

Localism in government service delivery: Implications for Australian federalism

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Introduction

Over the past two decades, most OECD countries – including Australia – have pursued public sector management reforms. A key feature of these reforms has been the adoption of market-like disciplines and mechanisms for the delivery of government services. These reforms are intended to make service delivery closer to the point of delivery, for the benefit of local communities.

For the purpose of this paper, reform measures that promote local decision-making and control over government service delivery will be collectively referred to as ‘localism’.

Why localism in government service delivery?

To understand why localism is important for improving the efficiency, effectiveness and responsiveness of government services, it is necessary to consider some fundamental differences between markets and governments.

The private market economy is a complex, evolutionary self-organising system in which individuals interact with each other to produce, exchange and consume resources (Novak 2006b). As the Austrian economist, Friedrich A. Hayek, famously observed, efficient markets transmit the tacit ‘knowledge of time and place’, through the unimpeded price mechanism, so that ‘in the resulting allocation of resources more of the knowledge of particular facts will be utilised which exists only dispersed among uncounted persons’ (Hayek 1974 [1978], p. 27).

In other words, competitive private markets resolve fundamental questions as to how local knowledge possessed by agents can be communicated to, and acted upon by, others, for economy-wide gain.

It is important to emphasise that market exchanges are voluntary. Buyers and sellers can choose with whom to contract (Kasper and Streit 1998). In doing so, market participants invariably woo each other with the ‘sweet talk of commerce’ (Palmer 1990; McCloskey and Klamer 1995; McCloskey 2006). Exercising this ‘voice’ option allows market participants to understand each others’ needs (Storr 2008).

In addition, market participants are free to exercise the ‘exit’ option by walking away from unsatisfactory economic offers (Hirschmann 1970). No matter how large or small suppliers are, if they do not heed the demands of customers, they are likely to

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go out of business.² The threat of exit provides an additional, in-built incentive for market agents to satisfy the needs of people with whom they interact.

By contrast, governments have traditionally undertaken the task of providing selected goods and services,³ which are, in turn, financed compulsorily through taxation. In other words, the coercive imposition of taxes for government services is tantamount to an *enforced* exchange (Wagner 2006a, b).

There are a number of reasons why this enforced exchange might fail to meet consumer demands. For service delivery systems that are heavily dependent on top-down decision making, the conveyance of information about what consumers want are more likely to be attenuated. Centrally administered government service providers might not heed the Tiebout-style exits of dissatisfied customers, in order to improve their performance in the future.

In addition, the feedback signals of voice – as reflected through voting and other forms of political expression – could be blurred or, worse still, ignored altogether. For these reasons, traditional modes of government service delivery tend to be somewhat distant from, and unresponsive to, the citizens they were designed to serve.⁴ These features could also be symptomatic of a much broader ‘knowledge problem’ afflicting those responsible for the delivery of government services.

Decisions about the delivery of government services are also invariably made through the political process (Harrison 2004). There is a heightened risk that government services may be configured for the benefit of politically powerful interest groups – such as trade unions and bureaucracies – rather than consumers.⁵

There has been a growing recognition that public sector performance in the delivery of services has been inadequate. A large number of empirical studies – inspired, in part, by the advent of public choice theory – have shown that highly centralised, rule-bound and inflexible government organisations tend to be more inefficient than their private sector counterparts in similar industries (for example, see Borchering 1977; Tanzi and Schuknecht 2000; Mueller 2003; Mitchell 2005).

Applications of localism in the Australian context

Australian governments have been active in implementing localism reforms for some time. In practice, the achievement of more client-focussed and responsive government services may be realised in two general ways:

² For an insightful study on the long term impact of market competition on the corporate sector, see Ormerod (2005).

³ According to the public economics literature, governments traditionally provide ‘public goods’ that are subject to non-rivalry in consumption and non-excludability of non-payers. However, a number of mechanisms (for example, specification of property rights, bundling private with public goods, exclusion devices, pre-contract excludability, franchising, privatisation) have been suggested to enable such goods to be provided voluntarily by private sector entities (Palmer 1990; Kasper and Streit 1998).

⁴ For some recent discussions on the concept of ‘social distance’, see Leeson (2006), Carilli, Coyne and Leeson (2008) and Chamlee-Wright and Lewis (2008).

⁵ This could be regarded as one element of a broader principal-agent problem (i.e., where political agents pursue their own purposes, often at the expense of the average citizen (the principal)) found in most polities (Kasper and Streit 1998).

- Measures could be introduced to loosen centralised, hierarchical controls that apply to government service provision. Governments retain regulatory and policy responsibilities, while providing greater operational self-management powers to otherwise restricted government service providers.
- Other measures aim to facilitate choice amongst a range of government *and* private sector suppliers, thus creating a ‘quasi-market’ for services. Some common instruments to promote choice include the separation of the government’s role as purchaser and provider of services, and allotting funding vouchers to consumers (OECD 1995, 1996; Kirby, 2000; Bishop and Davis 2002; Bailey 2006).

Localism initiatives are usually accompanied by accountability frameworks set by governments. These include contractual arrangements or charters specifying outcome targets and other service expectations, and the publication of performance data.

There is evidence of localism objectives at work in a range of social services, including school education and hospital health care services.

School education

The Australian school sector is comprised of government schools – owned and managed by State and Territory governments – and non-government schools that operate on a not-for-profit basis.

While the majority of school students are enrolled in government schools, the past two decades has witnessed a relative shift in enrolments toward non-government schools. In 2007, about 34 per cent of total full-time school enrolments were in non-government schools, compared to about 28 per cent in 1987 (ABS various years).

Various reasons have been cited to explain this enrolment drift. The non-government school sector tends to be more diverse – with a range of small and large, single-sex and co-educational schools of different religious affiliations and educational philosophies. Several studies have shown that this diversity provides an effective way of catering for the unique educational values and aspirations of parents for their student children (AISQ 2007; ISCA 2008).

A Commonwealth government funding system for non-government schools – that is, in effect, an implicit means-tested voucher⁶ - and rising parental incomes have also played important roles in facilitating the choice of, and access to, non-government schooling.

The emergence of a strong non-government school sector, and concerns about the inability of government schools to avert the enrolment drift, have led to localism

⁶ The socio-economic status (SES) funding arrangements for non-government schools were introduced by the Commonwealth government in 2001. Funding is based on the number of students enrolled at a non-government school, and weighted for the socio-economic status of the families of students at the school. The former Howard Coalition Government also abolished the Hawke-Keating ‘New Schools Policy’, which limited the number and growth of non-government schools, in 1997. For a summary of the Howard Government’s record on school education, see Donnelly (2008).

reforms in the guise of greater government school autonomy and self-management. During the 1980s and 1990s, State Coalition governments were particularly active in this regard. For example, the Kennett government in Victoria provided greater financial flexibility through global school budgets, and enabled school principals to hire their own teaching and other staff. Similar reforms were introduced in South Australia (under the ‘Partnerships 21’ program), Queensland (under ‘Leading Schools’) and other jurisdictions.⁷

While State Labor governments had initially reversed some of the reforms introduced by their Coalition predecessors,⁸ elements of State-driven localism for government schools (such as budget flexibilities) have been retained to this day.

The next phase of localism reform was introduced by the former Howard Federal Coalition Government. Under the 2005-08 quadrennial funding agreement, the States and Territories were obliged to provide government school principals with greater autonomy over staff, curriculum and budgets. In addition, all schools (government and non-government) would be obliged to provide enhanced performance information for parents and communities. Proposals were also put forward to create a new system of merit-based pay for teaching staff.

While some of the public soundings made by the Federal Labor – particularly before the 2007 election – appeared to be broadly favourable, it remains to be seen as to how far the new Rudd Government would be prepared to travel down the path of school localism. The ALP has signalled that it would endorse the funding formula used to fund non-government schools, at least until 2012 (Donnelly 2008). The Federal Education Minister has recently spoken of the need for better school performance information. On the other hand, the new Government has ended support for two important localism-style initiatives introduced by the Coalition.⁹

Hospital services

In Australia, as in most other OECD economies, health care services are delivered by a mix of providers. State and Territory public acute (non-psychiatric) hospitals are important providers of government-funded health services, and account for about two-thirds of beds and separations from hospitals across Australia (AIHW 2008).

The services provided by public hospitals are complemented by a strong private (for-profit and not-for-profit) hospital sector, with 543 hospitals accounting for the remaining third of beds and separations. The scope of operations by these enterprises

⁷ A number of State Governments, such as in New South Wales under former Premiers Nick Greiner and John Fahey, also established selective government schools to create greater customisation and diversity of education services.

⁸ For example, the Victorian *Education Acts (Amendment) Act 2000* repealed most of the legislative provisions that gave effect to self-governing schools. It also enabled principals and teachers previously employed by school councils to transfer to the general teaching service, and accept standard conditions of employment as offered under the *Teaching Service Act 1981*.

⁹ Under the former ‘Investing in Our Schools’ program, individual school principals and local school communities could directly apply to the Commonwealth for capital works funding, effectively bypassing centralised State education departments in the process. The former ‘Even Start’ program provided parents of eligible children with a \$700 voucher to access remedial education, either from school-based or private tuition providers.

is substantial – of the 661 procedures and treatments undertaken in Australian hospitals, 658 are provided by private hospitals.

Importantly, private hospital sector growth has been associated with greater diversity of treatments offered to patients,¹⁰ and has presented opportunities to relieve pressure on a strained and cumbersome public hospital system.

An important factor driving this growth has been the initiatives undertaken by the former Federal Coalition government to improve access to private health insurance. The introduction of financial incentives to purchase insurance¹¹ not only averted a collapse in membership, but encouraged patients to avail themselves of local private hospital services as an alternative to traditional public hospital care (Harper 2003; Ergas 2007).¹²

With the public hospital system seemingly unable to cope with a growing workload, State governments have increasingly contracted private entities to deliver services for public patients. Examples include the operation of the Caboolture Hospital emergency department by the Aspen Medical group for a fixed term, and past contractual arrangements between governments and private health care firms to operate some hospitals in South Australia and Victoria.¹³

With private hospitals bringing greater discipline and responsiveness to the Australian health sector, and in response to some highly publicised incidents of mismanagement within the public hospital system, renewed concerns have been raised about the capacity of public hospitals to deliver responsive, high-quality services to their respective communities.¹⁴

The Coalition at the last Federal election proposed the re-introduction of local boards for all public hospitals, as a condition of funding to the States under the next Australian Health Care Agreement. Under the proposal, boards would have included medical practitioners, as well as local community leaders with expertise in management, corporate governance and finance. A board would have had the power

¹⁰ As noted in a recent study by Henry Ergas, ‘the rebalancing ... [of Commonwealth health funding towards private providers] ... largely reflects (though it has doubtless also permitted) choices made by patients and their families, as well as by medical professionals – primarily, a choice to make greater use of private health care facilities’ (Ergas 2007, p. 19-20).

¹¹ Including the Private Health Insurance Rebate Scheme, Lifetime Health Cover and increases in tax rebates on insurance premiums for older Australians.

¹² Budgetary measures announced by the Rudd government to change the Medicare Levy Surcharge thresholds (to \$100,000 for single people and \$150,000 for couples) are estimated to lead to about 900,000 people no longer relying on PHI cover, thus placing additional pressures on public hospitals (AHIA 2008).

¹³ Other, non-clinical health services are increasingly being provided by the private sector, and the Federal Health Minister has recently announced an intention to have private hospitals play a greater role in training Australia’s medical workforce.

¹⁴ A number of measures have been introduced over the past decade or so to improve the efficiency of public hospitals. For example, the introduction of casemix funding for public hospital inpatient services by the former Kennett Government in Victoria, and subsequently implemented by other jurisdictions, had played an important role in this regard. In addition, reforms have been put in place to improve the flexibility of the public hospital sector workforce, including the removal of some outdated work demarcation practices (for example, relating to the roles of nurse practitioners). The Commonwealth and the States have also been working together, through the Council of Australian Governments (COAG) forum, in recent years to address cost-shifting issues in health care.

to appoint the CEO of its public hospital, and to set priorities and manage hospital budgets.¹⁵

An argument in favour of public hospital boards is that they would devolve hospital management accountabilities to the community level. Coupled with other localism policies – such as giving public hospitals greater flexibilities in using their allocated resources, and publishing meaningful performance information – local boards can help ensure that hospitals better meet both patient and health community needs.

Given the criticisms of this idea expressed by nurses unions, State Governments and the Labor Federal Opposition during the last election campaign, it is unlikely that this particular initiative will emerge as a funding condition in the next health care agreement.

Implications of localism reforms for Australian federalism

The preceding discussion has shown that localism issues have played a major role in State social services reforms over the past two decades. So, where does localism fit into the broader picture of federalism?

Economic theories of federalism emphasise the benefits that flow from decentralisation. Interjurisdictional competition encourages citizens to move to those regions that provide a preferred set of government services (Tiebout 1956). Even if mobility is not possible or feasible, the existence of a number of governments serves as a ‘yardstick’ to measure service performance, thus inducing long-term improvements (Besley and Case 1995). The availability of alternative services provided by States also represents a ‘laboratory testing ground’ for the discovery of consumer preferences about service provision (Vihanto 1992).

As noted above, some landmark reforms were pursued unilaterally by the States and Territories. According to federalism theory, State-based localism should encourage jurisdictions to compete against each other by imitating, or varying, best-practice localism reforms in ways that eventually improve services delivery across the nation. It could be reasonably hypothesised that these processes did, in fact, occur during the 1990s.

As the Howard government had demonstrated, the Commonwealth can also leverage its financial powers¹⁶ to ensure that the States empower consumers of government services. The case put forward for such intervention in recent years is that the Commonwealth is responsible for the national economy, yet the efficiency with which the States discharge their service delivery roles has significant implications for Australia’s economic performance (Ergas 2007). Indeed, a refusal by States to pursue localism objectives, where needed, could act as a drag on long-run productivity and growth.

¹⁵ Similar proposals had been put forward by most State Coalition parties in recent years, including in New South Wales and Queensland.

¹⁶ Under Section 96 of the Constitution, the Commonwealth makes specific purpose payments to the States (and local governments), for subsequent expenditure on traditional State functions. In most instances, the States must meet certain conditions to receive these payments.

The former Prime Minister, John Howard, spoke about these issues in a major speech presented in 2005. In that speech, he stated that '[w]e have no desire to take over functions that are being properly discharged by States and Territories. ... But nor will we shirk our responsibility to seek the best possible outcomes for the nation and to extend Australia's economic prosperity in the 21st century' (Howard 2005, p. 3). Howard also said that '[w]here we seek a change in the Federal-State balance, our goal is to expand individual choice, freedom and opportunity, not to expand the reach of the central government' (Howard 2005, p. 2).

For self-managed government services reform, there appears to be a rank order of preference on how best to proceed. In the first-best case, the States should break down rigid modes of government service delivery on their own accord, justified on subsidiarity and competitive federalism grounds.

Failing this, the Commonwealth and States could engage in strategic reform partnerships. Both levels of government would agree on the broad scope of localism disciplines to apply to State services, but the Commonwealth would not micro-manage the implementation of the reforms.¹⁷ It is desirable that the different circumstances of each State, where applicable, also be taken into account. In return, the States would receive tied funding.¹⁸

By far the *least* favoured option would be one that, first, transfers State Government service responsibilities to the Commonwealth, to then, perhaps, search around for the localism reform answers later. Prior to the last Federal election, Labor announced a plan to take over the funding of the States' public hospital system, perhaps as early as mid-2009.¹⁹ The establishment of a 'NHS of the South' would deprive future State policy entrepreneurs from improving services through localism, and thus extinguish competitive federalism opportunities between States. Given the Commonwealth's century of inexperience in health services delivery, there is also no guarantee that this proposal would improve public hospital efficiency.

As shown earlier, localism objectives can also be put into effect through greater private sector involvement in government service delivery.²⁰ This second stream of localism in fact *transcends* the conventional discussion about the optimal assignment of expenditure functions in a federation. Instead, the use of private sector entities to deliver traditional government services opens up more fundamental questions about the appropriate divide between governments and markets in the modern Australian economy.

Given the advantages outlined previously about the benefits of markets, it is reasonable to assume that localism reforms that continue to test the

¹⁷ These principles are described by Goetz and Margetts (1996) as reflecting a 'flexible, bottom-up approach' to setting intergovernmentally mandated localism standards.

¹⁸ These arrangements would also allow the States to pursue their own localism reforms, in addition to those agreed with the Commonwealth.

¹⁹ Under the proposal, if the States and Territories have not commenced the implementation of a National Health Reform Plan by mid-2009, the Federal Government would hold a plebiscite or referendum to seek financial control of the public hospital sector.

²⁰ In practice, the degree of private sector involvement in Australian social service delivery is high by OECD standards. As stated by the noted Australian economic commentator, Des Moore, this 'provides advantages waiting to be flaunted and used as a "model" for further development' (Moore 2007, p. 6).

government-market divide might yield excellent results for Australian economic growth and overall living standards. Either the States or the Commonwealth, in cooperation with States and Territories, can engage in this type of localism reform. A genuine commitment to low barriers to entry for private competitors, as well as government funding non-discrimination, will be important factors that underpin the future success of this strand of localism (Nahan 2003; Buckingham 2006; Moore 2006; Novak 2006a, c; Buckingham 2007).

At first glance, there appears to be a tension between this form of localism and the retention of service delivery functions by lower levels of government. However, the engagement of a more efficient private sector, to improve local decision-making and control over services delivery, would demonstrate – once again – that our Federation has a capacity to move with the economic times, and not against it.

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