

Chapter Two

The Case for Less Commonwealth Involvement in State Government Services A Practical View Based Around Exploiting Competition, Innovation and Entrepreneurship

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I am not a constitutional lawyer, an academic nor currently an active participant in State/federal deliberations on who does what. I have, however, been involved in such deliberations in the past and I have also been involved in a number of areas where Commonwealth/State cooperation has been required – specifically in areas including agriculture, electricity, transport, medical science research, education and water.

My reason for speaking at this conference is that I am vitally interested in sustainable practical outcomes for the betterment of Australians.

I want to make it clear at the outset that I am not going to concentrate on the important issue of where, and how much, governments should intervene in economic and social activity, and what services they should provide or sponsor. I am going to take for granted that government needs to act in this space. I note, however, that the role of government is being radically reassessed since the global financial crisis in many countries. Of particular relevance to Australia are the changes starting to materialise in the United States and the United Kingdom, driven by their fiscal problems. Even though Australia's fiscal problems are not of the same magnitude, we are very likely to follow their lead, in my opinion, and move to smaller government against the previous trend.

I also want to stress that I do not see better outcomes being an issue just about the split between Commonwealth/State responsibilities for service delivery. What I intend to argue is that better outcomes require the same drivers as economic growth – competition, innovation and entrepreneurship. More effective Commonwealth and State involvement in service delivery requires a framework that harnesses these mechanisms both inside and outside government.

Discussions about federalism often focus on Commonwealth versus State issues – discussing tensions between historical decisions made at Federation, which were guided by some sound principles but also influenced by the politics of the day, and contemporary economic structures, public pressures and politics. The title I was asked to speak on is a reflection of this!

The missing element in my view is how to move beyond cutting the cake of responsibility for service delivery in the sphere requiring government intervention and focusing on using the three tools that we know underpin growth in the rest of the economy. This involves consideration of other options for service delivery, including local government, community groups and the private sector.

Why have a federation?

This is a logical starting point for what I have to say. It is instructive to note two quotes. The first from Sir Samuel Griffith in 1891, as used in the promotional material for this conference:

We must not lose sight of the essential condition that this is to be a federation of States and not a single government of Australia. The separate States are to continue as autonomous bodies, surrendering only so much of their power as is necessary for the

establishment of general government to do for them collectively what they cannot do individually themselves.

The second is from Prime Minister John Howard in a radio interview on 27 November 2002:

Well, I suppose if we were starting Australia all over again, we'd only have . . . we mightn't have State Governments. But we're not starting Australia all over again. We've got to deal with the present system we have and we've all got to deal with history. And we have State Government, we have Local Government, we have the Federal Government, and we've got to try and make the system work. I think we do have a lot of layers of Government in this country.¹

Historical antecedents aside, there are a couple of major reasons for having a federation.

First, federation is built on the principle of subsidiarity.

A basic argument for doing some things at a State or regional or local level, rather than at the national level, stems from the subsidiarity principle. It is inherent in the quote from Sir Samuel Griffith.

The *Oxford English Dictionary* defines subsidiarity as the idea that “a central authority should have a subsidiary function, performing only those tasks which cannot be performed effectively at a more immediate or local level”.

In other words, only have central government do what cannot be effectively done locally. A classical example of this is protecting the nation from external aggression.

The reasons for applying the subsidiarity principle are multifaceted. A prime reason is that it best aligns local activity with local interests – exploiting direct influence and feedback if you like. It better enables different regional interests and priorities to be reflected by government. After all, there are big differences between North Queensland, urban Sydney and south-west Western Australia, to pick three regions.

As well, in the classical liberal view, no central authority is likely to have the knowledge necessary to intervene wisely on local issues.

Applying the subsidiarity principle also has benefits in terms of limiting central power, providing some protection against bad government. The abuse of power is much easier when it is concentrated centrally. Subsidiarity ensures that citizens do not put “all their eggs” in one government basket.

Subsidiarity also has strong links to the notion of local experimentation and innovation, as opposed to conformity to one approach, which is a consequence of centralism. This is one of the key points I shall return to later.

A centralist would say: do it centrally unless there is a compelling reason to do it locally. As a subsidiarist, I say: do it locally unless there is compelling reason to do it centrally. Understanding this difference in mindset is crucial to what I am going to say in the rest of my speech.

A second reason for a federation is to exploit competition. Competitive federalism is a consequence of the application of the subsidiarity principle. It involves competition between regional or local governments – competition for citizens, investment, tourism, etc. It also provides greater choice and diversity.

National solutions can always be agreed if there is a compelling case, but a one-size-fits-all approach is usually not the norm.

Competitive federalism acknowledges that no-one has a monopoly on the best approach in all situations. Better outcomes result from the greater policy innovation and experimentation that flow from competition between governments in a federation.

Very importantly, it rewards success and penalises failure!

A recent comparison of national governments by Twomey and Withers has shown that federations

have smaller public sectors than centralised or unitary systems, with public spending as a share of GDP being 13 per cent higher on average in unitary countries.² According to their analysis, compared to centralised, unitary governments, federal nations such as Australia have:

- more efficient governments; and
- higher rates of economic growth and higher per capita GDP.

Federation has its challenges

Federalism in Australia certainly has its challenges today. I need to address some of these briefly to provide a context for my central arguments on Commonwealth involvement in State government service delivery.

The Constitution established what the Commonwealth Government was responsible for and what the States were responsible for, largely consistent with the subsidiarity principle at the time. Resolving questions about who should do what now cannot, however, be easily resolved by simply going back to the list of Federal powers set out in section 51 of the Constitution.

Some major subsequent developments have considerably clouded the issue. These include:

- firstly, the effective control of most taxation being taken, over time, by the Commonwealth (with the exception against the trend being the Howard Government's decision to provide the States and territories with a growing revenue base in terms of the proceeds from the GST);
- secondly, the changed role and political composition of the Senate away from the original concept of it being a "State's house";
- thirdly, the gradual integration of commercial and social activities across States as transport and communication barriers have diminished (making more aspects of commercial and social activity national in nature); and
- fourthly, the advent of the use of the external affairs power (Constitution, section 51 (xxix)) to intervene and, indeed, override States in areas where they otherwise have constitutional responsibility.

On the first development, taxation, as pointed out by a number of commentators, Wolfgang Kasper for one, effective competitive federalism is difficult with the Commonwealth holding most tax revenue and the States dependent on "hand-outs" to carry out their constitutional functions – vertical fiscal imbalance is the technical term for this.³ The ease with which the Commonwealth can use financial carrots to "buy off" States and territories was shown with the recent attempted claw-back of some of the GST revenue in the "health deal", with the notable exception of Western Australia.

In my view, the single biggest impediment to a rational resolution of Commonwealth/State roles in service delivery is the power that rests with the Commonwealth in terms of taxation revenue. The motto I learned long ago as a Treasury official resonates here: remember the golden rule – he who has the gold rules!

On the second development, the changed role of the Senate – the Senate has long moved from a focus of protecting States and territories, and there seems no prospect of a reversal of this.

On the third development, the national nature of much economic and social activity, greater national co-ordination is required now than was necessary at the time of Federation. To be effective, federalism needs to be tempered by comparable laws and regulations in key areas – for example, to facilitate free trade and the movement of people, efficient national business activity and a competitive labour market. The revolutionary changes we have seen in communications technology have also made the country and the world a smaller place with impacts on where activities are carried out.

As an aside, communications technology is a two-edged sword. It has hollowed out regions as many back-office tasks previously done locally are now done centrally or even overseas. This is having significant impacts on many local economies across the nation, requiring greater attention from the State and Commonwealth governments. However, the technology also allows things to be done locally that previously had to be done centrally. The coming revolution in the health sector driven by central analysis and diagnosis of locally obtained patient medical data, supplemented by appropriate treatment advice, will make local medical services more viable. I shall return to this later.

Greater economic and social integration does not necessarily mean, however, that the Commonwealth must take over more responsibility from the States – there is scope for co-operative approaches to deal with many of these issues. I have first hand experience with three successful ministerial companies with Commonwealth and State ownership that embody a co-operative approach to ensuring nationally consistent service delivery. These operate in the diverse areas of the national electricity market, a national approach to the application of vehicle telematics in conjunction with the private sector, and education services to support national coherence in curriculum development.

The last of the four developments, the use of the external affairs power, gives an activist Commonwealth Government a means to lever itself into traditional State areas of responsibility via signing treaties. This contentious area is beyond my brief in this paper.

But there is another related element at play here, too – the strong tendency for power to centralise and for delegated authority to diminish, often as a result of the supposed imperative for administrative and financial accountability. I shall come back to this issue later.

A practical case for less Commonwealth involvement

Apart from the classic reasons for federalism that I have briefly overviewed, what then are the practical reasons why the Commonwealth should reduce involvement in State service delivery?

I would like to begin by stressing what I am going to argue for and, importantly, what am I not arguing about? I am going to argue four things:

1. the subsidiarity principle remains relevant and should guide what the Commonwealth does not do. In particular, local and regional interests and needs differ across Australia in important ways and need to be dealt with locally, not nationally, wherever possible;
2. there are differences in the capabilities, interests and incentives of the Commonwealth and State bureaucracies that impact on the effectiveness and efficiency of service delivery;
3. competition needs to be harnessed – there is great merit in different approaches being developed, trialled and applied – the Commonwealth does not have a monopoly on the best approach. Neither does the traditional government sector *per se*;
4. improving service delivery requires innovation, which in turn requires risk-taking and entrepreneurship. This raises tensions with bureaucratic approaches to administrative process and accountability.

The issue is not just Commonwealth versus State delivery of services. State and territory governments have many of the same deficiencies as the Commonwealth Government when it comes to their relationship with other layers in the pyramid. Local government, local institutions (for example, schools and hospitals), community groups and the private sector also have key roles that are often overlooked.

What I am not going to argue is that the States should always have exclusive interest in certain matters. I believe it is unrealistic to abstract from the common political interest at both the State and Commonwealth levels in most things. The question is not who should have *exclusive responsibility* for policy and funding in a specific area of service delivery, but how responsibility should be split in three key areas:

- policy formulation
- funding
- service delivery.

In this regard, a challenge is how to make the system work better. At one level, this involves the way COAG and ministerial councils operate. Reform in this area is ongoing – and it needs to be, because the current arrangements are sub-optimal. At another level, it requires new approaches to be pursued, based on exploiting the three tools I keep referring to – competition, innovation and entrepreneurship.

There are also some areas of the provision of services that the Commonwealth and the States should not be involved with directly at all because they can be more efficiently and effectively provided by the private sector. Governments have withdrawn from (that is, privatised) some commercial activities such as banking, airlines and some utilities. There is more to do, however, albeit mostly at the State level.

The subsidiarity principle should still guide who should do what today.

While as Australians we have much in common, where we live impacts on us in many ways. Local features and factors (including demographics) are reflected in the nature of employment opportunities, infrastructure requirements and service needs (for example, health and education and training). As well, they influence the social, recreational and cultural interests and priorities of communities.

Parramatta is very different from Bunbury or Townsville. A one-size-fits-all approach to all issues, determined in Canberra, just does not make sense.

Likewise, as I have previously pointed out, the subsidiarity principle needs to apply within States as well. It is still important that locals have the ability to influence what happens locally where practical.

The tendency to centralise always seems to dominate – it flows like a strong current that goes in one direction only. To counteract this requires concerted efforts to make local institutions stronger and more effective.

In particular, it requires reform of Commonwealth/State financial relations to give the States more financial autonomy.

Why are differences in capabilities and interests important?

The federal bureaucracy is well resourced with many very qualified staff who like policy, and neither like nor are comfortable with front-line service delivery. In fact, there are only a few areas where the Commonwealth directly provides services to citizens (welfare payments and immigration are two examples).

In key areas, the Commonwealth is in the policy zone, not the service delivery zone: for example, in education, health and transport. To put it bluntly – federal officials, many of whom are cloistered in Canberra for most of their working lives, see policy as a higher order calling that is more befitting of their lofty position than getting their hands dirty with service delivery and implementation matters.

This has some important implications:

- expertise in service delivery, and in project implementation *per se*, is often limited. This means that when the Commonwealth strays into direct service delivery it can stumble – as highlighted in the home insulation saga;
- awareness and interest in service delivery problems in the bureaucracy are often low (although federal politicians may be getting direct feedback). This translates into what the Prime Minister, Julia Gillard, towards the end of the 2010 election campaign, somewhat reluctantly admitted were mistakes in what she called “program development and program delivery”;
- also, being remote from the realities of service delivery can impact negatively on the quality of policy formulation.

At the State level, things are not perfect by any means, but there is generally more interest and expertise in direct service delivery. In addition, there is a more practical consideration of real service delivery issues in policy formulation. Also, the feedback loop to politicians is shorter!

As I have already stressed, the greater the level of *specific* Commonwealth funding for a specific service, perhaps logically, the greater will be the level of Commonwealth involvement in how the funds are used. Amongst other things, this is driven by accountability requirements on the use of public money. The problem is that, if you push requirements too far, it results in unnecessary administrative overheads and waste.

A recent approach to dealing with Commonwealth/State mutual policy interests has been to establish National Partnership Agreements. These articulate “objectives, outcomes, outputs and performance indicators, and clarify the roles and responsibilities, that will guide the Commonwealth and States in the delivery of services across the relevant sectors”.⁴

I have not the time to go into the details of this latest iteration in defining such arrangements. At face value this may appear to be a reasonable approach to delineating who does what, and on what basis. The problem is that in practice the agreements are a mechanism for greater Commonwealth interference in State service delivery. Specific purpose payments, which had their own limitations, have been replaced by apparently broader funding arrangements – but tied to detailed and onerous accountability arrangements that provide a mechanism for Federal interference in the name of accountability.

The only real solution to this is a reform of Commonwealth/State financial arrangements that moves to greater block funding, without an industry at the Commonwealth level (and consequently at the State/territory level also) establishing detailed targets and measuring performance, with the associated administrative costs.

How can competition be harnessed? A defining feature of competition is that there are winners and losers. This is good enough for private economic activity and the development of new knowledge in science, technology and health. Why should not we use it more in public sector activity?

To an extent, federalism can facilitate competitive approaches in service delivery (hence competitive federalism). Less Commonwealth intervention in State service delivery areas would facilitate more competition in establishing better approaches.

In my view, however, there are broader possibilities. The Commonwealth, under the Howard Government, pursued this in a number of areas such as delivery of services to unemployed people.

There is still greater scope, however, to harness competition across areas including health, social services and public housing.

In education, competition can also be further enhanced. The Victorian Government is pursuing this with vocational education and training by extending competitive opportunities for private registered training organisations in competition with technical and further education institutes (that is, TAFEs). If we did not have competitive federalism in this area we might all be following the NSW centralised approach that shies away from competition!

As I said, competition involves an acceptance that some competitors will not succeed. There has to be an acceptance of this and frameworks to cope with its consequences (for example, dealing with citizens who need to move to better performing service providers).

What has innovation and entrepreneurship to offer?

The last forty five years since Lyndon Johnson’s Great Society experiment have clearly shown that alleviating social problems through central action is problematic and challenging, to say the least. If we have learned anything, it is that success is more likely to blossom from a thousand flowers than from strongly centralised approaches. This involves promoting innovation and entrepreneurship in dealing with social problems.

The Economist had an interesting article on this very approach in the United Kingdom and the United States. In the UK, David Cameron is experimenting with a concept of Big Society – a bit of a misnomer in that what it is about is harnessing the energies of what might be more appropriately called “little society” – voluntary groups, community groups, charities, etc. But the idea reflects an appreciation that we need to use “social entrepreneurs” more.

As any manager knows, if you are going to delegate, you have to relinquish some authority and use accountability to promote the intended outcome. A real problem with Commonwealth funding of any service delivery in States and elsewhere is that it is highly risk adverse. It is accompanied by reporting and accountability requirements that are often beyond the capability of funded entities.

I have already discussed this in terms of Commonwealth/State financial relations. In dealing with other service deliverers, governments need to take a different approach to risk management than traditionally applied. Risk-averse mechanisms with large reporting and other administrative overheads need to be replaced by smarter mechanisms where risk is managed appropriately, not eliminated – this requires simpler contracts and performance agreements, less reporting and targeted auditing.

In this regard it will be worth following how reforms in the United Kingdom to abolish reporting requirements for local government proceed.

As mentioned above, communications technology is an important potential enabler of innovative local solutions for service delivery to citizens. I strongly believe that broadband technology will drive further innovation in this area. I am not talking specifically about the current National Broadband Network delivery model although, as I was a director of NBN Tasmania for a short period, I have views about it. What I am concentrating on is the scope for broadband technology, however it is delivered, to facilitate new solutions to old service delivery problems.

But who is sponsoring research on this? Both the Commonwealth and State governments should be. They should also be explicitly sponsoring innovation and promoting entrepreneurships in local service delivery.

The beauty of applying innovation in local service delivery is that you do not need to rush in with a comprehensive solution. You can trial alternative options and exploit competition between them. It is likely that no one option will come out in front in all situations – solutions usually need to match local needs and resources.

Citizens and the press will also need to be educated to accept that some experiments will not work, but the overall outcome should still be better. We do this with the funding of research – not every medical research project delivers something of practical value. But, when you get a winner, the impact can be profound.

Conclusion

What are my takeaway messages?

There are three:

- subsidiarity and competitive federalism continue to be important mechanisms to promote better outcomes, but without changed Commonwealth/State financial arrangements which give greater autonomy to State/territories, serious erosion of State autonomy will continue;
- we must harness the power of competition, innovation and entrepreneurship in dealing with problems requiring government intervention and service delivery. This will require smarter approaches to government funding, moving from risk aversion to risk management; and, finally,
- If we are going to be biased, we should be biased against centralism – the wind usually blows in that direction, and therefore needs to be consistently fought against. The danger of centralism is, after all, one of the great lessons from the twentieth century!

Endnotes

1. Transcript of interview available at: <http://www.australianpolitics.com/news/2002/11/02-11-27.shtml>.
2. Anne Twomey and Glen Withers, *Australia's Federal Future*, a report for the Council for the Australian Federation, 2007, 12-13. Available at <http://www.caf.gov.au/policyinnovation.aspx>.
3. Wolfgang Kasper, "Australia's hollow federalism. Can we revive competitive governance?", *IPA Review*, October 2007.
4. See details at <http://www.federalfinancialrelations.gov.au>.