

COAG: Where to now?

This document is based on discussions at the CEDA Council on Economic Policy (CCEP) meeting held 22 November, 2013. It does not necessarily reflect the views or opinions of any individual in attendance unless specifically cited.

There has been substantial debate in the media recently about the performance and usefulness of the Council of Australian Governments (COAG), including suggestions to dismantle it and delegate the task of progressing reform to Ministerial Councils. The media's reporting of COAG's work has been mostly negative, while the achievements of COAG are rarely publicised. This has contributed to a public perception that COAG has not achieved its objectives and therefore its future questioned.

At the November 2013 CCEP meeting, participantsⁱ discussed COAG's performance, its strengths and weaknesses and the role it has to play in shaping future reform agendas. The Hon. John Brumby, Chairman and Ms Mary Ann O'Loughlin AM, Executive Councillor and Head of the Secretariat, COAG Reform Council were guest speakers. Mr Terry Moran AC provided an expert critique.

The discussion on COAG and its future is particularly important given that the Coalition Government will be publishing a white paper on the Federation in 2014. It is anticipated that this will not only look at Commonwealth-state financial relations, but also the very architecture of the Federation.

Given the underlying conditions in the Australia economy- including demographic changes, the cost structure of our economy, the persistently high Australian dollar, average productivity outcomes and the structural budget deficit- the forward reform agenda will need to be bold and ambitious. This was reflected in CEDA's recent report, [*Australia Adjusting: Optimising national prosperity*](#). This report put forward a comprehensive economic reform agenda for an open and adaptive nation to enhance its economic flexibility, improve its capacity to innovate and maximise the potential of its human capital, with a view to drive a sustained improvement to Australia's productivity so the nation can realise ongoing economic growth.

COAG has a major role to play in ensuring this bold reform is achieved. Big reforms require the cooperation or involvement of different levels of government and even different ministers at each level. While the Commonwealth has responsibility for the broader public policy settings, the policy instruments or implementation phase are often the responsibility of the states. Further, ambitious reforms are difficult to achieve politically and as a result, a national policy becomes even more crucial. COAG is the right mechanism to bring everyone together into a cooperative system and it has done so successfully in the past.

COAG's successful reforms

Many of the most celebrated economic reforms would not have happened or been as successful and bold without COAG.

The National Competition Policy (NCP), for example, required cooperation between the Commonwealth and the states in order to influence the policy settings that required reform (for example, removing cross-subsidies and moving to a market pricing for water). It was noted that the NCP also worked because of reward payments to the states. Evidence in the most recent COAG evaluation report indicates that reforms happen more quickly where reward payments are available than reforms where they are not.

The GST is also another example of COAG's successful input into a reform agenda. Without the cooperation of the states, the GST would have been a simple (but useful) tax reform as the Commonwealth would still have been able to introduce the GST and cut income taxes. However, it became a major economic reform as many inefficient state taxes were abolished at the same time. It would have been difficult to abolish those taxes as part of the GST reform package without COAG.

The 2008 national reform agenda is a third example of COAG bringing together the states and the Commonwealth. The national reform agenda included significant reform of Australia's Federal financial relations which gave the states flexibility to achieve outcomes as well as clarify the roles and responsibilities of the Commonwealth and the states.

A COAG report card

In November 2013, the COAG Reform Council released their review of the 2008 national reform agenda. Although five years is not a long time for evaluation, the review indicated that Australia's achievements in terms of major reform were mixed.

For example, while Australia's education performance is good relative to other countries, our performance in numeracy scores and mathematical skills has declined over the past decade. In the health sector, we fare well at the macro level but more reform is needed at the micro level, for example, waiting times for elective surgery. COAG also made improvements in indigenous policy, particularly for early childhood intervention, and there are positive results for homelessness. The Seamless National Economy reforms were also positive with 29 of the 46 completed or about to be completed, which can be considered a success given the five-year timeframe.

Two major weaknesses were the Global Financial Crisis (GFC), which made the environment difficult for reform, and poor implementation of the reform programs. Implementation/execution of reform is crucial; the best policy plans come to nothing without proper execution and COAG could have scored better on that front.

In particular, the departure from the original agreement in respect to education and hospital reform was not discussed significantly enough between the Commonwealth and states which hindered reform progress. The original agreement stipulated the following model:

- > Agreed funding from the Commonwealth for particular goals;
- > Agreed indicators and outcomes rather than input measures;
- > Giving states flexibility in achieving outcomes; and
- > Independent measurement of outcomes.

The change of direction could have been discussed in more detail.

Key underlying issues

Six major issues should be discussed when setting reform priorities. The first is waste or the perception that there is widespread waste in the public sector. However, Australia's public sector is quite dynamic and reform-oriented. In terms of public sector expenditure as a proportion of GDP or public sector employment as a share of total employment, Australia fares well on an international level. The most significant issue is the budget deficit which needs urgent attention.

Second, accountability is a major issue. With efficient pricing in the hospital sector, the Commonwealth only pays the states if the states decide to provide the service. The responsibility falls back to the states and this will work with the proper accountability in place. It will also help to make clearer who has the responsibility for providing what over time. However, efficient pricing may not work everywhere. For example, it may not work in Tasmania, a state that is struggling economically and doesn't have the budget capacity to fund the services required. One solution would be to distribute revenue back to the states proportional to how it is raised, with the Commonwealth intervening in states and territories as required (for example, in Tasmania).

Third, while our health system is one of the best in the world, the quality of service could always be improved. Fourth, there continues to be role confusion between the Commonwealth and the states. As an example, the Commonwealth does not need to employ as many as 6,000 people in the health area and similarly in the schools sector. Fifth, there are problems associated with the Constitution but these are unlikely to be tackled. Finally, the last major issue is business expectations. Business leaders think that government should be like a large corporation. They do not understand how democracy works and that a policy will only be successful if the community will accept it. It was pointed out that politics is like a duopoly and that business leaders need to understand that.

Reform or perish

It is clear that reform is needed to ensure the long-term prosperity of Australia. The following areas were identified as being the key future reform priorities:

- **Taxation reform**
Taxation reform is not just about reforming tax arrangements and making the system more efficient. It is also about meeting higher expenditure requirements and reducing budget deficits more quickly. Structural issues mean that we need to assess if we have the appropriate level of taxes to meet growth in demand for services such as health;
- **Commonwealth/state reform**
This reform includes addressing the vertical fiscal imbalance and the implications for productivity gains. Linking reform of Commonwealth/state financial relations to taxation arrangement reforms can yield one of the biggest productivity gains for Australia;
- **Human capital reform**
The COAG Reform Council's review of the national reform agenda showed that there is room for improvement in the performance of Australia's school system and more reform is needed to achieve further improvement in outcomes. One of the suggestions was to extend the hospitals funding model to schools; and

> Infrastructure reform

Building more infrastructure and carrying out associated regulation reform (for example, road pricing) will be crucial to tackle congestion.

All these reforms require Commonwealth and state agreement and cooperation to work. COAG is the best vehicle to achieve that.

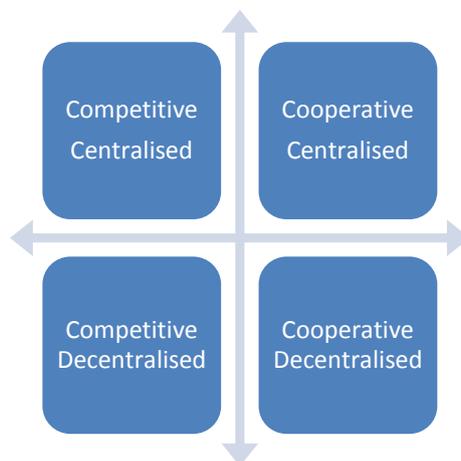
Other reforms mentioned include:

- > Health policy: Reintroduce measurable strategic outcomes in health;
- > Funding models: Apply the hospitals funding model to education sector and improve funding to social housing and disability sectors;
- > Fix deficiencies in policy settings in Australia, e.g., in the housing sector; and
- > Improve business engagement with policy making and how government works.

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Models of federalism

The following matrix describes four simple models of federalism. The two most common models are discussed below.



1. Competitive-Decentralised

In this model, the states receive money from the Commonwealth but they compete against each other. Different models could give states more or less money depending on the formula used.

2. Cooperative-Decentralised

In this model, the states and the Commonwealth agree on the big issues and national outcomes (for example, 'Australia is to be in the top five in the world in terms of education

outcomes by 2020'). The Commonwealth provides funding mechanisms to the states and gives them the flexibility to achieve these outcomes.

While no model is perfect and each carries its own set of pros and cons, it is clear that in Australia the Commonwealth holds financial power over the states, which can act against the spirit of co-operation. The argument for competition over cooperation however, lies in our lack of knowledge about how to get reform right. Competition between states can help to identify what the best policy is. On the other hand, there should also be balance between competition and cooperation that still allows dynamism within the COAG model. For example, COAG could experiment with a different education policy in different states to determine what the best approach is.

Improving COAG

Several suggestions were made to improve COAG.

COAG's governance should be improved with the COAG board more like private sector boards. The agenda should also be more forward-looking and set beyond the next meeting. This would also allow states to get their concerns on the agenda.

COAG could also benefit from better performance reporting and measurement of outcomes. The measurement issue has many dimensions and is not unique to COAG: it is sometimes difficult to know what needs to be measured and the short political cycle makes the choice of measures, which may often take decades to evaluate, even more difficult. Education policy is a good example of where the measures are simple and clear thanks to having time series of data from NAPLAN and the international tests, such as the OECD's Programme for International Student Assessment (PISA) which is easily tailored to the Australian education sector. Not every sector has such a resource.

In fact, the foundations needed for big picture reforms are missing in many instances. The rationalisation of policy research organisations has led to the disappearance of competition. Coupled with the difficulty in obtaining policy research funding and lack of incentives for academics to carry out this type of research, the dynamism and quantity of evidence-based policy has been eroded.

Building an evidence base and an assessment of what works and what does not could make measurement and performance monitoring more sophisticated. It should also be noted that evaluation and audits are not the same thing; evaluation requires an evidence base and sophisticated measures.

Finally, it was suggested that having fewer Ministerial Councils rather than more would also improve COAG. While a reduction in MCs tend to occur when a new Government is sworn in, they tend to rise subsequently and this should not happen.

ⁱ The following people attended the CCEP meeting on 22 November 2013: Professor Glenn Withers AO (Chair), Professor John Freebairn, Dr Alex Heath, Professor Stephen King, Professor Paul Kofman, Professor the Hon. Stephen Martin, Professor Greg Smith, Mr Nathan Taylor, Professor Elizabeth Webster, Ms Sarah-Jane Derby. The Hon. John Brumby, Ms Mary Ann O'Loughlin AM and Mr Terry Moran AC were guest presenters.