Reforming federalism without being radical

Anne Twomey describes some changes that can be achieved with a minimum of fuss

There are three main areas of our federal system that need reform. The first is the allocation of powers and functions between the levels of government. The allocation made by the framers of the Constitution in the 1890s may no longer be appropriate today. Many of the complaints of unnecessary duplication, cost-shifting and lack of coordination can be traced back to the absence of clear divisions of responsibility. The second area is Commonwealth-State financial relations, which currently provides perverse incentives for inefficiency and buck-passing. The third area is inter-governmental relations, where cooperative efforts have been thwarted by the absence of constitutional support.

The means of achieving reform vary. In some cases, reform can be achieved by non-constitutional methods, such as cooperative legislation, changes in administrative practices or simply vacating a policy field so that it can be taken over by a different level of government. In other cases, constitutional amendment is needed, requiring the approval of the people in a referendum.

The question of which level of government should be responsible for which functions often arises in highly charged political disputes. Examples include the controversy over Work Choices, concerning which level of government should control industrial relations, and the short-lived Commonwealth takeover of the Mersey hospital, concerning who is responsible for health. It would be better to take a step back from the political fray and consider these issues as a matter of principle. For example, instead of considering the content of Work Choices, one should ask which level of government is best suited to dealing with industrial relations. While good arguments could be made for either Commonwealth or State control of industrial relations, no one in their right mind would opt for the current situation in which most people fall under Commonwealth industrial relations laws, some under State laws and some in the limbo of constitutional uncertainty. The uncertainty arises from the fact that the Commonwealth’s constitutional power over corporations is confined to trading, financial or foreign corporations. Whether an incorporated body such as a local council, charity, religious school or football club is a ‘trading corporation’, with the consequence that its employees are covered by Commonwealth industrial relations laws, will depend upon a court’s assessment of whether trading forms a substantial part of its activities. In many cases, the result cannot be predicted with confidence, leaving both workers and employers unsure of their status and responsibilities.

Other areas in which the allocation of functions should be reconsidered include education and health. Instead of arguing about a hospital here or technical colleges there, we should really be thinking about what type of functions can sensibly be separated and allocated to different levels of government and which functions are so inter-related that they ought to be allocated to the one level of government. For example, in education it might be feasible for the States to become exclusively responsible for pre-school, primary and secondary education, while the Commonwealth could become exclusively
responsible for technical and higher education. On the other hand, a case could be made that the one level of government should be responsible for health care, aged care, mental health care and care for the disabled. At the moment there is too much cost-shifting in this area, with elderly people, for example, occupying State hospital beds because there are no Commonwealth sponsored aged care facilities for them. If these functions were the responsibility of one level of government, it is more likely that individuals would be given better care in the most appropriate facilities.

There are many different factors that should be taken into account in assessing how powers and functions should be allocated. Greater thought ought to be given to which types of laws and functions should be uniform across Australia and which should reflect the different needs, preferences and circumstances of different parts of Australia. One factor to consider is whether the exercise of a function by one jurisdiction has spill-over effects in other jurisdictions. For example, State environmental laws regarding rivers will affect States down-stream. If States provided unemployment benefits or pensions, there would most likely be a mass movement of the unemployed and pensioners to the State with the most generous benefits, straining services and distorting labour markets. Accordingly, the mobility of people, businesses and goods between States must be taken into account, along with other factors such as efficiencies of scale, the operation of national markets, the benefits of competition, the need for innovation and the importance of maintaining checks and balances upon power.

Where functions cannot be isolated and must be shared, it is still important to identify what roles and responsibilities are to be exercised by different governments in relation to the shared function and what mechanisms should be put in place to ensure cooperation and coordination.

Most importantly, consideration needs to be given to the principles which should guide any reallocation of powers and functions. For example, in the European Union, the principle of ‘subsidiarity’ is used in making these assessments. It provides that functions should, where practical, be allocated to the lowest level of government competent to fulfil them. The aim is to take the functions of government as close to the people as possible, so that they reflect community preferences and local conditions. This means that if a function is to be exercised at a higher level of government, the economic, social or practical reasons to support that case must be made out.

How one goes about conducting a process to reallocate powers and functions amongst levels of government will depend upon whether the constitutional or non-constitutional route for implementation is proposed.

Much could be achieved by the non-constitutional route if there were agreement between the Commonwealth and the States on which functions should be exercised by which level of government. The powers allocated by the Constitution to the Commonwealth are, thanks to the High Court’s interpretation, very broad indeed. Most Commonwealth powers are concurrent, meaning that both the Commonwealth and the States can legislate on the subject, but the Commonwealth law prevails in the case of inconsistency. If it
were agreed that a function should be transferred from Commonwealth control to State
control, this could be achieved in practice by the Commonwealth repealing its legislation
concerning the subject area and voluntarily vacating the field, both administratively and
financially. The States would then be free to exercise the function without any
Commonwealth interference.

Alternatively, if it were agreed that a State matter should be transferred to
Commonwealth control, there is a constitutional provision which allows the States to
legislate to refer State matters to the Commonwealth Parliament. The use of this
mechanism gives the Commonwealth Parliament an additional head of legislative power
over the referred matter. It has been used to expand Commonwealth power over matters
such as family law, corporations and anti-terrorism. It was even used by the Kennett
Government to refer Victoria’s industrial relations jurisdiction to the Commonwealth in
1996.

By using these two methods, the exercise of most functions could be rearranged. To
achieve this, one would need the agreement of all governments, which could be reached
through an inter-governmental process. Parliamentary support would also be required to
refer State matters to the Commonwealth Parliament or to fulfil any agreement that the
Commonwealth would withdraw from a field and not legislate in relation to it.

An advantage of this approach is that it does not entail the cost and uncertainty of a
constitutional referendum. Negotiations can be kept behind closed doors and confined to
the political players. This means that an agreement is more likely to be reached and
implemented. The disadvantages, however, are significant. First, if only the political
players were involved and negotiations took place in private, the agreement would more
likely be based on short-term political interests rather than principle and practicality.
Secondly, any agreement would be fragile at best and likely to be disowned as soon as
there was a change of government at either level, if not before. The States, given their
financially and politically vulnerable position, would find that whatever was given up
would be lost forever, and whatever was gained in exchange would be a transitory
benefit, soon lost.

The alternative is to contemplate constitutional change. The advantage is that once the
Constitution is amended it will continue to bind all governments in the future, until such
time as it is formally amended again (unless it is neutered by High Court interpretation).
Constitutional change also permits a wider range of options to be considered and allows
matters to be dealt with directly rather than by circumlocutions designed to get around
existing constitutional provisions. A third advantage of choosing constitutional change is
that the process used for agreeing on proposed changes must be more considered and
more inclusive.

Constitutional change at the national level requires a referendum approved by a majority
of voters overall and a majority of voters in four out of six States. Only eight out of
forty-four referenda have succeeded. The lessons from past failures tell us that both the
nature of the proposed constitutional amendment and the way in which it was developed
must be acceptable to the people if it is to succeed. A political deal supported by governments of one political party is unlikely to secure the required support. Not only is bipartisan support needed, but voters must also be convinced that the proposal was generated from careful and principled consideration and will benefit Australia as a whole, rather than particular governments or political parties. Another critical element is the extent to which voters feel that they were involved, or had an opportunity to be involved, in the generation of the proposal.

For these reasons, the Governance group at the 2020 Summit proposed a three stage process for the reallocation of powers and functions amongst the tiers of government. First, it proposed that an expert body be established to gather and analyse all the evidence that would be needed to make a principled and practical reallocation of powers and functions. It would do the intellectual spadework and prepare a range of specific alternative proposals. Secondly, this material would be put to a constitutional convention, incorporating members of the broader public, for its consideration. This would be the stage at which the public could make contributions, directly or indirectly, to the development of proposals for constitutional amendment. The intention is to prevent the Convention from floundering in generalities and arguments at cross-purposes, as so often happens with such bodies, by ensuring that it would be informed by hard evidence and analysis and debate specific proposals. If given sufficient time and support, unlike the 2020 Summit, such a Convention could make substantive and considered proposals that would be likely to be regarded as more acceptable by the public than those usually served up in referenda.

The third stage of this process, as proposed by the Governance group, was the implementation stage, which would involve a referendum for the constitutional measures and a package of reforms by inter-governmental agreement, legislation or administrative action for those details that it is not appropriate to include in a Constitution. None of this could be achieved, in practice, without bipartisan support. Politicians from all sides must therefore also be involved in the process of generating federalism reforms and be sufficiently persuaded by the case for reform and the public support for it, to put aside partisan politics and give their support.

The constitutional option is less useful with respect to Commonwealth-State financial relations. Although the Constitution has a significant impact on Commonwealth-State financial relations by, for example, giving the Commonwealth exclusive power to impose an excise, any referendum that proposed to increase State taxing powers would be likely to fail. In any case, very few taxes can be levied efficiently at the State level, so this would not be a particularly practical solution even if it were achievable.

At the moment, GST revenue accounts for 58% of Commonwealth payments to the States. These are unconditional grants that can be used as the States choose. However, the remaining 42% of Commonwealth payments to the States comes in the form of ‘specific purpose payments’, which are grants to which conditions are attached. It is through these conditional grants that the Commonwealth intervenes in State policy, causing duplication and costly administrative burdens in accounting for the use of
Commonwealth funding and satisfying the numerous attached conditions. Many specific purpose payments require the States to give ‘matching funding’, tying up around 30% of State budget outlays. This results in the over-funding of some functions and the under-funding of others. Specific purpose payments also create perverse incentives for inefficiency, because the money granted cannot be transferred to other uses if means are identified of providing the funded service more efficiently. These funding and policy constraints lead to people falling in the gaps between funded programs or being given services that are inappropriate to their needs.

The best solution would be to get rid of conditional grants altogether and replace them with an unconditional flow of revenue as part of an expanded tax-sharing plan. This should take into account any reallocation of the powers and functions of the States. Given that the Commonwealth is unlikely to relinquish its financial control over the States, the next best approach would be to reduce the number of specific purpose payments and the conditions placed on them, ensure that any conditions relate to the outcomes of the funded program, simplify the administration of grants and apply grants to wider fields so that the money can be moved around within the field according to where the need is greatest. Reforms also need to be made to the way that the Commonwealth Grants Commission assesses how GST and other grants are allocated among the States, to prevent States manipulating the system by altering their tax arrangements in order to gain a greater percentage of Commonwealth revenue. The current problems with the ‘gaming’ of grants are the consequence of the excessively complex and opaque system applied by the Grants Commission.

Finally, action needs to be taken to support inter-governmental cooperation. The High Court has thwarted such cooperation in the past, striking down the cross-vesting cooperative scheme which permitted courts to hear all aspects of disputes before them, regardless of whether they involved federal or State jurisdiction. It has also undermined the ability of the Commonwealth and the States to establish cooperative legislative and administrative schemes that are enforced by a single level of bureaucracy at the Commonwealth or State level. Cooperative federalism has been regarded by the High Court as no more than a ‘political slogan’ as there are no constitutional provisions that expressly support it. The Constitution needs to be amended to include provisions that permit cooperative measures, such as cross-vesting and cooperative legislative schemes.

This is an issue that has received bipartisan support in the past, as well as support at both the State and Commonwealth levels. However, it has not been put to a referendum because of an assumption that the subject-matter is so dry and technical that people will turn off and vote ‘No’. This assumption may not necessarily be correct. The types of referenda that have succeeded in the past have often been the dry and technical ones, such as the retirement age for judges or the taking over of State debts. Cooperation between governments is generally regarded as something to be applauded rather than rejected. A referendum to introduce into the Constitution support for cooperation might well succeed and would be a good first step towards more substantial federalism reforms.
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