

**QUEENSLAND GOVERNMENT  
SUBMISSION TO THE  
PRODUCTIVITY COMMISSION  
REVIEW OF NATIONAL  
COMPETITION POLICY  
ARRANGEMENTS**

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**Queensland Government**  
Treasury

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## ABBREVIATIONS

|      |  |
|------|--|
| ATC  | Australian Transport Council                           |
| BRRU | Business Regulation Review Unit                        |
| CoAG | Council of Australian Governments                      |
| CPA  | Competition Principles Agreement                       |
| CSO  | Community Service Obligation                           |
| EMTR | Effective Marginal Tax Rate                            |
| GSP  | Gross State Product                                    |
| MCE  | Ministerial Council on Energy                          |
| NCC  | National Competition Council                           |
| NCP  | National Competition Policy                            |
| NTC  | National Transport Commission                          |
| NWI  | National Water Initiative                              |
| OECD | Organisation for Economic Co-operation and Development |
| PC   | Productivity Commission                                |
| QCA  | Queensland Competition Authority                       |
| RIS  | Regulatory Impact Statement                            |
| SBA  | Significant Business Activity                          |

# Executive Summary

## Background

- ❑ On 23 April 2004 the Federal Treasurer commissioned a review by the PC into NCP Arrangements to inform the review of NCP agreed by CoAG in November 2000. In summary, the PC has been asked to:
  - report on the impact of NCP and related reforms to date on the Australian economy and community; and
  - identify areas offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition.

## Current NCP Arrangements

- ❑ While Queensland is committed to meeting its obligations under the 1995 NCP agreements, it is also committed to ensuring the reforms contained therein are implemented in as fair a manner as possible consistent with those obligations;
- ❑ Queensland has adopted a considered and pragmatic approach based on the view that NCP reforms will only be implemented where such reforms are clearly in the public interest;
- ❑ Queensland has placed a specific emphasis on the conduct of public benefit tests prior to introducing reform and on the Government's ultimate right to decide what is in the public interest;

## Progress to Date

- ❑ From Queensland's perspective, implementation of the 1995 NCP reform program is now complete, except for a small number of outstanding matters where action is being taken to meet the State's obligations. Programs have also been put in place to satisfy any ongoing obligations;
- ❑ The NCP reforms to energy markets have been essentially completed. The future electricity reform program has been negotiated through the Ministerial Council on Energy and endorsed by CoAG. A similar process is being followed for gas. Queensland's decisions to defer the introduction of full retail competition for electricity and gas are subject to further reviews of the costs and benefits to the community;
- ❑ The bulk of NCP reforms for the water sector have been completed. A few outstanding matters will be finalised before the NCC's 2005 assessment. Commitments are in place to complete any remaining matters in accordance with workable timetables, and from 2005, these will be dealt with under National Water Initiative arrangements;
- ❑ The road transport reforms outlined in the 1995 NCP agreements in relation to vehicle operation and registration and driver licensing have been completed;
- ❑ All the legislation identified in Queensland's 1996 legislation review schedule has been reviewed – with the exception of those pieces of legislation: which were reformed or repealed without review; or where further investigation found there were no or insignificant restrictions on competition. The implementation of reforms arising from the reviews is yet to be completed in a small number of instances, but these are expected to occur in 2004;
- ❑ Queensland has met its competitive neutrality obligations under the CPA in line with the policy application statement published in 1996. The QCA was established in 1997 with statutory responsibility for investigating complaints of breaches of competitive neutrality principles against 29 State Government and 31 Local Government SBAs;
- ❑ The great bulk of the benefits from competitive neutrality reform were achieved early in the reform process;
- ❑ Queensland has met its obligations under the CPA in relation to third party access by providing the QCA with the necessary power to regulate State-based access regimes in Queensland;
- ❑ Queensland has met its prices oversight obligations under the CPA by establishing the QCA and giving it an independent prices oversight role in relation to the pricing practices of government monopoly business activities. In Queensland, prices oversight applies to: State and local

government activities that have been declared Government Monopoly Business Activities; and private sector water suppliers;

- ❑ The local government sector in Queensland is responsible for a range of important services which are State responsibilities in other jurisdictions, the most notable being water and sewerage services. The level of reform achieved by Queensland local governments has been impressive;

#### **NCP Legal and Institutional Framework**

- ❑ To preserve flexibility and individual governments' autonomy, any new microeconomic reform program should continue to be based on intergovernmental agreements, not "black letter" law;
- ❑ Under any extended or new arrangements, CoAG (or an enhanced equivalent) should be the prime driver (through Ministerial Councils where appropriate) and the rightful role of individual governments in setting and implementing policy should be fully recognised. Appropriate governance arrangements will need to be negotiated as part of any new reform agenda package;

#### ***Competition Payments***

- ❑ The agreement between the Commonwealth and the States and Territories on competition payments recognised that, although the States and Territories are responsible for implementing the bulk of NCP-related reforms, much of the direct financial return accrues to the Commonwealth via increases in taxation revenue that flow from greater economic activity. The benefits of the reforms are enduring as are the costs to States and Territories. On this basis, the existing competition payments should continue in their current form;
- ❑ Existing competition payments beyond 2005-06 should remain untied as before; as should any additional competition payments. Competition payments should not be tied to the provision of structural adjustment payments to specific sectors or any other specific program;
- ❑ Any additional future reforms should be accompanied by additional competition payments;
- ❑ Structural adjustment issues should be considered and funded separately on a case by case basis, focussing primarily on targeted assistance from the Commonwealth;

#### **NCP's Underlying Objectives**

- ❑ While NCP's underlying objectives remain appropriate, there is a need to expand any new reform agenda to include other drivers of efficiency and growth -- productivity growth as a source of sustainable economic growth in particular;
- ❑ Higher population and employment growth rates in Queensland overall, and South East Queensland in particular, will require higher rates of capital investment than in most other jurisdictions. Therefore, any new competition policy arrangements should include removing the impediments to adequate and efficient infrastructure provision and investment in services, including education, training, health and transport services;
- ❑ Queensland also believes more attention should be given to the consumers' role in enhancing competition;

#### **Maximum Gain**

- ❑ Any new reform agenda needs to concentrate on sectors and activities where meaningful gains can be achieved – that is, where research has provided clear evidence:
  - that reform would be likely to provide significant net benefit to the community as a whole and not just particular special interest groups; and
  - of how that benefit would be achieved in practice.
- ❑ Individual reforms should not be undertaken unless it can be clearly demonstrated they are in the public interest. More recognition should be taken of the implications for communities, particularly rural and regional communities. States and Territories should be free to determine their own reform agendas within an agreed overall framework and each Government should have the ultimate right to decide what is in the public interest;

### ***Competitive Neutrality***

- ❑ As under the 1995 NCP agreements, any new competitive neutrality reform agenda should provide for jurisdictions to be free to determine their own reform agenda within an agreed overall framework. Any decision to extend the application of competitive neutrality reforms should be one for individual governments.
- ❑ Privatisation and contracting out/compulsory competitive tendering are valid reform options but their application should not be mandated or assigned preferential status in any way. Care should be taken in comparing rates of return to ensure like is compared to like;
- ❑ The payment of Community Service Obligations (CSOs) should continue to be at the discretion of individual governments, while meeting basic transparency and funding principles;

### **Legislation Review**

- ❑ The legislation review and reform program should not be extended beyond the initial legislation review schedule to include other areas as canvassed by the PC. Any ongoing legislation review program should be limited to the 10 year review program and the “gatekeeping” arrangements for new legislation which form part of the existing NCP agenda.
- ❑ Queensland has established processes for ensuring rigorous analysis of new legislation that restricts competition and does not support there is a need to establish a separate regulatory impact assessment body to demonstrate compliance with CPA clause 5;

### **Water Reform**

- ❑ Future water reform will be undertaken in accordance with the National Water Initiative;

### **Transport**

- ❑ Extending NCP to cover road and other transport reforms as proposed by the PC – through modified charging regimes for road users to encourage more efficient road usage, funding alternatives for infrastructure investment and maintenance that could provide the community with better value for the funds expended, and promoting more effective competition between road and rail transport to facilitate a more efficient mix of transport services – would appear to have merit. However, before any reform agenda can be developed, an essential first step would be to commission reviews to assess the various options to determine the most appropriate areas for possible implementation;

### **Drivers of Growth and the Role of Microeconomic Reform**

- ❑ Any new reform agenda needs to include consideration of other key drivers of economic growth — productivity and participation — as well as NCP-type reforms;
- ❑ The importance of infrastructure provision, innovation, education and training to increasing real per capita incomes also needs to be recognised;
- ❑ Reform of the taxation and social security systems is needed to: reduce the high effective marginal tax rates and replacement ratios; remove the greater disincentive to labour force participation in regions and States with lower wage levels; and address remaining impediments to investment in innovation;

### **Competition-related Reforms outside the Current NCP**

- ❑ The Queensland Government acknowledges the value of competition or market-based initiatives in promoting environmental goals and delivering social services, but would be opposed to such mechanisms being mandated in any way. Decisions on their adoption need to be taken on a case by case basis and made by governments in light of their individual circumstances;

### **Commonwealth Reforms**

- ❑ Any new NCP arrangements should include some effective mechanism to ensure the Commonwealth Government also meets its NCP reform obligations, particularly in relation to legislation review and reform; and
- ❑ Queensland is concerned that the failure of current arrangements to deliver appropriate telecommunications access for regional and provincial areas is inhibiting the development of competitive businesses and productivity growth in these areas.

## 1. Introduction

On 23 April 2004 the Federal Treasurer commissioned an inquiry by the Productivity Commission (PC) into National Competition Policy (NCP) Arrangements. In summary, the PC has been asked to:

- report on the impact of NCP and related reforms to date on the Australian economy and community; and
- identify areas offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition.

In November 2000, the Council of Australian Governments (CoAG) agreed to a further review of NCP arrangements by September 2005. One of the purposes of the PC inquiry is to inform the CoAG review.

## 2. Current NCP Arrangements

While Queensland is committed to meeting its obligations under the 1995 NCP agreements, it is also committed to ensuring the reforms contained therein are implemented in as fair a manner as possible consistent with those obligations. In particular, the Government recognises that the implementation of NCP-related reforms will at times involve adverse impacts on some sections of the community.

For this reason, Queensland has adopted a considered and pragmatic approach based on the view that NCP reforms will only be implemented where such reforms are clearly in the public interest. Queensland has placed a specific emphasis on the conduct of public benefit tests prior to introducing reform and on the Government's ultimate right to decide what is in the public interest. For example, rather than placing the onus in the legislation review process on the need to defend restrictions on competition, the aim of reviews in Queensland is to ensure that reviews focus on a thorough and meaningful analysis of the benefits and costs of alternative options, which takes full account of employment, regional development, social, consumer and environmental effects. Accordingly, governments have a responsibility to ensure that NCP reforms are only implemented where it is demonstrated that such reforms are clearly in the public interest, that is, there is a clear demonstration that competitive reform will yield a net benefit.<sup>1</sup>

## 3. Opportunities for Further Reform

### 3.1 Unfinished Business

The PC in its Issues Paper makes reference to unfinished business in relation to the NCP program agreed in 1995, referring to the National Competition Council's (NCC) 2003 assessment. From Queensland's perspective, implementation of the 1995 NCP reform program is now complete, except for a small number of outstanding matters where action is

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<sup>1</sup> Queensland Government, "Public Benefit Test Guidelines", Queensland Treasury, August 1999.



being taken to meet the State's obligations. Programs have also been put in place to satisfy any ongoing obligations.

### ***Energy Reforms***

The NCP reforms to energy markets have been essentially completed. The electricity reform program for the immediate future has been negotiated through the Ministerial Council on Energy and endorsed by CoAG (out of session). A similar process is being followed for gas, with its transition into the revised regulatory framework occurring over time. The only outstanding issues relate to the extension of retail competition to smaller commercial and domestic customers. Queensland's decisions to defer the introduction of full retail competition for electricity and gas are subject to further reviews of the costs and benefits to the community.

### ***Water Reforms***

The bulk of NCP reforms for the water sector have been completed, with a few outstanding matters to be finalised, and commitments in place to complete any remaining matters in accordance with workable timetables. Starting in 2005, the water reform program will be implemented through the National Water Initiative (NWI).

### ***Transport***

The road transport reforms which formed part of the 1995 NCP agreements related to vehicle operation and registration and driver licensing. These reforms have been completed. The impact of the major road transport reforms - focussed on competition and on improved national consistency in key areas - has been largely positive, and the process itself has assisted in the hastening of useful reforms. The road transport industry has retained a strong competitive element in much of its operations and there has also been good progress in areas such as innovation, which has boosted productivity.

### ***Legislation Review and Reform***

Since the NCC's 2003 assessment a number of outstanding matters have been addressed so that Queensland's legislation review program is essentially complete. All the legislation identified in the 1996 legislation review schedule has been reviewed – with the exception of those pieces of legislation: which were reformed or repealed without review; or where further investigation found there were no or insignificant restrictions on competition. The implementation of reforms arising from the reviews is yet to be completed in a small number of instances, but these are expected to occur in 2004.

In a number of instances, Queensland has undertaken a robust review and reform process in accordance with its obligations under NCP, but the NCC has assessed the matters as incomplete or as not meeting the State's NCP obligations because it disagrees with the outcome. In some instances, the NCC appears to hold that a lack of competition (eg where monopoly provision of government services is involved) is by itself enough to support an assessment of lack of compliance or completeness.

Queensland has met, or will shortly meet, its review and reform obligations as outlined in the *Competition Principles Agreement* (CPA). The NCC's decision not to accept the outcome of

some individual review and reform exercises does not mean that Queensland has not completed, or will not shortly complete its obligations.

The PC has asked whether aspects of NCP processes (for example, the requirement for separate State and Territory legislation reviews of common issues) have been inefficient and/or contributed to the time taken to complete the agenda. The experience has been mixed in relation to national reviews for example. A number of national review and reform matters are yet to be completed, reflecting the slow process of reaching consensus on the approach to be adopted and eliciting the views of all jurisdictions at various stages of the process. These include the Consumer Credit legislation, the Trade Measurement legislation, the Travel Agents legislation, Trustee Companies legislation and Pharmacy legislation. The finalisation of review and reform of the pharmacy legislation has been further complicated by the intervention of the Prime Minister to overturn the recommendations of the national review.

In practice, the experience to date suggests the scope for national reviews is limited, largely due to the fact that the underlying nature of the restrictions in a particular area may differ significantly from jurisdiction to jurisdiction in response to different market structures and historical responses. Nevertheless, it will always be appropriate to explore the option for a national approach, especially where there are elements of a national market.

### ***Competitive Neutrality***

Queensland has met its obligations under the CPA in line with the policy application statement published in 1996 as required under the CPA. The Queensland Competition Authority (QCA) was established in 1997. It has statutory responsibility for investigating complaints of breaches of competitive neutrality principles against 29 commercialised or corporatised government-owned entities declared as significant business activities (SBAs) under the *Queensland Competition Authority Act 1997* (the QCA Act). Complaints handling procedures, independent of the business activities, have been established within government to investigate complaints against smaller non-SBAs. The reforms are well embedded and the number of substantive complaints has been small.

The QCA also has the statutory responsibility for investigating complaints against the 31 large local government activities defined as SBAs under the *Local Government Act 1993*.

The great bulk of the benefits from competitive neutrality reform were achieved early in the reform process (including prior to the 1995 NCP agreements). For example, local government SBAs, all of which have been subjected to competitive neutrality reform under the *Local Government Act 1993*, account for over 80 percent of annual expenditure by local government business activities. The widespread extension of reforms to medium and smaller activities in response to the \$150 million Local Government Financial Incentive Package covers most of the remaining 20 percent, with further reform already under way. Similarly, most of the benefits from reform of State Government entities were achieved in the corporatisation and commercialisation of State SBAs.

### ***Third Party Access***

Queensland has met its obligations under the CPA in relation to third party access by providing the QCA with the necessary power to regulate state-based access regimes in Queensland.

Access to the services provided by electricity and gas pipeline infrastructure is governed by the respective uniform national access codes for these industries – by way of the *Gas Pipelines Access (Qld) Act 1998* for gas pipelines in Queensland. Access to services provided by other facilities is governed by either Part 5 of the QCA Act or Part IIIA of the *Trade Practices Act 1974*.

The services which have been declared as open to access by third parties under the QCA Act are:

- (a) the rail transportation service provided by the use of Queensland Rail's track infrastructure; and
- (b) the coal loading and unloading services provided by the use of the Dalrymple Bay Coal Terminal.

### ***Prices oversight***

Queensland has met its obligations under the CPA by establishing the QCA and giving it an independent prices oversight role in relation to the pricing practices of government monopoly business activities. In Queensland, prices oversight applies to:

- (a) State and local government business activities which are monopolies or near monopolies that have been declared by the Premier and the Treasurer to be Government Monopoly Business Activities; and
- (b) Private sector water suppliers (including the jointly owned State/local government company SEQWater).

The following activities have been declared to be Government Monopoly Business Activities for the purposes of prices oversight:

- the bulk water storage, water distribution and retail reticulation and drainage activities of SunWater;
- the bulk water storage, water delivery and treatment services and supply of water by Gladstone Area Water Board;
- the bulk water storage and water distribution activities of the Mt. Isa Water Board and the Townsville-Thuringowa Water Supply Board (trading as NQWater); and
- the water and sewerage services provided by the largest eighteen local governments in Queensland (i.e. Brisbane, Gold Coast, Rockhampton, Townsville, Toowoomba, Ipswich, Logan, Caboolture, Cairns, Caloundra, Harvey Bay, Mackay, Maroochy, Noosa, Pine Rivers, Redland, Thuringowa and Bundaberg).

Unfair pricing has not been a significant issue with only a small number of matters having been referred to the QCA for investigation in response to complaints or other matters.

### ***Local Government***

The local government sector in Queensland is responsible for a range of important services which are State responsibilities in other jurisdictions, the most notable being water and sewerage services. Rather than relying on a wholly prescriptive approach, Queensland has used a combination of: legislative requirements and financial incentives for SBAs; and business management training and support and financial incentives for other small to medium business activities. Reform progress has been subject to independent monitoring by the QCA. The level of reform achieved by Queensland local governments under this co-operative approach has been impressive:

- altogether, 573 local government businesses have been assessed by the QCA as applying at least some of the full cost pricing requirements of competitive neutrality. Of these, 465 have adopted all or most of the elements of full cost pricing, including all of the very large council activities defined as SBAs;
- over 90 percent of urban water connections are now subject to consumption-based charging using a two-part tariff; and
- the application of legislation review resulted in over 4000 superseded and anti-competitive local laws being repealed.

### ***NCP Legal and Institutional Framework***

The PC has queried whether the NCP framework agreed in 1995 (its legal underpinnings, processes, institutions and incentive payments) is the most effective way of progressing and extending competition reform and of ‘locking in’ the worthwhile changes that have already been made.

To preserve flexibility and an individual government’s autonomy, any new microeconomic reform program should continue to be based on intergovernmental agreements, not “black letter” law – except where referral of power to the Commonwealth and vice versa is necessary or agreement can be reached between the Commonwealth and all other jurisdictions in a co-operative and not pre-emptive manner.

The existing NCP arrangements do not always recognise the rightful role of individual governments in setting and implementing policy. Under any extended or new arrangements, CoAG (or an enhanced equivalent) should be the prime driver (through Ministerial Councils where appropriate) of any new microeconomic reform agenda. As such, CoAG should be responsible for setting policy directions, the timing of their implementation and the criteria for, and monitoring of, compliance. It follows that it is clearly inappropriate for the Federal Treasurer to continue to be the sole arbiter of performance, especially as the Commonwealth has been assessed by the NCC as setting a poor example for the States and Territories in progress in the review and reform of legislation. The appropriate governance arrangements, including the role of CoAG, Ministerial Councils, the NCC or new entities will need to be negotiated as part of any new reform agenda package.

Given that the 1995 NCP agenda is largely complete and jurisdictions have put processes in place to meet ongoing elements of the 1995 NCP agenda, the workload of the NCC will be significantly reduced after the 2005 assessment – other than its regulatory role in terms of third party access and prices oversight (the NCC's prices oversight role is minimal in practice). Therefore, it is arguable that a case can be made for retaining the NCC, at least in its current form. In the absence of the NCC, consideration will need to be given to the best way of delivering the regulatory services it currently provides in relation to third party access and, to a lesser extent, prices oversight.

### ***Competition Payments***

The agreement between the Commonwealth and the States and Territories on competition payments recognised that, although the States and Territories are responsible for implementing the bulk of NCP-related reforms and incurring a large share of the costs, much of the direct financial return accrues to the Commonwealth Government via increases in taxation revenue that flow from greater economic activity. The *Agreement to Implement the National Competition Policy and Related Reforms* provides for annual payments under the third tranche of competition payments to continue beyond 2005-06, despite the Commonwealth's contention otherwise.

The benefits of the reforms are enduring and irreversible, as are many of the costs to States and Territories. On this basis, the existing competition payments should continue in their current form. Queensland cannot stress this point too strongly. The payments were crucial to reaching agreement on the introduction of NCP and they remain crucial if States and Territories are to continue with the current arrangements.

Competition payments beyond 2005-06 should remain untied as before; as should any additional competition payments. Competition payments should not be tied to the provision of structural adjustment payments to specific sectors or any other specific program. This is not the purpose for which they were intended.

Any additional future reforms should be accompanied by additional competition payments commensurate with the impact of the reforms on States and Territories and the benefits accruing to the Commonwealth.

### ***Adjustment Issues***

Any new or expanded reform agenda should not include an automatic right of compensation for those allegedly affected by the implementation of reforms. Structural adjustment issues should be considered and funded separately on a case by case basis, focussing primarily on targeted assistance from the Commonwealth. Current or additional competition payments to States and Territories should not be tied to structural adjustment payments.

### ***NCP's Underlying Objectives***

The underlying objectives of the competition reform package were to enhance the national economic interest by improving Australia's international competitiveness as well as enhancing the interests of Australian consumers. Consumers would benefit from lower prices for government services as a result of the implementation of the package over time.

While these objectives remain appropriate, there is a need to expand any new reform agenda to include other drivers of efficiency and growth. In particular, there is a need to drive productivity growth as a source of sustainable economic growth. Detailed research carried out by the Queensland Government,<sup>2</sup> has found that the key drivers of productivity growth across the labour force and industry are:

- *capital deepening* – providing workers and firms with access to greater amounts of investment and high quality capital infrastructure;
- *efficiency improvements* – making better use of existing resources given existing technology; and
- *technological progress* – driven by innovation and improvements in human capital.

The higher population and employment growth rates in Queensland overall, and South East Queensland in particular, will require higher rates of capital investment than in most other jurisdictions. Therefore, any new competition policy arrangements should include removing the impediments to adequate and efficient infrastructure provision and investment in services, including education, training, health and transport services. More detail on this issue is provided in 3.3 below.

An example of an impediment to efficient infrastructure investment is the lack of recognition by the Commonwealth of the adverse impact on investment of the proposed taxation treatment of leases. Identified problems include:

- the tax exempt leasing changes could limit the scope for private sector infrastructure provision in the form of Build-Own-Operate or Build-Own-Operate-Transfer schemes, public/private partnerships and the like by disallowing the private sector entitlement to claim a tax deduction;
- the changes may put Government Owned Corporations (GOCs) at an unfair disadvantage to their private sector counterparts by taxing service contracts and leasing arrangements involving GOCs in a different manner from private sector companies; and
- the proposal to exclude operating leases from being “routine” leases for tax purposes could eliminate the operating lease market for high cost equipment.

This is just one example. There will be others which emerge on closer examination.

In addition to moving towards a greater emphasis on reducing the impediments to efficient infrastructure investment and away from, but not abandoning, the past focus on freeing up markets, Queensland also believes more attention should be given to the consumers’ role in enhancing competition. In the past, most attention has been on the behaviour of firms and there has been an assumption that consumers will react to product and price changes in a simple manner. However, there is ample evidence that in some markets this is not the case (e.g. choice in superannuation provider), and that the expected benefits of providing greater choice do not always materialise. Queensland suggests that any new competition policy agenda should pay greater attention to the role of consumers in improving competitiveness. While the current policy does provide for consideration of non-price/quality issues, in

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<sup>2</sup> Queensland Government, “Drivers of Economic Growth in the Smart State”, Queensland Treasury, August 2003.

practice other issues are not always dealt with adequately. For example, any new or revised agenda should afford more attention to the role of transaction costs, trustworthiness, product safety, certainty, consumer protection, transaction size, repeat purchases, low incentives for reputable behaviour and the effectiveness of redress measures.

### **3.2 Extending Existing NCP Reform**

Without prejudging the results of any negotiations as to the need for and scope of any future NCP arrangements, there are a number of overall conditions which should apply irrespective of the nature of such arrangements.

#### ***Maximum Gain***

Any new reform agenda needs to concentrate on sectors and activities where meaningful gains can be achieved. New areas should not be targeted just because they may not have been examined to date. The PC should only make proposals in relation to specific new areas for consideration if it can provide clear evidence:

- that reform would be likely to provide significant net benefit to the community as a whole and not just particular special interest groups; and
- of how that benefit would be achieved in practice.

Similarly, care should be taken not to propose new areas for reform that have the effect of providing support for the Commonwealth Government to impose policy solutions in areas where its view differs from States and Territories or it does not have Constitutional authority. While such areas may benefit from reform, their inclusion and the manner of their consideration should be agreed between jurisdictions in a co-operative way, not imposed unilaterally. They also should not be included without a valid case first being made of the net benefits of reform (see below).

#### ***Public Benefit***

The principle that reforms should be assessed as providing a net public benefit before any decision is taken to implement such reforms should be paramount. Care should be taken to avoid any tendency for competition to be introduced for its own sake. In this respect, public benefit assessments should be couched in terms of restrictions on competition being retained unless their removal is clearly in the public interest.

When considering the likely impact of reforms, more recognition should be taken of the implications for communities, particularly rural and regional communities. This is of particular importance to Queensland with its relatively decentralised population distribution.

Any future reform agenda needs to recognise that States and Territories should be free to determine their own reform agenda within an agreed overall framework and that it is each Government's ultimate right to decide what is in the public interest. Decisions about methods of service delivery are for individual governments to make in light of individual circumstances, particularly in the delivery of social and environmental services.

### ***Competitive Neutrality***

As under the 1995 NCP agreements, any new competitive neutrality reform agenda should provide for States and Territories to be free to determine their own reform agenda within an agreed overall framework. Any decision to extend the application of competitive neutrality reforms should be one for individual governments.

As currently applies, privatisation and contracting out/compulsory competitive tendering are valid reform options but their application should not be mandated or assigned preferential status in any way under any new arrangements. Queensland does not believe a clear case has been made that private ownership *per se* is always more efficient or should be preferred. The key issue is the level of competition, where this is feasible, and that the competition be fair and transparent. The PC has suggested, based on data it has collected, that government-owned enterprises have a tendency to achieve lower rates of return than their private sector counterparts and has sought Governments' responses to this suggestion. Queensland would like to make three points in response.

Firstly, the underlying aim of competitive neutrality reform is not only to improve the financial performance but to foster a cultural change in Government-owned entities towards improved and more efficient service delivery. Secondly, the emphasis needs to be on the medium to long term performance, with the key requirement being that the entities show evidence of progress. Thirdly, it is important that the comparison is fair, that is, like is compared with like. In particular, many government-owned enterprises are required to provide services to all areas of their States and Territories, including higher cost areas, and are often required to be the provider of last resort and may not have the option available to their competitors of withdrawing from less profitable areas.

The payment of Community Service Obligations (CSOs) is an important tool in ensuring commercialised government enterprises are not disadvantaged by having to provide services designed to meet social or other non-commercial objectives. The delivery of CSOs should continue to be at the discretion of individual governments, while meeting basic transparency and funding principles.

### ***Legislation Review***

In general, the legislation review and reform program should not be extended beyond the coverage of the initial legislation review schedule to include other areas as canvassed by the PC in its Issues Paper, such as areas reviewed immediately prior to the introduction of NCP, those with built-in review mechanisms or those impacting on business but not restricting competition:

- the exclusion of areas reviewed immediately prior to NCP was based in part on the fact of their recent review, but was also based on the specific objectives of the legislation. The areas covered by the examples cited by the PC are matters for individual governments to consider in light of their own circumstances;
- the inclusion of legislation with in-built review mechanisms would duplicate effort unnecessarily. Queensland already gives due recognition to competition issues when legislation is reviewed under in-built requirements. For example, the Queensland Fisheries legislation provides for a comprehensive policy justification and consultation



process when changes are proposed to fisheries management instruments (e.g. fisheries management plans, Regulations, Codes etc). This includes the preparation of Regulatory Impact Statements and/or Public Benefit Tests where appropriate; and

- in terms of legislation which impacts on business but does not explicitly restrict competition, some of the legislation examples cited by the PC in its Issues Paper (p.10) have already been subject to review in Queensland, most notably, a wide range of legislation regulating both the education and health areas. They will be subject to further review as part of the 10 year review program.

Any ongoing legislation review program should be limited to the 10 year review program and “gatekeeping” arrangements for new legislation which form part of the existing NCP agenda.

The 10 year review program should be confined to a robust re-examination of the restrictions identified and retained during the initial review and reform program (and any new restrictions added subsequently). When Queensland examined all its legislation to identify potential legislative restrictions on competition as part of the process of establishing its 1996 review schedule, Departments were advised to include all provisions which might conceivably restrict competition. Because of the lack of previous experience in these matters and the associated uncertainty, the basic principle was, if in doubt, include the provision in the list of potentially restrictive provisions. As a result, the review schedule contained legislation which subsequently was found not to contain restrictions on competition or legislation containing purely technical restrictions (e.g. *Sale of Goods Act 1896*, *Funeral Benefit Business Act 1982*). Therefore, there would be value in filtering the legislation subject to the 10 year review program to exclude such legislation.

While jurisdictions would continue with programs to review their legislation on a regular basis for relevance and efficiency, jurisdictions may need to reconsider their commitment to the ongoing NCP legislation review program if the accompanying competition payments are not continued in their current form in recognition of the ongoing nature of the impacts and benefits.

Queensland’s gatekeeping arrangements for new legislation comply fully with the State’s NCP obligations under Clause 5(5) of the CPA. Under the Queensland Government’s gatekeeping arrangements, all new (including amending) legislation that restricts competition must be subjected to a public benefit test prior to its consideration by Cabinet. The type and scope of each review is determined in accordance with the Queensland Government’s *Public Benefit Test Guidelines* issued by Queensland Treasury, which also monitors compliance.

In addition to the NCP gatekeeping requirements for all new primary and subordinate legislation, under the *Statutory Instruments Act 1992*, any proposed subordinate legislation which is likely to impose appreciable costs on the community or a part of the community must have a Regulatory Impact Statement (RIS) prepared before the legislation is made. The Act includes guidelines on what must be included in an RIS. The section of the Act relating to the conduct of RIS is administered by the Business Regulation Review Unit (BRRU) within the Department of State Development, which also provides more detailed guidelines and advice on the preparation of RIS.

Queensland has established processes for ensuring rigorous analysis of new legislation that restricts competition and does not support there is a need to establish a separate regulatory

impact assessment body to demonstrate compliance with CPA clause 5 as proposed by the NCC.

Concern has been expressed about the potential for some of the reforms flowing from the legislation review and reform program (and other NCP-related matters) to be unwound over time. Queensland does not believe this to be a significant problem, as any changes required to accomplish this will need to be examined as part of the 10 year review program and/or “gatekeeping” arrangements, and the Government will need to be satisfied the changes are in the public interest.

Rather than wait for the 10 year review, it has also been suggested that it may be appropriate to bring forward (e.g. to 5 years) the further review of matters assessed by the NCC as not meeting a jurisdiction’s CPA clause 5 obligations. Queensland does not support such a blanket proposal — reviews should only be brought forward where it is obvious there has been a material change in the market circumstances since the initial review.

### ***Insurance***

The appropriate treatment of insurance issues has been raised in relation to a number of scheduled legislation review matters. The issue has presented a number of difficulties for jurisdictions in terms of the ready availability of appropriate cover and cost, particularly where mandatory insurance is desirable and ‘long tail’ claims are prevalent. It has not always been possible to assume that the open market will provide reasonable cover in such circumstances. Queensland has argued these matters should be taken into account when assessing review and reform outcomes. The same should apply where such circumstances apply in the future.

### ***Energy***

The electricity reform program for the immediate future has been negotiated through the Ministerial Council on Energy (MCE) and endorsed by CoAG (out of session) with this framework to be extended to gas over time. Queensland supports this co-operative approach and the MCE’s ongoing role of providing national oversight and co-ordination of energy policy development. Any future consideration of NCP-related reforms on energy should recognise the MCE’s leadership role on this issue, endorsed by CoAG.

### ***Water***

Starting in 2005, the water reform program will be implemented through the National Water Initiative (NWI). Therefore, there is no need for water reform to form part of any new NCP-related reform agreement.

### ***Transport***

As outlined earlier, the road transport reforms which formed part of the 1995 NCP agreements have been completed. A substantial number of other reforms have been successfully developed and implemented nationally, with the involvement of the National Road Transport Commission (now the National Transport Commission (NTC)), State and Commonwealth agencies, and industry etc, and through other transport government organisations such as the National Transport Secretariat (for the Australian Transport Council (ATC)).

The national Third Heavy Vehicle Reform Package, now in progress under the NTC, includes some reforms which could significantly improve productivity and efficiency in the road transport industry, including:

- Heavy Vehicle Driver Fatigue Regulatory Review (more flexible working hours);
- Performance Based Standards initiatives (innovative vehicles, enhanced productivity); and
- Compliance and Enforcement reforms (ensure a level playing field within the road transport industry, extend the 'chain of responsibility' approach).

These reforms have involved scrutiny of past regulation systems, and other options, and have a focus on providing a less prescriptive regulatory approach, backed by clarifications of the responsibilities of participants, and by accreditation systems (but retaining some elements of traditional compliance systems for areas of the industry with poor performance records).

For rail, the effects of reforms to date have tended to be positive, with some enhancement in competition / involvement in relevant areas. However the process appears to have been less successful overall than for road (for both freight and passengers).

There may be merit in a closer examination of how to combine the beneficial effects of competition for provision of rail functions with issues of 'natural monopoly' in some areas, as well as to the inclusion of non-monetary benefits and costs, and investment issues - in order to understand the best approaches in the public interest. This could be considered as a possible area for further research and enquiry.

Extending NCP to cover road and other transport reforms as proposed by the PC Issues Paper (p.10) – through modified charging regimes for road users to encourage more efficient road usage, funding alternatives for infrastructure investment and maintenance that could provide the community with better value for the funds expended, and promoting more effective competition between road and rail transport to facilitate a more efficient mix of transport services – would appear to have merit:

- *Modified Road User Charging Regimes* – A key first step in developing appropriate reform in this area would be a major public review of land transport pricing, conducted by the PC or other suitable agency – that is, a study and review of the major future options for land transport charging for road and rail. This would assess the types of charging systems available (e.g. fixed charges, access, capital charges or tolls, fuel-distance/load based charging, charging for service quality as an option etc), the 'full-costs' dimension (non-monetised benefits and costs may be needed for competitive neutrality in land transport), and allied investment issues and links.

Due to the local specifics that are important in some aspects of land transport pricing, it might not be appropriate to develop a single pricing system for all areas of Australia. However a set of land transport pricing guidelines could be developed that would provide for nationally consistent principles/criteria, which could also address state and localised realities. Ultimately this might be agreed to nationally. The outcome of such work could also be useful for major governments as they consider decisions, by:

- raising the understanding of the nature of a more consistent charging system for road and rail; and/or
  - providing authoritative advice on the economically efficient as well as the socially acceptable and practicable paths to improved systems in future.
- *Alternatives for Infrastructure Investment and Maintenance* – Exploration and development of workable funding alternatives would appear to offer some potential for further gains to the Australian economy. As with road use charges, an essential first step would be a review by a suitable agency of the range, efficiency and effectiveness of various funding alternatives. This would include attention to competitiveness and competition issues, as well to an assessment of the differences between the current management systems between road and rail in Australia (including aspects of infrastructure planning and provision, funding and investment, services provision and access and operational management). A key outcome would be recommendations to governments on options for improvement.

On 7 June 2004, the Australian Government released a White Paper titled "*AusLink – Building our National Transport Future*". While the paper signals fundamental changes to long-standing Commonwealth funding responsibilities under *AusLink*, allocated funding under the program is very limited. In 2004-05 Queensland will receive \$415.3 million which is only \$22 million more than it received for national highways and Roads of National Importance in 2003-04, and a reduction of \$50m in 2005-06. With one fifth of Australia's rail network, Queensland will only receive approximately 0.5% of the available funding for rail.

The *AusLink* proposal effectively provides the Australian Government with greater control over infrastructure planning and enhances its ability to dictate policy to the State, while at the same time shifting more of the financial responsibility onto States and Territories. The *AusLink* strategy has provided little new funding for Queensland and, with the Australian Government suggesting it will expect State contributions for previously federally funded roads, will significantly disadvantage Queensland road users. While Queensland supports a nationally focussed, integrated land transport network strategy for Australia, the strategies outlined in the *AusLink* White Paper lack detail and do not address key issues such as the poor condition of the national highway system within Queensland and the structural issues in relation to road/rail investment. Satisfactorily addressing these issues is fundamental to improving and maintaining productivity growth in rural and regional communities in Queensland and elsewhere.

As with other 'related reforms', any new transport reform initiatives should be progressed through CoAG using the relevant Ministerial Council or other relevant mechanisms.

### 3.3 Drivers of Growth and the Role of Microeconomic Reform

Microeconomic reform, by increasing productivity growth, aims to deliver improved outcomes for the community through improvements in real incomes and living standards. Its success over the 1990s in helping to increase Australia's productivity performance has been ascribed to:

- sharper competition which has increased incentives for business to improve productivity to reduce costs;
- increasing openness to trade, investment and technology; and
- removing unnecessary regulations, which impede flexibility and responsiveness of business to changes in demand and consumer preferences.<sup>3</sup>

However, microeconomic reform, while important, is not the only driver of productivity growth in an economy.<sup>4</sup> For example, in commenting on the link between the microeconomic reforms of the 1980s and 1990s and Australia's productivity performance, the PC has acknowledged that human capital and innovation will be critical in sustaining productivity growth:

“our ability to continue performing well will increasingly depend on the innovativeness and analytical skills of people in the workforce and management alike. That in turn will largely depend on the quality and effectiveness of our education, training and research systems”.<sup>5</sup>

Real incomes can also be increased by increasing participation in the economy (total hours worked), mainly through rises in the labour force participation rate, but also through falls in the unemployment rate or increases in average hours worked per employed person.

Accordingly, a coherent approach to delivering sustainable improvements in real incomes requires a focus on the key drivers of economic growth — productivity and participation — as well as NCP-type reforms.

Strategies to raise productivity and participation have also been identified by the Australian Government<sup>6</sup> as integral to that Government's preferred solution to potential fiscal pressures associated with the increasing average age of Australia's population.

#### ***Productivity***

Compared to other OECD countries, Australia's participation rate and labour productivity are below many of our competitors (see Appendix 1, Figure 1) – for example, Australia's participation rate and productivity are respectively nearly 10 percent and 30 percent below that of Norway (a high participation rate/productivity country). While participation is

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<sup>3</sup> Parham, D., *Microeconomic reforms and the revival in Australia's growth in productivity and living standards*, paper presented to the Conference of Economists, Adelaide, 1 October 2002

<sup>4</sup> While microeconomic reform can facilitate increases in productivity growth as inefficiencies are eliminated, it cannot sustain improvements in economic growth - Foster (2003).

<sup>5</sup> Banks, G., 'Complacency the enemy in maintaining the Miracle', *The Australian*, 18 February 2002.

<sup>6</sup> Australian Government (2004), *Australia's Demographic Challenges*.

important, this suggests that, in Australia, the opportunity for greatest gains could come through improvements in productivity.<sup>7</sup>

This is reinforced by the results of a 2003 research project which highlighted the importance of productivity in explaining differences in real income growth across Australian States, and the important role that infrastructure and research and development have played in explaining interstate trends in productivity growth.<sup>8</sup> In summary, the project found that interstate differences in productivity growth were the most important factor in explaining differences in real income growth across the States over the past decade and a half. States that recorded the fastest average annual growth in real output per capita over 1985-86 to 2000-01, such as Western Australia and Queensland, also recorded the strongest productivity growth, whereas increases in the labour force participation rate were a relatively small contributor to growth in real incomes across the States (see Appendix 1, Table 1).

### ***Infrastructure***

The research results also stress the importance of infrastructure provision to productivity in a strong population growth State, such as Queensland. The project found that, despite similar rates of investment to the rest of Australia in the early part (late 1980s-early 1990s) of the period examined, the population boom in Queensland meant that it recorded little capital deepening (increases in the capital to labour ratio) relative to other States over this period, dragging Queensland's rate of labour productivity growth below other States over this period.

This finding underlines the importance of policy settings that encourage private sector investment in States such as Queensland, which will continue to record stronger migration and population growth relative compared to other States over coming decades.

### ***Innovation***

The research also found that innovation activity could explain a large amount of the variation in productivity growth across States over the past decade and a half, with faster productivity growth in Queensland and Western Australia due to contributions from growth in domestic business research and development of around twice that of other States.

This finding highlights the importance of policies that raise research and development activity in lower income States. For instance, in Queensland's case, faster *growth* in business research and development has partly reflected a 'catch-up' effect, where the *level* of research and development relative to the size of the economy is slowly converging on, but remains below, that of higher income economies.

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<sup>7</sup> This is not to say that improving participation is not important, as removing impediments to labour force participation (caused by taxation/social security arrangements, inadequate skills, poor health) is a crucial part of any strategy to raise real incomes. Raising participation also becomes important in a distributional sense, as it widens the share of the population who earn income and reduces the number of people who require some form of income support.

<sup>8</sup> *Productivity and Regional Economic Performance in Australia (2003)* – the report of a collaborative research project between Queensland Treasury, the University of Queensland and Griffith University. The project aimed to identify the factors that have driven Queensland's stronger economic growth performance relative to the rest of Australia, and to identify factors that will drive Queensland's economic growth in the future.

Factors that influence innovation include:

- incentives facing potential innovations, such as returns from innovation (which are influenced by tax and intellectual property arrangements), the costs of implementing innovation, and the competitive environment driving innovation in organisations; and
- the institutional capacity of the innovation system, including the availability of infrastructure, skills and opportunities for collaboration between researchers, financiers and entrepreneurs.

## **Human Capital**

Human capital represents the stock of knowledge, skills and attributes available in the workforce. Increases in human capital are an important driver of better employment outcomes, productivity growth and higher living standards. Human capital influences productivity growth through its effect on innovation as it is skills, both creative and analytical, that determine the rate at which an economy can create better products or absorb and improve technology.

This is supported by the results of the research project cited above which found, for example, that differences in human capital, as measured by education completion rates, explained 87% of the difference in Gross State Product (GSP) per capita between Queensland and New South Wales. Using 1996 Census data, the research found that Queensland could have gained an additional \$14.7 billion in GSP or about \$5,652 per capita, if it equalised its human capital stocks with New South Wales.

Human capital can be increased by formal education and training, informal training (including work and life experience), increased participation in the labour force and through immigration. Similarly, human capital can be reduced through long spells of unemployment (leading to skills atrophy), withdrawal from the labour force and the emigration of people with higher order skills.

Recognising the importance of investment in innovation and human capital to economic growth, measures to address current disincentives for labour force participation and investment in innovation also need to be considered.

The taxation system is one area identified for reform to:

- reduce the high effective marginal tax rates (EMTRs) that flow from the combined effect of increasing marginal tax rates and the withdrawal of social security benefits, particularly for lower income earners who are most adversely affected;
- address high replacement ratios<sup>9</sup>;
- remove the greater disincentive to labour force participation in regions and States with lower wage levels (because of higher EMTRs and replacement ratios); and
- review the impact of tax arrangements (such as the research and development tax concession) on investment in research and development.

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<sup>9</sup> Replacement ratios measure the value of after-tax real income received from unemployment and other social security benefits expressed as a ratio of the after-tax income that could be received from gaining employment

More detail in relation to these matters is contained in the Queensland Government's Submissions to the Senate Economics References Committee Inquiry into the Structure and Distributive Effects of the Australian Taxation System and Review of Business Taxation (1999).

### **3.4 Competition-related Reforms outside the Current NCP**

The PC Issues Paper (page 11) canvasses the use of competition or market-based initiatives in promoting environmental goals and delivering social services. The Queensland Government acknowledges the value of such mechanisms in many circumstances, but would be opposed to such mechanisms being mandated in any way under any new arrangements. Decisions on their adoption need to be taken on a case by case basis and made by governments in light of their individual circumstances.

Much of the debate in relation to the delivery of social services, and the growth areas of health and education in particular, has centred on the roles and responsibilities of potential service providers. Queensland believes there is value in exploring this issue further, but the focus should be on jurisdictions' roles and responsibilities, not public sector versus private sector service provision.

## **4. Commonwealth Reforms**

Any new NCP arrangements should include some effective mechanism to ensure the Commonwealth Government improves its poor performance (as assessed by the NCC) in delivering on its reform obligations, particularly in relation to legislation review and reform.

Another area which falls under the Commonwealth Government's responsibility where potential reform could significantly enhance productivity, is telecommunications. Queensland is particularly concerned that the failure of current arrangements to deliver appropriate telecommunications access for regional and provincial areas is inhibiting the development of competitive businesses and productivity growth in these areas.

Unlike sectors such as energy, water and transport which have been subject to significant reform under NCP and other policy initiatives, there has been no rigorous investigation or implementation of structural reform in relation to the telecommunications sector. In particular, the low level of competition in many areas means the incentives to improve service delivery and increase efficiency are also low. A first step in addressing these issues would be to examine the role of Telstra in terms of whether or not it is focussed on meeting market needs in these areas or on maximising the returns on its monopoly assets.

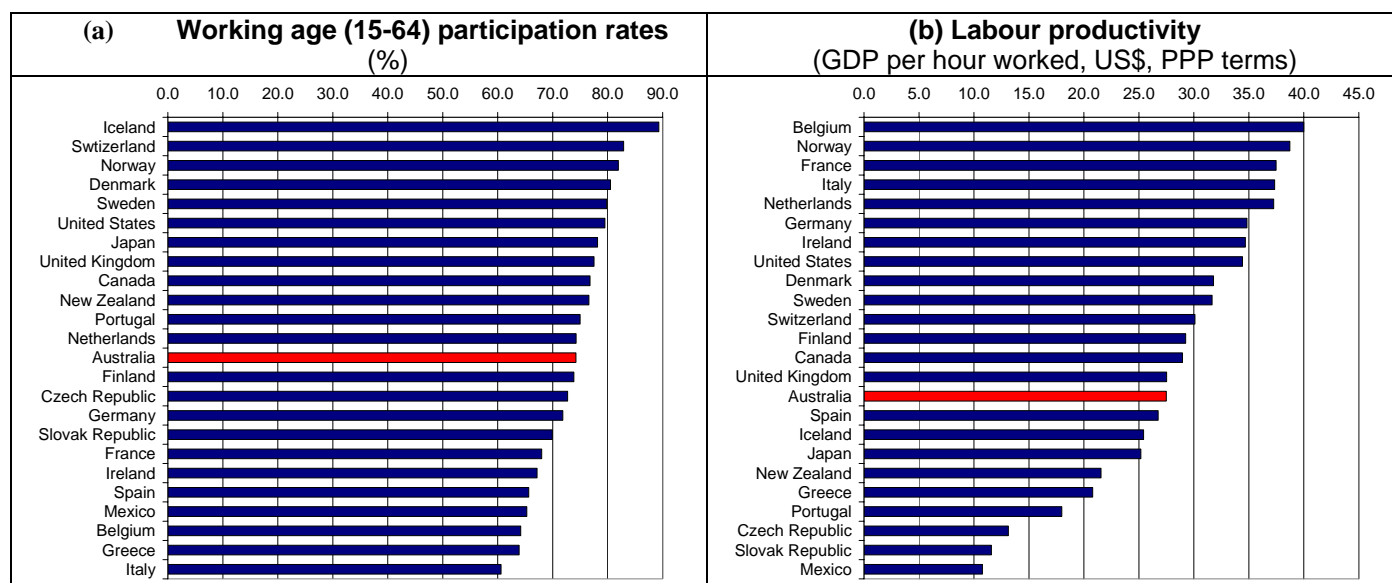


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## Appendix 1

**Figure 1 - Productivity and Participation across the OECD**  
(five year-average to 2001)



**Table 1 - Real Incomes in Australian States**  
(average annual growth, %, 1985-86 to 2000-01)

| Components                        |                           | Average Annual Growth |      |      |      |      |      |
|-----------------------------------|---------------------------|-----------------------|------|------|------|------|------|
|                                   |                           | NSW                   | Vic  | Qld  | SA   | WA   | Tas  |
| <i>Real output per Capita</i>     |                           | 2.2                   | 2.1  | 2.3  | 1.9  | 2.4  | 1.0  |
| <b>Labour productivity</b>        | Capital deepening         | 0.4                   | 0.4  | -0.1 | 0.3  | 0.4  | 0.5  |
|                                   | Multifactor productivity  | 1.2                   | 1.0  | 1.6  | 1.1  | 1.3  | 0.3  |
| <b>Labour force participation</b> | <b>Participation rate</b> | 0.2                   | 0.4  | 0.5  | 0.1  | 0.4  | 0.1  |
|                                   | Working age               | 0.3                   | 0.3  | 0.3  | 0.3  | 0.3  | 0.3  |
|                                   | Average hours             | -0.1                  | -0.1 | -0.2 | -0.1 | -0.2 | -0.2 |
|                                   | Unemployment rate         | 0.2                   | 0.1  | 0.1  | 0.1  | 0.2  | 0.1  |