
Public Policy and the Impact of Federal State Relations

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Paper

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In today's paper I will reflect on some of the broader, inter-governmental questions that are posed by the social inclusion agenda.

Firstly, I will situate that agenda within the broader debate that is taking public policy beyond economic rationalism.

Secondly, I will outline the converging policy fronts that led to the emergence of social inclusion agenda.

Thirdly, I will describe the National Competition Policy (NCP) and indicate the factors that led to its success as a national initiative.

Fourthly, I will enter the debate about the third wave of national reform. In particular I will outline the principles behind the Victorian government's proposals and contrast them with what has currently emerged from the Council of Australia Governments.

Finally, I will point to two issues that will need to be considered if the reform agenda is to deliver for the community – the roles and responsibilities of the different levels of government and the need for community engagement in the planning and delivery of policies and programs.

1. Going Beyond Economic Rationalism

There is little doubt that the capacity of the Australian economy has improved significantly over the last thirty years. This has been the result of important economic and social reforms that have incorporated a global and competitive outlook into our thinking and practice. We work hard and we have become adept at producing wealth.

This being said most sensible people acknowledge that it is only part of the story. Two questions come to mind: What about the environment? What about the quality of our social relationships?

In respect of the environment much has been said and much more will need to be said

and done now that we fully understand the wide-ranging implications of global warming. Working in a carbon constrained world will have enormous implications for the way we live and work and managing the transition will pose challenges for all levels of governments.

On the question of the health of our society we all know more needs to be done but what that "more" will involve has been the source of much contention. Some argue that we need a complete re-think of the way we measure progress and manage our performance. Concepts like "Gross Domestic Happiness" and "well-being" have entered the public policy vocabulary, as has "sustainability" and "the triple-bottom line".

Others argue that the focus should be on social inclusion and exclusion. What is important to this public policy agenda is the capacity of people to participate in the political, social and economic life of the community. It takes us to questions of attitude and values as well as policies and programs.

Writing in *The Age* earlier this year Paul Smyth has noted that the push for social inclusion has developed along two converging policy fronts. He explains:

The first was more welfare related. State governments in particular have picked up on the point that poverty is about more than an absence of money and that it is as much about a lack of skills, mental health, trust, social capital etc...

The second front has opened up in economic policy... Increasingly the economic value of our human capital is being linked to its social foundation. If children, for example, grow up in a family without adequate income and without universal high- quality childcare and pre-school then their future economic participation and productivity will be poor ¹

This second factor has, of course, been the basis for the so-called "third wave of reform" to boost Australian productivity.

It should be noted that there are actually two elements to this reform equation. The first involves a systematic attack on actually existing poverty and disadvantage. The second involves the institutionisation of what the Brotherhood of St Laurence have described as "life cycle" approach to social inclusion. This means putting in place specific policies and programs to deal with each of the key transition points in the modern day life-cycle, such as the early years, transition from school to work and ageing.² In other words the approach shouldn't just be about tackling poverty but about focusing on those periods of risk in the life-cycle. In other words, it deals with both poverty and the potential causes of poverty.

¹ Paul Smyth, "Business should seize its role in promoting social conclusion", *The Age: Business Day*, 11 October 2007, p.4.

² The Brotherhood's argument for a social inclusion agenda was recently re-stated by Tony Nicholson, "Social Inclusion the path to prosperity", *The Australian: Opinion*, 23 November 2007, p.16

Note also the recognition that social policy needs economics and economics needs social policy. This has been a crucial breakthrough in thinking that has encouraged social radicals to get serious about the labour market and employment policy and has encouraged economists to get serious about social capital as well as health and education policy.

Putting this another way there has been a recognition on the left that markets are important and, on the right, that human and social development is important. As a consequence, we see businesses becoming interested in their social responsibilities not just because of their commitment to corporate citizenship but also because of their recognition of the economic benefits of bringing the disadvantaged into the mainstream economy. Some have called this alliance between left and right the "third way".

This joining up of intellectual traditions and policy agendas has enormous implications for the way we are governed. Not only do they go to the heart of the way government is organised but also to the skills and capacities of those who work for the public sector. Governments will need better research capacity in order to identify what works and what doesn't work. Co-operation and integration within government as well as the community becomes important, as does the use of place and case management as a technique. Higher-level and lower-level co-ordinating instruments are going to be necessary not just to set goals and develop strategies, but also to monitor progress.

However, more than anything else there will need to be co-operation between the three levels of government – Commonwealth, State and Local. This is not just because of different levels of financial power and the shared responsibilities that have resulted, but also because of the wide range of issues that need to be addressed – health and education, the tyranny of distance, community networks, employment, transport and welfare. To be successful in addressing this wide range of issues the powers and resources – both formal and informal – of each of the levels of government will be needed. So too will be a strong measure of co-ordination and co-operation.

2. National Competition Policy

There are so many ways that governments come together to tackle problems. Sometimes there are relationships between particular governments to tackle issues of regional or local significance. For example, state governments and particular local governments often come together to plan and implement development strategies. Quite often, as well, local governments join together to form a regional grouping. Such regions share resources and ideas, co-ordinate policy development and seek support from other levels of government.

Given its financial strength the Commonwealth has initiated many partnerships with state and local government to promote policies and programs seen to be of "national significance."

In recent decades we have seen many such agreements in areas like water, training, counterterrorism, electricity supply and distribution and the environment. Commonwealth involvement in these matters has been made possible by favourable interpretation of its Section 51 powers by the High Court and through its extensive use of Section 96. This

enables the Commonwealth to make payments to the States on whatever conditions it determines. Alfred Deakin knew a thing or two when he said of the States in 1902 that although "legally free" they are "financially bound to the chariot wheels of the central government".³

In looking to how such agreements can be beneficial there is no better example than the National Competition Policy Agreement of 1995 (NCP). What did this agreement involve and why was it successful?

The NCP is identified as the second wave of economic reform following the first wave which involved the floating of the dollar, opening up of the financial markets to international competition and reducing trade barriers. The second wave followed in the 1990's with agreement between Australian governments that barriers to competition were holding back the economy.

In 1992 the Hilmer Inquiry was tasked with highlighting the areas in need of reform. In response the enquiry recommended the Commonwealth, State and Territory governments extend competition policy to government business, provide third party access to significant infrastructure and review legislation restricting competition. In 1995 the Industry Commission identified that the implementation of these recommendations would increase GDP and that the states alone would increase as much as 80% to this increase. As such at COAG in April 1995 all jurisdictions agreed to implement the Hilmer reforms. This was not a single policy but rather a mega-policy made up of many different parts targeting many diverse areas.

The NCP was successful and had a substantial impact on the Australian economy. Australia rose from 18th place in 1989 to 8th place on the global income ladder and increased Australia's per capita GDP by as much as a third. Both the OECD and IMF attribute this growth to the removal of government interventions which shielded the economy making markets more open, efficient and flexible. These reforms however required the involvement of all levels of government to achieve the national goal of improving competition. The reasons for this successful cooperation need to be understood. Firstly, there was an agenda agreed to by all governments up front that outlined the reform commitments with clarity and a high degree of specificity. Secondly, an independent body was established the National Competition Council (NCC) to negotiate, monitor and report on reforms. This body assisted the federal minister and the states and territories with advisory and research functions and made recommendations on access matters and also assessed the performance of governments in respect to their carrying out of the NCP. This was relevant to the distribution of annual competition grants by the Commonwealth to the States and Territories.

Thirdly and perhaps most significantly there were appropriate incentives for the states and territories to undertake reforms. In the negotiations that led up to the adoption of the NCP the states refused to sign any agreement until a deal was struck on the funding

³ Quotes in John Brumby, "The Reform Imperative in Commonwealth-State /relations", [ANZSOG Lecture](#), Canberra, 6 February 2007

aspects of the NCP. This was because the benefits of the policy were skewed towards the Commonwealth, with the States losing out in that they would have to give up their revenue raising monopolies. A deal was reached whereby the real per capita value of the financial assistance grants pool would be maintained. However, from 1997 special annual payments would be made to the states and territories on the proviso they met certain conditions. For instance, in order to gain access to the first tranche of \$200 million in 1997/8 states and territories had to meet the deadlines for reviewing legislation and the implementation of competitive neutrality policy. They had also to have implemented all COAG agreements on electricity reform and the national framework for free and fair trade in gas. Progress in road transport reforms was also required. In 1999/00 the amount was to increase to \$400 million subject to continuing progress in implementing the same reforms plus water industry reforms. In 2001/02 this increased again to \$600 million dependent on the states and territories having fully implemented and the continuing observance of all COAG arrangements with regard to electricity, gas, water and road transport. The tying of payments to performance and the use of an independent body to assess performance the NCC provided a fairer way in which the Commonwealth and States could share in the benefits of reform whilst also creating an enforcement mechanism and strong incentive for the states and territories to undertake reform.⁴

As such the process undertaken to implement the NCP required and achieved cooperation from all States and Territories and the Commonwealth. The structure created had an openness and flexibility that fostered innovation and autonomy for the states yet allowed for the achievement of national goals and priorities. This reform agenda and the initiatives it involved did not represent a centralizing process, nor did they override strongly articulated claims for diversity. The institutions and processes of the NCP showed that autonomy and interdependence could be married together.

It is also important to note that the process did not rule out politics in the process of seeking agreement and coming up with solutions. Indeed, there was a significant degree of political conflict that emerged in the process of consulting about desired competition reforms. This was occasionally reflected in the national inter-governmental forums when particular states pointed to different conditions and circumstances in their own jurisdictions. Such political argument is an important part of the process of ensuring legitimacy for reform. Without it the danger of populist reaction is always possible – and indeed we saw some of that with the emergence of One Nation.⁵

3. A New Reform Agenda

Whilst Australia's previous reforms have been highly successful the case for continuing effort has been clearly demonstrated. The fact that Australia was an early bird in the

⁴ Elizabeth J Harman, "The National Competition Policy: A Study of the Policy Process and Network" ", *Australian Journal of Political Science*, Vol. 31, No 2 (1996), pp.205-223.

⁵ On this point of the importance of political debate see also Geoff Gallop, "The Future of Federalism", *Keynote Address, Institute of Public Administration Australia, Perth, Western Australia, and 19 September 2007.*

reform process means that the incremental benefits diminish as other countries catch up and globalisation intensifies. Add to this emergence of China and India as major players in the world economy. Whilst this provides new opportunities it also means more competition in both low wage and high wage sectors of the economy. In the third place we need to fully understand the implications of the ageing of our population. It has been estimated that in the next forty years around forty five percent of our population will no longer be part of the workforce.

For governments the implications of these pressures on its policy-making are two-fold – firstly to continue the process of microeconomic reform and secondly to develop a new human capital agenda to boost labourforce participation and productivity. It is to this part of the third wave of national reform that I would now like to turn as it represents the incorporation of the social inclusion/exclusion policy agenda into the Australian debate.

Human capital is shaped by our systems of health, education, training and work incentives. In terms of health the healthier and more active the nation the better the economy. A national collaboration with an emphasis on prevention and a more evidence-based health system would improve health and limit the incidence and impact of ill health. Obesity is an area of health of particular concern and its occurrence is on the increase with a staggering 9 million Australians overweight or obese. This condition can cause a range of problems most particularly in relation to heart disease and type two diabetes.

These illnesses are in part preventable yet only 1.7% of the health budget is focused on prevention.

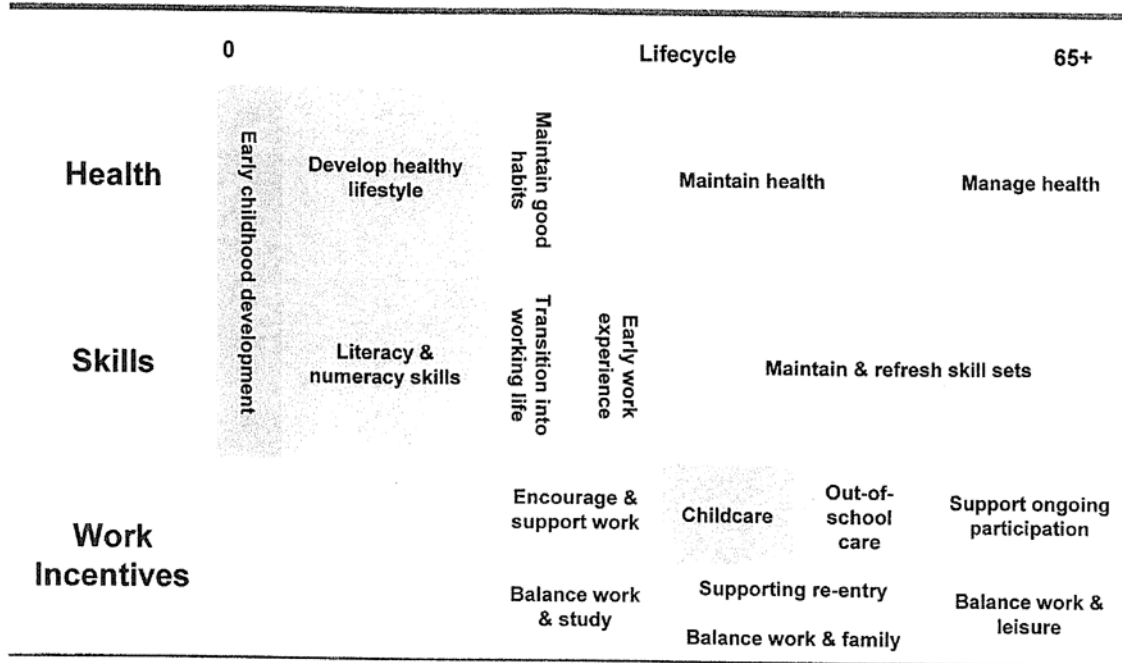
Education is equally as important to improving Australia's human capital. Skills shape economic and social opportunities and for Australia to progress there is a need for training to become a larger factor in Australia's economy. The ageing population makes this more relevant as does the changing nature of the economy where unskilled workers face serious disadvantages. A more systematic approach to education must be developed to be more flexible and responsive to a wide range of learning capacities and preferences.

As an example, there is a need for strategies to ensure that students stay longer in education or training. Access economics predicts that by increasing the number of students reaching year 12 to 90% will increase GDP by 1.1% by 2040. One of the most striking features of those who leave school early is that they are from poorer socioeconomic backgrounds, male, and living in remote areas. Leaving school at 15 is no longer a sufficient base for a working life.

It will also be necessary to improve the incentives to work. For instance, financial incentives are necessary to encourage people to use their talents and capabilities whilst the regulatory barriers preventing people entering the workforce need to be removed. In particular those in relation to part time work and working whilst drawing superannuation. There must be greater incentives to encourage people to move from welfare to work and schemes to encourage the world's brightest and most productive workers to Australia. This could involve reform to the tax system to simplify it and other incentives to encourage older people to remain in the workforce.

How the health, skills and initiatives agenda can be conceptualised in terms of policy priorities and the human life-cycle has been illustrated most clearly in the following diagram prepared by the Victorian Department of Premier and Cabinet:

A Holistic Approach to Change



Victorian Department of Premier & Cabinet, 2007

Victorian Department of Premier & Cabinet, 2007

The potential benefits of this human capital reform agenda are significant, and much greater than what can be achieved from the competition and regulatory reform agendas. The Productivity Commission has estimated that the competition and regulation stream could lift Australia's GDP by a further 1.74 percent over ten years. Human capital reforms, on the other hand, can increase net household disposable income and consumption by seven per cent. Victorian Treasury figures put the increase in GDP over ten years at around 2.5 per cent.

4. The Governance Question

We know then what the New Reform Agenda involves and we have learnt a good deal from the experience of implementing the National Competition Policy. Is the NCP model relevant for the future? However, before moving to answer that question it is worth reminding ourselves of the major governance questions that need to be asked.

1. What are the goals and objectives determined to be of national significance? By what process will that determination be made?

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2. What are the performance measures (and minimum standards) that are going to be set in relation to these goals?
 3. How will the roles and responsibilities of each level of government be allocated in relation to each of these goals?
 4. What reporting and accountability mechanisms will be put in place? Will there be an incentives and sanctions regime in connection to these goals?
 5. Will the monitoring regime be set up within the governments themselves or will it be set up independently from government?

We are fortunate the Victorian Government has devoted significant time and resources to provide answers to these questions. Their work is significant and deserves serious analysis.

The general principles involved in their thinking are as follows:

- The best results will come from a combination of jurisdictional flexibility and co- operation,
- The agenda will most likely be sustained if there is continuing independent and transparent assessment, and
- An incentives pool is required to ensure the appropriate sharing of the costs and benefits of reform.

In respect of the first principle there is a clear recognition of the need for policy diversity in order to promote innovation. At the same time there is a recognition that co-operation can add value to the reform effort through a sharing of responsibility – and possibly of funding as well.

One way to combine co-operation and flexibility is to set national goals but allow the states flexibility in how to meet those goals. For example the goals in health and education are designed to increase participation and productivity. They are:

- To reduce the proportion of the population not working because of ill health
- To reduce the incidence of chronic illness amongst children and the working age population
- To reduce the precedence of common risk factors that contribute to disease
- To reduce the burden of disease due to preventable morbidity and mortality
- To increase the proportion of students achieving benchmark levels of literacy, numeracy and writing in years 3,5 and 7
- To increase the proportion of students who complete year 12
- To increase participation in vocational education and training by the working age population
- To increase the proportion of the population who enter post-school education

The idea here is simple – set the objectives and then ask the jurisdictions to generate proposals on how they are to be achieved. In fact, this is what happened in Australia in the period following the July 2006 meeting of the Council of Australian Governments (COAG). Each of the States and Territories developed detailed reform proposals in the areas of literacy and numeracy, diabetes and early childhood development. Earlier this year the Victorian Government also released three 10-year action plans for co- operation with the

Victorian and Commonwealth governments in literacy and numeracy, obesity and type 2 diabetes and early childhood services.

Some progress was made at the 13 April COAG meeting with an agreement to some multilateral initiatives in health and education. The Commonwealth also committed \$100 million to combat growth in type 2 diabetes, to complement the already significant commitments outlined by the States and Territories in their own action plans. This takes us to the second and third of the three Victorian principles – independent assessment and joint funding.

It is the case that COAG agreed to the establishment of a Reform Council (CRC) to report annually on the progress in national reform. It was also agreed that the Council could make broad ex-post assessments of the costs and benefits of individual reform packages. It is envisaged that following the receipt of such assessment COAG may consider whether any "fair-sharing" payment would be appropriate.

It is at this point that we can see that the lessons of NCP have not been fully appreciated. The States and Territories had proposed to the Commonwealth there be a "reform dividend". The basis of their argument was simple – disproportionate benefits to the Commonwealth from the reform process. The Victorian Government had predicted that NRA would increase GDP by between 3 and 5 percent over the next ten years and 9 to 14 percent over the next twenty-five years. For the Commonwealth this would mean a fiscal dividend of between \$6 and \$10 billion and for the States a dividend of between \$1.5 to \$3 billion.⁶

As had been the case with the NCP it was proposed that an independent Reform Council undertake an on-going assessment of the costs and benefits of proposals. These assessments would provide the basis for sharing the costs of reform.

Not only does this provide an incentive for reform - as the Productivity Commission has noted in its support for gain-sharing – but it is also a recognition of the imbalance in Australia's system of revenue-raising. As we all know the states have the lion's share of responsibility for service delivery but a much narrower tax base to fund their services. Already forty per cent of state revenue is in the form of Commonwealth grants, with forty percent of that in the form of Specific Purpose Payments.

The Victorian argument that it would be impractical to wait until all the benefits are completely realised before assessing them has validity. Not only is it the case that there are significant time lapses involved before all the benefits can be realised, the whole question of incentives needs to be given priority. Chris Barrett, Deputy Secretary of the Victorian Department of Premier and Cabinet put it this way:

Ongoing assessment of costs and benefits as they are being realised will:

⁶ See Victorian Department of Treasury and Finance, National Reform Agenda: a case for sharing the gains (July 2006) and Productivity Commission, Potential Benefits of the National Reform Agenda (February 2007)

- help inform the development of reform proposals;
- accelerate the development of human capital modelling expertise;
- ensure the CRC is well-placed to decide when sufficient benefits have been realised to provide COAG with a comprehensive report;
- and allow early COAG consideration of a fair sharing of the costs and benefits of reform as soon as possible⁷

This is all commonsense if we are to create and maintain momentum in the reform process. When it comes to human capital reforms it is the consistency of the effort over a long period of time that is going to be crucial. What is also clear about the Victorian proposal is its emphasis on an "outcomes" basis for assessment. This gives the States and Territories the fullest scope for developing ways to achieve those outcomes in their own jurisdictions. What we need is activity and the sharing of the lessons across the nation.

The Governance Question (2)

What, then, of the question of the roles and responsibilities of the various levels of government within this framework of funding and assessment?

It would be simple of course if the Commonwealth were just the "funder" and the States and Territories the "providers". In fact, a large part of any national reform agenda will be of that nature – and must be so in the absence of radical reform of Commonwealth-State financial arrangements. However, in respect of the human capital agenda it is clear that there are enormous policy inter-relationships between the different levels of government, particularly but not only in the area of health. Duplication of roles and responsibilities may mean a blurring of the lines of accountability and the temptation to play what has been described as "the blame game".

It follows that reform is also going to require not just higher levels of co-ordination but also collaboration on the ground. A clarification of roles and responsibilities will be important. It is crucial that the governance framework is agreed and acceptable to all jurisdictions.

Achieving this remains a significant challenge for the reform effort but will be easier to achieve given the outcomes-based focus and commitment to the federal framework implicit in the current agenda.⁸

Whilst we have a pretty good idea of how the Commonwealth, State and Territories can work together for reform, as they did with NCP, we are still left with the question – is a top down, COAG-level approach going to be enough?

I say "top down" because the NRA is still conceived in terms of a top-level agreement between governments to achieve improved participation and productivity. It is true that the Victorian model has recognised jurisdictional flexibility as a key element in that it allows for

⁷Chris Barrett, "Facilitating National Reform", Presentation to the COAG Reform Council (Department of Premier and Cabinet), 16 October 2007

⁸Meredith Edwards, "Federalism", Presentation at IPAA National Conference, Perth, 2007

However, this doesn't tell us how we are going to deliver the policies and programs within the community, or should I say the "communities" which make up each State and Territory. In saying this I note the observation made by Tony Nicholson about a successful social inclusion policy.

It would recognise the importance of place, by prioritising resources to the most disadvantaged communities and giving local communities control over agenda setting and service delivery.⁹

It would also mean the engagement of employment-creating business (and local governments) to provide that all-important link between the social and economic dimensions of reform.

In many ways State and Territory governments are well equipped to play this role of promoting and facilitating a regional and community dimension to the reform process. Indeed they will need to see themselves as "brokers" between the communities they represent and the Commonwealth Government. This will need to involve the development of formal and informal networks at regional and local levels if it is to work.

Conclusion

Federalism offers significant benefits to its citizens. It provides for innovation through competition and institutionalises checks and balances at the heart of government. However, the Australian experience has shown that none of this means that co-operation and co-ordination across the system is not possible. Indeed, what is unique about the system is the mix of co-operation and competition that has been developed. This has provided the base for significant public policy innovation at the highest and lowest levels of government.

The particular nature of the social exclusion/inclusion agenda is such that joined up government is necessary within government itself, between governments and between governments and the community. By focussing on outcomes, shared responsibility and financial incentives the reform agenda developed by the Victorian Government has the potential to deliver improvements in participation and productivity. Just as importantly it will create an environment that encourages new ideas and innovation. Given the different circumstances that prevail in different communities throughout the nation this could prove to be its greatest strength.

⁹ "Social Inclusion as the Path to Prosperity", p.16.