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# Tony Abbott should flesh out plan to fix federalism

**HENRY ERGAS** THE AUSTRALIAN JANUARY 07, 2013 12:00AM

**BOB Hawke wants to abolish the states because he believes the commonwealth would provide services more efficiently.**

Presumably, the paragons of service delivery he has in mind are the Collins submarine, the Mersey hospital, pink batts and the National Broadband Network.

But however easy Hawke's claims are to ridicule, they highlight the malaise surrounding Australian federalism. Little loved at the best of times, our federalism's ungainly structure is more tolerated than admired. All too often, its supporters, typically those in power in the states, are driven by convenience rather than conviction. And as its problems accumulate, it survives less through a sense of purpose than as an uncomfortable legacy of distant history.

Yet federalism should be more than a vestige of the process that led to the formation of the Australian Commonwealth. At least in principle, it can make for better government by allowing for competition between the states, weakening the monopoly each government exercises over its citizens. And the diversity it permits gives states the ability to tailor services to electorates' preferences and changing circumstances, reducing the risk of a "one size fits all" approach predominating. Especially where jurisdictions are reasonably comparable, as they are in Australia, diversity also allows citizens to benchmark their government against others: and if performance is found wanting, they can vote with their ballots or their feet. Finally, federalism creates scope for experimentation, since "a single courageous state", in justice Louis Brandeis's words, "may serve as a laboratory, and try social and economic experiments without risk to the rest of the country".

Discussed in the Federalist Papers, those aspects of federalism were elaborated by James Bryce in his classic work, *The American Commonwealth*, which J. A. La Nauze described as "the compulsory reading of the framers of the Australian constitution". Delegate after delegate to the constitutional conventions of the 1890s therefore stressed the value of encouraging "varied local development" by limiting the role of the new federal government. Doubtless, many delegates were partly motivated by the desire to preserve their own power bases; but the federal commonwealth they designed reflected a keen appreciation of federalism's benefits.

Nor is there much doubt that Australian federalism has proved its worth. Most recently, microeconomic reform, which has underpinned two decades of prosperity, would not have occurred without the Kennett government's pioneering efforts in areas ranging from restructuring public utilities to hospital financing.

But it is not merely economic policy that has gained. Rather, the greatest benefits have been to Australian democracy, as the diversity of loci of power has tempered Westminster's winner-takes-all system of government. A unitary Australia, lacking the checks and balances provided by the multiplicity of states and a geographically-based upper house, would experience greater policy instability and veer more readily between extremes.

Indeed, it is unlikely such a purely unitary system could survive. Rather, unbridled central power would eventually provoke a fierce reaction. In New Zealand, that took the form of the 1996 shift to proportional representation, which made it impossible for either major party to ever govern in its own right.

As a result, the choice, if there is one, is not between our federalism and an idealised unitary state; it is between inherently imperfect alternatives, where the unitary option, hoisted on so large a country, could prove less efficient, less democratic and less durable.

But that doesn't mean our federalism needs to be quite as imperfect as it is. At the heart of its weakness is the persistent failure to address its fiscal foundations.

There is nothing inherently undesirable in central government collecting revenues on which sub-national jurisdictions depend: on the contrary, vertical fiscal imbalance is often efficient, particularly when it allows the taxation of mobile tax bases and reduces the costs of tax collection and compliance. But it is inherently undesirable for that imbalance to make state revenues unpredictable, subject to central government whims and accompanied by diktats that intrude on state responsibilities, override local preferences and muddy accountabilities.

These are not flaws to which there are easy solutions. But Canada's experience suggests we could do better.

With the federal compact crucial to its survival, Canada has evolved a fiscal federalism that ensures its provinces have viable revenue bases, including through preset tax-sharing rules. Moreover, its central government has been willing to stay clear of functions, such as education, where the provinces have a comparative advantage. And though Canada's constitution (unlike Australia's) mandates fiscal equalisation between the provinces, it has been more limited than our own and more respectful of the incentives for structural adjustment.

There is no prospect of the Gillard government undertaking the reforms a move in the Canadian direction requires. As the mining tax debacle showed and Hawke's comments confirm, it is not federalism, which Labor opposed from its earliest days, but unthinking centralism that still flows most readily through the ALP's veins.

Unfortunately, Tony Abbott, too, is not an instinctive federalist. But his recent statements are promising, especially in committing to reform the allocation of spending functions between the commonwealth and the states. He could fruitfully pursue that along the lines of the Canadian comprehensive "program review" of the 1990s, in which the central government withdrew from areas of costly duplication.

Those changes, however, must be accompanied by a credible program of tax reform, extending the GST agreement into new revenue sources, potentially including the income tax and (as suggested by the Henry review) a business cashflow tax. As for the Council of Australian Governments and its secretariat, they should be scrapped or completely reformed, and COAG's workload drastically streamlined, if any progress is to be made on the issues where co-ordination is genuinely required. On all that, Abbott has so far had little to say.

Ultimately, Australia's federalism is a poorly used opportunity. Like the camel, its gawkiness makes it the butt of jokes about being a horse designed by a committee. Yet camels survive in environments horses could never withstand. If Australia's federalism has endured, it is because it, too, has unique strengths. And with constitutional change so difficult, it is the system we have and will continue to have.

But its hardiness cannot justify allowing its problems to fester. Abbott has taken the first steps to explain what he would do; now he must flesh his program out.