Chapter Nine

Overlap and Duplication in Federal -- State Relations

David Trebeck and Greg Cutbush

Copyright 1996 by The Samuel Griffith Society. All rights reserved.

The original recipient of the invitation to address this conference was subsequently summoned to New Zealand to deliver a second paper, on another topic, but at the same time. This seems a good example of overlap and duplication at work! Hence this paper has two authors.

Overlap and Duplication vs Commonwealth/State Power

"Overlap and duplication between the Commonwealth and the States" is one of those expressions which rolls easily off the tongue. Most people are against it. Everyone is talking about it -- like the galah in the petshop chattering about microeconomic reform, as Paul Keating once remarked. Indeed, the subject has been discussed before this Society on an earlier occasion, by Des Moore.(1) His paper focussed on the increasing grab for power by the Commonwealth as it "seeks to involve itself more and more in the provision of the services administered by State Governments". In this sense, he suggested that:

"The terms duplication and overlap are something of a misnomer. What we are dealing with is Commonwealth intervention, the *apparent* objective of which is that the States would eventually move into the position primarily of administrative agencies, with the main lines of policy in all matters being nationally determined."

In considerable detail Moore's paper then discussed specific purpose payments from the Commonwealth to the States, with the conclusion that they should be abolished in favour of general purpose payments.

Since last November's conference, a good deal of water has flowed under the bridge. The change of government in March has, of course, seen issues of Commonwealth-State relations take on a new life. Following on from the Auditor-General's February, 1994 Special Purpose Payment report and the Industry Commission's Annual Report coverage of the issue in September, 1994 (both mentioned by Des Moore), the subject was included in the terms of reference of the Commission of Audit, the report of which is due to be handed to the Government within the next 10 days. Term of reference (vi) states:

"The Commission should focus on identifying duplication, overlap and cost shifting between the Commonwealth and the State/Territory tiers of government in delivering services, and recommend measures needed to promote more efficient service delivery, having regard to the need to improve outcomes for clients and value for money for taxpayers. This should include examination of the appropriate roles of the Commonwealth and the States/Territories, the relationship between service funder and service provider and the scope for contestability in service provision."

It is likely that the subject will feature strongly in the forthcoming Budget, if not before. Some of the work on which Des Moore's paper drew was the major project sponsored by the Leaders' Forum (comprising State Premiers and Chief Ministers) under the title of "The Australian Federation 2001" and with the following general focus:

"What the roles of the different levels of government in the Australian Federation, and the relationships between them, should be."

The Institute of Public Affairs was commissioned, via the Victorian Premier's Department (which was then chairing the Leaders' Forum), to undertake this work. In turn, IPA commissioned ACIL to conduct one sub-project:

"Specify, and where possible quantify, the costs to the States and Territories, the Commonwealth, the economy and the community resulting from overlap and duplication".

Our task was not to question the existing disposition of roles and functions between the Commonwealth and the States but, taking that as a given, to assess and quantify the costs involved. Thus we were focusing on `genuine' overlap and duplication of the type which Des Moore, in his context, found to be a misnomer.

As is now known, the Leaders' Forum research was somewhat de-railed late last year when an unrelated paper, which revisited the case for a broad-based consumption tax, was placed on the public record in an attempt to secure political gain. The Premiers responded by making the remaining material publicly available without giving it any overt publicity. Some references subsequently appeared in the press, but there was little coverage, let alone analysis, of the issues. Against that background, in this address we will highlight some of the main points from our research and conclusions. We will then go beyond that brief to make some observations about what should be done in the disposition of functions between the Commonwealth and the States, which to us is the bigger and more important issue.

What is Overlap and Duplication?

While the common understanding of "duplication and overlap" is synonymous with "waste", and therefore undesirable, some people acknowledge that a degree of overlap and duplication is an inevitable consequence of a federal system of government. Indeed, it may be seen as part of the checks and balances to the unbridled use of executive power, or as adding value to the quality of decision making or service delivery and, as such, to be desirable.

A threshold issue is to define what the terms actually mean. In our study, we took *duplication* as implying an identical function being undertaken by both tiers of government in a non-contestable market. One example, now thankfully resolved, was that of meat inspection, where both Commonwealth and State officials previously had responsibilities requiring a physical presence in abattoirs, performing virtually identical functions, one to provide export certification, the other in a domestic market context.

Overlap, in the normal management decision-making framework of setting goals, deciding strategy, implementing decisions and monitoring performance, could be said to exist whenever responsibility for a particular type of decision is shared between different levels of government in ways which are likely to raise the cost of service provision. In this sense, it is possible to identify different degrees of overlap:

- there is no overlap when one layer of government has sole responsibility;
- there is a low degree of overlap (some requirement for monitoring of performance) when one party is clearly the principal (setting policy) and the other is the agent (implementing policy);
- there is substantial overlap when both levels of government are actively involved in making policy in a particular area, with only one level involved in implementation; and
- there is complete overlap (duplication) where both layers are responsible for making policy and implementation in respect of a particular function.

We also identified *direct* and *indirect* overlap. In plain language, we defined the direct costs of overlap as the needless repetition of effort. The indirect cost of overlap, by contrast, we took to be the waste caused by the pressures created on State and Territory governments to alter the mix of their spending and effort.

Special Purpose Payments to the States

In 1993-94, nearly \$17 billion, or just over half of total payments from the Commonwealth to the States, were in the form of Special Purpose Payments (SPPs). A common condition imposed on SPPs is a requirement for matching funding. It is also common for SPPs to require that funds be applied to a particular project and not be redirected. Other conditions may apply. For example, in the transport sector, funding for the Australian Bicentennial Roads Program included a "maintenance of effort" requirement whereby the States were required to maintain average real expenditure on roads at or above the average level that had occurred over the five years prior to the program's commencement. Similarly, Medicare SPPs prevent the States means testing access to public hospitals, and so on.

More generally, SPPs are used by the Commonwealth to provide a degree of control over the application of funds by the States. They allow the Commonwealth to channel funds toward "national priorities". In cases where the recipient jurisdiction is required to provide matching funding as a condition of the payment, SPPs can also leverage federal funding. For example, in the field of mental health, where the Commonwealth currently provides less than 2 per cent of total funding, it is able to exert a disproportionate degree of influence, according to the States.

Some State and Territory governments and economic commentators have suggested that SPPs limit budgetary and policy flexibility and contribute to duplication of administration and role confusion.(2) SPPs have also been criticised on the basis that they may reduce incentives to improve productivity, since savings achieved through efficiency improvement cannot be redirected. The Industry Commission has suggested the need for "further analysis of the effects of SPPs on the budget flexibility of State and Territory governments, as well as an assessment of the extent of duplication between governments and its costs to the economy."(3) The Industry Commission notes that, if SPPs result in duplication of services or excessive administration, resources that could be better used delivering services, or allocated elsewhere, will be wasted.

The Practicalities of Measurement

It follows from this description that overlap and duplication are more likely to arise in the areas of specific, rather than general purpose payments. Therefore, attention in ACIL's study focussed on the four major expenditure categories of transport, housing, education and health, where SPPs are concentrated.

In principle, there are two different benchmarks which could be used to assess the extent to which running costs of government programs are raised by overlap and duplication associated with present funding/administrative arrangements. Under the first benchmark, all Commonwealth funding would be provided to the States and Territories via general purpose payments, so there would be no Commonwealth administrative effort required to administer specific programs. Under the second benchmark, the Commonwealth would undertake all activity and no costs would be incurred by the States. The two benchmarks would give different results if either the Commonwealth or the States were able to provide the services at a lower cost, for example, as a result of economies of scale (which would favour a centralist approach) or the advantages of decentralisation (such as being closer to service recipients). In practice, making carefully considered quantitative estimates against these benchmarks is not easy.

Utilising ABS data and departmental annual reports, we first attempted to ascertain estimates of corporate overheads, covering such activities as corporate support, accounting and project management, policy, computing, training, communications, human resource management, internal consulting services, and the like. These do not involve direct service delivery to final clients. They also comprise those areas of expenditure where different tiers of government interact extensively.

It turns out that departmental annual reports, especially at the State and Territory level are quite variable in the detail, form and quality of presentation, which makes the compilation of a consistent picture at even an aggregate level more complicated than it should be.

This "first pass" over the data leads to estimates of *direct* overlap and duplication. In the case of transport, for example, after determining estimates of overhead costs across various functional categories, we applied one of three, somewhat arbitrary, "factors for potential overlap and duplication":

- * a 10 per cent factor -- for those activities where the Commonwealth is the main service provider, but undertakes some liaison, policy development, standards setting or other works involving the States;
- * a 20 per cent factor -- for activities where there is substantial interaction with state agencies; and
- * a 100 per cent factor -- for activities where the Commonwealth has no direct program delivery responsibilities but merely administers funds to or through the States, or programs entirely devoted to national regulation issues.

Typically, these estimates of direct overlap and duplication are low relative to total program expenditure -- of the order of 1 per cent or less for overall departments or large programs, and somewhat higher for smaller or newer programs.

The next stage was to examine in greater detail particular programs where significant overlap and duplication is suspected. Our view was that such *indirect* overlap on duplication was likely to constitute the real story, but that details were likely to be well hidden, possibly deliberately so, from public documents, or the effects more subtle than a quick glance would reveal. For this reason, we held discussions with appropriate officials in line departments and central agencies and then undertook some specific case studies.

A paradox here is that the finer the level of disaggregation, the less is overlap likely to be identified in the sense that, say, no two public servants (one at the Commonwealth level, the other at the State level) are likely to be engaged in *precisely* identical tasks over any extended period of time.

A third source of information is provided by recent external studies, such as the Industry Commission's review of public housing(4) or the House of Representatives Standing Committee on Transport, Communications and Infrastructure's review of road funding.(5)

Indirect overlap and duplication come in various forms. They include costs of policy and strategy negotiations (including Ministerial Councils), incentives which reward inefficiencies or have perverse effects, additional staff resources used in accounting for fund transfers and communications, and travel and conferences. Some of these items may be minor in financial terms, others more costly. They represent the leverage impacts of administrative and policy decisions on the actual program areas where the major expenditure occurs. Examples include:

- * the costs of delays to a major capital works program as a result of an unwieldy decision making process;
- * the costs of failing to address the most worthy projects because the funds allocation processes may involve a trade-off between differing Commonwealth and State objectives; and
- * the costs of delays in implementing decidable regulatory reforms, or of sub-optimal outcomes, as a result of complex trade-offs and "lowest common denominator" effects which can occur when several jurisdictions have overlapping responsibilities.

These impacts of overlap and duplication may not be all negative, nor may the costs necessarily outweigh the benefits. As one commentator has observed:

"Proponents of a more efficient system of government usually support a greater, and more clearly defined, role for Commonwealth and State governments... but eradicating duplication and overlap can be synonymous also with reducing available policy options... Administrative checks and balances contribute to the overall stability of the federal system; citizen demands are more likely to be addressed by the combined operations of several governments rather than through the limited efforts of one central authority."(6)

According to this view, duplication and overlap between the different levels of government help to ensure that checks and balances are maintained in the policy formulation process, with the different levels of government "keeping each other honest".

While acknowledging these advantages, our conclusion is that the disadvantages, in terms of unclear objectives, poor accountability, perverse incentives and additional costs, outweigh them.

What We Found

Before coming to quantitative estimates, some of the qualitative conclusions we have drawn from our research are as follows:

- * the extent of overlap and duplication has been tending to increase over time, especially as the Commonwealth extends its involvement into issues once largely or exclusively the domain of States and Territories; quite apart from changing constitutional interpretations, the Commonwealth's financial dominance provides the muscle for this increasing role;
- * direct overlap and duplication are low and variable relative to total program expenditure; moreover, while they occur at both levels of government, care must be taken to avoid double counting;
- * in a number of situations, the conditions imposed by the Commonwealth can exert perverse incentives on the States:
- for example, in the health arena, the set of Bonus Pools and the Medicare Benefit Supplement contain penalties which, while designed to reduce costs to the Commonwealth, have the effect of encouraging the States to divert patients away from private hospital care, in the process adding to their own costs, not the Commonwealth's;
- other health cases where similar perverse effects arise are associated with the Home and Community Care Program and the National Mutual Health Strategy; these are described in some detail in ACIL's report;

- * while attempts have been made in many areas of expenditure in recent years to streamline Commonwealth-State relations and reduce overlap and duplication, significant problems still remain and in some areas have intensified; and
- * a common criticism by the States is that the Commonwealth insists on remaining too involved in the details, and that the process for obtaining funds and accounting for their acquittal are excessively drawn out, complex and costly.

The following table provides our estimates of the extent of overlap and duplication in the four program areas studied, in 1993/94.

Tentative estimates of the direct and indirect costs of overlap and duplication, 1993-94 (Sm)

<u>Activity</u>	<u>Direct</u>	<u>Indirect</u>
Transport	45	17
Housing	30	12
Education	6	70
Health	39	50

Despite the detailed research which underpins these estimates, we remain cautious about their robustness, let alone the appropriateness of extrapolating them across all areas of government expenditure.

To many people, the estimates may appear surprisingly small in the total scheme of things. Certainly, we have sought to err on the side of conservatism. Our two overall comments would be that:

- * merely "eliminating overlap and duplication" will not of itself solve the Commonwealth's fiscal problems; but
- * opportunities to reduce, if not eliminate, such costs -- largely in the nature of deadweight losses on the economy -- should be vigorously pursued wherever they may be found, because doing so will make a valuable contribution to more efficient as well as smaller government.

Sovereign Risk Arising from Overlap and Duplication

The second, and in many ways the more interesting part of our study was to examine the issue of sovereign risk arising from overlap and duplication. The question being posed here is: to what extent would investors and financiers take a different, more favourable view of Australian projects if the risks flowing from the additional government involvement that is implied by overlap and duplication of decision-making responsibility between the Commonwealth and the States were eliminated? This is not an issue which, to our knowledge, has been widely or systematically studied previously. That it is an important one goes without saying.

This is a somewhat different (more confined) concept than the more popular understanding of sovereign risk in current business parlance. Therefore we used the term *government approval risk* to denote that element of generalised country risk which relates to the possibility of government approval for a project being withheld or withdrawn, or the terms of such approval being unilaterally modified in a manner prejudicial to the project.

To explore the concept we focused mainly on four recent examples: woodchip export licensing; Shoalwater Bay mineral exploration; the Hindmarsh Island Bridge construction; and the Port Hinchinbrook Resort proposal. These examples served to illustrate that government approval risk incorporates a wide range of actions by governments which can impact on the commercial

performance of projects. Duplication and overlap between different levels of government turns out to be a factor in some, but not all, cases. Incumbent government effects (that is, following a change of government at an election), policy effects ("shifting the goalposts") and legal effects (such as the *Mabo* case or changes to royalty regulations) can be observed, both at an intra- and inter-government level.

Cases such as Shoalwater Bay owe little, if anything, to overlap and duplication between tiers of government, as they stem from decisions made by a single level of government. Other cases, such as Hindmarsh Island Bridge and the Port Hinchinbrook Resort, clearly involve Commonwealth intervention to override State authorisations. A third group (such as the Tully-Millstream Hydroelectric Project and the Century Zinc Project) involves indirect overlap of responsibility in that the Commonwealth's role, while crucial, was not directed against a project per se, but at a wider issue (such as world heritage listing or native title).

The result of the Commonwealth having become more active in matters previously the main preserve of the States is to make the approvals processes more conservative: both tiers of government need to reach a positive decision for a project to proceed.

In the course of ACIL's analysis, discussions were held with representatives of the business community -- both project developers and financiers -- to ascertain first-hand experience in dealing with government approval risk. There are clear examples of breakdowns in approval processes which have entailed significant costs for developers. The evidence suggests that the market has responded to the incentives built into these complex and often unpredictable approvals processes by adopting a particularly conservative approach to development prospects -- projects which stand a good chance of receiving approval are not being considered for development because of perceptions of the risks involved.

The overall conclusion is that the risks which can be attributed to interactions across tiers of government constitute a relatively small component of project risks, and even of wider government approvals risk, for most projects. For the types of projects we considered, the approvals processes are complicated, costly and probably discourage the more marginal proposals, but are unlikely to cause great damage across the economy as a whole.

However, in specific areas where past experience indicates a greater chance of projects being derailed -- such as sandmining and tourism development in sensitive areas -- there is evidence that prospective developers are declaring "no go" areas in which the investment conservatism referred to above is probable. It is difficult to quantify the extent of these effects on the economy but, based on the examples and evidence assembled, it is likely to be quite significant.

Specific issues identified during these discussions include:

- * widespread and continuing anxiety that the validity of existing or future approvals remains suspect, particularly in the light of the Sackville decision;
- * the "shifting of the goalposts" problem is more apparent when a tier of government becomes involved in an approvals process midstream, such as in the case of the Wesley Vale pulpmill project;
- * some State agencies now seem loth to make decisions because they may be invalidated by the Commonwealth or the courts, inducing a form of decision-making paralysis at State level; and

* financiers endeavour to pass the risks of approvals failure on to developers, but they note that, once proposals are put to financiers, they are rarely stopped because approvals are not forthcoming.

The balance between pro-development and pro-conservation forces can be better managed by making decision-making processes clearer and less susceptible to manipulation for political expediency or other reasons. Clear, robust and explicit guidelines, based on agreed principles, will allow improved decision-making accountability and transparency, regardless of who makes a decision and whether it is favourable or not to proponents.

It is not difficult to show that this matter is important to the economy.

According to official figures, private investment (expressed as "gross fixed capital expenditure by the private sector" in Australia) in 1994-95 totalled \$78.6 billion.(7) If an amount equivalent to just 0.5 per cent of that figure were deterred, that would represent roughly \$400 million of investment not taking place. The GDP contribution of an investment will be the value added it generates (that is, wages and other returns to factors net of bought-in goods and services) and this is likely to be at least 25 per cent. Thus the GDP loss caused by deterred investment could be roughly \$100 million annually.

This is separate and distinct from the direct and indirect costs of duplication we referred to earlier. It suggests that the total costs of overlap and duplication to the Australian federation might be close to \$400m per year in today's money. And since this is an annual cost, it may be fair to say that it is equivalent to a once-only lump sum of GDP of \$4 billion -- an amount well worth saving indeed.

Some Thoughts on Policy

In concluding, we will stray briefly beyond our terms of reference, both as regards the ACIL study and this paper, to offer some thoughts about what we should be doing in a policy sense to address costs created by overlap and duplication. This is a more interesting question than the one we were set. Of course, we will be watching carefully what the Commission of Audit has to say on the subject the week after next.

Vertical fiscal imbalance (VFI), a problem central to the subject of Cliff Walsh's address which we were to hear this morning, is partly to blame.

However, we assert that the needless and pointless aspects of duplication and overlap -- that is, essentially the costs of SPPs which have no offsetting *policy coordination* or *spillover internalising* or *uniformity of standards* benefit for Australia -- arise only partly because of the mismatch of responsibilities and taxing powers of the two levels of government (ie VFI), and more particularly because of a deep-seated confusion at both levels about the proper role of government in society in the first place. Bureaucratic empire building is also a cause, but arguably a subsidiary of the other two.

We would say this prognosis holds whether you view the States or the Commonwealth as the main perpetrators of duplication and overlap waste. Either way, it boils down to one or the other of them not "knowing their business" or not "minding their own business". But if you accept, as we do, the subsidiarity principle (which can be liberally interpreted as saying: "when in doubt leave it to the lower tier of government"), then much of the problem can be laid at the Commonwealth's door.

One is particularly struck by conclusions such as Mark Harrison's about the higher education budget. For example, on tuition subsidies he recently observed:

"It is difficult to give current tuition subsidies an efficiency rationale. The pattern of subsidisation does not reflect any plausible notion of externality production. Tuition

subsidies for all are poorly targeted at capital market imperfections, as those not facing capital market constraints receive them as well. Rationing by academic merit not only creates efficiency costs but also means those least likely to face capital market imperfections are most likely to receive the subsidies. Moreover, current subsidies are inequitable".(8)

The implication one may draw is that the rationales for many long standing policies would not stand up to close examination.

VFI has probably been given ample coverage, and in any case, duplication and overlap are not its most important casualties. By contrast, it occurs to us as economists that the analysis of the proper role of government, at any level, warrants much greater attention. The Commonwealth, in particular, should sponsor more analysis of this kind. We are confident that a substantial rationalisation of duplication and overlap would follow.

The most lasting contribution of work such as the study ACIL undertook for the Leaders' Forum through IPA, may be the way it helps uncover and bring into public view the complex tangle of measures which many of the traditional SPP areas entail. Upon seeing them in detail for the first time, our reaction was that a great many would be difficult to justify no matter which level of government undertook them.

Endnotes

- 1 Des Moore, "Duplication and Overlap: an Exercise in Federal Power", in *Upholding the Australian Constitution, Proceedings of the Sixth Conference of The Samuel Griffith Society*, November, 1995, pp.37Ä64.
- 2. For example, Industry Commission (1994), 1993Ä94 Annual Report, p.29. 3. Ibid., p.31.
- 4 Industry Commission (1993), *Public Housing*, Volumes I & II, Report No. 34, November, 1993.
- 5. House of Representatives Standing Committee on Transport, Communications and Infrastructure (1994), *Report on the Efficiency Audit Review of the National Highway Program.*
- 6. Fletcher, C (1991), Responsive Government: Duplication and Overlap in the Australian Federal System, ANU Federalism Research Centre, Discussion Paper No 3, p.1.
- 7 Australian Bureau of Statistics, *Australian Economic Indicators*, November, 1995 (Catalogue 1350.0).
- 8. Mark Harrison, Government Funding of Higher Education in Australia: Rationale and Performance, Unpublished Working Paper, Department of Economics, Australian National University, October, 1995, p.21.