

“The Future of Federalism”

by

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1. An election year is an ideal time to ask questions about our system of government. Ideally three topics should be covered.

- a. Australia's Head-of State ie. the republican debate
- b. Accountability within the Commonwealth ie. the executive government debate
- c. The state of the federation ie. the federalism debate

2. In respect of the first it will be interesting to see if the ALP puts it back onto the agenda. Certainly I'd be surprised if the subject doesn't get some attention in the course of the campaign.

3. The second definitely needs serious attention given the significant bureaucratic failures at the federal level, the continuing claims that the public service has been politicised (most recently by the Federal Court in the case concerning leave and the Day of Protest in 2005), and the powerful and unaccountable position of ministerial staffers working in Canberra.

4. Today, however, it is the federalism debate which is my topic of concern. Some preliminary comments are necessary, particularly about how we approach the question. Indeed, in examining the state of our federation the method of inquiry we adopt is crucial. It helps frame the debate and has a significant impact on the conclusions we reach. In looking at Australian commentary two approaches can be discerned, the pragmatic and the philosophical.

- a. A pragmatic approach will focus on the questions: What will work today? What produces the desired outcomes?

The problem here, of course, is that it begs a number of other questions such as "for whom is it supposed to be working?" and "what are the desired outcomes?"

Referring to outcomes also takes us into the territory of time. Are we talking about the short-term or the long-term?

- b. For these reasons it is important that the debate be given a more comprehensive framework. I would call this the political philosophy approach – what systems best survive the test of time and circumstances? What systems best promote the values and interests that underpin our society, such as liberty, progress and a healthy lifestyle? And surely we should be concerned with accountabilities as well as outcomes?

5. It is important to note that political philosophy isn't free of empirical content and assumptions are made about human nature, human society and what works and doesn't work. It was precisely this type of thinking that was put to work in framing the Australian Constitution. It was a mixture of idealism and realism and led to the creation of a nation whose system was, at the time, the envy of the world.

6. Ideally speaking both pragmatism and philosophy should be put to work in analysing federalism today. Our system needs to work for today but it also needs to be able to sustain success. What may be a "fix" today might prevent a "solution" tomorrow. As far as possible we need to raise the standard of public debate about these issues – just as the founding fathers of the Constitution did in the late nineteenth-century.

7. There is a view of politics and history that centralisation of power is inevitable. It has been, so the argument goes, a dominant feature of the twentieth-century and will continue to be so this century. The view that centralisation is inevitable is developed in relation to both ideas and power.

8. In terms of political ideology it is important to note that federalism has never occupied iconic status in our national imagination. ¹ As a governing philosophy it has had to battle against nationalism, bureaucratic rationalism and more recently economic rationalism for political space. For many years the ALP platform incorporated abolition of the states as one of its planks. This was a reflection of the Labour Movement's original hostility to a system over which it felt little ownership and which divided power in order to prevent the "tyranny of the majority", a description which for nineteenth-century radicals and conservatives alike, meant the working class. All too often federalism has been on the back foot justifying itself to a sceptical or hostile audience.

9. In the battle for power the Commonwealth has been more proactive, using its greater financial power and favourable decisions by the High Court to extend the range and depth of its influence. Two world wars and today's "war on terrorism" have helped centralise power from which there is rarely a turning back.

10. Those who argue that history is on the side of centralisation go further and point to

- a. the growing nationalisation of our cultural life rendering state loyalties meaningless,
- b. the globalisation of the economy requiring more centralised responses, and
- c. competitive pressures rendering duplication and overlap too expensive to carry.

11. It is interesting to note that some who favour centralisation point to the need to formalise the trend by abolishing the states altogether in the interests of uniformity and efficiency on the one hand and localism on the other. ² More often, however, the argument is pitched in terms of a centralised form of federation with the states increasingly a service deliverer on behalf of the Commonwealth.

12. There are a number of aspects of this style of thinking that particularly bothers me.

Firstly, it encourages an uncritical approach to the Commonwealth and its work. The habit is developed of thinking that the Commonwealth represents the "national" interest and the states "parochialism". Surely these are claims that need to be proven in each case, they can't be assumed.

Secondly, many of the historical claims are questionable. State loyalties are still part of the architecture of politics and state governments are still important in managing globalisation in ways that would be impossible for central governments. The presence of state governments obliges a central government to negotiate its global strategies in ways that can help assure the public that it is a process that serves their interests rather than undermines them. We need always to remember that the legitimating functions of government are very important, particularly in the context of social and economic change.

Thirdly, it needs to be said that whilst the federal idea is heavily contested, the states are often on the back foot, and Commonwealth power and influence has grown we still have a complex system of power relations unlike those that prevail in a unitary system. Indeed on the ground we have a mixture of coercive, competitive, cooperative and opportunistic federalism. Federalism is different today than it was in 1901 but it is still alive. The states

¹ See Robyn Hollander and Haig Patapan, "Pragmatic Federalism: Australian Federalism from Hawke to Howard", Policy Roundtable on Federalism, Institute of Public Administration and the Academy of the Social Sciences in Australia, Canberra, 17-18 May 2007.

² A recent example of this thinking can be seen in Paul Kerin, "Abolishing State governments would save \$30bn by slashing red tape", The Australian Business, August 28, 2007

are important players and their electorates are still supportive of their role as advocate, service provider, policy innovator, national and global facilitator and defender of difference.

13. This leads me to my fundamental point for the day – Australia needs a theory of government to support this new reality. As a “theory” it needs both to explain and to justify. In other words it must provide the intellectual ammunition to excite those concerned at the contemporary trends and keen to preserve “balance” and “pluralism” whilst recognising the political pressures for a national approach to a range of problems including the contemporary challenges of ageing and climate change. In other words it needs to be realistic in its analysis and idealistic in its aspiration for the nation.

14. The starting point for any such consideration must be an up-to-date account of the strengths of federalism. The paper prepared by Ann Twomey and Glenn Withers for the Australian Council for the Australian Federation Federalist Paper One: Australia’s Federal Future (2007) is essential reading for those keen to support our federal system. Twomey and Withers remind us that federalism (and to a lesser extent its twin brother “devolution”) are good systems for cultivating unity through accommodating diversity. Just as importantly solid public policy arguments can be marshalled in defence of federalism

- a. It gives more choice to electors by allowing them to vote for one party at the state level and another at the federal level. Voters do not have to put all their eggs in the one basket. In recent years voters have clearly appreciated the opportunity to support different parties at different levels just as they often vote differently in the upper houses where a checking function can be performed.
- b. It allows for competition between the states to attract people and investment, particularly from overseas. The view that this is a zero-sum-game is mistaken as resources devoted by one state to attract international investment and trade inevitable lead to spill over benefits for the wider national economy.
- c. It allows for innovation and the testing of new ideas in a constitutionally protected sphere. A current example is the establishment of charters of rights in the A.C.T. and Victoria. In this context note how new ideas in the Territories deemed unacceptable by the Commonwealth can be extinguished because the Territories lack the constitutional status of states.
- d. It provides checks and balances when policies that cross the boundaries are being developed. The Commonwealth was forced to negotiate with the States over its anti-terror laws because a referral of power was involved and this led to important amendments to their original proposal.
- e. It allows for variation and political differentiation in both “systems” and outcomes”. In this context note the different approach to poker machines in W.A. , the unique voting system for the Tasmanian Lower House , and the Queensland attitude to daylight saving. Surely Australia is a better place for these differences!

15. The case for federalism is akin to the economic case for dynamic efficiency. Indeed the notion that conflict and competition are wasteful embodies a very static and unrealistic view of progress. Let me illustrate this point in a number of ways:

- a. Conflicts between the Commonwealth and the States are not just about power but often involve crucial points of ideological difference that should be aired and if not resolved through the ballot box they should be approached in the spirit of negotiation between equal parties. All too often the critics of federalism write as if politics is a bad thing. Rather, it keeps all governments on their toes and alert to the tendencies at work within the community, especially when those tendencies are given politically important platforms as they often are in a federation with different parties in power at the state and federal levels.

- b. Competition between the states drives policy innovation and encourages diversity as different jurisdictions look for that “winning edge” in lifestyle, laws or infrastructure. This competition is coupled with continual and healthy dialogue between the jurisdictions about what works and what doesn’t.

16. In making these points let me ask you to engage in a process of political projection. Imagine Australia being run from Canberra. Is it feasible? Would it allow for local variation? What is the knowledge base in Canberra? Would the system become rigid and difficult to change? Such questions are not “Canberra-bashing”; they are questions one would ask of central government in any unitary system. In a centralised system it is one thing to acknowledge the importance of localism and regionalism, quite another to give sufficient power to lower levels of government so they can really make a difference. It is the constitutionally entrenched position of the states that has given them real power within the system. What follows is the capacity to be awkward and creative at the same time. This is an acknowledged strength of federalism.

17. Pointing to the benefits of federalism is a necessary but not sufficient condition for a proper defence of federalism. We are still left with the question of how to deal with the areas of functional overlap, most obvious in the Australian system in areas like health and education. I say this in the light of the not unreasonable assumption that some degree of functional overlap will always be with us. Indeed, it is unrealistic to expect a radical withdrawal of Commonwealth interest and a major revision of the balance of financial power. However, it is not unrealistic to expect that change is possible, particularly if it is based on a proper inquiry into “roles and responsibilities”.

18. You would recall that in the final years of the Hawke and Keating Governments there was serious consideration of a review of the roles and responsibilities of the Commonwealth and the States. It was mooted in the context of concerns about “buck-passing” and “cost shifting”. Such a review has been the subject of comment from time to time, but it has never happened. If it were to happen two questions would need to be answered: What principles ought to guide such a review? How would such a review be conducted?

19. On the first question the paper prepared for the ALP by Michael Keating, Geoff Anderson, Meredith Edwards and George Williams, A Framework to Guide the future development of Specific Purpose Payments (2007), provides much needed guidance. They outline the case for Commonwealth-State relations needing to balance two fundamental principles:

- the national interest principle and
- the subsidiarity principle.

Let me quote from their paper:

“The Commonwealth should be engaged when there are genuine national interests at stake, but only to that extent. Otherwise the subsidiarity principle should prevail”.³

20. This is a way of thinking about Commonwealth-State relations that is not a one-way street. The starting point is subsidiarity, the principle that decision-making should be devolved to the maximum extent possible. If issues can be dealt with locally or regionally greater responsiveness to individual or community needs will most likely be the result. This places an onus on those who wish to involve the Commonwealth to justify their argument by

³ Michael Keating et al, A Framework to Guide the Future development of Special Purpose Payments SPPS: a Discussion Paper, the ALP Advisory Group on Federal – State Reform, 31 July 2007, Sydney, p.3

reference to international obligations, national security, national economic policy and other cross-border necessities.

21. This is an argument we need to have and, as Keating *et al* note, “even where there is a clear Commonwealth interest, it does not necessarily require a Commonwealth takeover. Nor does Commonwealth interest automatically equate to the national interest nor automatically require strict uniformity”.⁴ This takes me into the territory of different models of Federal-State co-operation which I will discuss later in the paper.

22. On how such a review would work through the issues would largely be a function of how it was created. Serious consideration would need to be given to the direct involvement of people in the process as was the case with the Republic Convention in 1998. We have seen the use of democratic engagement put to good effort in the States over issues like urban planning, water, and drugs policy. There is no reason for thinking that the roles and responsibilities of our levels of government could not be given the same treatment and would not produce similarly clear and deliverable outcomes.

23 Whilst such a review ought to help delineate roles more clearly and assist in the process of avoiding the perennial problems of cost-shifting and buck-passing, we would not expect a pure system of co-ordinate federalism to emerge. Pressures will always be there for Commonwealth interest and involvement and we still need a model to be able to deal with financial and functional overlap in the myriad of joint Commonwealth-State initiatives.

24. Interestingly we do have a model for overlap in respect of comprehensive initiatives. I refer to the National Competition Policy which was initiated in 1995 and which is estimated to have delivered significant benefits to the Australian economy. The Policy aimed to extend the reach of competition policy to government enterprises, provide third-party access to significant infrastructure and review legislation restricting competition. However, the purpose of my argument today is not to rehearse the objectives and implementation of the policy itself, but rather to ask the question “why was it such a success?”

25. In reflecting upon this era of reform three elements of the approach stand out:

Firstly, the agenda itself was clear and agreed by all the jurisdiction as warranting priority. Concepts like competitive neutrality, third-party access and freedom of entry were understood, as were the arguments associated with the “public interest” test that might mean some restrictions were maintained.

Secondly, and independent body was set up to negotiate, monitor and report on reforms. I refer here to the National Competition Council.

Thirdly, the autonomy of the states was preserved but incentives for reform provided by way of the competition policy dividend. When States delivered reforms they could access these funds.

26. What followed was a remarkable degree of economic change in all the States and, as it turned out, a lesser degree of change on the part of the Commonwealth. The levels and quality of consultation varied but public participation did occur as part of the public interest considerations. Local politics could not be avoided and Upper Houses became the scene of important debates over the reform process. Some states proceeded faster than others. In my own state of Western Australia, for example, moderate changes to retail trading hours were rejected by the Legislative Council and these, plus more far-reaching changes, rejected by the people at a referendum held with the state election in 2005. In other words

⁴ Ibid, p.4

the change process was not so rigid as to disallow differences nor to loose as to breed complacency. State-based accountabilities were preserved with incentives to change provided by the Commonwealth. This was seen as a fair sharing of the burdens of reform as it was the Commonwealth Treasury which was the major beneficiary.

27. Whilst this was an era of remarkable reform time marches on and today there are new challenges requiring attention. I refer here to

- a. the new competitive pressures in the global economy as new nations exert their influence and
- b. the ageing of the population and its impact on workforce participation and productivity.

28. Following a strong campaign from Victoria in particular, the Council of Australian Government (C.O.A.G.) has accepted that we need a new “third wave” of reform based on human capital, participation and productivity.⁵ This means that a range of social policies, including health and education, have to be incorporated into the reform agenda. The principles behind this new reform agenda are very straight forward:

- In terms of health the healthier and more active the nation the stronger the economy.
- In terms of education and training it's a matter of skills generally and skills for those traditionally excluded from the labour market.

29. The Victorians proposed the setting of broad goals attached to which would be benchmarks for performance. In effect what is being proposed is a strategic planning exercise at the national level, with competition policy, regulatory reform and human capital reform as its primary aim. Just as good strategic planning now anticipates partnership for the realisation of the goals so too would the new reform agenda. At the same time the strength of federalism with its potential for innovation and creativity could once again be put to good use by allowing for agreed ends but state-determined means to achieve those ends.

30. Not surprisingly, then, the policy proposals emanating from this agenda revolve around issues like diabetes, obesity, chronic illness, literacy and numeracy, and educational disadvantage. It is much more complex and much more far-reaching in its implications than National Competition Policy. This takes us to the question: how can this New Reform Agenda be implemented? In answering this question let me turn to the three points that were fundamental to the success of National Competition Policy – charity and agreement, independent monitoring and autonomy coupled with incentives.

31. In respect of the first there has been agreement within C.O.A.G. A human capital stream has been added to competition reform and regulatory reform as the basis for a new agenda. Commitments from all the States and Territories have already been made in literacy and numeracy, diabetes and early childhood development complemented by a Commonwealth funding commitment in relation to diabetes.

32. In respect of the second a Reform Council has been established to monitor the progress of implementation and to assess the costs and benefits of reforms referred to it by C.O.A.G. I should declare an interest here as I have been nominated by the State to be Deputy Chair. In respect of costs and benefits (economic, fiscal and others) the assessment will be done on referral and ex-post-so that actual, realised costs and benefits are assessed.

⁵ On the Victorian Premier's proposal see Governments Working Together, A Third Wave of National Reform (August 2005). On the COAG agenda see A New Generation of Reform – Prosperity, Productivity and Participation (June 2005). More generally see Victorian Department of Premier and Cabinet, The History of the National Reform Agenda (n.d.)

It would then be a matter for C.O.A.G to determine whether any “fair-sharing” arrangements would follow from that assessment.

33. This takes us to the heart of the matter. The States were keen to have incentive payments built into the project upfront. They had established that the Commonwealth would receive between \$6 to \$10 billion over 25 years as a result of these reforms and the States between \$1.5 and \$3 billion and so it didn't seem unreasonable to lock such benefits into a reform dividend as had been done before. Such an arrangement is known as gain-sharing.⁶ The Commonwealth would not commit to substantial new funding arrangements to help the States implement the full package of reform proposals. However, it is not ruled out completely as is shown by the Terms of Reference for the Reform Council outlined above.

34. We see, then, that the national reform process is continuing but not with the same level of agreement as had characterised National Competition Policy. It is worth adding to this that our system yet to be fully tested in respect of the emerging agenda associated with climate change and the push for a national emissions trading system. This too will provide a significant inter-governmental challenge.

35. I believe the lesson from all of this is that work put into the C.O.A.G process that ensures clarity of purpose and genuine agreement on intentions can provide a framework for positive results, particularly when backed up by mutual respect and financial incentives. The alternative of the Federal Governments pursuing change in areas the traditional province of the States and without the co-operation of the States has little to recommend it from an economic or accountability viewpoint. This is why it is worthwhile to make a real effort to find the sorts of agreements that satisfy both levels of government. Only C.O.A.G can make this possible.

36. I trust I have been able to demonstrate that there is a model of federalism that merits our support. It allows for genuine differences to be aired, it ensures healthy competition and it locks in co-operation where there is mutual respect and a sharing of the financial burdens. It does, however, require a particular mindset that rejects centralisation and supports subsidiarity whilst not closing off co-operation around agreed goals. In institutional terms it would mean putting more time and effort into C.O.A.G, undertaking the roles and responsibilities review and building the concept of genuine partnership into the range of agreements between the Commonwealth and the States, including the Special Purpose Payments.

37. This is a way of thinking and a way of governing that merits our support. It is a way of conceiving of national purpose that recognises complexity and encompasses difference. This isn't understood by the economic and bureaucratic nationalists let alone the cultural nationalists. They view government through the lens of a single purpose.

38. I take heart in the fact that my former colleagues in State Government have established the Council for the Australian Federation. This body published the paper by Twomey and Withers referred to earlier. It remains to be seen whether the Federal Government that will emerge following elections later this year – whatever its political shape – will be able to reciprocate with a model of governance and policy that tackles the challenges we face by harnessing the energies of federalism.

⁶ Victorian Department of Treasury and Finance, National Reform: The Case for Sharing the Gains (July 2006), p.1