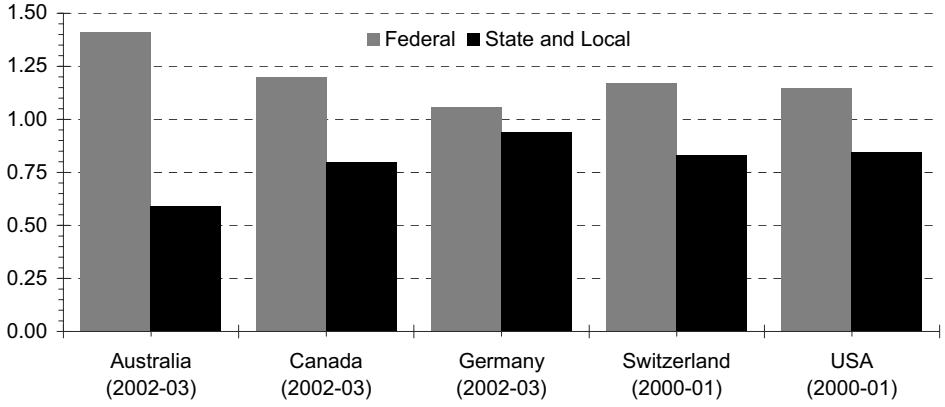
- There is no satisfactory priority-setting mechanism between Commonwealth and State functions, giving rise to claims that the Commonwealth is harsher on State grants and the activities they function than on its own outlays. The recent decline in State grants – whether as a share of GDP, of Commonwealth revenue and expenditure, or of States' revenue and expenditure, lends considerable weight to this argument.
- A preferred treatment of Commonwealth functions over State functions seems inherently likely in this division of fiscal powers. A consequence of this bias may have been that consumption is favoured over investment expenditure, because the States are responsible for much public investment while the Commonwealth's functions are substantially redistributive.
- Existing State taxes tend to be volatile, opaque, inefficient and regressive, and severely limit the revenue raising capacity of the States.
- Finally, there is a basic lack of agreement about the respective roles of the Commonwealth and State governments, resulting in policy conflicts and duplication.

Complete vertical balance is neither realistic nor desirable if the Commonwealth is to continue to provide the mechanism for fiscal equalisation between the States. All federal systems undertake some income transfers between their various levels of government. However, the degree of vertical imbalance in Australia is much greater than in other democratic federations around the world (Figure 1).

The States' own-source revenues as a percentage of total government revenues have fallen in a series of steps since federation (Figure 2). Virtually all have been associated with the States losing taxing powers – with the exception being the transfer of payroll tax to the States in 1971 and the introduction of franchise fees from the 1970s, both of which were success stories for the States, although as a consequence of a High Court decision they lost the ability to levy franchise fee revenues in 1997.

Although the introduction of the GST eased some of the pressures on States' revenue bases by giving them access to a "growth tax", this came at the cost of increased vertical fiscal imbalance. That increases the capacity of the Commonwealth to constrain in future the States' freedom to deliver services as they, and their residents, wish. The agreement to eliminate State "nuisance" taxes as a result of strong GST revenues will make this imbalance even more pronounced.

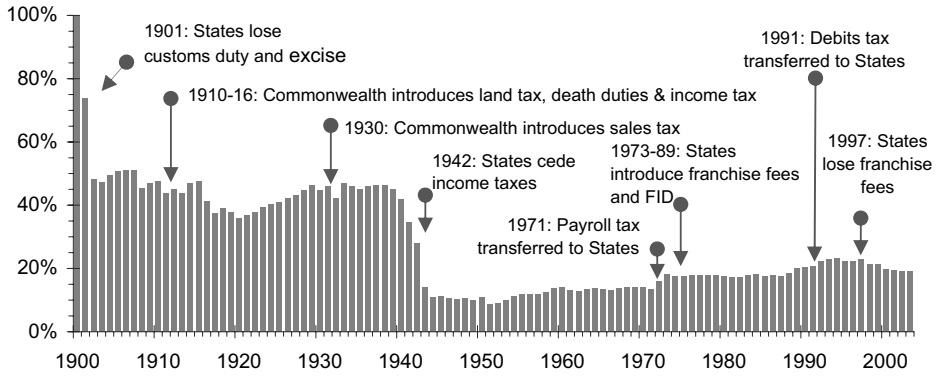
Figure 1
Vertical Fiscal Imbalance, Ratios
Own Source to Own Purpose Outlays



Source: Department of Treasury and Finance

CHAMBER OF COMMERCE AND INDUSTRY WESTERN AUSTRALIA

Figure 2
State Own Source Revenues
% Commonwealth and State Revenues



Source: Department of Treasury and Finance

The GST is not a tax the States control – they have no influence over its incidence or level, and limited influence over its distribution. Rather, the GST is simply a transfer from the Commonwealth to the States.

The GST tax changes of 2000 are unlikely to be the last word in tax reform. CCI envisages that tensions between the States and Commonwealth over fiscal independence and responsibilities will persist and probably worsen over the medium term. It is, admittedly, hard to see these changes coming to a head and precipitating further major changes in the immediate future. But financial adequacy and the capacity to exercise genuine political policy autonomy go hand in hand, and in the long term there will be no solution to vertical fiscal imbalance without the States having genuine control over the bulk of their revenue sources.

The following sections address some ways in which this might be achieved.

Centralise Tax and Spending

One way of achieving greater fiscal balance would be to transfer expenditure responsibility to the Commonwealth. The Commonwealth has already gone some way down this path through its increasing direct involvement in areas of policy and service delivery which were previously under the main or exclusive control of the States.

The Commonwealth has also achieved control of policy and services indirectly, through the use of specific purpose payments.

While centralisation may resolve in part the problems of the separation of revenue raising and service delivery roles, it is inefficient and inconsistent with the principles of federation. It also leaves some ambiguity about responsibility and accountability. For example, it is difficult to determine whether the increasing problems evident in the public health system are due primarily to inadequate Commonwealth (or State) funding, inappropriate State (or Commonwealth) policy, or inefficient State service delivery.

Such a wholesale shift of responsibility for spending and service delivery from the States to the Commonwealth would require a shift in the balance of governmental power in Australia which would have major political implications and would probably require constitutional change. It would, of course, require a far more compelling justification than the existence of vertical fiscal imbalance.

Australia's tax structure should reflect and support the jurisdictional and spending powers and responsibilities Australians want from their different levels of government. The tax system should be shaped by the political system, not the other way round.

Tax Sharing

Tax sharing represents a continuation of the current arrangement whereby the Commonwealth raises GST but passes the revenues to the States. While this arrangement is likely to persist for the foreseeable future, it has a number of weaknesses that may mean it proves unsustainable in the longer term.

It has increased, and is likely to continue increasing, the extent of vertical fiscal imbalance.

Although a guaranteed share of the Commonwealth's tax base makes the States' interest in the new tax relatively transparent, in reality taxpayers hold the Commonwealth responsible for its application, with good reason.

Although a guaranteed share of the Commonwealth's tax base makes the States' interest in the new tax relatively transparent, in reality taxpayers hold the Commonwealth responsible for its application, with good reason.

It does not allow different States to apply different levels of tax effort in order to provide different levels of service or to vary the incidence of the tax according to regional needs and interests. Even if the Commonwealth were inclined to apply, for example, different rates of goods and services tax in different States and remit revenues accordingly, it is constitutionally constrained from doing so. There is therefore still a gap between States' responsibility for service delivery and their service priorities, and their flexibility to achieve those objectives by adjusting revenues.

History shows that the size and use of taxes can change markedly over time. For example, payroll tax was originally introduced (at 3½ per cent, by the Commonwealth) to pay for child endowment. The Labor Government's 1992 "L.A.W." tax cut pledge was transformed successively into a deferred income tax cut, a superannuation co-contribution, and a promised tax incentive for savings. The Commonwealth claims that the States are guaranteed the full GST revenues; but in tax policy, especially in the long run, there is no such thing as a "guarantee".

That said, guaranteeing the States a share of Commonwealth revenue has a number of advantages which made it an attractive option to the States compared to pre-GST arrangements. Perhaps the most obvious are that it is simple and constitutional.

A "guaranteed" share of Commonwealth tax revenues might help to halt the persistent erosion of their share of Commonwealth revenues that occurred in the 1980s and 1990s (though this is questionable, as the Commonwealth retains substantial control at the margin through its discretionary grants).

This is a centralist compromise that at least gives the States access to a relatively secure growth tax. But a better reform process would also see the extent of vertical fiscal imbalance reduced.

If tax reform is in future to achieve a lesser degree of vertical fiscal imbalance without transferring spending powers from the States to the Commonwealth, it must allow States to increase their own-source revenues.

There are only three ways to reduce vertical fiscal imbalance without transferring spending responsibilities to the Commonwealth:

1. **raise existing State taxes** – the only State tax that has the theoretical potential to conform to the key taxation principles is payroll tax, and any increase in payroll tax would not be desirable as it would lead to a very sharp increase in the cost of labour;
2. **introduce new State taxes** – by giving the States new tax powers which would allow them to abolish existing inefficient taxes. Both measures (1) and (2) would need to be associated with a reduction in Commonwealth revenues and grants to avoid an overall increase in taxation collections; or
3. **pass tax powers from the Commonwealth to the States** – the most obvious candidate for such a shift is income tax. Passing the power for States to collect income tax is advantageous to the extent that:

   - it would be constitutionally possible. The States collected income tax prior to World War Two;
   - it could be done without changing the existing range of taxes raised – the States could take control of income taxes, while the Commonwealth uses GST revenues to finance its own activities; and
   - income tax generates more stable revenues than many of the States' own taxes such as stamp duties, and it is a "growth tax" whose revenues tend to increase automatically as the economy expands.

   However, there are practical difficulties associated with such a proposal, including:

   - it may undermine the Commonwealth's role in redistributing income and its ability to control the degree of progressivity in the income tax system;
   - it could also impede its ability to determine the overall process of redistribution by coordinating the cumulative impacts of progressive income taxes, unemployment and other benefits and social spending;
   - it is unlikely that the Commonwealth would be willing to give up its largest single source of revenue, or even part of it for that matter;
   - there appears to be no satisfactory mechanism by which the States could share the business income tax base (company tax);
   - if the States were to set different tax bases, "progressive" rates etc, the complexity of the income tax system, compliance costs and the potential for evasion would increase; and
   - if the States agreed to align their income tax bases with the Commonwealth's, and set single tax rates and competed only on those rates, then these problems would be largely ameliorated. However, this would again reduce their flexibility to design their own revenue-raising mechanisms, and might provide the Commonwealth with a powerful incentive to contract the income tax base over time, or change its structure so that income was generated in activities only taxed by the Commonwealth (eg. by encouraging incorporation).

Horizontal Fiscal Equalisation

The validity and appropriateness of the distribution of Commonwealth grants between the states under HFE is increasingly being challenged, especially by those states that are net losers from the process, namely New South Wales, Victoria and, until recently, Western Australia.

Briefly, the problems with the current system are:

- it is complex and not transparent, with CGC and state Treasury officials spending many hours arguing arcane technical points often laden more with self interest than sound argument that nonetheless can be worth millions to the states affected;
- it is based on an arguable rationale, has no clear constitutional warrant, and has never been defended explicitly before the electorate as a means of distributing its money;
- the WA Government believes that it penalises states with rapid population growth and large infrastructure needs; and
- it creates perverse incentives. The larger states, in particular, gain more funds when they allocate a larger proportion of spending to activities they are not especially good at. Conversely, it dampens incentives to promote economic growth, especially in smaller states like WA, where 90 per cent of any state government gain from growth in its tax base or royalties is clawed back though lower grants. Conversely, it keeps 90 per cent of any rise in the tax take arising from a more intense tax effort.

The objective of the grants allocation process is to provide all state governments with the capacity to provide the same level and standard of services from the same tax effort regardless of costs or capacity to raise revenue, and regardless of whether the states actually do provide those services to the standard level.

One key feature of this process is that it makes no presumptions about what a state "should" spend, meaning that States are free to adjust their own policy priorities individually and this is not taken into account in the equalisation process.

One key feature of this process is that it makes no presumptions about what a state "should" spend, meaning that States are free to adjust their own policy priorities individually and this is not taken into account in the equalisation process.

It is sometimes argued that the Commonwealth should use its power to control grants to encourage improved efficiency on behalf of the states, either by adjusting grants according to whether states meet some efficiency benchmarks or targets, or by factoring in assumed efficiency levels in service delivery when determining the size of grants. While CCI has sympathy with the aim of improving the efficiency of service delivery, it nonetheless supports state discretion on how to actually spend the grants they receive for two reasons:

- it is essential to the proper operation of a federation; and
- it is consistent with the principle of subsidiarity, which requires that public responsibilities should be exercised by those authorities closest to the citizens affected by their decisions.

However, while states should have freedom to spend their money as they choose, the grants they receive might be determined more judiciously than under the current formula.

The standard budget compiled by the Commonwealth Grants Commission represents the average per capita expenditure and revenue on all items of all the states. It might include trivial and wasteful items, luxuries and non-essentials, expenditure items which yield few if any benefits for the state's citizens and expenditures which the states undertake in order to benefit their own citizens or economies at the expense of other states, such as investment attraction incentives.

It seems questionable, to say the least, that the citizens of New South Wales might contribute the taxes used by a government of South Australia to induce a manufacturer to relocate from Newcastle to Adelaide.

The key weaknesses of the current equalisation process – that it equalises opportunities to indulge in spending that is wasteful or even damaging, and that it introduces incentives to distort spending and taxes to maximise grant revenue – could be addressed by reformulating the "standard" budget so that it is no longer the average of actual expenditures.

This would entail developing a standard budget which states should have the capacity to adopt if they choose, but which differs from the current standard budget in having no explicit link to the expenditures and revenues states actually raise. Its key complication would be determining the standard budget, a process which is not very controversial under the current formula.

Perhaps the most significant criticism of the current equalisation process is that it considers only state budgets. The current payments do not take into account the total Commonwealth fiscal and regulatory impact on the states and, in particular, the uneven impact that these policies have on resource allocation across states.

The Western Australian Department of Treasury and Finance argues that once Commonwealth taxes and spending are factored into the equalisation process, Western Australia provides the highest fiscal subsidy of any state and territory after the ACT[20].

The Western Australian Department of Treasury and Finance argues that once Commonwealth taxes and spending are factored into the equalisation process, Western Australia provides the highest fiscal subsidy of any state and territory after the ACT[20]. The subsidy to the other states reflects a number of factors including the high per capita taxes contributed by Western Australia and the State's low share of Commonwealth social security and health benefit payments.

The Department of Treasury and Finance paper makes the point that using measures of relative population shares and relative income tax shares are also options that may be used in the distribution process. However, the paper notes:

> *"what has been largely overlooked in this debate is that the distribution of Commonwealth grants is only one element in a complex web of redistributional impacts arising from the totality of Commonwealth tax and expenditure policies[21]".*

Hence the current method for allocating Commonwealth Grants to the states cannot be viewed as a comprehensive redistribution which ensures equal exposure of citizens to fiscal costs and benefits. Horizontal equalisation may be quite insignificant in the face of inequalities of capacity and treatment arising from the fiscal and policy activities of the Commonwealth government.

Complaints about the unequal regional impact of Commonwealth policies have not changed much since West Australians complained in 1910 of the burden imposed by manufacturing protection and industrial relations regulation on a state economy based on primary industries and focussed on exports.

An equalised Commonwealth budget may be even harder to achieve than a standard state budget based on what states should be able to afford rather than what they actually spend. But like an exogenously determined standard state budget, the very process of compiling such a model could contribute enormously to the transparency of fiscal policy, and introduce a degree of accountability and scrutiny to the Commonwealth's accounts and decision making processes which has long been lacking.

It should be noted, however, that some of the tension surrounding HFE might be eased if the States were less reliant on the Commonwealth for revenue. The substantial vertical fiscal imbalance is a feature of Australia's Federation, and until this issue is addressed, concerns over the HFE process will continue.

Growth in Specific Purpose Payments

Over time, Specific Purpose Payments (SPPs) as a share of Commonwealth grants has risen substantially (see Figure 3). At the same time, conditions on SPPs have become increasingly prescriptive through:

- matching conditions that prescribe how much a State must spend from its own sources. For example, the National Action Plan on Salinity and Water Quality, where the State Government was required to match Commonwealth funds despite its own substantial programs in the area; and
- how (and when) services are to be delivered and how the service delivery agency or projects are to be managed. For example, the new SPP on vocational eduction and training requires States to offer Australian Workplace Agreements, while capital grants over $10 million require the States to adopt Commonwealth implementation guidelines for the National Code of Practice in the Construction Industry.

Commonwealth Government intervention in such a manner can have a significant negative impact on State Government budget flexibility. As noted in the Department of Treasury and Finance's most recent discussion paper on Commonwealth State Relations:

> *"Where conditions do not demonstrably address national interest objectives and are inconsistent with State priorities, the result may be reduced service delivery outcomes, higher State taxes and a misallocation of resources."* [22]

Conditions on the level and application of funding can also reduce incentives for States to adopt more innovative, cost-effective service delivery methods, as any savings achieved cannot be redirected to other priority areas.

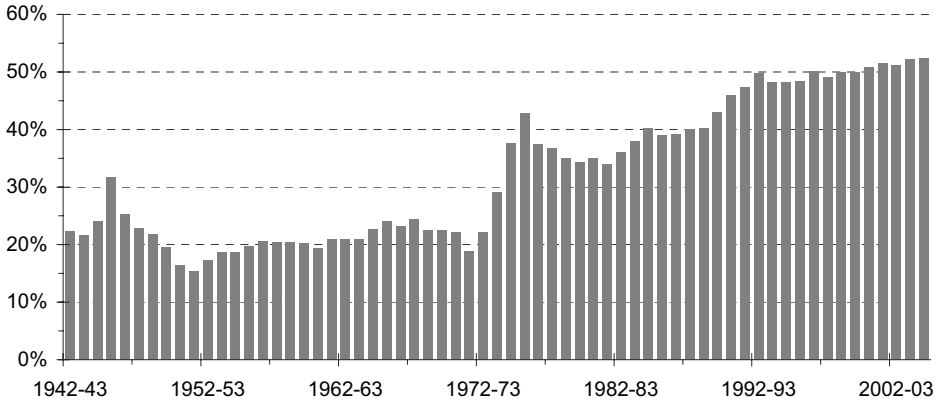
These issues highlight the need for the Commonwealth-State agreements to focus on common outcome based objectives rather than prescriptive financial and other requirements.

Infrastructure Provision

There are significant impediments to greater productivity and sustainability in several infrastructure areas. Many of these would be most effectively addressed within a nationally coordinated reform framework.

The problems with a number of key infrastructure areas stem from the division of policy responsibility between the Commonwealth and State and Territory

Figure 3
Special Purpose Payments
% Total Payments to States



Source: Department of Treasury and Finance

CHAMBER OF COMMERCE AND INDUSTRY WESTERN AUSTRALIA

Governments. As well as contributing to an array of inefficiencies in service delivery and in the interface between different services, the division of policy responsibility has retarded the development of the sort of institutional arrangements needed to support a more integrated approach to reform. Without more effective national coordination, it seems inevitable that future reform efforts will again fail to deliver the infrastructure Australia needs.

Payment for Common Infrastructure

The proposed Gorgon gas development and the development of the Burrup Peninsula have both highlighted the fact that, while the State Government has prime responsibility for the provision of common user infrastructure of a type that can justifiably be government supported, the bulk of additional tax revenues from major projects flows to the Commonwealth, through income taxes of employees, businesses' company taxes and GST.

The state government gains some tax revenues from stamp duties as development investment proceeds, and payroll tax from the development and operation of the project, but these are typically of smaller value. Furthermore, any increase in own-source revenue is almost entirely offset by reductions in Commonwealth grants under horizontal fiscal equalisation, so the net fiscal gains to the WA government are reduced even further.

At the very least, this sets up perverse incentives, with the costs and benefits of infrastructure investment allocated to different agents (the project proponents, the broader community, the Commonwealth Government and State Government) which seriously undermines the possibility of optimal investment decisions being made.

Even if a state government recognises the benefits of infrastructure investment and would like to realise them, budget constraints may make this impossible without the stream of future tax revenues that will flow to the Commonwealth. Furthermore, from the WA Government's own perspective, the net return from alternative investments (such as social investment) will appear relatively high, because more of the benefit will be captured by the WA community. Investment decisions will be skewed.

Even if a state government recognises the benefits of infrastructure investment and would like to realise them, budget constraints may make this impossible without the stream of future tax revenues that will flow to the Commonwealth.

The Commonwealth Government should carry a greater share of the responsibility for providing the infrastructure necessary for industrial development, because it collects the main tax benefits from such projects.

Another issue with the current method of accounting for infrastructure investment under horizontal fiscal equalisation is its treatment of depreciation and valuation of capital stock. A recent analysis of Commonwealth-State Funding[23] identified two concerns with the treatment of capital spending in the current horizontal fiscal equalisation process.

Firstly, the impact of population growth on the per capita level of State assets and liabilities is not accounted for, so states with higher growth will see a greater per capita reduction in net assets.

Secondly, the impact on capital expenditure requirements of growing demand for services (e.g. due to growth in population and economic activity) is not accounted for. States with higher growth will need to augment their capital stock to a greater degree (in per capita terms) to cater for this additional demand, and the faster the population is growing, the greater the level of investment that needs to be dedicated to expanding rather than maintaining the capital stock.

Both of these are especially problematic for Western Australia, because of its relatively rapid population and economic growth.

There is another, potentially more serious but less easily resolved concern. The Commonwealth Grants Commission's capital expenditure and depreciation calculations are based on estimates of the value of the capital stock derived from depreciated historic expenditures. There is no reason to expect that the value of an asset bears any meaningful relationship to what was spent on it, especially in the public sector. States that have invested inefficiently (i.e. the amount spent on infrastructure greatly exceeds its true value) actually gain under this equalisation formula compared to those that have invested efficiently, because the amount allowed for depreciation represents a larger proportion of the true value of their capital stock.

The formula used to determine states' relative capital expenditure needs should be amended to give greater recognition to the problems caused by population growth, and should seek to base depreciation estimates on a more realistic assessment of the value of capital stock than one derived from depreciated historic cost.

The Commonwealth's Infrastructure Responsibilities

In general, the Commonwealth and its agencies have had a relatively small role in the direct provision of infrastructure, and that role has diminished in time as the government has privatised most of its businesses in industries that typically require large-scale investments.

However, its indirect role remains significant, as it is responsible for the taxation regime affecting companies that can have a significant effect on companies' decisions on whether and how to invest. The Commonwealth also engages in investment attraction activities such as the provision of subsidies and incentives for developers of major projects, and provides special purpose payments to the states for the provision of particular infrastructure investments.

Under most circumstances, CCI is sceptical of the benefits of government subsidies to particular projects. By and large, projects should proceed only if commercially viable, Government subsidies tend too often to take money from efficient businesses and give it to inefficient ones, to the detriment of overall economic efficiency. Where the government exercises discretion in the allocation of funds, there is a risk that political considerations and patronage will influence the distribution of funds.

The WA Government's business support programs and objectives are, in this regard, preferable to the approach of the Commonwealth. The WA Government focuses on the provision of common user infrastructure that assists a number of businesses and is generally supportable on the basis of market failure. It also leaves the state with some residual benefit in the event that a project fails.

In contrast, the Commonwealth's approach to industry assistance is notoriously secretive – it focuses on providing financial benefits to individual businesses, and is discretionary (and therefore open to accusations of political patronage). Its efforts to pick winners have resulted in the picking of losers.

The inconsistencies in both the objectives and the methods for provision of state and Commonwealth funding can mean that the two levels of government are working at cross purposes, while the secretive and discretionary nature of Commonwealth decision-making on assistance makes a coordinated and mutually reinforcing approach between jurisdictions impossible.

The Commonwealth should review its business assistance programs to create a more transparent and predictable evaluation process and to provide support in cases where there is a demonstrable market failure and where net community benefits are likely to be maximised, such as common user infrastructure. There should also be a joint review between the Commonwealth and states aimed at achieving better consistency and coordination of assistance programs between jurisdictions.

In this regard, CCI also believes that the replacement of accelerated depreciation with the "strategic investment coordination process" was a retrograde step. Accelerated depreciation was particularly important in the case of risky projects and infrastructure, where there is a greater than usual risk of the value of an asset on completion being significantly less that its cost to create.

In recognition of concerns raised by industry, the Commonwealth announced in its 2006-07 Budget that it would increase depreciation tax concessions to increase the incentives for Australian businesses to undertake the investment in new plant and equipment that is necessary for them to keep pace with new technology and remain competitive. The diminishing value rate for determining depreciation deductions has now been increased from 150 per cent to 200 per cent (referred to as "double declining balance"), and this will apply to all eligible assets acquired on or after 10 May 2006.

By aligning depreciation deductions for tax purposes more closely with the actual decline in the economic value of assets, this should improve resource allocation. The changes will enhance the effectiveness of the uniform capital allowance regime, which replaced accelerated depreciation in 2001.

Government Regulation and Intervention

Increasing mobility and flow of Australian businesses and workers has raised concerns about separate, overlapping and conflicting regulation between state jurisdictions. This ad hoc regime increases the costs of complying with regulation without any associated increase or change in economic activity.

Cooperative federalism through COAG represents an important forum for reducing overlapping and inconsistent regulation in Australia. Simplifying regulation will go toward reducing the cumulative burden faced by business in terms of reducing overlapping and inconsistent requirements. State based regulation, which has the same objective yet different regulations, should be investigated by the COAG secretariat for possible alignment and simplification.

While consistency between federal, state and local governments is desired, there are advantages to allowing state and local government to regulate issues differently. For example, if public values and preferences differ by region, those differences can be reflected in varying state and local regulatory policies. In addition, state and local government regulation can serve as a testing ground for experimentation with alternative policies. Introducing an element of competition into regulation where one state can learn from another's experience while local jurisdictions may compete with each other to establish the best regulatory policies.

In February 2006, COAG agreed to a new *National Reform Agenda*, which will, among other things, focus on reducing the regulatory burden imposed by the three levels of government.

COAG agreed that effective regulation is essential to ensure markets operate efficiently and fairly, to protect consumers and the environment, and to enforce corporate governance standards. However, the benefits from each regulation must not be offset by unduly high compliance and implementation costs.

COAG agreed to a range of measures to ensure best-practice regulation making and review, and to make a "down payment" on regulation reduction by taking action now to reduce specific regulation "hotspots". While it is expected that all jurisdictions will undertake their own regulation review processes, they will be guided by the following agreed principles:

- establish and maintain effective arrangements to maximise the efficiency of new and amended regulation and avoid unnecessary compliance costs and restrictions on competition;
- undertake targeted public annual reviews of existing regulation to identify priority areas where regulatory reform would provide significant net benefits to business and the community;
- identify further reforms that enhance regulatory consistency across jurisdictions or reduce duplication and overlap in regulation and in the role and operation of regulatory bodies; and
- in-principle, aim to adopt a common framework for benchmarking, measuring and reporting on the regulatory burden.

While this agreement does not address ways in which separate, overlapping and conflicting regulation between state jurisdictions could be resolved, it has at least signaled the intention that a more cooperative approach will develop. This could commence with the agreement that COAG address six priority cross-jurisdictional "hotspot" areas where overlapping and inconsistent regulatory regimes are impeding economic activity, namely:

- rail safety regulation;
- occupational health and safety;
- national trade measurement;
- chemicals and plastics;
- development assessment arrangements; and
- building regulation.

One area of complex and overlapping legislative requirements not addressed specifically by COAG is food and beverage manufacturing. CCI has for some time argued that the regulatory framework for food in Australia is complex and fragmented, involving a plethora of Commonwealth departments and statutory bodies, State and Territory agencies and local governments.

The consequence of such an inefficient system is that food laws and regulations are too prescriptive, too costly to comply with, too restrictive, too ambiguous, and imposed significant and unwarranted regulatory burden and costs on the food industry.

CCI considers that food regulation is one area where a national approach is required, and this should involve the transferral of food regulation and standard setting policy to a single Commonwealth agency. However, the States should still retain carriage of enforcement of legislation especially on food safety matters.

CCI has for some time argued that the regulatory framework for food in Australia is complex and fragmented, involving a plethora of Commonwealth departments and statutory bodies, State and Territory agencies and local governments.

Competition Policy

One of the greatest achievements of cooperative federalism in recent years in Australia is (somewhat paradoxically) NCP. As part of that reform, the states cooperated to introduce a single national framework for corporations law in Australia so that each State had identical regulations covering companies and securities and some other regulations governing food standards, transport and financial institutions.

Cooperation need not require singular or identical legislation. States can agree to adopt broadly similar approaches. In the case of NCP, the States and Commonwealth agreed to a range of complementary reforms within their own jurisdictions, including reviews of anti-competitive regulations. In return for implementing the full raft of reforms, the States were to receive payments from the Commonwealth. The National Competition Council was given the role of assessing the extent to which governments complied with their agreed undertakings under the reform process, and making recommendations to the Commonwealth Treasurer on whether the states had implemented their agreed reforms and were therefore entitled to competition payments.

The results of this process have been patchy and at times disappointing, especially in Western Australia, where the government had the worst record of the State Governments in implementing competition policy reforms.

The results of this process have been patchy and at times disappointing, especially in Western Australia, where the government had the worst record of the State Governments in implementing competition policy reforms. However, the Commonwealth's record in implementing its own reform agenda was even worse – meaning that there in nothing to suggest that a more centralised approach would lead to a better outcome.

There is still much to be done in relation to competition policy, and a renewed focus is essential if Australia is to achieve higher living standards and be well placed to address some future challenges – including global competitive pressures as a result of continued global integration, and the pressures resulting from the reducing in labour supply from the ageing of the population, which without offsetting increases in productive capacity will constrain future growth potential.

In this regard, it is hoped that the *National Reform Agenda* agreed to by COAG in February 2006 will re-energise competition reform in Australia following the end of NCP. The COAG agenda is split into three streams – human capital, competition and regulatory reform.

The competition stream of the new agenda aims to further boost competition, productivity and the efficient functioning of markets through further reform and initiatives in the areas of transport, energy, infrastructure regulation and planning and climate change. This agenda follows the formula of national competition policy reforms, with governments working together to identify reform opportunities, and agreeing on a process for delivering them.

Importantly, all governments have recommitted to the principles contained in the *National Competition Principles Agreement*, which was established under the NCP. Jurisdictions have also agreed to continue and strengthen gate-keeping arrangements established under the NCP to prevent the introduction of unwarranted restrictions on competition in new and amended regulations, and all outstanding priority legislation reviews from the NCP review program also need to be completed.

COAG also agreed in-principle to establish new intergovernmental arrangements for the governance of the *National Reform Agenda*. Like NCP, it is envisaged that Governments at all levels will have a central and continuing role in elaborating and implementing the agenda.

Several steps still need to be taken to advance the new agenda, particularly, who will administer the new process. COAG has agreed in principle to establish a COAG Reform Council (CRC) to report to COAG annually on progress in implementing the *National Reform Agenda*. It is envisaged that the CRC will be an independent body that will replace the National Competition Council which currently oversees the NCP process.

The primary role of the CRC would be to report to COAG annually on progress towards the achievement of agreed reform milestones and progress measures across the broad National Reform Agenda.

Where to From Here?

What this discussion paper helps to highlight is the need for the allocation of responsibilities within the federation to be reviewed systematically and rationally, with a view to simplifying the system, improving its efficiency and transparency and eliminating duplication and overlap. This would require both state and Commonwealth governments to commit to a genuine review of functions and responsibilities, including a commitment to withdraw from areas deemed to be more appropriately sited in the jurisdiction of another layer of government. It also requires that funding adequacy and autonomy be addressed.

This would best be achieved through an independent review of jurisdictional boundaries and their efficiency by a body at arms-length from Government, perhaps modelled on the Productivity Commission or National Competition Council. Its first role would be to recommend new and clearly defined allocations of policy, spending and revenue raising responsibilities for funding, policy determination, and policy implementation.

The previous section helped to highlight the key issues that have emerged in the Federalism debate.

From CCI's perspective, the most important issue surrounds the uneven distribution of financial powers between the Commonwealth and the States.

From CCI's perspective, the most important issue surrounds the uneven distribution of financial powers between the Commonwealth and the States. Unless there is a genuine commitment to the reform of Commonwealth-State financial relations, it is unlikely that the federalism debate will go away.

There are also a range of other tensions in relation to federation, and indeed they have become a recurring issue in a surprisingly large proportion of Australia's political concerns and controversies – ranging from water rights to the provision of essential services such as electricity or infrastructure such as ports; from industrial relations reform to the funding of universities or the setting of school curricula. The issue of which layer of government has the ability and the authority to set policy is a recurring theme that clouds, and sometimes overwhelms, the question of what the best policy actually is.

However, these recent clashes are only the latest chapter in a saga of conflict between the States and the Commonwealth that has be running since Federation. Its fuel comes from the pursuit of power and the clash of ideologies, from social, economic and technological changes that force governments to develop policy responses to issues the founding fathers could not possibly have anticipated, and from periodic High Court rulings on the distribution of authorities that regularly shift the goalposts for political players.

These clashes take the form of turf wars more often than reasoned debates of the proper allocation of responsibilities between jurisdictions. By and large, the Commonwealth wins more of these clashes than it loses. This is partly because its greater financial clout allows it to use financial strings or incentives to influence the states, or simply to by-pass them and implement its own agenda; and partly because the changing political, social and economic climate means that some issues are more sensibly resolved at a national than a state level.

In the absence of a commitment to reforming Commonwealth-State financial relations, there are opportunities for reform through the examination of discrete issues.

To illustrate this, CCI undertook to examine the issue of public housing. This examination identified an opportunity for reform through the adoption of a model whereby the Commonwealth provides all of its funding by way of cash grants or income assistance for rental accommodation, and where the States are responsible for designing policies aimed at ensuring there is enough public or private sector housing stock for recipients of assistance to access.

This was a reform that was originally proposed by COAG in 1995, and would have done away with the Commonwealth-State Housing Agreements, and in the process eliminated a range of inefficiencies and delays caused by duplicate administration. Further, such a reform would go some way to eliminating the perverse incentives that exist through the present funding structure of matching grants. Under the present funding arrangements, the incentives to provide services at least cost are reduced because State Governments do not receive financial benefit from cost savings but rather are rewarded by spending more money on housing provision.

Appendix – An Examination of Public Housing

History of Commonwealth/State Housing Policy

The two main Commonwealth programs specific to housing assistance in Australia are the Commonwealth State Housing Agreement (CSHA) and Rent Assistance (RA).

The CSHA is a joint Commonwealth-State arrangement which is predominantly concerned with the provision of financial assistance to the states to allow them to provide a stock of public housing. Notably, its funding priorities include public housing, community housing, crisis accommodation, Aboriginal rental housing, private rental support and home ownership support. Nationally, the Commonwealth provides on average approximately two-thirds of the total funding for the CSHA with the remainder provided by the States and Territories through matching arrangements[24].

Rent Assistance involves the Commonwealth providing rental assistance to low income households and individuals in the private rental market. This assistance is given primarily in the form of a non-taxable income supplement which is paid to people who receive income support payments or more than minimum family payment in recognition of housing costs in the private market. Since the mid 1990s, total outlays on RA have exceeded those provided on the CSHA[25].

In addition to the CSHA and the provision of Rent Assistance to private renters, the Commonwealth also provides a range of other housing assistance measures[26]. However, this Discussion Paper will limit is consideration to the State and Federal arrangements that pertain to CSHA and RA.

The CSHA represents a series of Commonwealth state funding agreements spanning a 60 year period.

Prior to 1945, housing, which is residually allocated by the Constitution to the States, had been solely provided by the States with own source revenue according to state devised policy.

The Commonwealth expansion into the area of housing policy occurred in response the Commonwealth's determination that a shortage of housing stock attributable to the combined effect of the Great Depression and return of World War Two servicemen was a problem of national significance. The shortfall in housing stock was at the time estimated to be 300,000 dwellings[27].

Between 1945 and 1971 financial assistance to the States took the form of loans under the CSHA. The CSHA loans between 1945 and 1971 contained a variety of conditions and the interest rates applicable to the funds were lower than funds loaned pursuant to normal loan council funds. The States had a choice of accepting the lower interest loans under the CSHA in preference to market rate borrowings under the Loan Council agreements. After 1973, the Commonwealth allocated funds (rather than loans) pursuant to CSHAs. This meant that the choice did not remain for the States to forgo the CSHA loans (with their attached conditions) and take general Loan Council funds (at a higher interest rate but with no conditions).

Under the CSHA:

- grants are allocated pursuant to section 96 of the Constitution, which allows for the Federal Parliament to grant financial assistance to any State on such terms and conditions as the parliament thinks fit[28]; and
- that the conditions attached by the Commonwealth seek to affect a series of policy outcomes set and desired by the Commonwealth government.

The policy objectives sought to be achieved by the Commonwealth Government through the conditions, attached first to loans and then grants, changed with the changes in successive Commonwealth Governments. For instance, the 1945 CSHA reflected the desire of the Chifley post war government to provide rental accommodation to returned servicemen, which contrasted to the Menzies government use of the CSHA to promote home ownership.

The history of successive CSHA has found examples of both success and failure on the part of the Commonwealth government in achieving its policy aims.

One example of the difficulties faced by the Commonwealth in enacting its policy priorities, even with the financial dominance it possessed in funding after 1973, appears with the 1973 CSHA. The Whitlam government sought to institute as a priority policy outcome for the redirection of funding assistance to low income renters. To achieve this end, the 1973 CSHA was originally constituted by a rental only agreement, with strict controls on eligibility for assistance (directed at low income renters), and crucially restrictions on the sales of housing stock (the agreement also sought to set standards for housing developments).

As a consequence of State opposition (including ALP States) to the terms of the original agreement, the final 1973 CSHA was a compromise document. And further, the Commonwealth was only partly successful in achieving its policy aim of redirecting assistance away from home ownership to rental assistance for low income earners. In effect, this was because, whilst the 1973 agreement placed limits on the sales of housing stock, those limits applied only to stock constructed by use of funds provided under the 1973 agreement. Consequently, States could maintain a "home ownership" public housing policy by selling existing stock[29].

The Result of Co-operative Federalism

The history of public housing provision in Australia reveals that housing policy is a convenient case study which illustrates a policy area where a "cooperative" federal model is presently in place, where policy is jointly agreed between Federal and State Governments and where implementation then occurs pursuant to an agreement (or series of agreements) using either or both State and Federal government as service providers and using funds from each.

It is also a convenient area in which to assess what outcomes have been achieved pursuant to this co-operative approach.

The history of public housing provision in Australia reveals that housing policy is a convenient case study which illustrates a policy area where a "cooperative" federal model is presently in place.

Uniformity

There have been considerable efforts by the Commonwealth, through the conditional provision of significant funds to the States, to impose its policy will on the States in this area. Interestingly, however, a conventional wisdom appears to have developed amongst political scientists which argues that the States have engaged a variety of mechanisms and practices designed to offset the Commonwealth's financial pressure and that the result has been the Commonwealth's failure to direct States' policy in a comprehensive way. This is in turn said to be evidenced by the absence of Commonwealth mandated uniformity in the various States with regard to the issue of public housing provision.

This conclusion has been documented in a series of articles by Andrew Parkin[30], who, in the final article in the series states:

> *The very significant variations in programmes and policies between States (in both quantitative and qualitative terms) provides an especially strong rebuttal to the argument that CSHA conditions have somehow successfully imposed a uniform 'Commonwealth perspective' on the States[31].*

Similar conclusions have been drawn in other detailed examinations of the implementation of State and Commonwealth policy objectives through the CSHA. Such conclusions are to the effect that the Commonwealth has demonstrated some ability to influence the manner in which the States have provided State housing services and also some influence over the composition of the target groups receiving funding. But equally, that the States have generally retained a substantive ability to tailor policy to meet local needs and conditions, either because the Commonwealth has not attempted to limit their actions or as a result of Commonwealth attempts being ineffective[32].

According to this line of thought, the various CSHAs have represented hard fought compromises where neither the Commonwealth nor the States dominate the policy agenda[33].

In the final event, the weight of opinion appears to be that, to the extent that the Commonwealth has attempted to enforce policy uniformity (and the State's have resisted such uniformity being imposed upon them), the policy result has been one of stalemate.

Inefficiencies

Given the stalemate in policy dominance that appears to have developed pursuant to CSHAs, it is worth assessing the possible cost in terms of efficiency that may have arisen as a result of the overlap that has emerged in this area of human services provision.

One view that has emerged with respect to CSHAs is that they represent a classic example of cooperative federalism where shared and overlapping policy responsibility has resulted in indistinct lines of responsibility and thereby diminished accountability and efficiency[34].

This view has been founded in part upon the findings of a 1993 Industry Commission Report, which stated[35]:

> *Commonwealth grants to the States lead to a substantial blurring of responsibility and accountability. In the case of the CSHA, responsibility is particularly ambiguous because it is formally shared. Consequently, the collective decisions on policy matters provide opportunities for each level of government to escape scrutiny and avoid accountability. State agencies are left in a position where they have a great deal of latitude in how they formulate and manage their programs.*
>
> *The Commonwealth is a partner with joint responsibility but little real control over the effectiveness and the efficiency of the programs. It is currently trying to inject greater accountability into CSHA programs through performance monitoring.*

The Industry Commission report also made adverse findings with respect to the types of incentives that became built into the system of service provision by the system of matching grants. Notably, the Report found that incentives to provide services at least cost were reduced because State governments did not receive any financial benefit from cost savings. Rather, the system of matching grants meant the incentive existed to spend more money on higher levels of service provision. Consequently, the Report concluded that "funding on the condition that the monies must be spent may provide a perverse incentive" [36]. The Report also found that CSHA schedules contained vague statements of intended and not measurable outcomes which would be best expressed in terms of the number of people to be assisted and the standard and location of housing to be provided.

Notably, the Report found that incentives to provide services at least cost were reduced because State governments did not receive any financial benefit from cost savings.

The report concluded further that:

> *Although CSHA expenditure can be attributed notionally, say as the number of houses built, it is not possible to judge how well the money is being spent or how well the needs of people are being met… Present rent-setting policies do not ensure that those most in need receive the greatest benefit. The lack of clearly defined objectives under the CSHA weakens the incentive to make decisions transparent. Even if there is a will to promote performance monitoring, the absence of outcome orientated objectives would constrain its effectiveness.[37].*

In response to the 1993 Report, the new CSHA (which took effect from 1 July 1996) encompassed certain reforms designed to simplify the arrangements between States and the Commonwealth.

These improvements included[38]:

- The removal of some of the Commonwealth controls over State expenditure (such as requirements that a minimum proportion of funds be spent on capital purposes and requirements specifying the level of rents and rental rebates);
- The removal of two of the previous specific purpose programs and provision that remaining programs contained less detailed administrative measures (such as the removal of the necessity for specific Commonwealth approval of programs and projects); and
- Provision of a series of performance measures, with monitoring of the results by the Commonwealth[39].

The consequence of these reforms has been some improvement with respect to the levels of inefficiency in the area of CSHA.

Indeed, some commentators have expressed the view that some advantages arise through the sharing of responsibility, in terms of responsiveness of governments to its citizens, by virtue of having two levels of government involved in policy formulation. However, this assessment appears firmly in the context of an acknowledgement that there remains a considerable degree of duplication of administration and that administrative arrangements cause delays and lead to inefficiencies[40].

Potential for Reform

The provision of welfare assistance for housing is a contentious issue. Debate often centres on the quantum of funding that should be provided.

As noted above, the recent trend in funding has seen declines in the total CSHA outlays. Whilst these trends are instructive on the issue of possible reforms to Commonwealth-State relations in this area, it is not the intention of the present analysis to enter into the normative debate regarding the appropriate total level of welfare assistance for housing in Australia. Rather, this analysis seeks to determine whether, given present levels of funding, there may exists better options by which to structure the funding and policy arrangements as between the Commonwealth and State governments.

As set out above, certain reforms were instituted by the 1996 CSHA. These reforms can be traced back to the foundation, on 11 May 1992, of COAG as the mechanism for regular Heads of Government meetings. The 1996 reforms detailed above were originally identified during the consideration of the public housing sector that came out of the COAG. As well as identifying simplifications to Commonwealth-State arrangements and providing a series of performance measures, COAG also identified a further reform which was not subsequently adopted.

That reform, which has been described by some commentators as “radical”, was the suggestion that the Commonwealth provide funding for public housing exclusively in the form of cash rental subsidies to both private and public tenants, with the States retaining full policy responsibility with respect to the provision and funding of public and private housing stock for rental[41].

In Parliamentary debate, the purpose of such a reform was described as being to avoid duplication. The then Minister representing the Minister for Social Security stated the aim as being provision of, “a clean, accountable allocation of Commonwealth and State housing responsibilities.”[42] However, some commentators have argued that there existed a deeper Commonwealth policy aim which also motivated the proposal. Notably, that the provision of direct assistance by the Commonwealth to the users of housing services (rather than the funding being directed to the States for the provision of public housing stock) was seen as achieving the desirable policy ends of equity in the amount of assistance received by public and private tenants while also enhancing choice for all tenants in dwelling type and location[43].

In the event, the Commonwealth abandoned the reform citing opposition by the States. Again, commentators have argued that there existed an additional explanation for the abandonment of the reforms by the Commonwealth. Notably, the possibility of increased costs to the Commonwealth in funding[44].

Irrespective of the precise reason for the failure to follow through such reform, CCI considers, for the reasons stated in the conclusion below, that this model for reforming the funding arrangements extant in the public housing sector in Australia should be reconsidered.

Such a reform would have had the effect of doing away altogether with the CSHA grants system. This would have eliminated entirely a range of inefficiencies and delays caused by duplicate administration. Further such reforms would have gone some way to eliminate the perverse incentives that exists through the present funding structure of matching grants. Under the present grants the incentives to provide services at least cost are reduced because State governments do not receive financial benefit from cost savings but rather are rewarded by spending more money on housing provision. The alternative system would see State governments and the private sector compete for the dollars of citizens in receipt of an expanded system of Commonwealth direct assistance. Such a system would logically entail a renewed incentive to provide housing stock through public sector at the lowest cost.

In addition to these benefits, a practical achievability attaches to the proposal because the abandoning of the CSHA funding structure would not mean that the Commonwealth would deprive itself from its desired role in policy setting.

The use of comparable funds to the present CHSA grants by the Commonwealth in the form of direct cash grants to persons identified as being in need would allow the Commonwealth to achieve more efficiently what appears to be its presently desired policy priority – of targeting applicants in the greatest need. In recent years, the Commonwealth has shown an apparent favouring of Rent Assistance at the expense of CSHA grants (which favour public housing stock construction), as evidenced by the disproportionate increase in Rental Assistance relative to CSHA grants. This could suggest that the Commonwealth has adopted a limited and de facto version of the reform model from 1995 in any event.

CCI considers that real opportunity exists to minimising inefficiencies and delays caused by administrative duplication by replacing CSHAs.

CCI considers that real opportunity exists to minimising inefficiencies and delays caused by administrative duplication by replacing CSHAs.

Further, there are other reasons to now reconsider the model whereby the Commonwealth provides all of its funding by way of cash grants or income assistance for rental accommodation and where the States are solely responsible for designing policies aimed at ensuring that there is enough public or private sector housing stock for recipients of assistance to access.

These further benefits have been identified as including the following:

1. Greater choice for people requiring housing.
2. Equity between those who access publicly provided housing and privately provided housing.
3. Greater competition and efficiency in the provision of housing.
4. Clear and separate roles and responsibilities for the States and the Commonwealth. [45]

References

Australian Financial Review:

- 2004a, Howard win a threat to federalism, 6 October 2004.
- 2004b, Wool industry 'in crisis', 8 November 2004.

Chamber of Commerce and Industry of WA

- 1995 Economic Reform: A Discussion Paper Examining The Processes And Pressures Leading To The Adoption Of Economic Reform In The Australian States (response to the Hilmer Report).
- 2001 In Support of Free Enterprise.
- 2005 National Competition Policy: A Submission to the Productivity Commission Inquiry into the Impact of National Competition Policy.

Commonwealth Grants Commission, Report on State Revenue Sharing Relativities 2005 Update.

Department of Treasury and Finance:

- 1999, Fiscal Subsidies Within the Australian Federation – Western Australia's net Subsidy to Other States, Discussion Paper, Perth.
- 2006, Discussion Paper on Commonwealth-State Financial Relations: An Economic and Financial Assessment of How Western Australia Fares, Discussion Paper, Perth.

Galligan, B., 2000, Development of Federalism. Australian Parliament Politics and Public Administration Group Research Paper 26, 2000-01. http://www.aph.gov.au/library/pubs/rp/2000-01/01RP26.htm [01/09/05]

Garnaut, R. & Fitzgerald, V., 2002, Review of Commonwealth-State Funding – A review of the allocation of Commonwealth Grants to the States and Territories, Melbourne.

Howard, John. Reflections On Australian Federalism. Speech to the Menzies research Institute, 11 April 2005. http://www.pm.gov.au/news/speeches/speech1320.html [20 April 2005]

James, D, 1992, Intergovernmental Financial Relations in Australia.

Parliament of Victoria Federal-State Relations Committee:

- 1997, Report on International Treaty Making And The Role Of The States.
- 1998a, Australian Federalism: The Role of the States.
- 1998b, Federalism and the Role of the States: Comparisons and Recommendations.

Pincus, J., 2005, Productive Reform in a Federal System, Productivity Commission Background Paper.

Productivity Commission:

- 2005a Review of National Competition Policy Reforms, AusInfo, Canberra
- 2005b Economic Implications of an Ageing Australia, Research Report, Canberra.

Bibliography

Baldwin, R. E. & Frédéric, R-N. 2002, Entry And Asymmetric Lobbying: Why Governments Pick Losers NBER Working Paper 8756.

Banks, Gary, 2001, Competition and the Public Interest, presentation to National Competition Council Workshop.

Chamber of Commerce and Industry of WA:

- 1998, Market Failure, Industry Concentration And Regulation.
- 2002, Submission to the Independent Review of Commonwealth-State Funding.
- 2002, Mid-Term Review: A Business Assessment of the Labor Government's Record in it First Two Years.
- 2003, Submission to the Review of Retail Trading Hours Policy in Western Australia.
- 2006, Submission to the State Infrastructure Strategy.

Coase, R. 1960, The Problem of Social Cost, Journal of Law and Economics 1960 http://www.sfu.ca/~allen/CoaseJLE1960.pdf.

Council of Australian Governments (COAG):

- 1995 Agreement to implement the National Competition Policy and related reforms, Canberra.
- 2000, Communiqué, Canberra, 3 November 2000.
- 2006, Meeting Outcomes, 10 February 2006.

Cox, Eva (1995) A Truly Civil Society, ABC books, Sydney

Department of Treasury and Finance, 2002, Project Evaluation Guidelines.

Hilmer, Fred, et al, 1993, National Competition Policy: Report by the Independent Committee of Inquiry, AGPS, Canberra.

Handbook of Federal Countries: 2002 Montreal and Kingston: McGill-Queen's University Press, 2002.

Lee, Dwight and Buchanan, James M. Tax Rates and tax Revenues in Political Equilibrium: Some Simple Analytics, Economic Inquiry 20 (1982). p. 344-354.

National Competition Council, 2005, Assessment of governments' progress in implementing the National Competition Policy and related reforms, AusInfo, Canberra.

Norton, Latham, Sturgess and Stewart-Weeks (1997) Social Capital: The Individual, Civil Society and the State. Centre for Independent Studies, Policy Forum 14.

Pius XI. 1931. Quadragesimo Anno: Encyclical Of Pope Pius XI On Reconstruction Of The Social Order To Our Venerable Brethren, The Patriarchs, Primates, Archbishops, Bishops, And Other Ordinaries In Peace And Communion With The Apostolic See, And Likewise To All The Faithful Of The Catholic World. [http://www.vatican.va/holy_father/pius_xi/encyclicals/documents/hf_p-xi_enc_19310515_quadragesimo-anno_en.html]

Peltzman, S., 1976, Toward a More General Theory of Regulation, Journal of Law and Economics 19 (August 1976): 211-240.

Posner, R., 1974, Theories of Economic Regulation, Bell Journal of Economics and Management Science 5 (Autumn 1974): 335-358.

Postrel, V., 1999, External Cost: The dangers of calling everything pollution. Reason Magazine, September 1999.

Productivity Commission, 1999, Effect of Competition Policy Reforms on Rural and Regional Australia, Report No.8, AusInfo, Canberra.

Stigler, G. J., 1971, The Theory of Economic Regulation Bell Journal of Economics and Management Science 2 (Spring 1971).

Watts, Ronald L. 2002 The Relevance Today of the Federal Idea paper prepared for the International Conference on Federalism 2002 http://www.forumfed.org/federalism/Watts.asp?lang=en [16 November 2004].

Endnotes

(Endnotes)

[1] Productivity Commission (2005a).

[2] For example, the article in the Australian Financial Review of 6 October 2004 entitled Howard win a threat to federalism.

[3] Argentina, Australia, Austria, Belgium, Bosnia and Herzegovina, Brazil, Canada, Comoros, Ethiopia, Germany, India, Malaysia, Mexico, Micronesia, Nigeria, Pakistan, Russia, St. Kitts and Nevis, Serbia and Montenegro, South Africa, Spain, Switzerland, United Arab Emirates, United States of America, Venezuela. Quoting from the Handbook of Federal Countries: 2002, Montreal and Kingston: McGill-Queen's University Press, 2002 http://www.forumfed.org/federalism/cntrylist.asp?lang=en [16 November 2004]

[4] Parliament of Victoria Federal-State Relations Committee (1998a).

[5] Parliament of Victoria Federal-State Relations Committee (1998b).

[6] James, D. 1992, Intergovernmental Financial Relations in Australia.

[7] Productivity Commission (2005b).

[8] Pincus (2005), p.21.

[9] http://en.wikipedia.org/wiki/Subsidiarity

[10] This does not mean that CCI endorses the content of the Kyoto Protocol, which it believes to be profoundly flawed. Rather, it recognises that the issue of greenhouse gas emissions transcends national boundaries and needs an international solution (indeed, the fact that the Protocol proposes national solutions to an international problem is one of its key weaknesses).

[11] This term has been used to apply to the political left in the USA and conservatives in Australia. Here it is used more in the sense of classical liberalism, as a political philosophy stressing the value of personal liberty and the dignity of the individual.

[12] CCI (2001) p.10

[13] Howard (2005)

[14] Australian Financial Review (2004a).

[15] http://plato.stanford.edu/entries/federalism/

[16] See CCI's 2005 Submission to the Productivity Commission's review of NCP for further analysis.

[17] These issues have been summarised from James (1992).

[18] John Howard (2005).

[19] Commonwealth Grants Commission (2005), p. 5.

[20] Department of Treasury and Finance (1999).

[21] Ibid, p.10.

[22] Department of Treasury and Finance (2006), p.19.

[23]Garnaut and Fitzgerald (2002).

[24] Ibid

[25] Ibid

[26] Other types of assistance include recurrent and capital funding for residential aged care, including funding for high care (nursing homes), low care (hostels) and Community Aged Care Packages (CACPs). Specific Aboriginal housing programs that are largely administered by the Aboriginal and Torres Strait Islander Commission (ATSIC), for example, the Community Housing and Infrastructure Program (CHIP) and the Home Ownership Program. Specific programs (many of which are jointly done with the States and Territories) that are designed to help people move into more independent living arrangements or to provide for their ongoing support needs. Examples of such programs include the Supported Accommodation Assistance Program (SAAP), the Home and Community Care Program (HACC) and the Commonwealth-State Disability Agreement. Various concessional taxation arrangements such as negative gearing for rental properties, the First Home Owners Scheme and capital gains relief for the family home [see op. cit., 'The Commonwealth-State Housing agreement' Parliament of Australia Parliamentary Library at 1].

[27] Commonwealth Housing Commission ("CHC") 'Final report: 25 August 1944' Canberra: Ministry of Post-War Reconstruction.

[28] It should be noted that prior to 1973 when funds were allocated by way of loans the Commonwealth had received legal advice to the effect that loans repayments could not be compelled in the absence of a loan agreement. The original agreement reflected in part the Commonwealth

's policy aim to provide rental properties (not ownership) for the use of ex servicemen with the states being responsible for the construction of rental stock see Mendelsohn R, Reforming Public Housing, Department of the Parliamentary Library (Canberra: 1972).

[29] Monro, D 2000 'The Commonwealth State Housing Agreement 1945-1999: Commonwealth domination or compromises that enhanced democracy". Conference Paper delivered to the 2000 Conference of the Australasian Political Studies Association 3-6 October 2000. This article also details significant successes for the commonwealth in imposing its policy agenda via the CSHA.

- In 1978 Commonwealth conditions governing the sale of dwellings (which was strongly opposed by South Australia).
- From 1979 on the provision of specific funds for particular groups (opposed by most states particularly NSW).
- In 1978 the introduction through the budget process of requirements that states match Commonwealth funds (unwelcome but complied with by all States)

Available on 21 July 2006 at apsa2000.anu.edu.au/confpapers/munro.rtf

[30] Parkin A. 1988. 'Housing Policy' Comparative State Politics. Ed. Galligan B. Melbourne: Longman Chesire. And see Parkin A. 1991. 'Housing Policy' Intergovernmental Relations and Public Policy. Ed. Galligan B., Hughes O., Walsh C. Sydney: Allen and Unwin. And see Parkin A. 1992. 'Politics of Housing Policy' Australian Journal or Political Science 27 at 94 – 112.

[31] Ibid Parkin A. 1992 at 98.

[32] Monro D. 2001 The Results of Federalism: An Examination of Housing and Disability Services. A thesis submitted in fulfilment of the requirements for the award of the degree of Doctor of Philosophy, Faculty of Economics and Business: University of Sydney at 372 – 373.

[33] Ibid at 388

[34] Beresford Q. 2000. Governments, Markets and Globalisation: Australian Public Policy in Context. Allen and Unwin: Sydney 2000 at 186.

[35] Industry Commission. 1993. Public Housing Volume 1, Report No.34 11 November 1993, Australian Government Publishing Service: Canberra at 102 – 103.

[36] Ibid at 103

[37] Ibid.

[38] Op. cit., Monro 2001 at 169 – 171.

[39]Performance indicators were less than completely effective in allowing the Commonwealth to monitor the States' performance with The Australian National Audit Office undertaking an examination of the administration of the Commonwealth Housing Agreement in 1999. The ANAO concluded that, "there were problems with the quality and reliability of performance and financial information provided by the States which limited the usefulness of that information for measuring and/or assessing performance against required results." See Commonwealth State Housing Agreement Follow-up Audit, Department of Families, Community Services and Indigenous Affairs Australian national Audit Office Commonwealth of Australia 2006 at 13.

[40] Op. cit., Monro 2001 at 373.

[41] Op. cit., Monro 200at 6.

[42] Tambling S. 1996. Reform to Housing Assistance. Paper presented to ACOSS Conference on Housing Reform. 15 November 1996. Sydney. For further detail on the proposed model for reform see Caulfield J. 2000. Public Housing and Intergovernmental Reform in the 1990s. AJPS, Australian Journal of Political Science 35(1): 99-110. And see McIntosh G. 1997. Reforming Public Housing. Department of the Parliamentary Library. Canberra.

[43] Op., cit. Monro 2001 at 171 -172.

[44] Badcock, B. 1999. 'Doing more with less: public housing in the 1990s'. O'Connor K. Housing and Jobs in Cities and Regions: 81-93, Australian Housing and Urban Research Institute, Queensland University Press. Brisbane.

[45] These are the advantages proposed in op. cit., Wilkins R. 2006 at 13.

Notes

Membership Enquiries
Phone: (08) 9365 7455
E-mail: membership@cciwa.com

Business Advice Centre
Phone: (08) 9365 7660
E-mail: advice@cciwa.com

Employee Relations Services
Phone: (08) 9365 7576
E-mail: solutions@cciwa.com

CCI Training & Consultancy Services
Phone: (08) 9365 7500
E-mail: training@cciwa.com

Apprenticeships Western Australia
Northern WA
Balmoral Road, Karratha WA 6714
Phone: (08) 9144 2140
E-mail: apprenticeships@cciwa.com
Southern WA
180 Hay Street, East Perth WA 6004
Phone: 1800 008 234
E-mail: apprenticeships@cciwa.com
30 Boulder Rd, Kalgoorlie WA 6430
Phone: (08) 9091 3249
E-mail: apprenticeships@cciwa.com

Kwinana Skills Centre
41 Hope Valley Road
Naval Base WA 6165
Phone: (08) 9437 0100
E-mail: skillscentre@cciwa.com

CCI EMPLOYFAST
Phone: (08) 9365 7402
1800 224 224
E-mail: employfast@cciwa.com

International Trade Services
Phone: (08) 9365 7620
E-mail: trade@cciwa.com

E-Commerce Solutions
Phone: (08) 9365 7691
E-mail: info@cciwa.com

Occupational Safety and Health
Phone: (08) 9365 7415
E-mail: osh@cciwa.com

Economics and Research
Phone: (08) 9365 7618
E-mail: economics@cciwa.com

Business Networking and Functions
Phone: (08) 9365 7528
E-mail: functions@cciwa.com

Industry Capability Network WA
Phone: (08) 9365 7623
E-mail: icn@cciwa.com

Industry Development
Phone: (08) 9365 7619
E-mail: reps@cciwa.com

CCI Legal
Phone: (08) 9365 7799
E-mail: ccilegal@cciwa.com

Policy and Public Affairs
Phone: (08) 9365 7530
E-mail: pride@cciwa.com

Retail Traders' Association
Phone: (08) 9365 7695
E-mail: rta@cciwa.com

CCI Migration Services
Phone: (08) 9365 7555
E-mail: visas@cciwa.com

Federalism in Australia

A Discussion Paper

Business Leader Series

Prepared by the Chamber of Commerce and Industry of Western Australia

180 Hay Street, East Perth WA 6004
Phone: (08) 9365 7555
Fax: (08) 9365 7550
Website: www.cciwa.com
E-mail: info@cciwa.com

CCI Business Finder Directory: www.ccibusinessfinder.com