

“New Partnerships and Social
Compacts to Enhance
Federalism”

By

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In my talk today I will start by making a general point about how we ought to approach questions related to governance and our federal system. I will contrast what I will call the pragmatic and philosophical outlooks and link this to an assessment of federalism.

In the second place I will examine the way our federal system dealt with the microeconomic reform agenda which emerged as a dominant theme in the 1990s. Using the lessons from that era I will look at the problem and prospects associated with the Rudd government's productivity and participation reform agenda. I will argue that there are important differences in context and policy that will make partnerships with the community and a stronger commitment to fairness vital ingredients in the reform effort.

Pragmatism and Philosophy

However, let me begin with the distinction between pragmatism and philosophy. The pragmatist in these matters will ask: "What works today?" The former Prime Minister John Howard provided us with a case study in pragmatism in his speech to the Millennium Forum in 2007:

So much of the debates about Commonwealth-State relations concerns the respective roles of the two levels of government, as if an balance were an end in itself. To me, that misses the point. We should be neither centralist nor slavish adherents to states' rights. We should be focussed on outcomes, not systems.¹

Such an approach begs the question as to whether federalism – and the balance that comes with it – is conducive of good outcomes. Indeed the very study of government is about this question – what systems best survive the test of time and circumstance? And, surely, we should be concerned with accountabilities as well as outcomes.

This takes me to the philosophical approach. It encourages us to talk about means as well as ends and about process as well as outcomes. Good political philosophy – as practised for example by the Founding Fathers of the Australian Constitution – is both idealistic and realistic. It does make judgements about what works and what doesn't work but in the context of time and circumstance. Our system needs to work today but it also needs to be able to sustain success. What may be a fix today may prevent a solution tomorrow.

The Case for Federalism

Good systems need to be able to allow for change and to be able to manage change. They need to provide a framework that allows the creative and liberating aspects of politics to work. This means creating multiple centres of power and proper mechanisms of democratic accountability. A good federal system provides for this and that was recognised by the Founding Fathers when they took elements from the American Constitution and grafted them onto an English system of parliamentary government. Yes it is true that favourable interpretations of the Constitution by the High Court and enormous financial strength has seen the power and reach of the Commonwealth expand but the States still play a major role in our system – as service providers, law-makers, advocates, facilitators, innovators and partners in a range of national initiatives.²

¹ John Howard, Speech to the Millennium Forum, Sydney, 20 August 2007

² See Geoff Gallop, "A Radical Legacy", Griffith Review, Autumn 2008, pp. 55-62

All too often, however, the debate about these matters is treated in a narrowly utilitarian and economic manner, as if the nation is a giant factory. This manufacturing analogy is taken even further with the view that the sole aim of government is economic efficiency as defined by the neo-classicals. In such a view government itself and the number of governments need to be limited. In its most extreme manifestation such a view leads to the conclusion that politics itself is dysfunctional. Not surprisingly, then, the application of such an ideology has the unfortunate habit of breeding its opposite – populism – which as we know has the potential to develop in a particularly nasty way.

We need a philosophy of government that incorporates the values of liberty, equality and community. The federalist principle and its twin sister – subsidiarity – gives room for each of these principles. It gives choice to electors, fosters competition and innovation in policy, provides for checks and balances by creating multiple centres of power and allows for a healthy diversity to emerge in the way things are done throughout the nation. It is a system that is and has been successful in a range of ways, including economic.³

The implication of all of this is clear – we need to evaluate public policy proposals not only on the basis of their short-term outcomes but also on the basis of their longer-term system effects. We need to acknowledge that there will be pressures on the Commonwealth to take up a range of issues deemed to be of national significance such as productivity, social and economic disadvantage, climate change, water and security. Inevitably this will take them into areas of state government responsibility. Just how this intersection is handled becomes a crucial issue.

The Microeconomic Reform Agenda

In the last decade of the twentieth-century inter-governmental issues became crucial for a nation which had been constructed on the basis of protectionism and public sector monopolies. With the intensification of global competition and technological change a less risk-averse and more flexible economy was deemed necessary for national prosperity. It was agreed by the Commonwealth and the States that a more open and competitive economy was required and this meant less regulation generally and more contestability for the public sector. The microeconomic reforms that followed were far-reaching in their implications and generally regarded to have been successful in promoting productivity.

The federal system came into play because most of the reforms needed had to come from within the States. The model designed to facilitate change involved a Commonwealth/State Agreement, incentive payments from the Commonwealth in the event of successful implementation of reform, autonomy for the States in respect of the reform process and independent monitoring to determine outcomes.

The States all agreed on the need for reform and accepted the responsibility to pursue it. However, they were not forced to make changes, simply given payments in the event of successful implementation. In each of the States the reform process had to be debated in the community and in the Parliament. In all the States except Queensland this meant winning the support of the Upper House as well as the Lower House of Parliament, never as easy affair in today's world of proportional representation. Indeed the existence of these State Parliaments ensured that each

³ On the case for federalism see especially Ann Twomey and Glenn Withers, Australia's Federal Future (Australian Council for the Federation, 2007)

of the reform items was given a thorough working over as one would wish to see in a properly functioning democracy.⁴

This model of Commonwealth/ State co-operation has provided the template for the Rudd government's productivity and participation agenda. However, before looking at this new agenda and its implications for federalism let me note two important features of the successful microeconomic reform agenda.

Firstly, there was clarity in respect of the problem and what needed to be done to solve it. What we now call the neo-liberal or new public management ideology became established wisdom. Its policy prescriptions were straightforward-review legislative restrictions on trade and commerce and open up the public sector to competition and the level playing field. These "outputs" were seen to be necessary to achieve the desired "outcomes", that is improved productivity.

Secondly, and importantly, only the government itself, on its own or acting through the Parliament, was involved in the change process. That is not to say that there was no community debate and controversy but rather that the end of the process – as determined by the independent monitor – was a particular act or decision by the Cabinet and/or the Parliament.

The Third Wave of National Reform

With these two points in mind let me now move to the latest version of national reform. The focus of this so-called "third wave of reform" is on productivity and participation.⁵ It differs from the earlier phase of reform with its incorporation of human capital and social inclusion, alongside regulatory and competition reform from the earlier era, as forces for productivity growth.

The argument behind the addition of these elements is simple – a healthier and more skilled population is a more productive one. So too is productivity enhanced when those previously incapable or unwilling to participate in the labour market begin to play their part.

Although the focus is still very much on productivity – necessitated by the continuing and growing pressures of international competition and an ageing society – the terms and conditions of the debate have been widened significantly. It is as if the economic radicals became serious about health, education and social inclusion and the social radicals became serious about the labour market and employment policy. Paul Smyth has described the two converging policy fronts that have taken us to social inclusion as a policy objective:

The first was more welfare related. State governments in particular have picked up on the point that poverty is more about 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

⁴ See Geoff Gallop, "The future of federalism", Keynote address, Institute of Public Administration Australia, Perth, Western Australia, 19 September 2007

⁵ See Victorian Department of Premier and Cabinet, The History of the National Reform Agenda (n.d.) for a list of the major documents developed in support of the third wave of reform.

without universal high quality childcare and pre-school then their future economic participation will be poor.⁶

Whilst some of the policy prescriptions to promote racial inclusion and better health and education speak for themselves, not all do. This is an area of policy disagreement. However, what is not a matter for disagreement is the life-cycle approach that has been embraced to further this economic and social reform program. What it means is the development of specific interventions to deal with the key transition points in a person's life such as the all-important early years, schooling, the move from school to work and from work to retirement. The early years are seen as particularly crucial. As the Government's own Budget Papers put it:

Over the longer-term, early childhood education generates substantial cost savings from improved health and productivity and reduced expenditure on social services.⁷

What we have, then, is a description of the problem and a general understanding of what needs to be done to fix it. As was the case in the 1990's many of the initiatives that would need to be taken to address the problem are the province of the States. This takes us to the model of co-operative federalism that has been designed to engineer change today.

Kevin Rudd's Co-operative Federalism

There is little doubt that the Rudd model of co-operative federalism is the most sophisticated to have occupied this space for some time.⁸ It is designed not just to facilitate the new reform agenda with its proposed National Partnership Payments to support the delivery of specified projects or facilitate or reward nationally significant reforms, it also involves a major reform of the Specific Purpose Payments system of Commonwealth support for the States. In 2007-08 there were \$22 billion worth of SPP's, equivalent to 2 per cent of the Gross Domestic Product.⁹ They account for about one in six dollars of total state revenue and are many and complicated.

The aim of the reform exercise is to reduce the number of Specific Purpose Payments to five or six, backed up by new national agreements in the areas of health, early childhood development, schools, vocational education and training, disabilities services and housing. Rather than dictating how things should be done, it is intended that the new arrangements focus on agreed objectives and outcomes. Part of the agreement process will also be the clear identification of Commonwealth and State roles and responsibilities with only high-level strategic outputs critical to clarifying outcomes being specified. The agreements will be ongoing with independent assessment of performance to be undertaken by the COAG Reform Council. Such independent assessment is vital if there is to be accountability for performance.

The theme for this new system is simple and straightforward-unity over the objectives and significant autonomy for the States in respect of the means to achieve these outcomes. The current system of input controls will come to an end, being replaced by objectives, outcomes and strategic outputs.

⁶ Paul Smyth, "Business should seize its role in promoting social inclusion", The Age: Business Day, 11 October 2007, p.4.

⁷ Australian Government, "Ministerial Statement – Education Revolution", in Budget 2008-09

⁸ For a summary see Australian Government, Budget Paper No.3, 2008-09

⁹ Robert Carling, "Fixing Australian Federalism", Policy, vol. 24, no.1, Autumn 2008, p.32

It has also been agreed that each Statement of Objectives and Outcomes attached to a Specific Purpose Payment will need to address the issues of social inclusion, including responding to Indigenous social and economic disadvantage. In other words social inclusion is not to be treated as an “add-on” but is to be integrated with mainstream policy objectives.

The National Partnership Payments to facilitate or reward reforms deemed to be of national significance will be an addition to the system of Specific Purpose Payments. Reform facilitation payments will be paid in advance of implementation in recognition of the costs involved in reform. Reform reward payments will not be paid to a State unless the COAG Reform Council certifies that certain performance benchmarks have been achieved. Some payments will also be made to the States to assist with discrete infrastructure projects. Indeed one feature of the proposed model is that capital as well as recurrent expenditure is involved, the former via the proposed infrastructure funds (Building Australia Fund, Education Investment Fund, and Health and Hospital Fund).

One can see how some of the ideas associated with the microeconomic reform agenda of the 1990’s have been incorporated into the new model. Firstly, there is agreement between the Commonwealth and the States to tackle the human capital and social inclusion issues related to productivity enhancement. Secondly, there is a recognition of the need for flexibility in the delivery of change. Thirdly, there is a system of incentive payments designed to encourage change. Fourthly, there is a process of independent monitoring by the COAG Reform Council.

Some Contemporary Challenges

However, there are a number of differences that need to be acknowledged and their implications examined. The first relates to the relationship between outputs and outcomes. In respect of the economic reform agenda of the 1990’s it was agreed that microeconomic reform measures by State Governments and State Parliaments would promote productivity by way of increased competition and a greater reliance on market signals. In other words it was enough for all sides to agree on certain policy initiatives (or outputs) as it was assumed they would lead to the desired outcomes (increased productivity).

In respect of the current agenda the agreement is to be on the outcomes and perhaps some high-level strategic outputs seen as necessary for those outcomes. However, in respect of the specific policies and programs that will lift and extend education standards, improve health outcomes and promote labour market participation there is not the same level of agreement. We have already seen this illustrated in the debate over education and schooling. We know that the model is designed to allow for flexibility and diversity in policy and service delivery. However, the temptation will always be there for the Commonwealth to move away from a purely outcomes-based accountability. It has the financial power and, of course, history has taught it that the High Court will generally accommodate its point of view on constitutional interpretation.

One should also note that the level of transparency that will be created by this new regime will put the States on the spot in respect of their policy and implementation credentials. Indeed by clarifying roles and responsibilities in the context of a new financial agreement the States will be clearly accountable for their performance. They will be under pressure to perform.

In order for federalism to be the winner from these arrangements the Commonwealth will need to resist temptation and the States will need to improve their policy making and policy delivery mechanisms.

The second difference from the 1990's also relates to the question of outputs and outcomes and raises a major issue in respect of reform implementation. The competition reforms of the 1990's required action by governments and parliaments alone – introducing a purchaser-provider split, disaggregating and corporatising or privatising government utilities, removing restrictions on free trade and commerce and ensuring a level playing field between the government and private sectors. The financial incentives that were provided were to governments to do certain things. In an important sense it was a top-down government.

The third wave of national reform is quite different in that it seeks improved outcomes in health, education and employment. Not only is there the desire to lift standards generally, but also to tackle social exclusion. Issues like the incidence of chronic disease, the prevalence of common risk factors that contribute to disease, preventable morbidity and mortality, obesity and diabetes, literacy and numeracy, retention rates in education and the culture and capacities associated with work have become central to the productivity and participation agenda. And as noted earlier early childhood services have been elevated up the ladder of public policy priorities.

What is interesting about these issues is not just that there is fierce debate about what works and what doesn't work, none of them can be properly addressed without the engagement of the community and without recognising that a "one-size-fits-all" approach is doomed to fail. In fact when we speak of the community we need to acknowledge that we are really speaking about the many communities, some urban, some rural and some remote, that makes up each state. If the outcomes being sought are to be achieved engagement and specificity will be crucial. We are talking here about case and place management as well as the engagement of the private and non-government sectors at the national, state and local levels. It is an agenda that involves capacity-building as well as community involvement over agenda setting and service delivery.¹⁰

In other words what is going to matter is not just the structure of inter-government relations and the funding model that will back it up, but also the ability of governments to involve the community, including business in its health, education and labour market agendas. Reform is going to involve partnerships between governments, individuals and communities, particularly in respect of social inclusion. Indeed if the outcomes are going to be achieved the ability of the States to create and manage such partnerships is going to be crucial. They will need to be facilitators in the way they deliver their services throughout their jurisdictions. In other words the governance aspects of the new reform agenda don't just involve inter-governmental agreements but will also require partnership agreements at the regional and local levels within each State.

I think we need to acknowledge that whilst Australian public institutions have been generally effective they have not been able to produce the same "equalising" efforts as those of other nations.¹¹ Of course the social and economic backgrounds we have will have a strong influence on outcomes (such as levels of educational achievement) but the whole point of publicly funded services is to even these

¹⁰ See Tony Nicholson, "Social Inclusion the path to prosperity", The Australian: Opinion, 23 November 2007, p.16

¹¹ See Kevin Rudd, "Quality Education: Address to the national Press Club", 27 August 2008

differences out as much as possible. Reversing some of these statistics, and the inequalities they represent, won't be possible with a continuation of the status quo. This is where the National Partnership Payments become crucial – they will need to be designed to promote the sorts of changes that will make the system more responsive to the needs and interests of the most disadvantaged in the community.

Managing the Politics of Change

This leads me to another observation about the problems attached to the social inclusion agenda. Very rarely is it the case that complex agendas like this are given a free run within government. Usually they compete for time and resources with other agendas, in this case the more narrowly defined microeconomic reform agenda, a broader national security agenda which will come at significant cost, and, of course, the most diabolical of issues climate change. We know how microeconomic reform impacts on power and distribution and Professor Gernaut has been reminding us of how a reduction of our carbon imprint will have differential impacts through society. Perhaps it will be necessary to see social inclusion less as a means to greater productivity and more as a part of a broader fairness agenda designed to hold society together in a time of change. This means toughening up the equity elements of the new reform agenda.

I say this in the context of experience of the first and second waves of economic reform. At that time there was a clearly defined reform narrative and a major effort to involve not just the levels of government but also the major economic interests in the reform process. Indeed the Accord with the trade union movement and the articulation of the idea of a Social Wage for working families was important glue. However, even then it was difficult to contain the discontent that surrounded a change process dedicated to more fully exposing the economy to market risks. Significant interests, particularly in rural and regional Australia, felt they had no stake in the reform process and a sense of grievance emerged which remains a powerful force today. The point I am making here is that the Rudd model of co-operative federalism faces the sort of risks associated with any model of top-down performance management. Yes, there are clearly defined objectives, the precise measures of performance, the incentives for all levels of government to participate and an independent assessor to report to the nation on the achievement of the targets. However, not only will the achievement of the particular goals themselves require the engagement of individuals and the community (as I noted earlier in my talk) but so too will the success or otherwise of the project itself. It will require a justifying narrative that is widely understood and deft political management from the Commonwealth. Recognition of the institutions, interests and sentiments involved, in particular the States whatever their political colour, will be required. And, of course, society is always more restless and less rational than is assumed in the best of the change management texts. Thus I'm afraid it will remain unless we broaden and deepen the terms and conditions of the contract between government and people to strongly reflect the equality element of our commitment to liberty, equality and community.