

Chapter Three

Duplication and Overlap: An Exercise in Federal Power

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Introduction

The issue of duplication and overlap between the Commonwealth and the States has become more and more controversial under the Keating Government as it has become increasingly clear that that Government seeks to involve itself more and more in the provision of the services administered by State Governments.

In fact, the terms "duplication and overlap" are something of a misnomer. What we are dealing with is Commonwealth intervention, the apparent objective of which is that the States would eventually move into the position primarily of administrative agencies, with the main lines of policy in all matters being nationally determined. The latest development in this regard was reflected in the report in *The Australian* of 26 September, 1995 that a condition of future Commonwealth funding of States' public hospitals would be the meeting of efficiency standards set in Canberra. Imagine!

However, while a Commonwealth take-over may be the eventual aim, a close examination of the Commonwealth's use of the section 96 grants mechanism to date suggests that, with one or two exceptions, the program of specific purpose payments (SPPs) has little, if any, practical effect on the levels of the various services provided by State Governments.

The proposition advanced in this paper is that, in the great majority of cases where Commonwealth intervention occurs, the State Governments remain the primary determinants of service levels, and the provision of funding by the Commonwealth is largely an exercise of political power designed to give the appearance of a concerned and involved national Government, but which has limited substance to it.

It is not going too far to say that the provision under section 96 of SPPs by the Commonwealth is, to a significant extent, a sham, whose main purpose is to allow Commonwealth Governments and Ministers to be able to pretend they are performing a more useful function than they are. The arrangements certainly cannot be justified as they are presently structured, and it is also difficult to see any basis for the claim by Commonwealth Treasurer Willis that "Tied grants offer a means of satisfying broader community demands for minimum national standards in program areas such as health and education and, where the Commonwealth has a role in determining strategic goals, of fostering the optional provision of public services by States from the available resources."

Let me be clear as to the basis on which I am suggesting that SPPs are largely a sham political exercise. I am not saying that, if the Commonwealth were to eliminate SPPs, that would have little or no effect on State expenditures in the areas that are targeted by the SPPs. With the present division of taxation powers it would obviously be politically impossible for the States to replace the lost revenue and they would have to make substantial expenditure reductions. However, the issue is what would be likely to happen if SPPs were converted to general purpose grants. If, as my analysis indicates, there would then be little or no change in States' expenditures

on the great majority of targeted activities, this suggests that SPPs are serving little if any substantive, as distinct from political, purpose.

If judgment is to be passed on the substance of the Commonwealth's program of SPPs, there is a need to consider the possible substantive objectives of having such a program and to assess the extent to which such objectives are being met. Before doing that, however, it may be useful to set out a few relevant facts about SPPs :

(i) In 1994-95 the Commonwealth Government paid State and Territory Governments no less than \$17.6 billion under specific purpose programs that ranged from \$3.7 billion to help meet the operating costs of public hospitals to \$550,000 for the Bass Strait Passenger Service. The Commonwealth's Budget Paper No 3 for 1995-96 shows that there are 126 SPP programs, about 70 of which are for current expenditure and the remainder for expenditure on capital works of various shapes and sizes.

(ii) These 126 SPP programs now constitute over one half of Commonwealth grants to the States and Territories. By contrast, thirty years ago there were only just over 30 such programs and they made up only about 30 per cent of such grants. Seventy years ago there was only one such payment, that being the magnificent sum of \$1.5 million paid under the Main Roads Development Act passed in 1923.

(iii) The big increase in SPPs occurred, of course, under the Whitlam Government, when the number of such payments jumped to over 100. Between 1972-73 and 1974-75 the Whitlam Government increased by nearly seven times the amount provided under SPP programs—from \$632 million to \$4,152 million. Since then the number of SPP programs has increased, but at a relatively gradual pace.

(iv) SPPs now finance about 22 per cent of total expenditure by the State and Territory Governments, a proportion which has not changed markedly since the Whitlam era but one which is significantly higher than before that era. Around 8-9 per cent of this expenditure, equivalent to some \$6.5 billion in 1994-95, simply involves the on-passing to other institutions (mainly educational) of the Commonwealth grants.

(v) In terms of Commonwealth budget outlays, SPPs now account for about 14 per cent of the total. This is actually a little lower than it was in the Whitlam era, reflecting the fact that under the Hawke-Keating Governments Commonwealth "own purpose" outlays have increased significantly, mainly through the provision of additional social security and associated forms of assistance. In fact, since the late 1970s, Commonwealth own purpose outlays have increased by about 3.5 percentage points of GDP while SPPs are still about the same proportion of GDP as they were then (about 4 per cent).

(vi) These section 96 grants are heavily concentrated in four main areas where the Commonwealth's power to undertake spending directly is limited or non-existent:

- _ Education, where SPPs are about 70 per cent of total Commonwealth outlays in that area ;
- _ Health, where SPPs are about 30 per cent of Commonwealth health outlays;
- _ Transport and Communication, where SPPs are 35 per cent of Commonwealth transport and communication outlays; and
- _ Housing, where SPPs constitute almost all of Commonwealth outlays on this function.

On the surface, this analysis might raise a question as to what all the fuss is about, given that, in aggregate, specific purpose payments have not played an increased role in the budgets of Commonwealth or State Governments under the Hawke-Keating Governments. However, that does not mean that the Commonwealth has not become more "interventionist". Central power can be exercised in ways that do not necessarily involve the total take-over of financial

responsibility. There is potential for the Commonwealth to obtain enormous leverage through the provision of relatively small grants, or even no grants at all. The increased regulation of the use of State resources through the imposition or attempted imposition of environmental controls is one obvious example and, in regard to the harvesting of natural growth forests for wood chip exports, a very topical issue.

But there is also mounting evidence that the Commonwealth is applying detailed requirements to the expenditure of SPPs to an increasing extent and, particularly in the health area, is increasing the number of programs and sub-programs which are subject to such requirements. States are, in turn, exhibiting growing resentment of these detailed requirements, and of the increasing use of SPPs as a vehicle for the exercise of Federal political grand-standing.

On 4 November, 1995 for example, *The Age* reported that the heads of the Commonwealth and Victorian Departments of Health were at loggerheads over health trials for the chronically ill and that one of the heads had decided not to have any future dealings with the other. According to *The Age*, Dr John Paterson wrote in a letter to his Commonwealth counterpart, Dr Stephen Duckett, that: "It is difficult to escape the conclusion that your Minister resorts easily to what appear to be lies or half-truths, for the slightest political advantage".

The Age reported that Dr Paterson also accused Dr Duckett of "a subsequent campaign of obfuscation". Dr Duckett, however, denied this and claimed that Victoria was disrupting a process agreed to at an earlier Council of Australian Governments meeting. In the latest instalment, only last Wednesday, the Victorian Minister of Health was reported as accusing Federal Health Minister Lawrence of "immoral hijacking" of the COAG discussions on reorganising the 60 odd health programs into three streams of care.

While on the surface this sounds rather petty, even schoolgirlish, stuff, behind it lies a very real issue which relates to whether and when the Commonwealth should employ section 96 grants and, more broadly, to the respective roles which the Commonwealth and the States should be playing in the Federation. That is, of course, a massive subject on its own and it is not possible in this paper to do much more than touch the surface.

Commonwealth Intervention in Theory

The constitutional need for the Commonwealth to resort to grants under section 96 of the Constitution derives from the fact that the Commonwealth's direct legislative powers are largely limited to the areas specified in the 39 placitums of section 51. If the Commonwealth is to become involved in areas such as education, public hospitals, public housing, roads and railways it therefore has to do so mainly through the States via section 96 grants. (There is, however, a grey area where the Commonwealth appears to be able to legislate to spend money on these activities in its capacity as a national political entity where a national consensus can be said to exist. The funding of technical and further education through the Australian National Training Authority created under an agreement with the States appears to be based on such power.)

Of course, the Commonwealth does not even have to become involved in the matters listed under section 51. Given that the section 51 powers are concurrent with the States, the Commonwealth could leave it to State Governments to cover at least some of the matters designated under that section. In fact, the States do also operate in some of the areas designated under section 51, although to the extent that there is overlap, by virtue of section 109 the Commonwealth necessarily prevails where there is inconsistency. The focus of the present paper, however, is on those areas where the Commonwealth is intervening through section 96 grants.

One element in the economic case for Commonwealth intervention via section 96 grants derives from the argument that individual States will "underspend" if left to their own devices, because

some of the benefits of a State's expenditure will "spill over" to residents of another State or to the nation as a whole. Potential examples include expenditure by a State on education, on the building of roads or railways that run into next door States, or on the eradication of some disease or pest that may have minor adverse implications in one State but significantly adverse potential effects in others. A State may also under-spend on pollution prevention where a substantial proportion of its pollution "spills over" into neighbouring States.

The case for Commonwealth intervention is also based on the potential for national uniformity to reduce the transactions costs of doing business in the various States or to create what are judged to be more socially equitable outcomes. The Constitution recognised the possible case for uniformity in regulation of business transactions by giving the Commonwealth power with respect to such matters as currency, weights and measures, banking, trading and financial corporations, taxation and so on. In the area of social policy, additions to section 51 made under the social services powers referendum of 1946 also recognised a possible case for national uniformity in a range of social security type measures (including sickness and hospital benefits and medical and dental services), and the Commonwealth already had powers with respect to old age and invalid pensions and to matters such as marriage and divorce.

One problem with the "spill over" and national uniformity justifications for Commonwealth intervention is that in many cases there is no obvious point as to where the line should be drawn between leaving it to States and having the Commonwealth impose national uniformity. Common weights and measures and currency are obvious but there is frequently an absence of agreement even among so-called experts as to what are the right policies for delivering services or regulating business. Indeed, as we are seeing from the current debate about awards provisions under the present industrial relations system, what constitute "community standards" is by no means agreed. And although there has, for example, been a long running debate about gun laws, attempts to agree even on a uniform gun "code" have so far failed. Should that be a matter for the Commonwealth to intervene via a section 96 grant?

It is relevant that, even where there is wide agreement that there should be national uniformity—such as in the regulation of banking and companies and securities trading—it is by no means clear that the Commonwealth can claim that its policies and administration have produced efficient and effective results. Commonwealth failures in these and other areas of centralised control provide additional substance to the thesis that, where there is no obvious need for nationally uniform policy, there is much to be said for applying the subsidiarity principle, that is, limiting the central government's involvement to those functions which cannot adequately be performed by the States.

Those who argue for national uniformity also frequently fail to recognise the potential benefits from having competition between State Governments even where this may result in different rules applying to the conduct of business in the various States. Indeed, a strong case can be made that competitive federalism is likely not only to provide greater protection of individual liberty, but also the most efficient and effective economic result. Noted American economist and thinker Professor Aaron Wildavsky rightly posed the question a few years ago : "If we think so well of competition that we enthrone it in democracy, science and economics, why should we not tackle the problem of federal structure in the same way?"

The on-going dispute over workers compensation insurance is a good illustration of the competition/uniformity debate. Large businesses which conduct business in more than one State often complain about the different rules applying to workers compensation insurance and argue for national uniformity. Yet there is also considerable potential for a national compensation

scheme to be "captured" by interest groups and to impose unnecessarily high costs on businesses. Australia only just escaped copying in 1975 New Zealand's disastrous experience with its national scheme, and it is somewhat surprising that the Industry Commission should have recommended in 1994 that a National Work Cover Authority be established to 'minimise cost-shifting between jurisdictions, establish greater regulatory uniformity and provide competition with State-based schemes.' A Commonwealth scheme would surely provide an excess of competition, particularly at a time when the advantages of inter-State competition in this area are very apparent, with the Victorian reforms producing considerable cost savings while NSW and Queensland are clearly going through the "capture" stage, resulting in higher costs for business operations in those States.

A similar point can be made in regard to social policies. It may be argued, for example, that it is socially equitable that every school child in Australia receive the same standard of education. But who is to determine that standard? In the case of government school education the Victorian school system is only just starting to recover from the Gramscian policies pursued under the Cain-Kirner Governments. Imagine the disaster if such policies had been applied uniformly from Canberra right across Australia! Fortunately, NSW led the way in educational reform under the Greiner Government, even if that reform process did fade rather quickly.

The case for Commonwealth intervention to try to obtain "spillover" benefits is also a pretty thin one, and seems to have only fairly limited application if the various options are closely analysed. Commonwealth involvement in the construction of major interstate highways and railways may produce benefits additional to those that would flow if those matters were left entirely to the States, particularly with respect to the less populous States. But it is difficult to believe that individual States are likely to underspend on education because some of the benefits might flow to other States.

If we focus on the four main areas where there are programs of specific purpose payments-education, public hospitals, roads and railways, and public housing-there appears to be only a very limited theoretical justification for Commonwealth intervention on national uniformity or "spill over" grounds. That is not to say that the States may not need, on occasion, to be pushed or at least "persuaded" into reforms. For example, when grants to the States for universities were first introduced in 1951-52, there was probably a justifiable case that the States did not recognise the potential benefits from additional "investment" in tertiary education. But it would be difficult to mount such an argument now. Similarly, the Commonwealth deserves a good deal of credit for pushing the States to expose their public authorities to competitive pressures under the Hilmer reforms.

Some also favour having a national uniformity policy in regard to the level of services provided by State Governments in school education, public hospitals, public housing, and such like. However, there is a long history of quite wide differences between States in service levels in these areas without any serious apparent harm being caused. In fact, the very basis on which the Commonwealth itself distributes general purpose grants among the States recognises the right of each State to determine its own level of budget expenditures in such areas without being penalised for spending below the national average, let alone below the top spending State. Thus, the assessments by the Commonwealth Grants Commission on which general revenue grants are paid to each State effectively include amounts that allow each State to spend up to a certain standard but do not require the actual level of spending to be at that standard. Queensland, for example, has long been a low spending State, preferring to use part of its share of the general

revenue grants to operate a low tax regime. There is no penalty for that and nor does Queensland obtain any unfair advantage from it, contrary to claims by NSW and Victoria.

Commonwealth Intervention in Practice

Intervention via General Purpose Grants

Few people realise that the use of section 96 to provide general purpose grants which "equalise" the fiscal positions of the States is a form of "intervention" by the Commonwealth, or that such intervention is entirely consistent with the principle of subsidiarity. By contrast, to the extent that Commonwealth SPP programs for current expenditures in areas such as health and education purport to be setting or encouraging certain spending standards in each State, they are largely an unjustified form of intervention, and are certainly inconsistent with the 'philosophy' of the fiscal equalisation system.

Accordingly, it is appropriate that, as a matter of practice, the Grants Commission effectively over-rides the distribution of a large amount of current specific purpose grants where that is inconsistent with its assessment of the distribution of general revenue grants needed to achieve fiscal equalisation. In 1993-94, for example, the Grants Commission effectively treated some \$6.5 billion of the \$14.5 billion of SPPs it classified as being for current purposes as if they were general purpose payments. Thus, save in one possible respect, the programs under which these Commonwealth SPPs were provided may as well not have existed, and the grants may as well have been added to the general revenue grants pool.

It is worth noting some of the SPP programs which fall within this category. They include grants for:

- Government Schools;
- Technical and Further Education;
- Hospital Funding;
- Blood Transfusion Services;
- Pathology Laboratories;
- Breast Cancer;
- Home and Community Care;
- Disabilities Services;
- Bovine Brucellosis and Tuberculosis; and
- National Landscape Program.

As noted, there is one possible qualification to the generalisation that the SPPs which the Grants Commission effectively treats as general purpose payments may as well not exist. That qualification may be appropriate where the Commonwealth imposes conditions which restrict or inhibit the States in the management of the activity that is targeted by an SPP, or which put additional pressures on States' budgets.

Clearly, for example, the Commonwealth policy that makes grants for hospital services conditional on providing free treatment for eligible persons in public hospitals affects the demand for hospital services and hence impinges on States' capacity to manage their budgets. It also creates waiting lists for treatment for which State Governments are held politically responsible even though they basically result from Commonwealth policies. Even so, States spend on hospital services more than double the amount of SPPs they receive from the Commonwealth, and the quite wide differences between the States in per capita levels of spending on those services confirm that it is the States that determine at the margin the level of hospital services provided by them.

In fact, the Commonwealth could continue to require the States to provide free treatment in public hospitals for eligible persons without having hospital funding grants and without having a Commonwealth Human Services and Health Department, or at least not one employing as many as 6,800 public servants. It could simply make that requirement a condition of the general revenue grants. That would not destroy the general purpose nature of those grants and could readily be audited by the Department of Finance.

Other SPPs that are effectively treated by the Grants Commission as general purpose grants also have conditions attached to them. However, none of these conditions appears to prevent the States from effectively determining the overall level of service provided in the areas targeted by the SPPs. It is also evident that States have the capacity to effectively substitute at least some of the Commonwealth SPP money for their own funds, thereby freeing the latter for other purposes and raising a question as to the purpose of the SPP.

Grants for Government Schools

The sham that exists in the case of most Commonwealth SPPs has recently been highlighted in the case of SPPs for government schools, which total an estimated \$1,165 million in the current year. According to the latest report by the Schools Council :

"The task of ensuring that Commonwealth funds actually add value to State schools rather than merely substitute for State funding constitutes a considerable difficulty for the Commonwealth. No mechanism exists to enable the Commonwealth to monitor the expenditure of resources on schools. The Commonwealth Government has never had any substantive evidence as to whether the resources it has put into schools over the past 20 years have been effective in raising education standards" (emphasis added).

Such comments are scarcely surprising given that the Commonwealth SPP finances only about 12 percent of total State Government spending on government schools. One has to wonder whether anyone in the whole apparatus of the Commonwealth Government and Parliament is at all concerned that over \$1 billion of Commonwealth taxpayers funds is being provided for a particular purpose but that it may largely be substituting for State funding!

Funding of Technical and Further Education

A similar situation appears to exist with respect to Commonwealth funding of Technical and Further Education. Although this funding is now being channelled through a joint Commonwealth-State body, the Australian National Training Authority, and is no longer treated as an SPP, it remains in substance a grant to the States and is being treated as such by the Commonwealth Grants Commission. In 1993-94 the Commonwealth provided 29 per cent of the total current expenditure of \$2.3 billion by the States on Technical and Further Education (as identified by the Grants Commission), and the Commonwealth has since significantly increased its allocation for this purpose. Reflecting the Commonwealth's policy of big-noting itself in the field of vocational training, the 1995-96 Budget thus provides \$830.5 million, an increase of one third on the 1993-94 expenditure of \$622.3 million.

However, following the recent revelation that the number of students enrolled at TAFE Colleges actually fell in 1994, a question has naturally been raised as to whether the States have been substituting part of Commonwealth funds for their own funding. According to The Australian of 11 November, 1995 the Commonwealth has been "persuaded that productivity improvements compensated for reductions in TAFE spending in South Australia and Victoria", and has accepted "an assurance of renewed efforts from States whose TAFE teaching contact hours fell last year". Even so, Commonwealth Minister Simon Crean is reported as saying that he was "sick to death of State governments moralising about the importance of training but when it comes to

putting the money up, not even maintaining their efforts". He said it was "only, effectively, the Labor States that take the rhetoric seriously".

Clearly, the Commonwealth is firmly engaged in political grandstanding in this area. But, if Mr Crean is correct in saying that some States are not even maintaining their efforts, he should be asked what he intends to do about such a contravention of the agreement with the States, which "requires that States will at least maintain their effort on vocational education and training on an on-going basis".

Grants for Non-Government Schools

The Commonwealth also provides grants to the States for on-passing to non-government schools. These grants are described as being:

"To equip the nation's young people, particularly through the acquisition of key competencies, to pursue post-school qualifications, to compete in and contribute to the labour market, and to contribute to Australian society while developing their full potential, by providing them with the necessary education foundation in cooperation with government and non-government education authorities and institutions."

In 1992-93 the Commonwealth grants for this vague purpose amounted to \$1,371 million and no matching conditions were applied to the grants. In the same year, State Governments also provided grants to non-government schools, amounting in their case to about \$922 million, making the total of such grants from governments \$2,293 million. No data are available for total expenditure on education by non-government schools, but there is no doubt that these Commonwealth and State grants finance a substantial proportion, possibly over half, of such expenditure.

The fact that the Commonwealth provides about 60 per cent of total government payments to non-government schools, and that there are a number of sub-programs and conditions attached to the subsidies, indicates that the Commonwealth is the dominant player in regard to this particular activity. Some may argue that it is desirable that the Commonwealth be involved in subsidising private schooling, on which there is now (after many earlier years of heated political debate) bipartisan agreement. However, there is no need for national uniformity and, if the Commonwealth grants were converted to general purpose payments, there is no reason to suppose that States would cease to assist non-government schools. Moreover, with the likelihood that the operation of government schools will become more privatised or "contracted out", it is now even more appropriate for individual State Governments to decide on where to strike the balance between financial assistance to pupils attending government and those in non-government schools.

Higher Education Grants

Another case involving the straight on-passing of Commonwealth grants by State Governments relates to Commonwealth assistance for higher education, now running at around \$3.5 billion a year. Here it is clear that the States play no role in determining expenditure levels as the Commonwealth provides virtually all the funding. Yet, as already noted, the substantive case for Commonwealth intervention in this area is a comparatively weak one. The greatest need in this area would seem to be to get any sort of government out of funding higher education institutions and focus instead on assisting individuals.

Grants to Local Government

Commonwealth assistance to local government is another example of the political sham involved in SPPs.

In 1993-94 the Commonwealth made two SPPs to State Governments for on-passing to local governments, one for "general funding" (\$751.2m) and one described as being for "identified road funding" (\$333.3m) but in reality also for general funding. Indeed, the purpose of both SPPs is simply described as being "to provide (untied) or general purpose assistance to Local Government Authorities."

These Commonwealth grants of \$1,084.5million represented about 13 per cent of total revenues of local governments in 1993-94 and just over half of total grants received by them. While State Governments continue to provide grant assistance to their local governments, this has become a less important source of local government revenue as the Commonwealth grants have increased; that is, the Commonwealth grants have gradually substituted for State grants.

It is difficult to see any possible national "spillover" benefit from such grants by the Commonwealth. The grants are a relatively small proportion of total local government revenue and, even if their replacement by general revenue grants were to lead to some reduction in total grants received by local governments, the worst outcome would likely be a fairly marginal increase in local government rates and charges.

The only substantive argument for such grants is that they involve a requirement that State Governments undertake an equalisation exercise designed to help local authorities with low taxable capacities and higher overhead costs to maintain higher service levels than would otherwise be the case. This is, however, a matter that could readily be left to each State and is scarcely a national priority. Indeed, one effect of the equalisation arrangements may have been to entrench in the various States the existing structure of local government, which in most cases has significant inefficiencies.

This Commonwealth grant can be regarded as a classic example of the exercise of political power. Its main purposes are to allow Commonwealth politicians to be able to refer in their electorates to the fact that the Commonwealth Government provides "assistance"; and to help justify the existence of the Commonwealth Minister for Housing and Regional Development, and his Department. No less than five SES officers are responsible for the Local Government and Urban Development Division of that Department, and their duties are described in delightfully vague terms as being to administer "policies and programs to improve the social and economic wellbeing of local communities by assisting local government to achieve national objectives, and to improve the economic efficiency, social equity and environmental sustainability of cities and regions." It is difficult to envisage what "national objectives" local government might have.

Auditing of Specific Purpose Payments

The foregoing leads to a question as to the audit processes in regard to SPPs.

The Commonwealth Auditor-General has, in fact, produced an Audit Report on Specific Purpose Payments to and through the States and Territories which found that :

"For many programs accountability to the Commonwealth is poor. Some programs do not require statements or certifications of expenditure; of those programs that require statements or certifications of expenditure almost a third do not specify a time limit for their provision; and for those where a time limit is specified approximately 50% were late. Although the data collected suggests some improvement since a previous survey conducted by the ANAO in 1988-89, further room for improvement remains. Deficiencies have been identified in reporting to Parliament on SPPs and many problems exist in the collection of data on SPP programs.

"The survey identified a number of SPPs where the authoritative basis of the SPP consisted only of letters and/or Cabinet decisions, and one case where the authoritative basis was unknown. The ANAO considers that there is a need for formal agreements that include program goals,

performance indicators, targets and sanctions to facilitate the effective management of SPP programs. That is, the agreement should be comprehensive enough to allow it to be used as a management tool.....

"The overall results of the survey suggest that pockets of good performance exist across SPP programs. However, some agreements are not comprehensive enough to be useful as a management tool, there are failings in relation to accountability mechanisms and financial arrangements need closer scrutiny".

The report was forwarded to the Departments of Treasury, Finance and Prime Minister and Cabinet, each of which effectively disclaimed responsibility. The comments of the Prime Minister's own Department, which is supposed to have the supervisory role in Commonwealth-State relations, are particularly noteworthy (sic), viz :

"The Department of the Prime Minister and Cabinet does not administer any specific purpose payment programs. Accordingly, we are not well placed to discuss the practicalities of managing SPPs or to respond to those aspects of the report which are drawn from, or would impact on, particular cases. With that qualification, we would support the thrust both of the conclusions drawn from the survey, at page six, and of the recommendations of the report".

This Report is now presumably busily gathering dust in Canberra pigeonholes! The reality is however, that, while the Audit Office doubtless satisfies itself that the States spend the Commonwealth funds for the purposes specified, the Commonwealth taxpayer does not know whether his/her money is really adding value in the areas that are targeted. As there are no, or minimal, conditions on how much the States spend, funds provided by Commonwealth taxpayers may simply be being substituted for funds provided by State taxpayers.

Analysis of State Expenditures

As pointed out in the 1993-94 Industry Commission report on Federalism, the funds attached to most SPPs are potentially fungible, that is, they may simply displace State funds which are used for other purposes. In fact, even where the Commonwealth attaches matching requirements to an SPP they are not always on a dollar-for-dollar basis, and sometimes do no more than require that States maintain their own expenditure in nominal or real terms. In most cases States would normally exceed such a requirement in the course of time.

In any event, as the Industry Commission report noted, SPPs with matching conditions probably represented less than 4 per cent of total State outlays in 1992-93. It concluded that, "Even if all these SPPs involved dollar-for-dollar matching, the impact on State outlays appears not to be great".

Analyses which I have undertaken of State outlays by categories of expenditure suggest that, in the great majority of cases, Commonwealth SPPs finance a relatively small proportion of the expenditure area to which they are targeted. These analyses have taken three main forms:

- (i) At the broadest level of aggregation of expenditures (ie "education", "health", etc), SPPs directed to each broad category of spending generally finance less than 50 per cent of total State expenditure in that category;
- (ii) At the relatively disaggregated level of States' current budgetary spending undertaken by the Commonwealth Grants Commission (CGC), the proportions of such spending financed from SPPs targeted to the various CGC expenditure categories are relatively low in the great majority of categories; and
- (iii) Disaggregated figures for State outlays obtained from the ABS show that, in those areas which are targeted by SPPs, only about one-third of total State/Local outlays in those areas were financed by SPPs. Moreover, apart from one or two expenditure categories, the proportion of

State outlays financed by SPPs is generally so small that it seems very unlikely that the SPP agreements could have any significant influence on total outlays in the targeted areas.

These analyses do not rule out that, at the level of one or two individual SPP programs, total expenditure on the activity is determined by the SPP agreement. However, it seems likely that such instances are few. It is important to recognise that there is no necessary contradiction between State public servants and politicians being concerned about various aspects of SPPs, on the one hand, and the SPPs not in general being the determinant of levels of spending, on the other hand. My thesis does not deny that the SPPs are imposing administrative and other costs, and, as already pointed out in the case of the hospital grants, in some instances they impinge on States' capacity to manage their budgets.

Conclusion

It is of some interest that comparisons of expenditures by three levels of government in Australia and Canada indicate that there is a not dissimilar extent of "intervention" by the Canadian federal Government in areas such as education, health, transport and housing. The Canadian federal intervention, however, is largely by way of direct expenditure rather than by grants to the Provinces, presumably because direct legislative powers exist in the Canadian case. (Only about 12 per cent of the outlays of Canadian Provinces is financed from federal grants compared with about 40 per cent for the Australian States).

This similarity between Australian and Canadian experience suggests that the much greater extent of vertical fiscal imbalance in Australia is not the primary reason for Commonwealth intervention via SPPs. One possible interpretation is that it establishes that there are either spill over benefits, or justifiable needs for national uniformity, and hence a need for central government involvement. Another is that there is simply a common force which leads the central government in a Federation to try to expand its power.

This latter interpretation, which I favour as the main influence, is justifiable by reference to the fact that federal intervention or involvement preserves or extends the political power of federal Ministers and their bureaucracies: indeed, without such intervention some federal Ministers and their bureaucracies would either not exist or would have much smaller portfolios. Moreover, even though federal intervention seeks to change State priorities and creates political tensions between federal and State Ministers and their Governments, relevant State Ministers and their bureaucracies tend not to oppose federal intervention because there is a similar "enhanced activity" spin-off for them.

This interpretation has not been much examined or debated in Australia, although it is entirely consistent with public choice theory. It is consistent with that theory for federal politicians, abetted by federal bureaucracies with a clear self-interest, to be wooing particular interest groups by promising to provide benefits to those client groups. "Justifications" for the offer of such benefits are readily provided by the numerous "experts" in the various fields who, unsurprisingly in view of their areas of expertise, point to the "need" for increased standards, and to "deficiencies" in States' services. Such justifications are often, moreover, superficially plausible—there is, of course, unlimited potential to increase standards if one assumes that the taxpayer has unlimited resources. Further, as public choice theorists have rightly pointed out, given that the cost per taxpayer of promised benefits is relatively small, it is difficult to mount effective opposition to what appear to be desirable objectives.

In the case of SPPs it is even more difficult to do so given that State Governments—or, more specifically, the relevant State Ministers and their particular bureaucracies—are naturally reluctant to reject offers of funding to provide apparent benefits, even though the administrative

arrangements involved may be onerous and quite costly and even though State Treasuries may capture some of the loot. In fact, even State Treasuries will be reluctant to advise against such offers if they know that, at least to some extent, the SPPs will simply replace State funds which can then be freed for other purposes, including deficit reduction.

The extent to which this explanation is plausible in the case of SPPs depends importantly on the effect which SPPs have on overall levels of State outlays in the areas of activity which are the target of such SPPs. If, as suggested, it is most unlikely that SPPs are determining at the margin the level of outlays in the great majority of those areas, and that the conversion of SPPs to general purpose payments would thus have little or no effect on total outlays in the targeted areas, this suggests that their use by the Commonwealth is primarily an exercise in extending or preserving political power. The conversion of SPPs to general purpose payments would significantly reduce not only the Commonwealth bureaucracy but also the number of Commonwealth Ministers needed. There would be similar, but smaller, effects on State bureaucracies and Ministers.

For the program of SPPs to be justified, the Commonwealth would need not only to establish that there are substantive objectives such as spill over benefits or national uniformity, but that it is in the best position to determine what should be done. As the Industry Commission's 1993-94 Annual Report put it:

"If.....some SPPs forcibly alter State expenditures, in principle such programs should continue only where the Commonwealth knows better than the States how much of a given service is demanded (interjurisdictional spill-overs) and can provide greater community benefit through SPPs than would arise under general revenue funding. And national policy objectives (universal health cover, standard national railway gauge), where funds need to be tied to a particular purpose, would need to be assessed using similar criteria. If, on the other hand, SPPs were found to be fungible, this would raise the question of why have them, especially if real costs are attached to SPPs arising from complex administrative requirements".

My submission is that SPPs are largely fungible and that we should not have them.
