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# 1 Progressing the national reform agenda

The Council of Australian Governments is embarking on a new National Reform Agenda (NRA). Improvements in Australia's living standards over the next decade and beyond will depend, to a significant degree, on the success of the competition, regulatory and human capital streams of reform embodied in the NRA. The challenges facing Australia's governments in progressing the NRA are threefold. First, governments must agree, in the near future, on a robust governance framework that provides effective leadership and monitoring of their performance in delivering reform. Second, to be effective, the NRA's implementation arrangements must establish agreed outcomes, specific actions and clear milestones. Third, the financial arrangements associated with the NRA should not only recognise the fiscal revenue gains from reforms but also the differential expenditure requirements, including the need to address transitional issues and facilitate adjustment.

## Pay-offs from further reform

In February 2006, the Council of Australian Governments (COAG) endorsed a new National Reform Agenda (NRA) directed at further improving the performance of the Australian economy and the living standards of the community. The competition, regulatory and human capital streams of the NRA build on, and significantly extend, the scope of the successful National Competition Policy reform framework (COAG 2006a).

In this annual report, the Commission examines the scope of the NRA and highlights a number of issues which will need to be resolved in order to realise its potential in coming years.

## The NCP experience

A key factor underpinning the National Competition Policy (NCP) Agreement of 1995 was the recognition by Australian governments, from the mid-1980s, that Australia's living standards were being impaired by domestic policy settings.

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Earlier reforms had reduced barriers at the borders and subjected our traded industries to greater international competition. This in turn exposed performance problems in other parts of the economy. Notable among these were inefficiencies in infrastructure industries dominated by public monopoly suppliers, costly regulation of many product markets, and rigidities in the labour market which impaired enterprise innovation, competitiveness and productivity growth.

From the late 1980s, some governments individually started to tackle these problems. However, the Independent Committee of Inquiry into Competition Policy in Australia (1993) demonstrated that effective implementation of many of the reforms required a more coordinated approach. Hence, in April 1995, governments committed themselves to the NCP (box 1.1). While originally envisaged as a six year program, it was subsequently extended to 2005.

In April 2004, the Australian Government asked the Productivity Commission to review the impacts of NCP and report on further opportunities for gains to the Australian economy from removing impediments to efficiency and from enhancing competition. This was designed to help inform COAG's own review of NCP and decisions about future reforms (PC 2005a).

The Commission concluded that the NCP had been a landmark achievement, yielding substantial benefits, although it was not without some costs and defects. Among other things, NCP had:

- contributed to a surge in productivity growth and associated strong growth in household incomes;

**Box 1.1 NCP at a glance**

The National Competition Policy reform framework encompassed two broad streams.

- A general stream which provided for: the extension of the anti-competitive conduct provisions of the *Trade Practices Act 1974* to previously excluded businesses; reforms to government businesses to make them more commercially focused and expose them to competitive pressure; regulatory arrangements to provide secure third-party access to essential infrastructure services and guard against the possibility of overcharging by monopoly service providers; and a process for reviewing, and, as appropriate, modifying a wide range of legislation which restricted competition.
- A sector-specific stream which incorporated previously agreed reform programs and subsequently agreed extensions to these programs for the electricity, gas, water and road transport sectors. Where relevant, the general stream reforms also applied to this stream.

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- reduced the prices of key goods and services;
  - stimulated business innovation, customer responsiveness and choice; and
  - helped meet some environmental goals, including the more efficient use of water.

Productivity and price changes in key infrastructure sectors during the 1990s — to which NCP and related reforms directly contributed — were found by the Commission to have increased Australia's GDP by some 2.5 per cent or \$20 billion compared to a 'no change' base case. (This analysis excluded the effects of other reforms, such as extending the reach of the *Trade Practices Act 1974* and the Legislation Review Program, which would have yielded additional gains.) Significant contributors to the projected increase in GDP were productivity improvements and price changes in telecommunications and electricity (reflecting the significance of these sectors to both businesses and households) and port and rail freight services (reflecting their importance to the traded goods sector). Increases in GDP boosted tax revenues and enhanced the capacity of governments to finance services such as education and health.

The benefits of NCP have also been spread across the community. Benefits were found to have flowed to both low and high income households and to country as well as city Australia. For example, the Commission's modelling indicated that of 57 regions across Australia, all but one experienced a net income gain.

International observers have reaffirmed the positive assessment of the benefits of Australia's NCP reforms. For example, the OECD (2005a) suggested that Australia had become a model for other countries in the way it had created a 'competitive culture' through its structural reforms across the economy.

## **The need and scope for further reform**

In the face of a number of challenges facing Australia, further reform is not only desirable as a means of boosting our economic performance, but also as a way of lessening emerging constraints on our capacity to improve community living standards in the future. Some of the major challenges facing Australia are now well-recognised, and include:

- the ageing of Australia's population, which will present considerable economic and fiscal pressures as workforce growth falls and public spending on health and aged care rises (Australian Treasury 2002 and PC 2005a,b);
- the further integration of the world's economies, which will bring both new opportunities and additional competitive pressures; and
- the need to promote sustainable resource use.

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There is also widespread evidence of opportunities for further reform. Notwithstanding improvements to Australia's economic performance in recent years, the Commission's review of NCP pointed to performance gaps in a number of areas where further nationally coordinated reforms could provide substantial pay-offs to the community (box 1.2).

Moreover, while Australia experienced a surge in productivity growth during the 1990s (relative both to its own past performance and that of other OECD countries), there remain significant productivity gaps relative to other high income countries. For example, Australia's level of GDP per hour worked is currently around 80 per cent of that of the United States. Australia's industry mix and population density explain some of this gap (Parham and Dolman 2006). Even so, if Australia's labour

**Box 1.2 The Productivity Commission's proposed agenda from its review of NCP**

- In a number of reform areas, national coordination will be critical to good outcomes. These areas — some of which were encompassed by NCP — should be brought together in a new reform program with common governance and monitoring arrangements. Priorities for the new program include:
  - strengthening the operation of the national electricity market;
  - enhancing water allocation and trading regimes to better address scarcity and negative environmental impacts;
  - delivering a more efficient and integrated freight transport system;
  - addressing uncertainty and policy fragmentation in relation to greenhouse gas abatement policies;
  - improving the effectiveness and efficiency of consumer protection policies; and
  - introducing a more targeted legislation review mechanism, while strengthening arrangements to screen any new legislative restrictions on competition.
- An 'overarching' policy review of the entire health system should be the first step in developing a nationally coordinated reform program for this sector to address problems that are inflating costs, reducing service quality and limiting access to services.
- National action is needed to re-energise reform in the vocational education and training area.
- A future review could identify areas of natural resource management (beyond water and greenhouse gases) where the pay-offs from new nationally coordinated reform could be high.
- While reform is important in other areas, including industrial relations and taxation, there would be less pay-off from new nationally coordinated initiatives in these areas.

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productivity gap with the United States — still below the world's highest levels — could be halved, gross average annual household incomes would be about 10 per cent higher than current levels.

Work commissioned by the Business Council of Australia (BCA) goes further and suggests that by building on existing reforms to promote strong growth over the next 20 years, Australia could become the third most prosperous country in the developed world in terms of GDP per capita (Access Economics 2005). The additional reform areas identified by the BCA (2005a, 2006c) include workplace relations, taxation, a further round of competition policy reform, business regulation, planning and provision of infrastructure and federal-state reforms (including notably health and education).

Preliminary economic modelling by the Victorian Government indicates that, while the completion of unfinished business under NCP would yield useful benefits, larger gains are potentially available from a wider agenda covering further reductions in red tape burdens, improvements to health and education, and tackling barriers to workforce participation and productivity (Bracks 2005).

Modelling work currently being undertaken by the Commission for COAG, while also still preliminary, suggests that the economic gains from further reform under the NRA could be large, with both competition-related and other reform areas making important contributions to potential benefits. For example, if reducing the regulatory burden lowered compliance costs by one fifth from conservatively estimated levels, a cost saving of around \$7 billion (0.8 per cent of GDP) would be achievable (PC 2006d forthcoming).

Quantifying the potential benefits of reforms directed at human capital is particularly challenging. In the case of NRA, this is exacerbated by a lack of specificity about actual reform initiatives at this stage (see below) — including initiatives to increase public expenditure on health, education and training to improve the work-readiness of the population. As such, simulations can only be exploratory in nature and provide only broadly indicative results. That said, if an improvement in health sector productivity of around 5 per cent could be achieved, this would represent a cost saving of the order of \$4 billion (or about 0.4 per cent of GDP). The Commission's modelling suggests that the potential impacts on GDP of policy-related improvements in workforce participation and productivity could be greater again. It also supports COAG's view that further reforms, including in human capital related areas, have the potential to yield gains at least comparable to those associated with the NCP (COAG 2006a).

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## How does the NRA measure up?

In October 2005, with deliberations by governments on a possible successor to NCP still occurring, the Commission convened a roundtable on *Productive Reform in a Federal System*. As noted in the published proceedings:

There was a feeling expressed by participants that there was currently a rare opportunity for progressing economic reform at a national level, both in relation to completing unfinished business under NCP and to embracing new initiatives discussed at the June 2005 meeting of COAG. (PC 2006a, p. 14)

In the event, the subsequent COAG meeting (February 2006) laid important foundations for further national reform in the years ahead. In their Communiqué, Heads of Government declared:

This was a historic meeting with significant outcomes. All governments have seized a unique opportunity to work together to deliver a substantial new National Reform Agenda ... (COAG 2006a, p. 1).

### A wide ranging program

The NRA is wide-ranging and ambitious. It lays down some challenging objectives for reform within its 'human capital' stream, along with more specific initiatives in the competition and regulatory reform streams to complete and build on the NCP (box 1.3).

The three streams focus on areas where nationally coordinated reforms are needed to meet the emerging challenges facing Australia and to improve living standards well into the future.

COAG's reform agenda also includes a number of initiatives which, while not formally part of the NRA, or only partially linked to it, are generally consistent with its underlying policy aims. For example, 'the better health for all Australians' package, the health workforce initiatives and the proposed national electronic health records system, complement initiatives envisaged in the health sub-stream of the NRA. Similarly, as a complement to the education and training sub-stream, there are initiatives to develop a national approach for apprenticeships, recognise training and skill qualifications and address skills shortages.

In addition, there are initiatives outside the COAG framework that are likely to be complementary with the human capital stream of the NRA. For example, the Australian Government is considering further reforms aimed at removing inefficiencies and work-incentive problems in the tax system, including by improving its interface with social support programs.

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### Box 1.3    **The NRA at a glance**

The National Reform Agenda comprises three streams — competition, regulatory reform and improvements to human capital.

- The *competition* stream involves reforms in the areas of energy, transport, infrastructure and planning and climate change.
- The *regulatory reform* stream comprises two distinct sets of initiatives. The first is designed to promote best-practice regulation making and review. The second focuses on reducing the regulatory burden in ‘hot spots’ where overlapping and inconsistent regulatory regimes are impeding economic activity.
- The *human capital* stream covers three areas — health, education and training, and work incentives.
  - The health element comprises two distinct parts. The first is aimed at improving workforce participation and productivity by reducing the incidence of chronic disease in the population. The second seeks to improve the delivery of health services and to modify specific purpose health payments where they cause perverse outcomes.
  - The education and training element seeks to equip more people with the skills needed to participate in the workforce. Four areas have been targeted: early childhood development; literacy and numeracy; transitions from school to further education or work; and adult learning.
  - The workforce incentives element is designed to increase workforce participation by improving incentives for those groups with the greatest potential to raise their participation rates: people on welfare, the mature aged, and women.

Beyond this, any assessment of how the NRA ‘measures up’ needs to take into account the different stages of development of the three reform streams. Indeed, recognising this, governments have tailored the reform framework to reflect the characteristics of particular areas. Where there is broad agreement on the desired outcomes, specific reform proposals have been developed. Where the underlying problems and potential reform options are less clear, the reform framework provides for further investigation to clarify the problems and identify solutions.

### **The ‘competition stream’: building on NCP**

Most of the reform proposals within the competition stream of the NRA — notably in energy, transport, and infrastructure regulation and planning — draw on well-established reform principles and seek to build on programs advanced under NCP.

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### *Further energy market reforms*

In the case of energy, initiatives to promote the development of a fully national electricity transmission grid, address structural issues affecting the ongoing efficiency of the sector, and secure transparent and effective financial arrangements to support the energy market, could yield considerable productivity gains and lower energy prices for users. COAG has established the Energy Reform Implementation Group to report back on proposals for progressing reform in these areas by the end of the year. Other initiatives associated with the Ministerial Council of Energy reform program, developed in response to the Parer review (COAG 2002), offer the prospect of additional benefits. However, as foreshadowed by COAG, further detailed developmental work needs to be undertaken to progress this program. It is crucial that this work be well-managed and closely monitored to ensure that governments follow through with the implementation of these reforms, thus avoiding the slippage that has characterised energy reform over the past decade.

### *A national approach to transport reform*

The transport component of this stream exemplifies the differentiated approach to progressing reform referred to above. The move to a more integrated inter-modal framework for assessing reform options within the transport sector represents an improvement over the fragmented approach applied under NCP.

Where there is broad agreement on desired outcomes of the transport reform agenda, COAG has agreed to expedite implementation. Examples include the proposed harmonisation and reform of road and rail regulation in the areas of safety and performance-based standards for innovative vehicles, and the strengthening of coordination for transport planning and project appraisal processes to ensure the best use of public investment resources. Securing timely and effective implementation in practice, however, will be a test for jurisdictional cooperation.

Other less settled parts of the transport reform agenda have been singled out for further analysis to secure a better understanding of the problems and to identify effective reform remedies. Examples include the reviews initiated by COAG to assist it in developing efficient pricing regimes for road and rail infrastructure and tackling urban traffic congestion. In its Discussion Draft on *Road and Rail Freight Infrastructure Pricing*, the Commission did not find compelling evidence of inter-modal price distortions. However, it found significant potential efficiency benefits from more market-oriented pricing and institutional reforms, as well as scope to achieve productivity gains in both road and rail freight from regulatory and other reforms (PC 2006b).



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### *Nationally consistent regulation of nationally-significant infrastructure*

The Competition and Infrastructure Reform Agreement offers a simpler, nationally consistent system of regulation for nationally-significant infrastructure covering ports, railways and other export-related infrastructure. The declared willingness of the Australian Government to legislate for a single regulator of export infrastructure if the proposed arrangements prove ineffective, should provide a discipline on the relevant parties to progress reform. However, the value to be gained from the agreed five-yearly reporting by each jurisdiction on the state of their economic infrastructure remains to be seen, with the first batch of reports due by end-January 2007.

### *Examine remaining restrictions on competition*

The competition stream of the NRA also needs to target unfinished business associated with the legislation review program under NCP. At the time of the Commission's review, around 20 per cent of proposed reviews were either yet to be conducted, or involved outcomes deemed by the National Competition Council to be inconsistent with NCP principles (PC 2005a).

Amongst these outstanding reviews, a number fall within the jurisdiction of the Australian Government, including the scheduled review of anti-dumping legislation and an examination of cabotage restrictions. Priority should also be given to undertaking the previously recommended 'second round' review of the single desk marketing arrangements for export wheat and the second round review of pharmacy regulation. In the case of the former, the Australian Government has indicated, as part of its response to the report of the Regulation Taskforce (2006), that it will consider this issue following the release of the report of the Inquiry into Certain Australian Companies in relation to the UN Oil-for-Food Programme (Costello 2006c). In the case of the latter, it would be desirable for the review to cover all of the restrictions on competition in the pharmacy sector and for the review to be conducted in time to inform negotiations for the 2010 Australian Community Pharmacy Agreement.

### **The regulation stream: seeking best practice**

There are two elements to the regulation stream of the NRA: one designed to promote best practice regulation-making and review processes; and a second which seeks to address the problems caused by overlapping and inconsistent regulatory regimes across governments.

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The new best-practice framework proposed under the NRA provides for the establishment of more effective mechanisms for the assessment of new and existing regulation (box 1.4). The agreement establishes some important principles, but appropriate follow-up action will be needed to ensure that the agreed framework operates as envisaged.

**Box 1.4 The best-practice regulation making and review framework**

To promote best-practice regulation and review outcomes, COAG agreed in February 2006 that all governments will:

- establish and maintain effective arrangements to maximise the efficiency of new/amended regulation and avoid unnecessary compliance costs and restrictions on competition;
- undertake targeted public annual reviews of existing regulation to identify priority areas where reform would provide significant net benefits to businesses and the community;
- improve regulatory consistency across jurisdictions or reduce duplication and overlap, including in the role and operation of regulatory bodies; and
- in principle, aim to adopt a common framework for benchmarking, measuring and reporting on the regulatory burden.

The continuing challenge is to ensure that new regulation is subject to rigorous assessment of need, with appropriate cost-benefit analysis of alternatives, including the option of choosing not to regulate further. While existing processes include provision for the preparation of regulation impact statements (RIS), compliance with their requirements has varied greatly both within and across jurisdictions. Importantly, it has tended to be lowest for more significant or contentious regulation, where good process is most needed (Regulation Taskforce 2006).

Entrenching good process through procedural and institutional means is the key to better regulation. In this respect, the Australian Government, in its response to the report of the Regulation Taskforce, has endorsed a number of significant initiatives (box 1.5). Most importantly, it has undertaken that regulatory proposals that do not comply adequately with (strengthened) RIS requirements — as independently assessed by the new Office of Best Practice Regulation — will not proceed to Cabinet or other decision makers. If effectively implemented, this should elevate considerably the discipline on regulation-making at the Commonwealth level, and provide a useful model for the States and Territories. At the same time, to facilitate take-up and a smooth transition to the new arrangements, the Office of Best Practice Regulation will be providing training and assistance to all government agencies.

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**Box 1.5      The Australian Government's response to the Regulation Taskforce**

In its final response to the Regulation Taskforce's Report — *Rethinking Regulation* — in August this year, the Australian Government accepted in full or part 158 of the 178 recommendations made by the Taskforce.

The recommendations included 99 proposed reforms to specific areas of regulation, 51 regulatory reviews for action by either the Australian Government or COAG and 28 proposals for systemic reforms to improve regulation-making and enforcement.

Importantly, the Government also emphasised the need to tackle the underlying causes of bad regulation:

A key step the Government is taking towards reducing the regulatory burden is in ensuring that systems are in place to guard against the introduction of unnecessary regulation and improve the quality of existing and new regulation. ... Government ministers will ensure that these strengthened processes are implemented in their respective portfolios. (Costello 2006c, p. 2)

- The Government endorsed the overarching principles of good regulatory process identified by the Taskforce and agreed to 'raise the bar' on the analytical and procedural requirements on regulation-makers, including the development of a whole of government policy on consultation.
- The Government is mandating the use of a 'Business Cost Calculator', to quantify the business compliance costs of proposed regulatory options.
- The Office of Regulation Review is to have its role enhanced as the Office of Best Practice Regulation. It will work with government agencies to help ensure that new regulation meets the more stringent tests.

The Australian Government noted that it will seek COAG agreement for the improved regulation-making framework to be applied to ministerial councils. The Government also affirmed the importance of COAG members actively working, through the regulatory reform stream of the NRA, to address overlaps and inconsistencies in a number of regulatory 'hot spots'.

Sources: Costello (2006c) and Regulation Taskforce (2006).

The regulatory reform stream also includes an element directed at reducing the burden associated, in particular, with overlapping and inconsistent regulatory regimes in so-called 'hot spots', the costs of which were highlighted by the Regulation Taskforce. COAG has nominated ten areas as initial priorities for action: rail safety; occupational health and safety; national trade measurement; chemicals and plastics; development assessment arrangements; building regulation; environmental assessment and approvals processes; business name, Australian Business Number and related business registration processes; personal property securities; and product safety regulation (COAG 2006a,b). Ongoing leadership and monitoring of progress by COAG will be important if the mixed results from similar

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cross-jurisdictional or national reviews under the legislation review program of the NCP are to be avoided.

At the Commonwealth level, in addition to the wide-ranging review conducted by the Regulation Taskforce, the Productivity Commission will undertake more targeted annual reviews. Reviews are also underway or foreshadowed in other jurisdictions. For example, the Independent Pricing and Regulatory Tribunal is undertaking a review of the burden of existing regulation in New South Wales and released a draft report in July 2006 (IPART 2006).

### **Challenges of the 'human capital' stream**

The third stream of the NRA, which focuses on human capital, is arguably the most ambitious. It comprises eleven aspirational outcomes in three areas — health, education and training and work incentives — directed at lifting the participation and productivity of Australia's workforce (box 1.6).

#### *Scope for improvement*

Analysis of Australia's performance in these areas, relative to the better performing OECD countries, highlights significant scope for improvement.

- Australia's mortality rates for a number of chronic diseases are relatively high compared to various other developed nations. For example, for colorectal cancer, Australia has the third highest mortality rate. And, in the areas of coronary heart disease and diabetes, Australia ranks near the middle (AIHW 2005).
- Data from the OECD reveal scope to improve education and training outcomes in Australia. For example, while the average test scores for literacy, maths and science of Australia's 15 year olds are significantly above the OECD average, we have a longer tail of lower achievement than do most other countries. Importantly, Australia's secondary school completion rates are well below average. Among 30 OECD countries, Australia ranked 20<sup>th</sup> on this measure in 2003, with just over 75 per cent of the population aged 25 to 34 having completed an upper secondary education (OECD 2005b).
- Labour force data for OECD countries, corrected by the Commission for inter-country differences in statistical reporting practices, indicates potential for raising Australia's participation rate.
  - In 2004, Australia's total labour force participation rate (64.9 per cent) was below that of six other OECD countries including Canada (67.3 per cent), New Zealand (66.8 per cent) and the United States (65.1 per cent).

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- In the same year, Australia’s participation rate for females aged 25-54, at 72.1 per cent, was below that of 19 other OECD countries while for males aged 25-54 Australia’s participation was below 22 other OECD countries (PC 2006d,e).

Performance measures for each indicative outcome, together with independent assessment and transparent reporting arrangements, would create the preconditions for an effective accountability mechanism. Over time it would also facilitate the development of a valuable information base to encourage ‘yardstick’ competition. If progressed along these lines, this aspect of the human capital stream would have

**Box 1.6 The outcome framework for the human capital stream**

Eleven ‘indicative outcomes’ were agreed to by COAG in July 2006 in the areas of health, education and training, and work incentives.

*Health outcomes*

- Significantly improve the proportion of children that are born healthy (subsidiary outcome: the gap between indigenous and non-indigenous children is closed).
- Reduce the proportion of the working age population not participating and/or under-participating in paid employment due to illness, injury or disability.
- Reduce the incidence of preventable chronic disease and serious injury among the working age population.
- Reduce the prevalence of key risk factors that contribute to chronic disease.
- Increase the effectiveness of the health system in achieving health outcomes.

*Education and training*

- Significantly improve the proportion of children acquiring the basic skills for life and learning (subsidiary outcome: the gap between indigenous and non-indigenous children is closed).
- Increase the proportion of young people meeting basic literacy and numeracy standards, and improve overall levels of achievement.
- Increase the proportion of young people making a smooth transition from school to work or further study.
- Increase the proportion of adults who have skills and qualifications needed to enjoy active and productive working lives.

*Work incentives*

- Improve overall workforce participation, with a particular focus on target groups, in a manner consistent with the long-term interests of the individual and the economy, giving due regard to productivity.
- Increase the provision of flexible working arrangements within the workforce, in a manner consistent with the long-term interests of the individual and the economy.

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some parallels with the existing performance monitoring arrangements for government-provided services, and there would be advantages in developing the potential synergies between the evaluation frameworks (SCRGSP 2006).

### *Developing effective programs*

The biggest immediate challenge is to develop specific reform proposals and their implementation plans. This will take time. It involves areas of public policy where there are different perspectives on appropriate policy responses and information gaps on costs relative to benefits. Beyond this, many reform initiatives in the health and education and training areas are likely to have very long lead times before any demonstrable pay-offs are realised. The development of effective reform proposals will inevitably require careful analysis and review. It will also be important to build flexibility into the policy development process to allow for experimentation and innovation.

## **Key issues going forward**

The successful development and delivery of reforms under the NRA will demand a considerable collaborative effort by Australian governments, given the broad scope and differing stages of development of the various reform streams. Looking to 2007 and beyond, and drawing on lessons from NCP, three issues are of particular importance:

- establishing a robust governance framework;
- developing effective implementation arrangements; and
- clarifying the role of financing arrangements in the reform process.

### **Establishing a robust governance framework**

The successful development and implementation of the NRA will depend on the strength of its overarching governance arrangements — including the need for effective leadership from COAG and related implementation bodies — and the quality of its review and assessment processes. The National Competition Council has observed:

... while the *reform agenda* is more important than any particular institution ... the *institutional framework* drives the content, and determines the success, of the reform agenda. (NCC 2004, p. 2)

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In its review of NCP, the Commission identified several crucial elements, which are of direct relevance to the NRA:

- clearly specified reform objectives and principles, including effective public interest tests;
- agreed implementation timetables;
- independent monitoring and public reporting on progress;
- adequate resourcing of key coordinating/decision making and assessment bodies; and
- mechanisms to lock-in reforms.

COAG will need to provide leadership at two levels. First, in setting broad objectives or desired outcomes and developing and clearly specifying associated reform proposals. Second, in ensuring that there are effective arrangements for the implementation of such policy initiatives against agreed milestones.

In some areas of the NRA, COAG has devolved responsibility for developing specific reform proposals to other bodies such as ministerial councils. Experience with similar arrangements under the NCP has highlighted the importance of governments providing such bodies with adequate guidance on their expected roles and establishing adequate accountability mechanisms. These bodies, in turn, need to provide clarity about the development and implementation of reform and have effective processes in place for achieving a national approach.

The diverse nature of the NRA places a premium on distinguishing between areas where desired outcomes and beneficial reforms can be readily identified, compared with areas where the direction and specifics of reform are less clear. For the former, the priority should be to settle implementation frameworks relatively quickly. For the latter, there is likely to be an important role for review mechanisms to aid policy development. In particular, the development of effective reform proposals in the human capital stream is likely to depend on the quality of analytical inputs and on review processes to address information gaps and assess the relative merits of alternative approaches.

Experience with NCP demonstrates that transparent and independent assessment mechanisms reinforce the reform process. They create pressures on governments to adhere to agreed reforms, lessening the risk of reform slippage or backsliding. Further benefits include the sharing of experiences across jurisdictions and assisting in fine-tuning the implementation processes. The assessment process needs to be adequately resourced if it is to contribute effectively to progressing the NRA.

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Important in this regard is the creation by COAG of a new independent high-level body — the COAG Reform Council (CRC) — to monitor progress and assess the performance of governments in meeting their reform commitments under the NRA (COAG 2006a).

In July 2006 COAG agreed on an extension to the CRC's role. Specifically, it agreed that, following consideration of reform proposals by COAG, there would be an independent assessment of the relative costs and benefits of each proposal by the CRC.

Assessments would give due regard to economic, demographic, geographic and other differences between jurisdictions. Each jurisdiction would retain full discretion as to how they act upon the assessment from the CRC. The CRC would draw on the work of the Commission in assessing the potential benefits of the NRA. (COAG 2006b, p. 9)

Given the need for the economic and social effects of proposed reforms to have been taken into account by COAG in identifying appropriate ways forward, it follows that referrals to the CRC would be primarily concerned with the fiscal implications and, in particular, the distribution of consequent changes to revenue and expenditure. These can be expected to vary significantly, depending on the nature of the reform program. For example, the States are responsible for delivery of health services, while the funding and financial responsibility of health services partly rests with the Commonwealth. Reform in this area offers a cost saving through the more efficient delivery of health services, but is likely to represent a proportionately larger gain to the States. On the other hand, reforms to reduce regulatory burdens on business have the potential to induce widespread improvements in the productivity of labour, with proportionately larger gains in GDP and associated taxation revenue flowing back to the Commonwealth.

The Commission's work in assessing the potential economic effects of the NRA should prove useful to the new CRC, primarily in terms of the updated and refined modelling framework now available (PC 2006d). The results from this work, however, are likely to be too broad-brush to guide useful assessments of the fiscal implications of specific reform programs. Further work would be needed. The most important task is to understand the likely effects of a given reform program on productivity or labour participation, as necessary inputs in evaluating the economy-wide outcomes. Ideally, such analysis would need to be conducted before reform proposals are developed for COAG's consideration.



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## **Developing effective implementation arrangements**

As with NCP, progress in the NRA is likely to be shaped by the effectiveness of the implementation plans for specific reforms. In several areas of the NRA, most notably the human capital stream, there is a considerable way to go.

Effective implementation demands agreement on outcomes and reform commitments as well as on specific actions and milestones. The reform effort needs to be focused on areas where the pay-offs are likely to be highest. The provision of some flexibility in how jurisdictions develop their approaches to broadly agreed reforms is also desirable, provided the overarching principles are clear.

Weaknesses in some of these areas caused several problems for the NCP. For example:

- lack of specificity in relation to water and road transport led to considerable delays in advancing their reform agendas; and
- the absence of clear guidelines in relation to coverage and priority-setting gave rise to several problems for the legislation review program. These included anomalies across jurisdictions in the listing of relevant legislation, the inappropriate scheduling of some reviews relative to the significance of the anti-competitive restrictions involved, and the under-utilisation of joint or national reviews of some regulations.

Another lesson from the NCP experience is that, where a reform agenda includes challenging elements, monitoring of outcomes yields information that can be used to refine reform commitments and priorities, as well as to modify reform strategies. Monitoring or oversight arrangements, however, should also be sufficiently rigorous to encourage governments to progress reforms.

## **The role of financial arrangements**

In its review of NCP, the Commission concluded that the ‘competition payments’ from the Commonwealth to the States had played a useful role in sustaining progress. Looking towards a future reform agenda, it judged that there were four rationales for making some payments to the States and Territories:

- returning ‘revenue dividends’ from some of the reforms (a vertical fiscal imbalance argument) — though the goods and services tax would reduce the magnitude of the revenue transfers involved;

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- recognising that reforms would be undertaken in some areas, such as health care, where funding and delivery responsibilities are shared between governments — which could require concomitant adjustments in fiscal transfers;
  - using financial incentives to help ameliorate transitional costs, or adverse distribution effects from reform, that were not adequately addressed by generally available income support and other mechanisms; and
  - making payments to help leverage reforms that, in the face of opposition from vested interests, might otherwise be put in the ‘too hard basket’.

The funding arrangements for the NRA, as agreed at COAG’s February 2006 meeting, envisage consideration of payments to State and Territory governments on a case-by-case basis, once specific implementation plans have been developed. This approach recognises that the rationale for, and value of, any such payments, depends on the underlying nature of the benefits and costs of specific reform proposals, with the CRC providing information on the fiscal implications.

These should not be confined to income-related effects on the level and distribution of tax revenue gains from reform, but also encompass differential expenditure requirements. As noted above, these may include expenditures to address transitional issues or to facilitate adjustment. These are matters on which the CRC could also usefully help inform COAG’s deliberations. Ultimately, however, political judgements will be required, including about the desirability of achieving additional reform leverage through fiscal means in particular cases.

## **Summing up**

The NRA represents a wide-ranging and ambitious reform agenda. It offers significant potential for further improving the performance of the Australian economy and the living standards of the community in coming years. The realisation of this potential, however, will require a considerable commitment from all of Australia’s governments. While the last two COAG meetings have established a promising foundation, much more remains to be done.

Three matters are essential to securing future progress: establishing a robust governance framework for the NRA; developing effective implementation plans for the first tranche of reforms; and settling the financial arrangements in support of the reform process. How these are resolved will shape the ability of the NRA to deliver the significant gains that are potentially available from a further round of nationally coordinated reform.