Successful reform: past lessons, future challenges*

Introduction

My assigned topic, the future course for reform in Australia, is an important one. There are two dimensions to it. One relates to priorities within the reform agenda itself. As Chairman of the Productivity Commission, that of course is something I am more than willing to discuss, and have done so previously at some length. But, important as it continues to be to know what future reforms are most needed, arguably the bigger challenge for Australia right now is the other dimension, knowing how to implement them successfully.

Paul Kelly, Australia's pre-eminent policy journalist and chronicler of our reform history over the past three decades, asserted earlier this year that "the historic post-1983 reform era is terminated". Ross Garnaut, one of the most policy-influential academics of that era, recently made the following assessment: "Economic policy since the GST [2001] has been characterised by *change*, rather than productivity enhancing reform". He went further: "Attempts at major reforms have failed comprehensively and poisoned the well for further reform for a considerable while".

Similar sentiments have been expressed by other observers of the policy scene. It is notable that they have been doing so despite what must be the most extensive and ambitious national reform agenda ever placed before the Council of Australian Governments. Their assessments appear to have been prompted by the recent setbacks for the major reform initiatives for climate change and taxation, together with the handling of the 'Big Australia' issue in the lead-up to the recent federal election. But they may also reflect on some policy excursions over the past decade in areas such as infrastructure, industrial relations, industry assistance, energy efficiency, water, hospitals and family support.

The electoral outcome itself, in bringing us the so-called 'new paradigm' of minority government dependent on the cooperation of independents, is seen by many as an obstacle to further productivity-enhancing reforms. The Australian

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Financial Review's editorial just after the election declared it "the worst possible outcome for stable government and the unpopular economic reforms that are needed...".

Moreover, reform must now occur in a post-GFC context, with fiscal pressures that will limit the scope for investment in a number of the 'human capital' areas within a National Reform Agenda devised in fiscally more bountiful times. The need to rebuild its budget has also constrained the ability of the Australian Government to 'reward' the States for their reforms, a central tenet of the National Competition Policy's successful implementation and likely to remain the key to ongoing state support for the COAG Reform Agenda.

This comes at a time when the promise of a more cooperative or collaborative Federalism has been wearing increasingly thin. Not only has Western Australia continued to play hard to get on national reform, there has been strong resistance to Commonwealth initiatives in key reform areas by the two 'heavyweight' eastern states, Victoria (eg water, hospitals) and NSW (eg OH&S, national curriculum). This apparent discord may be heightened by changes in government at the state level.

The productivity imperative

If 'productivity enhancing' reform is indeed becoming a no-goer, Australia is in for a tough time. For a start, this would make it harder for us to meet the fiscal challenges from the Global Financial Crisis in the short term and, in the long term, the ageing of the population. We would also struggle to meet the demands and costs of more sustainable resource use and desirable environmental rectification. Australians may again start to see international competition and globalisation as threats rather than opportunities. And our capacity to raise the living standards of Indigenous and other disadvantaged members of the community would be weakened, when it needs to be strengthened.

Productivity enhancing reform is so crucial to our economic (and social) futures because productivity growth itself — the ability to get more out of a country's resources — is the mainstay of economic progress. Growth in labour productivity accounted for around 80 per cent of the growth in per capita incomes of Australians over the past four decades, with 'multifactor' productivity growth (which abstracts from the growth effects of increasing capital) accounting for about 40 percent of that.

If, as the Nobel Laureate Paul Krugman has famously put it, 'in the long run productivity is nearly everything', Australia's prospects currently may not appear very promising. Following a stellar performance in the 1990s, driven in large part by the structural reforms initiated in the previous decade, our productivity growth in the early 2000s fell back to its long term average. That in itself is no cause for alarm. But since then it has fallen below even pre-1990 rates. In the most recent year for which we have data, 2009-10, there was only slight growth in (the traditional 12 industry) market sector MFP; though this was an improvement on the previous year when MFP, buffeted by the global crisis, actually fell by 2.4 per cent, something not seen in almost 30 years.

Just as the productivity surge in the 1990s yielded substantial income gains on average for Australian households, the productivity slump of the 2000s could have been expected to bring with it a decline in incomes. In fact, thanks largely to our rampant terms of trade, income growth for most of that period was at historical highs. But both history and economic logic tell us that this cannot go on indefinitely. I will leave forecasting to those expert in that field, simply noting that the escalation in prices for our mineral exports reflects circumstances on both the demand and supply sides of markets which can be reversed or which can give rise to 'correcting' changes.

At some point we will then return to Krugman's long run, and reliance on productivity growth to achieve further improvements in the living standards of Australians. I am intentionally abstracting here from growth in the other two Ps, participation and population. The former has natural limits — and is currently historically high — while population growth is dependent on (net) immigration, the impact of which on the average per capita income of existing residents is ambiguous (with a greater likelihood of it being negative than positive).

So how do we ensure that productivity again rises to the occasion? This question is being posed primarily as a challenge for further reform. While I would naturally agree with its importance, we need to keep things in perspective. As Commission research has demonstrated (and we have previously been at pains to point out) much of the recent pronounced decline in *multi-factor* productivity can be traced to developments in a few specific markets — reflecting the mining boom and drought — that cannot be blamed on lack of reform or poor policy. It is therefore likely to be at least partly self-correcting in time. (Agricultural MFP has already rebounded — growing by 14 per cent in 2008-09 — but mining much less so, in part because investment and employment continue to grow strongly.)

This is set out in some detail in a number of Commission research publications (and in a refereed journal article). But even without the benefit of such 'forensics', the coexistence of historically low growth in multifactor productivity with historically high growth in income, capital investment and jobs over recent cycles is likely to have been more than coincidental.

That said, some of the decline has also reflected unusually high growth in labour and capital absorbed by the energy and water sectors, which in part has been induced by policies that are likely to have a lasting negative influence on *measured* productivity. By the same token, Australia's recent productivity declines obviously would not have been so pronounced had there been more productivity-enhancing reform over the past decade, depending on the lead times involved. And even if we can expect some 'natural' recovery in the productivity numbers in time, reforms that reinforced or added to such gains could bring substantial additional benefits to the Australian community.

For example, if (labour) productivity growth could just get back to the long-run average rate of 1.75 per cent that preceded the 2004-2008 cycle, rather than the 1.6 per cent average growth assumed in Treasury's latest Inter-generational Report, then, abstracting from changes in the rate of employment and investment, per capita incomes would be 6 per cent higher by 2050. And if we could reclaim the 2 per cent average annual growth recorded in the 1990s in a sustainable way — admittedly a big ask — Australia's GDP would be some $400 billion larger than otherwise, with per capita incomes 17 per cent higher (worth nearly $19,000 per person in today's dollars).

In short, a little bit of productivity growth goes a long way. Any reform that could achieve this successfully is a reform worth pursuing. The real risk stemming from the boom, if our own history is any guide, is one of complacency about pursuing those reforms.

That of course begs the question as to what 'successful reform' actually means in this context. This is not a trivial question.

What is a 'successful reform'?

The term 'reform' is being employed liberally today by the proponents of almost any policy change, whether it is likely to advance the public interest or not. It has accordingly begun to lose meaning in public discourse and, worse, risks giving real reform a bad name. (A senior state official mentioned to me recently that his government now avoids using the term.)

The dictionary tells us that the word 'reform' actually means "change for the *better*". In a policy context, that translates to changes in existing government financial, regulatory or procedural arrangements that are likely to make the community 'better off' (which I interpret broadly to encompass living standards and quality of life).

Against this (reasonable) benchmark, I am sure that many of us can think of policy initiatives that have had a doubtful entitlement to the reform label. For example, over the past decade, there has been widespread questioning of the benefits of such initiatives as the subsidy for local ethanol production, the Baby Bonus, the bans on filament light globes, the Fuel and Grocery 'watches' and Cash for Clunkers, among many others. (You will have noted that even this truncated list transcends politics.)

For a policy initiative to be worthy of the name 'reform' we must have some confidence, based on established theory or evidence, that it is likely to yield a net benefit to the community over time. Moreover, the likely gains should exceed those from other policy options directed at the same objective. To take a topical example, the estimated 'price' for a tonne of carbon abated varies greatly, depending on the particular policy measure employed, ranging around $10-40 per tonne under an explicit tax or trading regime, to hundreds of dollars for solar feed-in tariffs, and thousands of dollars for some other schemes. The latter programs accordingly should have little claim on the term 'reform' in a greenhouse policy context (apart from any claims they may have on industry policy or other grounds).

So what is a '*successful*' reform? There are two key conditions that I believe need to be satisfied.

One is that the outcomes of the reform broadly accord with its objectives and what was anticipated when it was introduced. In other words it should achieve its goal, and do so without major collateral damage or unintended consequences. The fact that the latter phenomenon has acquired the status of a 'law' (more popularly attributed to 'Murphy') tells us that bad surprises are all too common. While sometimes this may be of little consequence in the total scheme of things, in other cases it can compromise the objective being pursued. For example, it is possible to imagine a greenhouse policy that actually *increases* global emissions, or a resource rent tax that *reduces* production activity, or alcohol or drug initiatives that encourage *greater* usage by target populations.

The second feature of a successful reform is that it is *sustainable*; that it is not vulnerable to being reversed, or substantially amended in ways that negate its objectives. To satisfy this condition, the reform must either be broadly accepted by the public when introduced or, if not, it must become so in time. It must not remain too contentious, nor (related to this) meet much ongoing organised resistance.

This is illustrated by the contrasting experiences of the GST and Work Choices. The former, which was vigorously debated and opposed politically when implemented, has come to be accepted as an established part of the policy framework. Indeed the only remaining contention surrounding the GST is over its rate and coverage — and how the revenue should be distributed among the states. Work Choices faced similar initial resistance, but this did not subside after implementation. Rather, opposition escalated — ultimately contributing to the defeat of the government that introduced it.

Other illustrations that come immediately to mind are the 25 per cent tariff cut of 1973 versus the incremental program of ‘tops down’ tariff reductions introduced from the late 1980s, and the contrasting electricity market reform experiences of Victoria and NSW.

It follows that a reform could be a ‘good’ one at some level — in terms of its foundations and likely community-wide effects — yet still not be successful. Reform will often fail if its effects have not been sufficiently thought through or it does not win acceptance as being beneficial. Among such failures in earlier years one might arguably again include the original 25 per cent tariff cut, together with various aborted reforms in such areas as taxi regulation, property taxation, nursing home funding, pharmacies and broadcasting.

Why is it so *hard*?

Knowing what reforms are needed, while difficult enough to get right, is clearly only half the battle. Getting such reforms up, and making them stick, are arguably the more difficult challenges. There is nothing new or particularly Australian about this. On the contrary, it could be described as the natural order of things and has been long observed. In his famous little instruction manual for heads of state in Renaissance Italy, Nicolo Machievelli described the problem thus:

> There is nothing more difficult to carry out, more doubtful of success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all who profit from the old order, and only lukewarm defenders in those who would benefit from the new.

While political scientists and public choice economists have since elaborated in more technical terms on the political and informational forces at work, Machievelli’s insight remains the essential one.

The corollary to it is that often there is nothing easier for governments to do than to introduce *bad* policies, especially those that can meet the wishes of particular interest groups without being on the wider public’s radar. Consider how easy it is for governments to provide a new subsidy or regulatory benefit to an industry or community group and how hard it can be to remove them again. Australia's tariff history once again provides the stand-out illustration, with the 'removal' phase having gone on for some 40 years so far, even then being partially offset by new forms of assistance along the way. But there are many others. For example, even the dismantling of the home insulation subsidy scheme, though it was in existence only a short time and having public support for its termination, required a special further assistance program to compensate the emergent suppliers who were beneficiaries of the scheme.

The obstacles to success are so great that any true reform might fairly be considered a significant achievement. This is particularly so in Australia's case, given the additional challenges posed by the relatively short and multiple electoral cycles in our Federal system. That Australia has successfully implemented as much reform as it has since the 1980s — reforms that have significantly enhanced the average living standards of Australians — is therefore something to be celebrated, and has attracted international attention.

Achievements of the 'reform era'

The range of reforms has been extensive. But some could be described as 'game changers' because of their scale or scope, or the ongoing impetus they provided for further necessary change and reform. Among these, the stand outs were the floating of the dollar in 1983 — which exposed structural weaknesses in our economy while facilitating adjustment to further necessary reforms and market shocks — and the opening of our markets to foreign capital and merchandise, which heightened competitive pressures on Australian enterprises and led in turn to pressure on governments for reforms that would reduce the costs of businesses and improve their operational flexibility.

The dismantling of centralised wage fixation and advent of enterprise bargaining was a key consequence — enabling firms more scope to fashion remuneration and work practices to the circumstances of their markets and regions. Another was the reform of inefficient government monopolies responsible for such vital infrastructural services as energy, telecommunications, transport and water. The reforms brought improved governance and more competition, yielding higher productivity and lower costs, with more cost-reflective pricing.

Those latter reforms commenced at the state level, but eventually found more consistent expression in the National Competition Policy, which also incorporated a process for systematically identifying, and testing the justification for, anti-competitive arrangements across the whole of Australia's regulatory landscape.

The 1980s also saw some important reforms to the tax system that reduced burdens and inefficiencies, and helped improve the attractiveness of Australia as a place to do business. These included the broadening of the tax base through the introduction of a fringe benefits tax, taxation of realised (real) capital gains, and plugging of various loopholes and exemptions (eg for the gold industry), combined with cuts to high marginal rates on income and the introduction of dividend imputation. While some unjustifiable tax concessions for investment were removed, a justifiable one for Research and Development was introduced. This period also saw the successful introduction of the Petroleum Resource Rent Tax.

There were also some path-breaking reforms in key social policy areas of education (notably the HECS scheme) and health (such as Victoria's 'casemix' funding mechanism).

Some of these reforms admittedly could be categorised as 'low hanging fruit'. But none were straightforward to engineer and nearly all faced high political hurdles at the time.

What were the success factors?

A number of aspects of the 'design' of the reform program in this period help explain its success. One has already been alluded to — namely, the prioritisation or sequencing of reforms. Addressing major reforms one at a time enabled adequate public resources to be brought to bear, while also enabling a focussed public discussion. The sequence chosen — beginning with the international markets for currency, capital and goods — in itself created pressure for further reforms in key domestic markets (for labour and infrastructure services in particular). These gained momentum and ultimately accumulated into a reform program of considerable breadth. The range of ongoing reforms in different areas brought further advantages through the ability of losers from some reforms to become winners from others.

The pace of change in the different reform streams differed, depending on the nature of the market and the adjustment issues. Thus, while the floating of the dollar happened overnight, the tariff reform process, following the attempt to do essentially the same thing a decade before, became a gradual 'tops down' one. An incremental approach was also followed for the public utility and labour market reforms. The phasing of reforms served to reduce both the potential economic and political costs of adjustment. In addition, some specific labour and industry programs were introduced to assist the adjustment process further (though with variable success).

These design features of the reforms of the 1980s and 90s, while important, can nevertheless only be part of the story. They beg the question of how such features were arrived at in the first place. And they are unlikely in themselves to have overcome the political economy obstacles noted earlier.

There are several other factors that I believe were of more fundamental importance. None could be said to be novel, let alone offering blinding insights. They boil down to what we would hopefully all accept as simply good process for developing public policy — a process that begins by identifying why change is needed; that then communicates this to the community; before going on to reach a policy solution that has been properly analysed, tested and, once again, explained. In all of this, leadership and institutional support were crucial.

Establishing the need for reform

A common theme in the successes of the 'reform era' was general recognition that reform was needed. This did not mean that there was *consensus*. It was to be expected that those who saw themselves disadvantaged by reform — and most real reforms involve some losers, at least in the short term — would resist it. Support was strongest among the professional policy cadre — within government, academia and the 'commentariat', including opinion media. But there was also strong support from peak business, and to some extent from community organisations, depending on the reforms. Broader public opinion, if not actively supportive, was at least not actively hostile.

Acceptance that reform was needed did not come about overnight. It emerged over time, with mounting awareness of the costs of the status quo and the potential gains from doing something about them. This in turn resulted from research and evidence on the deficiencies of existing policies, and deliberate efforts to communicate that information to the community.

For example, Australia is one of very few developed countries to have substantially liberalised its industry protection regime unilaterally, outside the conventional concession-swapping milieu favoured by other countries. It is hard to imagine this happening in the absence of evidence on the true levels of industry assistance, who benefitted from it and who effectively paid for it. A novel feature was the development of analytical tools to estimate relative (net) assistance levels across industries, and the impacts of protection not just on consumers but also on domestic user industries. As a result, the farmers and miners came to appreciate that, contrary to the accepted myth of 'protection all round', a tax on imports was actually a tax on (their) exports. They accordingly became a countervailing political force for reform.

Similarly, the reforms that eventually became the National Competition Policy were built on the foundation of evidence about the costs of existing anti-competitive arrangements that protected public utilities and other services. For example, it was demonstrated that many businesses, who were increasingly exposed to international competition, were bearing excessive costs for vital energy needs because of both inefficiencies in supply and cross-subsidisation of household demand. The costs to the economy of governments effectively using public utilities as vehicles for social welfare became manifest, informing public debate and creating increased momentum for reform.

A number of key reforms in social policy were similarly made possible by publicly available evidence of deficiencies in existing arrangements. Sometimes this evidence was counterintuitive, or contrary to the conventional wisdoms that had sustained the policies. For example the introduction of the HECS model of university funding (another Australian innovation) was preceded by information and public discussion about the perverse distributional effects of 'free' education. Similarly, regulatory reforms to reduce adverse selection in private health insurance as a consequence of the 'community rating' system — long an article of faith and regarded as politically untouchable — became possible through credible public evidence that the system had not only became inefficient and unsustainable, but ultimately also unfair.

Industrial relations provides a more mixed story. The initial moves to a productivity-based general wages policy, and then to enterprise bargaining, under the Hawke-Keating Governments, were founded more on commonsense than detailed empirical verification of the costs of the status quo. Nevertheless, some benefitted from research demonstrating the adverse effects on costs and productivity of work practices in 'strategic' industries (coal, building and construction, stevedoring, meat processing) and research on such issues as youth and long-term unemployment and their relationship to wage-setting.

Finding and selling the solution

The major reforms that defined this era also followed considerable research and public testing of the pros and cons of different possible reform measures. This generally occurred through review processes that made effective use of discussion papers, draft reports or 'green papers'. In most cases, sufficient time was allotted to the consultation processes to enable proposals to be properly explained, digested and responded to, and to inform a wider public debate. This was central to the industry assistance and national competition policy reform processes, as well as to the major reforms to financial regulation and taxation.

In the latter case, the Labor Government, on coming to power in 1983, had the advantage of a detailed report on taxation reform instigated by the preceding Coalition Government (though still not acted upon). Specific proposals in the Asprey Report were developed for further public discussion, with this process culminating in the Tax Summit of 1985. Some options, notably the GST, did not find sufficient favour and were jettisoned, but as noted, other important changes were implemented, including capital gains taxation and imputation. (Only one reform — the abolition of negative gearing — was subsequently reversed.) As we know, the GST was to make two further appearances in the public arena before ultimately getting up, demonstrating that even reforms with strong credentials often need considerable time and effort before winning sufficient support to make them politically viable.

The process of exposing reform options to proper public scrutiny and debate, in most cases resulted in significant changes to what was actually implemented. In some cases, these were necessary improvements to make the reform more cost-effective, or to avoid what would have been unintended consequences that only became apparent through such consultation. In others, changes were negotiated to overcome political resistance (as finally for the GST). In both circumstances those changes ensured that reforms could be implemented and, importantly, sustained.

The experience has been that consultation is valuable not only to develop and get acceptance for broad reform options, but also to get the detail right in the option that is finally implemented. For example, the Petroleum Resource Rent Tax took a couple of years to be developed and a couple more to be refined, through intensive consultations with industry, before it was finally implemented in 1989. The detail of the Life-time Community Rating Scheme took some 18 months to work through, once the Government had accepted its in-principle merit following the Industry Commission's 1997 inquiry into private health insurance.

Without good feedback on the design details, even a broadly agreed reform can run into trouble through implementation glitches and unintended consequences. Some of the most useful feedback often comes, not from experts, but from those in the firing line of the new policy (especially in relation to its workability and compliance costs).

Institutions and processes mattered

Evidence, analysis and their influence on the environment for reform did not occur in a vacuum. Institutions and processes within government played a crucial role in the reform successes.

Virtually every major reform in that period was preceded by public review processes that were commissioned by but conducted at arms length from government; that undertook in-depth research and analysis, and that engaged in extensive public consultation. These included the Asprey Review, the Campbell and Martin reviews of the finance sector; the series of inquiries into industry assistance, government business enterprises and other competition-related topics conducted by the IAC and Industry Commission, and the Hilmer review of national competition settings.

These reviews played a central role in establishing the case for reform, and in identifying (and explaining) the best solutions. In most cases, they drew on earlier work, and often considerable time elapsed before their recommendations were finally implemented — in some instances after a further election or change of government. This again demonstrates the importance of *time* to reform: allowing enough of it, and choosing the moment.

The arms length nature of these reviews had a number of important benefits. For one thing, it meant that the reviews were generally seen as being not only ‘expert’, but above politics — in what were often politically sensitive, as well as complex, areas of public policy. This ensured that their recommendations carried more weight with the community. At the same time, because the reviews were removed from executive government (at least in a formal sense — they often had secretariats composed largely of departmental officials) the governments of the day had the advantage of ‘deniability’. They also had an opportunity, at a distance, to read the public’s reaction and to consider the implications of different courses of action.

As an aside, it is a fact that most members of the community are rationally ignorant about policy detail, but they are not oblivious to good process. Their very ignorance about complex policy matters means that they look to institutions in which they can put their trust, and those institutions and processes can become politically very important in advancing reform. Arguably one reason for the loss of support for the ‘Carbon Pollution Reduction Scheme’ in the lead-up to the last election, for example, was the ‘Climate-gate’ email scandal that weakened the IPCC’s authority on the (incomprehensible to most) science of global warming.

In the case of the National Competition Policy, the Hilmer Review identified a procedural way forward, as well as making recommendations for specific policy actions. It thus spawned many smaller, more targeted reviews in different jurisdictions, with public benefit as the common assessment criterion. The National Competition Council was the institutional vehicle for bringing coherence to this process and played an important role in sustaining ongoing reforms (armed with the ability to recommend fiscal sanctions if justifiable reforms did not proceed).

Nevertheless the experience of the NCP's legislative review program was that 'reviews ain't reviews'. The quality of the reviews undertaken in that period was highly variable. This was in part due to the sheer number of them, which exceeded the resources available to do them all well. A proliferation of reviews also confused the public about what was important, and what governments were trying to achieve. There was an emerging sense of 'reform for reform's sake' and this was unhelpful to further progress.

A related problem was that many of the reviews lacked sufficient distance from the policy department most concerned with the outcome. Experience tells us that if external consultants are to properly inform public policy, there must be governance arrangements that can effectively deter them from simply reflecting or second-guessing their client's wishes. These are also important to the wider credibility of the reviews. However such arrangements are not very common. More often, consultants seem to be engaged with the opposite intent.

Leadership was paramount

The reform era was unusual in the quality and depth of political leadership. It was manifest not only at the Federal level, beginning with Bob Hawke's ascendancy in 1983, but also among key states. Moreover, the leaders of the reformist governments often had the benefit of Opposition leaders who were broadly supportive of the major reforms.

Leaders with the right vision for a better Australia and the skills to realise it, were fundamental to all the individual success factors just described — they could be said to be have been the ultimate success factor.

Their effectiveness was enhanced, however, by other initiatives at the political level for which they were ultimately responsible. These included effective cabinet processes and special committees to provide forums for scrutiny and debate. Among these, the Structural Adjustment Committee of Cabinet was perhaps the most notable. It enabled a more coherent approach to identifying priorities within the wider structural reform agenda, as well as bringing cross-portfolio scrutiny to individual reform proposals, enabling the various impacts and tradeoffs — economic and political — to be discussed among the most relevant Ministers.

Another key ingredient lay within the offices of the political leaders themselves — namely, the people they chose as their advisers. The high calibre and extensive experience of 'political staffers' at that time has perhaps never been equalled. It ensured that the leaders not only received good advice, overlaying that from their departments, but that they had people of substance around them to act as sounding boards and, importantly, to 'speak truth to power'.

As noted, the task of reformist leaders in that period was also made politically more tractable by the support they often received from the 'other side'. For example, it was crucial to the second round of tariff reductions in 1991, with recession clearly looming, that Keating's 5 per cent target, though challenging, was more moderate than Hewson's target of zero!

Moreover, the Reform Era was also characterised by strong support from business. The Business Council of Australia, National Farmers' Federation, Australian Mining Industry Council and Australian Chamber of Commerce and Industry were prepared to back key reforms publicly, even those that some of their members may not have liked. That was partly because, as organisations encompassing wide interests, they could rely on the support of other constituents, but it also reflected the qualities of the people leading those organisations. A similar observation could be made about the Australian Council of Trade Unions, which supported, or at least did not actively oppose, a number of key reforms, including enterprise bargaining, more pro-competitive arrangements for public utility services and, to some extent, trade liberalisation.

The challenges ahead

So what does all this mean for the challenges we face in advancing reform today — and into the future? While there were clearly some special forces at work during the Reform Era, most of the success factors are surely generaliseable. If anything, the systematic approach to identifying, prioritising and building political support for structural reform — which the OECD has referred to approvingly as 'the Australian model' — would seem more relevant than ever. Following the recent election, Government ministers emphasised that the imperative was to build consensus behind all their policies to get them through Parliament.

The challenge implicit in this, of course, is to achieve necessary political support for the *right* policies. This applies within COAG as well as within the Federal Parliament. While there is a large menu from which to choose — the COAG Reform Agenda alone entailing some 200 policy initiatives — governments cannot prosecute reform successfully on too many fronts at once. A key lesson from the past is that prioritising and sequencing the reform effort are fundamental to its success.

The current economic context for considering reform priorities to promote productivity is itself a challenge. One key dimension is the budgetary constraints that governments face in the aftermath of the Global Crisis. This has limited the scope for governments to promote productivity improvements through further spending and investments in the human capital and infrastructure areas that have been at the centre of the COAG Reform Agenda, pre-dating the crisis. (Moreover, many of those reform areas cannot yield productivity dividends for a decade or more.)

A second challenging feature of the current public policy landscape is paradoxically a bi-product of our economic *success,* namely structural pressures associated with the mining boom.

The 'two (or three!) speed economy', as it is now called, is not a new phenomenon in Australia, though it is a few decades since its last major manifestation. (In earlier times it was labelled the 'Gregory Effect', after Professor Bob Gregory's 1976 exposition of the forces at work.) Now, as then, the chain of economic impacts begins with windfall wealth from mining and increased domestic spending on non-traded goods, squeezing other traded goods industries via real appreciation of our currency. There are also some more direct impacts on the supply side, to the extent that mining competes labour away from other sectors. However, the main pressures have come from higher incomes and consumption of domestic services, accentuating longer term structural trends.

The combination of fiscal constraints from the Global Financial Crisis and structural pressures from the mining boom suggests that the productivity enhancing reforms that deserve some priority right now are those that can reduce business costs and enhance the economy's supply-side responsiveness, while being fiscally parsimonious.

Attempts to counter structural pressures by either hobbling the mining sector or (further) assisting manufacturing, could only detract from Australia's longer term productivity performance and living standards. Indeed, there is a stronger case than ever right now for *reducing* any government assistance to manufacturing (or other) activities that is not justified by genuine market failures — to free up skills needed in the expanding sectors. As the Commission has noted previously, this would be a win for both productivity and the budget. (Concerns about the possible reversal of our good fortune at some point would be better met by saving some of it for later than undermining it.)

Other big spending areas previously identified as providing scope for 'win-win' reforms, include government procurement (not forgetting *defence* procurement that favours high cost local production — like submarines costing multiples of equivalent imported models — without a clear quid pro quo for society); infrastructure projects that do not demonstrably yield a net social benefit (not forgetting railways), and those human services programs where benchmark data suggest scope for more cost-effective delivery (especially health services, given their magnitude and growth trajectory).

Most other prospective territory for productivity enhancing reform is regulatory in nature, with attention needing to be given not only to reducing compliance burdens (where progress is being made) but also to regulatory constraints on flexibility and adaptability at the enterprise level, and regulations that distort business decision-making. As noted previously, the challenge here is both to reform existing regulations and to prevent *new* regulatory impositions that would erode our productivity performance. Regulatory proposals that would have pervasive effects across the economy need particular scrutiny, especially those impacting on the markets for labour and capital, and key infrastructural inputs to production such as transport (not forgetting coastal shipping), energy, telecommunications and water.

Among these, industrial relations regulation is arguably the most crucial to get right. Whether productivity growth comes from working harder or working 'smarter', people in workplaces are central to it. The incentives they face and how well their skills are deployed and redeployed in the multitude of enterprises that make up our economy underpins its aggregate performance. It is therefore vital to ensure that regulations intended to promote fairness in Australia's workplaces do not detract unduly from their productivity. Getting the balance right is challenging and requires careful ex ante assessment and ex post review. This is particularly important in the context of the structural pressures described earlier, given the premium they place on flexible, adaptable labour markets. However, regulatory changes (in both directions) have generally been exempt from even the cursory obligations of regulation impact statements. If we are to secure Australia's productivity potential into the future, the regulation of labour markets cannot remain a no-go area for evidence-based policy making.

The renewed policy priority being attached to carbon pricing also has significant implications for productivity. Given the marked asymmetry between the costs and benefits of action by Australia — pending a significant global response — perhaps the strongest economic argument for carbon pricing is that it would displace more costly alternative measures targeted at particular products or technologies. If this were not achieved, the potential value of any new economy-wide instrument would be compromised. Unfortunately, most of the programs in question serve more as industry assistance than environmental assistance, and they will accordingly be difficult to terminate.

The need for regulatory vigilance has if anything been heightened by the Global Financial Crisis and its aftermath. For one thing, in times of fiscal stringency there is more risk of regulatory measures being adopted to get around budgetary constraints (for example, anti-competitive regulation rather than subsidies for Community Service Obligations); for another, the economic crisis has given rise to renewed pressure for regulatory interventions of various kinds. To take the example of banking, Australia managed to 'dodge a bullet' from template international regulatory changes; but recent domestic proposals — such as to address alleged 'price signalling' — pose risks of their own.

Even this brief re-cap of some current priorities suggests that the political difficulties facing (real) productivity-enhancing reform are at least comparable to those of the past. As in the past, it will be necessary to carefully build and effectively sell the case for such reforms, while resisting demands for policies that would take us backwards. In both cases, sound evidence on what is at stake for our economy and society has a fundamental role to play. Under the 'new paradigm' there will be more call on political negotiation to get reforms through than in the past. The challenge is to ensure that this does not compromise their essential character and their potential benefits. The stronger the evidence base for a proposed reform, and the better the consultative processes underpinning it, the greater are the chances that it will end up being a 'successful reform'.