

## **It's time to repair Australia's tattered federalism**

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COAG has delivered important reforms in areas like health and water. Unfortunately, our dysfunctional federal system remains a major barrier to delivering services efficiently and at the highest quality. Until we fix the underlying structure of Australian federalism, the best we can hope for is that governments continue to quell the symptoms caused by the problem. Our 1901 Constitution was meant to establish the states as the master of the system. The Commonwealth was given power over specific areas like marriage, corporations, external affairs and defence, with everything else left to the states, including taxation, health, education and industrial relations. For the first two decades of the new nation, the High Court interpreted the Constitution to maintain the position of the states and limit Commonwealth power. This changed abruptly in 1920. In that year, in the famous Engineers' Case, the High Court overturned many of its earlier decisions. A new

approach evolved that involved a generous reading of the listed Commonwealth powers. Over time, the Engineers' Case allowed powers like those over external affairs and corporations to be extended to other areas like the environment and industrial relations something that had not been anticipated or intended by the framers of the Constitution. After the case, ideas like "federal balance" and "states' rights" became constitutional heresy. Today, they are nothing more than political slogans. Another equally significant loss for the states was in the area of taxation. It was another two decades before High Court decisions in the Uniform Tax Cases of 1942 and 1957 upheld the Commonwealth takeover of the income tax system and gave it the ability to attach conditions to the money it granted to the states.

Today the states do not raise income taxes and cannot impose taxes on goods. Their financial position is dire because they cannot raise the revenue they need to provide the services they are constitutionally expected to provide. While they have turned to new sources of taxation, such as gambling, they depend heavily on Commonwealth grants including \$45 billion of GST revenue. Federal handouts account for almost half of NSW's revenues. All the states are in the same predicament. The Commonwealth grants money with strings attached and the states have no real choice but to accept the money, thereby fulfilling the prophesy of the nation's second prime minister, Alfred Deakin, who wrote in the London Morning Post in 1902 that the states would find themselves "legally free, but financially bound to the chariot wheels of the central Government".

Australian federalism is in tatters because it is based on rules that no longer match reality. High Court decisions and canny prime ministers from John Curtin to John Howard have transformed the system. Australia now has one of the most centralised federal systems of government in the world. Despite its dominance, the Commonwealth cannot exert compete control. This has proved a recipe for buck-passing and administrative duplication which the Business Council of Australia estimates to cost at least \$9 billion a year, and probably more like \$20billion when the costs of duplication and red tape are factored in. This is 9 per cent of all general government expenses, and 3 per cent of gross domestic product. This is not just a loss to taxpayers, but a lost opportunity: every dollar squandered could have been used for schools,

hospitals, aged care or affordable housing. There is a stark choice: to continue to pay extra tax for second-rate services, or to accept the challenge and opportunity of reform and fix the system of government by a proper allocation of tax revenue and a more appropriate division of power over areas of responsibility. The answer is not to abolish the Australian territories and states. That would be unrealistic and bad policy. Few local problems can be solved by unilateral action from a national government. At least one lower tier of government is needed to help develop regional solutions and deliver services. Problems of legitimacy are another reason why federal systems evolved. People in Western Australia were the last to accept federation and, at a time of unprecedented economic success, are as unlikely to accept rule by a single government in Canberra.

While Australia's federal system of government is broken, the answer is to fix that system, not to jettison it. We should focus on pragmatic, achievable change that lowers taxes and improves the quality of government services. In the short term, there are many things that can be done to improve how our federal system works, like facilitating cooperation and re-examining finances. COAG has made an important start on this. In the longer term, the text of the Australian Constitution will also need to change. If the rules are not reformed, bad habits will resurface and blockages re-emerge. There is a need for a revised set of rules to accommodate the changes of the past century and to prepare for the next. This needs to be part of a new deal for Australia's federal system.

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