1 Microeconomic reform and adjustment to change

Over the last decade, successive governments in Australia have actively pursued microeconomic reforms to raise productivity and community living standards. There have been improvements in many areas where performance had previously been poor. While reforms have benefited the community at large, they have also added to adjustment pressures for some individuals, groups and regions. Concerns and confusion about reform and its effects — and about the effects of change more generally — are threatening to halt socially beneficial reforms. This underlines the importance of having policy choices informed by the best available information on the benefits and costs of reforms, including the adjustment and distributional consequences, as well as attention to implementation issues.

Debate about change and reform

The Productivity Commission has been launched at a time of vigorous debate about the most appropriate policy directions for Australia. The issues in contention cut across all major areas of policy. They include our openness and attitude to foreign investment and immigration, the forms and level of taxation, the implementation of competition policy, the protection of industry, the privatisation of major utilities, labour market regulation, indigenous land rights and environmental issues, and the role of government generally in the economic and social life of the community.

Much of this debate reflects disquiet in sections of the Australian community about the effects of change and a heightened sense of uncertainty about the future. Some people feel they are working longer and harder without seeming to get ahead. While the rate of unemployment varies considerably around Australia, in some parts of the country it looks intractable. Many in rural and regional areas feel that the viability of their towns is threatened by the closure of bank branches and other service providers.

Sections of the community are questioning whether the program of microeconomic reform undertaken in Australia over the last decade has achieved its supposed gains.

Some say the gains are inherently small or do not justify the adjustment costs involved and express concern that those adversely affected have not been compensated adequately. There is scepticism about whether ordinary Australians are sharing equally with the 'big end of town' and dissatisfaction with how adjustment to change has been managed.

Against this background, it is understandable that those government policy changes which have exposed people and their workplaces or regions to greater competition have become targets for resistance and hostility. Yet competition policy and other microeconomic reforms are often being blamed for changes over which governments have little control. For example, the drift from small country towns to the cities and larger regional centres has been driven by various influences — including increased agricultural productivity and the additional amenity that city life can provide — and long predates the relatively recent period of microeconomic reform. Indeed, between 1911 and 1976 the proportion of Australians living in rural areas declined steadily from 43 per cent to 14 per cent, whereas there has been little change since then (ABS 1998a, p. 140).

Reform is only one source of change

Microeconomic reform is only one among many sources of economic and social change affecting the community. The changes occurring in the Australian economy about which some people complain — as well as the favourable effects of change about which much less is heard — are driven by a range of forces, both domestic and international. Key factors include the introduction of new technology, global shifts in the competitiveness of industries, the discovery of new mineral wealth, variability in weather patterns and fluctuations in the business cycle. Many of the changes are 'people driven', as reflected in shifts in spending patterns due to demographic trends (including the ageing of the population), higher educational attainments and job aspirations, and changing community values and attitudes (such as towards working mothers and extended shopping hours).

Long-term developments in the world economy — particularly the sustained growth in trade, the increased international mobility of capital and the growing skills base and rising incomes in developing countries — are creating both opportunities and challenges for Australians. Over the decade to 1996, world trade in goods grew twice as fast as real world output. Many Australian industries and their workers have come under competitive pressure to lift their performance as Australian consumers and businesses have taken advantage of imports, partly in response to lower trade barriers. Imports have risen as a share of national spending from 17 per cent to a little under 21 per cent in the decade to 1997. At the same time, lower

domestic tariffs, the growth of world trade, reductions in international trade barriers and rising standards of living in other countries have offered new possibilities for Australian exporters. Indeed, exports have risen in line with imports: the export share of Australia's GDP has increased from 17 per cent to a little over 21 per cent in the last decade. Growth in manufactured exports, tourism and the export of educational services has been even stronger.

The introduction of new technology typically sees new markets expanding and old ones coming under pressure and sometimes declining. The dramatic 25 per cent average annual fall in the cost of computing power over the last 30 years has been a boon to consumers and business users. This has created new industries and new jobs, faster and cheaper communications and access to information (such as through the Internet), and enhanced the quality of life (from medical diagnosis and treatment of illness through to the convenience of EFTPOS transactions). But with progress has come the displacement of some traditional work opportunities (such as in large typing pools and routine clerical functions) and a requirement for people to upgrade their skills to take advantage of new technologies.

Would stopping reform avoid adjustment pressures?

It is unrealistic to believe that, by stopping or reversing reform, the diverse pressures for change in people's lives will evaporate. Indeed, the pressures will build and be more disruptive if our economy is not flexible enough to adapt as changes occur at home and abroad. This is a compelling reason for Australia to press on with policies directed at enhancing the flexibility of the economy and people's ability to grasp new opportunities as they arise. Improvements in the operation of the labour market and training systems, for example, can assist when technological progress and other beneficial changes inevitably require people to change jobs and acquire new skills. Reducing the extent and duration of unemployment is a key to sharing the benefits of economic growth.

Of course, governments can attempt to shield selected industries or groups in the community from adjustment pressures. But this only shifts the burden of adjustment to other Australians. For example:

- Tariffs to protect import-competing industries translate to increased taxes on Australian consumers, user industries and exporters — many in the rural and mining sectors are themselves struggling against depressed world prices.
- Bounties and subsidies intended to make recipient industries more competitive in domestic and world markets have to be paid for by Australian taxpayers, including other businesses.

- Acceptance of overmanning in public utilities may ease the adjustment burden on some workers but entails a continuing burden on taxpayers, less competitive cost structures for business users and higher prices for consumers, including low income families.

There can be no overall security in resisting the changes needed to make the Australian economy more productive. Instead, there would be costs to Australian living standards in drawing back from the opportunities and challenges presented by a dynamic global economy. For instance:

- Foreign capital and the technology that comes with it will not be forthcoming unless Australia is a productive and profitable place in which to invest. Given Australia's low saving rate, foreign capital is indispensable to finance the investment in industry and the economic and social infrastructure necessary for growth, employment and higher living standards.
- Reversing competition reforms would, among other adverse consequences, stymie the development in Australia of a single national market and see a return to high-cost, fragmented and less competitive production evident when State purchasing preferences and other forms of parochialism prevailed. An integrated Australian economy creates a stronger base from which Australian firms can compete in the global marketplace.

The reforms needed for our economy to rise to the challenges and opportunities of global change will inevitably involve losses for some groups in the short term. The challenge for society is to handle this process such that socially beneficial reforms can still proceed. This requires policy choices to be informed by the best available information and analysis of the costs as well as the benefits of specific reform proposals, not just for particular groups, but across the wider community and economy. It also requires care in implementing reform and for potentially significant adjustment consequences to be addressed at the outset. Adjustment costs can be sensitive to how reform is implemented.

That raises questions about how well the adjustment process has been handled in the past and what might be done to improve it in the future. This is a key issue for all governments and an area where the Productivity Commission is expected to make a contribution.

There is also a continuing need to promote community understanding of the objectives of microeconomic reform and the benefits realised and in prospect. The sense of fatigue and even hostility towards reform that has developed in some sections of the community has been compounded by misunderstandings and, at times, misrepresentation of the role of microeconomic reform.

Why has Australia undertaken reform?

Considerable confusion is evident in the public debate about microeconomic reform. One source of confusion is that not everything done in the name of microeconomic reform is genuine reform. Even use of the term can provoke a negative reaction from some people. This inhibits an understanding of what is involved. We need to sort through what it is and what it is not.

Reform is a means to higher living standards

The origins of microeconomic reform lay in the gradual realisation that, over the years, some key government policies and practices were preventing Australia from reaching its economic potential. Inappropriate regulation and red tape — which inhibited healthy competition while raising the costs of doing business — and mandated government monopolies which denied freedom of choice of supplier, were among the policies which had weakened incentives for people in all walks of life to be innovative, self-reliant and to use the resources available to them to the best effect.

Microeconomic reform seeks to change the incentives facing people to encourage them to be more productive. Requiring government businesses to adopt a more commercial focus, winding back unnecessarily prescriptive regulation of business and labour markets, reducing import protection and opening previously closed markets (such as airlines and telecommunications) to new operators, for example, provide incentives for private and public firms to be more cost conscious, to price their goods and services competitively, and to be innovative and seek new markets. This can have social and economic pay-offs. Policies which make consumers conscious of the true costs, for instance, are an essential guide to socially beneficial investments and provide price signals that prevent wasteful consumption of energy, water and other scarce natural and environmental resources.

Microeconomic reform also seeks to provide people with opportunities for greater choice. Greater competition allows people to walk away from inadequate services and obtain something better. For example, until the financial reforms of the 1980s, interest rate controls on housing and small business lending meant that finance was often available at less than true market rates, but it was rationed. Among home-seekers, the poor, women and minority groups were particularly disadvantaged in being forced to borrow from higher cost finance companies and other sources.

In seeking to enhance choice and improve incentives for people to do better in all the activities and institutions that make up Australian society, the ultimate objective of microeconomic reform is to improve living standards. Higher productivity and

growth are essential to support higher wages and improve job prospects. They are also the only sustainable basis for community expenditures on health and education and the maintenance of fair and effective social support mechanisms, including for those most vulnerable to change.

Reform aims to harness market forces properly

Microeconomic reform is not, as is often implied, doctrinaire adherence to unbridled market forces. Competition, deregulation and privatisation can be legitimate and powerful tools for achieving society's economic and social objectives, but they should not be used indiscriminately. They are not objectives in themselves, but possible means to desirable ends. Nor are they the be all and end all of reform. An important focus of reform efforts has been to ensure that governments intervene where markets fail and they can improve on market outcomes.

Indeed, there is reason to be careful about how market incentives are introduced into some activities. In areas such as health, education and housing, the aim is to ensure access to services of acceptable minimum standards as well as the efficient and effective provision of those services. Similarly, while some market-based mechanisms — such as tradeable pollution and water rights — are increasingly recognised as playing a complementary role with other policies in achieving better environmental outcomes, a number of conditions need to be satisfied for their effective application (Wall et al 1997).

Privatisation of public utilities can spur better performance by removing political and bureaucratic interference in day-to-day operations and imposing the extra disciplines of the share market. But case-by-case assessment of all the potential benefits and costs is needed to determine whether it would be in the public interest. There could, for example, be substantial costs in regulating the exercise of market power where a natural monopoly provider has been privatised.

Far from allowing unconstrained market forces, competition policy in part seeks to control the excesses and concentration of market power that endanger smaller yet efficient producers to the ultimate detriment of consumers. The Trade Practices Act requires, for example, that mergers which substantially lessen competition be opposed, unless there is a demonstrated public benefit. Small businesses are also protected by the Act from the anticompetitive behaviour of other large businesses. One notable case involved action and fines of more than $20 million against companies which operated a ready mix concrete cartel in southern Queensland to fix prices to the detriment of public works projects and other businesses, both large and small (ACCC 1996, p. 11–12).

A major thrust of recent microeconomic reform efforts has been to establish ground rules to enable competitors to have access to the services of certain essential facilities that cannot be duplicated economically. These provisions have been a factor in allowing new competitors to run trains between Melbourne and Perth in competition to National Rail, with a consequent reduction in freight rates of up to 40 per cent (NCC 1997, p. 16). The ACCC has new responsibilities for determining the terms and conditions for access in the telecommunications industry. Its recent decision no longer to require data service providers to route their traffic through Telstra's capital city switches will mean reduced costs and an expanded range and quality of digital data services, particularly in regional areas. High quality data products are one of the fastest growing areas of the telecommunications market — valued at more than $500 million annually — and are crucial to business customers such as retailers, financial institutions and to government agencies (ACCC 1998).

Reform is as much about developing and implementing appropriate regulation as it is about deregulation. In this way, governments are striving to ensure that social and economic objectives which would not be met through market forces alone are achieved in the most efficient manner. For instance:

- An important aspect of reform is the use of public benefit tests in developing regulatory proposals and in assessing whether existing anticompetitive regulation should be maintained.
- Although there has been substantial deregulation in Australia's financial sector, following the Wallis inquiry the Government moved to establish an improved regime for financial system regulation, including a single prudential supervisory authority for all deposit taking institutions, life and general insurance companies and superannuation funds.
- Efforts are being made to ensure that regulatory objectives for firms can be met with reduced compliance costs. One example is the simplified immigration rules and streamlined procedures covering temporary entrants which enable businesses to bring into Australia quickly the skilled overseas people they need (Ruddock 1996). Another example is one-stop shops for business licences. In Queensland, Smart Licence is expected to save small businesses $37 million annually by extending licence terms, reducing the nominal number of licences by nearly 50 per cent and by combining the most common licences into the one application (DTSBI 1998, p. 4).

The role of regulatory and institutional arrangements — which establish a foundation of law and property rights that enable markets to work effectively — is often overlooked. Such rules underpin the division of labour, the exchange of goods and services and technological developments that have been the keys to economic

progress. In a study of the role of government in a changing world, the World Bank (1997, p. 41) stressed:

> Markets rest on a foundation of institutions. Like the air we breathe, some of the public goods these institutions provide are so basic to daily economic life as to go unnoticed. Only when these goods are absent, as in many developing countries today, do we see their importance for development. Without the rudiments of social order, underpinned by institutions, markets cannot function.

Good reform is not driven by budgetary imperatives

Microeconomic reform is sometimes wrongly identified with cutbacks in public expenditure. Microeconomic reform seeks to improve efficiency and this may lead to reduced expenditure, but the reverse need not hold. Budgetary considerations alone are unlikely to provide a basis for sound structural reforms. One example was the 3 per cent duty imposed as a revenue measure on business inputs previously imported duty free under the tariff concession system. It is also important, for example, that research and development policy, while potentially involving substantial budgetary outlays, is designed to address effectively the sources of market failure which can inhibit technological innovation and economic growth. In 'big ticket' areas of government expenditure such as health and education, incentives for responsive and efficient delivery of services, not just budgetary outlays, are critical to good social and economic outcomes.

Reform can help governments achieve social objectives

By generating higher levels of national income, reforms directed at improving the productivity of the economy provide the wherewithal to fund social services and government expenditures including education, health and other services.

Microeconomic reform is also intended to help governments meet social objectives better. It is concerned primarily with how to allocate rather than how much to allocate. For example, to avoid unduly constraining the commercial activities of their business enterprises, some governments have moved to fund community service obligations from the budget rather than through cross-subsidies embedded in the pricing structures of government business enterprises. Rail authorities received $1.2 billion in 1996-97 in payment for explicit community service obligations (PC 1998f). Cross-subsidies can mask inefficiencies and are a hidden tax on some users. The shift to on-budget financing is allowing decisions about community service obligations to be made openly rather than by default. Such transparency is often resisted by the beneficiaries of previously hidden cross-subsidies who fear that exposure will see their assistance cut. But explicit budget financing allows the

justification for such subsidies and level of support to be assessed more readily against other social expenditures.

The substantial and growing resource costs of providing healthcare and community services are concentrating government and community attention on the means to promote better and more efficient service delivery. Where properly implemented, the move to separate the roles of purchaser from provider, and parallel initiatives such as competitive tendering, have required governments to be more precise about the types of services to be delivered, fostered improvements in the quality and timeliness of services and led to a greater focus on the needs of the client (SCGSP 1998b).

The gains from reform

Significant milestones in microeconomic reform now date back many years. Key initiatives included the removal of import licensing in 1960, the 25 per cent tariff cut in 1973 and the floating of the Australian dollar and financial market liberalisation in the early 1980s. However, the reform effort on which much discussion is currently focused only gathered momentum in terms of coverage and intensity in the mid to late 1980s (IC 1998a).

While much has been achieved, the reform process is far from comprehensive or complete and a number of agreed reforms are yet to be fully implemented (PC 1996).

Nevertheless, we have come a sufficient way to ask whether we are starting to see reform outcomes that accord with expectations. Are improvements in Australia's productivity performance becoming evident? Have government business enterprises and private firms lifted their performance? Are the benefits of lower prices and greater choice flowing to other sectors of the economy and to consumers? What lessons can be drawn from the reform experience to date?

A range of indicators point to substantial benefits from reform, but accurate measurement of the benefits is not possible. Many factors, including technology and macroeconomic conditions, affect performance but the complex interactions between them and reform makes it difficult to disentangle their separate impacts. Any evaluation of the gains also needs to take account of what is happening to the quality of goods and services, indirect effects throughout the economy as well as direct effects, and the fact that benefits accrue through time and can have ongoing or 'dynamic' effects on behaviour which enhance productivity. This suggests that a range of indicators need to be examined to build a picture of the benefits of reform.

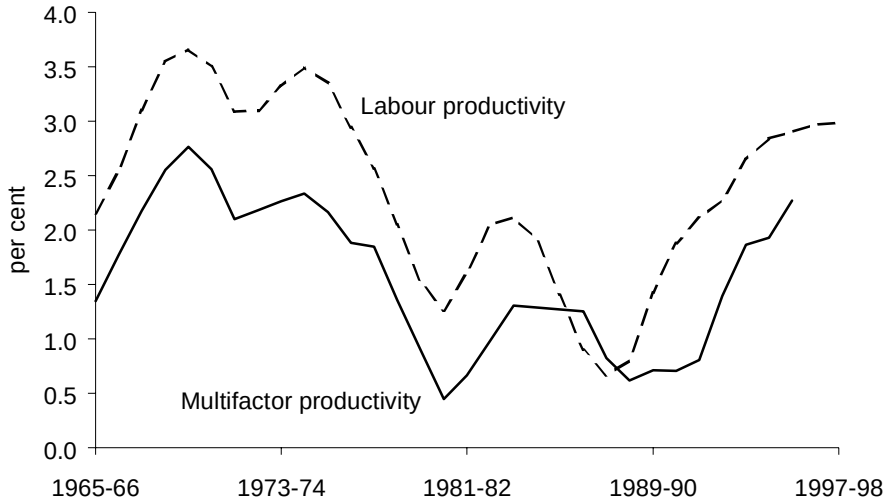
National productivity has improved

Microeconomic reform is about making Australia a more productive place. At the aggregate level, Australia's productivity performance — the main source of higher living standards — has shown an encouraging upturn in the 1990s (figure 1.1). The latest available data show the rate of multifactor productivity growth in the market sector running at around 2 per cent or more a year, compared with an historical average of 1.5 per cent a year. Labour productivity has shown a similar improvement and has been increasing recently at around 3 per cent a year.

This upturn has followed the concerted microeconomic reform effort of the mid to late 1980s. Sectors subject to intensive reform, such as Transport and communications and Electricity, gas and water, have been major contributors to improved national productivity performance (IC 1997d).

National productivity indicators are showing stronger and more sustained growth than could be expected on the basis of past recoveries from recession. The fact that there has been no general acceleration in OECD productivity growth in the 1990s also suggests that Australia's recent performance reflects domestic rather than international factors (Dowrick 1998, p. 131).

Figure 1.1 **Annual growth in trend labour and multifactor productivity[a], 1964-65 to 1997-98**



a Market sector; percentage changes from previous year. MFP data are available only to 1995-96.

Source: IC 1997d (derived from ABS data). Labour productivity growth derived from unpublished ABS trend data.

There is, however, reason to be cautious in attributing all of this observed improvement to microeconomic reform (PC/ANU 1998). The questions of causation and the linkages are complex. Other factors such as low inflation and improved technology are undoubtedly contributing to higher productivity growth, although they in turn are not entirely independent of microeconomic reform. There will always be some difficulty in interpreting aggregate productivity indicators because various macroeconomic events can mask the influence of reforms. A proper assessment of the benefits of reform must also investigate outcomes at the industry or firm level.

Gains in a range of industries

There is now considerable evidence across the economy of how reforms are benefiting consumers, firms, industries and other groups. For example, while the major reforms of government business enterprises have required considerable adjustment by managers and workers, in many though not all areas there have been substantial reductions in prices to consumers and user industries, improvements in productivity and increased dividends to governments (PC 1998f). Some indicators of improved performance in various sectors of the economy are in box 1.1.

It is not always easy, however, to separate the influence of microeconomic reform from other factors — such as improved production processes, skill levels and technology — which have an important bearing on industry performance. A detailed study of the whitegoods sector, though, has revealed how a positive response from business to the increased competition induced by tariff reductions (from 45 per cent in 1978 to 5 per cent in 1996) can improve performance. Over the last 20 years, production volumes grew and exports of whitegoods increased from under 3 per cent of turnover to around 8 per cent. Consumers now have a wider choice of products and models at world competitive prices. In analysing reasons for improved performance, it was noted:

> It is not possible to isolate out the causative impact of MER from other drivers affecting the organisation of production in whitegoods. But there are some strong correlations that are difficult to ignore. Market price pressures from general tariff reductions and free trade with New Zealand under the CER have been associated with plant rationalisation and increased specialisation of manufacture ... When the inexorable direction of MER trade reforms became clear by the mid 1980s, to its credit, management responded. Far-reaching decisions were taken to aggressively compete for market share. Email, Hoover and later Southcorp successively sought strategic acquisitions. Considerable investment went into modernising manufacturing operations. Product designs were improved and export markets developed (Wiggins Price 1998, pp. 38–9).

Box 1.1 **Examples of improved performance**

- Changes in the electricity industry have seen widespread benefits to residential consumers and businesses (PC 1998f).
  - Real electricity prices for residential consumers in all jurisdictions were lower in 1996-97 than in 1991-92: by 30 per cent in Queensland, 18 per cent in Western Australia, 13 per cent in New South Wales and up to 10 per cent in other States and Territories.
  - Business users, who were previously forced to cross-subsidise residential consumers, received even larger price reductions except in Tasmania and Western Australia.
- Corporatisation of Australia Post and increased competition, albeit as yet limited, have seen the real price of posting a standard letter fall by 8.7 per cent over the five years to 1996-97 and the 45 cent standard letter rate is locked in until 2003. Dividend payments (excluding capital re-payments) to the Government grew from $50 million in 1991-92 to $220 million in 1996-97 (PC 1998f).
- Telephone calls continue to become cheaper. The average weighted real price of calls fell by 23 per cent in the five years to 1996-97, primarily due to the substantial price reductions in the competitive long-distance market (PC 1998f).
- While a survey of the Australian aluminium industry found unanimous agreement that further broad-based microeconomic reform is needed to improve the competitiveness of this major export industry, individual firms could point to benefits already experienced (IC 1998b). For example:
  - Following divestment of the Queensland Government interest in the pipeline between Wallumbilla and Gladstone, Queensland Alumina Limited reported an immediate 25 per cent reduction in their gas transportation tariff, with the prospect of further reductions as pipeline throughput increases.
  - The waterfront reforms of the early 1990s facilitated renegotiation of manning arrangements at Capral's raw materials unloading facility. Together with ongoing improvements in equipment performance, this saw ship unloading costs fall from $2.10 per tonne to less than $0.85 per tonne in the period from 1985.
- The performance of NSW rail freight operations has improved following commercialisation in 1988-89 and corporatisation in July 1996. Better operational efficiency has been achieved through investment in new rollingstock and systems, better fleet management, the development of strategic alliances with the private sector; workplace reforms and staff reductions, a stronger focus on service delivery and customer retention and the rationalisation of some services and facilities. FreightCorp has continued efforts to improve its efficiency in anticipation of increased competition and opportunities for growth beyond NSW. According to FreightCorp, since corporatisation labour productivity has improved by 55 per cent, locomotive productivity by 39 per cent and wagon productivity by 25 per cent and rail freight charges have fallen on average by 16 per cent in real terms.

(continued on next page)

Box 1.1 (continued)

- Increased competitive pressure in the meat processing industry and a more facilitative industrial relations framework are enabling firms to introduce productivity improvements in their workplaces and to benefit workers. Although there is scope for further improvement, a Commission study of five large processors found that productivity per person per shift had generally increased — in one firm by more than 35 per cent — following implementation of workplace agreements. Several firms reported a significant decline in the level of industrial disputation. Major benefits for employees in some firms have included higher earnings and more stable income, greater opportunities for training and the introduction of career paths linked to training (PC 1998e).

It is important in assessing the effects of microeconomic reform to look beyond readily measurable costs and prices. Reforms can affect choice, quality of service and amenity. The quality and service dimensions of some reforms can be difficult to assess but are nonetheless important. For example, the convenience of extended shopping hours makes life easier, particularly for working couples and single working parents, but the benefit is not well captured in traditional productivity measures. While there are clear pointers to improved quality in some areas, in others performance is mixed and the reasons for this need to be better understood and addressed. Some illustrations are in box 1.2.

Lasting incentives for improved performance

One of the main thrusts of reform is greater competition and the gains from competition are dynamic as well as once off. Competition creates ongoing incentives and disciplines to do better, including through innovation and the implementation of more flexible work practices. It may thereby raise the *rate* of productivity growth. The state of knowledge is such that the potential dynamic effects are neither well understood nor adequately captured empirically (PC/ANU 1998). However, there is evidence to indicate their importance.

Greater competition can change the mindset of managers and workers in their search, and acceptance of the need, for higher productivity:

- Increased competitive pressures on the Australian black coal industry have led to the growing realisation that past management and industrial practices are no longer sustainable (PC 1998c). With weak competition in the product market until the mid-1980s and in an environment of prescriptive industrial relations and safety regulation, mine managers' efforts were directed more at complying with the regulations and maintaining supply than with pursuit of production

efficiency. Increased competition in both the domestic and world markets has focused attention on changing work arrangements which unnecessarily restrict productivity as the major means of improving the industry's competitiveness.

- Equally, the positive attitude of stevedoring workers at the Port of Adelaide to work performance has been moulded both by new management sharing information and communicating directly with employees and by increased competition from the Port of Melbourne following the establishment of Patrick's dedicated Melbourne–Adelaide rail link in 1997. The outcome has been a substantial rise in productivity, despite scale disadvantages (PC 1998a, p. 140 and PC 1998b, p. 136).

Box 1.2 **Quality and service are important too**

- Reductions in industry protection over the years have benefited consumers in terms of quality and choice as well as price. For example:
  - Reported faults in the first three months of ownership for locally made cars roughly halved between 1988 and 1995.
  - With the abolition of import quotas, the number of motor vehicle models available to Australian consumers rose from 69 in 1985 to 101 in 1995 (IC 1997b).

  It is hard to envisage small cars being offered at $13 990 with air bags and three year warranties if tariffs were still at 57.5 per cent, let alone if quotas had been retained.
- Improved performance by Australia Post has been achieved with increased levels of satisfaction by business and private customers since the early 1990s (PC 1998f).
  - Accessibility to mailing services was improved with the decision in 1994 to allow customers to lodge mail up to 6 pm at all major population centres.
  - Consumers have gained from access to a wider range of services including giroPost financial services and bill paying facilities.
  - Of the estimated 2.35 million delivery points in rural and remote areas in 1996-97, 94 per cent received five deliveries every week. The remaining 6 per cent received between one and four deliveries a week.
- Monitoring of Telstra's service quality performance over the six years to 1996-97 reveals a decline in the frequency of calls not being answered due to network failures and an improvement in the percentage of operator-assisted services answered. There were improvements in the proportion of customers connected to new or in-place services within agreed times in country areas but declines for residential and business customers in the metropolitan areas (PC 1998f).
  - The Australian Communications Authority (ACA 1998) recently reported a deterioration in a number of services indicators. The ACA has been asked to review the standards governing customer service and to introduce benchmarking against performance measures.

- Privatisation, increased competition (including from Ansett's entry to some international routes) and greater opportunities to pursue commercial activities have spurred Qantas to improve its performance. Labour productivity, as measured by revenue passenger kilometres per employee, improved by up to 21 per cent in the four years to 1996-97 (PC 1998d, p. 31).

Where firms or their employees find government responsive to overtures for special assistance, they may devote considerable resources to securing it. Such activities may have a pay-off to the firm but are socially wasteful. Microeconomic reforms which reduce rewards for lobbying will encourage firms to expend managerial effort

on increasing productivity and output rather than on influencing government. Agreement among the States to cease or limit selective assistance to industry would, for example, reduce the pay-offs to lobbying and produce a more competitive industry structure in Australia. The Industry Commission (1996d) found that State and Territory budgetary assistance to industry — estimated at $5.7 billion in 1994-95 — often involves competitive bidding for major investments and 'events'. This, at best, shuffles jobs between regions and, at worst, burdens tax and rate payers, and reduces the competitiveness of Australian industry and the income of Australians as a whole.

Openness to trade can stimulate technology transfer and innovation, which are drivers of productivity growth. Reductions in tariffs and other forms of protection reduce the cost of imported capital goods which embody the latest technology. It is no coincidence that the opening of the Australian economy has been associated with increasing technological innovation; but catching up will take time (IC 1995).

Gains can take time to accrue

Assessment of the impact of reforms is complicated because the benefits of reform accrue over time. Apart from the dynamic effects just discussed, it can take a considerable time for firms and individuals to accept that new market incentives are likely to be sustained and to evaluate the implications for their own activities. Time is required to identify new market opportunities, plan and carry out investment and to learn new skills and business practices. Infrastructure assets have particularly long lives, so the full benefits of reforms which involve access regimes and better structured incentives to guide new investments will not be realised until the next century.

The gains can also be delayed because of contractual and other arrangements. For example, some firms in the Australian aluminium industry will not be able to take advantage of the lower electricity prices resulting from reform until existing long-term contracts expire (IC 1998b, p. 71).

Ensuring that reforms deliver benefits

While evidence of substantial gains from reform is mounting, it is equally evident that not all reforms are working as anticipated. A well managed reform process should be able to identify where outcomes are falling short of expectations, to understand why and to determine how implementation could be handled better.

- There is evidence that the quality of service has suffered when contracting and competitive tendering processes have been inadequate. A careful weighing of the full costs and benefits is required, as well as effort to improve competences in public administration including in contract design and monitoring (IC 1996a).
- Experience shows that, in some circumstances, undertaking one reform without other supporting reforms can lead to disappointing results. Without policies to promote greater competition between stevedores, for example, it is not clear that the benefits of workplace productivity improvements will be passed on to users. A major barrier to new competitors is the exclusive, long-term leases (up to 40 years) that stevedores currently have with Australian port authorities (PC 1998b).
- There is legitimate concern that governments are pushing the boundaries of appropriate private sector involvement in infrastructure projects. The build-own-operate-transfer (BOOT) arrangements for roads involve risks and uncertainties and, when these are not allocated properly between the public and private sector, additional costs will arise (Hepburn et al 1997).
- The success of reforms in areas of continuing natural monopoly or significant market power depend, in part, on the design and operation of regulatory regimes. Inappropriate price controls or access arrangements may offset some of the potential gains from the reform of public utilities (Forsyth 1998, King 1998).

Monitoring of reforms and benchmarking of performance are critical to identifying where further attention is required. An ongoing research and inquiry program is also essential to identify impediments to productivity, how to address them and the scope to improve the implementation of beneficial reform.

Dealing with adjustment problems

Reforms which improve the living standards of the general community inevitably involve adjustment pressures and some dislocation. It may take time for people to find alternative employment and for capital to be redeployed. During the transition, their lost productivity can detract from growth in national output.

The adjustment process may involve people retraining and/or changing jobs within a region, or moving to locations with expanding opportunities. For some, change can be accommodated relatively quickly and easily, and soon prove beneficial. For others, however, the period of adjustment may be protracted and involve personal hardship. The total number of jobs in the economy has expanded — on average by 1.6 per cent annually over the last decade — offering new opportunities for employment and re-employment. Nevertheless, both the rate and duration of

unemployment remain stubbornly high and the probability of unemployed people moving to full-time employment has declined since 1980. The evidence that older blue collar workers and middle management have had particular difficulty in regaining equivalent full-time work suggests that adjustment has been more difficult for some than others.

Job mobility in Australia

The extent of reform-induced adjustment problems needs to be assessed in the light of typical patterns of job mobility in Australia.

A sizeable number of Australians change jobs in any given year. Of the 8.4 million people working in February 1998, about 14 per cent had been in a different job and 8 per cent had been unemployed a year earlier. Thus, more than one-fifth of job holders had also been job seekers during the year. Nevertheless, a stable core within the workforce had relatively secure jobs — 41 per cent of people employed in February 1998 had been in the same job for five years or more. Job mobility is lower for workers over 35, those born in non-English speaking countries and those without post-school qualifications.

While many people changing jobs do so within their current industry and occupational groups, there is substantial movement to jobs in different industries and occupations. Of the 1.2 million people who had changed jobs and previously been employed in the year ending February 1998, 40 per cent had changed their industry and 34 per cent had changed their occupation.

People leave or lose their jobs for a host of reasons, many of which are not associated with microeconomic reform. Most commonly, people voluntarily leave their existing jobs to take up better ones, or for family reasons or to retire. Job losses due to retrenchment or business closure tend to rise sharply in times of economic downturn, but for the past 20 years have typically accounted for 15 to 20 per cent of total job separations. That proportion has shown no upward trend (PC 1998h).

The changing fortunes of regions and the geographical mobility of the workforce provide other important perspectives on the adjustment process. While some regions in Australia are contracting, others are expanding. There were 578 towns with populations in the range 1000 to 20 000 in 1986. A decade later, 31 per cent of these towns had sustained population losses (totalling 60 000) and 47 per cent had grown by 10 per cent or more (an increase of 455 000). Towns in decline were usually inland in wheat-sheep belts and dryland grazing or mining regions. Most towns experiencing substantial population growth were coastal, located near capital

cities or associated with growth industries such as wine or tourism (ABS 1998b, p. 10).

How well regions adjust to change depends partly on how mobile the workforce is in response to growth or decline in regional employment opportunities. A recent study suggested that interstate migration has played an important role in reducing differences in labour market conditions between the States (Debelle and Vickery 1998). Most of the migration from States suffering employment shocks was seen to take place, on average, within four years and the process of adjustment was complete after seven years. Nevertheless, the study found evidence of persistent differences between State unemployment rates, employment growth rates and participation rates.

An important role for government

Governments have a key role to play in facilitating adjustment so as to reduce unnecessary costs in the transition and to help people adjust to change. Community support for reform efforts is more likely to be maintained if adjustment issues are handled well.

Governments have at their disposal a range of measures to deal with adjustment problems. Experience indicates that some programs have been more successful than others. Adjustment programs need to be kept under review to ensure their suitability to particular circumstances. The design and implementation of effective programs present significant challenges not least because, in seeking to facilitate adjustment, measures can introduce new disincentives which need to be minimised.

The general social security system provides a minimum level of income support for people who would otherwise be unable to cope with adjustment, whether caused by microeconomic reform or other changes. Over the years, governments have also provided various general labour market programs (such as wage subsidies, training programs, job search assistance and counselling) and targeted programs for particular industries (such as the TCF, automotive and native forest industries) to assist displaced workers acquire new skills and otherwise improve their employability.

One of the most important contributions government can make to minimise adjustment problems is to review and change those of its own policies which unnecessarily impede the efficiency of adjustment. Some of the things which make it hard for people to adjust, either within or between regions, stem from the unintended side effects of existing government policies or practices directed at other objectives. Regional concentrations of public housing away from areas of job

growth are one example. Stamp duty on property sales is another. Labour market regulation which provides insufficient scope for differentiated responses to the needs of particular firms and regions, and the interplay between the social security and income tax systems, exert a powerful influence on how people respond to adjustment pressures (IC 1993).

Phasing reforms is one of a range of possible implementation strategies which may go some way towards easing adjustment pressures. There are, however, difficult trade-offs involved which are best assessed on a case-by-case basis. Phasing can provide firms and their employees with valuable time to adjust but, in so doing, delays receipt of the benefits of a reform to users, consumers and taxpayers. Phased reductions in tariffs and the graduated introduction of other reforms were recommended by the Commission and its predecessors when that was judged to be to the net benefit of the community. Illustrations of how phasing can be used to ease adjustment pressures are provided in box 1.3. Financial compensation is an option when established property rights are devalued by reform.

While broad-based microeconomic reform is seen by some as contributing to reform fatigue, it can serve to reduce adjustment problems. Groups adversely affected by a particular reform are more likely to receive offsetting benefits where reforms are implemented on a broad front. For example, a study of the combined distributional effects of tariff, electricity, telecommunications and public sector reform estimated that, although tariff reform reduced manufacturing employment by 0.3 per cent, the net effect of all four reforms was to increase employment in that sector by about 1.2 per cent (IC 1996c, p. 18).

If governments are to handle adjustment problems well, they need effective processes to identify where problems are likely to arise and to provide a clearer understanding of contemporary adjustment experiences and the economy-wide consequences.

A core task in the Commission's current inquiry on safeguard action for Australia's pigmeat industries is to determine the contribution of import competition, as well as other factors, to the problems facing these industries. In a separate inquiry, the Government has asked the Commission to investigate the transitional and ongoing impacts of competition policy and related reforms on rural and regional Australia, to assess the extent to which these communities are sharing in the benefits of reform and to identify measures that could increase the flow of benefits or reduce the costs. This public inquiry will provide an opportunity for people all around Australia to put their views and to explore solutions.

Such public consultation is an important ingredient in addressing adjustment issues within a consistent framework, both to generate ideas and information and to help community understanding of the ultimate decisions of government. This is especially important in those areas of microeconomic reform with potentially significant effects on the distribution of income as well as on national productivity. Public consultation can also help to avoid unanticipated community reactions which could impede effective policy implementation or even force policy reversals.

Further studies of adjustment experiences would help enlighten policy formulation. Borland (1998) has summarised existing Australian evidence and points to the

Box 1.3 **Phasing can help adjustment**

- The Industry Commission (1994) estimated that the removal of entry restrictions in the taxi industry would result in fares falling by up to $2 per trip on average. But in order to secure this benefit in an orderly manner, it recommended that entry should be liberalised over a number of years by selling new licences through public tender each year, with the possibility of sales proceeds being used to compensate existing licence holders.
- When the Industry Commission (1992) investigated Australia's water industry, it found that prices for bulk irrigation water fell well short of recovering costs, thereby distorting investment and consumption decisions. While recommending that bulk water suppliers immediately increase the price of water to a commercial level, the Commission recognised that irrigators would need time to adjust and proposed an interim subsidy that would be reduced progressively over time.
- In its urban transport inquiry, the Industry Commission (1994) found that rail fares did not recover costs and needed to be restructured. Fares needed to involve greater differentials between peak and off-peak periods and to reflect distance travelled. The Commission proposed that fare increases be phased in over a number of years and be accompanied, if not preceded, by improvements in service quality.
- In its report on private health insurance, the Industry Commission (1997a) recommended modifications to community rating based on the age of entry, but specified that these arrangements apply only to new entrants, with a grace period to allow people of any age to understand the implications and enter under the old rules.
- In the textiles, clothing and footwear inquiry, the Industry Commission recommended gradual reductions in import protection to 5 per cent over an eight year period (IC 1997c). This would have involved a maximum 3 percentage point annual reduction in tariffs for clothing, and for other parts of the sector such as footwear, only a 1 or 1.5 percentage point annual reduction.

dearth of empirical evidence which relates directly to workers displaced by microeconomic reform. The questions of how Australia is adjusting to change, the effectiveness of existing labour market programs in easing the burden on individuals and what else can be done to facilitate adjustment feature prominently on the Commission's work program.

Studies on the distributional effects of reform can be helpful in addressing claims about adverse impacts. For example, a recent study by Commission staff found that reduced trade barriers had not been a major contributor to the increasing inequality of earnings or to unemployment over the last decade and a half (Murtough et al 1998). The wage and employment effects of changes in trade barriers have been overshadowed by technological change (requiring more high skilled labour) and by other developments such as adverse shifts in international trading conditions for primary commodities.

General or specific adjustment measures?

A recurring, but difficult, issue in implementing reform is whether governments should introduce targeted support measures in addition to generally available welfare, job search and training programs. This raises complex equity, efficiency and strategic considerations for which there are no hard and fast policy prescriptions.

The advantage of relying primarily on general support programs is that they aim to address the training and income maintenance needs of the unemployed regardless of the particular combination of circumstances that may have caused their job loss. Such general support programs target those adversely affected in net terms and in genuine need. Cash transfers through the welfare and tax system, together with non-cash benefits (such as Medicare, childcare and education) appear to have substantially offset an observed trend towards increased dispersion in market-derived incomes in Australia (IC 1996b, p. 24).

The design and administration of general support measures need to be kept under review. The Industry Commission (1997c) assessed the efficacy for TCF workers of generally available measures and found them wanting, particularly with regard to eligibility criteria and funding levels. It recommended that eligibility for employment services should be separated from eligibility for social security benefits so that jobseekers who are not immediately eligible for benefits — such as newly arrived migrants, people receiving redundancy payments and those with employed spouses — could, subject to means testing, gain immediate access to general employment services. Likewise, funding for the Assistance to Depressed Regions

Program should take into account any significant regional impact of TCF activity reductions.

There are circumstances in which targeted assistance to address particularly concentrated adjustment difficulties may be justified. One example is where an adjustment shock is large relative to the size of a regional community, placing excessive strain on the existing assistance infrastructure, including training and retraining facilities. In circumstances where there is advance knowledge of major adjustment requirements, an early action plan drawing on generally available measures can ameliorate adjustment problems (IC 1993, p. 314). Previous evaluations of labour market programs point to the greater likelihood of success if they are aimed at specific disadvantaged groups such as the long-term unemployed and women re-entering the labour force (EPAC 1996, p. 88ff and OECD 1994). However, analysis of industry-specific programs reveals disappointing results. For example, the TCF Labour Adjustment Package achieved good participation rates but lower direct employment outcomes than general training programs, including for its primary target group of overseas-born women workers (IC 1997c).

Special industry-specific adjustment assistance may also be seen as a pragmatic means of reducing resistance to reforms that are in the overall community interest. But this has to be balanced against other considerations. These include the political horse-trading engendered over amounts of assistance, the incentives created to hold out for compensation (which would actually slow adjustment) and the signal that it sends to other firms and workers to seek similarly favourable deals.

Special adjustment assistance to compensate individuals or firms for microeconomic reform might also raise equity concerns. Such assistance treats people coping with adjustment problems due to structural reforms in a more favourable manner than those coping with other types of adjustment pressures, even though their needs may be comparable. It is difficult to argue that workers who lose their jobs in the automotive industry due to tariff reductions should be compensated when compensation is not paid to retail workers who lose their jobs as a result of an unfavourable business cycle.

Moreover, the task of identifying individuals and groups adversely affected by reform can be informationally demanding and administratively complex, and runs the risk of duplicating existing general welfare measures. Not the least of the difficulties is how to take account of the fact that losers from one reform may be winners from other reforms. Such factors militate against successful compensation.

Where governments choose to provide targeted adjustment assistance, several principles can be observed in order to achieve the greatest benefit and minimise the costs to the community:

- Measures should facilitate adjustment rather than resistance to change — protecting yesterday's jobs means lower living standards for Australians as a whole and, where the forces for change are powerful, may be futile.
- Measures should be targeted to particular areas or groups where adjustment pressures are being felt — industry-wide measures such as tariffs are typically blunt, ineffective and costly.
- Measures should be limited in time and expenditure. They should also be transparent, simple to administer, easy for participants to understand and avoid distortions which advantage some firms over others in the industry.

Conclusion

There is a danger that community concerns about the effects of change and a desire for greater stability and security could derail many reforms which are to the overall benefit of the Australian community.

While resistance to change is understandable, the real consequence of slowing or stopping reform would be a gradual decline in the relative living standards of Australians. There would be lower growth in per capita incomes and a reduced capacity to fund social expenditures on health and education and to care for those most in need.

Ultimately, it is only by being more productive and competitive that Australians can achieve real security in their workplaces and regions. Like other countries, Australia faces continuous change and must continue to adapt if living standards are to improve. Maintaining the microeconomic reform process is of central importance if the economy is to have the flexibility and resilience to perform to its potential.

If beneficial reforms are to proceed, there must be a wider community understanding of what is at stake. That requires a capacity to bring into account publicly the costs as well as the benefits of different reform initiatives — not just for particular groups, but also across the community and the economy. This highlights the importance of processes and institutions which can generate the best possible information for governments on which to base policy choices and explain the basis for those choices to the community.