

TIED GRANTS AND FEDERAL REFORM: EXPERIENCES FROM PUBLIC HOSPITALS AND SCHOOLS

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I INTRODUCTION

The specific purpose payment, or ‘tied grant’,² has been a long-standing and controversial aspect of Australian federalism. First appearing in the 1920s, use of the tied grant remained fairly contained until the Whitlam government substantially expanded their role and significance in fiscal federal relations during the 1970s.³ Since that time, and in spite of shifting federal ideologies, the grants have evolved into a primary mechanism for facilitating Commonwealth policy interventions across a broad range of state-run services.⁴ In 2011/12, tied grants are estimated to account for \$45.515 billion or 48 per cent of total Commonwealth payments to the states.⁵ The largest tied grants are for health and education services, including public hospitals and schools. Over the past thirty years, tied grants have facilitated a range of policy and governance reforms to state systems in these areas. In public hospital services, the grant has been used to introduce or advance reforms such as universal hospital care, salaried and sessional doctors’ remuneration, constraint of doctors’ rights of private practice, the automation of statistical reporting, and the establishment of intergovernmental machinery for improving

¹ This chapter is based on the results of a study funded through an Australian Research Council and industry-funded research project (LP0669283) on federalism and tied grants.

² A tied or earmarked grant is one that is provided on the condition that it is used only for a specific purpose. In Australia, tied grants can be attached with a range of conditions: policy conditions; expenditure conditions; input control conditions (for example matching or maintenance of effort requirements); reporting conditions; and conditions that require the federal government’s funding contribution to be publicly acknowledged. The significance of tied grants is heightened in the Australian federal system due to the presence of extreme vertical fiscal imbalance, a distinguishing feature since 1942. See Vassiliki Koutsogeorgopoulou, ‘Fiscal Relations Across Levels of Government in Australia’ Economics Department Working Papers: Organisation for Economic Co-operation and Development (2007) 15; Daniel Bergvall, Claire Charbit, Dirk-Jan Kraan and Olaf Merk, ‘Intergovernmental Transfers and Decentralised Public Spending’ (2006) 5(4) *OECD Journal on Budgeting* 111-158; Neil Warren, ‘Designing Intergovernmental Grants to Facilitate Policy Reform’, chapter # in this volume.

³ Alan Fenna, ‘Commonwealth Fiscal Power and Australian Federalism’ (2008) 31 *UNSW Law Journal* 518. See also Russell Lloyd Mathews and Bhajan Grewal, ‘Fiscal Federalism in Australia: From Keating to Whitlam’, Centre for Strategic Economic Studies Working Paper 1(1995), 37; and Russell Lloyd Mathews and William Robert C. Jay, *Federal finance: Intergovernmental Financial Relations in Australia Since Federation* (Melbourne Thomas Nelson 1972).

⁴ See Robyn Hollander, ‘Using Regulation to Effect Constitutional Change: The Case of Higher Education’, chapter # in this volume.

⁵ Department of the Treasury (Cth), *2011–12 Australian Government Budget — Australia’s Federal Relations*, Budget Paper No 3 (2011).

hospital efficiency and doctors' wage setting. In primary and secondary school services, tied grants have been a vehicle for introducing a whole host of targeted programs to address service gaps in the education of Indigenous and other disadvantaged students, science and mathematics education and digital education. Additionally, the grant has played a defining role in achieving greater national consistency in areas such as schools' curricula, student testing and evaluation, and teaching quality. Without doubt the grant has had a marked impact on the functioning of the Australian federal system, states' policy settings and service design and, most importantly, outcomes for communities.

Yet the tied grant is also an instrument renowned for its considerable performance deficiencies. In the past, the grant has been associated with a long list of administrative, political and accountability problems that are alleged to have reduced the innovativeness, responsiveness, efficiency and effectiveness of state-delivered services.⁶ This prevalent view of the grant, emanating mostly from practitioners, combined with growing electoral dissatisfaction, drove the Rudd government to embark on a dramatic transformation of grant arrangements after its election in 2007.⁷ The early results of these unprecedented and still-evolving changes are mixed, but nonetheless promising. Certainly, the new National Healthcare Agreement and National Education Agreement remove much of the policy and funding rigidity and administrative burden of the old arrangements. There is also a renewed strategic focus on outcomes and policy collaboration, and a consolidation

⁶ See Allen Consulting Group, Report to Department of Premier and Cabinet (Vic), *Governments Working Together: A Better Future for All Australians* (14 May 2004); Allen Consulting Group, Report to Department of Premier and Cabinet (Vic), *Governments Working Together? Assessing Specific Purpose Payment Arrangements* (1 June 2006); Robert Dalton, 'The Adverse Attributes of Specific Purpose Payments in Australia' (2006) 10 *Southern Cross University Law Review* 43; Ross Garnaut and Vincent Fitzgerald, *Review of Commonwealth-State Funding Final Report* (Committee for the Review of Commonwealth-State Funding, 2002); Joint Committee of Public Accounts, Parliament of Australia, *The Administration of Specific Purpose Payments: A Focus on Outcomes* (1995); Joint Committee of Public Accounts and Audit, Parliament of Australia, *General and Specific Purpose Payments to the States* (1998); Federal-State Relations Committee, Parliament of Victoria, *Australian Federalism: The Role of the States* (1998); Department of Treasury and Finance (WA), *Discussion Paper on Commonwealth-State Relations An Economic and Financial Assessment of How Western Australia Fares* (2006).

⁷ Michael Keating et al, ALP Advisory Group, *A Framework to Guide the Future Development of Specific Purpose Payments* (Australian Labor Party, 2007); Council of Australian Governments, *Intergovernmental Agreement on Federal Financial Relations* (2008); Mary-Ann McQuestin, 'Federalism Under the Rudd and Gillard Governments', chapter # in this volume.

of the proliferation of tied grants that had come into being since the Whitlam government.⁸

Whether or not this significant makeover of tied grants will lead to sustained improvements in policy settings and governance remains to be seen. In terms of evaluating these new arrangements, it is concerning that from a scholarly perspective, we know very little about the inside workings of tied grants. There has been limited in-depth analysis of the policymaking and implementation dynamics underpinning earlier grant agreements. While practitioners have long bemoaned the performance problems of tied grants, and there have been repeated calls for constitutional change or grant restructuring, we have only an obscure understanding about the causes of these performance deficiencies and hardly any evidence about the beneficial aspects of past grants that are worth retaining or emphasising in the new regime. Interestingly, in the case studies of past tied grants that are available, there is a more balanced view of the grant. These examinations assert that the vociferous criticisms of the tied grant, and the Commonwealth policy interference that the grant has come to represent, are exaggerated. In particular, it is suggested that the states have more than adequate ability to maintain policy autonomy; indeed, they have been described as ‘political actors with considerable capacity to secure their ends via successful bargaining and meanwhile remained responsible for a large and significant area of public policy’. Further from a performance perspective, it is asserted that shared governance can actually prove more effective than a coordinate model, with the benefits being more apparent when the Commonwealth limits its role to achieving a small number of national policy objectives. These differing assessments are important signals that there are greater subtleties in the tied grant relationship than is currently apparent.⁹

In this context, and given the astonishing momentum that has now gathered around the transformation of the tied grant, it is crucial that a more rigorous picture of former grant arrangements be established. A closer reflection on past arrangements would no doubt enable the current developments to be evaluated more meaningfully. It is to this end that

⁸ Interview with a member of a state policy community (1) (28 March 2011).

⁹ See Andrew Parkin, ‘The States, Federalism and Political Science: A Fifty-Year Appraisal’ (2003) 62 *Australian Journal of Public Administration* 103, 107; Dugald Monro, *The Results of Federalism: An Examination of Housing and Disability Services* (PhD Thesis, University of Sydney, 2001).

this chapter is focused. Drawing on case study research I have conducted, incorporating a longitudinal case study of the public hospitals grant,¹⁰ and a strategic study of schools grants, this chapter is aimed at enhancing understanding of the advantages and disadvantages of the tied grant as a policymaking and governance instrument. Further, the chapter seeks to inform future implementation and evaluation of tied grants by clarifying how the grant is best applied, including the key factors to be considered in the design or assessment of the grants.

Importantly, this chapter adds to the earlier findings of scholars and practitioners by putting forward new evidence to support three fundamental propositions. First, the tied grant is both a fragile and uncertain policy making instrument, consistently open to political opportunism; ideological fluctuation; and policy and implementation resistance from the states and local stakeholders¹¹. Secondly, the performance deficiencies of tied grants arise in large part because the Commonwealth seeks to counter such resistance through a number of ‘top-down bargaining behaviours. In this regard, five different behaviours are identified, with the Commonwealth observed to adopt: sub-optimal policy choices; a bias towards the larger states; a preference for macroeconomic performance over managerial efficiency; convoluting policy compromises; and excessive regulation. Finally, the tied grant can in fact function as an effective policy making instrument where it is used selectively and in a manner that builds on states policy preferences. In going forward, this chapter argues that policy makers need to recognise these desirable and undesirable characteristics of the tied grant. With more astute use of the tied grant, policy makers at both the Commonwealth and state levels would be better equipped to drive enduring improvements to the efficiency and effectiveness of local service delivery and community outcomes.

II LIMITATIONS ON THE COMMONWEALTH’S POLICY REACH

Legislative authority for the tied grant is found in s 96 which has been described as ‘the constitutional link by which the ALP Government hitched the States to the star of the

¹⁰ The case study research involved an in-depth examination of agreements negotiated under the Whitlam, Fraser and Hawke governments, and a strategic, high-level examination of agreements under the Hawke-Keating and Howard governments.

¹¹ The term ‘local stakeholders’ refers broadly to the medical and teaching profession and organisations that represent and lobby government on their behalf, such as local professional associations and union groups.

Commonwealth'.¹² While the Commonwealth generally prefers to envision s 96 as providing an open-ended capacity for policy intervention in areas outside its jurisdiction, my case study research into tied grants in the public hospitals and schools area revealed a much more ambiguous and uncertain state of affairs, despite federal fiscal superiority. A key observation is that the constitutional division of powers remains an ever present constraint on the Commonwealth's policy reach through tied grants. More specifically, while tied grants certainly do enable the Commonwealth to introduce national policy settings, it is clear that with states holding firm control over service delivery, the shape and timing of goals and reforms is heavily dependent on ongoing, rigorous negotiation with the states.

At all stages of the policymaking process, the Commonwealth is susceptible to open or passive resistance from states and local stakeholders, causing the delay, re-modeling or even the quashing of tied grant goals. In this regard, the states prove to be shrewd negotiators, not at all afraid to shift their bargaining or policy positions to suit their circumstances. For example, in negotiations over hospitals grants, the states' commitment to a block funding model or formula funding fluctuated depending on the relative gain or loss to their funding positions.¹³ In terms of more passive resistance, the manipulation of admission practices and a proliferation of private practice trust funds were used as 'loopholes' through which the terms and conditions of grant agreements were discreetly overcome.¹⁴ Further, in negotiations over the schools grants, the states were very successful in prolonging and adjusting Commonwealth-desired reforms to national curriculum statements, profiles and national testing, as it suited them.¹⁵ Even under the Howard government, where such policy reforms were incorporated as conditions of grant funding, the states overcame requirements by taking advantage of wording ambiguities and, in doing so, were able to secure vital control over local policy design and the timing

¹² Clem J Lloyd and Gordon Stanley Reid, *Out of the Wilderness: The Return of Labor* (Cassell, 1974) 285.

¹³ Western Australia Government, *Extracts from Medicare Policy File* (State Records Archives 5253, 1984) vol 1, 190.

¹⁴ See Commonwealth, Commission of Inquiry into the Efficiency and Administration of Hospitals, *Final Report* (AGPS, 1981) 454–5; Western Australia Government, *Extracts from Health Insurance Act Medibank Policy File* (State Records Archives 5380, 1975) 29.

¹⁵ See Bob Lingard, Paige Porter, Leo Bartlett and John Knight, 'Federal/State Mediations in the Australian National Education Agenda: From the AEC to MCEETYA 1987–1993' (1995) 39 *Australian Journal of Education* 50, 52; Susan Mann, 'The Progress of Statements and Profiles' (1994) 2 *EQ Australia* 46;

of implementation. The states can be highly persistent in their bargaining over time, actively and passively defying and delaying Commonwealth goals until an agreeable compromise is reached. More importantly, the states have displayed a tendency to negotiate for a minimalist national policy platform; this appears to be a key factor permitting them, their agencies or alternatively local stakeholders, to retain control over patterns of implementation.¹⁶

Within this environment of state resistance and operational dominance, the Commonwealth's bargaining position in the tied grant is by no means an assured one. Indeed, my longitudinal case study research confirmed that the balance of policymaking power has wavered between the Commonwealth and states, with neither holding an advantage for extended periods of time. In the past, these policymaking constraints of the tied grant have been a source of considerable frustration for the Commonwealth, whose response has been to engage in a range of bargaining behaviours which are discussed further below. Significantly, my research demonstrated that these same bargaining behaviours precipitated many of the performance deficiencies cited by practitioners. Additionally, and perhaps not so surprisingly, this cause-and-effect relationship was exacerbated when the Commonwealth became more unilateral and prescriptive in its policy setting, these traits being reflective of a heavily top-down governance approach. This suggests that, if the tied grant is to become a more effective policymaking instrument under the emerging regime, it is essential that the Commonwealth avert or restrain its propensity for the top-down bargaining behaviours described. Instead, the Commonwealth would be better placed to build on, and take leverage from, policy developments already evolving at the state and service delivery levels. As befits a federal system, this bottom-up mode of policymaking and governance appears to have been responsible for some of the early gains made by the Rudd and Gillard governments in moving towards improved tied grant performance.

¹⁶ Interview with a member of a state policy community (2) (Perth, 23 October 2009); Interview with a member of a state policy community (2) (Perth, 4 November 2009); Interview with a member of a state policy community (2) (Perth, 30 November 2009); Interview with a member of a state policy community (2) (Perth, 1 March 2011).

III POLICY DISTORTIONS CAUSED BY TOP-DOWN USE OF THE TIED GRANT

My case study examination of hospitals and schools tied grants revealed that the Commonwealth employs a number of dysfunctional bargaining behaviours to counter resistance by the states and local stakeholders to the unilaterally-developed policy goals of tied grants. Five different types of behaviour are apparent, as listed earlier and discussed in detail below.

A *Tendency for Sub-Optimal Policy Choices*

One form of resistance-counteracting behaviour evident in the Commonwealth's use of tied grants is the conscious adoption of sub-optimal policy solutions. The Whitlam era provided the most significant example of this tendency. There is strong evidence that the pursuit of universal hospital care, driven by the Commonwealth's desire for a speedier and politically secure implementation, resulted in the undermining of an alternative policy proposal to expand community based health services. A study by De Voe puts forward an intriguing proposition that constitutional constraints led to a very deliberate choice by the Commonwealth to attach higher policy priority to the Medibank program (a publicly funded national universal health and hospital insurance scheme: a model of 'indirect remuneration') as opposed to an alternative Community Health Program (publicly funded community health centres: a model of 'direct service delivery'):

(Medibank)...was an enticing alternative that differed from Labor's attempts to establish a national health service in the 1940s, providing an option to circumvent the anticonscription addendum in the 1946 constitutional amendment....Aware of historic barriers that had set a distinct path for future health policy reform, politicians were eager to craft Medibank in a way that avoided major legal challenges from individual states and from the medical profession...Proposals for federally funded community health centres, however, contained elements that challenged both of these significant historic barriers to health care reform – federalism and medical pressure group opposition.¹⁷

The community health option was the preferred policy direction of the states, who for a number of years had advocated a less institutionalised system as the most efficient and effective means of improving health service access and sustainability. Papers from the 1971 Health Ministers Conference, an event that *preceded* the Whitlam government's assumption of office, shows that the States had discussed the need for a national inquiry to restructure the health system and improve coordination, efficiency and effectiveness.

¹⁷ Jennifer De Voe, 'A Policy Transformed by Politics: The Case of the 1973 Australian Community Health Program' (2003) 28 *Journal of Health Politics, Policy and Law* 93, 98, 101.

The NSW government stressed that: ‘if a system were being designed afresh, it would not take the form of our present structure’, additionally pointing out ‘institutional care accounts for 45% cent of total spending’ but ‘it is clear that the mass of poor health which afflicts the population is not be found in the hospitals but in the community’s homes, schools and industries’. The NSW government also called for further investigation into ‘ways and means of providing an organisation for comprehensive care outside the hospitals which is endowed proportionately at least as well as is the complex organisation inside the hospitals’.¹⁸ At a 1973 Health Ministers Conference, SA and Queensland expressed their interest in the community health policy concept with the SA government stating: ‘in the long run, by shifting the emphasis on health care from “institutions” to more broadly based community services, public monies...are likely to be better spent, a higher quality and more personalised service made available and at the same time, savings effected’.¹⁹

While community health was not completely overlooked by the Whitlam government, the Commonwealth’s universal hospital care goal was undeniably the more dominant policy objective.²⁰ By way of evidence at the time, the states noted in 1979 that compared to the \$1 billion in funding contributed towards the hospital tied grant, only \$70 million had been expended on community health programs.²¹ This preoccupation with the most costly end of service delivery created a structural bias within the health system which continues to permeate the Australian health policy settings 30 years on, and arguably one that has placed unnecessary strain on both Commonwealth and state budgets. The less institutionalised, community health policy option necessitated a lengthier implementation timeframe and was likely to attract greater medical profession resistance; however, one can only ponder whether a more cost effective health system would have evolved, had the Commonwealth chosen to work more collaboratively with states at the time.

¹⁸ Western Australia Government, *Extracts from Health Ministers’ Conference Queensland 1972* (State Records Archives 487, 0487, 1971) 9–16.

¹⁹ Western Australia Government, *Extracts from Health Ministers’ Conference 1973* (State Records Archives 378_72) 22.

²⁰ Nancy Milio, ‘The Political Anatomy of Community Health Policy in Australia 1972–1982’ (1984) 19(2) *Australian Journal of Political Science* 18, 20–21.

²¹ Western Australia Government, *Extracts from Health Ministers’ Conference 1979* (State Records Archives 219, 1978) 32–3.

B *Bias towards the Larger States*

Another bargaining distortion repeatedly demonstrated in past tied grant negotiations is the tendency of the Commonwealth to push aggressively for ‘one-size-fits-all’ solutions, often tailored to suit the larger states whose support can be critical for the success of policy reforms. While standardisation in this manner may be justified as necessary for the ‘national interest’, it has often come at the cost of local innovation and the efficiency and effectiveness of services within the smaller states.

For example, during the Hawke era, the Commonwealth’s ‘national’ goal to constrain doctors’ rights of private practice was primarily aimed at overcoming tenacious professional resistance to remuneration reform in New South Wales. It ultimately led, however, to a wide-ranging professional revolt which caused the unwinding of reform advances previously secured in South Australia and Western Australia . In SA, long-standing patient election reforms unraveled when the Commonwealth opted to nationalise a policy compromise, agreed with the NSW medical profession, which automatically classified all privately insured patients as private patients.²² Further, the WA government, in spite of having efficiently reached an early accord with its medical profession, was compelled to reopen negotiations on *eighty* separate operational and remuneration issues. These issues included appointment terms; review of salary structures and sessional remuneration; rostering and on-call arrangements; and conditions for university clinicians.²³

This bias towards larger states also exists with respect to schools grants. When the Commonwealth adamantly desires a policy reform in this area, it tends to concentrate its policymaking efforts on NSW and Victoria as they possess the resourcing and political capacity to ‘make or break’ the feasibility and success of a national tied grant goal. The bargaining dynamics associated with the establishment of the Australian Curriculum,

²² Western Australia Government, *Extracts from Medicare Policy File* (State Records Archives 5253_V1, 1984) 126.

²³ Western Australia Government, *Extracts from Medicare Policy File* (State Records Archives 5253_V2, 1984) 104–22, 59.

Assessment and Reporting Authority²⁴ provides an example in this regard. While the states were initially united in their opposition to a funding increase for this new agency, the Commonwealth eventually managed to bring NSW and Victoria on side. This placed the smaller states at a bargaining disadvantage and compelled them to fall into line. Further evidence of this trait is apparent in the Howard government's push for a common school starting age which, after much delay and complication, was finally adopted by some of the smaller states. In the end, however, the policy reform was stifled by NSW and Victoria, whose lack of policy commitment eventually forced the Commonwealth to abandon its goal.²⁵

C *Emphasis on Macroeconomic Performance*

A third bargaining distortion created by the top-down use of tied grants is the tendency of the Commonwealth to give greater weight to redistributive and macroeconomic outcomes, as opposed to those of a managerial efficiency nature. While, the latter is a policy space avidly guarded by the states, the evidence indicates that the Commonwealth often neglects managerial efficiency concerns in its framing of goals and implementation timeframes, simply out of expediency .

During the Whitlam era, a range of known governance shortcomings in public hospitals²⁶ were overlooked by the Commonwealth in its haste to secure states commitment to universal hospital care and its redistributive benefits, in spite of the implications for local managerial efficiency. The Fraser government made significant attempts to understand and tackle hospital managerial efficiency, but information constraints prevented any

²⁴ ACARA is an independent authority that was established by the Commonwealth with the support of the states in 2009. It is responsible for the development of a national curriculum, a national assessment program and a national data collection and reporting program. Refer <<http://www.acara.edu.au/html>>

²⁵ Interview with a member of a state policy community (2) (Perth, 23 October 2009); Interview with a member of a state policy community (2) (Perth, 4 November 2009); Interview with a member of a state policy community (2) (Perth, 30 November 2009); Interview with a member of a state policy community (2) (Perth, 1 March 2011).

²⁶ Governance shortcomings found to exist in the public hospital system prior to the framing and introduction of the Whitlam government's tied grant included a lack of: sophisticated planning and evaluation machinery; utilisation monitoring; resource allocation processes; cost accountability; and, middle management skills. Refer to Commonwealth, Commission of Inquiry into the Efficiency and Administration of Hospitals, above n 14; Public Accounts, Parliament of South Australia, *Financial Management of the Hospitals Department: Assessment and Recommendations for Action* (1979); and Commonwealth, *Report on Hospitals in Australia* Hospitals and Health Services Commission (1974).

meaningful advances being gained.²⁷ In the end, it also retreated to a focus on macroeconomic performance, imposing *ad hoc* funding caps that did little to provide incentives to states or to otherwise stimulate genuine enhancements in service delivery efficiency. The Hawke government, too, was driven primarily by broader social and macroeconomic objectives. Under Hawke, the tied grant was formally woven into the Commonwealth's economic strategies, with universal hospital care forming an essential piece of the wages accord reached with business groups and the unions.²⁸ The tied grant was explicitly expected to reduce the Consumer Price Index, or CPI, by 2.6 per cent in the first two quarters of its implementation.²⁹

Admittedly, the Commonwealth has sought to enhance managerial efficiency through the incorporation of tied grant goals to reform doctors' remuneration. My case study research confirmed that the Whitlam government made the most progress in this regard; it assisted SA and WA to secure remuneration reform but was unable to establish the same in the larger States of NSW and Victoria. Progress stalled under an uninterested or preoccupied Fraser government,³⁰ while the Hawke government's overly prescriptive approach provoked professional resistance in NSW, resulting in the abandonment of the national goal altogether.³¹ The Hawke government's reform efforts seem to have been driven by a need for immediate cost control, and differed from the more gradual and passive approach to policy reform favoured by the states. Having reached workable compromises with their local medical workforce over a number of years, most states sought to avoid 'rocking the boat'. In WA, for example, the State government's policy platform provided for long-term transition to a complete salaried and sessional workforce; whilst in the medium term, the State engaged in ongoing dialogue with the profession on reforms to peer review, hospital accreditation, recruitment processes, quality of care and

²⁷ Western Australia Government, *Extracts from Hospitals Cost Sharing Agreement: State Standing Committee of WA File* (State Records Archives 5088, 1977) 1–26, 34–6.

²⁸ Frank J B Stilwell, *The Accord ... and Beyond: The Political Economy of the Labor Government* (Pluto Press, 1986) 8–11.

²⁹ Commonwealth, *Parliamentary Debates*, House of Representatives, 6 September 1983, 400 (Neal Blewett); Western Australia Government, *Extracts from the Medicare Policy File* (State Records Archives 5124_V1, 1983) 91.

³⁰ Western Australia Government, *Extracts from Health Insurance Act (Medibank) Policy File* (State Records Archives 5188, 1978) 9–10, 16–21.

³¹ Western Australia Government, above n 21, 267.

rationalisation of services.³² The Commonwealth, on the other hand, had a short term and singular focus on ensuring cost containment in relation to the Medicare program.³³ This macroeconomic motivation resulted in the loss of more sustained performance gains that might have eventuated through the states' broader policy agenda to enhance managerial efficiency.

A more recent example of this Commonwealth tendency was the Rudd government's school building program. Reid observes that, while the program may have satisfied a genuine need for additional investment in school infrastructure, it was mainly initiated as a vehicle to address the Commonwealth's macroeconomic goals following the 2008 global financial crisis. As such, it is asserted that the program was not always driven by 'educational aims and the associated curriculum and pedagogy', this integration becoming a secondary aspect of policy making process.³⁴ The program inflexibility and prescriptive administrative arrangements associated with these grants are further indicators of the Commonwealth's propensity to lose sight of local managerial efficiency.³⁵

D *Convoluting Policy Compromises*

Another bargaining dysfunction arising from the top-down use of tied grants is the Commonwealth's tendency to make extensive and convoluted policy compromises. Given the fervent attachment of states and local stakeholders to policy and operational autonomy, the Commonwealth can be required to offer financial sweeteners and other policy compromises in order to entice states and professional groups to accept its tied grant goals. My case study research of public hospitals tied grants revealed such compromises to be evident at all stages of a grant goal: at the Commonwealth level

³² Ibid 194; Western Australia Government, *Extracts from Medicare Policy File* (State Records Archives 5018, 1984) 26–27.

³³ Western Australia Government, *Extracts from Medicare Policy File* (State Records Archives 5124_V3, 1983) 124.

³⁴ Alan Reid, 'Is This a Revolution?: A Critical Analysis of the Rudd National Education Agenda' (2009) 29(3) *Curriculum Perspectives* 1, 11.

³⁵ See, eg, Dan Harrison, 'Audit Slams Rudd's Primary School Building Program' *The Sydney Morning Herald* (Sydney), 5 May 2010 <<http://www.smh.com.au/national/audit-slams-rudds-primary-school-building-program-20100505-u98l.html>>. Refer also to Australian National Audit Office, 'Building the Education Revolution – Primary Schools for the 21st Century' (Audit Report No 33, Commonwealth of Australia, 2010) 17-18.

during goal establishment; between the Commonwealth and states during goal negotiation and implementation; and finally between the state governments and their bureaucracies and workforces during goal implementation. In the schools area too, it is claimed that the necessity for Commonwealth policy compromises engenders a ‘lowest common denominator’ effect³⁶ and can diminish the quality of end outcomes.³⁷

Additionally, it has been shown that states can be quite successful in extracting policy concessions and in manipulating political partisanship to their advantage. For example, during the Whitlam era, the only two Labor states, South Australia and Tasmania, made discerning use of their political advantage by securing, in return for their signing up, Commonwealth agreement to an open-ended 50–50 cost sharing formula; a ten year grant timeframe; and a non-offsets clause. This outcome was in stark contrast to the considerably more moderate, bed–day funding formula initially put forward by the Commonwealth, which would in fact have cut funding to the SA government. Being acutely aware that the Commonwealth ‘badly needed to give substance to the hospital program by securing an agreement in principle with at least one State’, the Labor states certainly held the upper hand.³⁸

It is also apparent that the compromises made by the Commonwealth in tied grants do not always remain within the confines of the tied grant, but can also spill over into other fiscal federal arrangements. Notes from the February 1984 Premiers’ Conference reveal acrimony between the WA government and the Commonwealth over the potential inclusion of Medicare grant funding in the Commonwealth Grants Commission (‘CGC’) review of relativities. Western Australia had initially consented to universal hospital care on the basis of a concession from the federal Health Minister that new hospital funding would be quarantined from the CGC review. However, a ‘Mexican standoff’ later ensued when the Health Minister’s deal was reversed by the federal Treasury. The Commonwealth, wary of a backlash from WA and similar responses from other states, was keen to resolve the dispute quickly. Its response was to try and appease WA by offering ‘an increased allocation for semi-government borrowers’. In return, WA sought

³⁶ Reid, above n 34, 15.

³⁷ Refer to Lindsay Connors, *Making Federalism Work for Schools: Due Process, Transparency, Informed Consent* (NSW Public Education Alliance, 2007) 42.

³⁸ R B Scotton and C R Macdonald, *The Making of Medibank* (University of New South Wales, 1993) 87.

a \$21 million increase to its general purpose capital funds and an increased limit for “larger authorities” borrowings³⁹. Ultimately, a truce was reached: WA signed up to universal hospital care in return for the Commonwealth agreeing to compensate for any loss arising from the CGC review, and also offering the possibility of exempting certain government trading agencies from the diesel excise.⁴⁰ The somewhat predictable need for policy and financial compromises in the negotiation of tied grants, often hidden from public view, clearly increases the risk of haphazard policymaking that has little direct correlation to service costs, community needs or service delivery structures. It is hardly any wonder that state Premiers have described dealings with the Commonwealth to be akin to ‘horse-trading’ as opposed to a logical policy discourse centred on the ‘facts’.⁴¹

E *Excessive Regulation*

Time and again, it is apparent that the Commonwealth resorts to excessive regulation as a means of better managing state and stakeholder resistance to tied grant goals. Excessive regulation has occurred both in terms of the grant *goals* themselves and in the *monitoring and reporting requirements* associated with the grants. The case study evidence I gathered on past tied grants confirmed excessive Commonwealth regulation to be a significant contributor to administrative inefficiency, as repeatedly cited by practitioners. Further exacerbating this performance loss is the fact that much of the Commonwealth’s regulatory activity has been passive and ineffectual, thus calling into question its value to the policy setting and service delivery process.

For example, a key mechanism for regulating the implementation of past tied grants was the Commonwealth’s scrutiny and approval of state implementation plans against prescribed guidelines. In spite of the onerous deliberations, my research confirmed that this lever can provide little scope for meaningful policy influence.⁴² In submitting their proposed implementation plans, it appears that the states can be highly competent

³⁹ Western Australia Government, *Extracts from Premier’s Conference: Meeting with Federal Treasurer February 1984* (State Records Archives 16400_V1, 1984) 3.

⁴⁰ *Ibid.*

⁴¹ John Cain, *John Cain’s Years: Power, Parties and Politics* (Melbourne University Press, 1995) 157.

⁴² Interview with a member of a state policy community (2) (Perth, 23 October 2009); Interview with a member of a state policy community (2) (Perth, 4 November 2009); Interview with a member of a state policy community (2) (Perth, 30 November 2009); Interview with a member of a state policy community (2) (Perth, 1 March 2011).

negotiators who are usually able to steer the Commonwealth towards an outcome that meets their local policy needs and program preferences. In their dealings with the Commonwealth, the states seem to face little risk of losing funding (perhaps for accounting reasons, federal bureaucrats tend to dissuade unspent or returned grants) and were able to adopt a very liberal attitude to the interpretation of the grant guidelines. Even with regards to the highly criticised requirements of the Howard government to report on school flagpoles and ‘Safe Schools’ posters, interviews suggested that the Commonwealth was ultimately reliant upon faithful implementation and reporting by individual schools — in no respect a water-tight policy control. It was observed that, in spite of increasingly detailed reporting requirements, the Commonwealth did not appear to act on this information, with no recollection of sanctions or penalties being applied for non-compliance, and little interaction over positive or negative state results.⁴³ A similar situation was evident in relation to the public hospitals grant, where ‘limited resources’ and ‘lack of jurisdiction’ made it difficult for the Commonwealth to collect necessary evidence and investigate grant agreement breaches.⁴⁴

A fundamental obstacle to effective Commonwealth regulation has been the ambiguity and incomparability of performance data.⁴⁵ Where national standards or benchmarks are open to interpretation, naturally it becomes challenging for the Commonwealth to regulate state performance. For example, the Fraser government significantly expanded Commonwealth regulation of hospital spending, seeking regular reports on a host of operational matters such as bed numbers, staff availability per bed, hospital admission procedures,⁴⁶ and at one stage, even requesting details on the supply of disposable syringes at outpatient clinics.⁴⁷ In spite of the hefty administrative effort and costs involved in meeting these information needs, the extent to which the Commonwealth

⁴³ Interview with a member of a state policy community (3) (Perth, 10 December 2008).

⁴⁴ Australian National Audit Office, ‘Administration of State and Territory Compliance with Australian Health Care Agreements’ (Audit Report No 19, Commonwealth of Australia 2007) 15.

⁴⁵ The COAG Reform Council has faced similar challenges in fulfilling its monitoring and reporting roles: see Geoff Gallop, ‘The COAG Reform Council: A View from the Inside’, chapter # in this volume.

⁴⁶ Western Australia Government, *Extracts from Health Insurance Act (Medibank) Policy File* (State Records Archives 5114, 1976); Western Australia Government, above n 24; Western Australia Government, *Extracts from Hospital Cost Sharing Agreement: Policy, Budgets and Related Matters File* (State Records Archives 5226, 1979); Western Australia Government, *Extracts from Hospitals Cost Sharing Agreement: Budget and Related Matters File* (State Records Archives 5282, 1980).

⁴⁷ Western Australia Government, *Extracts from Health Insurance Act: Medibank Policy File* (State Records Archives 5070, 1977) 14–16.

actually made use of this information to improve the efficiency and effectiveness of implementation of the 1976 hospitals funding agreement⁴⁸ is unclear. At the same time, the underdeveloped nature of hospital statistics made it very difficult for the Commonwealth to rely on the data. For example, at a State Standing Committee meeting in April 1977, the Commonwealth criticised WA's relatively high 'admitted patient costs'⁴⁹. However, a subsequent survey of the reporting practices of the NSW, Victoria and SA governments (initiated by WA) revealed each of the states to be using different formulae to determine the resultant cost, essentially rendering the Commonwealth's comparisons meaningless.⁵⁰

IV POLICY ADVANTAGES OF THE TIED GRANT

While many studies cite the distortions and deficiencies of tied grants, there is comparatively little research on their potential policy advantages. Perhaps surprisingly on this front, my case study research revealed that when used in a more targeted capacity, the tied grant has been highly effective in assisting states to build policy momentum and overcome local political barriers to achieve desired policy reforms.

The SA and WA governments' experience with the doctors' remuneration goal offers a prime example in this regard. During the Whitlam era, a collaborative Commonwealth-state approach was a critical factor in enabling policy makers at both levels of government to overcome professional opposition to the mutually-desired goal of salaried and sessional doctors remuneration. Under the Hawke government, close interaction between the Commonwealth and the WA government appears to have assisted in securing an early settlement with the medical profession over remuneration goals agreed to within the 1984 hospitals funding agreement.⁵¹ While the settlement was subsequently compromised, it is important to recognise that the ensuing concessions were the result of

⁴⁸ Commonwealth, Agreement between the Commonwealth of Australia and the State of Western Australia in relation to the Provision of Hospital Services (1976).

⁴⁹ Measured at the time as the 'average cost per inpatient bed day'.

⁵⁰ Western Australia Government, above n 27.

⁵¹ Commonwealth, Agreement between the Commonwealth of Australia and the State of Western Australia in relation to the Provision of Hospital Services and Other Health Services (1984). Also refer to Scotton and Macdonald, *The Making of Medibank* above n 38, 62, 223; Western Australia Government, above n 13, 25; Western Australia Government, *Extracts from Health Ministers Conference 1976 File* (State Records Archives 1063_V1, 1975) 19; Western Australia Government, above n 32, 37; Western Australia Government, above n 33, 99-100.

implementation tensions outside WA, and thus in no way diminish the policy advantages that were initially gained from collaboration between the Commonwealth and WA governments.

In tied grants for schools, my research suggests that the Commonwealth has played a value-adding role in assisting states to overcome local resistance to controversial policy reforms such as greater principal autonomy and performance pay. There is evidence that the close involvement of the Rudd government facilitated greater reform progress than may have been feasible if states had acted independently. Interviews suggested for example that the reform process was assisted by the productive discourse which took place between the Council of Australian Governments ('COAG') and professional group unions, and Commonwealth interactions with school principals following their objections to the *MySchool* website proposal.⁵²

More generally, the grant also appears to be a powerful lever for stimulating enhancements to the reliability and comparability of states' performance data, which has obvious flow-on advantages for public accountability and transparency and the practice of evidence-based policymaking. Case study evidence confirms that the Commonwealth can play a capacity-building role in health data, with the Hawke government, for example, assisting the states to streamline and improve reporting practices by investing in their information systems.⁵³ More recent developments show that Commonwealth moves to link grant funding with performance targets can stimulate state efforts to improve the quality and reliability of data, and address local barriers hindering this end. For example, following claims by the Victorian Auditor-General of data manipulation in Victorian hospitals, the State government sought to quickly address the issue, its response no doubt partly driven by the prospect of losing Commonwealth funding.⁵⁴

⁵² Interview with a member of a state policy community (2) (Perth, 23 October 2009); Interview with a member of a state policy community (2) (Perth, 4 November 2009); Interview with a member of a state policy community (2) (Perth, 30 November 2009); Interview with a member of a state policy community (2) (Perth, 1 March 2011).

⁵³ Western Australia Government, above n 29, 132–46, 202–4, 24; Western Australia Government, *Extracts from the Medicare Policy File* (State Records Archives 5124_V2, 1983) 110–20; Western Australia Government, above n 27, 32–33, 37.

⁵⁴ Julia Medew, 'Data Fiddling Threatens Funding', *The Age* (Melbourne), 1 April 2009; "'Fundamental Flaws' in Hospital Data: Auditor", *The Age* (Melbourne), 1 April 2009.

Earlier it was suggested that grant shortcomings were more prevalent when the Commonwealth acted unilaterally and was overly prescriptive in its goal setting. Conversely, the above discussion shows the tied grant can also assist states to improve local efficiency and policy outcomes. This beneficial side of the tied grant appears to be most apparent when the Commonwealth behaves as an agenda-setter: first, by adopting a strategic and selective approach to its application of the grant; and secondly, by collaborating and building on evolving policy developments in a bottom-up governance manner. These contrasting characteristics of the grant are important determinants of the efficiency and effectiveness of tied grants which should be factored into their design and evaluation going forward.

V CONCLUSIONS

Close study confirms the Commonwealth's policy reach through tied grants to be a limited one, in spite of federal fiscal dominance. This is primarily due to the policy resistance and implementation uncertainty that inevitably comes with tied grant goals and, in particular, those goals that are unilaterally and prescriptively established. In attempting to overcome such resistance and uncertainty, the Commonwealth shows a propensity to engage in a range of counter-productive bargaining behaviours, including the deliberate adoption of sub-optimal policy solutions, excessive regulation, an emphasis on macroeconomic objectives, convoluted policy compromises, and biases towards larger states. My case study research confirmed that it is these behaviours that have driven many of the performance deficiencies commonly associated with earlier tied grant arrangements. The discarding of these behaviours and top-down approaches is therefore vital to securing more efficient and effective tied grants into the future.

It is much too early to use these historical insights to form a conclusive assessment of the Rudd and Gillard governments' reform of tied grants. By way of an indication, however, discussion within this volume and elsewhere⁵⁵ indicates that the results of reform to date are mixed, but nonetheless contain some encouraging elements. The increased policy

⁵⁵ See Alan Fenna 'Adaptation and Reform in Australian Federalism', chapter # and Mary-Ann McQuestin 'Federalism under the Rudd and Gillard Governments', chapter # both in this volume. Also see Alan Fenna and Geoff Anderson 'The Rudd Reforms and the Future of Australian Federalism' in Gabrielle Appleby, Nicholas Aroney and Thomas John (eds), *The Future of Australian Federalism: comparative and interdisciplinary perspectives* (Cambridge University Press, forthcoming).

flexibility, policy convergence and funding certainty that is evident is certainly a welcome shift in the application of these grants and signal a more bottom-up policy making approach. However, aspects of the new regime such as the proliferation of National Partnership Payment grants, the expanding reporting requirements and the data gaps evident in the reporting frameworks appear to pose a very real threat to the long term success of the new arrangements. If an efficient and effective ‘cooperative federalism’ is to prevail, it is highly important that the Commonwealth does not revert to its earlier unilateral and prescriptive policymaking tendencies. To ensure that the reform effort and investment that has been made can deliver the desired benefits, it is crucial that the Commonwealth remains committed to a strategic and bottom-up policymaking approach that recognises and gives appropriate credence to four factors:

- a) The inevitability of state and local stakeholder resistance to unilaterally determined tied grant goals, making it much more advantageous for the implementers – the states – to drive the policy setting process;
- b) The capacity of the Commonwealth to integrate and stimulate converging policy advances being made by individual states. Securing greater national uniformity in this manner allows states to carry the initial risk associated with policy innovation, and permits the federation as a whole to learn from the lessons and experiences of states’ implementation processes;
- c) The potent leverage that the Commonwealth is able to provide in breaking down local political and interest group pressures delaying or preventing worthwhile policy reforms; and
- d) The value-adding role that can be played in the improvement of service delivery performance and public accountability. The Commonwealth can offer both financial leverage and policy momentum in enhancing performance management frameworks, evidence-based policy making and the quality of performance datasets.

In contrast to those who advocate return to a more ‘coordinate’ model of federalism, this historical analysis of tied grants confirms that within the hospitals and schools area a cooperative model offers distinct policy making advantages, provided the Commonwealth remains a refined and strategic player. If the efficiency and effectiveness of the Australian federal system is to be improved, the Commonwealth must learn to detach itself from the myriad policy-setting roles it has attempted to play in the past, and instead concentrate on using the tied grant in a much more selective manner that is founded on a

sound policy consensus between the Commonwealth and the states. It is quite understandable that the Commonwealth can become impatient with the states in its deliberations over policy reform. However, this apparent policy ‘sluggishness’ should be viewed as part of the reality of implementing policy reform. Rather than resorting to coercive approaches, the Commonwealth must recognise the considerable journey that lies between a policy idea and operational delivery – a journey that involves policy learning and negotiation, and systems and organisational adjustments at the ground level. The historical evidence considered in this chapter reveals the dysfunctionalities that arise from expedient, unilateral or excessively regulated approaches. To motivate and sustain tied grant and federal system performance over the long run, and move beyond superficial ‘fixes’, the key is step back and allow those who implement policy – the states and local stakeholders, to drive policy making and performance improvement. Ultimately, unless the hearts and minds of these local providers remain engaged in policy reform processes, little lasting benefit will be gained for the federation.