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# A Framework to Guide the Future Development of Specific Purpose Payments (SPPs)

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A discussion paper by the ALP Advisory Group on Federal-State  
Reform

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## **Terms of Reference for Advisory Group on Federal-State Reform**

To propose a detailed outline of a proposed reform, or alternative options for reform, of the architecture and operation of federal-state relations to reduce inefficiency, duplication, and the opportunity for blame shifting and cost shifting, particularly in the light of the:

- Widespread recognition of the economic cost of waste and inefficiency;
- Need for a new round of micro-economic reform;
- The budgetary and resource implications for all levels of government; and
- The impact of the ‘Workchoices’ decision of the High Court.

In particular, the Advisory Group should examine:

- Reform of the scope and nature of Specific Purpose Payments (SPPs) arrangements;
- Council of Australian Governments (COAG): its frequency of meeting, support structures and programs;
- COAG Reform Council: proposed structure and function;
- The role of local government;
- The roles and performance assessment of Ministerial Councils;
- The role of incentives for improved performance by all levels of government;
- Independent assessment of outcomes;
- The case for a Constitutional Convention to consider proposals for reform;
- A framework for defining immediate priorities and medium and long-term options;
- The need for constitutional reform to facilitate co-operative arrangements; and
- Processes for community consultation.

## **ALP Advisory Group on Federal-State Reform**

### **A Framework to Guide the Future Development of Specific Purpose Payments (SPPs)**

*“...The use of S.96 grants is a means by which the Commonwealth shapes national policy priorities, ...There is no turning back. Nor should there be. The challenge, instead, is to make our current arrangement more workable, more rational and less dysfunctional”*

*“The challenge for a future Labor government will be to rebuild the federation. And it is my argument that the federation can be rebuilt based on the principles of co-operative (rather than coercive) federalism”*

Kevin Rudd *The Case for Cooperative Federalism* Address to the Don Dunstan Foundation 14 July 2005

#### **Introduction**

Federalism is constitutionally and politically embedded within the Australian system of government. Attempts to circumvent it, or to construct policies on the basis that it might have been better had it never existed, are not only the basis of inefficient government, but also certain to fail over the long run.

However, the development of a national economy, the pressure of a global economic environment, and the need to apply national resources to address the demands of a modern society, has necessitated a central role for the Commonwealth with the Federation

Specific Purpose Payments (SPPs) have become a major vehicle through which the Commonwealth has taken on that central role. SPPs allow the Commonwealth Government to pursue its particular policy objectives – which at present may or may not be nationally significant – in areas that are administered by the States. Typically the States are required to fulfil specified conditions in order to receive these SPPs, and it is this aspect of conditionality that effectively defines SPPs<sup>1</sup>.

#### **Problems with SPPs**

SPPs have a long history in Australia, and since the 1960s they have become a very significant source of funding. This development of the Commonwealth's role in areas such as education, health, and transport, which account for more

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<sup>1</sup> Technically there are some other payments that are treated as SPPs in the Australian Budget Papers, such as financial assistance to local government, which is passed through the States, but because these payments are untied they are not covered by this paper. However, assistance to local government and its role in the Australian federal system will be considered in the final report by the Advisory Group.

than three quarters of total SPPs, is for the most part accepted by the States. Certainly the States have become dependent on the funds that are provided through SPPs, which amount to more than 40 per cent of the total payments from the Australian Government to the States.

It seems most likely therefore that SPPs will continue, but there are a number of problems that need to be addressed if SPPs are to be more effective in achieving their legitimate purpose of achieving what are genuinely national objectives.

1. There is what Kevin Rudd has described as a basic level of frustration and confusion in the business community and the general community about who is responsible for what.
2. Associated with this lack of clarity regarding the respective roles and responsibilities of the Commonwealth and State governments, there is the tendency of each level of government to blame the other, and the lack of proper democratic accountability that often occurs when there is a problem.
3. There are considerable opportunities for each level of government to shift costs on to the other, particularly in the health, disability, ageing and broader social security systems.
4. The nature of the conditions imposed on SPPs can sometimes distort priorities and lead to inefficiencies.
5. There is typically some overlap and duplication in the administration of SPPs, with accordingly some loss of administrative efficiency.
6. Recently there has been a proliferation of small SPPs, that have no obvious national purpose and which seem principally designed to give Federal members of parliament a local political advantage.

### **Objectives for Reform**

The overriding objective of reforming the way in which the Commonwealth establishes SPPs and the process by which the Commonwealth and the States manage SPPs must be to enhance and support co-operative federalism.

In their modern form, SPPs have come to represent the practical expression of Federalism. SPPs are a legitimate means for achieving a genuine national purpose, but they should be directed to that national purpose and be based on a genuine partnership built between the Commonwealth and the States. Unfortunately under the current government SPPs have frequently become the mechanism for Coercive Federalism with the Commonwealth dictating conditions to the States. Often these conditions have nothing to do with the objectives of the program (eg, industrial relations conditions on program funding), or they seek to dictate delivery processes where there is no need for national uniformity and where diversity and experimentation might better achieve the program's objectives.

In contrast with coercive federalism, cooperative federalism should use SPPs as a vehicle for developing partnerships between the Commonwealth and the States. These partnerships will be the basis for:

- reducing the “blame game” and improve public accountability of who is responsible for what, with fewer possibilities for cost shifting
- improving the quality and cost-effectiveness of services, minimise duplication and overlap, and maximise administrative efficiency.

A focus on the reform of SPPs as a step towards co-operative Federalism does not, however, eliminate the need for a more fundamental audit of the respective roles of the Commonwealth and the States. Rather, sorting out these roles in a modern economy will be a central aspect of any reform process.

### **The Scope of Reform**

There are three areas in which reform of SPPs needs to take place. These are:

1. Establishing broad principles for Commonwealth State Relations
2. Setting Objectives for SPPs
3. Managing SPPs

### **Establishing broad principles for Commonwealth State Relations**

SPPs should be situated within a broad set of principles governing future Commonwealth-State relations.

There are two fundamental principles, which must be balanced:

- The national interest principle, and
- The subsidiarity principle

The Commonwealth should be engaged when there are genuine national interests at stake, but only to that extent. Otherwise the subsidiarity principle should prevail.

Under the national interest principle, traditionally SPPs have been introduced in pursuit of the Commonwealth’s chief responsibilities for the performance of the national economy and income security. The national economy includes the development of a national market for those goods and services that are readily traded beyond State borders. The Commonwealth’s responsibility for income security extends to ensuring the access of all Australians to minimum standards of basic services. More recently SPPs have also been introduced to assist the achievement of the Commonwealth’s responsibilities for national security, human rights, and the environment and national heritage. But as a general principle the Commonwealth should only become involved in those issues traditionally managed by the States where Commonwealth-State inter-action is

necessary to enhance efficiency, equity and/or access, or the basic rights and heritage.

Criteria for determining the extent of national interest include:

- Spill-over effects – Murray-Darling basin
- Equity or common national interests – social welfare support, defence and external affairs
- Need for uniformity where a diversity of rules would create inefficiency – national market, climate change
- Significance and/or difficulty of issue – aboriginal health, national disaster, Asian languages, national heritage
- Policy inter-relationships – education & training and economic performance; health and housing and income support.

Under the subsidiarity principle decision making should be devolved to the maximum extent possible to those who are closest to the beneficiary of the service. This improves the quality and responsiveness of the service to individual and community needs, and achieves maximum democratic accountability.

Even where there is a clear Commonwealth interest, it does not necessarily require a Commonwealth take-over. Nor does Commonwealth interest automatically equate to the national interest nor automatically require strict uniformity.

One of Federalism's major strengths is its capacity for policy innovation and policy transfer across jurisdictions. This can develop through "Competitive Federalism" which recognises the potential for competition between the states by allowing the States to choose how best to deliver services can promote innovation and efficiency through healthy competition, as well as being more responsive to local conditions.

The Commonwealth can set broad guidelines for service standards or outcomes with the States maintaining maximum discretion about how the service is delivered. In particular, where a service is place-specific (eg urban transport and water), and there is no chance of a national market developing, the maximum extent of Commonwealth intervention should be limited to agreeing some broad guidelines for the States to follow (eg water pricing by the States could follow the principles agreed in the National Water Initiative; environmental assessments can be carried out by the States, using processes accredited by the Commonwealth, where the environmental issues are of national significance).

However, it will never be possible to completely delineate the respective responsibilities of the Commonwealth and the States. Most importantly, the extent of inter-relationships between different policies (eg education and economic performance) means that whole-of-government solutions that

necessarily involve both the Commonwealth and the States are increasingly called for.

In addition, no Commonwealth government, of either political persuasion, will move to fund the states through non-tied revenue grants or make 'room' for them to create their own revenue sources to adequately meet those specified responsibilities. Practically some level of revenue transfer is always likely, and even a reduction in VFI would not necessarily convince the States that they were adequately financed relative to the demands on that finance. And so long as the States are dependent on Commonwealth payments for a significant part of their revenue, the present perverse incentives for the blame game may well continue even if there were a substantial reduction in the present level of VFI.

Nevertheless the architecture governing future Federal-State relations could seek to discourage the creation of SPPs, for purposes unrelated to the national interest. In the main, however, the focus of reform of SPPs is on the principles and options for making them work better where there are genuinely shared responsibilities.

## **Actions**

The starting point for reform of SPPs must be a commitment by both the Commonwealth and the States to work towards identification of those SPPs which do not meet the "national interest" test. This could be made a priority for COAG and conducted as part of the fundamental audit of the respective roles of the Commonwealth and the States envisaged by the Leader of the Opposition in his Dunstan Foundation speech.

*"The first step under a co-operative Federalism model might be a simple audit of current roles and responsibilities between the Commonwealth and the States in critical portfolio areas."*

This audit should assess the inter-governmental arrangements for current SPPs and could use the following criteria, first proposed by the Allen Consulting Group (ACG) report to the Victorian Government:

- Degree of *strategic outcomes focus*, including identification of agreed strategic outcomes and agreed measures of progress
- Degree of *coordination of related programs* bearing on the agreed outcomes, including targeting these outcomes, coordination of policies and planning, minimisation of inconsistencies and overlaps
- Degree of *inter-governmental collaboration*
- *Promotion of efficiency* – absence of input controls and micro-management
- *Dynamic improvement stimulated by diversity*

Following this audit, the Commonwealth should withdraw from those SPPs that perform poorly against these criteria and/or are not really nationally significant, possibly replacing some or all by untied revenue grants, which

might then be separately identified. This and other possible options for reform of SPPs are further explored below.

### **Setting Objectives for SPPs**

The objectives which are set for SPPs by governments are important because they set the framework for how SPPs are managed by Commonwealth and States officials.

To the greatest extent possible the objectives for each SPP should be agreed by both the Commonwealth and the States. This agreement on objectives should be facilitated if negotiations recognise some key principles, also suggested in the ACG report. These principles are:

- governments should focus on *better outcomes*
- State governments should have the fullest scope for developing *diverse ways to deliver improved services* for their own communities
- SPP arrangements should be reformed in the mould of a *partnership* – consistent with collaborative federalism.

Adoption of these principles would ensure the future compatibility of collaborative federalism with competitive federalism. The Commonwealth and the States would *collaborate* in determining the objectives and outcomes to be achieved by each SPP. But the States would still be free to *compete* about how best to achieve those objectives and outcomes. It is this competition that can lead to greater efficiency and innovation, without the risks of all being wrong for the same reasons. Rather over time it can be expected that best practice will be disseminated among the various States through competition, while still allowing collaboration with the Commonwealth in planning services and the outcomes to be achieved.

### **Managing SPPs**

To a large extent the friction that arises between the Commonwealth and the States over SPPs stems from the conditions the Commonwealth imposes in an attempt to control the management of the programs. The concerns of the States are long standing and were documented in the Discussion Paper prepared by the Heads of State and Territory Treasury Departments in 1999. These concerns include:

- lack of flexibility and a focus on program inputs rather than outputs or outcomes
- duplication of roles and responsibilities
- costs of compliance and administration
- lack of consultation
- blurred accountability with no recognition of the separate roles of State and Commonwealth governments



Understandably, the Commonwealth's concern is to ensure that it can account for its own expenditures, that the States fulfil their obligations to jointly fund programs and that SPPs are not a means to shift costs. But it is debateable as to how successful the Commonwealth is in preserving its legitimate interests through many of the present conditions that it imposes on the States' administration of SPPs.

Even where there are shared responsibilities between the Commonwealth and the States it can be possible to identify and agree on separate roles in meeting those responsibilities. The Commonwealth most often is a source of funds and has a principal role in policy development. The States are mainly engaged in the delivery of programs, and they must have the flexibility to be able to redeploy inputs so as to adapt to local circumstances. Agreement on how program performance is to be measured and assessed is therefore critical to the future management of SPPs, and the Commonwealth should refrain from making information demands upon the States unless it can be agreed how that information will be used to advance the management of the relevant SPPs. The States must also be able to use their practical experience in program delivery to inform the development of future policy. Acceptance of proper consultation is therefore important, whereas at present too often announcements seek political advantage through surprise.

The ACG report addresses these issues and follows the WA Government in offering a set of Best Practice Principles for SPPs that are reproduced in Attachment A.

Many of the ideas underlying these principles have been incorporated into the framework for the future development of SPPs advanced in this paper, and in particular these WA principles have been used to inform the following options for reform of SPPs.

### **Options for Reform of SPPs**

A number of options have been identified to reform the present melee of SPPs, but the choice between different options may well depend upon the nature of each SPP. In addition, the options are not mutually exclusive, and for particular SPPs two or even more options could be combined.

- Reduce the number of separate SPPs. There are presently more than 90 separate SPPs, of which one third on average cost less than \$5 million each per year. It is doubtful if many of these small programs serve any national purpose, and they are relatively expensive to administer.
- An alternative to eliminating many small SPPs would be to consolidate groups of SPPs into broad-banded programs

- Narrowly defined programs can prevent funds being spent efficiently on other closely related items of greater need (eg as allegedly happens under the HACC agreement)
- Attempt to more clearly separate responsibilities by swapping areas of shared responsibility so that only one government retains responsibility for previously shared functions
  - eg under the previous Labor Government, the Commonwealth was solely responsible for national roads, and the States or local government were solely responsible for all other roads
- Introduce a funder/provider model to separate responsibilities
  - eg funds could be pooled so that Commonwealth becomes the sole funding source for a program, and the Commonwealth would then purchase at an agreed price units of program output where the States would be providers
- Reduce conditionality, especially where the conditions have nothing to do with the purpose of the program
  - Eg flag poles in schools, industrial relations conditions imposed on program funding
- Replace with agreed output or outcome conditions wherever possible
  - In principle output or outcome conditions can avoid the use of matching conditions for funding
  - Critical issues will be the specificity of these conditions and their relationship to the program, and the assignment of risk and responsibility for achieving the agreed outputs and outcomes
- Agree on data requirements and reduce reporting requirements
  - Commonwealth could agree to have to justify why it needed information, how it would be used, and how it served a national purpose
- Direct Commonwealth funding via competitive bids
  - Performance criteria and assessment arrangements are agreed as part of the normal tendering process, and the States can then help determine the performance criteria as part of the partnership negotiations
  - This approach has been used extensively with non-government providers (eg the Job Network), but has also been used for labour market programs involving TAFE.
- A broker model where the Commonwealth funds a case-manager to advise a group of clients and help them access a sometimes complex array of related services that they need

- This option is closely related to the previous option based on competitive bids
- It has sometimes been proposed for assisting health clients in need of continuous care who require a number of services

## **Conclusion**

The principles advanced in this paper provide the basis for an audit of SPPs that should result in their rationalisation. For those areas where it is agreed that shared responsibility between the Commonwealth and the States should continue, the aim should be to identify and agree on the respective roles of each level of government. Collaborative federalism should then be founded on a partnership between the Commonwealth and the States, where there is proper consultation on program objectives and information demands. The States would then have considerable discretion and more flexibility as to how they achieve those objectives, having regard to their particular local circumstances. In this way it will be possible to achieve a better balance between the national interest and subsidiarity principles, and thus combine the virtues of both collaborative and competitive federalism in the future.

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## **Attachment A**

### **Best Practice Principles as originally proposed by the WA Government**

- SPP arrangements should be constructed to maximise the coverage of related policy areas, rather than establishing multiple agreements.
- Combining a smaller number of SPPs into a larger pool can increase flexibility and reduce administrative costs. Options such as broad-banding would enhance the process
- Administrative and accountability arrangements should be simplified and standardised wherever possible
- SPP details, such as funding levels and timetables for re-negotiation of agreements, should be known well in advance. Access to a common SPP data base would assist in that process
- Where responsibilities are shared, SPP arrangements should reflect a spirit of cooperation between governments, defining broad principles, objectives and performance measures
- Where it is appropriate that States and Territories should be accountable for results, these should be defined in terms of the achievement of broad outcomes or of delivering outputs, rather than for their own expenditure of inputs
- Flexibility for the States and Territories to tailor programs to suit their local needs can lead to more efficient and effective programs. Agreements should avoid prescribing delivery mechanisms wherever possible
- Criteria for the allocation of resources between the States and Territories, including indexation arrangements, should be clearly defined within each SPP
- SPPs should be avoided where there is the potential to increase unnecessary and costly duplication of functions between different levels of government. Where necessary, SPP agreements should encourage coordination of the SPP with any similar existing State programs
- In keeping with their status as inter-governmental Agreements, SPP agreements should be written in plain English rather than in the nature of a legally binding document, including any provision for sanctions which may be included in the agreement.