

Victorian Government Submission



Inquiry into National Competition Policy Arrangements

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Productivity Commission Inquiry into National Competition Policy Arrangements

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Section 1: Executive Summary

Victoria supports the development of a new national reform agenda

Victoria is a National Competition Policy reform leader. Victoria has met its National Competition Policy (NCP) reform obligations and has been a model for implementing reform in a manner that best reflects the interests of the community. More than one third of the national gains from NCP are attributable to reforms undertaken in Victoria. Victoria is keen to engage with all jurisdictions on the development of a new national reform agenda.

Victoria welcomes the Productivity Commission inquiry into NCP, but it is important that the inquiry is appropriately comprehensive in scope. The inquiry should not only focus on measuring the benefits of NCP reforms to date, but also on estimating the ongoing future benefits from those reforms.

The inquiry should also estimate the ongoing benefits to the Commonwealth Government and the costs and benefits to State and Territory Governments from past NCP reforms. Also, the inquiry should address the issue of growth in the scope of NCP obligations. The growth in the requirements faced by States and Territories is continuing and has not been matched by increased payments from the Commonwealth.

Victoria has set out a number of preconditions for future reform.

Firstly, the existing NCP agenda must be satisfactorily resolved. There are substantial differences across jurisdictions in the progress of reform under the existing NCP arrangements. The Commonwealth, in particular, has been a follower rather than a leader in reform, and has been slow to meet its own obligations. All jurisdictions must be at a similar stage of progress before a major new agenda is adopted. Moreover, reform leaders, like Victoria, should continue to be recognised and rewarded.

Funding associated with the existing reform agenda must be unconditionally guaranteed to continue. The benefits of reforms carried out by the States are ongoing, as are the revenue flows, which disproportionately favour the Commonwealth. Continuity of the payments was the clear intention of the original NCP agreement.

Any new reform obligations must be accompanied by new payments from the Commonwealth. To support any new reform agenda and to ensure the gains from reform are appropriately shared, any new reform obligations must be accompanied with commensurate compensation, in recognition of the fact that fiscal outcomes will inevitably and overwhelmingly favour the Commonwealth.

Reform payments must not be tied to particular end-uses. There is no justification for the Commonwealth to direct the States and Territories as to how payments should be spent. The individual jurisdictions are the best judges of their needs and priorities.

Victoria has also set out the desirable features of a new national reform agenda.

Any future reform agenda must be strongly based on a substantial and credible case for the need for reform. The original NCP agreements were built on a strong foundation,

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the Hilmer Inquiry. Precisely how a case for further reform should be made is a matter for The Council of Australian Governments (COAG).

New reforms must demonstrably deliver net benefits to the community. In the assessment of whether reforms will deliver a net benefit, regard must be given to equity and efficiency:

- *Equity*: reforms should have regard to fairness, social justice, the distribution of wealth, and community cohesion.
- *Efficiency*: the reforms should be such that incentives are provided for resources to move to their most productive uses.

A new reform agenda must be supported by appropriate institutional arrangements and guidelines for their operation. These arrangements must be agreed by COAG and be genuinely national in character. Enforcement bodies must have the appropriate expertise and accountability.

The reform agenda should focus on issues that have general applicability across a number of Australian jurisdictions, thereby making them appropriate for a COAG framework. Reforms must be 'COAG friendly'.

Reforms must be achievable within the framework and timetable established. The enforcement regime should focus on outcomes. There must be sufficient time and flexibility for jurisdictions to achieve in good faith any new reforms.

There must be robust boundaries around obligations established under a new national reform agenda. Victoria is concerned at the potential for 'scope creep' in obligations. In the past this has arisen from the broad interpretation of obligations imposed upon jurisdictions. In all cases, any increase in jurisdictions' reform obligations must require explicit COAG endorsement.

The future agenda must reflect current and future developments in the economy and society. As an example, future reform must be cognisant of the economic and social impacts of an ageing population, the long term outlook for economic growth and progress the delivery of a sustainable environment.

Section 2: Victoria – The Reform Leader

Summary points

- Victoria is a reform leader. Victoria has met its reform obligations and has been a model for implementing reform in a manner that best reflects the interests of the community.
- Victoria has achieved the exemplary record of never incurring a permanent penalty in the seven years since assessments have been conducted and competition payments made.
- More than one third of the national gains from National Competition Policy (NCP) are attributable to reforms undertaken in Victoria.

2.1 Introduction

Productivity growth has been the engine of income and Gross Domestic Product (GDP) growth in recent decades. That productivity growth has been driven to a large extent by microeconomic reform. The evidence of a significant ongoing reform dividend for Australia from NCP reform highlights the importance of the changes and the need to ensure the States and Territories continue to be compensated for the changes already made.

The NCP payments that accompanied the Council of Australian Governments (COAG) agreements of the 1990s, that ushered in the NCP reforms, provided a significant incentive for jurisdictions and their communities to complete their reforms. A summary of the evolution and establishment of the 1995 NCP Agreements and related reforms is provided in Appendix A.

2.2 Stocktake

The impressive progress made by Victoria in implementing the agreed NCP reform agenda is detailed in Appendix B.

Victoria has largely completed its agreed reform agenda:

- all major legislative reviews and the reforms arising out of them have been completed;
- structural reform of infrastructure and other Government monopolies has been completed, as have pricing and related reforms of those infrastructure services that remain under Government control;
- prices oversight in key industries such as electricity, gas and water has been implemented and the Essential Services Commission (ESC) established to ensure ongoing, independent monitoring;
- competitive neutrality policy has been implemented by all State and local government bodies, producing a major change in the operations of many government sector bodies that operate in markets;

- institutional arrangements for ongoing competition policy review of new legislative and regulatory proposals have been established; and
- the related reform agenda has largely been finalised.

Indeed, Victoria has gone well beyond many of the initial expectations of NCP reforms and this has contributed to the State's strong economic performance in recent years.

In its 2003 Assessment, the National Competition Council (NCC) concluded that Victoria had met its related reform obligations, its obligations with respect to testing new restrictions against NCP principles, structural reform of government monopolies and prices oversight, and competitive neutrality requirements. It also noted that with 210 pieces of legislation to review and reform, at that time (August 2003), Victoria had completed around 80 per cent of its review and reform activity. The NCC noted that this is well above the average of all jurisdictions. Victoria has continued to work towards the completion of this task.

2.3 Modelling

Literature review: impact of NCP and related reforms

The Department of Treasury and Finance (DTF) has modelled the economic impact of the major NCP reforms. The modelling results are presented later in this section. An important input into this modelling process has been the findings of similar studies undertaken on the subject of the impact of microeconomic reforms in Australia, including some undertaken by the Productivity Commission.

Appendix C presents a discussion of such studies. The key messages from the literature are summarised below.

Key messages

The main focus of the literature has been on exploring the impact of reform on productivity in Australia during the 1990s. An increase in productivity is a major factor contributing to higher levels of economic growth and, hence, living standards.

In the studies that have been undertaken, the impact of NCP has tended to be considered within the context of the *broader* microeconomic reform agenda in Australia, which includes:

- the liberalisation of trade and investment;
- deregulation of capital markets;
- more flexible institutional arrangements for labour markets; and
- the restructuring of public utilities.

The Productivity Commission has noted the various ways in which these microeconomic reforms have helped to raise Australia's productivity performance. These include:

- sharper competition — lower trade and foreign investment barriers and domestic deregulation and pro-competitive regulation (such as that associated with NCP) have provided greater incentives for businesses to improve productivity by seeking out more value-adding products and new markets, and by reducing costs;
- greater openness to trade, investment and technology has encouraged greater specialisation and has provided easier access to up-to-date technology and know-how; and

- greater flexibility for businesses to adjust production and distribution processes, through removal of unnecessary business regulation and greater flexibility in work arrangements.

There is much support within the literature that Australia's microeconomic reforms – including NCP and related processes – have played a major role in Australia's productivity surge. This, in turn, has contributed to faster levels of economic growth than would have been the case in the absence of the reforms.

The Productivity Commission provided one of the few examples of analysis that attempts to isolate the specific impact of NCP reforms on macroeconomic variables. As part of an Inquiry undertaken in 1999 (see Appendix C), the Productivity Commission estimated that selected NCP reforms provide a sustained increase in output from the Australian economy (as measured by real GDP) of 2.5 per cent above what would have otherwise occurred.

2.4 Impact of reform

For this submission, DTF has modelled the economic impact of NCP reforms for Victoria. The estimates draw on the original modelling of the NCP reforms by the Industry Commission, subsequent updates to the initial modelling by the Productivity Commission, and input on specific NCP reforms. The main points arising from this analysis are summarised below. Details of this modelling exercise can be found in Appendix D.

The NCP reforms have been modelled for eleven areas of reform: electricity and gas; water; rail transport; road transport; telecommunications; statutory marketing arrangements; unincorporated enterprises; postal services; federal airports/Airservices Australia; ports; and an overall review of anti-competitive legislation. We have not modelled all of the NCP reforms due to various data and model limitations. The results, like the earlier Industry Commission and Productivity Commission results, should only be taken as indicative.

The DTF modelling has produced the following main results:

- Australian GDP is estimated to improve by 1.5 per cent or \$11.0 billion in the long run, with consumption 1.8 per cent higher and investment 1.1 per cent higher. The national real wage is 2.4 per cent higher, rewarding productivity as a result of the package of measures.
- Victorian Gross State Product (GSP) is estimated to be 2.0 per cent or \$3.8 billion higher, in real terms, in the long run. Victorian consumption increases by 2.3 per cent, investment increases by 1.6 per cent, and GSP per capita increases by 1.7 per cent.
- Thus, Victoria is estimated to account for about one third of the Australian results, in excess of its share of the national economy (25 per cent). These gains are larger than those achieved for the rest of Australia because of the more extensive nature of the Victorian reforms. It is recognised that it is extremely difficult to quantify both the direct impact of each reform on the relevant industry and the extent of interstate variation in these direct impacts.
- About one third of the gains to Victoria are due to reforms in the electricity and gas industries, and reform of statutory marketing arrangements for the dairy industry. Commonwealth reforms to telecommunications are also estimated to have made a significant contribution to the overall benefits of the package.

The DTF modelling finds that NCP reforms have resulted in a smaller gain to national GDP (1.5 per cent) than the earlier Productivity Commission study (2.5 per cent). There are several reasons for this:

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- the DTF modelling does not include all the reforms addressed by the Productivity Commission because of data limitations in the DTF model;
- the DTF modelling assumes that the revenue gains from the reforms contribute to an increased public sector surplus, while the Productivity Commission study assumed that they would enable taxes to be reduced, with additional potential stimulatory effects; and
- the DTF and Productivity Commission models and databases are different. The Productivity Commission modelling approach involved a degree of allocation of national results to individual States and regions. The DTF model, although structurally similar to that used by the Productivity Commission, treats each State as a separate economic entity within a national framework.

These factors also account for differences in estimates of impact for individual reform components between the DTF modelling and earlier work of the Industry Commission and Productivity Commission.

Table 2.1 summarises the modelled impacts of particular reform components for Victoria while Table 2.2 provides the impacts for all of Australia.

Table 2.1: Estimated real long-run macroeconomic impacts for Victoria
(% deviation from the base case in the absence of the reforms)

Victoria Reform component:	% deviation from baseline	
	GSP	GSP per capita
Electricity and gas	0.68	0.54
Water	0.33	0.12
Rail transport	0.06	0.04
Road transport	0.13	0.14
Telecommunications	0.30	0.48
Statutory marketing arrangements	0.24	0.01
Unincorporated enterprises	0.16	0.21
Postal services	0.07	0.11
Federal airports/Airservices Australia	0.01	0.00
Ports	0.01	0.01
Review of anti-competitive legislation*	0.13	0.13
TOTAL NCP reforms package	2.05	1.70

Note: Results from individual simulations need not sum exactly to total package simulation

* This understates the benefits as it has not been possible to model gains from greater competition in professions.

Table 2.2: Estimated real long-run macroeconomic impacts for Australia
(% deviation from the base case in the absence of the reforms)

Reform component:	% deviation from baseline	
	GDP	Real wage
Electricity and Gas	0.45	1.00
Water	0.11	0.34
Rail transport	0.06	0.02
Road transport	0.13	0.16
Telecommunications	0.40	0.50
Statutory marketing arrangements	0.01	0.03
Unincorporated enterprises	0.21	0.22
Postal services	0.09	0.08
Federal airports/Airservices Australia	0.01	0.01
Ports	0.01	0.02
Review of anti-competitive legislation*	0.12	0.15
TOTAL NCP reforms package	1.50	2.45

Note: Results from individual simulations need not sum exactly to total package simulation

* This understates the benefits as it has not been possible to model gains from greater competition in professions.

Because the modelling does not cover all NCP reforms, the modelling results are likely to underestimate the actual benefits from the range of competition policy reforms conducted over the past decade. For example, the model does not, and cannot, take into account the substantial benefits arising from reforms such as implementation of competitive neutrality.

More importantly, the modelling cannot quantify the change in management practices and approaches that have been engendered by a decade of competition policy reforms. The local government case study in Appendix E makes the point that much of the benefit from implementation of competitive neutrality has arisen from change in business attitude and more professional management.

The modelling supports Victoria's contention that it has been a leader in the reform process: about a third of the national gains accrue from actions taken in Victoria, based on the components we have modelled. The corollary is that the benefits of reform could be maximised if other jurisdictions, particularly the Commonwealth, were to step up their reform efforts. In particular, Victoria has benefited from a strategy of concentrating reform effort on a few major areas with a high expected pay-off while pursuing a wide range of smaller reforms (for example, completion of an ambitious program of legislative reviews).

2.5 Practical outcomes

The stocktake and modelling exercises clearly demonstrate that Victoria has been a reform leader. A series of cases studies highlighting some key examples of specific reforms undertaken in Victoria and their outcomes are detailed at Appendix E. These relate to Victoria's experience with:

- electricity industry reforms;
- the Latrobe Valley Ministerial Taskforce;
- gas industry reforms;

Section 2: Victoria - The Reform Leader

- review of the health professional regulatory regime;
- reform of the liquor licensing regime;
- deregulation of the dairy industry;
- reform of Victoria's barley marketing arrangements; and
- the application competitive neutrality by local governments.

In relation to the last case study, it is useful to note that in signing the 1995 NCP Agreements, State and Territory Governments also accepted reform obligations on behalf of local governments within their jurisdiction. In Victoria, the State Government agreed to share part of its annual NCP payments with local governments. The payments offer an incentive for local government to implement competitive neutrality and put their businesses on a more commercial basis.

Section 3: Competition Payments and Costs of Reform

Summary points

- The reform obligations under NCP are ongoing.
- Revenue benefits from NCP reform are also ongoing, but continue to be disproportionately received by the Commonwealth.
- The permanent increase in tax arising from the NCP reforms is 15 times greater for the Commonwealth than for Victoria.
- Given this, competition payments for the existing reform agenda must be ongoing and untied.
- Any new reform obligation must be accompanied by new payments from the Commonwealth.
- There have been costs associated with reform including adjustment costs, assistance costs, administrative costs to government, participation costs of stakeholders.

3.1 The competition payments should continue

One of the drivers behind the 1995 NCP reform agenda was the belief that the reforms would deliver economic benefits to the Australian economy. With economic growth came increased revenue flows to government – primarily the Commonwealth Government – while the States were responsible for delivery of most of the reform activity.

As part of the 1995 NCP reform agenda, it was agreed that the Commonwealth would make payments to the States and Territories for implementing the NCP as a means of sharing some of the revenue benefits of the reforms. The schedule of payments was based on giving approximately 10 per cent of the estimated annual incremental revenue received by the Commonwealth arising from the NCP reforms back to the States and Territories (Industry Commission 1995).

In 2004, the competition payments available to States and Territories will total approximately \$780 million (p.21, Commonwealth Budget Paper 3: *Federal Financial Relations* 2004-05). Payments are divided between States on a per capita basis and adjusted annually for inflation and population growth to ensure their real per capita value is maintained.

The competition payments represent the dividend to states for implementing (or investing in) ongoing reform. Given that investment in ongoing reform has been made, and continues to be made, and given that the benefits of this reform are ongoing, these payments should continue to be made to the States as an ongoing dividend. As detailed below, there is a strong case to support the continuation of the competition payments.

Sharing the benefits of reform - the rationale for the NCP payments

The rationale for the continuation of competition payments is set out clearly in the 1994 and 1995 COAG meeting minutes and communiqués as:

- sharing the economic benefits of economic growth associated with the reforms, particularly recognising that:
 - the Commonwealth would be the main beneficiary of the NCP reform induced economic growth through its control over income tax collection; and
 - the States and Territories would lose revenue from the loss of monopoly rents from state-owned monopoly businesses; and
- assisting in managing the adjustment process and its costs.

A detailed explanation of the rationale for the NCP payments drawing on the mid-90s COAG Communiqué and related documents is at Appendix F.

The NCP Agreements do not contain a sunset clause

The 1995 NCP Agreements do not impose, either explicitly or implicitly, an end-point or sunset on the competition payments. In fact the opposite inference is true. As noted above, the obligations imposed on governments under the NCP agreements are ongoing, a view supported by the NCC (p.28 NCC Annual Report 2002-03).

The COAG senior officials (including the Commonwealth representative) who conducted the 2000 review of the NCP Agreements agreed that there was a common understanding that the competition payments would continue beyond 2005-06. The Final Review Report noted:

'The working Group noted its common understanding that competition payments continue beyond 2005-06 subject to continued observance of reform commitments identified in the Implementation Agreement.'

The Final (2000) Report of the COAG Officials Working Group
'Review of the Competition Policy Agreements'

The Commonwealth has previously indicated its commitment to the ongoing funding of competition payments through its budget papers. In 2003-04, the Commonwealth noted that explicit provision had been made for competition payments beyond 2005-06.

Basis of 1995 NCP Agreements still valid

All Australian governments continue to be signatories to the NCP Agreements, and the conditions outlined in the Implementation Agreement for receipt of the competition payments have not decreased. In fact, in some reform areas (such as water reform) the thresholds are now higher.

The prerequisite for States and Territories receiving NCP payments is the demonstration of progress against the NCP obligations. The Implementation Agreement states:

'...the provision of financial assistance by the Commonwealth is conditional on the States making satisfactory progress with the implementation of the NCP and related reforms.'

The Implementation Agreement sets out, in very broad terms, the conditions States and Territories must meet. These can be summarised as:

- giving ongoing effect to the NCP Agreements and, in particular, meeting the deadlines relating to the review of regulation and competitive neutrality; and
- effective ongoing implementation of the related reform agreements covering electricity, gas, water and road transport, and setting national standards consistent with agreed guidelines.

The benefits of past reforms continue to accrue

The benefits accruing from past NCP reforms are embedded in a permanent increase in GDP. The modelling undertaken by the Victorian Department of Treasury and Finance for this submission supports this conclusion (see Section 2 for details). This was also recognised by the Industry Commission and the Productivity Commission in their modelling of the benefits and revenue implications arising from the NCP reforms.

The NCP reforms have permanently increased productivity and economic growth. This has driven higher incomes and, in turn, resulted in higher individual and corporate income tax revenues to the Commonwealth. In Victoria's case, the gains to the Commonwealth were compounded by revenue windfalls associated with the privatisation of State government business entities. Dividends and revenue streams from previously state-owned entities ceased to flow to State governments, while the privatised entities became liable to pay corporate income tax to the Commonwealth.

The increased revenues to the Commonwealth are ongoing. Therefore, as the competition payments represent a sharing of the revenue effects from reform, the States and Territories have already 'earned' the ongoing NCP payments through their NCP reform activity.

NCP payments and taxation revenue

The competition payments represent a partial sharing of the Commonwealth's growth in revenue arising from NCP reforms.

The introduction of the goods and services tax (GST) in 2000, and the abolition of several State taxes altered the mix of the various taxes which respond to economic growth. However, the GST should in no way be seen as a replacement for NCP payments. The GST was never meant to be a form of compensation or reward for the costs/benefits of NCP reform. This is confirmed by the fact that there is no mention of NCP in the GST inter-governmental agreement. In fact, under the GST reforms (which occurred after the NCP system was already in place) it was agreed that GST receipts (and their embedded growth) would be used to compensate the States for giving up Financial Assistance Grants and a number of state taxes.

In addition, the growth in Commonwealth taxes after the reforms (which is partially redistributed via NCP payments) is not affected at all by the introduction of the GST.

In any case, the distribution of GST receipts does not reflect the growth benefit of NCP reforms. This is because the GST is currently distributed through complex CGC formulas that are more concerned about disabilities, instead of being distributed in accordance with each State's share of economic activity (i.e. GSP).

Incentives for reform

Victoria has led the NCP agenda. In the seven years since assessments have been conducted and payments made, Victoria has achieved the exemplary record of never

incurring a permanent penalty. However, Victoria has (proportionately) lost more revenue through privatisations and made a greater contribution to the Commonwealth's revenue windfall. The division of competition payments on the basis of each State's population means that greater reform effort and associated benefits are not recognised or reflected in the payments. That is, there is no incentive to do any more than the minimum required to obtain a positive assessment.

The importance of the incentive effect of the competition payments should not be underestimated as can be demonstrated by the Commonwealth Government's poor performance on reform. The NCC in its 2003 assessment highlighted this, where it noted:

'...the Commonwealth's performance was well below average and not commensurate with its leadership role...'

NCC 2003, 'Assessment of Governments' Progress with Implementing the National Competition Policy and Related Reforms: 2003' Vol 1, p4.15

Without a financial or other sanction, the Commonwealth has repeatedly failed to deliver on its NCP obligations while some States and Territories have been financially penalised.

Financial independence

While the competition payments have been indexed to retain their 1994-95 values, the payments in total fall short of full compensation. While the NCC has argued that the payments cannot and should not be hypothecated to particular reforms¹, Victoria has a history of providing adjustment assistance for those adversely affected by microeconomic reforms. Victoria is of the opinion that, in general, each jurisdiction should be responsible for deciding on the nature and type of adjustment assistance provided.

3.2 Ongoing nature of past reforms

Past reforms do not stop providing benefits and revenue flows. They are not one-off jumps in GDP, they are continuing contributors to economic growth. For example, the national electricity reforms will continue to provide lower prices and better allocation of investment over time and will, therefore, continue to contribute to increased Commonwealth revenues.

The Chairman of the Productivity Commission endorses this view:

'...there are grounds for optimism about the longer-term outlook for productivity growth. For one thing, the heightened incentives and disciplines for improved performance are not temporary. The reduction of barriers to competition and removal of impediments to innovation can be expected to have lasting effects on the dynamism of our economy.'

G. Banks, Chairman, Productivity Commission,
'Micro reform's productivity payoff', in *The Australian* 18 February 2002,
'Complacency the enemy in maintaining the miracle.'

As detailed in Section 2, the current Victorian modelling found the NCP reforms had contributed to a permanent increase in Victorian GSP of 2.0 per cent and Australian GDP

¹ For example, in its 2002-03 Annual Report the NCC said; "The State and Territory governments are in the best position to analyse the impact of change when they analyse other reform issues. While the Council considers that explicit recognition of the need for change management would be beneficial in any future reform agreements, and that it may be possible to develop principles for determining assistance, it also considers that individual cases should be decided by each State and Territory government, based on the circumstances of each reform." (p 20)

of 1.5 per cent, and associated higher consumption of 2.3 per cent and 1.8 per cent, respectively (DTF 2004).

Further, the study revealed that the Commonwealth receives 15 times more than Victoria in the permanent tax revenue increases attributable to the national and Victorian reforms modelled.

This is consistent with the findings of the earlier Productivity Commission and Industry Commission studies that the NCP reforms have contributed to a permanent, sustained increase in economic growth, of which the Commonwealth receive the largest share of the resulting revenue benefits while the States do most of the reforms. This was the basis of the competition payments as detailed in the 1995 Implementation Agreement.

Reflecting this ongoing benefit from reform, it follows that the revenue effects are also permanent and that the States should continue to receive the competition payments beyond 2005-06 without new reform hurdles being imposed. **Consequently, any future reforms that States agree to will provide benefits on top of those already achieved and should receive additional compensation.**

3.3 Costs of reform

Delivery of the NCP reform agenda has not been without costs. The NCP framework acknowledges that there will inevitably be costs associated with reform and that these must be taken into account. The NCP Agreements are underpinned by the concept of net public benefit that requires governments to assess and balance the costs and benefits associated with proposed actions to ensure reforms are undertaken where they deliver a benefit to the community as a whole. There are a range of costs that can arise from reform activity.

Adjustment and assistance costs

One of the challenges with implementing the NCP, faced by all governments, has been how to manage change. Even where a reform is clearly in the overall community benefit, there may be negative impacts on specific individuals or groups. Frequently the costs of reforms are acute, localised, identifiable and immediate, while the benefits are longer term and more dispersed. Governments have sought to address these short-term transitional impacts and assist the change process in order to reap the longer-term benefits of reforms.

The adjustment assistance may be provided in a range of forms. These include various financial payments or concessions to individuals and communities directly affected, and can also include transitional arrangements, staged reforms to allow time to adjust, new industry facilitation and assistance to existing industries to improve performance and drive adaptation to change. Assistance may also include the provision of information and consultation to better understand the drivers of reform and appropriately design mechanisms and target reforms.

Victoria has provided various forms of assistance throughout the course of the NCP. The leading example is the Latrobe Valley Ministerial Taskforce which tackled the impact of changes in the electricity industry on a regional community. The result was an innovative package of initiatives designed to bolster business and employment, which also sought to re-invigorate the community through education and community building. Details of the Latrobe Valley Taskforce initiatives are included in a case study at Appendix E.

Participation costs of stakeholders

A key feature of the implementation of the NCP has been community and stakeholder engagement and consultation. As with governments, those who participate in NCP processes incur their own costs – including staff, search, travel and report preparation costs – and divert them from other productive endeavours. For small stakeholders,

particularly individuals, at times these costs have proven prohibitive to participation particularly given the breadth of the NCP reforms and of other government reform and consultation activities (i.e. the new tax system in 1999).

Administrative costs of government

Implementing the NCP, or any policy agenda, is not costless. Some of these costs are one-off costs associated with a specific task such as the conduct of a review, while others are associated with processes or institutions that are ongoing. For example, governments need to dedicate staff and other resources to intergovernmental negotiations, policy development, research, reviews, extensive stakeholder consultation, production of reports and preparation of new legislation.

Initially, governments may have underestimated the time and resources required to undertake these activities. For example, in the NCP Agreements the legislation review program was originally due to be completed by mid-2000. However, with almost 2000 pieces of legislation identified for review by governments and the time, expertise and staff resources required to progress these reviews and the subsequent reforms, this deadline for completion was unrealistic and was extended by COAG. One consequence of the magnitude of the legislation review program was the use of consultants to undertake specific tasks as a means of accessing specialistic skills which were not always available within government in sufficient quantities.

Compliance costs of government

There are also a range of compliance costs that governments face with implementing the NCP agenda. First, the basis of the NCC's assessment are governments' annual reports to the NCC on their progress with implementing the NCP form. The annual reports are detailed and require the collation of a large amount of information from across government. These reports are typically followed by extensive consultation between the NCC and a State's NCP officials over a period of several months prior to the finalisation of the NCC's assessment and recommendations on the competition monies.

Second, governments have established structures and institutions to embed the competition reforms and meet their NCP obligations. These include gatekeeper bodies to ensure that: new legislation is tested against competition principles; competitive neutrality complaints are addressed; and there is independent oversight of economic regulation for prescribed industries. The Victorian Office of Regulation Reform, and its replacement the Victorian Competition and Efficiency Commission (from 1 July 2004), has played a the gatekeeper role for Victorian assessments of new regulation. Victoria established the Essential Services Commission to oversee the economic regulation of the electricity, gas and water utilities, and to consider third party access to state-based infrastructure.

The cost of time

One of the hidden costs of the NCP process has been the cost of time. An original driver of the NCP was recognition of the need to facilitate mechanisms to achieve national reform and consistency. Fewer national reviews of legislation have been undertaken than were anticipated. Those that have been undertaken have tended to be protracted and often difficult exercises. The slowness of inter-jurisdictional reviews and processes, and the overlaps between related processes have delayed the delivery of reforms and, therefore, the anticipated benefits.

Section 4: NCP Institutional Arrangements

Summary points

- A new reform agenda must be supported by appropriate institutional arrangements and guidelines for their operation.
- The reform agenda should focus on issues that have general applicability across a number of Australian jurisdictions, thereby making them appropriate for a COAG framework. Reforms must be 'COAG friendly'.
- Reforms must be achievable within the framework and timetable established.
- There must be robust boundaries around obligations established under a new national reform agenda.

4.1 The current process

Victoria has concerns about the process of annual review of jurisdictions' reports by the NCC (before recommendations are forwarded to the Commonwealth Treasurer), particularly:

- the lack of transparency;
- the lack of a clearly defined formal process after the annual submission;
- the fact that, while the States and Territories do receive a draft report to comment on, they do not see the draft recommendations;
- the lack of clear processes for demonstrating correspondence between the recommendations of the NCC and the benchmarks; and
- the lack of a logical framework underpinning the decisions of the NCC to recommend penalties.

The enormous administrative costs of annual reporting by the jurisdictions to the NCC are also a matter of great concern. Victoria would prefer that the annual reporting process be changed to be on a 3-5 year basis.

When the NCP Agreements were first signed, national processes were anticipated to be established more often and with better outcomes than has generally been the case. National processes offer the opportunity to move forward in a co-ordinated and consistent manner across all jurisdictions. They are well suited to addressing those issues that have a national, COAG-oriented focus.

However, the national processes have not always delivered the benefits expected. Some have taken a considerable time while others have suffered from multiple attempts to reach common ground. COAG guidelines have also not always been strictly adhered to.

Nevertheless, national processes can enhance the consistency of response to particular issues. Harmonisation of regulation is an important benefit from national processes.

Encouraging more useful, timely and vigorous national processes, will improve the national framework and harmonisation. A commitment to reform requires a substantial benefit-cost case and full agreement by all participants through COAG. Any new reform agenda must address current shortcomings in the national processes so they can be used better and achieve the outcomes originally envisaged.

The NCC assessment process has sometimes over-emphasised assessment of fine details. While this has been an issue more broadly, it has been particularly pertinent for the related reforms. The structure of the related COAG reforms has lent a degree of inflexibility to the assessment.

Since the NCP agreements were drafted, some of the jurisdictions have established their own institutions and processes for implementing NCP (and other) reforms. For example, most jurisdictions have established bodies to conduct independent prices oversight. In Victoria the Essential Services Commission (ESC) takes on this role. The recently established Victorian Competition and Efficiency Commission also has a role in fostering better regulation. These bodies have a role in encouraging and monitoring broad competitive outcomes and formalise and administer the regulatory review processes. The establishment of these institutional arrangements in jurisdictions indicates how Competition Policy principles and processes are becoming embedded in the way jurisdictions do business.

4.2 Future institutional arrangements and processes

A new reform agenda must be supported by appropriate institutional arrangements and guidelines for their operation. These arrangements must be agreed by COAG and be genuinely national in character. Enforcement bodies must have the appropriate expertise and accountability.

The reform agenda should continue to focus on issues that have general applicability across a number of Australian jurisdictions, thereby making them appropriate for a COAG framework. Reforms must be 'COAG friendly'.

Reforms must be achievable within the framework and timetable established. The enforcement regime should focus on outcomes. There must be sufficient time and flexibility for jurisdictions to achieve in good faith any new reforms.

There must be robust boundaries around obligations established under a new national reform agenda. Victoria is concerned at the potential for 'scope creep' in obligations. In the past this has arisen from the broad interpretation of obligations imposed upon jurisdictions. In all cases, any increase in jurisdictions' reform obligations must require explicit COAG endorsement.

Section 5: Future Reform

Conditions for Victoria considering a new national reform agenda

The existing NCP agenda must be satisfactorily resolved. All jurisdictions should complete the existing agenda before new obligations and agendas are taken on. There are significant differences across jurisdictions in the progress of reform under the existing arrangements. The Commonwealth in particular has been a follower rather than a leader in reform, and has been slow to meet its own obligations. Reform leaders, like Victoria, should continue to be recognised and rewarded.

Funding associated with the existing reform agenda must be unconditionally guaranteed to continue. The benefits of reforms carried out by the States are ongoing, as are the revenue flows, which disproportionately favour the Commonwealth.

Any new reform obligations must be accompanied by new payments from the Commonwealth. To support any new reform agenda and to ensure the gains from reform are appropriately shared, any new reform obligations must be accompanied by commensurate compensation, in recognition of the fact that fiscal outcomes will inevitably and overwhelmingly favour the Commonwealth.

Reform payments must not be tied to particular end-uses. There is no justification for the Commonwealth to direct the States and Territories as to how payments should be spent. The individual jurisdictions are the best judges of their needs and priorities.

Features of a new national reform agenda

The original NCP agreements were built on a strong foundation. The Hilmer Inquiry was a thorough review that made a substantial and credible case for the need for reform. **Any future reform agenda needs to be equally strongly based.** Jurisdictions should make no commitment for further reform until a substantial case is made. Precisely how that case should be made is a matter for COAG. Any program for future reform must be evidence-based and reflect the respective reform efforts across jurisdictions to date.

New reforms must demonstrably deliver net benefits to the community. In the assessment of whether reforms will deliver a net benefit, regard must be given to equity and efficiency:

- *Equity:* reforms should have regard to fairness, social justice, the distribution of wealth, and community cohesion.
- *Efficiency:* the reforms should be such that incentives are provided for resources to move to their most productive uses.

A new reform agenda must be supported by appropriate institutional arrangements and guidelines for their operation. These arrangements must be agreed by COAG and be genuinely national in character. Enforcement bodies must have the appropriate expertise and accountability.

The reform agenda should focus on issues that have general applicability across a number of Australian jurisdictions, thereby making them appropriate for a COAG framework. Reforms must be 'COAG friendly'.

Reforms must be achievable within the framework and timetable established. The enforcement regime should focus on outcomes. There must be sufficient time and flexibility for jurisdictions to achieve in good faith any new reforms.

There must be robust boundaries around obligations established under a new national reform agenda. Victoria is concerned at the potential for ‘scope creep’ in obligations. In the past this has arisen from the broad interpretation of obligations imposed upon jurisdictions. In all cases, any increase in jurisdictions’ reform obligations must require explicit COAG endorsement.

The reform agenda must also be cognisant of the economic and social impacts of an ageing population, and the long-term outlook for economic growth (see *Shaping a Prosperous Future* for an extensive analysis of demographic change and the long term fiscal outlook). Victoria’s long-term projections indicate that all jurisdictions will face considerable fiscal pressure over the coming decades. The major pressures will arise from rising health costs, and demographic change. Any future reform agenda must be cognisant of these pressures. Also, continuing the theme of previous reforms, any new national reform agenda should encourage and reward the development of competitive national markets and closer harmonisation between jurisdictions.

Other national reform

In seeking to progress a new national reform agenda, the Productivity Commission and the Commonwealth and the States need to recognise that there will be other COAG-led reform to Commonwealth-State relations outside the scope of the Productivity Commission’s terms of reference for the present inquiry. Primary among these may be necessary reforms to Commonwealth-State institutional arrangements and funding of health and education services, and reforms that progress the delivery of a sustainable environment.

Section 6: Conclusions

Victoria is a reform leader under NCP. More than one third of the national gains from NCP are attributable to reforms undertaken in Victoria. Victoria is keen to engage with all jurisdictions on the development of a new national reform agenda, and welcomes the Productivity Commission inquiry into NCP.

It is important that the inquiry is comprehensive in scope. The inquiry should not only focus on measuring the benefits of NCP to date, but also on estimating the ongoing future benefits from previous reforms. This would be consistent with past Commission reviews on the impacts of NCP.

The inquiry should estimate the ongoing benefits to the Commonwealth Government and the costs to States and Territories from past NCP reforms. The inquiry should also address the issue of growth in the scope of NCP obligations. The growth in the requirements faced by States and Territories is continuing and has not been matched by increased NCP payments from the Commonwealth.

In this submission, Victoria has set out a number of preconditions for future reform. The existing NCP agenda must be satisfactorily resolved, with all jurisdictions at a similar stage of progress before a major new agenda is adopted. Funding associated with the existing reform agenda must be unconditionally guaranteed to continue, and any new reform obligations must be accompanied by new payments from the Commonwealth. Reform payments must not be tied to particular end-uses, as individual jurisdictions are the best judges of their needs and priorities.

Any future reform agenda must be strongly based on a substantial and credible case for the need for reform. New reforms must demonstrably deliver net benefits to the community and have regard to equity and efficiency.

The current NCP institutional arrangements are beginning to break down. A new reform agenda must be supported by institutional arrangements that are agreed by COAG and genuinely national in character. Any new enforcement regime should focus on outcomes, and there must be sufficient time and flexibility for jurisdictions to achieve in good faith any new reforms.

The reform agenda should focus on issues that have general applicability across a number of Australian jurisdictions, thereby making them appropriate for a COAG framework. There must be robust, COAG-endorsed boundaries around jurisdictions' obligations.

With these features, a new national reform agenda would have great potential to generate benefits for the community as a whole, and to build on the successes of national reforms already undertaken

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Appendix A: Background to the NCP Agreements

During the 1980s Australian governments pursued a range of microeconomic reforms including floating the Australian currency, financial deregulation and reductions in trade barriers. As these reforms were implemented, governments realised that a co-ordinated national approach to reform was needed to further build a flexible and dynamic economy.

In 1992 the Council of Australian Governments (COAG) commissioned an independent *Committee of Inquiry into National Competition Policy* (the Hilmer Inquiry) to propose a framework for achieving their ambition for a national competition policy. The Hilmer Inquiry envisaged a competition policy which would:

‘...facilitate competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives.’

(National Competition Policy: Report by the Independent Committee of Inquiry, 1993, p.xvi)

To this end, the Hilmer Inquiry laid out a framework for a national competition policy encompassing six key policy areas:

- extension of the *Trade Practices Act 1974* (TPA) to unincorporated businesses and State and Territory government businesses;
- extension of prices surveillance to State and Territory government businesses in certain circumstances;
- application of competitive neutrality when government businesses compete with private firms;
- structural reform of public sector monopoly businesses;
- review of all legislation which restricts competition; and
- provision for third party access to nationally significant infrastructure.

In April 1995, all Australian Governments agreed to reforms, based on the Hilmer Inquiry recommendations. State and Territory governments also accepted reform obligations on behalf of local governments within their jurisdiction. COAG signed three separate agreements, which together form the NCP Agreements:

- the Competition Principles Agreement;
- the Conduct Code Agreement; and
- the Agreement to Implement the National Competition Policy and Related Reforms (the Implementation Agreement).

COAG also agreed to draw four existing reform agreements - relating to electricity, gas, water and road transport - under the umbrella of the NCP framework.

Competition payments and assessments

As part of the 1995 NCP reform agenda, as initially laid out in the Implementation Agreement, the Commonwealth agreed to make payments to the States and Territories conditional on the States making satisfactory progress with the implementation of the NCP and related reforms. The competition payments recognised that while the States and Territories would undertake the majority of the reforms, Commonwealth taxation revenues would benefit disproportionately from the revenue boost to economic growth. The purpose of the competition payments was to enable the States and Territories to obtain a greater share of the Commonwealth taxation benefits – to share in the ‘growth dividend’ – particularly as most of this would be generated from State level reform.

Progress was assessed by the National Competition Council (NCC), initially in three tranches, in 1997, 1999 and 2001. Following the NCC’s 2001 Assessment, COAG asked the NCC to conduct assessments annually. On the basis of its assessment of governments’ progress, the NCC makes recommendations to the Commonwealth Treasurer on the quantum of the competition payments to the States and Territories. The NCC may recommend a withholding (permanent or temporary) of part or all of the annual competition payments or require a further supplementary assessment, if, in its view, a government has not made adequate progress against the reform agenda.

In November 2000, COAG directed the NCC in making its recommendation on the competition payments, to have regard to:

- the extent of the jurisdiction’s overall commitment to implementing the NCP;
- the effect of one jurisdiction’s reform efforts on other jurisdictions; and
- the impact of the jurisdiction’s failure to undertake a particular reform.

(COAG Communiqué, Canberra, 3 November 2000)

The NCC has interpreted this to mean:

‘That minor breaches of reform obligations should not necessarily have any adverse payment implications if the responsible government has generally performed well against the total NCP program.’

(NCC, 2003 Assessment of Governments’ Progress with Implementing the NCP and Related Reforms)

In the seven years since assessments have been conducted and payments made, Victoria has achieved the distinctive record of never having incurred a permanent penalty.

Each year, the States, Territories and the Commonwealth are obliged to report to the NCC on progress in implementing the NCP. The NCC uses these annual reports as the basis for its assessment of the jurisdictions’ progress in implementing NCP. In its report, the NCC assesses the degree to which the jurisdictions have fulfilled their NCP obligations and it makes recommendations to the Commonwealth Treasurer on the competition payments to the States and Territories. The NCC also assesses progress by the Commonwealth on reform within its jurisdiction.

The NCC aims to complete its assessment by the end of June each year when it sends its report to the Federal Treasurer. Since 2000, the Treasurer has then given the jurisdictions a month to comment on the report before making a final decision on the NCC’s payment recommendations.

The NCC has generally provided a framework for the assessments early in the year. The framework for the water assessment is provided separately and is subject to a negotiation

process involving a limited number of interested parties. After the jurisdictions have submitted their annual reports, the NCC secretariat liaises with them to obtain any further information.

Evolution and review

Over the past decade, all Australian governments have established and implemented the 1995 NCP reform agenda. In this time, the NCP has continued to evolve, in particular as governments have sought to translate the high-level policy principles of the NCP Agreements into specific reform actions. This has been most evident in the continuing refinement of the water reform agenda.

In 2000, five years after the commencement of the NCP Agreements, COAG Senior Officials reviewed the implementation of the NCP and the NCC's role. The review affirmed the importance of the NCP. Heads of Government agreed to several changes to fine tune the arrangements. These measures included:

'...that the National Competition Council determine its forward work program in consultation with COAG Senior Officials; that COAG Senior Officials continue to clarify and specify NCP reform commitments and assessment benchmarks for the NCC; that the deadline for completing the NCP legislation review and reform program be extended from 31 December 2000 to 20 June 2002; and that the NCP Intergovernmental Agreements be amended to provide further guidance to the NCC on how to assess whether jurisdictions have complied with their legislation review commitments.'

(COAG Communiqué, 3 November 2000)

A further key recommendation of the 2000 review was that COAG review the operation of the NCP Agreements and the role of the NCC by September 2005. The 2005 review will need to consider whether the existing NCP framework and institutions should continue, be extended, cease or evolve. This will require the engagement of all Australian Governments. The Productivity Commission's current inquiry is a precursor, and an important input, to this review.

Appendix B: Stocktake of Major NCP Reforms in Victoria

B.1 Energy reforms in Victoria

Key points

- Over the past decade, Victoria's competitive electricity industry has become a best-practice model throughout Australia and internationally and has positioned Victoria to lead the development of integrated national markets for both electricity and gas.
 - Competition between generators has led to reduced costs, improved performance and better services.
 - Households have benefited from a real reduction in the cost of their electricity and improved reliability and quality of service.
 - Large industrial and business customers have achieved substantial savings.
- Victoria has largely addressed its competition reform commitments in the generation, transmission and distribution operations of the electricity industry. Victoria has fully implemented reforms in relation to retail competition and regulation of the electricity sector.
- Victoria's gas market has been fully disaggregated and privatised with domestic, industrial and commercial customers (small, medium and large) able to choose their retailer.
- Victoria has largely addressed its competition reform commitments in relation to the gas supply industry. Victoria has fully implemented reforms in relation to retail competition in the gas sector.

Background

The Victorian Government reformed the structure of the Victorian energy sector in the 1990s to provide a pro-competitive framework for electricity and gas services. The objectives of the reforms included providing more efficient services and pricing for consumers, encouraging efficient investment and promoting long term security of supply.

The reforms complied with the NCP Agreements on electricity and gas reform, including the agreements on the national access codes for electricity networks and gas pipelines which minimise the ability for network infrastructure operators to exercise market power. Full retail competition was also introduced. The Victorian reforms went further in many respects than required by the NCP Agreements for electricity and gas. The Victorian reforms substantially disaggregated the electricity and gas industries both vertically and horizontally, and the Government privatised the disaggregated businesses.

Reforms

Electricity sector

Reforms to the electricity sector provided for a fully competitive national electricity market (NEM), featuring a national wholesale electricity market, an interconnected national electricity grid, open access to the grid under an agreed National Electricity Market Access Code and the introduction of full retail competition.

In October 1994, Victoria began operating a wholesale electricity market (VicPool) which was extended to a NEM involving NSW, the ACT and SA in May 1997. The NEM, as currently operating under the National Electricity Code with the addition of Queensland, began in December 1998.

Vertical disaggregation in the Victorian electricity sector was provided for by:

- separating all generation, transmission and distribution activities of the former government-owned entities into different companies with independent boards and management structures, and also separating the retail functions from the distribution entities;
- selling the interests in the generation, transmission and distribution entities to different parties, thereby fully separating these activities;
- separating the operation of the transmission network from the ownership and maintenance of the assets; and
- separating transmission planning from ownership and vesting it an independent entity (VENCorp).

Horizontal structural change in Victorian electricity generation provided for the establishment of five independent generation businesses which were then privatised. The five businesses were established at the plant level which provided sufficient economies of scale and created sufficient competitive pressures to ensure a reduction of the wholesale price of electricity.

Horizontal changes were introduced in the distribution and retail sector by establishing five businesses which were also privatised. The distribution businesses were required by legislation to provide open access to their grid. Mergers and acquisitions since privatisation have further separated distribution and retail activities.

Gas sector

The main elements of the NCP gas commitments were:

- structural separation of the transmission, distribution, production and retail sectors of the gas industry;
- the removal of all legislative and regulatory barriers to the free trade of gas both within and across State and Territory boundaries;
- the provision of third party access to gas pipelines; and
- full retail competition.

Victoria implemented substantial changes to the structure of the former Gas and Fuel Corporation, which included the:

- separation of transmission from distribution/retail;
- separation of the network operation function for the Principal Gas Transmission System (PTS) (i.e. the Longford – Melbourne pipeline), from its ownership and maintenance, with the network function to be undertaken by an independent entity (VENCorp);
- separation of the distribution and retail function into three separate businesses, with the service area of each of the retail businesses only overlapping with about half the service area of its paired distribution businesses; and
- separation of the State's single gas purchase agreement with the Gippsland Basin producers into an allocation to each of the retailers, and sale of a fourth allocation to a new retail entrant. The single gas purchase agreement was later sold to the three principal retailers.

Victoria also established a wholesale gas spot market on the PTS managed by VENCorp.

National energy market reforms

The Ministerial Council on Energy meeting of December 2003 finalised the policy decisions for the national energy market reform program, in response to the 2002 COAG energy market review. The new arrangements strengthen competition and encourage investment in Australia's energy market. The reforms respond comprehensively to the independent review of energy market directions commissioned by COAG. The reforms remove regulatory complexities and inconsistencies in the NEM and the gas market. The reforms will allow the full benefits of a national energy market to be realised.

New national energy institutions to simplify rule making and regulation in the electricity and gas markets will commence on 1 July 2004. The Australian Energy Market Commission will be responsible for rule making and market development.

The Australian Energy Regulator (AER) will be the market regulator. The AER will be a separate legal entity and a constituent part of the Australian Competition and Consumer Commission (ACCC). The ACCC will continue to be responsible for general competition regulation under the *Trade Practices Act*.

The AER will be responsible for national regulation of distribution and retailing (other than retail prices) from 2006 following the development of an agreed national framework for distribution and retail. This is aimed at reducing regulatory costs, improving the environment for investment and removing unnecessary regional differences.

Victoria took a lead role in the reforms given the importance of effective energy markets and the signals they provide for efficient and timely investment in energy for the State and Australia. Victoria is leading the implementation of the economic regulation program, including development of a national framework for distribution and retailing, and a national energy access regime.

Benefits

Electricity sector

Electricity reform has provided substantially lower electricity prices to all consumers over an extended period of time. Customers have also received better services and increased choice.

Experience since the disaggregation of the Victorian electricity industry has demonstrated:

- increased production efficiency in generation;
- increased availability and reliability in generation;
- reduced operating costs for generators, distributors and retailers;
- delayed the need for investment in additional generating capacity;
- increased reliability of network services; and
- reduced wholesale and retail prices.

Gas sector

Victoria's gas market reform program has provided the framework and impetus for substantial market development that has increased competition and efficiency.

Major developments have included:

- the development of new sources of gas;
- new pipeline infrastructure, including the Eastern Gas Pipeline (Longford to Sydney) and the expansion of the capacity of the interconnect with NSW through Culcairn.

In April 2002, Mr Grant King, Managing Director of Origin Energy Ltd noted:

'Until deregulation in the 1990s, energy infrastructure was limited and markets were heavily regulated and there was no incentive for people to explore for gas in eastern Australia - as long term contracts were locked up for 25 to 30 years. But the opening up of markets has since stimulated Australian gas exploration with a number of resources waiting to come on line.'

Gas market reform has provided more flexible and price responsive sources of gas supply in south-east Australia and the amelioration of adverse effects of supply failures at the Moomba Gas Processing Plant in South Australia. The market reforms also delivered full retail competition and customer choice.

B.2 Stocktake of other major reforms

Area of activity	Description of reforms
Overarching and machinery of government reforms	
Legislation review	<p>The regulatory decision-making process has been improved through:</p> <ul style="list-style-type: none"> • reviewing legislation and removing redundant legislation. Victoria has met its commitments to undertake legislation reviews in accordance with NCP requirements; • changing sunset arrangements; • instituting the Regulatory Impact Statement (RIS) process. This includes guidance to departments on the preparation of RISs, independent review of RISs, and review by the Scrutiny of Acts and Regulations Committee of Parliament of compliance with the <i>Subordinate Legislation Act</i>; • establishment of the Victorian Competition and Efficiency Commission (VCEC). This independent body will be the State's premier advisory body on business regulation reform. The core functions of the VCEC are to: <ul style="list-style-type: none"> • review RIS and advise on the economic impact of significant new legislation; • undertake business Impact Assessments for all legislation with potentially significant effects for business and competition; • undertake inquiries into specific matters referred to it by Government; and • operate Victoria's Competitive Neutrality Unit (CNU) which ensures government-owned businesses face costs and commercial pressures consistent with those faced by private sector competitors; • the review of anti-competitive legislation has been comprehensive; and • In relation to gatekeeping, Victorian processes ensure compliance with clause 5(5) of the CPA which requires that legislative review principles are taken into account when developing new legislation.
Competitive neutrality	<p><i>Application of competitive neutrality</i> – Competitive neutrality (CN) has applied to all significant public sector business activities in Victoria since 1996. Many of the commercial government businesses have been corporatised or commercialised and others have been sold. All significant government businesses are subject to income tax equivalents. The best practice guidelines for Victorian Government purchasing incorporate CN. Partnerships Victoria also includes CN adjustments in its public sector comparator model.</p> <p>Government businesses that have not been corporatised or commercialised are required to apply the full cost reflective pricing CN measure. Local government uses this measure in relation to specific business activities offered such as childcare services and fitness facilities.</p> <p><i>Incentives for future compliance</i> – Since 1999, the Victorian government has shared 9 per cent of its NCP payments with local government under agreements between the State and each council, providing the Council is assessed as CN compliant. The Competitive Neutrality Unit (CNU) has adopted a more educative role to ensure sustainable acceptance of CN by local government.</p> <p><i>Local government and best value</i> – CN policy has been promoted in the context of a best value framework within local government.</p> <p><i>Educative role of Competitive Neutrality Unit</i> – In December 2002, the CNU changed its name from the 'Competitive Neutrality Complaints Unit' to reflect a change in its approach to competitive neutrality application. The CNU recognised a need to broaden its educational focus in addition to its investigatory role. In 2003, CNU representatives undertook visits to councils, to meet and to conduct workshops on specific issues. The objective of visiting councils is to improve council understanding of CN principles and sustain application of CN policy.</p>

Area of activity	Description of reforms
Mutual recognition and review of professions	Victoria has signed up to mutual recognition of regulatory requirements among States and with New Zealand and removal of licensing requirements for selected occupations.
Government business enterprises and infrastructure reforms	<p>Reforms in provision of infrastructure have included:</p> <ul style="list-style-type: none"> • structural separation (for example, breaking up vertically-integrated utilities), and introduction of competition in markets previously dominated by monopolies (typically government-owned); • separation of contestable and natural monopoly activities; • structural reforms such as privatisation, and commercialisation to provide with a more commercial focus; • establishment of the Essential Services Commission (ESC) as the economic regulator for price and access regulation for essential infrastructure services; • improved governance arrangements and performance targets for public utilities; and • encouraging private sector provision, either by withdrawing from service provision, or by increasing the extent of private provision (eg contracting out, greater use of private capital in public works projects) to full service provision (for example, BOOT-type infrastructure projects).
Natural resource management	
Water	<p><u>Institutional reform and price reform</u></p> <p><i>Structural reforms</i> – the disaggregation of one metropolitan water business into one wholesale business and three retail businesses and amalgamation over 80 water authorities supplying provincial towns into 15 State-owned businesses.</p> <p><i>Pricing and commercial reforms</i> – Victoria's metropolitan water businesses operate on a commercial basis, being Corporations Law companies and State-owned businesses. This commercial focus includes skills-based boards, payment of dividends and competitive neutrality in financing structure, competition by comparison and commercial charters. Victoria's 15 regional urban water authorities, four metropolitan urban water authorities and five rural water authorities are setting prices to achieve full cost recovery. Pricing reforms include the elimination of cross-subsidies, and recouping of operating and maintenance costs in rural water. Victoria's metropolitan urban, regional urban and rural water authorities have implemented consumption-based pricing. Community Service Obligations are funded by government in a transparent manner.</p> <p><i>Economic regulation</i> – On 1 January 2004, the ESC became the economic regulator of the Victorian water industry. The Victorian Government is to issue Statements of Obligation to all water authorities to clarify the Government's expectations of the businesses with regards to the performance of their functions and exercise of their powers.</p> <p><i>Regulation of water quality</i> – On 1 July 2004, a new regulatory framework for drinking water quality will come into operation.</p> <p><u>Water management: water entitlements and provisions to the environment</u></p> <p><i>Sustainable water supplies</i> – The \$320 million Victorian Water Trust was established in 2003 to assist in securing sustainable water supplies for Victoria and in particular, to help address the need for major innovation and new approaches.</p> <p><i>River health</i> – The Victorian River Health Strategy provides the framework by which government in partnership with the community can make decisions on the management and restoration of rivers.</p> <p><i>Water rights</i> – Under the legislative framework of the <i>Water Act 1989</i>, Victoria has established a program to convert the existing rights of water authorities to clearly defined bulk entitlements that provide the basis for sharing resources between water authorities and the environment. In rural water systems that supply water for irrigation, the water rights of individuals are aggregated under</p>

Area of activity	Description of reforms
	<p>bulk entitlements held by rural water authorities.</p> <p><i>Water trading</i> – Victoria has a well established water market with water trading continuing to play an important role in agricultural production. Water trading activity in Victoria occurs within the framework outlined in <i>The Value of Water: A Guide to Water Trading in Victoria</i> and Watermove, the statewide water exchange.</p>
Forestry and fisheries	<p><u>Forestry</u></p> <p><i>Institutional reform</i> – VicForests was established in 2003 as a state-owned corporation. VicForests is a new, independent, commercial entity that is to introduce market based pricing of timber resources sold from state forests. VicForests is required, under the <i>State Owned Enterprises Act 1992</i>, to operate its business as efficiently as possible, consistent with commercial practice. It must be commercially focussed and deliver value for money services. Its overall profitability will depend on the prices that can be realised on the various products, decisions on its role in delivering community service obligations and market access.</p> <p><i>Separation of policy and regulatory functions</i> – Commercial functions are now being split from policy/regulatory functions, following the establishment of VicForests.</p> <p><i>Pricing</i> – Transparent allocation and pricing systems will be facilitated by VicForests' introduction of a new system based on contracts rather than licences. The streamlining of leasing, licensing and permit provisions will facilitate competition and efficiency in the utilisation of forest produce.</p> <p><u>Fisheries</u></p> <p>The reforms have concentrated on:</p> <ul style="list-style-type: none"> • implementation of efficient features of fisheries access licences, such as transferable licences; • allocation of new licences and quotas by mechanisms such as auctions, tender or ballot; • reviews of the limits on the number of persons employed, where applicable; • full cost recovery for fishery management costs is to commence in 2004; • use of royalties or rent taxes; and • investigation of sustainability and compliance issues, to ensure that any input restrictions are based on ecological sustainability of the fishery (that is, to ensure that the public benefit of these restrictions based on the ecological sustainability of the fisheries outweighs any restrictions on competition).
Mining and petroleum	<p>The reviews of legislation have been completed. In some cases, no major restrictions were identified. In those cases where major restrictions were identified, the reviews found either that these were justified in the public interest, or were not justified. In the latter situation, the Victorian Government has removed these restrictions.</p>
Network infrastructure industries:	
Road transport	<p>All road transport reforms in both the first and second heavy vehicle reform packages have been implemented. This covers reforms in the areas of increased mass limits, combined vehicle standards, Australian road rules, combined bus and truck driving hours, consistent on-road enforcement for roadworthiness, the second heavy vehicle charges determination and the ultra-low floor bus axle mass increase. This includes uniform registration charges for heavy vehicles and uniform vehicle regulations. While Victoria may have fully implemented increased mass limits, there is a query over the full impact being generated until all jurisdictions have completed the reform.</p> <p>Reforms in the provision of road infrastructure include increased private sector participation in the construction and maintenance of public roads.</p>

Area of activity	Description of reforms
Rail transport	<p>Major reforms include:</p> <p><i>Institutional and pricing reform</i>— This includes prices surveillance and competitive neutrality in pricing. Community Service Obligations for light general freight are covered by a service agreement based on transparent payment by government.</p> <p><i>Third party freight access</i> – On 1 July 2001, the Freight Network together with the strategically located Dynon and South Dynon Terminals and Bayside Network were declared for freight purposes. This means that the access regime now applies to all intrastate tracks in Victoria used for the carriage of freight.</p>
Shipping and ports	<p>Major reforms include:</p> <p><i>Institutional reforms</i> – The four Victorian ports (Melbourne, Geelong, Hastings and Portland) have undergone significant structural reform since 1995. There has been a separation of regulatory and commercial activities. The Port of Melbourne is a state-owned corporation, which operates with a commercial focus. The ports of Portland and Geelong have both been sold.</p> <p><i>Price and Access Regime forming part of economic regulation</i> – The independent economic regulator is the ESC. The ESC oversees competitive neutrality in pricing, efficient pricing to address potential monopoly pricing where there is substantial market power and the access regime.</p> <p><i>Channel management</i> – The <i>Port Services (Port Management Reform) Act 2003</i> establishes the Victorian Regional Channels Authority (VRCA) as the legal successor to the Victorian Channels Authority (VCA) with responsibility for all of Victoria's commercial shipping channels, except those servicing the Port of Melbourne, which are now the responsibility of the new Port of Melbourne Corporation (POMC). A new access regime is being developed. Declaration of the commercial shipping channels in Port Phillip Bay, and potentially other commercial ports, is expected to occur during 2004 following further consultation with the ESC and port operators. In the meantime, the VCA and the POMC have entered into a formal agreement for the provision of channel services by POMC to VCA (and its successor, the VRCA). This agreement is subject to the oversight and endorsement of the ESC to ensure that competitive neutrality in terms of access and pricing between Melbourne and Geelong is maintained.</p> <p>Divestment of non-core and non-commercial assets and functions from ports.</p> <p>Sale of onshore port assets (Ports of Portland and Geelong).</p> <p>Contracting out of services.</p> <p><i>Competitive neutrality</i> – All of the new entities created through the two-stage legislative process in response to the Russell Review – the Port of Melbourne Corporation, the Victorian Regional Channels Authority and the Port of Hastings Corporation – are port corporations under the <i>Port Services Act 1995</i>. Therefore they are subject to the same competitive neutrality principles and requirements as their predecessors. Each is subject to all State and Federal taxes in compliance with the Victorian Tax Equivalence System, all State and Federal regulations applying to private sector organisations, all local government rates and charges, and the State's Financial Accommodation Levy.</p>
Public transport	<p><u>Country passenger rail and coach services</u></p> <p>These services have been tendered out by the Government. Current contracts with service providers are due to expire on 28 August 2009. The Government has also committed to the re-establishment of passenger rail services in additional regional areas and contracts for these services are being tendered.</p> <p><u>Train and tram services</u></p> <p>These services, previously provided by the Public Transport Corporation, are provided by private companies under partnership agreements. New partnership agreements have been executed between Yarra Trams and Connex to establish one metropolitan tram company and one metropolitan train company to deliver stable and improved services to customers and to achieve efficiencies through economies of scale.</p>

Area of activity	Description of reforms
Other industries	
Unincorporated enterprises	Examples include: the removal of restrictions on employment of dental auxiliaries, removal of monopoly on conveyancing, advertising by barristers and entry to specialist professions.
Professions and occupations	Legislative reforms have been made for private agents, surveyors, architects, estate agents and travel agents.
Agriculture	<p>The major areas of deregulation have been:</p> <p><i>Dairy</i> –statutory marketing arrangements (which had been used to set farm gate market milk prices and production levels) have been removed.</p> <p><i>Egg marketing</i> –statutory marketing arrangements (which had been used to set egg prices and production levels) have been removed.</p> <p><i>Barley</i> –from 1 July 2001, the single export desk for Victorian barley was removed, meaning growers are no longer required to sell their export grain to ABB Grain Export Ltd. This followed domestic market reform for feed and malting barley in mid-1999.</p> <p><i>Grain handling</i> –storage, handling and transport of grains has been deregulated. The <i>Wheat Marketing Act 1989</i> has been repealed.</p>
Taxis, hire cars and tow trucks	<p><u>Taxis and hire cars</u></p> <p>Entry has been relaxed and opened with the issue of additional peak service taxi licences (a minimum of 100 per year for 12 years).</p> <p>Victoria has removed the needs test restriction on entry into the hire car industry and relaxed vehicle type standards for hire cars.</p> <p>The ESC will undertake an independent and public review of any proposals for increases in taxi fares.</p> <p>The Bendigo Stock Exchange (BSX) has been appointed to accredit brokers who trade in taxi licences and to manage a public register of prices paid for licence transfer and assignment transactions.</p> <p><u>Tow trucks</u></p> <p>Victoria has removed the needs test restriction on entry into trade towing.</p> <p>An independent public interest test is currently being undertaken of the needs test restriction on entry into accident towing services.</p> <p>The ESC is to undertake an independent and public review of any proposals for increases in accident towing fees.</p>
Health and pharmaceuticals	<p><u>Private provision of hospital services</u></p> <p>The private sector has increasingly become involved in the provision of hospital services through private provision of traditional private hospital services, contracted private services in a public hospital, BOOT type arrangements, joint delivery of public and private hospital services by the one private service provider, and co-location or shared service provision.</p>
Other professional, occupational and business licensing	<p><u>Deregulation of the conveyancing profession</u></p> <p>There is increased competition in the market for conveyancing services by removing fee scale regulation, permitting fee advertising and reductions in restrictions on entry into the market for conveyancing services.</p> <p><u>Deregulation of the optometry profession</u></p> <p>Victoria reduced regulatory barriers to the supply of optometry services.</p>
Fair trading and consumer legislation	Victoria has met its NCP commitments in relation to fair trading.
Finance, insurance and superannuation	The Government accepted the recommendations of the reviews of workers' compensation arrangements and transport accident compensation to retain the single manager for each scheme. The ESC will advise on premiums for both.

Appendix B

Area of activity	Description of reforms
Retail	There has been deregulation of shop trading hours, with the removal of most restrictions on shop trading hours. There has been liquor licensing reform which is detailed in a Case Study at Appendix E.
Gaming	Reforms have been focussed on ensuring that legislation and regulations are in the public interest. This includes increasing the scope for competition where possible, streamlining of regulatory processes and introduction of further responsible gaming measures.
Planning, construction and development services	The reviews found that the main restrictions contained in the following legislation were in the public interest: <i>Planning and Environment Act 1987</i> , the <i>Architects Act</i> , and the entry barrier in the <i>Surveyors Act 1987</i> .

Appendix C: Literature Review of Impact of NCP and Related Reforms

Two strands of literature shed some light on the benefits of NCP reforms:

- macroeconomic level studies that examine Australia's aggregate productivity performance during the 1990s, with possible explanations of the 'acceleration' in productivity improvement; and
- specific case studies of microeconomic reforms (including NCP) at the industry or microeconomic level.

C.1 Macroeconomic studies

The focus of macroeconomic studies has been on exploring Australia's productivity performance during the 1990s and, in particular, the apparent acceleration of labour and multifactor productivity in the late 1990s. As observed by Parham (2002a), productivity growth in Australia more than doubled in the 1990s to reach record high levels, outperforming the OECD average.

The majority of studies to examine the impact on productivity of NCP and other aspects of a more proactive domestic competition policy do so within the context of *broader* microeconomic reforms, which include liberalisation of trade and investment; deregulation of capital markets; more flexible institutional arrangements for labour markets; and the restructuring of public utilities.

As noted by the Productivity Commission (1999a), microeconomic reforms have helped raise Australia's productivity performance.

A number of analysts, calling on a range of empirical and other evidence, have found that microeconomic policy reforms have played a major role in Australia's productivity surge. For example, the OECD's Growth Project (2001) highlights the importance of competition in stimulating productivity performance in Australia, while an earlier International Monetary Fund study (Singh *et al*, 1998) examined in detail a range of macro and micro factors affecting Australia's performance. Citing government interventions that shielded large sectors of the Australian economy from competition as an important factor behind the disappointing productivity growth rates prior to the 1990s, the OECD study attributed much of the improved productivity performance thereafter to structural reforms that opened the economy, made product and factor markets more flexible and input use more efficient.

In a series of papers, Dean Parham concludes that microeconomic reforms provide the *major* explanation for the upturn in Australia's productivity performance (with more modest roles being played by the smarter use of information and communications technology, and a better educated and highly-skilled workforce).

Analysing panel data from 20 OECD countries (including Australia), Salgado (2000) found that structural reforms – comprising trade liberalisation, labour market reform and increased competition – had lifted Australia's trend multifactor productivity in the 1990s by between 0.5 and 0.9 of a percentage point.

The Productivity Commission provided one of the few examples of analysis that attempts to isolate the specific impact of NCP reforms on macroeconomic variables. In its October 1999 Inquiry Report, *Impact of Competition Policy Reforms on Rural and Regional*

Australia, the MONASH-RR model is used to estimate the major macroeconomic impacts of the following significant NCP reforms:

- gas and electricity;
- rail transport;
- road transport;
- telecommunications;
- water; and
- Commonwealth and State statutory marketing authorities.

The economy-wide impact of this modelling is presented in Table C.1.

Table C.1: Estimated macroeconomic effects of selected NCP reforms
(per cent change)

	Electricity & Gas	Rail transport	Road transport	Telecom	Water	SMA's	All NCP reforms
Real GDP	1.1	0.2	0.2	0.8	0.0	0.1	2.5
Real consumption	1.0	0.3	0.3	1.0	0.0	0.3	2.8
Post-tax real wages ¹	1.4	0.2	0.2	1.0	0.2	0.5	3.4

Source: MONASH-RR projections, as published in the Productivity Commission's Inquiry Report, Impact of Competition Policy Reforms on Rural and Regional Australia, October 1999.

Note:

1. In its modelling, the Productivity Commission assumed that the benefits of additional economic growth would be reflected in improvements in real wages rather than increases in employment.

The main results of this analysis can be summarised as follows:

- the selected NCP reforms provide a sustained increase in output (as measured by real gross domestic product, GDP) of 2.5 per cent above what would otherwise occur in the absence of the reforms;
- the estimated annual gain in real household consumption is 2.8 per cent; and
- lower domestic production costs arising from the NCP reforms are estimated to enhance the competitiveness of Australian exporters.

C.2 Microeconomic studies

In terms of studies that examined the impact of NCP reforms at the specific industry/sector level, the Productivity Commission once again provides a valuable source of information.

As part of its November 1999 Research Paper, *Microeconomic Reforms and Australian Productivity: Exploring the Links*, the Commission presents a number of detailed industry case studies, noting positive outcomes in white goods, the automotive industry, textiles, clothing and footwear (TCF), rail freight operations in New South Wales, and the introduction of competitive tendering and contracting out at Yarra Valley Water.

In each case, the report examines the impact on, and adjustment of, the industry/sector as a result of recent microeconomic reforms, focusing on changes in productivity

performance. Key findings of the industry/sector-specific analysis included the benefits of competitive tendering and contracting. These benefits included greater labour productivity levels in civil maintenance services at Yarra Valley Water due to the introduction of new computerised technology; an increased focus on business processes; and the increased flexibility of labour utilisation.

Appendix D: Modelling the Impact of NCP Reform

D.1 Introduction

This appendix examines the economic impact of elements of the NCP reforms outlined in reports by the Industry Commission (1995) and Productivity Commission (1999). The estimates draw on the original modelling of the NCP reforms by the Industry Commission, subsequent updates to the initial modelling by the Productivity Commission, and assessments by the Victorian Department of Treasury and Finance (DTF) analysts.

The economic impact is examined using the MMRF-GREEN general equilibrium model. Our estimates of the impact on productivity and other economic variables are drawn largely from the original modelling of the Hilmer reforms by the Industry Commission, subsequent updates to the initial modelling by the Productivity Commission, and input on NCP reform from DTF analysts.

D.2 Modelling approach: using the MMRF-GREEN general equilibrium model

The model and closure assumptions

DTF uses the MMRF-GREEN general equilibrium model. The model divides Australia into regions representing the six States and two Territories. It models each region as an economy in its own right, with region-specific prices, consumers and industries. There are four types of agent: industries, households, governments (national and regional) and foreigners. The 32 sectors identified in the model can produce a variety of products, and each creates a single type of capital. Capital is sector and region-specific. Finally, the model includes demand curves for international exports and supply curves for international imports.

The distinguishing feature of the MMRF-GREEN model is that each State and Territory economy is modelled individually with explicit recognition of interstate trade flows. However, this regional modelling is conducted within a national economic framework that recognises that some variables (such as the exchange rate) are determined nationally. Economic shocks, including changes to underlying productivity in specific industries, can be applied to individual States.

The modelling is 'long-run' in that:

- industry capital stocks fully adjust to the productivity improvement;
- national employment is unchanged;
- State employment (and population) levels adjust in response to changes in the demand for labour by each industry (with unchanged labour force participation rates in each State, this implies that State unemployment rates are unchanged);
- Commonwealth and State tax rates are fixed, expenditure and grants move in line with economic growth (including Commonwealth grants to the States), and the budget balance for each government adjusts accordingly. This differs from the approach taken

by the Productivity Commission (1999) where income tax cuts were modelled in response to higher government revenue from the reforms; and

- the trade balance of each region is endogenous and the ratio of State government consumption to private consumption is fixed.

In our modelling we have taken a comparative static approach. This means the results give the difference between our scenario and what the economy would otherwise have looked like in the absence of the reforms modelled.

The reforms modelled

DTF estimates of the economy-wide impacts of these NCP reforms should be treated as indicative in nature. This is because general equilibrium modelling involves various simplifying assumptions and approximations, including estimations of the direct impact of the reforms in the affected industries, assumptions inherent in the structure of the model (such as substitution elasticities and industry shares) and the extent to which other features of the economy do not change in response to the reforms.

In summary, we have modelled NCP reforms for eleven areas:

- Electricity and gas - Productivity gains from increased competition and contestability (higher in Victoria where reforms have been more extensive), relative price changes from removing cross-subsidies, and lower gas prices from interstate trade;
- Water - Productivity gains from commercialisation, and relative price changes from removing cross-subsidies;
- Rail transport - Productivity gains from corporatisation and removing statutory monopolies, and relative price changes;
- Road transport - Productivity gains from uniform regulations, and higher road construction costs;
- Telecommunications - Productivity gains from competitive reforms;
- Statutory marketing arrangements - Reduced costs in the dairy industry following removal of quantitative restrictions on marketing;
- Unincorporated enterprises and business services - Productivity gains in the health and business services industries;
- Postal services - Productivity gains from the removal of the monopoly element of many services;
- Federal airports/Airservices Australia - Productivity gains from competition among privatised airports, and corporatisation of finances of Air Services Australia;
- Ports - Productivity gains from corporatisation and contracting out; and
- Overall review of anti-competitive legislation - Removal of over-regulation across industries, including in professional occupations, tendering of government services, and building regulations.

D.3 Modelling results

In most cases, the NCP reforms involve an improvement in the productivity of factors of production in particular industries in Victoria and (usually) other States. In the model, the

direct impact on the national or State economy of an improvement in productivity in a particular industry in the long run is to increase GDP or GSP per employed person by the amount of the industry productivity gain, adjusted by that industry's share of GDP/GSP. Because population movements are proportional to changes in employment levels in the model, the impact on GDP/GSP per employed person will be the same as the effect on GDP/GSP per capita.

There will also be indirect effects as reforms in one industry affect costs in others. These indirect effects occur if:

- an industry can supply goods or margin services (activities that facilitate trade, such as wholesale trade or road transport) to other industries at lower cost,
- there is a lowering of investment costs across the economy, and/or
- improved competitiveness in one industry leads to increased demand for the products supplied to that industry.

Finally, the NCP reforms are likely to increase the national real wage in the long run. This is because labour is the fixed factor of production in the long run and the benefits of the reforms accrue to the fixed factor.

Table D1 shows that for Victoria:

- the NCP reform package, as modelled, results in a 2.05 per cent (or \$3.8 billion) improvement in long-run GSP, compared to what it would have otherwise been in the absence of the reforms, with an associated improvement in consumption of 2.33 per cent. Investment is also estimated to be 1.63 per cent higher as a result of the package of reforms, and in terms of living standards (GSP per capita), Victoria is better off by 1.70 per cent as a result of the NCP reforms; and
- in general, when Victoria generates a greater impact on the Australian outcome than the rest of Australia, employment and population rise in Victoria (at the expense of other States and Territories). This is the case for the overall NCP reforms package and in all but a few of the individual reforms.

Table D2 presents the estimated long-run macroeconomic impacts for Australia as a result of the NCP reforms. Table D2 shows that, for Australia as a whole:

- the NCP reform package results in a 1.50 per cent (or \$11.0 billion) improvement in long-run GDP, compared to what it would have otherwise have been, with an associated improvement in consumption of 1.84 per cent. Investment is estimated to be 1.13 per cent higher as a result of the package of reforms and the national real wage is expected to rise by 2.45 per cent; and
- Victoria is estimated to do better than Australia as a whole mainly due to making more significant reforms in the areas of electricity/gas and statutory arrangements for the dairy industry, compared to the other States and Territories.

Table D1: Estimated real long-run macroeconomic impacts for Victoria**
(per cent change)

Reform component	GSP	Consumption	Investment	GSP per capita	Employment*
Electricity and gas	0.68	0.95	0.83	0.54	0.14
Water	0.33	0.48	0.36	0.12	0.21
Rail transport	0.06	0.03	0.05	0.04	0.02
Road transport	0.13	0.14	0.09	0.14	-0.01
Telecommunications	0.30	0.19	-0.12	0.48	-0.18
Statutory marketing arrangements	0.24	0.29	0.19	0.01	0.23
Unincorporated enterprises	0.16	0.12	0.14	0.21	-0.05
Postal services	0.07	0.03	0.02	0.11	-0.04
Federal airports/Airservices Australia	0.01	0.02	0.01	0.00	0.01
Ports	0.01	0.02	0.01	0.01	0.00
Review of anti-competitive legislation	0.13	0.12	0.07	0.13	0.00
TOTAL NCP reforms package	2.05	2.33	1.63	1.70	0.35

* The percentage impact on employment is the same as for population.

** All results are expressed in real terms. Note that the aggregate figures do not equal the sum of the individual components.

Source: DTF estimates using MMRF-GREEN.

Table D2: Estimated real long-run macroeconomic impacts for Australia*
(per cent change)

Reform component:	GDP**	Consumption	Investment	Real wage
Electricity and Gas	0.45	0.72	0.61	1.00
Water	0.11	0.25	0.09	0.34
Rail transport	0.06	0.01	0.04	0.02
Road transport	0.13	0.14	0.09	0.16
Telecommunications	0.40	0.36	0.02	0.50
Statutory marketing arrangements	0.01	0.04	0.01	0.03
Unincorporated enterprises	0.21	0.17	0.18	0.22
Postal services	0.09	0.06	0.05	0.08
Federal airports/Airservices Australia	0.01	0.01	0.01	0.01
Ports	0.01	0.01	0.01	0.02
Review of anti-competitive legislation	0.12	0.11	0.06	0.15
TOTAL NCP reforms package	1.50	1.84	1.13	2.45

* All results are expressed in real terms. Note that the aggregate figures do not equal the sum of the individual components.

** Since national employment is effectively fixed in the long-run, the GDP per capita result is equivalent to the GDP result.

Source: DTF estimates using MMRF-GREEN

Components of the reform package

The results are discussed below in terms of the individual components of the NCP reform package:

Electricity and gas

The results show that Australian GDP increased by 0.45 per cent due to the NCP reforms in electricity and gas.

Victorian GSP increased by 0.68 per cent, more than the other major States. Victorian consumption rises by 0.95 per cent and investment by 0.83 per cent. As a result there is a deterioration in net exports for Victoria. Victorian employment is increased slightly (by 0.14 per cent) as workers are attracted to Victoria from other States. The industries that gain the most are the electricity generation and supply industries, urban gas distribution and the big users of electricity (e.g. the aluminium industry) and those industries that produce large inputs to the electricity industry (e.g. the coal industry).

Water

We estimate that Victoria received a 0.33 per cent gain in GSP as a result of the reforms. This is higher than the national GDP result.

Victorian consumption rises by 0.48 per cent and investment by 0.36 per cent. The Victorian industries that gain as a result of the water reforms include the trade/hotels industry, the food and drinks industry and the construction industry. The construction industry gains because an increase in the real economic rate of return for the water industry induces higher investment and in turn greater demand for construction services.

Rail transport

We estimate a 0.06 per cent long-run GSP improvement as a result of the rail transport reforms modelled. This is in line with the national GDP result. The Victorian consumption result is half the GSP gain. Investment in Victoria is estimated to rise by 0.05 per cent. In this case there is a net improvement in net international exports for Victoria.

The rail transport industry benefits directly as a result of the rail reforms and since rail services are a margin commodity, a broad cross section of using industries (mainly energy related industries) benefit as a result in lower margin costs.

Road transport

Victorian GSP and national GDP increased by 0.13 per cent due to the road transport reforms. Consumption rises by 0.14 per cent in Victoria. Investment is estimated to rise by 0.09 per cent. Victoria's net international trade balance shows little movement. Most industries benefit, as road transport is modelled as a margin on trade. The mining industry benefits the most, and as a result Western Australia's GSP grows by more than the other States. Given that the Victorian and national impacts are similar, there is no notable effect on Victorian employment.

Telecommunications

The labour and capital productivity improvement in the telecommunications industry causes national GDP to grow by 0.40 per cent, and Victorian GSP to grow by 0.30 per cent. Consumption in Victoria rises by 0.19 per cent, while net international exports for Victoria improved as a result of the strong productivity improvements.

Statutory marketing arrangements

Various agricultural industries have statutory marketing arrangements. Our modelling examines only the dairy industry, because it is by far the most important to Victoria (Victoria accounts for about two thirds of Australian milk production).

The increased competitiveness of Victorian dairy relative to the other States contributes to an expansion in Victorian GSP of 0.24 per cent, while GSP in most of the other States shrinks slightly. Consumption in Victoria increases by 0.29 per cent and employment increases by 0.23 per cent. National GDP grows by only 0.01 per cent.

Unincorporated enterprises

The reforms related to unincorporated enterprises are assumed to improve labour productivity across the economy. We estimate that Victorian GSP rises by 0.16 per cent, in line with the national GDP result of 0.21 per cent. Victoria's aggregate labour productivity (GSP per capita) rises by 0.21 per cent.

Postal services

Postal services reform is modelled as a nationwide labour productivity improvement. The estimated impact is similar for each State and Territory, with Victorian GSP estimated to rise by 0.07 per cent, in line with the national estimate of 0.10 per cent. Victorian consumption expenditure rises by 0.03 per cent, investment by 0.02 per cent and net international exports improve.

Federal Airports Corporation / AirServices Australia

We estimate an increase in GDP and Victoria's GSP of about 0.01 per cent. Real consumption is 0.02 per cent higher in Victoria, slightly higher than the result for Australia as a whole of 0.01 per cent.

Ports

GDP is estimated to increase by about 0.01 per cent, and Victorian GSP increases by 0.01 per cent.

Review of anti-competitive legislation

The review of anti-competitive legislation, including removal of over-regulation across industries (including in professional occupations), tendering of government services, and building regulations, has been modelled as a uniform labour productivity improvement across all States and Territories. Hence, the increase in Victorian GSP of 0.13 per cent is in line with the national results.

Appendix E: Case Studies of the Victorian Experience

CASE STUDY: ELECTRICITY REFORMS

Nature of reforms

The NCP commitments for electricity reform were established under the Agreement to Implement the National Competition Policy and Related Reforms, the Competition Principles Agreement and other agreements on related reforms for the electricity market.

The reforms provided for a fully competitive national electricity market (NEM), featuring a national wholesale electricity market, an interconnected national electricity grid, open access to the grid under an agreed National Electricity Market Access Code, and the introduction of full retail competition.

Victoria began operating a wholesale electricity market (VicPool) in October 1994 which was extended to a NEM involving NSW, the ACT and SA in May 1997. The NEM as currently operating under the National Electricity Code with the addition of Queensland commenced in December 1998.

Horizontal structural change in Victorian electricity generation provided for the establishment of five independent generation businesses which were then privatised. The five businesses were established at the plant level which provided sufficient economies of scale and created sufficient competitive pressures to ensure a reduction of the wholesale price of electricity.

Horizontal changes were introduced in the distribution and retail sector by establishing five businesses which were also privatised. The distribution businesses were required by legislation to provide open access to their grid.

Mergers and acquisitions since privatisation have further separated distribution and retail activities.

A second round of COAG-sponsored reform commenced in June 2001 to realise the full benefits of the market reforms for electricity and gas. The Ministerial Council on Energy (MCE) was charged with addressing a series of priority tasks and overseeing an independent review of energy markets directions.

The MCE Report on Reform of Energy Markets was submitted to COAG in December 2003. Victoria played a leading role in the development of the Report and securing the agreement of the MCE.

The Report recommended reforms to governance, economic regulation, electricity transmission, user participation and natural gas penetration to provide a basis for the development of a truly national and efficient energy market. COAG has accepted the recommendations and implementation is underway.

Governance will be simplified as the COAG Ministerial Council on Energy assumes full responsibility for national energy policy development.

A major element of the reform program is the establishment of national regulation of electricity and gas, including distribution and retailing (other than retail pricing). This new framework will improve the quality, efficiency and uniformity of regulation - with benefits to business competitiveness and the delivery of electricity and gas services to consumers.

The new structure provides for a single Australian Energy Regulator (AER), with a new Australian Energy Market Commission (AEMC) to be responsible for market rules and network access codes. The AER and AEMC are expected to commence on 1 July 2004. The national framework for regulating distribution and retailing (other than retail pricing) will commence in 2006.

Co-operative arrangements will be developed between the new bodies and the ACCC to provide streamlined management of competition issues in the energy sector.

The transmission reform package includes the establishment of a new NEM transmission planning function. An Annual National Transmission Statement will commence in 2004.

The national energy market reforms also include new arrangements to enhance the participation of energy users in the markets.

The MCE will consider further reforms in 2004 to the national gas market and network access regime following consideration of the lessons of recent supply interruptions and the Productivity Commission review of the gas access regime, due to report in June 2004.

What were the Impacts?

Experience since the disaggregation of the Victorian electricity industry has demonstrated:

- Increasing production efficiency in generation;
- Increasing availability and reliability in generation;
- Reduced operating costs for generators, distributors and retailers;
- Delayed the need for investment in additional generating capacity;
- Increased reliability of network services; and
- Reduced wholesale and retail prices.

CASE STUDY: LATROBE VALLEY MINISTERIAL TASKFORCE***Adjustment assistance***

The Latrobe Valley Taskforce was established in 2000 in response to the economic and social upheaval in the Latrobe Valley through the restructuring of the electricity sector which was a key industry in the region.

Following receipt of the Taskforce's report, the Victorian Government approved a \$106 million package of 50 initiatives designed to boost community confidence, facilitate economic growth and improve opportunities for the most disadvantaged in the Latrobe Valley. The major elements of the package included:

- marketing to potential growth industries;
- digital geological model of the valley coal resources;
- support for research and development into mechanical thermal expression (coal drying) technology for Clean Power from lignite;
- development of an aviation-focused industrial estate at the Latrobe Regional Airport;
- clearing and decontamination of potential industrial land in Morwell;
- transformation and renewal of public housing stock;
- resources for the Community jobs program and support for training of apprentices from Years 10-12;
- establishment of the Gippsland Learning and Integration Centre and redevelopment of the Traralgon Secondary College;
- facilitation of the establishment of the Latrobe Valley Small business Network; and
- financial assistance to support vulnerable families and individuals.

The package of initiatives illustrates the State Government's commitment and ability to influence a wide range of drivers of community and business development and structural adjustment.

CASE STUDY: GAS INDUSTRY

Why did we undertake reform?

The main aim of the GOAG Agreements is to create a national gas market characterised by more competitive supply arrangements.

What happened?

Victoria implemented substantial changes to the structure of the former Gas and Fuel Corporation, which included:

- the separation of transmission from distribution/retail;
- separation of the network operation function from its ownership and maintenance;
- separation of the distribution and retail function into three separate businesses; and
- separation of the State's single gas purchase agreement with the Gippsland Basin producers into an allocation to each of the retailers, and sale of a fourth allocation to a new retail entrant. The single gas purchase agreement was later sold to the three principal retailers.

Victoria also established a wholesale gas spot market on the Principal Gas Transmission System (PTS) managed by VENCORP and legislated transitional limits on cross-ownership between the new entities in electricity and gas to allow competition to develop. Victoria took a lead role in the reforms given the importance of effective energy markets and the signals they provide for efficient and timely investment in energy for Victoria.

Victoria is also played a leading role in the development of the MCE Reform of Energy Markets program agreed by COAG in 2004, and is leading the development of implementation arrangements for a national framework for distribution and retailing, and a national energy access regime.

The Significant Producer Provisions (SPP) in the Gas Industry Act 2001(GIA) were introduced as a transitional measure to regulate anti-competitive market conduct by large gas producers. They have been repealed following the development of a more competitive upstream market.

Victoria initiated a review by VENCORP of the pricing and balancing arrangements on the PTS in April 2003, for report to the Government by June 2004. The objective to establish more efficient arrangements as gas supply diversifies and gas-fired power generation increases. .

The review is an important component of the Government's strategy for ensuring ongoing investment in energy supplies, and for meeting energy demand efficiently and sustainably. Victoria already has the most advanced and competitive gas market in Australia, and this review will ensure Victoria continues to lead the way in energy market initiatives.

What were the Impacts?

Victoria's gas market reform program has provided the framework and impetus for substantial market development providing increased competition and efficiency. Major developments have included:

- full retail competition and customer choice and more flexible and price responsive sources of gas for all customers;

- increasing availability and reliability of gas transmission and distribution;
- new sources of gas and higher levels of gas exploration in Australia;
- increased access to capital and technology, the construction of considerable new pipeline infrastructure and new resources waiting to come on line; and
- reduced fatalities and gas related incidents since the establishment of the Office of Gas Safety.

CASE STUDY: CURRENT REVIEW OF THE SYSTEM OF REGULATION OF VICTORIA'S REGISTERED HEALTH PROFESSIONS

Since 1995, Victoria has performed a systematic review and reform of all Victorian health practitioners under our NCP obligations. To date, professions which have undergone reform include: medical practitioners, chiropractors; osteopaths; optometrists; podiatrists; physiotherapists; dentists; psychologists; Chinese Medicine practitioners; nurses; and pharmacists.

Why are we undertaking further reform?

The framework for regulating Victoria's health professionals should be up-to-date, responsive and equip health practitioner registration Boards to protect the public and address emerging challenges. Further reform of the regulatory system will assist in promoting consumer and community confidence in the operation of Victoria's regulatory scheme. Reform will also enhance links between mechanisms that oversee practitioner quality and those that ensure health system quality.

What has happened?

The Department of Human Services has commenced a review of the system of regulation of Victoria's registered health professions. A discussion paper was released in October 2003. Submissions received are being reviewed, with further consultation to occur. It is proposed that legislation will be introduced in Autumn 2005.

What were the intended impacts?

It is intended that the reforms will facilitate:

Greater accountability: registration boards should be accountable to the Victorian community for their decisions and operations.

Increased transparency: the decision-making processes of registration boards should be open, clear, and understandable to both consumers and professionals.

Fairness: registration boards should maintain an acceptable balance between protection of patients/consumer rights and interests, and those of the regulated health professionals.

Effectiveness: the regulatory system should be effective in protecting the public from harm and supporting and fostering the provision of high quality care.

Greater efficiency: the resources expended and the administrative burden imposed by the health professions regulatory system should be justified in terms of the benefits to the Victorian community.

Greater flexibility: the regulatory system should be able to respond to emerging issues in a timely manner as the health care system evolves and the roles and functions of health professionals change.

Improved consistency: there should be consistency across Australian States and territories in the regulatory arrangements for the health professions.

CASE STUDY: LIQUOR LICENSING REFORMS

Victoria's experience with applying NCP to liquor licensing laws highlights the benefits that competition reforms can bring to consumers, while demonstrating how the transition process can be designed to take account of those who may be adversely affected by reform.

What reform was undertaken?

Victoria's NCP review of its liquor licensing framework in 1998 led to a major pro-competitive reform package that included:

- abolishing the 'needs criteria' for new licence applications;
- replacing the 'primary purpose' licence condition with a 'predominant activity' test, ;
- streamlining the number of licence categories from 17 to 9; and
- the abolition of the 8% limit on a person or company's holdings of general (ie. hotel) licences, but the retention of the 8% limit with respect to holdings of packaged liquor licences (which are required to operate liquor stores).

The NCC concluded in its second tranche assessment that Victoria would need to abolish the 8% limit in order for it to be compliant with its NCP commitments.

The Government commissioned a further review in 2000 to examine the socio-economic consequences of the eight per cent rule. The review found that although the Victorian packaged liquor market was intensely competitive, particularly compared to other States, the 8% rule was becoming ineffective over time in promoting diversity in the industry and protecting small liquor retailers from competition by the major chains.

In response to the review's findings the Government announced new arrangements for the packaged liquor industry. The key elements of the reform package include:

- an orderly legislated phase out of the 8% rule, with the cap abolished from the end of 2005;
- transitional arrangements during the phase-out period, whereby the major chains can generally only obtain additional licences by offering to buy out existing small liquor stores; and
- the major chains agreeing to provide funding of \$3m over the phase out period to establish an innovative \$3m Packaged Liquor Industry Development Trust Fund. The aim of the fund is to ensure that small liquor retailers have access to the right support and advice to improve their competitiveness in the market. The fund cannot be used to compensate liquor store owners.

What were the impacts?

The Victorian Government's reform of the 8% limit represents a balanced approach to NCP, whereby competition reform is implemented in a supportive transitional environment that enables small business to adapt. By providing advance notice of the changes, small businesses have the opportunity within a stable regulatory environment to re-position their business. The transitional period also enables the industry to develop long-term strategies through the Packaged Liquor Industry Development Trust Fund that will improve the capacity of small businesses to compete into the future.

CASE STUDY: DEREGULATION OF THE DAIRY INDUSTRY

Nature of reforms

In July 2000, farm gate prices across Australia for market and manufacturing milk were deregulated. In concert with the removal of State Government regulation of the farm gate price for market milk, the Commonwealth removed price support arrangements for manufacturing milk.

To assist with dairy industry restructuring, the Commonwealth Government established the \$1.63 billion Dairy Structural Adjustment Program. Under this program, assistance is provided to dairy farmers over an eight year period, funded by a levy (of 11 cents per litre) on consumers of fresh milk.

What were the impacts?

In addition to the expected fall in farm gate prices for fresh milk (to levels close to manufacturing risk adjusted milk prices), deregulation has led to, or assisted, many other improvements. These include rationalisations in the farm and processing sectors. There is now a higher level of specialist production of dairy products, such as cheeses, produced through groupings of farmers at the local level.

Price competition was also facilitated by the tendering by large retailers of the production of generic milk products.

These reforms have also assisted in providing a larger range of choice for consumers, via the diversity of dairy products now available at retail outlets.

CASE STUDY: DEREGULATION OF THE BARLEY INDUSTRY***Nature of reforms***

Prior to the reforms, barley marketing in Victoria was highly regulated. Legislation applying in Victoria and South Australia meant that the barley grown in Victoria and South Australia had to be sold to the Australian Barley Board (ABB).

The independent legislative review found that the existing arrangements enabled ABB to extract a higher price on the domestic market, and that the restrictions of competition led to a net community cost (estimated to be \$8.5 million per year).

In response to this review, the Victorian Government removed all restrictions on the sale, delivery and purchase of barley for domestic stockfeed purposes in 1999-00. This single export desk was removed for grain harvested after the 2000-01 season.

Impacts of reforms

Since the reforms, the benefits of deregulation have occurred in grower choice, investment, innovation and marketing.

The reforms concentrated on providing choice to growers, so they can take advantage of changes in the domestic and export markets. This now enables growers to shop for the best deal when they sell barley grain. This includes the option of trading grain through ABB Grain Export Ltd. In addition, growers now have greater choice in how they manage their various risks. This includes ability of growers and exporters to negotiate on forward contracts. Deregulation also allows for new competitors and innovation in related services such as financing for growers.

There has been considerable rationalisation and vertical integration across the grain industry to achieve benefits of scale and scope.

Deregulation has led to increased investment by growers in on-farm storage and segmentation, to take advantage of niche market opportunities (for example, specialised types of malting barley and grain certified as organically grown).

CASE STUDY: COMPETITIVE NEUTRALITY (CN) AND LOCAL GOVERNMENT

Why did we undertake reform?

CN reforms have been implemented to ensure that government-owned businesses do not gain a competitive advantage by virtue of their government ownership, thus encouraging private businesses to compete with the government businesses.

What happened?

Indigo, Casey and Monash Councils have applied CN principles to their significant business units.

Indigo

The Indigo Way Services (IWS)/Indigo Shire model operates on a vertical split with fully separated activities. The pricing of IWS's tenders provides the Council with an accurate assessment of the costs of operating a range of community services including pools, maternal and child health, homecare and road construction. IWS actively tenders for work within and outside of the Shire, which brings benefits to the local community and through the use of locally based sub-contractors also adds to the local economy.

Casey

The City of Casey opened its largest leisure centre in 2001, the Casey Aquatic and Recreational Centre (ARC). This centre has a large gym, two pools and a wave pool with a construction cost of \$17 million. It conducted 10,800 swim lessons and had 364,000 visits to its gym in the past year. There are several smaller private competitors within its catchment; some have operated for many years prior to the opening of the Casey ARC. The Victorian State Government provided a \$5 million grant towards the centre.

Competitive Neutrality's (CN) full cost reflective pricing principles have been applied to the operation of this leisure centre. The dry gym/fitness component has fully complied with full cost reflective pricing principles since late in 2002 and operates at a CN profit. The swim lessons component is on target to achieve full cost reflective pricing for the 2003-04 year. Since the Casey ARC was opened, commercial operators have opened new swim schools within its catchment.

Monash

Following an extensive feasibility study, the Council built a new complex on the site of the Waverley Aquatic Centre.

The Monash Aquatic and Recreation Centre (MARC) comprises a mixture of non-business and business activities. Two business activities that were deemed to be significant business activities for the purposes of CN were:

- Dry Programs (Group exercise & gymnasium); and
- Learn to Swim Program

Under the MARC business plan, these two significant business activities are to achieve full cost recovery, including applicable CN accounting adjustments, following the initial three year establishment period. On-going financial analysis is occurring to ensure that achievement of these objectives is to timetable.

What were the impacts?

The application of Competitive Neutrality Policy to local government has clearly articulated and emphasised the responsibility Councils have for financially defensible and acceptable decisions for the supply and delivery of commercially competitive services. The community benefits from fair competition between suppliers. The policy also facilitates a range of suppliers within the market place, which assist in improving the community's life style.

Competitive Neutrality has introduced a raft of good business practices into council processes. In the case of the leisure centres, councils and council officers have broadened their approach from considering a council leisure centre is an independent community asset, to one where councils choose both a community and business position within the market place and compete fairly. More generally, Councils now run their business units on a more business-like basis; understand their costs better; make more informed decisions; and use their capital and assets more efficiently.

Appendix F: Stated Rationale for Competition Payments

F.1 Summary

The 1995 NCP Agreements themselves make no direct reference to the purpose of payments. Even at the time of signing the 1995 Agreements, the Commonwealth was denying that it was under any obligation to 'compensate' States for NCP. However, the Commonwealth had previously agreed explicitly that it would consider assistance 'for loss of monopoly rents and the process for managing adjustment' (COAG February 1994) and that 'all Governments should share the benefits...from Hilmer and related reforms' (COAG August 1994). In March 1995, the Industry Commission also factored loss of monopoly rents into its calculations.

F.2 Detail

At the **February 1994** COAG meeting, the Commonwealth agreed to consider assistance to the States and Territories for loss of monopoly rents arising from the structural reform of government businesses and the process for managing adjustment.

Subsequently, at the **August 1994** COAG meeting, it was agreed 'all Governments should share in the benefits to economic growth and revenue from Hilmer and relate reforms to which they have contributed. An assessment of such benefits would be made by the Industry Commission on a brief provided by Heads of Treasury. This would be used to assist the Council in determining at its February 1995 meeting the increase in the Commonwealth revenue which might be expected from these reforms and the appropriate percentage which would accrue to the States, Territories and Local Government.'

In **March 1995**, the Industry Commission issued its report: *'The Growth and Revenue Implications of Hilmer and Related Reforms'*. This concluded that it was difficult to quantify the likely benefits of NCP. However, it estimated that State, Territory and local government reforms would contribute about \$2.6billion to their own revenue and about \$4.7billion to Commonwealth revenue, while Commonwealth reforms would contribute about \$1.2billion to its own revenue and about \$0.4billion to State, Territory and local government revenue.

However, by **early April 1995**, the Commonwealth was seeking to draw back from the August 1994 COAG agreement that all States should share the benefits expected to flow from Hilmer and related reforms. It argued that it had already paid a competition dividend at the March 1994 Premiers Conference by guaranteeing a specific Financial Assistance Grant (FAG) per capita in real terms. It noted in its April 1995 Loan Council Offer document:

'The Commonwealth is aware that the States and Territories will demand additional financial assistance from the Commonwealth in return for their cooperation in implementing the National Competition Policy. The Commonwealth does not accept that there is an obligation on it to provide such assistance. However, in the interests of ensuring that the substantial benefits of these reforms are achieved, the Commonwealth will be prepared to consider modest additional funding. In deciding the amount and timing of any additional funding it will be necessary to take into account the need for a fiscal policy to contribute to national savings and to moderate aggregate demand in the economy.'

In response, the States and Territories pointed out that: (a) while, in March 1994, Premiers had noted that the Commonwealth expected States to make credible progress on microeconomic reform, the FAG guarantee had not been made conditional on this; (b) the August 1994 COAG agreement superseded any impression that the March 1994 FAG guarantee was to be a competition dividend; (c) current draft National Fiscal Outlooks, prepared by all governments to determine the FAGs pool, explicitly excluded the effect of Hilmer from forward estimates.

At the COAG meeting on **11 April 1995**, a compromise was reached whereby Competition Payments to the States would form a pool separate from the FAGs pool and be distributed to the States on a per capita basis, but where the FAG guarantee would also be conditional on States commencing implementation of the Hilmer reforms.

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