

The Future of Australian Federalism — Following the Money

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Introduction

Money is the key to Australia's federal system. Money was one of the main catalysts for bringing the colonies together in a federation but also the 'lion in the path' to federation. Money has transformed the power relations between the constituent parts of the federation and is the root cause of most of the complaints about the operation of our federal system. Unsurprisingly, money is also the driver for the reforms to federalism that are currently being implemented by the Rudd Government, and will be the key to the future of Australian federalism.

Federation and Financial Control

When the federation movement stalled after the 1891 Constitutional Convention it was revived in the mid 1890s by 'federation leagues' of people living on the border between Victoria and New South Wales. They resented paying money in customs duties and excises when goods were transported across the Murray. Issues concerning free trade and excise played a major role in both the Constitutional Convention debates¹ and in popular debate about the merits of federation. One of the main arguments against federation made prior to the first federation referendum in New South Wales was that the citizens of New South Wales would end up paying more tax to support the citizens of the less populous States.²

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¹ See Cheryl Saunders, 'The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution', in G Craven (ed.), *The Convention Debates 1891–1898: Commentaries, Indices and Guide* (Legal Books, Sydney, 1986) p 149, at 151. Saunders notes that the debate on finance and trade during the Melbourne session of the Convention occupied almost one third of the 2500-odd pages of proceedings.

² Helen Irving, 'New South Wales', in H Irving (ed.) *The Centenary Companion to Australian Federation* (Cambridge University Press, 1999) 20, at 76.

A financial compromise was cobbled together by the colonies. It was specific about some matters but entrusted others to the Commonwealth Parliament to resolve in the future. The financial structure established by the Constitution was as follows. First, s 88 provided that uniform duties of customs shall be imposed within two years. Once this occurred, s 90 stated that the power to impose duties of customs and excise then became an exclusive power of the Commonwealth. Section 92 then required that trade and commerce between the States be ‘absolutely free’. At the time of federation, customs and excise duties were the primary source of revenue for the colonies. It was therefore recognised, prior to federation, that the consequence would be that the Commonwealth, which was to be a government of limited powers and functions, would be vastly over-funded with revenue while the States, which would retain the expensive service-delivery functions, would not have adequate revenue to fulfil their responsibilities. Samuel Griffith noted at the 1891 Constitutional Convention that the ‘great difficulty’ peculiar to the proposed Commonwealth Constitution was that the Commonwealth would take over ‘a very small part of the expenditure’ while receiving ‘an enormous annual surplus of many millions, which it could not retain or expend, but must return to the different states’.³ Vertical fiscal imbalance was therefore built into the federal structure from the beginning. It was no accident, but nor was it a preferred outcome.⁴

The framers of the Constitution were particularly concerned that a ‘government with a large surplus will develop a system of waste and extravagance’ and considered that one should keep the temptation of a surplus ‘out of the hands of the Federal Treasurer’.⁵ Charles Kingston noted that ‘there is nothing which conduces more to the reverse of sound finance and good government than an overflowing Treasury.’⁶ They recognised that vertical fiscal imbalance was therefore not only a threat to the States and their capacity to function, but also a risk to the proper economic management of the Commonwealth — both of which has proved to be the case.

The framers of the Constitution dealt with this problem by inserting short-term and long-term measures. In the short-term, s 87 provided that for the first ten years after federation, the Commonwealth was to apply no more than a quarter of the net revenue from duties of customs and excise to its own expenditure. The rest was to

³ *Official Report of the National Australasian Convention Debates*, Sydney 1891, p 528.

⁴ The ‘unwisdom’ of giving to a legislature money that it had not raised was noted by Sir George Turner: *Official Report of the National Australasian Convention Debates*, Adelaide, p 45.

⁵ *Official Report of the National Australasian Convention Debates*, Sydney 1891, p 805, per Sir John Bray and Adelaide 1897, p 45 per Sir George Turner. See also: Cheryl Saunders, ‘The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution’, in G Craven (ed.), *The Convention Debates 1891–1898: Commentaries, Indices and Guide* (Legal Books, Sydney, 1986) p 149, at 163.

⁶ *Official Report of the National Australasian Convention Debates*, Melbourne 1898, p 864, per Mr Kingston.

be paid to the States or applied towards the payment of interest on State debts taken over by the Commonwealth. Accordingly, for the first decade of federation the States retained an income flow amounting to three-quarters of the Commonwealth's customs and excise revenue.

One of the critical questions was how that money was to be returned to the States. Was it to be allocated amongst the States by reference to their populations, or was it to be allocated by reference to the amount of revenue raised from the particular State by way of tax? At the Constitutional Conventions this was an extremely contentious issue with provisions being amended to accommodate one view or the other. In the end, s 89 provided that what became known as the 'book-keeping method' should apply for the period prior to the imposition of uniform duties of customs. This meant that the Commonwealth credited each State with revenue collected in it by the Commonwealth and debited each State for Commonwealth expenditure with respect to that State, and was required to pay the balance to each State on a monthly basis. After uniform duties of customs were imposed, s 93 applied for the next five years. It continued to apply the book-keeping method, so that the money returned to the States took into account the amount raised in the State and expenditure with respect to the State.

After this period of 5 years, then s 94 applied. It was the long term provision which left it up to the Parliament to decide 'on such basis as it deems fair' how the monthly payments of the Commonwealth's surplus were to be distributed amongst the States. The intention was to move to a population-based distribution, as soon as it was fair to do so. The framers, however, were unable to predict future economic circumstances, so they were prepared to leave it to the Parliament to assess how the distribution should be made after five years from the imposition of uniform duties.

Section 94 is also critical, however, as it is the provision that sets out (or perhaps more accurately, assumes) the right of the States to the Commonwealth's surplus in the long term. It provides that after the five year period expires 'the Parliament may provide, on such basis as it deems fair, for the monthly payment to the several States of all surplus revenue of the Commonwealth'. As s 81 of the Constitution limited the Commonwealth Parliament to appropriating revenue 'for the purposes of the Commonwealth',⁷ and those purposes were limited to matters within Commonwealth legislative and executive power, it was anticipated that there would always be a significant surplus and that it would be paid regularly to the States.

While the word 'may' in s 94 looks to modern eyes as if it is merely a matter of discretion as to whether the Commonwealth should pay this money to the States, the Convention Debates and contemporary commentaries show that the level of discretion was only directed at *how* the surplus should be distributed amongst the States (i.e. whether it should be distributed per head of population or by reference to

⁷ The High Court has since taken a broader view of the meaning of 'purposes of the Commonwealth': *Victoria v Commonwealth and Hayden* (1975) 134 CLR 338.

the amount of revenue collected from the State) rather than *whether* it should be distributed.⁸ Quick and Garran noted that although ‘the basis of fair apportionment [of the surplus between the States] is left to the Commonwealth, two things are laid down by the Constitution: (1) that all surplus revenue must be paid to the States; (2) that such payments must be made monthly’.⁹ Harrison Moore noted that the ‘Constitution thus confers on the States a definite legal right to the “balance” of revenue over expenditure’.¹⁰

In 1908 the Commonwealth decided to avoid its financial responsibilities by appropriating all its revenue to trust and other funds so that there was no surplus to distribute to the States.¹¹ The validity of its action was upheld by the High Court.¹² The Commonwealth has not had a surplus since 1908, divesting the States of their legal right to such funds. While the Commonwealth Government in May 2008 boasted of an anticipated budget surplus of \$21.7 billion for the 2008–9 financial year,¹³ its efforts to squirrel this surplus away in various funds have as much to do with depriving the States of the money to which they are otherwise constitutionally and legally entitled as they do with long-term planning.

The States retain their legal right to the Commonwealth’s surplus. As was noted by Chief Justice Barwick in 1975:

[A]lthough the undoubted demands on the Consolidated Revenue Fund including the amount of grants under s 96 may reduce in present times the extent of surplus revenue, the right of the State to the distribution of such surplus revenue remains. Whilst s 94 is expressed in facultative rather than mandatory terms, if there is at any time surplus revenue which the Commonwealth may not appropriate and expend, the

⁸ *Official Report of the National Australasian Convention Debates*, Sydney 1891, pp 528–9. See also the changing approaches of the Convention discussed in: Cheryl Saunders, ‘The Hardest Nut to Crack: The Financial Settlement in the Commonwealth Constitution’, in G Craven (ed.), *The Convention Debates 1891–1898: Commentaries, Indices and Guide* (Legal Books, Sydney, 1986) pp 149–169. It must be remembered that in the final draft Constitution adopted by the Constitutional Convention in 1898, s 87 provided that three-quarters of all revenue from customs and excise had to be returned to the States in perpetuity. Section 94, as drafted, focused more on how this money, as part of the surplus, was to be distributed. Section 87 was altered at the 1899 Premier’s Convention to limit its application to an initial 10 years, with its continuing application being subject to the will of Parliament. No alteration, however, was made to s 94.

⁹ J Quick and R Garran, *The Annotated Constitution of the Australian Commonwealth* (1901, Legal Books reprint), p 865.

¹⁰ Sir W Harrison Moore, *The Constitution of the Commonwealth of Australia*, (2nd edn, 1910, Legal Books reprint), p 533, referring to *Tasmania v Commonwealth and Victoria* (1904) 1 CLR 329, per Griffith CJ at 340.

¹¹ Denis James, ‘Federal–State Financial Relations: The Deakin Prophecy’, in G Lindell and R Bennett, *Parliament — The Vision in Hindsight* (Federation Press, Sydney, 2001) 210, at 215–6.

¹² *New South Wales v Commonwealth* (1908) 7 CLR 179.

¹³ Commonwealth Treasury, Budget Paper No 1, May 2008.

practical effect must be that that surplus can only be and will be made available to the States, though the Parliament may determine the basis of its distribution.¹⁴

While there is no point in the States crying over lost surpluses of decades past, the point that should be drawn from this piece of constitutional history is that it was always intended that Commonwealth revenue was to be shared with the States. Vertical fiscal imbalance was to be ameliorated in its effects by tax-sharing, as is the case in many other federations. The revenue that the Commonwealth reaped, be it from excise or other sources such as income tax,¹⁵ was always anticipated to be greater than the Commonwealth's limited needs and was ear-marked for return to the States. The Commonwealth surplus was not meant to be the Commonwealth's exclusive treasure trove, to be paid out in pre-election pork-barrelling or to be used to bribe or manipulate the States. If we could move away from the notion of this being the 'Commonwealth's money' to it being the money of the people of Australia, to be distributed in the manner that best meets their needs, then this would be a major step towards making our federation work better and in accordance with the manner in which it was originally intended to operate.

Federalism and Economic Efficiency

There are many myths about federalism. It is often argued that federalism is necessarily an inefficient system of government and that it is impossible to compete in this globalised world while being a federation. This ignores the fact that of the G8 nations, which have the largest economies in the world, half of them are federations (the United States, Canada, Germany and Russia) and the other four (France, Italy, the United Kingdom and Japan) have been involved in decentralising or devolving power to sub-national units in recent years.

Over the last 50 years, the economies of federal countries have consistently outperformed the economies of unitary nations. Federations tend to be more economically efficient than unitary nations because of the benefits of competition over monopoly. If one compares federations with unitary nations, one discovers that the proportion of the workforce that is comprised of public servants is higher in unitary nations than federations and the relative size of public expenditure is also higher in unitary nations than federations.¹⁶

¹⁴ *Victoria v Commonwealth and Hayden* (1975) 134 CLR 338, per Barwick CJ at 358.

¹⁵ After the States lost their ability to impose excises, they developed income tax as their main source of revenue. This source of revenue was taken over by the Commonwealth in 1942 'for the duration of the war', but was not returned to the States. See: *South Australia v Commonwealth* (1942) 65 CLR 373; and *Victoria and NSW v Commonwealth* (1957) 99 CLR 575.

¹⁶ See the statistics and analysis set out in A Twomey and G Withers, *Australia's Federal Future*, Federalist Paper No 1, April 2007, pp 12, 13, 21 and 40–42.

Another constant refrain is that Australia has too many levels of government and that Australians are the most over-governed people in the world, with too many politicians. In neither case do the statistics back the claims. Again, all the G8 nations have at least three tiers of government, and in some cases, four. In terms of geographical size, all countries that are larger than Australia are federations with at least three tiers of government, except for China which is regarded as a quasi-federation. In terms of Australia's population, most countries with a broadly comparable population (eg Chile, Malaysia, Netherlands, Romania and Venezuela) have at least three tiers of government. Similarly, democratic countries with much smaller populations (such as Austria, Belgium, Greece, New Zealand, Sweden and Switzerland) also have at least three tiers of government. It is, indeed, extremely difficult to find any democratic countries with fewer than three tiers of elected government.

*Tiers of Government*¹⁷

<i>Country</i>	<i>Population</i>	<i>1st tier National</i>	<i>2nd tier State/Province</i>	<i>4th tier Districts/Regions</i>	<i>3rd tier Local</i>
Australia	21,446,187	1	6 States, 2 Territories		673
Austria	8,340,924	1	9 Provinces		2300
Belgium	10,666,866	1	10 Provinces		589
Canada	33,401,300	1	10 Provinces		3160
Chile	16,763,470	1	15 Regions	53 provinces	345
France (metropolitan)	64,473,140	1	22 Regions	96 departments	36,679
Germany	82,169,000	1	16 Länder	439 districts	12,320
Greece	11,215,000	1	13 Regions	51 prefectures	272
Italy	59,619,290	1	20 Regions	110 provinces	8101
Japan	127,690,000	1	47 Prefectures		3100
Malaysia	27,730,000	1	13 States (3 territories)		151
Netherlands	16,456,600	1	12 Provinces		496
New Zealand	4,281,800	1	12 Regional Councils		74
Romania	21,528,600	1	14 Counties		3166
Russia	141,900,000	1	89 Regions		12,215
South Africa	47,850,700	1	9 Regions		284
Sweden	9,234,209	1	21 Counties		290
Switzerland	7,647,600	1	26 Cantons		2867
United States	305,421,000	1	50 States		87,849

¹⁷ In the absence of an authoritative and current source, this table is assembled from information gathered from the internet, and therefore may not be completely reliable or up-to-date. It is, however, at least indicative of the tiers of government in comparable countries. In assembling this information, an effort has been made to exclude levels of government that are merely administrative in nature and do not have elected representatives. I have not yet found a Western democratic country that has only two tiers of government, but this is not to say that one does not exist. Population statistics were taken from Wikipedia — 'List of countries by population', linked to official government sites.

United Kingdom ¹⁸	61,186,000	1	3 devolved governments	410 district and county councils	10,000
Venezuela	28,018,018	1	23 States		335

As for over-government and disproportionately high numbers of politicians, Saul Eslake has shown that again the statistics do not match the claims.¹⁹ Eslake also makes the important point that it is simplistic to measure ‘over-government’ by reference to tiers of government or the number of politicians. He points out that a more relevant measure is how much is spent on government, and notes that measured by expenditure as a proportion of GDP, ‘Australia’s “government” is the third-smallest of 28 OECD countries for which data are available’. Moreover, Switzerland, being ‘one of the few OECD countries in which both taxation and government spending are lower as a percentage of GDP than in Australia’, has a much higher number of politicians per million of population than Australia.²⁰

The suggestion that federalism, by virtue of its very nature, is an overly expensive and economically inefficient system of government is simply misconceived. The element of competition built into federal systems suggests the opposite conclusion, as do the statistics concerning the economic efficiency of federations. Federalism *can* be an economically efficient system of government, but this will be dependent upon how that system of government *operates* in practice in each particular country.

Money is the Root of All (or most) Federal Evils

The problems with how Australia’s federal system has operated in the past largely come down to money. The Commonwealth’s dominance in revenue raising and the related dependence of the States upon Commonwealth grants have resulted in the Commonwealth interfering with State governance by placing both policy and procedural conditions upon a significant proportion of Commonwealth grants to the States (known as ‘specific purpose payments’). The consequence has been the establishment of large Commonwealth bureaucracies to oversee the operation of specific purpose payments to the States and to develop the policy that the Commonwealth seeks to impose on the States. Hence we have a Commonwealth Department of Education which does not run any schools. This interference in areas of State responsibility is the source of most of the complaints concerning duplication and overlap.

¹⁸ The United Kingdom is difficult to categorise in this context, because the layers of government differ in different parts. Some parts of England may have only two tiers of government, but in many parts there are two levels of local government (making three tiers in total) — with district and county councils being one level and town, parish and community councils being another level.

¹⁹ Saul Eslake, ‘New Fiscal Possibilities’, paper delivered at the ANZSOG Conference, ‘Making Federalism Work’, 12 September 2008, Melbourne, pp 1–2.

²⁰ *Ibid.*, p 3.

A further consequence has been the lack of coordination between government services and the financial inefficiency that comes from States being required to spend Commonwealth grants on particular aspects of a policy area, while other more needy areas have been left under-funded. Those who rely on government services have often fallen between the cracks or ended up with inappropriate levels or types of services because of the idiosyncrasies of the conditions placed on Commonwealth funding. Commonwealth interference in State policy areas has also led to blurred lines of accountability and the ‘buck-passing’ that so irritates Australian citizens. Each level of government can rightly blame the other because no one is fully responsible for any area of government policy.

The conditions placed on specific purpose payments have also given rise to excessively high levels of administrative burdens, both at the Commonwealth and State levels, making the administration of government far less economically efficient than it ought to be. These conditions, by requiring that States match grants or maintain levels of funding to particular programs, have tied up large portions of State budgets, leaving States unable to manage their finances in a manner that best meets the needs of the State.

The specific purpose payment system has been the subject of sustained complaint for some time from a variety of sources.²¹ None of these problems, however, is the necessary consequence of a federal system. They are the consequence of how we have *operated* that system, but there are other choices which could be made. As noted in a report to the Council for the Australian Federation in April 2007:

Options to improve the operation of [specific purpose payments] include reforming their operation so that they:

- support the achievement of outcomes agreed by the States and the Commonwealth;
- permit flexibility by focussing on those outcomes rather than on inputs and processes, and by not compartmentalising funding into narrow subjects;
- include incentives to find more efficient ways to achieve the desired outcomes;
- complement and coordinate with other existing State policies to avoid overlap and confusion amongst those who seek to use government services;
- avoid micromanagement and the imposition of costly reporting and administration requirements; and

²¹ National Commission of Audit, *Report to the Commonwealth Government* (AGPS, Canberra, June 1996) p 48; Business Council of Australia, *Reshaping Australia's Federation – A New Contract for Federal–State Relations* (2006), Appendix 2; The Allen Consulting Group, *Governments Working Together? Assessing Specific Purpose Payment Arrangements*, (Department of Premier and Cabinet, Victoria, June 2006); Anne Twomey and Glenn Withers, *Australia's Federal Future*, (Federalist Paper No 1, Council for the Australian Federation, April 2007).

balance obligations, contributions and risk-sharing.²²

Proposed Fiscal Federalism Reforms

One way of eliminating all these problems would be for there to be true revenue sharing between the Commonwealth and the States, negotiated on the basis of need, without Commonwealth policy conditions attached. The Commonwealth Government has, not surprisingly, declined to take this path as it would effectively reduce Commonwealth power across the range of policy areas that the Constitution did not allocate to the Commonwealth but over which the Commonwealth has assumed power through the exercise of its financial clout.²³

However, the Rudd Government has proposed reforms that would ameliorate many of the problems arising from the operation of specific purpose payments. First, it has proposed to reduce the number of specific purpose payments from 92 to 5.²⁴ The significance of this is that each specific purpose payment will now cover a broad subject area, allowing the funds to be used where most needed within that area, rather than being compartmentalised in a manner that has previously caused over-funding of some areas at the cost of others. It will also permit the States to coordinate services better and reduce the problem of cost-shifting.

The second significant reform proposal is that specific purpose payments focus upon outcomes agreed with the States and Territories, rather than inputs or processes. This will permit the States to be innovative and give them an incentive to find more efficient ways of achieving the agreed outcome, as any saved money can still be used within the broad policy area of the specific purpose payment. It will also free State budgets from the previous constraints imposed by matching funding requirements, allowing the States to prioritise their spending and provide services according to need. The third advantage is that it should reduce the administrative burden and the associated cost involved in the States accounting for inputs and reporting on unnecessary detail.

The shift from inputs to outcomes will also affect State accountability for the payments received. Previously, States had to establish at the input stage that they were meeting Commonwealth requirements. Under the new regime it is proposed

²² Anne Twomey and Glenn Withers, *Australia's Federal Future*, (Federalist Paper No 1, Council for the Australian Federation, April 2007), pp 48–9.

²³ Note, however, that the Commonwealth Treasury has stated that some specific purpose payments will be turned into general revenue assistance grants 'where there are no compelling national objectives associated with the payment', Commonwealth, *Australia's Federal Relations*, Budget Paper No 3, 2008–9, p 6.

²⁴ COAG Communiqué, 26 March 2008. See also Wayne Swan, 'Modern Federalism and Our National Future', Address to the 2008 Social Outlook Conference, Melbourne, 27 March 2008.

that the States will be made publicly accountable for achieving the agreed outcomes through public reporting of State performance by the COAG Reform Council. It will independently assess States against agreed performance indicators and report to both COAG and the public on successes and failures. Reliance will be placed on the electoral pressure that will be imposed on governments that fail to achieve agreed outcomes and are being out-performed by other jurisdictions. This is competition and accountability at work.

Other proposed reforms to specific purpose payments include giving them a continuing status, rather than five year terms, so that the States have a degree of certainty in their budgeting. The risk of this proposal is that the specific purpose payments may not be adjusted to meet changing needs. The Commonwealth Treasurer has stated that the payments will be subject to periodic reviews to ensure that funding levels remain adequate, but this remains to be seen.²⁵ In addition, specific purpose payments will be sent directly to State Treasuries in monthly lump sums, rather than to relevant departments, giving State Treasuries better centralised control over grant revenue.²⁶

In theory these reforms should have a significant impact in reducing the problems that are well-recognised in the operation of federalism in Australia. The proof of the pudding, however, is in the eating. We have yet to see the terms of the specific purpose payments, which are currently still being negotiated. Whether they live up to what has been promised, remains to be seen.

There are two reasons for continuing concern. The first is the Commonwealth Treasury's estimate of future funding to the States. For years, the Howard Government was criticised for starving the States of funds. As Commonwealth revenue grew astronomically, the States were left behind. Not even the allocation of GST revenue to the States was enough for them to keep up. In the 2005–6 financial year, net Commonwealth funding to the States as a proportion of GDP was at a 30 year low, with the States in a worse position than prior to the GST.²⁷ Taking into account the Rudd Government's proposed changes to the funding of the States, the Commonwealth Treasury has predicted that total payments by the Commonwealth

²⁵ Wayne Swan, 'Modern Federalism for Australia's Economic Future', Press Release No 17, 26 March 2008.

²⁶ Commonwealth, *Australia's Federal Relations*, Budget Paper No 3, 2008–9, p 16.

²⁷ Commonwealth funding to the States in 2005–6 was effectively 5.1% of GDP (6.5% of GDP less compensation for abolition of State taxes of 1.4%), which is less than the pre-GST position, and a three-decade low, R Robertson, 'Budget/Federalism Watch', Macquarie Bank Research Note, 15 May 2007; and R Robertson, 'Why Canberra is rolling in cash', *The Australian*, 6 July 2006.

to the States in the financial year of 2008–9, as a percentage of GDP, will be lower still.²⁸

The second reason for concern is that while significant reforms are proposed to be made to specific purpose payments, the old problems are likely to arise again in relation to national partnership payments instead. In other words, it may be the case that the problems are simply being shifted rather than resolved.

National partnership payments are to be the vehicles for driving continuing Commonwealth involvement in areas of State policy. They may be used for implementing Commonwealth election promises made with respect to State areas of responsibility, such as computers for school students, or they may be used to achieve Commonwealth policy goals. The Commonwealth Government has proposed the establishment of three types of national partnership payments. The first, the project payment, will be used to pay for specific projects, such as the making of capital payments for infrastructure or the construction of a highway. The second is the ‘facilitation payment’ which is intended to assist States to lift standards of service delivery.²⁹ The third type will be the ‘reward payment’ which is intended to reward the States for meeting ‘milestones and performance benchmarks’ in achieving particular reforms. For example, COAG has proposed that there be a national partnership to fulfil the needs of ‘low socio-economic status school communities’³⁰ and a national partnership to address the needs of indigenous children in their early years.³¹ Unlike specific purpose payments, if a State fails to meet any of the conditions or benchmarks under a national partnership payment agreement, its payments may be withheld or commensurately reduced. The democratic sanction of the electors is not the stick in this case — it is the Commonwealth’s control of the money. The COAG Reform Council will assess whether or not States have met the necessary requirements to receive any of these ‘reward’ payments.³²

These national partnership payments appear likely to replicate some of the very problems that the new specific purpose payments were intended to do away with. For example, if a State is to accept funds from the Commonwealth to pay for computers for secondary school students, the State must then tie up a considerable portion of its budget to pay for associated costs, such as the re-wiring of schools, the cost of software and its ongoing upgrading, virus protection, maintenance and repair, electricity and internet access. This takes away the flexibility the State needs

²⁸ The prediction (made before the economic crisis) was for payments amounting to 6.4% of GDP, which is lower than the average of 6.8% during the Howard era, Commonwealth, *Australia’s Federal Relations*, Budget Paper No 3, 2008–9, p 9.

²⁹ Commonwealth, *Australia’s Federal Relations*, Budget Paper No 3, 2008–9, p 17.

³⁰ COAG Communiqué, 26 March 2008.

³¹ COAG Communiqué, 3 July 2008.

³² Commonwealth, *Australia’s Federal Relations*, Budget Paper No 3, 2008–9, p 17.

to apply its budget in the most efficient and appropriate manner. An updated version of an old adage applies — “Beware of Geeks bearing gifts!” In the case of New South Wales, the cost of accepting the Commonwealth’s ‘benevolence’ was more than it could afford.³³

Further, recent comments made by the Prime Minister with respect to funding for state education have suggested that it will be conditional not only upon a specified level of school reporting, but upon all sorts of other matters integral to the running of school, such as performance pay for teachers and the hiring and firing of teachers in under-performing schools.³⁴ If this is so (and we are yet to see the terms of any agreements underpinning national performance payments) it suggests that the Commonwealth is not seriously committed to removing itself from micro-managing State functions and eliminating the problems of duplication, buck-passing and excessive administrative burdens.

The Future of Federalism

Where does this point to for the future of federalism? Much remains uncertain. While COAG has been extremely active in the past year and has a large agenda of work to achieve, it is reasonably clear that the Commonwealth Government intends to pursue federalism reform through the reform of Commonwealth–State fiscal relations, rather than constitutional reform or a reassessment of the functions and responsibilities of the different levels of government. Money is still the driving force and still remains under the ultimate control of the Commonwealth. However, it is also apparent that the economic benefits of reforming the federal system to make its operation more effective and efficient are also great. So the future of federalism in Australia may well depend upon whether the self-interest in making more money through a more efficient federal system overcomes the desire to exercise greater power over the federal system through the control of existing revenue. ▲

³³ Justine Ferrari, ‘State rejects “unfair” school computers deal’, *The Australian*, 27 September 2008; Anna Patty, ‘Digital revolution stalls over funding’, *The Sydney Morning Herald*, 27 September 2008, p 7. See also: ‘School computer program to cost territory millions’, *The Canberra Times*, 22 October 2008, p 2.

³⁴ The Hon Kevin Rudd, ‘Quality Education: The Case for an Education Revolution in Our Schools’, Address to the National Press Club, Canberra, 27 August 2008: http://www.pm.gov.au/media/speech/2008/speech_0443.cfm [viewed 28 August 2008].