

# Australian Fiscal Federalism



Federalizing Process in Italy 2010

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# The Federal Idea

1. Potential for diversity is a central value
2. Diversity requires maximal appropriate local control (subsidiarity)
3. Tasks should be assigned to level of most approximate scale (fiscal equivalence)
4. Effective local autonomy and accountability requires reasonable degree of fiscal autonomy

Commonwealth of Australia Constitution Act.

**A N A C T**

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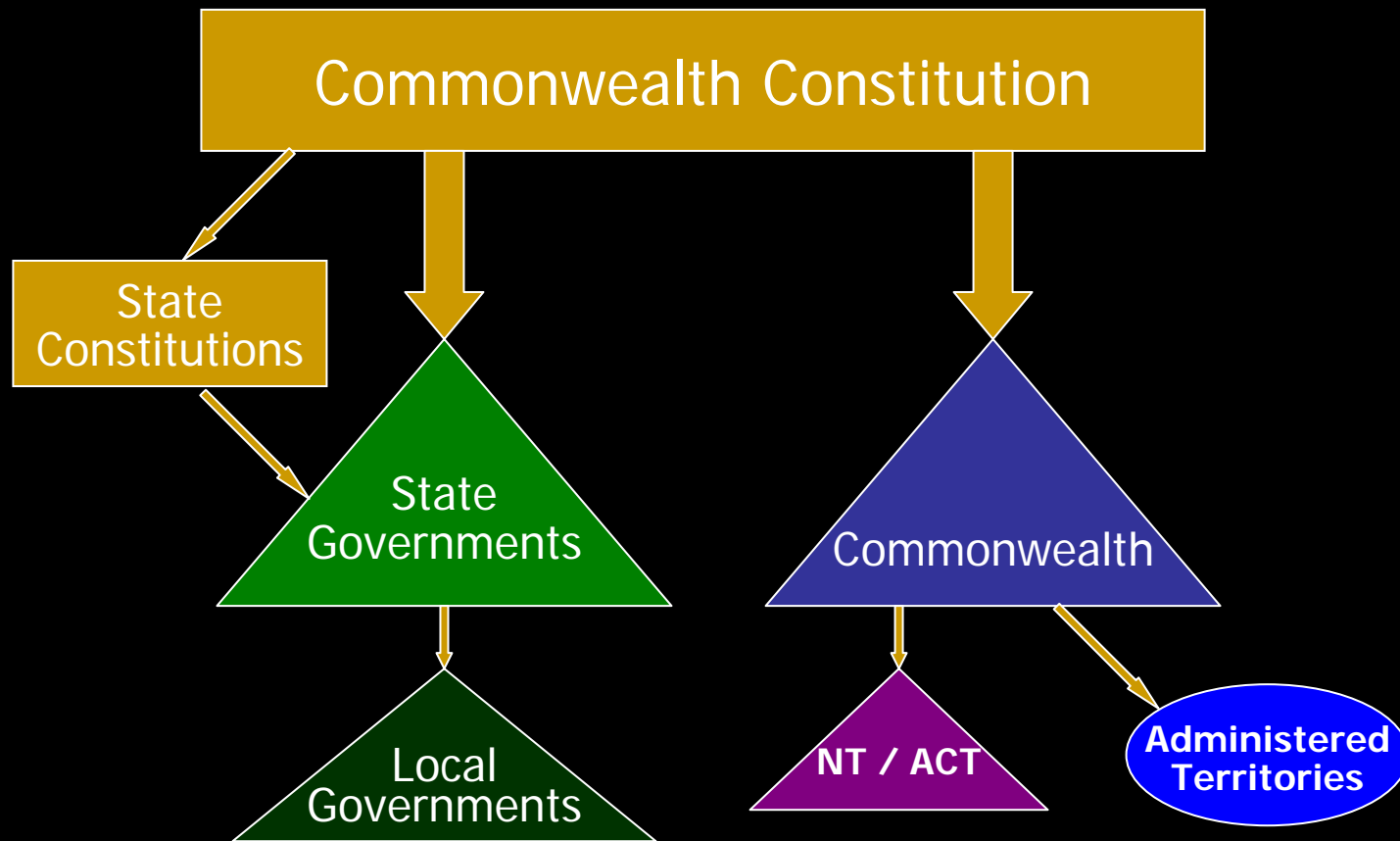
Constitute the Commonwealth of Australia.

*Cap 12*

*[9<sup>th</sup> July 1900]*

- Drafted by democratically-elected conventions; adopted by popular referendum in each Colony; enacted by the UK Parliament in 1900; operational 1 January 1901.
- Formally amended via the required national referendum process 8 times (of 44 proposed).
- Only 1 amendment of fiscal relations and 1 wide-ranging amendment to the division of competencies

# Created Classic Federal Structure



# Composition

- Six original States:
  - Two 'large' States (NSW & Victoria)
  - Two resource-based States (Qld & WA)
  - Two 'small' States (SA & Tasmania)
- Two self-governing Territories:
  - Northern Territory (since 1978)
  - Australian Capital Territory (since 1987)

# Some Basic Characteristics

- 'Aggregative' rather than devolutionary origins
- 'First generation' federation with a pre-industrial division of powers.
- Legislative division of powers rather than administrative division of functions
- Regionally homogenous society with highly symmetrical federal system

# Following the US model: the 'single list' approach to dividing powers

- Enumerated powers of parliament
  - s. 51. "The Parliament shall...have power to make laws...with respect to:-"
    - then enumerates 39 (now 39½) matters.
  - An exhaustive and concurrent list
- 'Residual powers' guaranteed to States
  - "Every power of the Parliament of a Colony which has become or becomes a State, shall, unless it is by this Constitution exclusively vested in the Parliament of the Commonwealth... continue as at the establishment of the Commonwealth...."

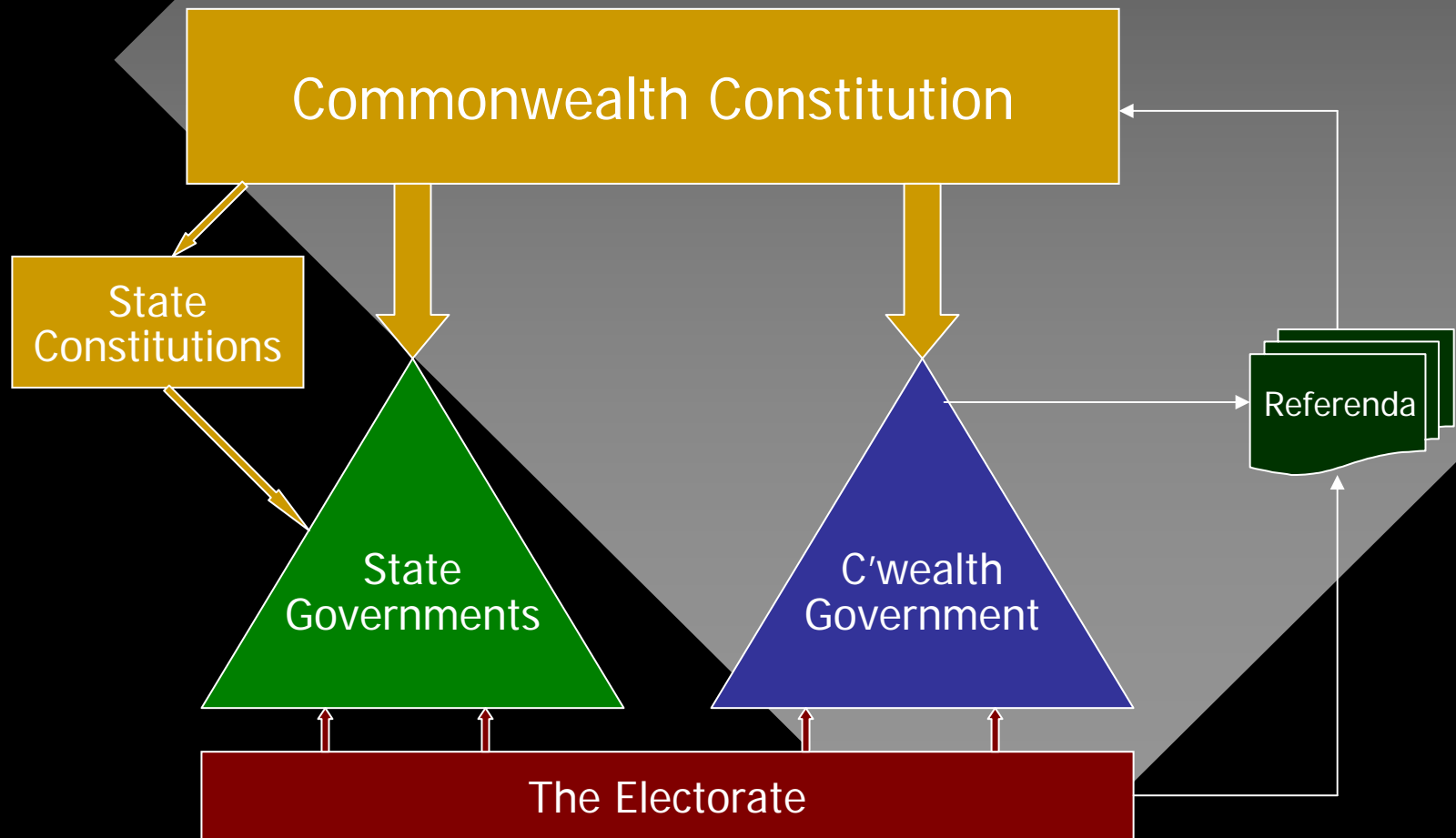
# What was Assigned to the Commonwealth?

- international & *inter*-state trade
- communications
- currency
- quarantine; immigration
- defence; external affairs

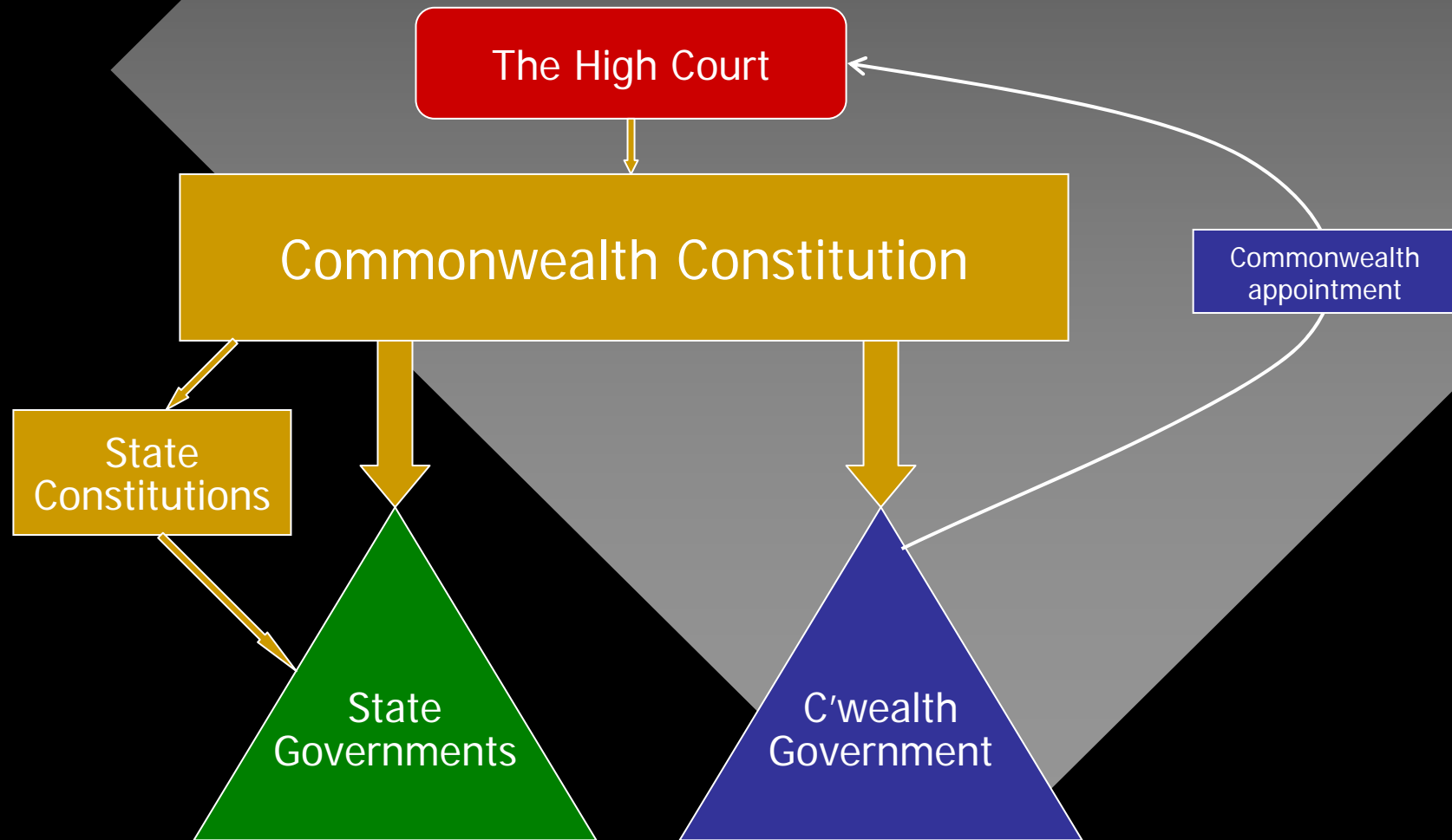
# What Remained with the States?

- *intra*-state trade & commerce
- infrastructure & local government
- resources; land use; environment
- criminal + civil law; police
- health care
- social policy (except OAP)
- education

# A 'Federal' Amending Procedure?



# *Quis custodiet ipsos custodes?*



# The Constitutional Division of Fiscal Powers

Commonwealth	v.	States
An explicit plenary power to tax	v.	In implicit plenary power to tax – with exception of “customs and excise”
Supremacy clause		
Defence power		
Granting power		

# The Commonwealth's Only Exclusive Revenue Powers

- Concerning taxation:
  - s.90: "...the power of the Parliament to impose duties of customs and of excise...shall become exclusive."
- Immediately created substantial Commonwealth surplus in period of reliance on tariff revenue.
- Interpreted broadly by the High Court as a general prohibition on sales taxes.

# The Commonwealth's 'spending power'

- Section 96:
  - "...the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit."

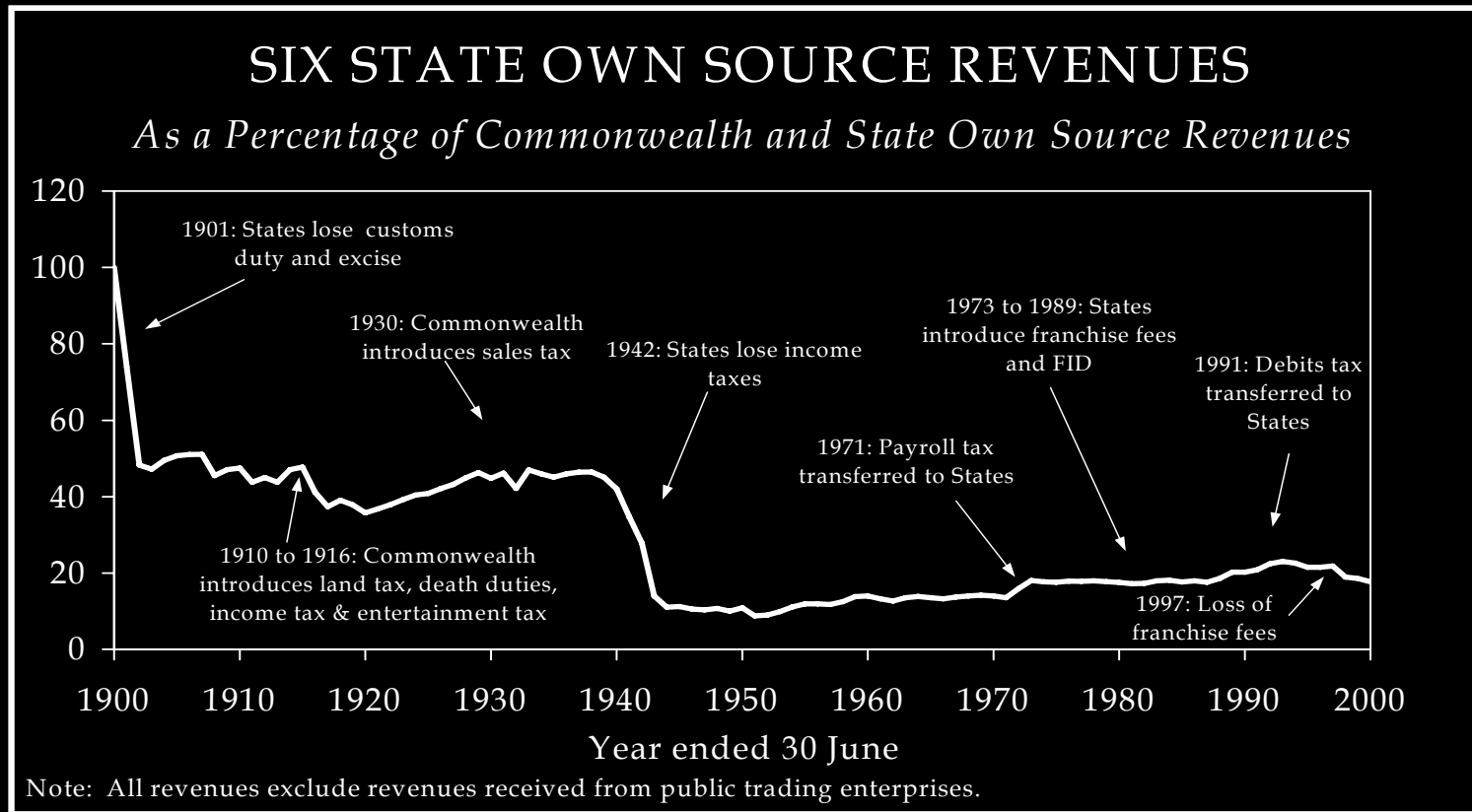
# The Turning Point

- Income tax a concurrent power and the States dominated income tax collection
- Commonwealth's war-time need for revenue
- States forced to vacate the field or lose money granted under s.96

# Who Now Controls What?

<b>Commonwealth</b>	<b>v.</b>	<b>States</b>
Personal Income Tax (entire)	v.	Payroll tax
Corporate Income Tax (entire)		Stamp duty
Sales Tax (entire)		Gambling taxes
Resource rents (offshore)		Resource rents (terrestrial)
Excise Taxes (entire)		Property & Estate

# Revenue Centralisation



# Vertical Fiscal Imbalance

- Commonwealth now raises 82% of total govt tax revenue.
- States rely on transfers for average 50% of revenue.
- Since 1970s, transfers split roughly equally between:
  - General purpose payments (unspecified)
    - \$42 000 000 000 in 2009–10
  - Specific purpose payments ('tied grants')
    - \$50 000 000 000 in 2009–10

# What Does the Commonwealth do with all that Money?

- It implements a strict and comprehensive *horizontal fiscal equalisation* (HFE)
- It indulges in extensive policy direction in virtually all areas of State jurisdiction

# HFE

- Australia has no constitutional or statutory requirement (or mandate) for HFE.
  - Though s.96 granting power has some implication
- In 1933, the electors of Western Australia voted overwhelming in a plebiscite to secede from the Commonwealth.
- A few months later, the Commonwealth Grants Commission was created.

# How Would Things Look Without HFE?

- “...if all States and Territories had adopted the same revenue and service provision policies in 2006–07, per capita own-source revenue would have ranged from \$1847 (Tasmania) to \$3852 (Western Australia) and per capita expenses from \$5227 (Victoria) to \$14 535 (Northern Territory).”
- Mineral resource revenues the single biggest cause of fiscal disparities.

# How Much Does Australia Equalise?

- “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 standard.”

# The CGC's Formula for HFE

- Estimate the revenue-raising capacity of each jurisdiction.
- Estimate the expenditure burdens of each jurisdiction.
- Distribute the general purpose payments so as to ensure that each jurisdiction has equal fiscal capacity given its cost and revenue profile.

# Winners and Losers

- Four States net contributors
  - The two 'large' States of NSW & Victoria
  - The two resource States of Qld and WA
- The two 'small' States and the two Territories (NT enormously so) net beneficiaries

# Tied grants

- Began with roads in the 1920s
  - then schooling in the 1950s
- Greatly expanded in 1970s:
  - universities
  - health
  - local government
- Further expanded in the 1990s
  - environment
  - vocational training

# Specific Purpose Payments: conditionality

- Mandated purpose
- Matched funding requirements
- Administrative conditions
- Policy/political conditions

# What Remains of the States' Exclusive Jurisdiction?

- Intrastate trade?
- Infrastructure & local government?
- Resources & land use?
- Police?
- Health?
- Education?
- Community services?

# Reforming Federal Financial Relations in Australia

1. Reforming the general purpose transfer arrangements:
  - Howard govt's introduction of the GST in 2000.
2. Reforming the specific purpose transfer system:
  - The Rudd govt's new model for SPPs in 2009.

# The Goods and Services Tax ('GST')

- s. 90 prohibition meant that there was no retail sales tax anywhere in Australia for the first 99 years of federation.
- National VAT ('GST') legislation enacted by Parliament in 1999.
- GST began operation 1 July 2000.

# The GST and the “Reform of Federal Financial Relations”

- GST endorsed by the States and Territories in *Intergovernmental Agreement* of 1999.
- All net revenues hypothecated (by C’wealth legislation) to the States.
- Replaced the general purpose payments (FAGs) that had previously been determined as part of Commonwealth’s annual budget process.

# Reforming Tied Grants: out of the frying pan?

- 97 different SPPs 'broadbanded' into 5 general categories
- Input and output requirements removed
- Transferred via State Treasuries rather than directly to individual line departments in the States

## ... and into the fire?

- Commonwealth adds new conditional grants called “National Partnership Payments” (old tied grants in new guise).
- States must sign up to outcomes agreements
  - Performance monitoring and benchmarking
- Some of the biggest problems remain
  - Notably health