



STRATEGIC REVIEW OF  
**The Administration of Australian Government  
Grant Programs**

**SEPTEMBER 2008**

**DR JOANNE KELLY**





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Department of Finance and Deregulation  
Financial Management Group

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The Hon Lindsay Tanner MP  
Minister for Finance and Deregulation  
Parliament House

Dear Minister

Please accept this Report of the *Strategic Review of the Administration of Australian Government Grant Programs – Second Element*. The report focuses on understanding how to improve the way Discretionary Grants are used by the Commonwealth Government to deliver government programs and achieve policy objectives. To this end, the report discusses the political impetus behind the recent expansion in the use of relatively small scale discretionary grant programs, and the policy implications of this trend. The next section illustrates the vast diversity of programs included under the discretionary grant heading and argues that these differences in size, scope, longevity, and recipients is typically indicative of the many policy purposes toward which they are directed. The sections offer options on how to adapt the system of discretionary grant administration so it is tailored toward policy success rather than political or even administrative ends.

This report argues that all stakeholders – ministers, central agencies, program administrators and recipients - must re-conceive discretionary grant programs as instruments of policy delivery rather than a “way to get money out of the door”. The research shows very clearly that discretionary grant programs cover such a complex and multifaceted domain of public policy that any uniform approach seems destined to fail. If the government is to improve program delivery through discretionary grant programs, then it must adopt a more systematic and tailored approach to the design, management, and evaluation of these programs. In particular, the mechanisms of grant allocation, the longevity of funding arrangements, and the systems of performance management and evaluation must be tailored to support the policy objectives underpinning the grant program.

Achieving these changes will require adjustments to the current administrative framework, a more sustained period of program development for new grant programs, and a comprehensive review of all existing programs. The program design must link policy or program objectives, the desired relationship between the government and grant recipients, and the development of appropriate mechanisms for grant allocation and performance management and evaluation. It is argued that all discretionary grant programs should include a specific budget for policy evaluation, and learning. Very few – if any – discretionary grant programs should deliver funding to a single recipient, operate for a single year, or provide one-off “rewards”. Similarly, the large scale, multi-year infrastructure or capital projects should not be funded through *discretionary* grant mechanisms.

Bringing about this type of reform will require sustained leadership in both the ministry and at the senior levels of government as any changes to the formal systems must be accompanied by a change in attitude and approach.

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## **Thanks and acknowledgements**

My gratitude and recognition goes to those who agreed to be interviewed for this research and to the Review Team in the Department of Finance and Deregulation. Thanks also to Mr Peter Grant PSM who led the first element of this review. To those anonymous interviewees who gave their time to be interviewed and shared their opinions and experiences in the best traditions of frank and fearless policy advice – thank you. Clearly, all errors of fact and interpretation in this report are entirely mine.

# CONTENTS

<b>EXECUTIVE SUMMARY</b>	<b>1</b>
<b>THE PROBLEM OF 'DISCRETIONARY GRANT': WHEN POLITICS TRUMPS POLICY</b>	<b>3</b>
The politics of grant allocation – an overview of the debates	5
<b>THE EXPANSION OF DISCRETIONARY GRANTS IN AUSTRALIA: CLARIFICATION, EXPLANATION AND IMPLICATIONS</b>	<b>9</b>
Some facts and findings about the growth in discretionary grant spending	10
Impact of the growth: politics, policy and culture	12
<b>UNDERSTANDING THE DIVERSITY OF PURPOSE AND FORM IN DISCRETIONARY GRANT PROGRAMS</b>	<b>15</b>
Discretionary grants as a policy tool: three key explanations	16
Assessing the appropriateness of discretionary grant programs	19
<b>TAILORING DISCRETIONARY GRANTS TO POLICY PURPOSE</b>	<b>23</b>
Learning from budget theory: “on what basis do we decide to allocate x dollars to activity A or B?”	25
Performance management and evaluation	31
What happens now?	31
<b>FROM PROCESS TO PURPOSE: REFORMING THE MANAGEMENT OF DISCRETIONARY GRANT PROGRAMS</b>	<b>37</b>
<b>APPENDIX 1: TERMS OF REFERENCE</b>	<b>43</b>
<b>APPENDIX 2: A LITERATURE REVIEW OF THE ADVANTAGES, DISADVANTAGES, POSSIBLE USES AND ALTERNATIVES TO DISCRETIONARY GRANT PROGRAMS</b>	<b>45</b>
<b>APPENDIX 3: BIBLIOGRAPHY</b>	<b>52</b>



# EXECUTIVE SUMMARY

## Introduction

This report was requested by the Minister for Finance and Deregulation as the second element of the Strategic Review of the Administration of Australian Government Grant Programs. This element of the review analyses discretionary grants as an instrument of policy delivery. This stands in contrast to the first element of the review which examined the administrative and governance framework around grants. The report draws on an extensive international literature review; primary and secondary documents describing discretionary grant programs from Australia and overseas; qualitative data from a variety of internal sources; and interviews and focus groups with key stakeholders and experts. The report does not aim to describe all of the evidence collected throughout this study. Rather, it draws on these sources to get behind the rhetoric of discretionary grant programs – both positive and negative – and understand where they are most appropriate and offer suggestions for improvements into the future.

The report begins with a brief discussion of the political context within which discretionary grants programs operate. This draws on the local and international literature that identifies electoral and other political factors that are likely to influence decisions on both creating grant programs, and the allocation of grant funding.

Within that context, the next section discusses the apparent growth in discretionary grants programs in Australia during the last four years. The section provides data on the size and scope of discretionary grant programs; and identifies the major areas in which discretionary grant programs operate. Definitional problems and data deficiencies hampered this assessment somewhat (as discussed in the first element of this review). However, we address this problem by using a number of different data sources which together provided sufficient information to analyse trends and patterns in both the overall structure of discretionary grants, and the direction and source of recent increases. Nonetheless, it should be noted that these definitional difficulties illustrate the breadth of programs potentially included in the category of ‘discretionary grants’, and are a source of great frustration for line and central agencies alike<sup>1</sup>. It is a key argument of this review that *from a policy perspective* this diversity makes the category almost meaningless for descriptive or analytical purposes and should therefore be amended either by extending the possible categories, or by augmenting the legal/accounting definitions with policy-based advice.

Section three of this report discusses three primary policy logics underpinning use of discretionary grants programs to deliver government programs, each of which has both strengths and weaknesses. Specifically discretionary grant programs are primarily used to:

- > bring about change in a new, changing or unsuccessful policy area;
- > manage uncertainty or variability in the policy environment; and/or
- > exert policy influence where the government lacks either legitimacy or experience.

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1 In this report, I use the generally accepted terms of central and line agencies: the former referring to the Departments of the Prime Minister and Cabinet, Treasury and Finance and Deregulation; the latter referring to all departments and agencies with a more specialised policy or service delivery mandate.

Based on this framework, three major categories of discretionary grant programs are assessed to develop suggestions for alternative policy delivery mechanisms and identify policy areas most likely to require review or reform. In this regard I note the Minister is interested in the impact of discretionary grants on different recipient groups and program objectives, and so these two issues are specifically assessed.

The next section discusses options for reforming two rudimentary elements of any discretionary grant program: the mechanisms of grant allocation, and the framework for performance assessment and evaluation. Neither process is an end in themselves and must therefore be tailored to policy purpose and the desired relationship between the government and grant recipients. Budget theory highlights that the mechanisms of resource allocation will shape who participates in deciding the allocation of resources, and the degree of change likely to occur within the policy area. And to that extent, the process of allocating grant money is not a neutral instrument, but one that can be harnessed to achieve policy objectives. More specifically, the section discusses the possibility of adopting more devolved, participatory and negotiated methods of grant making as already used in Australia and elsewhere.

Similarly, best practice in the area of performance management and evaluation shows quite clearly that the means and purpose of measuring performance must be aligned. At present most – although certainly not all – performance management efforts focus on ensuring the probity and effectiveness of grant spending. This is necessary under the *Financial Management and Accountability Act 1997* (FMA Act) and this review does not undermine the importance of these issues. However, it is argued that this overemphasis on questions of financial management – or control – have distracted from other elements of performance management, namely policy learning and development. Element 1 has provided some useful recommendations for building the performance information systems by locating discretionary grants within a broader program architecture or logic and the revitalised outcome structure. This section argues that better information is only one element of a performance evaluation and management system – and that the key issues are ensuring that performance information is ‘fit for purpose’ and that decision makers – throughout the Cabinet and the bureaucracy – need to create the demand for performance information. In other words, a well functioning performance management and evaluation system needs to translate performance data into useful information for decision-makers whether in departments, Cabinet or in recipient organisations.

Section five builds on the preceding discussions to present recommendations for reviewing and adapting the current system of discretionary grant programs.

# 01

## THE PROBLEM OF 'DISCRETIONARY GRANTS': WHEN POLITICS TRUMPS POLICY

**To the victors belong the spoils.**

Senator William Marcy,  
Debates in Congress  
(1832, 22nd Congress, 1325)

Discretionary grants are universally problematic because of the implied association with pork-barrel and other forms of overt political “meddling” in the allocation of public resources. In Australia both major parties have been accused of pork-barrel while in government (Sport Rorts; and Regional Partnerships); and it is often seen as the *raison d'être* of the minor parties (get as many discretionary grants to Tasmania for example). At the centre of the current debate in Australia lies an apparent increase in the use of discretionary grant programs coupled with perceptions of *ad hoc*-ery in both the design and allocation of grant funding. This sense that spending on discretionary grant programs is out of control has been exacerbated by a series of critical reports by the Auditor-General.

To some these issues are simply a media beat-up – surely the job of any politician is to get the best deal possible for their electorate – for others, it represents a waste – if not abuse – of public resources. Between these two extremes lies the complexity of discretionary grant programs in Australia today: used in policy areas from industry to education, Indigenous affairs to regional development; they may provide substantial funding to a few recipients for many years; or provide a one-off payment of a few hundred dollars to thousands of recipients. Indeed the complexity of discretionary grant programs in Australia today seems to defy any definitive classification or meaningful discussion of this issue – a problem that has dogged both elements of this review.

The aim of this review is to examine discretionary grants as instruments of policy delivery so they may be employed more judiciously and with greater emphasis on policy success. To that end this review examines four key issues:

- > the apparent expansion of discretionary grant programs in Australia, and the policy implications of this growth;
- > the programmatic logic informing the use of discretionary grants to deliver government programs; and their continued usefulness over time;
- > the mechanisms and system for allocating grant funding; and
- > the role of performance management and evaluation in enhancing the success of discretionary grant programs.

The review draws on multiple sources of data and evidence. First, an extensive review of the international literature on discretionary grants provided the framework for constructing this project and analysing conclusions. Second, documents describing the use of discretionary grant programs in Australia and overseas were used to explain the scope of discretionary grants in Australia, and some possible alternatives. Third, qualitative data from the Discretionary Grants Central Register (DGCR) provided baseline information on the value, size and distribution of discretionary grant programs, and this was supplemented by an extensive examination of relevant documentation on agency websites and documents. The difficulty in collecting data on discretionary grants has been discussed in the first element and is indicative of the variety of programs included under this heading. Fourthly, we conducted interviews and focus groups with grant managers and policy officials in the key “grant agencies” in Australia to understand the strengths, weaknesses and frustrations of delivering government programs via the discretionary grant mechanism. These were augmented by a number of less formal interviews and information sessions held in other jurisdictions – including with officials from HM Treasury and the Cabinet office in the UK, and a brief discussion with Regional Co-ordinators from New South Wales.

Two key messages emerged from this research: 1) discretionary grants cover a complex and growing area of government activity that seems to defy clear definition and 2) from a policy perspective, discretionary grant programs can provide the basis for innovation and change but are vulnerable to political manipulation and simplistic assumptions about policy design. This report argues strongly that all stakeholders need to move away from the commonly held view of discretionary grant programs as ‘funding mechanisms’ if they are to contribute more fully to policy success, and that more attention is required in terms of program design, grant allocation mechanisms and performance evaluation.

But this discussion requires a context – and that is clearly political. The following presents a brief review of the literature to ask what role can and should elected officials perform in the distribution of funding from grant programs? This raises questions on the appropriate division between the role of politicians as members of the legislature (whether government or opposition) and politicians who are also government ministers and, therefore, members of the executive. What are the limits to ministerial prerogative in establishing new programs, or deciding to fund new activities and organisation? Particularly if these decisions are taken without (or contrary to) a department’s existing program structure?

## **The politics of grant allocation – an overview of the debates**

One of the key lessons from the international literature on discretionary grants is that they are inherently ‘suspicious’ because they offer the opportunity, means and – many argue – the incentives for political manipulation. In terms of opportunity and means, the very fact of ministerial discretion provides the flexibility to overturn “expert” advice on the appropriate distribution of grant funding. This introduces an electoral or political logic that may divert resources from stated policy goals of the program. In terms of motivation, grants provide a way to target funding to specific constituencies - whether located in specific communities, social sectors, or electorates – which is seen to increase electoral fortunes. At their worst, discretionary grant programs are established on an *ad hoc* basis primarily for electoral purposes with little consideration for longer-term questions of policy legitimacy or coherence, probity, or the impact on recipients. Yet, the reputation of discretionary grants as ‘vote winners’ is not borne out by the research. There is little to show that grant funding can change the course of an election, and the research is split over the approach to grant redistribution typically favoured by government members: should grants ‘reward’ loyal party supporters or be allocated to win over swinging voters? Should they be directed to the electorate at large or targeted to major sponsors within the electorate?

It should be stressed at this early point that discretionary grants program *are not* the same as making unilateral or *ad hoc* decisions on spending. In the first instance there is a program in place which provides the responsible minister with a degree of flexibility in the allocation and possibly in deciding the use and level of funding. The latter term refers to decisions made ‘on the run’ by ministers without a formal program justification – say to provide some funding to a community arts centre. Clearly there is a mile of grey between these two points – but instances where departments are forced to ‘retro-fit’ spending into a program structure are clearly such instances. This review focuses on improving discretionary grant programs and argues that a critical first step in this direction is to restrain the capacity of ministers to establish new grant programs on an *ad hoc* basis.

From the (welfare) economic perspective, the essential problem of discretionary grants is a clash of rationales or decisional frameworks. Put simply, economics suggests that decisions on resource allocation should be based on a clearly articulated analytical framework which is underpinned by some

form of economic analysis whether it be cost-benefit analysis, market failure or other framework. From this perspective, the fact that political actors – including Cabinet, central and line ministers or parliamentarians – incorporate a political or electoral dimension into the decisional process makes this form of resource allocation inherently suspicious because it dilutes the drive toward allocative efficiency. Therefore, ‘discretionary grants’ are necessarily undesirable because, by definition, they allow politicians to assume an active role in grant allocation.

From this perspective, the solution is to design a more rigorous analytical framework to guide the allocation of grant funding, thereby removing any opportunities for politics to corrupt the process. The more sophisticated contributions to this debate recognise a role for elected officials. Nonetheless, the model typically limits the role of ministers to shaping the selection criteria and excludes them from the analysis of applications and the selection between applications. Section four of this paper discusses the usefulness of this ‘generic’ model of grant allocation.

From the political sciences, much of the research into and theories of discretionary grants spending seeks to understand institutional variables that shape the decisional logic of political actors (and therefore predict the distribution of grant allocation). More specifically, this body of research examines how key political institutions – such as the electoral system, party strength and structure, and the political system – shape politicians’ incentives. So, for example, some look to broad electoral maps, outcomes, or performance and argue that legislators will collectively bias resource allocation toward medium-voters, or swinging electorates or margin electorates. The following quote gives a flavour of the focus and breath research conducted in this area:

*...Some recent empirical research has found evidence that electoral competition influences the allocation of discretionary government spending...Cain, Ferejohn and Fiorina (1987) document the rise in influence of backbench MPs in UK politics. But this has been associated with a relaxation of party discipline in UK House votes, a phenomenon that has not occurred in Canada. Dahlberg and Johansson (2002) study the political allocation of an environmental spending program in Sweden, finding support for models suggesting politicians target swing voters. Dasgupta et al. (2002) find support for a swing voter model of the allocation grants from central to state governments in India, and Cadot et al. (2002) reach similar conclusions on the regional allocation of spending on roads in France. Crampton (2004) examines the allocation of job training grants in Canada in the 1990s, finding some evidence of spending targeted to swing districts and districts of Cabinet ministers. Stromberg (2004) examines the allocation of New Deal spending among US counties and argues that, controlling for unemployment and other measures of need, spending was greater where voters had better access to news media.*

(Milligan & Smart 2005:2-3).

One problem of translating these research findings into lessons for reform is that much of the work is based on models from the US. As a result, they assume weak party structures, a presidential model of interaction between the executive and legislatures, and a budget decision-making process akin to that in the US. This sets up a very specific form of bargaining between the two arms of government which stands in stark contrast to the system in Australia, and therefore complicates the transfer of lessons from one country to another. The following issues are perhaps most important.

First, US budget system *requires* legislators to decide on the allocation of grant money through the budget committee process – that is, the US system *authorises* individual legislators to play an active role in allocating public money. It is assumed that the competition between legislatures will result in

a relatively balanced distribution of grant money. This stands in marked contrast to the Westminster system such as Australia where the budgetary role of individual parliamentarians is constrained by both party discipline and constitutional limits on the budgetary role of parliament.

Second, the US budget is constructed and authorised on the basis of detailed line-item votes, whereas the Australian budget is built around high level “outcomes”. This means that, typically in the US decisions on specific grants programs (and often specific allocation within the grant programs) must be decided as part of the budget process and set out in the budget papers if they are to be authorised. This requirement does not exist in the Australian system and in recent years the budget process imposes few legislative limitations on either the creation or allocation of grant programs.

Third, in the US “discretionary” grants are defined as any grants program that is decided and authorised through the annual budget process (ie through the appropriations process) rather than through the statutory spending. In other words, the “discretion” lies with the legislature’s ability to a) authorise a program and b) the level and recipients of funding. In contrast, in Australia, *ministerial* discretion is the defining feature of a discretionary grant program whether it be authorised via appropriation or statute.

These factors are complicated in the Westminster Cabinet system which institutionalises the overlap between two of the arms of government. Ministers are members of both the executive and the legislature and it is therefore difficult to differentiate between their electoral and administrative functions. This is especially important in the budget system where parliament has essentially ceded authority to allocate public resources to the executive in exchange for a full and frank exchange of *post facto* information that allows parliament to hold the executive to account for those decisions.

In Australia, the introduction of outcome budgeting essentially cemented the first part of this ‘bargain’ but irrevocably broke the second half.<sup>2</sup> Within this environment, discretionary grants are a key source of administrative freedom and rarely appear separately in the appropriation bills. The government has an opportunity to address this lack of transparency in the use of discretionary grant programs in the context of two other reviews currently being undertaken, namely the review of outcome definitions and program structures, and the adequacy of parliamentary budget documents.

In summary, most research into discretionary grants assumes that politicians *will* seek to influence the allocation of grants, but how successful they are in doing so and, more importantly whether this significantly improves their chances of electoral success remains an open question. Specifically, the research and experts point to issues of the opportunity costs. From a policy perspective, discretionary grants that are created with an electoral rationale in mind are likely to be developed in haste and therefore poorly designed and likely to fail; they also divert funding from the core mandate of the government.

Similarly, the research into the factors that shape electoral success highlight the importance of ‘government achievements’ over local issues, again suggesting that some marginal advantage for individual minister or MPs will lead to collective disadvantage. More research could be done in this area, but there is nothing to support a correlation between increasing grant funding and a government’s electoral success.

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2 For discussion see Kelly 2007 and the High Court decision of 2006.

## Section 1: Key points

- > Discretionary grant programs cover a complex and growing area of government activity. They can provide for innovation and change but are vulnerable to political manipulation and simplistic policy design.
- > Ministerial involvement in decision making incorporates an electoral dimension and makes discretionary grants inherently suspicious. Discretionary grants that are created with an electoral rationale are likely to be developed in haste, be poorly designed, likely to fail and will divert funding from the core mandate of the government.
- > All stakeholders need to move away from the commonly held view of discretionary grant programs as 'funding mechanisms' if they are to contribute more fully to policy success.

# 02

## THE EXPANSION OF DISCRETIONARY GRANTS IN AUSTRALIA: CLARIFICATION, EXPLANATION AND IMPLICATIONS



It has been widely reported that between 2003 and 2007, Commonwealth Government spending approvals under discretionary grant programs increased from \$494 to \$4,550 million, and the number of grants awarded rose from 7,459 to 49,060. In contrast, the period 2000 and 2003 saw discretionary grants approvals dropping slightly from \$580 to \$494 million, although the number of grant recipients increased from 3,941 to 7,459 over the same period. The following discusses the main sources, significance, impetus and the implications of this apparent explosion of discretionary grant programs.

## Some facts and findings about the growth in discretionary grant spending

### 1. The structure of discretionary grant spending in Australia: size and key policy areas

As discussed throughout this review, the amount of spending on discretionary grant programs by the Commonwealth Government is disputed and difficult to measure. The first element of this review revealed shortcomings in the availability of data on discretionary grant spending that makes it “impossible to compile a comprehensive and reliable picture of grant program activity across the Commonwealth”<sup>3</sup>. To overcome this problem, we augmented the information held in the DGCR by collecting data on the most significant and identifiable grant programs from a variety of available sources. The aim is to improve our understanding of the apparent growth in discretionary spending by unpacking features of grant expenditure over the last four years. The discussion below is based on a combination of these data sources – that is, spending recorded in the DGCR and the Element 2 updated figures. *Importantly, both sets of figures provide a consistent message on the trend, structure and the growth in spending on discretionary grant programs.*

Spending on discretionary grant programs appears to be relatively small as a proportion of total general government spending. In 2007–08, payments through discretionary grants comprised 3.5 percent of all general government sector payments, compared with 2.5 percent in 2004–05. Additionally, the largest discretionary grant programs are relatively small when compared to the largest programs administered by the government. For instance, the largest discretionary grant program recorded on the DGCR is WaterSmart worth \$370 million in 2007–08, and the largest overall grant program is the Commonwealth Grant Scheme which is \$3.6 billion. In contrast, in 2007–08, the Commonwealth Government provided around \$25 billion through the Age Pension, \$14 billion through the Family Tax Benefit; and \$13 billion through Medicare Services.

Yet, spending on discretionary grant programs is not insignificant when compared to the size of annually appropriated expenditure, for example. At \$9.6 billion in 2007–08, discretionary grant spending is equal to just over 19 percent of annually appropriated government expenditure. This amount is exceeded only by appropriated expenditure in the Defence portfolio (\$19.7 billion) and is higher than the amounts for the next two portfolios – Health and Ageing (\$4.9 billion) and Education, Employment and Workplace Relations (\$4.5 billion). While this is an inexact measure, it does give some indication of the significance of programs delivered using this policy mechanism, and stresses the importance of ensuring the programs contribute to policy success. Consequently, it should be recognised that this review is discussing a substantial and growing proportion of spending by the Commonwealth Government.

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3 Grant, P (2008): *Strategic Review of the Administration of Australian Government Grant Programs*.

The majority of discretionary grant funding in 2007–08 (\$4.8 billion) is provided through three large, on-going grant programs which are not included in the DGCR. Specifically,

- > the Commonwealth Grant Scheme which supports the provision of Commonwealth supported places at universities and other higher education providers (\$3.6 billion in 2007–08);
- > National Competitive Grants Program administered by the Australian Research Council (\$577 million in 2007–08); and
- > grants provided by the National Health and Medical Research Council (\$560 million in 2007–08).

Most discretionary grant programs in the DGCR for 2007–08 provide funding of less than \$10,000. Around 29,000, or two-thirds, of the grants approved in 2007–08 and recorded on the DGCR were for amounts of \$10,000 or less. These small grants accounted for \$73 million (or 2 percent) of the \$3.9 billion approved in 2007–08. In contrast, 57 percent (\$2.2 billion) of the funding approved in 2007–08 was distributed through 60 programs which allocated 809 grants of more than \$1,000,000 each.

Almost half of the discretionary grant programs reported to the DGCR in 2007 had less than ten recipients. This could be due of irregularities in the reporting system (the problems of which are discussed in Element 1); or because control over the entire grant program is transferred to an “intermediary” body for distribution. Nonetheless, it seems inappropriate that a program with so few recipients should be delivered via a policy instrument that should be primarily intended to allow for a competitive allocation process.

## 2. The direction and growth of discretionary grant programs

Since 2004, the growth in spending on discretionary grant programs has increased at a rate well above the average, regardless of the measure used. As indicated in Table 1, the amount of expenditure delivered through discretionary grants has increased by \$4.0 billion or 70 percent from 2004–05 to 2007–08. This contrasts with the overall growth in general government sector payments of 24 percent over the same period. An even more abrupt increase is suggested using figures from the DGCR: here the increase in discretionary grant spending is slightly less in dollar terms but much more striking proportionately. As reported in Element 1, in 2004 the DGCR reported total grant spending of \$730 million; by 2007 this figure was \$4,550 million – an increase of 524 percent.

**Table 1: Commonwealth Government general government sector payments and estimated discretionary grant payments, 2004–05 to 2007–08.**

Year	General government sector payments <sup>4</sup> \$ million	Discretionary grant payments <sup>5</sup> \$ million	Discretionary grants as a percentage of payments %
2004–05	222,327	5,654	2.54
2005–06	240,060	7,833	3.26
2006–07	253,242	8,763	3.46
2007–08	275,090 <sup>e</sup>	9,638	3.50

4 Source: Statement 10, Budget Paper No. 1, 2008–09 Budget

5 Source: Department of Finance and Deregulation, unpublished estimate

Regardless of the measure, there has been non-incremental growth in government spending which is typically illustrative of an explicit decision to shift government priorities. The following provides some explanation for this growth, suggesting it is due to deliberate decisions to expand some existing programs and create others.

Most of the spending growth over the past four years is explained by spending in two portfolio areas: Education, Employment & Workplace Relations (EEWR), and Families, Housing, Community Services and Indigenous Affairs (FAHCSIA). The greatest growth in expenditure occurred within the EEWR portfolio, with an increase of \$1.2 billion from 2004–05 to 2007–08. The data also indicates significant growth in expenditure of \$780 million within the FAHCSIA portfolio. The key programs that contributed to this growth include the inclusion of the Services for People with Disability program (\$257 million in 2007–08); a \$200 million increase to the Community Housing and Infrastructure program; the establishment of the Mental Health program (\$98 million in 2007–08)<sup>6</sup>; and increased funding to universities through the Commonwealth Grant Scheme and the Capital Development Pool program.

Newly established discretionary grant programs explain half of the \$4.0 billion growth in discretionary grant programs between 2004–05 and 2007–08<sup>7</sup>. Specifically, establishment of Investing in Our Schools Program contributed an additional \$294 million in 2007–08 (and a total of \$1.1 billion from 2005–06 to 2007–08). The Water Smart Australia program accounted for \$370 million in 2007–08 (and a total of \$935 million from 2005–06 to 2007–08).

## Impact of the growth: politics, policy and culture

From an electoral perspective, the growth in discretionary grant programs was not successful. The former government did not win the last federal election and this provides support to the general assertion that there is little correlation between grant allocation and electoral success. A detailed analysis of these issues is beyond the scope of this paper, although two points are worth noting. First, there is little evidence that pork-barrelling will win elections. Yes, it can redistribute grant money but, more fundamentally, it is often met with cynicism by voters and the dollars spent on this type of spending are likely to be wasted dollars. Arguably then, a rise in discretionary grant programs can be seen an indicator that the government is distracted from their wider policy objectives by the more immediate and limited electoral issues.

In addition the growth in discretionary grant programs seems to have produced some confusion over the relationship between 'arbitrary' or 'ad hoc' spending announcements made by government ministers and discretionary grants. The evidence given in interviews suggests a general acceptance within the Australian Public Service that government ministers can allocate public money as and when they like. Yet this stands in direct contrast to the principles of budgeting implied by the compact of Westminster government whereby the parliament approves the spending plans of government. As discussed, the outcome appropriation structure significantly reduces the level of detail presented in parliamentary budget bills and in doing so increases the flexibility available to ministers.

- 6 The very significant growth that can be attributed to the 'establishment' of the Services for People with Disabilities program illustrates the inadequacy of DGCR data and underlines the need to discount the apparent growth in expenditure in discretionary grants. Advice from the agency that administers Services for People with Disability indicates that the program has actually experienced a reduction of funding in 2007–08 compared to 2004–05 and that the apparent emergence of this program and its descendant programs within the DGCR is an artefact of changes to reporting.
- 7 The growth due to the establishment of new programs may be overstated because this category would capture program rebranding or changes to the way programs are grouped in the DGCR. The converse growth due to increased funding under existing programs may therefore be understated.

Coupled with the pressure on ministers to respond to the 24/7 news cycle, it appears that discretionary grants are being used as a mechanisms for “issue management” and *ad hoc* policy making. Discretionary grants seem to provide a convenient vehicle for “getting money out of the door” whether by announcing a new grant program in response to lobbying or a perceived ‘crisis’, or by providing a way to legitimise *ad hoc* grant allocations by requiring the department to “retro-fit” the announcement into an existing discretionary grant program.

Both practices are a matter of grave concern primarily because they undermine confidence in, and the coherence of, government programs and encourage gaming by potential recipients. And, it is likely that ministers in the new government will face similar pressures. In fact, the impetus to make new policy announcements and difficulties of learning to work within the bureaucracy may exacerbate these pressures. As a result, the issue needs to be confronted directly by the Cabinet and the public service.

## Section 2: Key points

- > Discretionary grant spending is a substantial and growing proportion of spending by the Commonwealth Government. The non-incremental growth in government spending is typically illustrative of an explicit decision to shift government priorities.
- > It appears that discretionary grants are being used for “issue management” and *ad hoc* policy making and as a convenient vehicle for “getting money out of the door”.
- > There is little evidence that pork-barrelling will win elections and rise in discretionary grant programs can be seen an indicator that the government is distracted from wider policy objectives by the more immediate and limited electoral issues.
- > The use of discretionary grants for issue management and electoral purposes undermines government programs and encourages gaming by potential recipients. The issue needs to be confronted directly by the Cabinet and the public service.



# 03

## UNDERSTANDING THE DIVERSITY OF PURPOSE AND FORM IN DISCRETIONARY GRANT PROGRAMS



Discretionary grant programs traverse a complex and multifaceted area of public administration that belies neat categorisation. This is reflected throughout this research in both the difficulties we experienced in trying to quantify the size, growth and distribution of discretionary grant programs, and in the repeated expressions of frustration by program managers. Certainly there is a lack of clarity around the term 'discretionary grant' – often it is regarded as a “catch-all grouping for any funding mechanism not captured elsewhere”; “the term is so broad that it’s meaningless”; “not all discretionary grants are discretionary”. The first element of the review has discussed the problems this poses for accounting, control and categorisation. Here we focus on the implications of this diversity for policy success.

From a policy perspective, this diversity reflects the multiple uses toward which discretionary grants are directed. The Commonwealth provides small one-off grants to 'reward' past achievements, and large, complex, on-going grants to bring about social or economic change. Depending on the policy objectives they establish very different relationships between the government and recipients. As a result, efforts to impose a prescriptive framework are unlikely to capture all relevant programs and, more importantly contribute to policy failure because it shifts attention away from very real differences in purpose that underpin these programs.

In this section, I draw in the international literature and arguments presented in interviews to argue that, from a policy perspective, discretionary grant programs have three potential and often interrelated purposes: they can promote change and innovation within a policy community; can be tailored in response to uncertainty or variability in the policy environment; and provide policy leverage in areas where the government may have limited authority or capacity.

On the basis of this framework, I discuss whether or not discretionary grant programs are suitable instruments to achieve the policy and program goals identified. Later in this section, I use these groupings as the basis for discussing whether or not discretionary grant programs are likely to support policy goals in particular areas. To that end I have sought to understand the different policy purposes of discretionary grant programs by drawing on interviews with program administrators and managers, and a review of the existing stock of discretionary grants.

## **Discretionary grants as a policy tool: three key explanations**

**First**, discretionary grant programs can *promote change within a policy area* by establishing a regular competitive grant allocation process. In other words, they promote a form of bottom-up program design by tapping into the knowledge that exists within a community of potential recipients. From this perspective, discretionary grant programs are useful instruments when a policy area requires regeneration or innovation in terms of developing alternative approaches to policy delivery or encouraging new program providers.

Conversely, these benefits are unlikely to be realised if there is limited competition within the policy area either because the grant allocation process does not encourage new entrants, or because of limits in the policy market. Similarly, the competition and uncertainty inherent in a competitive funding process is also a key limitation of discretionary grant programs. So, this instrument is of limited use in policies intended to build capacity where it does not exist, to support a limited number of 'expert' program deliverers, or where competition and instability undermine the ability of recipients to deliver programs or projects.

**Second**, by definition, discretionary grant programs incorporate an element of flexibility in terms of program design which allows the details of program delivery to be tailored in response to an *uncertain or variable policy environment*. A policy environment will be *uncertain* in areas of government activity where there is little agreement around how to address or even define the policy problem. Possible examples of uncertainty include the emergent policy areas of climate change and government's social inclusion agenda. But uncertainty can also exist in longstanding policy areas such as rural unemployment or aboriginal health, where previous policies are deemed to have failed.

So, where there is no clear 'right way' to achieve policy objectives the flexibility of discretionary grant programs can allow for experimentation and possibly contribute to policy learning. Examples include providing funds to pilot new approaches to policy delivery or to allow primary research into the underlying causes of a policy problem. Under these circumstances, however, the discretionary grant program should recognize the possibility of failure, and include deliberate mechanisms for program evaluation and lessons sharing. The timeframe required for these types of programs is unclear – on one hand policy experimentation is likely to take more than a single year to yield results and should be allowed to be adapted in response to lessons. While on the other, "experimentation" should not be a permanent feature of policy design.

The notion of *variability* in a policy environment is more likely to be a permanent condition of some policy areas. For example, the prerequisites of "community regeneration" are very different in the inner city than in regional or remote Australia; the transport infrastructure needs differ across the country; and supporting people with long-term mental disabilities will require a mix of services that is difficult to define in advance. In these and many other policy areas, program delivery must be tailored to individual circumstances and the flexibility of discretionary grant programs seems to allow grant recipients discretion over the detailed use of grant funding. Our interview evidence suggests a belief – true or otherwise – that few other funding mechanisms that are available to the Commonwealth agencies provide recipients with this degree of flexibility in terms of tailoring program delivery. If this is the strength of discretionary grant programs, then any move toward project-specific funding will undermine the success of programs so delivered. Clearly, however, this raises tensions between the accountability requirements of government and the need for flexibility in program delivery.

It should also be noted that the flexibility inherent in discretionary grant programs is also one of the main disadvantages of this policy instrument. Flexibility provides the opportunity for manipulation; can lead to an *ad hoc* approach to program development (that is allows poor program design) and can leave the decisions on allocation and use of grant money open to multiple interpretations and therefore confusion. In the response to these problems we see efforts to reduce flexibility by tightening the legal or administrative standards around grant programs which, in turn, undermines one of the potential strengths of adopting a discretionary grant program. Clearly all public policies need to be well designed and tailored to achieve the desired goals, regardless of policy mechanisms. However, some programs need to incorporate a degree of flexibility and adaptability to achieve program goals. If this is the case, the flexibility needs to be designed into the program, that is, clearly justified, explained within the policy framework, and routinely evaluated. In these types of programs, it is important to use extensive evaluation for the purpose of policy learning and redesign so that it will reduce program uncertainty and, allow for more clarity.

**Third**, discretionary grant programs enable a government to *exert influence over a policy area where it lacks a clear legal or moral standing to deliver programs directly*. The jurisdictional overlap inherent in Australian federation means that the Commonwealth Government is continually seeking to influence the policy direction of State and local governments. This is most evident in policy areas that

are primarily the domain of the States, including sections of the health, education, and transport portfolios. Sometimes this is achieved through policy negotiations and political agreement; other times by providing project-specific or tied funding directly to line agencies or departments in other levels of government. As discussed below, 25 percent of discretionary grant funding recorded in the DGCR for 2007 was directed to government organisations.

We have also seen a number of instances where the minister devolves discretionary powers. For example, by establishing an intermediary body of experts to decide the criteria for or distribution of grant funding; to grant recipients so that they can decide the best way to achieve the policy goals or deliver project outputs; or by agreeing to abide by the result of formula-based technical assessments. This for example explains why the Commonwealth Grant Scheme is not seen as a *discretionary* grant program. However, where grant funding is distributed automatically, then it is worth considering whether this program should be classified as an entitlement rather than a grant program?

In both instances, the government can use discretionary grants to encourage other actors more legitimate than themselves to deliver policies or programs on their behalf. In other words, they use the power of the purse to influence the policy agenda by providing targeted funding to specific groups or projects. But, the power of the purse is a very blunt tool and may do more harm than good. Where reliant on the reputation and/or expertise of others it may be more sensible to use this in designing the program either by delegating authority to allocate funding within the recipient's own strategic framework (this is why using State government treasury's as main conduit is sensible), or by providing expert Non government Organisations or whatever with a block grant to be used for either core or project funding. Yes the government wants some degree of influence, but this should be negotiated – and evaluated through policy outcomes. Where the government has limited alternatives in terms of policy providers, then it is captured and should not pretend that withdrawing funding is a real option.

In addition to overlap, there are clearly tensions between these three explanations for using discretionary grants. If the program is designed to enable 'experts' to develop customized service delivery, then they will need the funding to be certain in terms of level and longevity, but flexible in terms usage. Under these circumstances, annual grant funding that is allocated via a competitive process is unsuitable because a) it introduces instability and uncertainty that undermines continuity in service delivery; b) it assumes that there are multiple 'experts' able to deliver the program; c) in providing project-based funding, the grant program undermines the capacity of recipients to tailor and adapt programs as required; and d) has the potential disadvantages of distracting recipients from their core mandate. In these circumstances, it seems more appropriate to provide funding through alternative mechanisms, either a multi-year operating-grant; or as a less restrictive category of 'contribution' which could be used for either special projects or core activities. This latter option suggests the need for on-going negotiations between government and recipients.

Similarly, when a program is designed to introduce policy change or innovation, but reaches outside the traditional mandate of the Commonwealth Government, it is likely to set up conflict within the program area. This is a problematic area of grant activity as it has the potential to undermine the objectives of other levels of government, and overextend the legitimate and practical reach of the Commonwealth Government. We need to ask whether the Commonwealth Government should be engaged at this level of activity. Through the *Strategic Regional Program*, for example, the Commonwealth Government seeks to influence road and transport infrastructure across the country. While some are co-funded partnerships, many are fully-funded by the Commonwealth Government – why this discrepancy? On what basis, other than electoral preference or regional equity, could the Commonwealth Government use to choose between spending proposals?

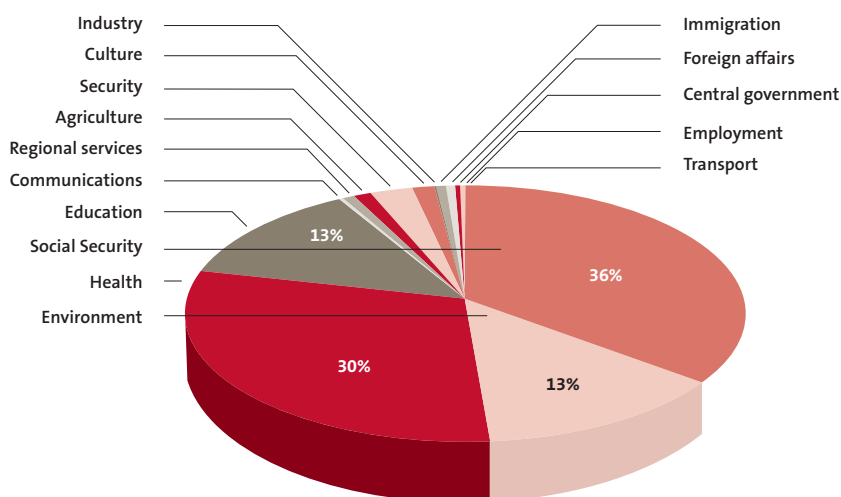
## Assessing the appropriateness of discretionary grant programs

### 1. Policy or program areas: is the Commonwealth Government over-reaching?

The preceding discussion shows that discretionary grant programs are not suitable for use in all of policy areas, and the following begins to use this framework to assess applicability across some key areas. Three questions guide the following analysis of appropriateness:

- > is the program designed to encourage change and innovation in the policy area?
- > is there uncertainty in the policy environment; or is this program dominated by variability in the needs of service delivery?
- > is the Commonwealth Government using discretionary grants to extend beyond its particular area of legitimacy and expertise?

Figure 1: Distribution of discretionary grants by policy function (number of grants, 2007)



As illustrated in the chart above, the Commonwealth Government uses discretionary grant programs to deliver policies across most, if not all, policy areas. Four policy areas clearly predominate: social security; environment; health and education.

In particular the use of discretionary grant programs in Health (30 percent) and Education (13 percent) policy areas suggest the potential for overlapping or conflicting mandates between the Commonwealth and State governments. A closer examination of these two areas as reported in the DGCR shows that:

In the area of health policy:

- > 'Indigenous' programs received the majority funding distributed through "health grants" in 2007 (\$646 of \$785 million); whereas
- > 'sport' received the largest number of grants – 13,179 of the 14,637 reportedly allocated.

In education:

- > “Early childhood” programs received both the majority of grant funding (\$168 of \$268 million) and the largest number of grants (5,680 of 6,562).<sup>8</sup>

In the latter instance, this is clearly a policy area where the former government sought to introduce change by working directly through community organisations. Whether this continues to be the policy of the new government needs to be reviewed, as does the continued appropriateness of using discretionary grant programs that have the potential to undermine policies delivered by State or local governments. It seems sensible to review the use of discretionary grant programs in these areas within the context of the Council of Australian Government (COAG) reform agenda.

The area of environment policy is defined by uncertainty which is prompting the need for policy innovation and change. So it is not surprising to see that \$832 of \$1,132 million provided through environmental and arts discretionary grant programs are directed toward ‘water’ issues given the problems in this policy area. Yet the structure of the key program – WaterSmart – seems at odds with the central elements of a discretionary grant program. In particular, the WaterSmart program provides up to \$1.6 billion to 2010 to “accelerate the development and uptake of smart technologies and practices across Australia” by providing a minimum grant of \$1 million for up to four years<sup>9</sup>. In other words it is an effort to impose a national agenda on what has previously been a policy area controlled by State and local governments. Yet categorisation as a ‘grant’ program is curious because funding is allocated through a number of different mechanisms, including but not restricted to, a competitive process nor is there any real regularity to the offering. The key recipients of this grant are State and local governments, and it is being conducted within the context of the National Water Initiative. The complexity of the projects being funded through this project and the strength of the recipient parties, make it almost impossible for grant managers to manage performance through phased-funding. Hence the Commonwealth Government is reliant on the recipients of the grant to develop the projects and report on progress and performance. There is little or no capacity for officials within the responsible federal department to withhold funding for poor performance or late delivery.

This suggests two issues should be revisited within this and similar types of programs. First, whether WaterSmart, and other multi-year infrastructure or capital projects such as AusLink should be included in the ‘discretionary grants’ category when they appear to be closer to a procurement or a Special Purpose Payment (SPP). The justification of using discretionary grant programs to facilitate a competitive allocation process does not hold in either case – the negotiated system used in AusLink is discussed below. And the threat to withhold of funding for non-performance cannot be exercised because of the pressures imposed by the Commonwealth Government’s annual budget framework, and the lobbying power of the recipients.

Second, it raises the question of whether these projects compliment or conflict with the broader national agenda on water, climate change, the environment currently being negotiated through COAG. Again, discretionary grant programs should be subject to a cross-cutting review within the context of recent policy changes and possible alternative funding mechanisms.

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8 As discussed earlier, the DGCR does not report spending on a number of significant grant programs (including the CGS, IOSP, ARC and NHMRC grants).

9 DEWHA (2008)

## 2. Implications of different recipient groups for discretionary grant design and policy success

Discretionary grant programs establish a reciprocal relationship between the government and recipients. By definition, recipients should receive the ‘primary benefit’ of the grant funding, however from a policy perspective there is no justification for a grant program if it does not contribute to public policy objectives. The preceding section discussed the main reasons for using discretionary grant programs and these reasons shape the type of relationship established through grant funding. This relationship can range from a purchaser-provider arrangement; to a partnership of equals; delegated authority arrangements; and a ‘compact’ style relationship where the two parties work together to resolve policy programs. Therefore it is important to understand the type of relationship needed to deliver the program and, ensure the program is designed to support the ability of recipient organisations to deliver the program obligations.

The table below shows the breakdown of discretionary grant recipients by seven broad groupings in terms of the total and average value of grants received. Sporting bodies and educational institutions received the smallest average level of grant funding, whereas government organizations received the largest average grant. The following discusses how discretionary grant programs shape the relationship between the government and grant recipients focusing on two particular groups of recipients in particular: Indigenous organisations, and community organisations.

**Table 2: Commonwealth Government Discretionary Grants, 2007 – Distribution by Category of recipient organisations (DGCR only)**

Recipient group	Number of grants received	% of total	Value of Grants received (\$'000)	% of total	Average value of grant (\$)
Community organisations	25,008	51.0	1,710,063	37.6	68,400
Government organisations	2,030	4.1	1,122,234	24.7	552,800
Indigenous organisations	2,765	5.6	1,014,637	22.3	367,000
Educational institutions	10,012	20.4	162,816	3.6	16,300
For-profit-organisations	3,482	7.1	222,610	4.9	64,000
Sports-related bodies	2,558	5.2	35,389	0.8	13,800
Other, n.e.c (c)	3,205	6.5	282,072	6.2	88,000
<b>TOTAL</b>	<b>49,060</b>	<b>100</b>	<b>4,549,820</b>	<b>100</b>	<b>92,740</b>

### Indigenous organisations

Indigenous organisations were awarded over \$1 billion in grant funding in 2007 through 2,765 grant allocations. When these figures are calculated on a *policy* basis, the amount climbs to almost \$1.5 billion. The largest proportion of this funding was directed toward two policy areas: social security (\$769 million) and health (\$646 million). The amount of money granted through these programs ranges from a few thousand dollars to many millions. The largest grant program is the National Aboriginal Health Strategy. Discretionary grant programs constitute approximately one third of the total funding of \$3 billion directed toward “Indigenous specific” programs by the Commonwealth Government.

The use of discretionary grant programs is problematic because of tensions and uncertainty within this area of public policy. Firstly, the use of discretionary grant programs in aboriginal policy can primarily be explained by a wide-spread belief that “Aboriginal policy should be delivered by Aboriginal people” (quote by an interviewee). In other words, the government lacks the standing and expertise to deliver Indigenous programs directly and therefore relies on Indigenous organisations. Yet, this policy area is dominated by uncertainty in terms of what works, and variability in terms of the needs of different groups.

Together these factors have created a unique tension within this sphere of Indigenous policy: on one hand the government is dependent on external organisations to deliver policies; on the other hand there is uncertainty and tensions over *how* to deliver policies that will improve the well-being of Indigenous Australia. So on one hand we see policy failures that result from the general uncertainty on how to address these policy problems (or from failed experimentations with new options); yet the failures undermine any claim of expertise by the Indigenous organisations. As a result the government has sought to increase its influence in the policy area by providing project specific, rather than core funding.

But the use of project specific, annual funding has the potential to undermine the success of these programs. First, providing grants through project rather than core funding limits the extent to which organisations can tailor their resources in response to the changing demands or the needs of individuals or communities. The administrative burden of annually applying for grants and accounting for both the expenditure and program delivery shifts limited resources from program delivery. This problem is magnified as grants become more specific and smaller because organisations must rely on a number of different funding sources from different programs and departments. Not only is the administrative burden intensified, but tensions will emerge between the requirements of various programs, and between the delivery of grant priorities and the organisation’s core mission.

This problem is recognised within most granting organisations and certainly the recipients, however, the annual granting process persists for a number of reasons including the requirements of the FMA Act. Interestingly it seems that there is broad acceptance that the annual funding round *does not* significantly change the allocation of grant monies – there are few potential recipients with the necessarily expertise and reputations. However, it does provide departments with the opportunity to undertake a health-check on grant recipients or to change some of the terms and conditions of the grant funding.

In sum, the use of discretionary grant programs to provide Indigenous organisations is problematic. On one hand they allow governments to shape a policy area over which they have limited authority, on the other hand the mechanism for funding seems to distract from the core policy goals.

It is recommended therefore, that the government adopts alternative mechanisms for grant funding that provides for funding certainty, allows policy experimentation and innovation, but does not distract from the core mandate of Indigenous organisations. The government should therefore consider undertaking a cross-cutting review of all discretionary grant programs used to deliver Indigenous policies, with a view to streamline the program offering and move away from annual funding arrangements. In addition, the review should work with Indigenous organisations, service recipients, the key agencies, and the Office of Evaluation and Audit to develop better mechanisms for using performance management and in-depth evaluation as a tool for on-going policy improvement and lesson learning, rather than for managerial purposes.

### Section 3: Key points

- > Discretionary grant programs traverse a complex and multifaceted area of public administration, which reflects the multiple uses toward which discretionary grants are directed.
- > Efforts to impose a prescriptive framework will compromise policy success because it shifts attention away from differences in purpose that underpin these programs.
- > Discretionary grant programs have three potential and often interrelated purposes, they:
  - can promote change within a policy area by establishing a regular competitive grant allocation process;
  - incorporate an element of flexibility which allows the program to be tailored for an uncertain or variable policy environment; and/or
  - enable a government to exert influence over a policy area where it lacks a clear legal or moral standing to deliver programs directly.
- > The appropriateness of a discretionary grant program for a given policy purpose will depend on the policy context and sector capacity. The detailed design of discretionary grant program needs to be based on the benefits and limitations of the use of grants for particular purposes.
- > Discretionary grant programs establish reciprocal relationships between the government and recipients. It is important to understand the type of relationship needed to deliver the program and ensure the program is designed to support recipient organisations to deliver their program obligations.

#### Indigenous policy

- > Alternative mechanisms should be adopted for funding Indigenous organisations in order to provide funding certainty, allow policy experimentation and innovation, and facilitate the core mandate of Indigenous organisations.
- > The Government should consider undertaking a cross-cutting review of all discretionary grant programs in this area.



# 04

## TAILORING DISCRETIONARY GRANTS TO POLICY PURPOSE

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*...when administrative concerns predominate, designing a grant program becomes a question of operation rather than policy, and efficiency rather than appropriateness*

The research conducted for this report shows very clearly that discretionary grant programs cover such a complex and multifaceted domain of public policy that any uniform approach seems destined to failure. If the government is to improve program delivery through discretionary grant programs, then it must adopt a more systematic and tailored approach to the design, management, and evaluation of these programs. In particular, the mechanisms of grant allocation, the longevity of funding arrangements, and the systems of performance management and evaluation must be tailored to support the policy objectives underpinning the grant program.

The following section discusses some options for reforming two rudimentary elements of any discretionary grant program: the mechanisms of grant allocation, and the framework for performance assessment and evaluation. This discussion begins from the position that neither process is an end in itself and must therefore be tailored to policy purpose and the desired relationship between the government and grant recipients.

### **Using the power of the purse: tailoring grant allocation processes to policy purpose**

Budget theory highlights that the mechanisms of resource allocation will shape who participates in deciding the allocation of resources, and the degree of change likely to occur within the policy area. And to that extent, the process of allocating grant money is not a neutral instrument, but one that can be harnessed to achieve policy objectives. Consequently this section discusses the options of adopting more devolved, participatory and negotiated methods of grant making as already used in Australia and elsewhere.

All discretionary grant programs allocate public resources: once the program receives funding, a choice must be made between possible recipients. To that extent, all grants involve a micro-budgeting exercise. Much of the research into discretionary grants to date focuses on how to reform the system of grant allocation to remove the incentives for political interference by increasing rationality, to improve the efficiency of grant distribution through better technology, and to ensure grant recipients spend. Hence we are offered a generic model of grant allocation that highlights issues of transparency of process, clarity of purpose and criteria, and regular, competitive bidding rounds.

Yet, from a *policy* perspective the critical issue in designing a system of grant allocation is to support program outcomes. We know from budget theory that processes matter because they “put some issues on the agenda and removes others, strengthens one set of actors over another and sets the framework and conditions for evaluating the success of the program” (Schick 2007). Other work highlights the need to fit the system of allocating resources to the broader mission or objectives of an organisation. So the questions are not just, what are the criteria, but who should decide the criteria. Does the eventual allocation of grant money appear to support the policy objectives? How has the process of grant allocation improved the capacity of recipients to deliver program outcomes? In other words, grant allocation should *not* be seen as the end in themselves but as part of program management.

Given the diversity in discretionary grant programs, it is unreasonable to expect a single model of grant allocation to meet the policy needs of all discretionary grant programs. If, for example, a discretionary grant program is established to build capacity within a community, then the process for allocating grant funding should not be on an annual basis or require existing capacity. Similarly, a grant program is unlikely to succeed if it seeks to change future behaviour but allocates on the basis of past achievement (ie a reward based program). In contrast, if the government has established a grant program to draw on the expertise in a specific industry or sector then it should engage those experts throughout the process of resource allocation.

## **Learning from budget theory: “on what basis do we decide to allocate x dollars to activity A or B?”**

In 1941, V.O. Key posed a central question of budget theory: “What is the basis upon which we decide to allocate X dollars to activity A rather than activity B?” Wildavsky (1964) picked up this question and said public resources are typically allocated through a process of incrementalism and that history is the key determining factor. On the other hand, Zero-Based Budgeting systems aim to begin from “zero” every year and therefore re-open the ‘base’ each year (Phyrr 1977; Schick 1966). Yet after 65 years of debate, the “Key” question of budgeting remains unresolved - aside from the conclusion that there can never be one basis for allocating public resources. An extended discussion of budget theory is beyond the scope of this paper, however the debate prompts us to ask *how to structure the process of allocating grant funding to ensure support for differing policy outcomes, relationships with recipients, and differing policy environments.*

In this regard, the following discussion provides some alternative means of understanding grant allocation, and is based on three questions prompted by budget theory. If the system of grant allocation is tailored to policy outcomes:

- > should the system of grant allocation be designed to deliver *stability or change* in terms of recipients and program outcomes?
- > should grant funding be determined on the basis of: a) predefined ‘rational’ criteria; b) an evaluation of the past performance of either applicants or the program; and/or c) the potential of applicants to achieve the strategic aims of the program, policy or government?
- > who should be primarily responsible for deciding the allocation of grant funding: the government (ministers or bureaucrats); an intermediary organisation; or the potential grant recipients?

## **Allocating grant funding for program stability or change?**

In designing discretionary grant programs, the relative turn-over in the allocation of grant funding must be tailored to the desired relationship between the government and grant recipients. If the government is relying on the reputation and continued engagement of a limited set of expert providers, then uncertainty on the outcome of grant funding will undermine program success. Conversely, if the grant program is intended to prompt change or innovation, then grant funding should vary regularly and be designed to identify and engage with new recipients. Often these two outcomes have to be balanced within the same policy area – but when that is the case, it seems sensible to build the program around ‘boutique’ grant programs designed to achieve these different objectives, rather than use one consolidated grant program. This conclusion sets up a potential tension with the move to streamline grant programs which is intended to improve operational simplicity and efficiency. Again it seems that the general principle is to design the grant program with an eye to policy aims – if multiple grants are

directed toward the same recipients then perhaps streamlining is appropriate; if on the other hand, there may be a good argument for two or three separate grant programs where they are intended to access different sectors of a community, or to provide an element of innovation in an otherwise stable policy area.

So, we note that incremental budgeting reduces conflict and increases certainty by making history the key determinant of future funding allocations and a zero-based system will bring 'churn' into the system and can provide the basis for more competition and innovation. The former is likely to exclude new entrants from the process, but provides the basis for trust and on-going policy learning; the latter has the potential to fund many potential recipients and allow for program innovation or policy change. When related to grant allocation processes, these two models provide a basis for linking grant purpose, process, and design.

A zero-based grant making process would:

- > be structured around annual competitive bidding rounds where funding is reallocated each year; and there is limited or no expectation of continuity built into either the program design or on behalf of recipients;
- > assume a competitive market of 'suppliers' (recipients) and transferability between different suppliers; and
- > seem to be appropriate in some areas where funding is primarily for relatively short-term projects; and where there are multiple providers.

Some possible examples include grant programs that fund time-limited research projects, small scale community projects, or pilot projects and seed-funding intended to support innovation and change in the policy area. This system is not suited to programs where delivery relies on the expertise or reputation of grant recipients; where there are very few potential grant recipients, or in an emergent policy area where the government is seeking to learn about what does and does not work.

An incremental grant-making process would:

- > allocate funding on the basis of historical precedence, reputation and trust between the key actors – even if the formal system is built around an annual competitive system;
- > enable continuity of the established relationships and networks;
- > allow service deliverers to engage in long-term project planning and management;
- > be the outcome where there are few potential service providers – and in this instance the annual competitive round is likely to be used for other purposes (a form of performance evaluation for example); and
- > be most suited to programs where the government is seeking to build long-term capacity or relying on expert providers to deliver programs on their behalf.

## **Deciding the criteria for allocating grant funding**

The second question asks "on what basis should we develop the criteria for discretionary grant programs?". Here, three main options are offered in this regard: an internally consistent ranking system; past performance or future strategic goals. While these may be used together, it is important to recognise the differences in the focus and pre-requisites of each approach; and how this will shape the both the information requirements of the process and how they relate to different grant programs.

Again, appropriateness seems to differ according to the basic policy environment and objectives, and the possible recipients.

- > *Rational decisional models* seek to establish a relatively technical basis for grant allocation, and focus on evaluating grant applications internally and comparatively so they can be ranked and funded accordingly. For example, a decision-making process that draws on economic theory would develop criteria that focus on deciding allocative efficiency and/or marginal utility; others look to assess applicants against a professional standard (medical research funding). In these instances, selection criteria are developed to ensure grant applications can be assessed impartially and “on their own merits”. This type of model seeks to ensure all applications are judged without reference to “external” criteria.

This approach is most suited to relatively simple project-based grant programs, where applications are likely to be sufficiently similar to provide a basis for comparison. They will require stable and certain policy environment so that the criteria for judging a good program is fairly knowable. They are less suited to programs intended to fund complex projects (unless cost is central criteria), identify new or innovative ways to deliver a program, or where the policy environment limits choice. In most cases, this type of assessment criteria is difficult to design, will be difficult to implement if applications are dissimilar, and if important but informal criteria (typically political) are designed incorporated into the criteria. Significantly, the philosophy underpinning this approach stands at odds with the notion of assigning ministers’ discretion to decide grant allocation, and will create tension within a grant system when ministerial discretion is exercised.

- > *Performance-based grant allocation* means that applicants are judged on the basis of past performance. Much has been written on the topic of performance based budgeting and this will not be repeated here (see Robinson and Brumby 2007; Curristine 2008). However, two issues are particularly important: performance based budgeting does not remove the need for judgement and interpretation; and it is difficult to implement when the decision-maker does not have full control over all performance data. If, for example, an innovative – but risky – community engagement project fails to reduce crime rates, should the recipient receive additional grant funding to build on the lessons learned or be considered a program risk? Similarly the problems of result attribution will hamper this type of system: if divorce rates fall do we celebrate marriage guidance councillors or the upturn in the economy? Do we increase or decrease program funding? Nonetheless a performance based system of grant allocation can be useful in instances where potential grant recipients are easily comparable (across schools in a similar district for example) and performance measured accurately.
- > *Strategic budgeting* says resource allocation should be based on future plans and objectives, and should provide the basis for future performance<sup>10</sup>. For example, the AusLink program was built around a national plan that identified which roads needed to be funded over a given period of time, and grant funding was allocated within this broad framework. The planning literature sets down three preconditions for strategic planning including: a knowable, stable and certain external environment; simple organisational structures; and full control over resources. Clearly very few policy environments offer this type of simplicity but these preconditions seem particularly problematic when translated to the area of discretionary grant programs.

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10. There is extensive debate over the terms “strategy” and “planning”, whether strategy is ‘deliberate’ or ‘emergent’; policy based or managerial; focused on the future or reactive – even whether it is possible. For the purposes of this discussion, I am using the term simply to imply forward planning (see Mintzberg and Waters 1985 *Of Strategies Deliberate and emergent*, and Wildavsky, A. (1973), “If planning is everything, maybe it’s nothing”, *Policy Sciences*, Vol. 4 No. 2.) pp. 127-53.

This raises questions over the capacity (or power) of grant administrators to develop an overarching plan that sets the broad policy direction and priorities against which allocation decisions can be made. The previous section presented three situations where discretionary grants are most appropriate: when there is a need for policy change or innovation; under conditions of uncertainty or variability in the policy environment; or when the government lacks authority to act unilaterally. Alas, these seem to stand in direct conflict with the preconditions for strategic planning – particularly when the government depends on others to deliver complex social programs. As a consequence, developing a strategic framework for grant allocation often requires ministers to delegate some deliberative authority, models of which are discussed below.

## Who should decide? Devolved models in grant allocation

The question of who should decide the allocation of funding in a discretionary grant program lies at the heart of most debate and tension on this topic. The first part of this report followed most of the literature by focusing on one component of this debate: what is the role of politicians *vis a vis* their departmental officials? Yet the scope of this debate is broadened considerably if we look to alternate models of budgeting and grant making. In brief, the notion that the Commonwealth Government can (or should) control resource allocation lies at odds with most understandings of budgeting.

Throughout this research we have discussed a number of instances where the minister shares or devolves decision-making power over the allocation of grant funding. For example, by establishing an intermediary body of experts to decide the criteria for or distribution of grant funding the, such as the Australian Research Council (ARC); by allowing grant recipients to decide the best way to achieve the policy goals or deliver project outputs; or by agreeing to abide by the result of formula-based technical assessments. In doing so, the government (or minister) shifts deliberative authority over grant allocation to grant recipients, expert bodies, or program beneficiaries. In most instances these allocation models are adopted where the government relies on the expertise or legitimacy of others to design and deliver programs. Elsewhere the devolving of authority is intended to generate new ideas from an otherwise disengaged community, or to empower a community of interests.

The following focuses on two partial models of devolved grant making: negotiated and participatory grant making. In both of these examples, the government remains involved in the process although in differing levels. A third model sees the minister delegate most – if not all – authority to an intermediary body, typically because of expertise or reputation. So, for example the ARC uses field experts to evaluate and rank proposals, and advise on the distribution of grant funding; the Country Women's Association was delegated the authority of allocate emergency aid grants within program guidelines. One of the key problems of this model is that if authority is delegated to a closed community, it can lead to insularity and reinforce a professional elite, therefore reducing the likelihood of innovation. Similarly the model assumes existence of an 'authoritative' body that the government will trust sufficiently to abide by its decisions. Where this does not exist, the government is likely to challenge or overturn funding decisions and thereby undermine the system.

## Negotiated Strategies for Grant Allocation

Negotiated strategies for grant allocation will typically occur where multiple levels of government are working to deliver national objectives. This model is useful where policies draw on local expertise and seek to build policy coherence across a policy area. They are not suitable for a policy area where the Commonwealth Government is seeking to *impose* an agenda on grant recipients. This model requires

trust and a relative balance of power between the two parties (levels of government). The key to this model is that it allows for co-ordination between policy agenda and priorities, but recognises there are likely to be differences in terms of approach or timing of the implementation.

The AusLink program provides a useful example of this model from which to build. AusLink was developed through a Negotiated Strategy that included the Commonwealth, State, and Territory governments. The primary aim of this program was to develop a co-ordinated national strategy for road building projects that could be funded from this program. Traditionally road building is the responsibility of State governments – they typically hold the professional expertise and the perceived legitimacy. Through the AusLink program, the Commonwealth sought to implement a national strategy by influencing the decisions of State Governments. The program proceeded at two levels: initial discussions focused on developing an overall strategic framework for future decision-making: put simply the AusLink Grid identified which roads of critical national importance as agreed by all governments. During the next stage (implementation) of the grant programs, State governments applied for funding within this over-arching framework, but in accordance with their own infrastructure planning framework. Projects were funded in amounts ranging from \$1 million to \$500 million and provided over a number of years. In other words, AusLink provided a set of priority project options negotiated by all parties, and then allowed States governments (grant recipients) to determine the processes and priorities on the basis of local expertise and authority.

Given that “government organisations” constitute one of the largest recipient groups in the sphere of discretionary grants, it is worth considering whether to extend the use negotiated grant allocation to other areas. This is particularly relevant where the discretionary grant program is designed to achieve a co-ordinated, national approach, and where the key recipients are either different levels of government or quasi-government entities. That being said, the recent moves to reform COAG may eliminate the use of many discretionary grant programs in this domain. In the area of Indigenous policy and many other areas reliant on third sector deliverers, this will be more difficult because the current relationship between government and recipients is largely conceived through a purchaser-provider framework. Regardless of rhetoric, this essentially means the government determines the right way to deliver policy by setting performance requirements, for example, and recipient organisations implement that policy. It will only really change if or when the expertise held in these organisations is recognised as an important contribution to the development of policy in the relevant areas.

## Participatory grant-making

Participatory grant making draws on experiments – initially conducted in third world countries – to provide mechanism for engaging relatively small communities in deciding the allocation of grant funding. Based on experience in the UK, Canada, and Porto Alegre, participatory grant making seems to work most successfully when constituencies are located within geographically defined regions – for example, districts, towns and cities; where the program aims to increase the involvement of either the local community or sectors within the community; and when the process is transparent and seen to be fair to all.

This mechanism can be tailored to allow broad-based participation in grant making at three different levels of program design and grant making:

- **Strategic planning:** deciding the key priorities of your area; the medium-term goals and direction for the community and, in doing so, identifying *which grant programs should be accessed* by the community.

- > **Grant allocation:** public events are held to decide either the criteria for choosing between grant applications – “development” or “green and clean” for example; and then deciding which applications should be funded and how much money should they receive (typically within an aggregate limit).
- > **Working to develop project proposal:** the community is asked how to achieve outcomes (rather than for specific projects), and/or for innovative projects. Typically these programs are designed to support the development of potential applications; often they will focus on verbal presentations, or a two staged process where professional work to support the development of projects – and typically act as mentors throughout the delivery stage. The point here is capacity building, engagement and innovation.

One indicative example will suffice for this report. Since 2004, the district of Keighley has run a participatory grant-making process to allocate £300,000 in funding for neighbourhood renewal available locally under the Stronger, Safer, Communities Fund. The aim of the initiative is to engage local groups in project proposal and decision-making for grants of up to £6,000 each offered under the “Safer, Cleaner, Greener” program. Applications were received from community groups, they required little paper work, and were presented verbally. Two representatives from each group attended the meeting to present the proposal and rank other proposals according to predefined criteria. Eventually 60 proposals were funded – each with a slightly lower cash amount due to a ‘give back’ process held at the end of the session.

In other examples the process was adapted to allow a two-staged application process where applicants to work with experts to fully develop their proposals – including to ensure their legality. Here the aim is to encourage – rather than discourage – participation in the grant program.

Importantly the risks of participatory budgeting should not be overlooked<sup>11</sup>. They include that the process will be viewed as another bandwagon; be damned by a lack of support from public officials and managers or hijacked by special interest groups; that it will be developed as a top-down process that excludes the community rather than through a process of mutual consultation. Other challenges include the complexity and bureaucracy that can accompany this process, the need for strong commitment, time and capacity building; and the danger of raising expectations within the community that cannot be met.

The suitability of this model of grant allocation in Australia is as yet unexplored. However, it seems important to explore the option given the Social Inclusion Agenda, the move toward a more sustained engagement with community and third sector groups, and the very large number of grant programs that allocate funding of less than \$10,000.

## **Moving to a delegated model of grant allocation for policy development**

It is important to note that moving to a different system of grant allocation is rarely easy. All of the suggested processes shift deliberative power from government ministers and officials to community actors. Learning about and then setting up a new allocation system will impose additional costs and require a different skill-set in grant managers. In other words, while these alternative models of grant allocation support policy objectives, they are often seen to be in tension with the existing principles of operational simplicity and cost efficiency.

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11. This paragraph is based on Levan, K. 2007, *Participatory Budgeting in the UK: assessment for a practitioners perspective*. For this and other research publications see the following website:  
<http://www.participatorybudgeting.org.uk/documents/PB%20evaluation%20Jul%2007.pdf>.

Therefore government should move cautiously and pick the simplest options first: in the Australian context there are some interesting examples of both the negotiated and the delegated allocation systems. These should be studied for both success and for transferability. There are fewer – if any – examples of participatory grant making in Australia and it is therefore likely to be met with more resistance. It is, however, an option worth exploring if the Commonwealth Government intends to continue offering discretionary grant programs which provide small amounts of funding to encourage community engagement and capacity. To that end, the experiments in the UK are well documented and provide a useful starting point.

## Performance management and evaluation

Best practice in the area of performance management and evaluation shows quite clearly that the means and purpose of measuring performance must be aligned. At present most – although certainly not all – performance management efforts focus on ensuring the probity and effectiveness of grant spending. This is necessary under the FMA Act and this review does not undermine the importance of these issues. Element 1 of this review discussed the numerous problems with performance management and evaluation in this area, and provides recommendations for building the performance information systems by locating discretionary grants within broader program architecture or logic and the revitalised outcome structure. This builds on this work and recent criticisms by the Auditor-General in relation to discretionary grant programs and more generally. In particular, it notes that the lack of program structure in most discretionary grant programs confounds performance management and evaluation, and that evaluative systems need to be built into the up-front program design.

This report also argues that an overemphasis on questions of financial management – or control – have distracted from other elements of performance management, namely policy learning and development. The following argues that better information is only one element of a performance evaluation and management system, and that a well functioning performance management and evaluation system needs to translate performance data into useful information for decision-makers whether in departments, Cabinet or in recipient organizations.

## What happens now?

*the existing system of discretionary grants management does not preclude outcome-focused performance management and evaluation but the overall framework does not encourage it either.*

Given the preference for discretionary grants to be viewed as funding mechanisms, it is not surprising that evaluation frameworks focus primarily on financial probity to the virtual exclusion of other forms of performance management. In line with recommendations elsewhere, I support any move to adopt a risk-based approach to financial management and probity, including an abolition of any need to provide receipts to support expenditure below a minimal threshold. Given that many grant recipients receive less than \$500, any cost-benefit analysis would suggest that the benefits of extensive compliance assessment are limited. This will reduce the administrative burden on recipients and administrators.

As the total funding distributed through many of these programs is relatively significant the evaluation effort should therefore shift to whether or not the program as designed is achieving its objectives. *This effectively means a shift from evaluating recipients to designers and managers of the discretionary*

grant program. Program evaluation should examine whether and how the program as a whole has achieved the desired results or outcomes, and how the various initiatives funded through grants spending has contributed to these outcomes. The first step in this direction can be linked to efforts currently underway in government to develop a program and outcome structure that can be used to locate discretionary grants within a broader program architecture or logic and the revitalised outcome structure.

**Measuring performance: matching purpose and means.**

*Budget processes are among the most deeply rooted routines of government, involve powerful players, political interests, and crucial distribution issues... trying to overlay a performance management system on this process is fraught (Pollitt 2004).*

The following table summarises the work of Professor R.A. Behn of Harvard University. The framework is offered as the basis for understanding the different purposes for measuring ‘performance’ and how different types of performance information can be used and combined to achieve these different purposes. It should be noted that Behn builds on the basic structure of input-output-program objective-policy outcome and, while this framework is under review, it still provides a common reference point.

**Table 3: Eight purposes for measuring performance and the performance measures related to those purposes<sup>12</sup>**

The purpose	The public manager’s question that the performance measure can answer:	To help achieve this purpose, public managers need:
Evaluate	How well is my program performing?	Outcomes, combined with inputs and with the effects of exogenous factors.
Control	How can I ensure that grant recipients are doing the right thing?	Inputs that can be regulated.
Budget	On what programs, people, projects should grant funding be allocated?	Efficiency measures (specifically outcomes or outputs divided by inputs).
Motivate	How can I motivate staff, managers, or grant recipients to do the things necessary to improve performance?	Almost-real-time outputs compared with production targets.
Promote	How can I convince political superiors, parliamentarians, stakeholders, journalists etc that my program is doing a good job?	Easily understood aspects of performance about which citizens etc really care.
Celebrate	What accomplishments are worthy of the important organizational ritual of celebrating success?	Periodic and significance performance targets that, when achieved, provide people with a real sense of personal and collective accomplishment.
Learn	Why is what working or not working?	Disaggregated data that can reveal deviances from the expected.
Improve	What exactly should who do differently to improve the performance of this program?	Inside-the-black-box relationships to connect change in operations to changes in outputs and outcomes.

<sup>12</sup> Source: adapted from table in Behn, (2003)

If we are to shift the focus of performance management in grant programs, then the key issue is how to differentiate between performance measurements for control purposes on the one hand, and for program learning and improvement, and potentially questions of motivation on the other.

At present, most of the emphasis on performance management is centred around control and budgeting. For example, the government sets up a control-focused performance relationship with recipients whenever they ask for proof of output, service or benchmark delivery before funding is provided. In the context of an on-going service delivery relationship, this will include requiring grant recipient to engage in an annual granting round, or it could be a phased-funding model for one-off projects.

From a policy perspective this raises a number of problems - even if we leave aside the more blatant examples of gaming where recipients end-run the system either by lobbying the minister directly, or creating other forms of political pressure. When the performance relationship between program managers and deliverers is based around the threat of withdrawing funds, then there is every reason to expect gaming on behalf of the service deliver (recipients). Rarely will they provide full and frank performance information – particularly not evidence of difficulty or failure in reaching their mandate. As a result, there is little opportunity for program designers to learn about what is and is not working within the program, or how it could be redesigned to enhance policy success. Often evidence of policy failure is blamed on the deficiencies in the recipients rather than in program design or changes in the program environment, for example. Suspicion between managers and recipients often leads the government to engage 'independent' evaluation or audit professionals to assessment key performance indicators. This consumes valuable resources which could be directed toward program improvement or learning.

Other difficulties in adopting a control focus when building the performance measurement and evaluation framework around grant programs include:

- > Where the grant program operates in a complex, changing or variable environment the attribution of outcomes or even outputs is not a neat process. Outcomes cannot always be tied to budget because of different timeframes and changes in other external factors. At the most basic level, the Police Department's objective is to reduce crime, but we do not cut the police budget if the crime rate goes up.
- > The use of simple performance indicators as the basis for continuing or providing funding may actually undermine the program success by distracting the organisation from the core mandate or mission, which is the basis of their ongoing reputation or expertise, but not directly measured in Key Performance Indicators (often because it is not funded by the grant program).

## **Developing an on-going system of performance evaluation and program review**

What then, are the options available to grant managers when developing the performance measurement and evaluation frameworks? Throughout the course of this research we observed many innovative, interesting approaches in this direction. The Clever Networks program spoke of the need to build an on-going partnership between the government and recipients to ensure recipients could deliver programs on time and within budget. They also built performance capacity into the system by bringing groups of recipients together to discuss what did and did not work in delivering the various projects and to exchange ideas on future projects. The critical issue here is that the broader program aims of capacity building are supported by this approach to performance management – it is not a question of reward or sanction, but adaptation and learning. This builds access to systems and

engages the broader recipient community. Interestingly these discussions brought together recipients from a number of different but related grant programs, suggesting they are seen collectively as the mechanisms for policy delivery rather than a series of individual programs.

The Envirofund program included a monitoring and evaluation package that is intended to measure the effectiveness of the overall program rather than the achievement (or otherwise) of grant recipients<sup>13</sup>. In sum, all recipients are asked to complete pre and post-grant surveys which are to be aggregated to “provide a national picture of the Envirofund’s achievements and ensure the programme is contributing to the goals of the Natural Heritage Trust”<sup>14</sup>. The important example here is that *program* evaluation has been built into the system – although it appears with the dual aim of ‘promoting’ achievement as well as enabling program learning.

Finally, the Office of Evaluation and Audit (Indigenous Programs) provides an example of moving the performance management framework outside the closed relationship between grant provider and recipient. First, the office stands as an *independent* office inside the Department of Finance and Deregulation and focuses on Indigenous programs across the government. Therefore it has the potential to provide a whole of government view in a policy area that spans departments. Second, the office evaluates performance regardless of the instruments used to deliver the policy – that is the review is focused on program effectiveness rather than specific funding arrangements or the continuity of a specific grant allocation. Thirdly, the office publishes a forward agenda of upcoming program evaluations which is authorised by Cabinet. This makes evaluation a regular exercise, rather than one that is prompted by a specific event, which has the potential to build the expectation of change and re-design into the policy community. Finally, as that the Office represents neither grant recipient nor provider is likely to broaden the scope of the evaluation to include performance of both parties and issues of program design as well as delivery.

Together these examples suggest a number of important lessons in terms of performance management for grant programs. First, and foremost, performance evaluation should be seen as integral to program design and on-going improvement, rather than a means of judging recipient performance. Nor should it be tagged-on to determine whether or not the program or funding should continue. To that end, most evaluation should be treated as ‘diagnostic’ rather than summative; a means rather than an end.

Working toward a system of performance management and assessment that is focused on questions of program improvement and learning will require wide ranging changes. On one hand, it will mean redefining the purpose of performance measurement to ensure that issue of control and financial probity are not the most important objective. To that end, the current system of using the annual grant process as a performance control mechanism should be re-examined and abandoned, wherever appropriate. As discussed earlier, an annual allocation process imposes administrative costs on grant managers and recipients. More importantly, it defines the relationship between these key actors in the program arena around issues of control, reward and sanction, rather than policy development and learning. Awarding grant funding on a longer term basis opens up the time and resources to build a system of performance improvement.

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13 The point being made here is a broad one of program design, the adequacy or validity of these measures has not been examined as part of the review.

14 National Heritage Trust website ([www.nht.gov.au/publications/guidelines/envirofund-me-pack.html](http://www.nht.gov.au/publications/guidelines/envirofund-me-pack.html))

As the minimum, this will require:

- > more up-front analysis in terms of the purpose and costing of proposed programs (through NPP); and require review of the existing suite. This is likely to increase the unit cost of establishing an individual grant program.
- > grant programs to be seen as part of a broader suite of policy instruments intended to deliver policy outcomes, and therefore the system of evaluation and performance management should be treated as a cross-cutting exercise rather than merely focus on one component of the delivery suite (i.e. the grant program).
- > grant recipients to recognise their obligation to engage in activities that enable policy learning – such as attending workshops, presenting at ‘lessons-learned’ events, proving performance data as part of a broader efforts to evaluation the impact of government programs.

This degree of change in the performance management ethos will only be successful if the implications and extent of these changes are recognised. In particular questions of demand and training should be noted:

- > the Commonwealth Government is increasing the impetus for performance management and evaluation through the COAG reform; and should ensure that discretionary grant programs related to this program are managed and evaluated accordingly;
- > The Government of Canada has moved to professionalise performance management and evaluation in the same way the government has worked to improve the financial management skills within government. This includes efforts to certify evaluators through specifically tailored academic and other training programs, and to establish an evaluation unit within the central management structure of each department.

## Conclusion

The mechanisms of grant allocation and performance assessment and evaluation are intricately related to whether or not a grant program will succeed. As argued previously neither process is an end in itself and must be tailored to policy purpose and the desired relationship between the government and grant recipients. The research conducted for this report offers some options for moving beyond the traditions of grant program design to build a more nuanced system that recognises the complex and diversity of grant programs. Any change in this direction should recognise the significance of reform being proposed, and therefore be informed by future experimentation and research – especially the use of pilot studies and participant based workshops. A change cannot proceed without the engagement of all stakeholders – particularly in areas where the government is dependent on grant recipients for expertise, reputation, and good will.

## Section 4: Key points

- > Government should adopt a more systematic and tailored approach to the design, management, and evaluation of discretionary grant programs. Particularly, the mechanisms of grant allocation, the longevity of funding arrangements, and the systems of performance management and evaluation.

### Grant Allocation

- > Concern about political interference, efficiency of grant distribution, and how grant funds are spent has led to grant allocation processes that highlight issues of transparency of process, clarity of purpose and criteria, and regular, competitive bidding rounds.
- > The process of allocating grant money is not a neutral instrument, but one that can be harnessed to achieve policy objectives. From a policy perspective, the critical issue in designing a system of grant allocation is to support program outcomes. Critical design questions include:
  - whether there is a need to promote stability or change; and
  - which kind of allocation model would be support the policy objective in the given policy context.
- > Some allocation models will require devolution of some decision making. There are some examples of devolved decision making in Australian grant making and further use of these models, including negotiated grant making and participatory grant making should be explored. Given the relative inexperience with these models and some of the risks, the government should move cautiously and pick simplest options first.

### Performance Management and Evaluation

- > Currently most performance management efforts focus on ensuring the probity and effectiveness of grant spending. This overemphasis on financial management raises a number of problems, many of which undermine a cooperative and open relationship between managers and recipients, and distract from policy learning and improvement.
- > Performance evaluation should be seen as integral to program design and on-going improvement, rather than a means of judging recipient performance.
- > Evaluation effort needs to focus on whether the program is achieving its objectives. This means shifting the effort away from evaluating recipients and towards evaluating designers and managers.
- > Performance management and evaluation systems need to provide useful information for decision-makers and decision-makers need to create demand for this information.

# 05

FROM PROCESS TO PURPOSE: REFORMING  
THE MANAGEMENT OF DISCRETIONARY  
GRANT PROGRAMS

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This review argues that a uniform approach to managing discretionary grant programs will be problematic, because they traverse such a complex and multifaceted domain of public policy. The following proposes recommendations for a more tailored approach to discretionary grant management that emphasises policy purpose and the desired relationship between the government and recipient. This approach is intended to improve the delivery of public policies by providing a basis for deciding whether and when to use a discretionary grant program, the choice of grant allocation mechanisms, and grant performance management and evaluation regimes.

## **Addressing the politics of discretionary grants**

***There is clearly a need for all stakeholders to recognise discretionary grant programs as a mechanism for policy delivery rather than simply a funding tool.***

Politicians need to move away from seeing discretionary grants programs as pots of money over which they have full discretion or that can be used to “spread a little sunshine”. The fact that discretionary grants can be targeted to specific jurisdictions or communities is both a strength and weakness of this policy instrument. Where discretionary grant programs are used to electoral rather than policy ends, they undermine the collective policy goals of government. This is likely to result where a government adopts a reactive or *ad hoc* approach to creation and management of discretionary grant programs. Where ministers operate outside the policy as designed, they are likely to undermine confidence in the program and contribute to a culture of grant-bidding and ‘end-running’.

Second, the departments responsible for establishing and delivering discretionary grant programs need to adopt a more holistic view of discretionary grant program design so that these programs are clearly incorporated into the broader policy framework of the government. Many departments choose a discretionary grant program because they are unclear of the alternatives or because they feel pressure to do so. This can set up a “grant” mind-set where alternative mechanisms of program delivery are not examined either when developing new programs or when reviewing the success of existing grant programs.

Thirdly, central agencies need to be aware that they contribute to some of the current difficulties around discretionary grant management. PM&C was seen by many program managers as a driver of “responsiveness” and the source of many demands for either creating a new grant program on the run, or retro-fitting spending decisions into grant programs. Within the context of reform in PM&C, the new strategy unit may be the best locale to quell these pressures to introduce new grant programs outside of the government’s broader policy framework. Similarly, the budget office needs to revisit the impact that some of its practices have on the culture of grant management. For example, the reliance on one-year, project based approach to grant spending is seen as a way of reducing pressures on the bottom line; components of the financial management framework can inhibit the ability of departments to develop grant programs that offer funding for multiple years or as a “contribution” to core activities and the ability to withhold grant funding in a phased payment scheme.

Recipients of grant programs also need to recognise that government grants are neither ‘free money’ nor a right. Recipients need to recognise that by applying for and accepting grant funding, they are entering into a partnership with government to deliver policy objectives. As a result, accepting grant funding imposes obligations on both parties which goes beyond the minimum requirements to fully account for the expenditure of the grant money and includes the obligation to participate fully in program evaluation and review.

## Improving clarity in the realm of discretionary grant programs

*There is also a need to establish more clarity in between different types of discretionary grant programs.*

These could be incorporated into the grants framework proposed by Element 1 as sub-categories; or operate as complementary framework for grant management. Some possible ways of distinguishing between different types of discretionary grant programs include:

- > Grant Purpose: Special-purpose grants (whether for project or core-operating) versus “block” grants (which could be called “contributions”).
- > Longevity of grant funding: annual or multi-year.
- > Amount of funding provided to recipients over the life of the grant: in addition to the existing ‘grants’ category, I propose small grants (less than \$10,000); large grants (+\$1,000,000).

*Some types of programs should be explicitly excluded from the category of discretionary grant programs.*

By way of discussion, these should include those programs that are intended to:

- > deliver funding to less than five recipients as there is little justification for a competitive process allocation process;
- > provide “rewards” for previous behaviour or achievements, with no conditions attached (such as prizes and rewards) – these should be classified as gifts as they impose no expectations reciprocity between the government and recipients; or
- > deliver large scale, multi-year infrastructure or capital projects. These should be reclassified as either procurements where there is a clear project output and a purchaser-provider relationship (such as WaterSmart), or as an SPP where the relationship is with another level of government (such as AusLink). Many recipients discussed the difficulties of managing complex projects that resulted from the system of discretionary grant administration. In particular, the tensions between managing a phased-funding agreement (i.e. where grant payment depends on the achievement of milestones) within a broader system of financial management that required annual spending. Is it possible to establish a separate roll over fund to finance these types of long-term projects?

It should be noted that moving outside the discretionary grant realm does not prohibit a competitive allocation process.

## Improving the systems of discretionary grant allocation

By moving away from a norm of annual grant funding policy makers will recognise the longevity of most discretionary grant programs, and the on-going nature of the relationships between the government and grant recipient. Our research suggests that very few discretionary grant programs can be designed and delivered within such a short time frame and adopting an annual focus will bias the system toward simple projects that can be completed over a very short-term time frame. Further, annual grant funding imposes an excessive administrative burden on program managers and recipients which shifts attention away from program delivery; is likely to reduce investment in up-front policy design and, will shift attention away from questions of program learning and performance improvement.

This relatively simple change in emphasis is likely to benefit both grant managers and recipients of discretionary grant programs. For recipients it can reduce the ‘grant merry-go-round’ and the

administrative burden of grant application; provide the legal and managerial stability that is required to engage in longer-term employment contracts; provide a stable basis for relationships between recipients and their clients; and allow for more strategic planning. In addition, it can facilitate a shift in the emphasis of relationships between recipients and government from questions of continued funding to program improvement and learning.

For departments administering the grant programs, this will reduce the number of applications and the need to manage process; shift the focus of work from allocation to program performance management and evaluation. It should be noted that this change is likely to demand a different set of skills from the managers of grant programs. For the budget office it will require a more realistic costing of grant programs in the forward estimates – both in terms of the through funding and in terms of the cost of program delivery and management costs; the basis for program costing must recognise the need to include funding for program evaluation and feedback – most of which can be off-set by savings from a longer allocation cycle.

***There is a need to study the feasibility of adopting alternative methods of grant allocation.***

The government should consider extending the use of negotiated and delegated grant allocation mechanisms to areas where there is a relatively balanced power relationship between the government and recipients; or where the recipient has more expertise in the policy area than the government. This is particularly relevant where the discretionary grant program is designed to achieve a co-ordinated, national approach, and where the key recipients are either different levels of government or quasi-government entities.

The government should also consider piloting the use of participatory grant allocation in those program areas where the key objective is to enhance community participation or the need to be tailored to local requirements – rather than accord with a national agenda. To this extent, participatory grant making requires devolution of authority from the Commonwealth Government to regional or local ‘intermediaries’. They can be designed to allow significant involvement by elected officials from the specific region or community.

While this review has offered some options in alternative approaches to grant allocation, this area requires more sustained attention and review. Some issues for further consideration on this topic are:

- > any alternative system of resource allocation will necessarily shift the relationship between the public service and grant recipients.
- > the government may need to engage intermediary institutions to act as either grant-managers or to facilitate the participatory engagement.

These could be explored as part of the longer-term strategic policy reviews; work through steering committees that bring together policy analysts, grant managers, recipients and key stakeholders; and pilot studies that build on the recent experiences in the UK through both the Office of the Third Sector and the Participatory Budgeting Unit.

## **Improving performance management and evaluation in discretionary grant programs**

As discussed in the previous section this evaluative role should become more active and focus on questions of program improvement and learning in addition to financial monitoring and oversight requirements. To this end, program managers should provide venues where grant recipients exchange

lessons and best practice. This is particularly important in areas where “innovation and problem solving” are the key justifications for delivering the program through discretionary grants programs. This will mean more up-front analysis is required in terms of the purpose, costs of proposed programs and suggest the need to systematically review of the existing suite of programs.

## Concluding comments

It is important that discretionary grants programs are recognised as one of many possible tools for delivering government policies: they are neither an end in themselves, or necessarily evil. Discretionary grant programs present unique challenges because they provide ministerial freedom, they allow governments to target specific constituencies, and they provide the basis for delivering relatively small amounts of funding to a large group of recipients quickly. As a consequence, discretionary grant programs are vulnerable to political manipulation more than most other tools of government. For those reasons, there is a need to pay particular attention to the creation, use, design and evaluation of discretionary grant programs.

But these “problems” of flexibility and targeting are also the primary reasons for using discretionary grants to deliver government policies. Any reform of discretionary grant programs must recognise that limitations on flexibility may reduce policy success and should therefore balance the impetus for operational efficiency with the needs of specific programs or recipient groups. Where the aim is to build capacity within a particular community, for example, recipients should be coached and encouraged which is an expensive, time consuming process. If, however, this achieves the longer-term policy goals, then it may be an effective use of public resources. Similarly if the grant program is directed toward drawing on the authority or expertise of other parties, then a process that discourages recipients either by an overly controlling administrative environment or by diverting them from their core objective is likely to fail. All of which speaks to the need to a much more sustained period of program development during the initial stages, and for on-going evaluation to allow for policy learning and improvement.

Finally, it must be recognised that discretionary grant programs are only *one* possible instrument for the delivery of government programs – they may be suited to the initial period of program development but not to allow for a period of stable delivery. This suggests a need for on-going review and reconsideration. Hence, the use, allocation, and evaluation of discretionary grant programs need to be assessed in relation to their contribution to the broader system of policy making and delivery. This review examined how and whether this is occurring and concludes that the current dissatisfaction with discretionary grants is indicative of more wide-spread problems in the system of policy development at the federal level.

As a result the recommendations made here should not be limited to how and why discretionary grant programs should be used (and the answer here is judiciously!) but must look to the broader system of policy making within the Commonwealth Government. The recent COAG reforms and restructure of PM&C appear to be moving in this direction. Despite these changes, there is evidence that the new government will persist in using discretionary grant programs unless there are substantive changes to the whole of government system of policy making.

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September 2008



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## APPENDICES

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# APPENDIX 1: TERMS OF REFERENCE

The second element of the review will assess the merit of discretionary grants as a mechanism for delivering Government policy; this will include considering possible methods to measure, over time, the longer term benefits of using discretionary grants as a funding mechanism. In doing this the review will:

- > review the advantages and disadvantages of discretionary grants as a funding mechanism including for different customers and different expenditure objectives;
- > review international best practice, adapting principles for use in the administration of discretionary grants in Australia;
- > review the merit of past significant growth in the number and value of discretionary grants provided by the Commonwealth Government;
- > review alternate ways of achieving program outcomes other than through discretionary grants;
- > review the appropriateness and effectiveness of providing ad hoc discretionary grants;
- > review best practice in the performance management of discretionary grants, particularly the measurement of outcomes; and
- > review the long term effectiveness and benefits of discretionary grants.

## APPENDIX 2: A LITERATURE REVIEW OF THE ADVANTAGES, DISADVANTAGES, POSSIBLE USES AND ALTERNATIVES TO DISCRETIONARY GRANT PROGRAMS

The following is an extract from a literature review undertaken as part of this research. It describes the advantages and disadvantages of discretionary grants and alternatives to discretionary grants.

### Alternative policy mechanisms

All governments use grants (Sendt 2002). However, it is important to be aware of other policy mechanisms that are available to governments.

There are numerous ways in which the various policy mechanisms available to government can be grouped and described. The following represents one possible taxonomy of policy mechanisms:

- > **Indirect mechanisms**<sup>15</sup>: these are ‘macro-level’ mechanisms which promote economic, political and social stability and generic infrastructure, for example trade restrictions, interest rate policies, land tenure policy, market development, security and political and macro-economic stability.
- > **Direct mechanisms**:
  - **Revenue mechanisms**: taxes, tax relief, tax rules (for example, tax deductibility rules, accelerated depreciation rules), fees and levies.
  - **Regulation mechanisms**: this would include the imposition of regulation as well as removal of regulations (for example, regulations on media ownership).
  - **Information mechanisms**: this would include government funded advertising campaigns (for example, advertising to discourage speeding) and provision of technical assistance (for example, information on how to reduce water use).
  - **Spending mechanisms**<sup>16</sup>: spending mechanisms include actions that involve financial outlays or potential financial outlays by the government:
    - **Physical inputs**: gifts and provision of specific-local infrastructure, for example, in forestry seedlings or a government built timber mill.
    - **Procurement**: apart from standard purchasing of goods and services by government, this category may include government guaranteed purchases which can be useful in maintaining industrial capacity and capability.

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15 The difference between indirect mechanisms and direct mechanisms is derived from Enters et al (2003) direct and indirect incentives. The placement of the divide between direct and indirect mechanisms appears to depend on the scope of mechanisms under consideration. For example, Davis (2006) classifies tax incentives and grants as ‘direct policies’ and regulation of IP rights, public procurement of R&D and competition policy as ‘indirect policies’.

16 This list is largely informed by KMPG et al (1997), although ‘formula grants’ has been classified as a type of entitlement here.

- **Investments:** these include programs that provide capital with the view of making a return for the government.
- **Loans:** these may include income-contingent loans such as those provided under the Higher Education Loan Programme.
- **Risk acceptance:** this includes mechanisms where the government may accept contingent liabilities through instruments such as indemnities, guarantees, warranties.
- **Entitlements:** in addition to entitlements such as income support provisions (for example, the Age Pension), this category may include any direct provision of cash on the basis of preset formula, such as industry subsidies under the Export Market Development Grants program or first home owners grants.
- **Grants:**
  - > **Inter-government transfers:** this includes all payments specifically targeted at other levels of government, such as GST revenue distributions to the States and Territories and SPPs to the States, Territories and local governments.
  - > **Competitive grants:** these are where applicants compete for funding by submitting proposals, which are assessed against preset selection criteria and awarded on the basis of merit, for example, the Australian Research Council's National Competitive Grants Program.
  - > **Non-competitive grants:** these are grants which are provided outside a competitive process, for example, the \$35 million grant to Toyota announced by the Prime Minister on 10 June 2008<sup>17</sup>.

Both competitive grants and non-competitive grants can be considered 'discretionary grants' because in both instances the recipients of funding, the amount of funding and the purposes of the funding are subject to decisions made by the government.

Some intergovernmental transfers also have the fundamental characteristics of what could be considered a discretionary grant. They are separated out in the above classification because government deals with funding to other levels of government in a distinct manner.

None of the policy mechanisms mentioned above is without its disadvantages.

- > Tax mechanisms require legislative change; they further contribute to the complexity of the tax system, and create the potential for tax avoidance.
- > Regulation generally creates compliance costs for the organisations and the government and can create inflexibilities or reduce competition.
- > Government loans can compromise private provision by banks, which may be better placed to efficiently manage loans. Subsidised government loans can contain hidden indirect subsidises (write-downs, doubtful debt and loss of present value). Excessive use of loans can lead to recipients incurring unsustainable levels of debt.
- > Physical inputs can be bulky and inflexible.
- > Government purchase guarantees or other industry subsidies may distort the market, foster inefficient practices and increase costs to the government<sup>18</sup>.

<sup>17</sup> [www.pm.gov.au/media/Release/2008/media\\_release\\_0295.cfm](http://www.pm.gov.au/media/Release/2008/media_release_0295.cfm).

<sup>18</sup> KPMG et al (1997)

## Disadvantages of grants

Discretionary grants arouse suspicion.

- > Sendt (2002): argues that discretionary grants are subject to perceived bias in decision making, and decision makers are usually “guilty until proven innocent”. Sendt suggests that the problem of perceived bias is not confined to politicians and notes that grant proponents faced with lengthy and frustrating administrative processes, find that making direct representation to ministers more effective. Sendt suggests that the less transparency and accountability of a grant process, the greater the chance for misuse of funds or the perception of misuse.
- > Even where processes are in place to promote fairness and transparency, decision makers (sometimes with the assistance of their agencies) can make post hoc adjustments to approve a favoured but apparently less-meritorious grant (for example see GAO-06-268).
- > The distribution of grants can be influenced by the special interest groups. Lowry and Potoski (2004) showed that discretionary grant spending in the US was influenced by interest groups and public and private organisations, even when latent demand (for example, demographically driven demand) and supply pressures (for example, electoral margins) are controlled. This study suggests that the allocation of discretionary grants depends on the demands expressed by organised interests, not just the self-serving interests of politicians. However, given that the extent to which latent demand translates into organised demand varies, the pattern presented by Lowry and Potoski suggests that funding can be directed to ‘squeaky wheels’ rather than areas of greatest need.
- > Donovan (2006) indicates that the discretion available in grants processes, if improperly used, can lead to unfair competition and give rise to political favouritism and corruption.

Project based grants do not provide the same long-term certainty that more entrenched mechanisms can provide, for example, tax incentives or deregulation. Unless the grant is used to obtain some durable good, for example physical or human capital (such as training), then the benefits of the grant can predictably cease when the funding ceases.

- > Reifschneider et al (2000): since competitive grant programs usually judge each proposal on its own merits, they are seldom credited with being good instruments for capacity building or supporting the sustainability of organisations.
- > Depending on design, there may be delays in receiving funds and starting projects due to funding cycles. There is no certainty for recipient until decision on grant is made. With entitlements, people can do the sums before going into a venture.

Project based grants can involve ‘picking winners’, which may be an unreliable method of allocating funds. Ross (1991): the paternalistic preference for funding for particular commodities caters more for the preferences of donors than recipients.

Grants can be seen as ‘gifts’, which fail to guarantee outcomes and reduce recipient efforts:

- KPMG et al (1997): nominally, grants do not have to be paid back, so there is often no guarantee that the government will get the desired outcomes.
- Cohen et al (2005) reviewed literature in relation to overseas development assistance and showed that relative to grants, loans were associated with higher levels of fiscal and tax effort, lower public consumption, higher investment rates and lower dependency on external funding.

Some disadvantages of grants appear to emerge from poor design rather than something implicitly wrong with grants as a policy mechanism:

- > KPMG et al (1997): the process of obtaining and managing grants can be time consuming and expensive for recipients and grants can be too restrictive.
- > Enters et al (2003): direct incentives can be difficult and costly to administer (that is, they can be inefficient), they are easy to abuse and are frequently flawed if they are designed according to the interests of the government rather than with the needs of the recipients in mind.
- > Sendt (2002): Grants, as with other mechanisms need to be applied appropriately, efficient and effectively, but there are special risks for grant programs:
  - vagueness of purpose – rationale and desired outcomes are historical and not regularly reviewed for ongoing relevance.
  - rationing as part of the selection process – lack of sound selection criteria, failure to adhere to criteria, failure to document application of the criteria, lack of openness about why applicants were unsuccessful.
  - poor management and monitoring of recipients use of grants.
  - evaluation will not be undertaken, there will be poor information to work with or be conducted by people not sufficiently independent.

## **Advantages of grants**

Grants are one of the simplest and direct forms of incentives available to government to address a policy problem:

- > Unlike instruments like loans, entitlements and tax incentives, the cost is capped and certain for the government (Davis 2006).
- > Grants are an attractive source of funds for potential proponents.
- > Grants do not need to entail extensive administrative costs (as required for loans) (FEMA 1993).
- > Grants are relatively easy to modify once they are in place.
- > Ongoing 'block grants' can provide organisations with the funding certainty needed to build capacity and optimally engage in the delivery of outcomes.

Grants enable highly specific targeting of funding:

- > Grants for the purchase of specific goods or services can ensure that the funds are directed in the way that the government (and taxpayers) wish. If the government is to be held accountable for the use/misuse of public funding, it seems reasonable that government should assume a high degree of control over funding.
- > Ross (1991) showed that the direct funding of specific outputs is important where the government 'cares' more about the beneficiaries of the funding than the service provider. For example, it is better to directly subsidise the cost of health and education for children rather than provide the funds for that purpose to parents in circumstances where parents care less about the welfare of children than the government.

- > Davis (2006) suggests that grants typically aim to help firms doing certain types of research and, through conditions imposed on funding, may encourage collaboration and private co-funding.
- > Davis (2006): grants can avoid the deadweight losses that can be involved in some non-discretionary mechanisms, for example, tax credits may subsidise existing activity, encourage the reclassification of activities at the margins, and potentially lead to input price inflation (for example, salary increases).
- > Davis (2006) discretionary grant programs enable the government to weigh the relative merits of particular projects and adjust funding as appropriate. Many non-discretionary policies have the weakness of treating all work/projects as being of equal value.
- > 'There is no substitute for good judgement'. Non-discretionary mechanisms often need to draw hard lines between who is eligible for support and how much funding each case/proposal will receive. Unless the criteria for entitlement are objectively measurable and perfectly valid, there will be people/projects that miss out at the margins, even though they are captured by the policy intent. Discretionary grants provide the opportunity to respond flexibly to the merits of particular cases/proposals.
- > Reifschneider et al (2000): competitive grants:
  - enable the allocation of funds to the higher quality proposals and encourage the improvement of the quality of proposals.
  - (cited) can identify the lowest cost bidder for a given problem and ensure that government obtains value for money.
  - can promote collaboration.

Non-ongoing grants can be good 'kick-starts', for example:

- > Davis (2006): one limitation of broad-based non-discretionary support is the limited impact on non-R&D performing firms. Evidence on the effectiveness of tax credits suggests that they are effective at encouraging existing R&D performing firms to undertake more R&D but do not appear to encourage substantial numbers of non-R&D performing firms to begin undertaking R&D. This may be because subsidies only lower the cost of R&D at the margin whereas non-R&D performing firms may face fixed costs associated with beginning R&D. If a goal of policy is to encourage more non-R&D performing firms to begin conducting R&D, then targeted support that addresses the technical and other impediments to starting R&D is likely to be more effective than a broad-based non-discretionary initiative.

### **In what sort of circumstances might grants be the best option?**

A decision to establish and maintain a grant program should be based on an analysis that demonstrates that the provision of grants would be the most appropriate, effective and cost-effective approach compared to other available policy mechanisms.

Grants may not always be the best option and their effectiveness can depend on the nature of the policy problem, political and socio-economic context and the presence of established incentives and disincentive structures.

- > Johnstone (2004) within the context of access to post-secondary education, suggests that if grants and loans were found to be similarly effective then the preference ought to be for loans.

- > Enters (2003) noted that direct mechanisms may only have marginal effects in an environment characterised by strong disincentives. In the context of forestation, indirect incentives generally play a much greater role in encouraging investments than direct incentives. And of the direct incentives, tax related mechanisms were better than loan and grant schemes.<sup>19</sup>
- > Silkman and Young (1982): looked at library services and school bus services to show that grants-in-aid (from federal and State governments) reduce the productive efficiency of local government services. It is theorised that this occurs because:
  - by distorting prices faced by local government, grants can lead to the selection of inefficient inputs or production strategies.
  - grants reduce the expenditures that have to be financed locally which reduces the incentive for local citizens to hold their local government accountable.
  - complicate revenue streams, therefore reducing the ability of local citizens to hold their local governments accountable.

Silkman and Young's discussion points to the flexibility of grants by noting that grants have been modified to include productivity requirements or performance incentives that are linked to efficiency. Although Silkman and Young maintain that another possible approach is to look at alternative means of distributing resources to local economies and individual citizens to create greater reliance on local taxation.

- > In some instances, grants might only be effective when implemented in conjunction with other policy mechanisms. For example, the provision of vocational training to improve employment prospects may be ineffective if employment in that vocational or region area is not available.

One theme in the literature on the effectiveness of grants is whether there is an existing capacity and the policy needs to focus on redirecting that capacity or whether there is a need to develop capacity.

- > Reifschneider et al (2000) in the context of research and development, it is suggested that competitive grants will only be effective if there is a diverse market in which competition can take place. It is further suggested that if there is a need to develop capacity, rather than mobilise it, institutional block funding is preferable to competitive grants. If this is not an either/or situation, there is a need to find the appropriate mix of competitive and block funding for optimal performance.
- > Reifschneider et al (2000) suggest that competitive grants should be structured according to the stage of development and economic environment, with realistic objectives and focussed priorities.
  - Low development: where the objective is to initiate economic development - capital grants, matching support, foreign technical advice and business support is appropriate.
  - Early development: where regional disparities have emerged and there is a greater awareness of needs and the capacity of small business – start using greater selectivity in incentives and greater use of matching grants.
  - Mature developed: where the objective is to focus on black spots and improving technologies – shift from grants to advice and information.

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<sup>19</sup> There may be limits to what we can generalise from this article, since forestation is a unique policy area given that growing trees takes a long time, with high expenditure early on and uncertainty of prices and benefits that will be realised in the long term. However, the countries included in the study are very diverse culturally, politically and economically.

- > Reifschneider et al (2000):
  - In the context of agricultural research, the papers argue that competitive grant programs (CGPs) can be effective but must complement long-term funding for strategic research through block grants. The article suggests that viability of long-term research is compromised when block grants fall below 40 to 50 percent of funding.
  - CGPs are not appropriate in all circumstances and should be linked with other funding sources for research, extension and training to promote a complementary system of R&D funding.
- > In forestation policy, Enters et al (2003) argued that direct mechanisms are most likely to be important when the forestation industry is being initiated but that a good sign of success is that direct mechanisms are replaced by indirect mechanisms as the industry matures.
- > van der Meer and Noordam (2004) citing TDI (2002) suggests that the use of grants needs to evolve with the level of economic development.
- > Donovan (2006): in relation to impure public goods, whether grants are the best remedy depends on the reasons for the market failure. He argues that:
  - grants are generally justified for skills training, technology, innovation, information, start-ups of businesses, project preparation, trade fairs, private investment in local infrastructure, networks, lumpy capital and collective action.
  - grants are generally not justified for current inputs or credit, where their use may crowd out private suppliers.

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