National Competition Policy

A Submission to the Productivity Commission Inquiry into the Impact of National Competition Policy

June 2004

CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

Table of Contents

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Introduction and Overview

About CCI

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

Background and Introduction

> That concentrated interests so readily prevail over dispersed interests is the bane of democratic politics. Because consumers are many and dispersed, they cannot organise as readily as can producers. This gives rise to a 'supplier bias'. Concentrated interests prevail because only they have enough at stake to let one issue influence their vote or to cover the cost of mounting a political campaign.

- John Hyde[1]

CCI is greatly disappointed that the Government of Western Australia has the worst record of any of the state governments in implementing competition reform, a failing for which both major political parties bear responsibility. It is no consolation that the Commonwealth Government's record is, arguably, even worse.

However, the many failings and few successes of competition policy in WA do at least provide an opportunity to review and compare the circumstances and pressures that can influence whether the attempt to introduce a competition policy reform is successful or not. This document draws mainly on CCI's experience and understanding arising from the attempt to implement competition policy reforms in WA.

The format of this document broadly follows the structure and order of the questions raised in the Issues Paper[2], although this submission has not addressed all the questions that the Paper raised, and has expanded on issues where it seems necessary and appropriate. Specific questions that the Issues Paper asked for submissions to address are highlighted in blue boxes.

Before proceeding to address the specific questions raised in the issues paper, however, this submission also provides a brief overview of the benefits of competition policy, and the reasons why CCI has been a staunch supporter of competition reform for more than a decade.

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Key Points

Recent academic and practical work on regulation has led to a more cautious approach to regulation issues. Regulation is not costless, and legislators and regulators do not necessarily have either perfect knowledge or pure intentions (page 19).

The balance of evidence suggests strongly that the economic effects of NCP have been positive (page 22).

There is convincing evidence that, where NCP reforms have been implemented appropriately, they have achieved the benefits envisaged by the Council of Australian Governments when it agreed to the package in 1995 (page 23).

NCP has not only improved Australia's productivity growth by raising the competitiveness and flexibility of the economy. Productivity growth has also brought higher incomes and living standards. It also allows governments to spend more on health and education and improved social welfare and environment (page 24).

Social provisions such as welfare and redundancy payments are available to mitigate the effects of economic change induced by reform. Indeed, arguably governments have sometimes over-provided adjustment assistance to the perceived losers from NCP reform (page 27).

The Western Australian experience with a range of NCP reforms provides a number of lessons for any future reform initiatives:

- attempts to 'buy' reform can invite vocal political resistance to reform;
- poor adjustment assistance targeting can result in a wasteful transfer or resources from taxpayers and consumers to producers; and
- phasing reforms not only delays the implementation of reforms that are in the public interest, it can also provide additional time for those opposed to reform to lobby governments (page 32).

The most important impediment to completing the current NCP agenda is a lack of political will and leadership (page 34).

Given government's lack of political will to confront vested interests, public servants have had little incentive to make sure that NCP processes are rigorous and carried out in a manner that conforms with the spirit, intent or even letter of the *Competition Principles Agreement*. (page 35).

In Western Australia, Ministers have been responsible for reviewing legislation in their portfolios. This arrangement has in many instances reduced the probability of successful NCP outcomes (page 36).

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In hindsight, all NCP legislation reviews should have been the responsibility of one designated Minister (to champion NCP reform) and conducted by one designated central agency; or, at the very least, agencies should not have reviewed their own programs (page 36).

The key issue is how to maintain proper sovereign authority within the states' jurisdictions, and proper regard for democratic processes and accountability, while at the same time diminishing the tendency of the political process to produce outcomes that are not in the community interest (page 37).

With weak political leadership on NCP in Western Australia ,it appears that the competition payments 'stick' (of threatening to withhold payments) is valuable and necessary, but not sufficient, to induce reform. Perhaps a greater conviction that the penalties would indeed be applied if the state failed to reform, and a better explanation of why this is an entirely fair outcome, would have furthered the National Competition Council's effectiveness in this regard (page 38).

The underlying objectives of NCP are to raise the competitiveness and flexibility of the economy and improve living standards, and these remain entirely appropriate (page 38).

Public interest is a necessarily broad concept taking full account of social, environmental and regional impacts, as well as economic impacts. While this is the intent, the public interest test is often poorly applied. The major reason for this is that the sorts of economic, social and environmental factors that need to be considered in making a net benefit judgement can pull in different directions making any assessment of public interest contestable. The real difficulty therefore is in how the tradeoffs among any competing effects should be made – this task is inherently subjective and political and therefore ultimately requires strong leadership by governments. (page 40).

In Western Australia, a number of significant NCP reviews have suffered from a lack of independence and a lack of rigour in the review process. As a consequence there has not been a strong incentive for those agencies conducting reviews to ensure that the quality of the analysis undertaken is high (page 41).

It would appear that Western Australia's competitive neutrality complaints mechanism needs a wider scope, a greater degree of independence and a substantial revision to its complaints handling processes for it to be deemed fair and effective (page 43).

The payments threat would have been much more effective if payments penalties (in particular suspensions rather than deductions) were used much earlier in the NCP process, and the National Competition Council had consistently and plausibly indicated that the threat of further penalties was real. Some indication of the magnitude of likely penalties would also have been helpful – in WA, senior politicians expressed (or feigned) surprise at the magnitude of payments eventually deducted. (page 45).

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NCP should be extended to the labour market. The case for more deregulation, and for extending NCP to include labour market regulations, lies in the expectation that more deregulation will result in more of the benefits already enjoyed as a result of the more flexible labour market. Despite the reforms to date, Australia's labour markets remain highly regulated. (page 51).

One weakness of NCP is its centralisation and uniformity. There was always a certain paradox in an approach to competition policy that tries to encourage innovation, deregulation and competition by imposing a uniform regulatory framework on previously diverse practices and jurisdictions. "Competitive federalism" suggests that a major stimulus for reform might derive from the differences between governments' taxation and regulatory frameworks, the efficiency of their trading enterprises, etc. In this respect, the emphasis on national consistency and uniformity that have shaped some National Competition Policy reforms may have actually served to reduce competition (page 52).

Executive Summary

First Principles – Competition

In a textbook world, perfect competition is characterised by costless entry and exit into a market with homogenous goods and services and with many buyers and sellers. In general, this market arrangement leads to an optimal outcome for consumers through the most efficient production of goods or services, efficient allocation of resources between firms and industries and dynamic efficiency as the economy develops over time.

Real markets seldom if ever conform to the paradigm of perfect competition. For practical or policy purposes this does not necessarily mean that they fail to deliver outcomes in the community interest. If there is a high degree of competition, accurate product information and prices closely correspond to social costs then the outcome of most markets will be highly, if not perfectly, efficient. However, public interest theory has long argued that instances of what economists call "market failure" may justify government intervention. Markets may fail under a range of circumstances:

- where there is a monopoly or natural monopoly or some lesser degree of monopoly power;
- in the provision of public goods;
- where there is imperfect or asymmetrical information;
- where there are harmful or beneficial externalities[3].

Regulation can only make failing markets work better if government is both willing and able to take actions in the community interest. However, governments can make mistakes, and those mistakes may be at least as widespread and potentially more costly than the errors of private individuals or businesses. Furthermore, government failure may not arise merely from mistakes. 'Public choice' and similar models start from the assumption that politicians and public servants are no less self-interested actors than consumers or producers, and may therefore act in ways that put the wellbeing of vested interests above the community interest.

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Competition policy needs to be designed to address government failure as well as countering the effects of market failure.

These ideas underpin National Competition Policy (NCP) and motivate its advocates. While only indirectly relevant to the specific points raised in the Productivity Commission's terms of reference, they are important in that they provide the intellectual framework and evidence that justify competition reform. Without this supporting argument, advocacy of competition reform can seem arbitrary and ideological – a fact that its opponents have capitalised upon on several occasions. For this reason, the following analysis of reforms to date refers back to this theoretical discussion on occasion, as appropriate.

Impact of NCP and Related Reforms to Date

Competition policy comprises a raft of related economic policies and reforms instituted on the assumption that, in general, the performance of Australia's economy and the welfare of its citizens will be improved if competition in markets for goods and services is increased. Its objective is to use competition as a means to an end, rather than viewing competition as an end in itself. The underlying benchmark used in evaluating competition-based reform is whether reform will result in a net benefit to the community.

Economic Impact

The Productivity Commission estimates that, as result of competition policy (and other micro-economic reforms), Australia's GDP is about 2.5 per cent higher than it would otherwise have been, and Australian households' average annual income is around $7,000 higher. Furthermore, the benefits are spread across the community and the regions.

Recently the OECD highlighted that Australia's robust growth in the face of external shocks - such as the 1997-98 East Asian crisis and the global economic slowdown in 2001-02 - was due to a combination of sound macro-economic policies and structural reforms. NCP, along with other structural reforms, has enhanced the Australian economy's capacity to grow more quickly and respond more flexibly to shocks.

Competition policy reforms lead to improved productivity through greater domestic competition and the incentives this provides to adopt better work and management practices, including resource use. Technological change and education and training are important factors in determining productivity growth. However, without the spur of competition encouraging efficient businesses (and discouraging inefficient ones), it is doubtful that the Australian economy would have had the capacity to grow as fast, and respond as flexibly, as it has done in recent years.

Achieving Stated Objectives

Where NCP reforms have been implemented appropriately, they have achieved the benefits envisaged by the Council of Australian Governments (COAG) when it agreed to the package in 1995. However, where NCP reforms have been inappropriately or poorly implemented, or not implemented at all, the interests of consumers have not been enhanced.

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One clear example of this is the case of retail trading hours in Western Australia. All other jurisdictions have substantially deregulated trading hours, but Western Australia decided to retain prescribed shopping hours that discriminate between sellers on the basis of location, business size or product. These restrictions prevent sellers from trading, and consumers from shopping, when and where they want. In contrast, not only has employment grown, but consumers are also taking advantage of the convenience offered by extended retail trading hours in those jurisdictions that now have deregulated trading hours.

Achieving Wider Objectives

NCP has not only improved Australia's productivity growth by raising the competitiveness and flexibility of the economy. Productivity growth has also brought higher incomes and living standards. It also allows governments to spend more on health and education and improved social welfare and environment. Banks (2001) showed that, without the productivity growth experienced in the 1990s, annual income would have averaged $7,000 less per household.

Evaluating Costs and Benefits

There has been considerable public criticism of NCP, much of it incorrectly targeted. Many phenomena blamed on NCP are in fact a result of other causes, for example regional bank closures and lack of regional telephony services. Public opinion is influenced by media coverage that is frequently dominated by the views of groups who are losers from competition reform, while the wider community may have no representative and its interests generally receive less attention. The media, public and politicians alike share what Anne Krueger has termed "identity bias" - giving more weight to the interests of visible and identifiable losers from reform than the more diffuse but also more substantial losses that anti-competitive measures impose on the broader community.

Criticism has also centred on the public interest test, with calls for it to be more broadly based. This criticism is largely misguided because it does not recognise that public interest is defined broadly in the NCP agreements, to allow a wide range of community benefits to be considered, including social, environmental, employment as well as economic objectives. Any failure in the public interest test would appear to be a result of its poor application in some reviews, rather than being constrained by narrow definition in the *Competition Principles Agreement*. There is also a tendency for those whose interests are threatened by the conclusions reached by applying the test to blame the test itself for failing to give their own interests and concerns sufficient weight. This is not a failing of the test, but evidence that it works as intended.

Causes of Relative Success and Failure

One of the few significant NCP successes in Western Australia has been in grain marketing. The *Grain Marketing Act 2002* has separated the roles of the regulator and the single desk marketer of prescribed grains in Western Australia, establishing the Grain Licensing Authority as the independent regulator of bulk barley, lupin and canola exports from Western Australia. The Grain Licensing Authority is responsible for considering applications for special export licences for bulk prescribed grains (barley, lupins and canola).

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Western Australia's new licensing arrangements have give grain growers added flexibility in marketing their barley, canola and lupins. Greater competition in the grain export industry is a major legislative reform that introduces competition in the export market, while retaining any identified price premiums arising from the exercise of market power available to the single desk. The new arrangements have been a great success, with growers clearly welcoming more choice.

Lessons for the Future

COAG (2000) recognised that assistance may be necessary where reform has a large effect on specific industries or communities, and large costs are expected in adjusting to change. However, providing adjustment assistance is fraught with difficulty because it is not easy to accurately identify and assist those people and communities most deserving of assistance. In addition, phasing the implementation of reforms or providing a grace period to allow affected parties to prepare for the new business environment can also prove costly.

Opportunities for Further Reform

As Western Australia is the worst performing jurisdiction on NCP reform, it has the most to gain from completing the agenda. The main areas of unfinished business are legislation review and structural reform. Western Australia's sub-standard record is documented by the National Competition Council's *'Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2003.'*

In some cases the Western Australian Government had decided to reform anti-competitive restrictions based on a strong public interest justification only to subsequently reverse its decision after being subject to intense pressure from vested interests (e.g. the failed attempt to deregulate liquor licensing and retail trading hours).

However, it is in the area of structural reform where the most gains can be made from completing the NCP agenda.

Impediments to Completion

Vested interests, though small in number, have prevailed in Western Australia because they have strong incentives to gain political support compared with the diffuse majority of consumers. Western Australian consumers have suffered the consequences of this failure - higher prices, reduced choice, lower quality, lost flexibility and inconvenience.

In hindsight, all NCP legislation reviews should have been the responsibility of one designated Minister (to champion NCP reform) and conducted by one designated central agency; or, at the very least, agencies should not have reviewed their own programs. Under this process other Ministers/agencies responsible for the legislation could have made submissions to NCP reviews but they would not have had direct control of the process. Such a model would have encouraged NCP outcomes more consistent with NCP principles delivered in a timely manner.

With weak political leadership on NCP in Western Australia it appears that the competition payments 'stick' is valuable and necessary, but not sufficient, to induce reform. Perhaps a

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greater conviction that the penalties would indeed be applied if the state failed to reform, and a better explanation of why this is an entirely failed outcome, would have furthered the National Competition Council's effectiveness in this regard.

Appropriateness of Objectives

The underlying objectives of NCP are to raise the competitiveness and flexibility of the economy and improve living standards, and these remain entirely appropriate.

Under NCP, encouraging competition is not an end in itself. It is the means to an end that is effected by creating the incentives that lead to higher incomes, more productivity and a better quality of life for the community (i.e. greater convenience and more choice). Where the public interest is better served by restrictions on competition , NCP says this is acceptable as long as it can be transparently justified.

Public Interest Test

A core principle of the NCP is that governments should retain (or introduce) restrictions on competition only where they can demonstrate that the benefits to the community exceed the costs. The factors relevant to making such an assessment are broad, including ecologically sustainable development, social welfare and equity considerations and economic and regional development.

A requirement for governments to demonstrate that their regulatory arrangements are in the interests of the community would at face value seem unexceptionable. Nevertheless, this approach to evaluating government restrictions on competition has been contentious.

One of the main reasons for this is the NCP has reversed the traditional onus of proof in policy reform, whereby it has generally been up to the proponents of change to demonstrate that change will be worthwhile.

Public interest is a necessarily broad concept taking full account of social, environmental and regional impacts, as well as economic impacts. While this is the intent, the public interest test is often poorly applied. The major reason for this is that the sorts of economic, social and environmental factors that need to be considered in making a net benefit judgement can pull in different directions making any assessment of public interest contestable. The real difficulty therefore is in how the tradeoffs among any competing effects should be made – this task is inherently subjective and political and therefore ultimately requires strong leadership by governments.

Procedural Issues

In Western Australia, a number of significant NCP reviews have suffered from a lack of independence and a lack of rigour in the review process. As a consequence there has not been a strong incentive for those agencies conducting reviews to ensure that the quality of the analysis undertaken is high since they did not have to withstand detailed scrutiny from a range of sources. Complaints have also arisen about the composition of review panels, particularly where vested interest group representatives have been prominent on those panels.

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The importance of independent, transparent and rigorous processes when considering significant public interest matters cannot be overstated. Such processes are essential to maintaining community confidence that public interest considerations have been objectively examined and that it is the public interest that is paramount, rather than the concerns of vocal vested interests (or to a much lesser extent in Western Australia, reform proponents).

WA's competitive neutrality complaints mechanism needs a wider scope, a greater degree of independence and a substantial revision to its complaints handling processes for it to be deemed fair and effective. The complaints mechanism should be transferred to the newly established Economic Regulation Authority.

Extending Existing NCP Reforms

COAG energy and water initiatives

CCI regards the management of Western Australia's water resources as extremely important. Many industries, particularly those in the resource and energy sectors are dependent on reliable and certain access to water. It believes that a two-tiered approach could be adopted to water entitlements.

In the first case, where there are doubts about the effective operation of the market (for example the size of the resource cannot properly be determined), or there are a small number or a low diversity of users the traditional approach of fixed term, non-tradeable water entitlements would be the appropriate approach.

On the other hand, when the catchment or aquifer is nearly fully allocated, and there are a large number and diversity of users, then it is appropriate to define water entitlements as an open-ended or perpetual share of the water resources available. This would ensure certainty of title while stimulating water trading to the maximum extent possible.

Competition-related reforms outside the current NCP

Standards and Regulation

Voluntary and mandatory standards have extended and multiplied in recent years. At their best, standards have a number of advantages over legal regulation:

- they are more flexible, less costly and less prescriptive;
- they are developed by practitioners, and can be improved incrementally;
- they can be a useful tool in achieving and demonstrating quality and standards.

However, in some cases, notionally voluntary standards can become increasingly like mandatory regulation, with businesses in effect having no option but to comply. In other cases, compliance with standards is written into legislation, and the standard is thus effectively mandated, as is the case where compliance with standards is required under the Trade Practices Act, or occupational safety and health regulations.

It is important that standards do not impede competition and innovation, or add undue costs to business operations. International standards can play an important role in facilitating trade, while incompatibility between national and international standards increases costs and

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potentially excludes Australians from competing in international markets. Conversely, domestic standards should not be manipulated to impede legitimate competition from imported products and services.

Labour Markets

Regulation of labour markets was explicitly excluded from the Hilmer report and subsequent NCP provisions, as politically contentious and unlikely to receive the assent of Parliament. Since then, labour market reforms have nonetheless proceeded at both Commonwealth and State levels, broadly in line with the style and intent of the reforms implemented under NCP.

Deregulation of the labour market aims to improve Australia's productivity growth – and consequently, the living standards of its workers and consumers - by decentralising wage setting and removing legislative impediments to employment. The benefits of decentralisation include:

- flexibility and the ability to adapt to local market conditions and employees' needs;
- fostering co-operation, mutual respect and industrial harmony;
- win-win negotiation of more productive and more lucrative working conditions (wages are typically higher under decentralised than centralised bargaining arrangements);
- a fairer and more acceptable pay structure, reflecting the employee's skill, effort and contribution to the business.

The case for more deregulation, and for extending NCP to include labour market regulations, lies in the expectation that more deregulation will result in more of the benefits already enjoyed as a result of the more flexible labour market. Despite the reforms to date, Australia's labour markets remain highly regulated.

There are, of course, many good reasons why aspects of the employment relationship should be subject to regulation. What has long been missing in the confrontational and quasi-judicial processes of determining industrial regulations, however, is a comprehensive and impartial consideration of their impact on the wider community. For example, raising minimum wages may benefit employees paid the minimum wage, but if the cost is higher unemployment, this may not be a net benefit to the community as a whole.

Subjecting anti-competitive labour market regulation to the public benefit test would not result in widespread abolition of employee protections, but it would broaden the evaluation of the costs and benefits of those regulations beyond the self-interest of directly affected parties and their representatives, and ensure that regulations are more carefully evaluated before being passed into law and onto employers.

Competitive Federalism

In CCI's first (1995) response to the Hilmer Report, it argued that:

> "Perhaps the most disappointing aspect of the Hilmer Report is that it gives no consideration to the benefits to be gained from competition over the regulatory framework itself, rather than within that framework."

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Competitive federalism suggests that a major stimulus for reform might derive from the differences between governments' taxation and regulatory frameworks, and the efficiency of their trading enterprises. In this respect, the emphasis on national consistency and uniformity that has shaped some NCP reforms may have actually served to reduce competition.

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First Principles – Competition

Competition

In a textbook world, perfect competition is characterised by costless entry and exit into a market with homogenous goods and services and with many buyers and sellers. All participants have perfect knowledge of market conditions, and none is such a large buyer or seller that they are able to influence the market price of the product.

In this simple model, excess profits attract new firms into the market and drive down prices to a point where they match the marginal cost of production, and the industry earns "normal" profit (the level of profits which neither attracts new firms to a particular industry, nor induces any firms to leave the industry).

In general, this market arrangement leads to an optimal outcome for consumers through the most efficient production of goods or services, efficient allocation of resources between firms and industries and dynamic efficiency as the economy develops over time.

Recent analysis emphasising the dynamic nature of economic growth and the importance of innovation in sustaining growth emphasises the dynamic benefits of competition more than traditional static welfare models.

Real markets seldom if ever conform to the paradigm of perfect competition. For practical or policy purposes this does not necessarily mean that they fail to deliver outcomes in the community interest. If there is a high degree of competition, accurate product information and prices closely correspond to social costs, then the outcome of most markets will be highly, if not perfectly, efficient. Certainly, it is unlikely in such circumstances that government intervention and regulation will act to improve community welfare significantly.

However, public interest theory has long argued that there are circumstances in which government regulation can act to constrain the operation of markets in ways that improve the welfare of the community. In general, these circumstances comprise instances of what economists call "market failure". Markets will fail under a range of circumstances:

- where there is a monopoly or natural monopoly or some lesser degree of monopoly power;
- in the provision of public goods;
- where there is imperfect or asymmetrical information;
- where there are harmful or beneficial externalities[3].

A further case where intervention is frequently deemed appropriate and in the community interest, though not really market failure in its strict interpretation, is social intervention intended to distribute benefits to certain groups even if this imposes greater costs on others. As an explicit policy objective, this most commonly entails transfers of money or goods and

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services from the affluent to the less well off, but it can also be to other groups such as residents of remote and regional areas, or certain ethnic groups.

The term "market failure" is often misunderstood to indicate the failure of markets to deliver what governments, regulators or others think they should deliver, or failure to provide goods because it is not profitable. For economists, market failure refers to a situation in which economic efficiency has not been achieved through market mechanisms. Its result is the failure of a market to produce goods for which there is effective demand, or a mal-distribution of resources which could be improved in such a way that some consumers could be made better off without making others worse off.

So "market failure" is an expression with a particular meaning. And it is only in the instance of demonstrable market failures that government intervention is justified. Furthermore, even market failure does not necessarily justify government intervention. As a WA Treasury paper states[4]:

> "While market failure is a necessary condition for Government intervention, it is not a sufficient condition. For one thing, the benefits to the economy of Government intervention must outweigh the net financial costs of the project to Government for the project to be justified."

Other things being equal, the best solution to market failures is to remove their causes – breaking up monopolies and eliminating legislative sources of monopoly power, for example. This is the thrust of a great deal of competition policy, including many of the specific measures introduced under NCP, and in particular its efforts to remove artificial monopoly powers.

However, in some cases, the scope for such solutions is limited, and this is where more extensive regulation is appropriate. Such interventions should be appropriate to the market failure they address. For example, if the problem is information asymmetry, the government can redress the balance by providing information itself or compelling market players to do so. If the problem is a negative externality, the intervention should seek to internalise it (e.g. by "polluter pays" price adjustments).

While the market failure exceptions to a general preference for competition are important, they remain exceptions. By and large, consumers are better off if markets are left unregulated, and this assumption is crucial to competition policy.

Competition policy is founded on a presumption that, unless there are strong reasons to restrict activity in a market, competition is the most effective means of maximising public benefit. Hence, in the application of competition policy, the burden of proof lies with advocates of regulation or restricted market access to demonstrate both that a competitive market yields fewer community benefits than an uncompetitive one, and that the benefits attributed to regulation or restricted access cannot be achieved in any other way.

The reason why a strong burden of proof is demanded of proponents of regulation is discussed in the next section.

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When Regulations Fail

Regulation can only make failing markets work better if government is both willing and able to take actions in the community interest – sometimes called the 'benevolent despot' model, which assumes that governments and public servants have both the motivation and the capacity to devise and enforce regulation in the public interest.

However, governments can make mistakes, and those mistakes may be at least as widespread in effect, and potentially more costly, than the errors of private individuals or businesses.

Governments' potential to do more harm derives from many factors, including:

- the greater financial resources available to governments, and the expectation that this makes them responsible for large-scale, comprehensive 'visionary' investments and programs;
- their capacity to legislate to enforce policies;
- the separation of decision-makers from the providers and consumers of goods and services who sometimes have the greatest awareness of what will and will not work in practice, including unintended consequences;
- their bureaucratic and legislative processes for implementing change, which make trial and error learning slower and more cumbersome than in private businesses;
- the arms-length relationship of decision-makers from the consequences of their actions.

For example, many of the major environmental problems faced in Western Australia today are primarily a result of government failure, not market failure, including policies that encouraged the clearing of native vegetation and over-stocking of rangelands.

Furthermore, government failure may not arise merely from mistakes. 'Public choice' and similar models start from the assumption that politicians and public servants are no less self-interested agents than consumers or producers.

In the past 40 years, a growing body of research has focussed on potential sources of sub-optimal community outcomes that result from government failure or regulatory failure, in which government intervention is the cause rather than the cure of undesirable outcomes.

As Winston noted[5], the weakness of traditional regulation theory was its assumption that perfectly informed social welfare maximisers are either managing the regulation or running the regulated firms. More often than not, this is not the case.

Private Interest Theory

It is more than 40 years since Stigler and Friedland (1962) formulated an econometric model to test the effect of regulation on electricity prices, and discovered that the existence of regulation made no difference to the prices charged to consumers.

Stigler (1971) and others were also among the first to offer a theory of regulation that analysed the behaviour of regulators and revealed the source of inefficiencies[6]. Stigler argued

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that compact, well-organised groups (usually producers) tend to benefit more from regulation than broad, diffuse groups (usually consumers), and that regulatory policy will seek to preserve a politically optimal distribution of rents across a coalition of well-organised groups.

Politicians

Stigler argued that businesses will form coalitions to lobby for government action that provides them with direct subsidies or other benefits, which constrain competition from similar or substitute suppliers, which permit collusion and other forms of price fixing, or which prevent the entry of new competitors into a market. For businesses, these measures may prevent effective competition and so mean that sustained monopoly rents are possible – that is, sustained profits above 'normal' (see definition on page 12). Activity aimed at persuading governments to impose such measures is termed "rent-seeking". Many regulatory instruments can be employed to this purpose, including quotas, licences, subsidies, import controls and product specifications, any of which can lead to wealth transfers, usually from consumers to producers.

Such policies are unlikely to be countered by strong opposition from consumers because the costs of a particular regulation for an individual consumer is typically quite small, perhaps only a few cents or dollars per transaction, even if in aggregate the cost for all consumers may be very large. Because of this asymmetry, beneficiaries of regulation are quite likely not only to lobby for regulation but also to change their votes according to the parties' policies on regulating their industries. For consumers, however, the issue is likely to be too trivial to influence voting patterns.

This is a plausible explanation for the WA government's retention of a range of anti-competitive regulations including those on taxis, retail trading hours and potato marketing.

Regulators

A distinction can be drawn between the motivation of politicians and of regulators, as the latter have no personal incentive to re-distribute rents to gain political advantage with key electoral groups, beyond serving the interests of their political masters.

However, there are different factors that can prevent regulators from serving the interests of the wider community.

There is a tendency for professional regulators to be 'captured' by the industries they regulate. As with political lobbying, it is in the interests of business to devote significant resources to influencing the opinions of those public servants whose decisions could affect or determine their regulatory environment. The regular change of personnel between regulators and regulated industries is evidence supporting this proposition.

Institutionally as well as personally, single-industry regulators have a stake in ensuring that their industries remain regulated. Deregulation of the industries they control would effectively make them redundant.

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Finally, there is a problem of imperfect knowledge for regulators. By and large, government authorities have incomplete knowledge of the businesses and industries they seek to regulate. Firms are usually more informed about their own costs and structures and have little incentive to provide this information to the regulator. Even where information on a firm's operation is known, wider changes in an industry's conditions usually are not. For comprehensive regulation, detailed information about current and future technologies, consumer preferences and industry cost structures is required. The costs of obtaining such information can be prohibitive and insufficient information about these factors is often the cause of poor or failing regulation.

As a result, the regulator is forced to base decisions on limited information. This information asymmetry means that economic regulation rarely achieves an efficient outcome[7].

These structural defects of regulation need to be borne in mind when assessing alternatives and formulating solutions to perceived market failure.

Inducements to Regulate

Peltzman (1976) developed Stigler's ideas into a general theory of regulation, assuming that the regulating government seeks to maximise its electoral majority. As legislator, it is the supplier of legislation, while the community contains diverse interest groups that might benefit or lose from various regulations. These groups demand regulations that are in their own interest, and oppose those that are not. In this purely self-interested electoral calculus, legislators choose the level of regulation that maximises the proportion of vote winning to vote-losing regulation. In the language of micro-economics, regulation will be supplied up to the point where the marginal political costs of regulation equal the marginal political benefits.

Peltzman concludes that legislation will favour the politically powerful over the politically weak, that it will not favour one model or group but rather several, perhaps including competitors or rivals - no single interest or group of like interests will be completely favoured at the expense of others.

Posner (1974) suggested that maximising an electoral majority is only part of regulators' motivation. Interest groups in fact have three main means by which they can induce politicians to legislate in their interest – the votes of members, money (such as bribes or campaign contributions) and public pressure, the latter perhaps in the forms of favourable or adverse advertising or other publicity, or a threat of strike action or plant closure. Any one of these inducements and threats can motivate a regulator to impose or remove regulation to the benefit of the interest group concerned.

Theft and Deadweight Losses

Another refinement of this theory suggests an additional limitation to inefficient government regulation, because the effect of redistribution creates deadweight losses. Regulation to prevent competition in the absence of market failure reduces the total value of resources available to be distributed, and so there is a further internal check to the system.

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Further, Tullock (1967) argued that the use of regulatory power to bestow monopoly profits on vested interests is analogous to theft. It creates a large involuntary transfer from one party to another, and while this in itself does not necessarily result in a welfare loss (the consumer's or rightful owner's loss is the thief's or rent-seeker's gain) the amount expended by the thief or rent-seeker on securing measures to improve their own welfare, and the amount incurred by the owner or consumer in trying to prevent that loss, both detract from aggregate welfare. Furthermore, the costs of unsuccessful efforts to impose or resist regulations imposing monopoly rent are also welfare losses.

The ethical dimension of such transfers is not strictly a concern of welfare economics, although the low regard most economist have for "rent seekers" is perhaps coloured by more than the deadweight losses and inefficiencies their activities generate.

Other Ideas on Regulation

Regulation as Taxation

Another way of conceiving regulation is as a type of internal subsidy, in which businesses are compelled to provide unprofitable services that they otherwise would not. This works fairly well as a model of many types of social regulation, and of the non-commercial obligations governments impose on their own business enterprises. Examples might include requiring businesses to provide parking and access for disabled staff and clients, giving preference to certain suppliers on the basis of location, size, market or business behaviour, or compelling businesses to meet minimum service levels for remote, regional or disadvantaged clients.

Such regulations are not necessarily inefficient, inappropriate or anti-competitive. But there is a danger that governments will be over-inclined to resort to them, as the political benefits of such regulation accrue to the government, while the costs are hidden as *de facto* taxes in business cost structures. Quite often, government does not even bother investigating systematically what the costs of such regulations might be. Recent developments in the reporting and funding of government business enterprises' community service obligations have improved the transparency of these arrangements.

Regulators' Time Horizons

A further concern with legislators in democracies is their relatively short time horizon. The incentive to implement measures that increase their chances of winning the next election even at long-term cost is considerable. Lee and Buchanan (1982) argue that, if government makes a decision on the basis of its impact in a time period shorter than is needed for its full consequences to take effect, then sub-optimal policy will result, including a likelihood of higher taxes, accumulating government debt, and regulation to create artificial rents.

Evaluating Impacts, and Identity Bias

Theories such as public choice emphasise the potential for regulation to favour producers over consumers, or to benefit the few over the many in a variety of other ways. But quite often, majority opinion supports regulations that would, by most economic analysis, be deemed not in the majority economic interest.

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There are many reasons why this might be so, including a range of social, political, ethical and value judgements that people are individually and collectively willing to elevate above economic self-interest. This is an entirely desirable and proper element of the political process.

Sometimes, however, this results from a failure to apprehend the scope and consequences of particular policies, or a choice to ascribe greater weight to some welfare effects than others of comparable magnitude.

One reason for the media and general public favouring anti-competitive regulations that reduce aggregate economic welfare is what Anne Krueger has termed "identity bias" - giving more weight to the interests of known, familiar, visible and identifiable people and organisations than to unknown and unidentifiable ones. Because losers from pro-competitive reforms are often readily identifiable, while winners are unknowable and diffuse (and indeed, may not even know they are winners), winners attract less attention and are given less weight than losers. Hence, Krueger (2004) argues that:

> Thus a manufacturer, or a farmer, or a worker whose own livelihood might be threatened will be more strongly motivated to defend himself than **either** a consumer, who might have only a vague idea of how much extra he will have to spend on this good or that, **or** even a worker who might otherwise find more highly-paid employment in an export industry that would expand in the absence of trade-distorting policies.
>
> … This problem of identification becomes even more complicated when we try to assess who might actually lose because of jobs not created in exporting industries: protection of some industries is taxation of others. Those who stand to gain from freer trade are less easily identifiable: but the overall economic gain far outweighs the benefits to the limited group enjoying protection.

Knowing that the public's opinions matter to politicians, lobbyists have a similar incentive to persuade the wider community of the virtues of anti-competitive measures as they have to persuade legislators and regulators. These arguments are seldom phrased in terms of naked self-interest, however, but rather in terms that appeal to the community's own fears, interests or sympathies. Hence in WA, opponents of deregulation have argued that small shops will disappear, employment will fall, or fresh milk will no longer be available if deregulation is permitted.

Krueger notes a similar process in the anti-globalisation movement's opposition to free trade:

> Thus we hear much about the need to protect the environment, to act in solidarity with workers in the third world, and to campaign against child labor. But these are often arguments of convenience, concealing the primary motive of jobs, or firm, protection. Such tactics exploit those with good intentions.

Identification bias and similar asymmetries in the weighting of interests have been blamed for the "loser's paradox" – the fact that declining, unprofitable and ill-managed businesses seem to have a better success rate in winning government protection and assistance than emerging, solvent and well-managed ones. This is one of the key reasons why governments tend to pick losers not winners, according to Baldwin and Robert-Nicoud (2002).

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Conclusions

The emerging analysis of regulation outlined in the preceding sections has led to a more cautious approach to regulation issues. Regulation is not costless, and legislators and regulators do not necessarily have either perfect knowledge or pure intentions.

Imperfectly competitive markets reflect market power that may result in inefficiency, but in some cases the loss of efficiency may not be large, and the cost of regulation might be greater than the benefits.

Any form of government intervention is likely to result in costs to the economy, either directly or indirectly. The costs of intervention can be significant and often outweigh any loss associated with some degree of market power (especially if market power is a reflection of a factor giving major players a competitive advantage, such as economies of scale).

The objective of regulation should not be to reduce market power *per se*, but to reduce market power that allows for monopolistic behaviour that in turn reduces efficiency. Even where some market power exists, it does not automatically follow that any form of regulation is required.

Increasing competition is generally the key to improving the efficiency of the economy, and increasing competition is a preferable form of addressing market failure than introducing further regulation.

This section has outlined some of the analysis and research that provides the theoretical underpinnings for National Competition Policy, and motivates its advocates. While only indirectly relevant to the specific points raised in the Productivity Commission's terms of reference, they are important in that they provide the intellectual framework and evidence that justify competition reform. Without this supporting argument, advocacy of competition reform can seem arbitrary and ideological – an accusation its opponents frequently employ. For this reason, the following analysis of reforms to date refers back to this theoretical discussion on occasion, as appropriate.

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Impact of NCP and Related Reforms to Date

Background

Competition policy comprises a raft of related economic policies and reforms instituted on the assumption that, in general, the performance of Australia's economy and the welfare of its citizens will be improved if competition in markets for goods and services is increased.

Its objective is to use competition as a means to an end, rather than viewing competition as an end in itself. The underlying benchmark used in evaluating competition-based reform is whether reform will result in a net benefit to the community.

Competition policy was not invented by Fred Hilmer. Governments at all levels throughout Australia and overseas have for years undertaken reforms such as deregulation, reform of government business enterprises, and measures to prevent anti-competitive behaviour with the explicit intention of improving economic performance and community welfare by enhancing competition. But while Hilmer's 1993 Report[8] on National Competition Policy did not initiate Australian competition policy, it did make a vital contribution to its evolution. Its key contributions were to propose a co-ordinated, systematic and uniform approach to competition policy across all government jurisdictions, and to recommend mechanisms designed to address the institutional and political factors that can lead governments and regulators to adopt anti-competitive measures that are not in the public interest. In particular, it proposed:

- the establishment of a clear principle that anti-competitive regulation and legislation should be permitted only when it can be demonstrated to be in the interest of the community, and cannot be achieved by other means; and
- the establishment of 'arms-length' bodies to oversee and advise on the general implementation of competition policy (the National Competition Council) and regulate its detailed application (the Australian Competition and Consumer Commission).

National Competition Policy

On 11 April 1995, the Council of Australian Governments (COAG) agreed to a national competition policy package providing for uniform legislation on protection of consumer and business rights and increased competition in all jurisdictions. The Prime Minister, Premiers and Chief Ministers signed two inter-governmental agreements to implement the package. COAG reaffirmed its commitment to continuing micro-economic reforms in key industries, and this was reflected in a third agreement which provided for financial arrangements, including a series of competition payments to be paid to the State Governments in return for implementing competition policy reforms.

In summary, the three key measures provided:

- a Conduct Code Agreement along with the Competition Policy Reform Act and various State and Territory legislation, which extended coverage of Part IV of the Trade Practices Act to all businesses irrespective of their legal form or ownership;

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- a Competition Principles Agreement, which set standards on structural reform of public monopolies, reviews of anti-competitive legislation and regulation, prices oversight, access to essential infrastructure, competitive neutrality, and local government; and
- an Agreement to Implement the National Competition Policy and Related Reforms, which set out conditions for financial transfers to the States and local government in return for implementing competition reforms.

Under the *Agreement to Implement the NCP and Related Reforms*, the Commonwealth Government was to make payments to the States and Territories as reform progressed. The payments are appropriate because while the States and Territories have responsibility for key elements of NCP, much of the financial dividend from the economic growth arising from the NCP reforms accrues to the Commonwealth through the taxation system, notably in company and personal income tax. The agreement also recognises the political reality that governments can be intimidated by vocal (usually narrow) vested interest groups determined to preserve anti-competitive regulations that line their members' pockets. So it was hoped that the payments would stiffen the spines of state cabinets and Premiers to act in the community interest.

Competition payments therefore depend on the extent of reform actually implemented in each State. If there is no reform, there is no financial dividend for the Commonwealth to reimburse to the States, nor any reason in principle why they should expect payments. In this context, the claim of Western Australia's Premier and opposition leader that WA should receive payments for reforms it has not undertaken is risible (see Appendix 2).

In announcing NCP, then Prime Minister Paul Keating said:

> the reforms that will flow from the agreements we reached on competition policy will bring lower prices for consumers, a faster rate of economic growth, more jobs and more exports. Lots of dark rooms of protection and privilege in the economy will be opened up. Just as we have seen competition with telecommunications result in a dramatic reduction in STD charges and dramatically lower domestic airfares, Australians can expect to benefit from cheaper electricity and lower legal fees.[9]

In introducing legislation to implement NCP, the Commonwealth Government stated its view that:

> Implementing this policy is the most important single development in micro-economic reform in recent years. Ultimately, the ability of the economy to grow, to provide jobs and an improved standard of living, depends on how well the productive potential of the economy is employed and enhanced…The payoff…for ordinary Australians is very real. It paves the way for cheaper prices, more growth and more jobs.
>
> The new integrated and complete approach to national competition policy, which balances economic efficiency and broader elements of the public interest, will give Australia one of the most sophisticated competition policies in the world. … The reward will be an economy that provides more opportunities to satisfy the aspirations of all Australians.[10]

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Economic Impact

Would the strong economic outcomes evident in recent years have been possible without micro-economic reform in general, and NCP in particular?

How important have NCP initiatives been relative to other factors (for example, technological change and education and training) in contributing to Australia's recent economic performance?

Measuring the effects of NCP is difficult because they must be separated out from a range of other demographic, government and market factors that affect economic and social conditions. While these difficulties must be acknowledged, the balance of evidence suggests strongly that the economic effects of NCP have been positive.

The Productivity Commission estimates that, as result of competition policy (and other micro-economic reforms), Australia's GDP is about 2.5 per cent higher than it would otherwise have been, and Australian households' average annual income is around $7,000 higher[11].

Furthermore, the benefits are spread across the community. A report by the Productivity Commission (1999) on the regional effects of NCP suggested that, although initially metropolitan areas had benefited more than rural and regional areas from reform, nearly all regions gain in the long term. Regions most likely to gain the greatest benefits tended to be in Queensland and Western Australia. For Western Australia, gross regional product was estimated to be 3.3 percent higher because of the NCP reforms.

Recently the OECD highlighted that Australia's robust growth in the face of external shocks - such as the 1997-98 East Asian crisis and the global economic slowdown in 2001-02 - was due to a combination of sound macro-economic policies and structural reforms. NCP, along with other structural reforms, has enhanced the Australian economy's capacity to grow more quickly and respond more flexibly to shocks[12].

The OECD also notes that there can be temporary negative side effects in terms of lost incomes and employment associated with NCP reforms which generates opposition from the groups that currently benefit from protection. Combined with broader concerns about the speed of economic and social change, this opposition can create a political environment that impedes economic reform. Hence, strong government leadership is required in explaining the need for change, and the removal of restrictions that have been shown not to be in the public interest. Where NCP reforms have failed in Western Australia, this has been the key cause.

Competition policy reforms lead to improved productivity through greater domestic competition and the incentives this provides to adopt better work and management practices, including in resource use. Technological change and education and training are important factors in determining productivity growth. However, without the spur of competition encouraging efficient businesses (and discouraging inefficient ones), it is doubtful that the Australian economy would have had the capacity to grow as fast, and respond as flexibly, as it has done in recent years.

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Achieving Stated Objectives

Have NCP outcomes been consistent with their stated objectives (that is, to raise the competitiveness and flexibility of the economy and improve living standards)?

There is convincing evidence that, where NCP reforms have been implemented appropriately, they have achieved the benefits envisaged by the Council of Australian Governments when it agreed to the package in 1995. For example, in the electricity and gas sectors competition has led to increased efficiency and reduced prices in many parts of Australia, and more efficient use of a range of infrastructure resulting from third party access regulation.

COAG (1995) emphasised that the competition policy reform package would enhance the national economic interest by improving Australia's international competitiveness and promoting the interests of Australian consumers.

However, where NCP reforms have been inappropriately or poorly implemented, or not implemented at all, the interests of consumers have not been enhanced.

One clear example of this is the case of retail trading hours in Western Australia. All other jurisdictions have substantially deregulated trading hours, but Western Australia decided to retain prescribed shopping hours that discriminate between sellers on the basis of location, business size or product. These restrictions prevent sellers from trading, and consumers from shopping, when and where they want.

In 2003, the Western Australian Government decided that Sunday trading (outside of tourism precincts) was not in the public interest. It gave the following reasons:

- concerns about the negative effect of Sunday trading on the leisure and family time of owner/operators and workers in the retail sector; and
- concerns about removing the existing competitive advantage to small and medium-sized retail shops, reducing their ability to compete with larger chains.

Little was said about the interests of consumers, for predictable political reasons. Surveys consistently show that WA consumers want trading hours deregulated. For example, research commissioned by CCI from ACNielsen found overwhelming support for making less restrictive shopping hours available to all retailers. The survey canvassed 700 people throughout the state – 500 in the metropolitan area and 200 in the country. A clear majority (55 per cent) supported full deregulation with only one in three (33 per cent) against. Two out of three (65 per cent) favoured allowing all stores to open on Sundays and almost three quarters (73 per cent) were in support of freedom for all to trade till 9pm during the week.

The National Competition Council (2003) said in its subsequent assessment report that:

> The liberalisation of trading hours across Australia reflects that no properly constituted NCP review has determined that the restrictions provide a net community benefit. On the contrary, evidence from reviews and from the experience of deregulated jurisdictions negate the arguments put by proponents of such restrictions. For example small retail business

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> employment in Victoria has grown since it removed restrictions in 1996 whereas it has fallen by almost 10 per cent over the period in Western Australia.

Not only has employment grown, consumers are taking advantage of the convenience offered by extended retail trading hours in those jurisdictions that now have deregulated trading hours. In Sydney and Melbourne, where large supermarkets can trade on Sundays, around 35 per cent of consumers shop for food and groceries on Sunday. But in Perth, where only smaller grocery stores can trade on Sunday, only 7 to 8 per cent of people shop for food on that day (Jebb Holland Dimasi 2000).

A vehement and emotive advertising campaign by medium-sized grocery stores seeking to maintain their regulated trading privileges intimidated the government into backing away from reform. A notable and, in the event, crucial deficiency in the debate was the lack of a high-profile advocate of the consumer interest. The Australian Consumers' Association (ACA) argued for deregulation, saying that "*ACA believes that governments should not restrict the opening hours of shops in any way. Consumers have a right to shop when they choose and all traders should be free to respond t o consumers' behaviour*"[13]. However, it has no full-time presence in WA that might have represented the consumer interest in ongoing media and public discussions. A well-resourced consumer interests' organisation could perhaps have ensured a more balanced public debate on this issue (and many other NCP issues), and exposing the flaws in the Government's inadequate public interest apologetics that in fact defend the status quo and suborned the community interest to vested interest.

WA's position is also in marked contrast to the approach and achievements of other state governments. The Victorian Government sees its business environment as a competitive advantage, recently boasting[14] that "*the Bracks government has led Australia in most areas of competition policy, with the National Competition Council recently describing Victoria's performance as 'impressive'*." It has recently established its own Victorian Competition and Efficiency Commission, charged with three core functions:

- reviewing regulatory impact statements and advising on the economic impact of significant new legislation;
- undertaking inquiries into matters referred to it by the Government; and
- operating Victoria's Competitive Neutrality Unit.

The Commission's inquiries will consider how to make it easier to do business in Victoria by examining, reducing and streamlining regulation.

Achieving Wider Objectives

To what extent have NCP and related reforms contributed to the achievement of other policy goals (for example, social, regional and environmental objectives)?

NCP has not only improved Australia's productivity growth by raising the competitiveness and flexibility of the economy. Productivity growth has also brought higher incomes and living standards. It also allows governments to spend more on health and education and

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improved social welfare and environment. Banks (2001) showed that, without the productivity growth experienced in the 1990s, annual income would have averaged $7,000 less per household.

NCP electricity and gas reforms have contributed to the achievement of environmental objectives. The establishment of electricity wholesale markets and third party access to electricity infrastructure have enabled renewable generators to enter the market as stand alone entities. Electricity reform has also encouraged demand-side management and energy efficiency leading to greenhouse gas reductions. Third party access to gas infrastructure has facilitated the rapid expansion of the use of natural gas, both as a primary energy source and for electricity generation.

Rural water reform through the creation of tradeable water encourages water to be used where it is most highly valued, and provides incentives to use water more efficiently. Irrigators can sell water they no longer need into the water market. Importantly, there will also be environmental benefits from trading where water moves from less productive areas to areas that are more suited to irrigation. In addition, the NCP obligations recognise, for the first time, the environment as a legitimate user of water.

Evaluating Costs and Benefits

How large have the benefits and costs of individual NCP and related reforms been? In what form have they been manifest? Which community groups and regions have been affected most? What have been the social benefits and costs?

There has been considerable public criticism of NCP, much of it incorrectly targeted. Many phenomena blamed on NCP are in fact a result of other causes, for example regional bank closures and lack of regional telephony services. Public opinion is influenced by media coverage that is frequently dominated by the views of groups who are losers from competition reform, while the wider community may have no representative (see page 24), and its interests generally receive less attention. The media, public and politicians alike share what Anne Krueger has termed “identity bias” - giving more weight to the interests of known, visible and identifiable losers from reform that the more diffuse but also more substantial losses that anti-competitive measures might impose on the broader community (see page 17).

The impact of NCP on the regions has attracted particularly fierce criticism. This generally overlooks the fact that the regions are also often the biggest winners from NCP, and also sometimes attributes to NCP developments that in fact have other causes (see page 25). However, it must also be acknowledged that the identifiable losers from NCP are found disproportionately in regional areas, and also that the concentration of costs on particular groups or types of business can have a greater proportional effect on small communities than larger ones. For these reasons, the implementation of NCP should be sensitive to local impacts, in some cases implementation should be phased, and it may be appropriate for Government to provide transition assistance or compensation for losers. The fact that there may be some adverse consequences for some groups in the community is not, of course, a

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reason for failing to proceed with reform that is demonstrably in the interests of the community as a whole; even if the adversely affected groups are in the regions.

The Productivity Commission's (1999) modelling of the regional effects of NCP showed that, although the early results had benefited metropolitan areas more than rural and regional areas, there are also benefits for regional Australia. Regions likely to benefit most tend to be in Queensland and Western Australia. The Productivity Commission modelling showed that all except one of 57 regions will gain from NCP in terms of output, and that all 57 regions will gain in terms of average income per person employed. The estimates for employment are less encouraging, with 14 regions expected to suffer job losses from NCP. However, some of the job loss is short-term, with five of these regions recouping job losses after five years of relatively slow economic growth.

These results indicate that any negative influences on a region from some reforms are likely to be offset in the vast majority of cases by positive effects of other reforms. The benefits of lower inflation, higher productivity, more choice and better prices do not reside solely in metropolitan areas; regional areas also benefit. There would appear to be significant gains for the Western Australian community, and for regional Western Australia as a whole, from implementing NCP reforms.

In addition, while NCP reforms may lead to economic/social costs in some regions, a number of other factors are having a more significant effect in these areas. As the Productivity Commission (1999) outlined, the viability of some rural communities has been threatened by a combination of a long-term decline in commodity prices, population migration to coastal areas, and technological progress in farm equipment leading to reduced labour needs.

Criticism has also centred on the public interest test, with calls for it to be more broadly based. This criticism is largely misguided because it does not recognise that public interest is defined broadly in the NCP agreements, to allow a wide range of community benefits to be considered, including social, environmental, employment as well as economic objectives. Any failure in the public interest test would appear to be a result of its poor application in some reviews, rather than being constrained by narrow definition in the *Competition Principles Agreement*. There is also a tendency for those whose interests are threatened by the conclusions reached by applying the test to blame the test itself for failing to give their own interests and concerns sufficient weight. This is not a failing of the test, but evidence that it works as intended.

A range of specific NCP reforms has benefited either the whole community or sections of the community. The extent of the benefits depends heavily on how many people are affected. For example, electricity consumers in the eastern states are now able to choose their electricity suppliers. Such retail contestability has a range of benefits, including cost savings for consumers, incentives for increased cost efficiency among retailers, incentives to develop new and innovative products, and better demand management leading to more efficient investment in infrastructure.

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In retail trading, significant trading hours restrictions have been removed in all jurisdictions except Western Australia. Victoria was one of the first states to deregulate and it has reaped the benefits. According to Jebb Holland Dimasi (2000) growth in both Victoria's retail sales and in the State's trend level of retail employment has been better than the national figures since deregulation in December 1996.

In Western Australia the Labor Government and its Coalition predecessor both had poor records in implementing NCP. So it is appropriate in this jurisdiction to focus on the cost to the community of not implementing NCP, which are far more extensive than the competition payments foregone. For example, with the recent failure to achieve electricity reform, Western Australian consumers will not see the projected 8.5 per cent fall in electricity prices, the $300 million per annum increase in Gross State Product, or the 2,900 jobs created by 2010 as outlined by the Final Report of the Electricity Reform Task Force (2002).

Oversights and Omissions

Are there perspectives that have not been sufficiently considered in implementing the reform program (for example, have distributional impacts and adjustment costs been adequately taken into account)?

The COAG considered the distributional and adjustment implications of NCP in November 2000. The COAG agreed that when determining the public interest associated with particular reforms, governments would be required to give consideration to explicitly identifying the likely effect of reform measures on specific industry sectors and communities, including expected costs in adjusting to change.

Social provisions such as welfare and redundancy payments are available to mitigate the effects of economic change induced by reform, and in many cases governments make additional provision to help in transition or compensate losers. Indeed, arguably governments have sometimes over-provided adjustment assistance to the perceived losers from NCP reform.

According to the National Competition Council (2002):

> The key considerations in determining whether adjustment assistance is warranted are the severity, speed and permanence of the effects of change, and whether significant hardship would be likely to result in the absence of assistance.

Where such considerations are based on sound social benefit arguments they are generally not controversial. However, in some cases, a government's underlying rationale for providing adjustment assistance seems more about concerned with politics than rigorous social benefit analysis. This is complicated by the fact that determining the level and form of assistance is not easy. Decisions on assistance also have to be made before the full effects of change are evident to 'lock in' the reform program.

A good example of the over-provision of adjustment assistance is national dairy deregulation. Prior to July 2000, the domestic milk market was regulated in all states. Farmers could not

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produce milk for drinking purposes unless they had quota entitlements. This led to a considerable price premium for wholesale milk used for direct consumption compared to milk for manufacturing.

In the lead up to 2000, there was a large incentive for Victoria to deregulate its domestic milk marketing arrangements because it was producing much more manufacturing milk (95 per cent) than drinking milk (5 per cent). It was correctly anticipated that deregulation would result in an increase in the wholesale price of milk used for manufacturing purposes because deregulation would have the effect of 'equalising' milk prices and this would lead to an improvement in average farm incomes in Victoria.

Dairy deregulation occurred on 30 June 2000, under a national agreement. The trigger was the decision by Victoria to remove its regulation. Victoria had undertaken an NCP review that found the arrangements were not in the public interest. Victoria also held an industry-based plebiscite, which overwhelmingly supported deregulation. The Commonwealth Government responded to industry calls by offering assistance to dairy farmers to adjust to the anticipated reduction in income, on condition that national agreement on change was reached.

The National Competition Council (2002) found that the Commonwealth assistance package was worth over $1.8 billion. As at 30 June 2001, an independent adviser had assessed the businesses of 29,819 farmers, who received structural adjustment payments averaging $54,367. Others who chose to exit the industry received up to $45,000 tax-free. Help was also provided to dairying communities to assist them to adjust. The cost of the assistance package is being recovered by a levy of 11 cents per litre on retail sales of drinking milk. The levy/assistance package commenced on 8 July 2000 and will run for about eight years.

Despite the 11 cents per litre levy, consumers in Western Australia have enjoyed much lower drinking milk prices since deregulation. In the year ending June 2000, just prior to deregulation, the nominal weighted average price[15] of a litre of full cream milk sold from supermarkets in Western Australia was $1.33. Within six months of deregulation it was $1.20 per litre and within 12 months of deregulation the weighted average price was $1.12 per litre. Since that time, the nominal weighted average price of a litre of full cream milk has never exceeded $1.18.

In 2001, the Australian Bureau of Agricultural and Resource Economics (ABARE) reported that there were 402 dairy farms in Western Australia at the time deregulation occurred. This means that Western Australian farms will each receive an average of $305,000 in adjustment assistance payments from the Commonwealth scheme.

Information from the Dairy Adjustment Authority shows that some enterprises received between $500,000 and $1 million. The Dairy Adjustment Authority also reports that 2,189 individuals received or are receiving payments from the adjustment package in Western Australia (averaging $56,248), indicating there is often more than one owner of a dairy farm.

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According to the Economics and Industry Standing Committee of the WA Legislative Assembly (2003), average assistance payments to Western Australian farmers are the highest of any state, reflecting the high proportion of Western Australian milk that was supplied under quota before deregulation.

In addition, Western Australia was the only State Government to provide additional restructuring assistance to complement the Federal assistance. That assistance, valued at $30 million, is a combination of direct grants to farmers, grants to dairy processors and transfer of public assets to farmer-owned companies. The combined Federal and State Government restructure assistance to dairy farmers in Western Australia is in excess of $150 million, or a little under $375,000 per dairy farm.

The Standing Committee found that many Western Australian dairy farmers used the State Assistance Package for upgrading farm infrastructure and increasing dairy and beef herds. No data was available on how the Federal adjustment assistance was spent, however anecdotal evidence suggests that it was most likely spent on debt reduction, investing in improved productive capacity and investment to enable inter-generational transfer or industry exit. Inappropriate uses of adjustment assistance outlined by the Standing Committee were lifestyle expenditure and to supplement business cash flow.

Irrespective of whether some dairy farmers have misused taxpayers' funds, the overall level of assistance to Western Australian farmers appears excessive. ABARE estimates that the average net worth of a Western Australian dairy farm is about $3 million, so it seems doubtful that significant hardship would result from the absence of at least some of the financial assistance provided.

In Western Australia, the dairy industry is concentrated in the State's South West corner. This region has a rapidly expanding population, as people are drawn to the area by the climate, environmental amenity and the wide range of recreational and tourism services on offer. Property prices, which positively affect dairy farmers' net wealth, have been growing strongly in this region. Dairy farmers therefore have alternative commercial opportunities if dairy farming proves to be economically unviable.

It would appear that the dairy adjustment assistance has been overly blunt and costly. Assistance could have been better targeted at individual farmers for whom adjustment pressures were most acute and who were unlikely to be able to adjust without assistance. Australia's Auditor-General has also heavily criticised the handling of the dairy deregulation, saying that it was rushed, and that governments and bureaucrats under-estimated the size of the task. A report on the Department of Agriculture and the Dairy Adjustment Authority by the auditor found the expected cost of handling industry deregulation blew out by 400 per cent.

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Adjustment Problems

Have significant adjustment problems been widespread or limited to a subset of NCP reforms? What are the distinguishing characteristics of those reforms where significant adjustment problems have arisen?

A cynic might observe that adjustment problems seem to be concentrated in industries whose businesses are well placed to resist reform perceived to be to their detriment. A good example of such an industry is the Western Australian taxi industry.

One of the major policy issues with the taxi industry is the entrenched value of property rights associated with taxi licences. The property right (as reflected in the price of taxi licences) has proven to be a major obstacle for policymakers in reforming the industry or improving service, since the release of new taxi licences depresses the price of licenses and is consequently resisted by existing licence holders.

In June 2003, the NCP review of the Taxi Act 1994 recommended that taxi plate owners be given the opportunity to voluntarily surrender their ownership of taxi licences with the offer of fair compensation being paid at the market value of the licence plate. The review report indicated that the offer to buy back taxi licences should last for three years.

Within a month of the review findings being made public, taxi plate owners were running a public campaign opposing the buyback proposal. In response to vocal opposition of the industry, in September 2003 the Minister announced that Government would not make the buyback offer unless there were representations by industry supporting it.

In keeping with the Government's commitment to release more taxi licences (in response to consumer demand), the Minister introduced a Taxi Amendment Bill 2003 to Parliament that passed in December 2003. The amendments allow licences to be leased rather than sold by tender. These amendments are a prerequisite for a buyback scheme because the cash flows generated by leased licences are used to pay back the capital and interest on funds raised for compensating taxi plate owners who have their ownership rights revoked.

As the Bill progressed through the Upper House, the Opposition insisted on amendments, which imposed a cap on the number of licences to be issued to only 20 per cent of the total licences currently issued. In December 2003, the Government advertised 48 lease licences (32 'conventional' taxi plates at $250 a week; four Multi-Purpose Taxi plates at $100 a week; and 12 Peak Period plates at $50 a week). There were about 200 applicants for the licences, indicating that there is considerable demand within the industry. These will be the first new full-time taxi plates released in over 14 years.

While there has been some progress with the passing of the Taxi Amendment Bill 2003, there remains the outstanding issue of how many licences will be released in the future. It seems unlikely that a plate release formula will be determined in Western Australia any time soon given the perceived political ramifications.

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Causes of Relative Success and Failure

Have some NCP reforms been more successful than others in meeting their objectives and delivering benefits? If so, why?

One of the few significant NCP successes in Western Australia has been in grain marketing. The *Grain Marketing Act 2002* has separated the roles of the regulator and the single desk marketer of prescribed grains in Western Australia, establishing the Grain Licensing Authority as the independent regulator of bulk barley, lupin and canola exports from Western Australia. The Grain Licensing Authority is responsible for considering applications for special export licences for bulk prescribed grains (barley, lupins and canola).

The main export licence for the Grain Pool Pty Ltd holds bulk prescribed grains, formed from the privatisation of the Grain Pool of Western Australia and its merger with Cooperative Bulk Handling Ltd.

The Grain Licensing Authority provides export licences except where it is convinced that a proposed export would affect significantly a price premium earned by the Grain Pool by exercising market power in certain uncompetitive export markets.

Western Australia's new licensing arrangements have given grain growers added flexibility in marketing their barley, canola and lupins. Greater competition in the grain export industry is a major legislative reform that introduces competition in the export market, while retaining any identified price premiums arising from the exercise of market power available to the single desk.

The new arrangements have been a great success, with growers clearly welcoming more choice. The first export licences were effective from 1 November 2003, the start of the 2003 harvest. Since 22 September 2003 when the new licensing system came into effect, the Grain Licensing Authority has approved a total of twelve licences, with:

- nine export licences for the bulk export of 433,000 tonnes of feed barley to the Middle East. These licences represent approximately 29 per cent of Western Australia's feed barley production in 2003-04;
- one export licence for 48,000 tonnes of canola to the sub-continent;
- one export licence for 20,000 tonnes of lupins to East Asia; and
- one export licence for 35,000 tonnes of malting barley to Asia. This approval was provided through appeal to the Minister.

The Grain Licensing Authority has declined applications for 318,000 tonnes of feed barley to the Middle East, 45,000 tonnes of canola to the sub-continent, and 40,000 tonnes of canola to Asia, in recognition of the marketing efforts of the Grain Pool in generating price premiums. The latter application was the subject of an unsuccessful appeal.

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It now seems likely that South Australia will follow Western Australia's lead and introduce a grain licensing authority. It has been reported that 70 per cent of South Australian grain growers support the introduction of a grain licensing authority in that State.

It would seem that this reform has been easier to implement than reforms to other statutory marketing arrangements (potatoes, eggs, and milk) in Western Australia because of the significant level of industry support. Once the majority of grain growers became convinced that it was in their own commercial interests to sell their grain to a buyer other than the single desk, reform was implemented.

Lessons for the Future

What could have been done better and what lessons does this provide for future reform initiatives?

COAG (2000) recognised that assistance may be necessary where reform has a large effect on specific industries or communities, and large costs are expected in adjusting to change. However, providing adjustment assistance is fraught with difficulty because it is not easy to accurately identify and assist those people and communities most deserving of assistance. In addition, phasing the implementation of reforms or providing a 'grace period' to allow affected parties to prepare for the new business environment can also prove costly.

The Western Australian experience with a range of NCP reforms provides a number of lessons for any future reform initiatives:

- attempts to 'buy' reform can invite vocal political resistance to reform (e.g. taxi buyback);
- poor adjustment assistance targeting can result in a wasteful transfer or resources from taxpayers and consumers to producers (e.g. dairy assistance); and
- phasing reforms not only delays the implementation of reforms that are in the public interest, it can also provide additional time for those opposed to reform to successfully lobby governments resulting in reforms proposals being withdrawn (e.g. electricity reform, retail trading hours deregulation, liquor licensing deregulation).

Governments serious about implementing successful NCP reform must have:

- a properly constituted review process (including community consultation) that provides independent, transparent and rigorous analysis reflecting the interests of the whole community rather than just vested interests;
- where it is warranted, adjustment assistance should target individuals for whom adjustment pressures are most acute and who are unlikely to be able to adjust without assistance; and
- courageous political leadership, that elevates the community interest above sectional interest and political expediency, that publicly supports the reform, and that explains the reform and the 'public interest' reasons why it is necessary.

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Opportunities for Further Reform

Unfinished Business

Outstanding Reforms

How important are the remaining NCP reforms compared to those already undertaken? How significant are the potential gains from completing the agenda?

As Western Australia is the worst performing jurisdiction on NCP reform, it has the most to gain from completing the agenda. The main areas of 'unfinished business' are legislation review and structural reform. Western Australia's sub-standard record is documented by the National Competition Council's '*Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2003.'*

As the National Competition Council (2003) says, "Western Australia's legislation review performance has been below that of all other jurisdictions." Western Australia still retains a number of legislative restrictions on competition that have been removed (in the public interest) in all other jurisdictions (for example, restrictions on retail trading hours, potato marketing and egg marketing).

In some cases the Western Australian Government had decided to reform anti-competitive restrictions based on a strong public interest justification only to subsequently reverse its decision after being subject to intense pressure from vested interests (e.g. the failed attempt to deregulate liquor licensing and retail trading hours).

However, it is in the area of structural reform where the most gains can be made from completing the NCP agenda. As the Western Australian Government said in its 2003 Progress Report to the National Competition Council, Implementing National Competition Policy in Western Australia:

> "NCP reforms in the energy sector have provided the major focus because they have by far the greatest potential effect on the State's economy. Research has shown that electricity reform alone could yield benefits up to $300 million per annum to the Western Australian economy by 2010."

Regrettably, the Government failed to progress the necessary structural reforms through Parliament – not for lack of trying, but because the opposition parties that control the upper house refused to support it. The remaining parts of the package, such as the introduction of a wholesale market, are a step in the right direction. But without successful structural reform there is unlikely to be a competitive market and hence limited benefits for business and consumers.

As a consequence of this NCP reform failure it appears that Western Australian businesses will continue to pay 19.4 per cent more than the Australian capital city average, greater than for all other States and Territories[16]. Western Australian households are unlikely to fare much better, currently paying 4.9 per cent more than the capital city average, with only Darwin and Adelaide recording higher prices.

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Impediments to Completion

Are there specific impediments to completing aspects of the current NCP agenda and how could they best be addressed? Have aspects of NCP processes (for example, the requirement for separate State and Territory legislation reviews of common issues) been inefficient and/or contributed to the time taken to complete the agenda?

The most important impediment to completing the current NCP agenda is a lack of political will and leadership. Both sides of Western Australian politics, when in Government or when in opposition, have failed to pursue NCP reforms.

Vested interests, though small in number (e.g. monopoly utilities, independent food retailers, potato farmers, hotel licensees, taxi owners), have prevailed in Western Australia because they have strong incentives to gain political support compared with the diffuse majority of consumers. For political parties, the costs of opposing such groups in many cases outweighs the community's interest in the implementation of NCP reforms (see discussion on page 14). Western Australian consumers have suffered the consequences of this failure - higher prices, reduced choice, lower quality, lost flexibility and inconvenience.

An example of the Western Australian Government putting the interests of a vocal and geographically concentrated minority ahead of the wider community is in potato marketing. The NCP review of the *Marketing of Potatoes 1946* concluded that deregulation of the potato industry would benefit neither farmers nor consumers. The review recommended the continuation of the statutory marketing arrangements, in order to maintain industry stability in regional areas of the State and provide reliable supplies of potatoes to Western Australian consumers.

Western Australia's potato regulatory arrangement is unique in Australia. It remains in existence even though it was initially designed to deal with post war scarcity of potatoes that required centralised control.

The current regulatory regime is responsible for:

- high potato prices charged to Western Australian consumers, and also poor quality and limited choice;
- the dumping of potatoes on export markets by the Potato Marketing Authority, at times in competition with Western Australian exporters;
- thwarting the establishment of a potato processing industry in Western Australia – the last business to try (Simplot) has relocated to Tasmania;
- inflated land prices (by $3,500 to $20,000 per hectare), providing benefits to those owning potato licences, but adding substantially to the cost structure of the industry; and
- the cost of an unnecessary Authority which includes the expense of inspectors (That CCI once dubbed 'potato police'[17]) whose role is to seek out and penalise any unlicensed grower or licensed grower who is growing more than the allotted area.

That such anachronistic and costly regulation remains, despite an NCP review having been conducted, is a scandal. In effect, the Western Australian Government is ignoring the interests

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of two million consumers to appease less than two hundred potato farmers. As the editorial of *The Australian* newspaper said on 7 April 2004:

> "Rorts like this reward insiders at the expense of everybody else. They are a blight on consumers, denying them the right to buy products they want at a price set by the market."

In addition to the damage done to consumers - higher prices, less choice, and inferior quality - retaining this potato regulation is now costing Western Australian taxpayers $3.76 million a year in lost competition payments.

In the context of the Government's lack of political will to confront vested interests, public servants have had little incentive to make sure that NCP processes are rigorous and carried out in a manner that conforms with the spirit, intent or even letter of the *Competition Principles Agreement*. Instead of implementing policy dispassionately, government departments have been expected to produce review conclusions that reflect the outcome the government wants.

The lack of political will has also contributed to bureaucratic inertia in completing reviews and implementing reforms in Western Australia. Not surprisingly, the National Competition Council's 2003 assessment resulted in Western Australia incurring competition payments suspension of 20 per cent ($15.04 million) where the review and reform of legislation was not completed or where completed reviews and/or reforms did not satisfy NCP principles.

Reform Framework

Is the current NCP framework (its legal underpinnings, processes, institutions and incentive payments) the most effective way of progressing and extending competition reform and of 'locking in' the worthwhile changes that have already been made? What modifications to the present framework would improve its operation?

In Western Australia, relying on the government to take responsibility for reforming its own laws has not been successful. In many instances, NCP processes designed to act as a counterweight to vested interests have not succeeded. The well-documented tendency of the political process to fail to deliver reforms in the community interest (see discussion from page 14) was not averted, and the 'public interest test' was effectively sidelined or distorted.

For example, in the Western Australian Government's 2003 assessment report to the National Competition Council it said that a package of reforms to liquor licensing arrangements (based on public interest) was being developed to come into effect after the next election due in 2005. However in 2004, the package of reforms was withdrawn, without any public interest justification, after strong lobbying by the Australian Hotels' Association (AHA).

As a consequence of this decision the public 'needs' test for a new liquor outlet licence will be maintained. Under this arrangement, applicants for new licences or extended trading must show a public 'need' for a new liquor outlet that is not met by existing businesses in the locality. This effectively reverses the burden of proof as implemented under NCP. Whereas NCP presumes in favour of competition unless a public interest case against it can be demonstrated, WA's liquor laws prescribe that competition should be prohibited unless an

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unmet need can be demonstrated. This archaic process clearly works to the advantage of incumbent retailers and against the interest of consumers. It may be one reason why WA consistently records the highest pub beer prices in Australia[18].

In addition, the restriction on Sunday trading by liquor stores continues. Only holders of a hotel licence can sell packaged liquor to the public on Sundays. This differential treatment disadvantages liquor stores and does nothing to reduce the supply of liquor (since there is no limit on how much packaged liquor hotel bottle shops can sell).

It is not appropriate to exempt liquor licensing from reform without first conducting a rigorous cost-benefit analysis – to have done so invites claims that the reform has been withdrawn to appease vested interests. According to the Western Australian Government, a new review (but not an NCP review) is being established with new terms of reference, developed in consultation with major industry stakeholders. Only a supreme optimist would expect that any decisions arising from this review would be consistent with NCP principles.

In Western Australia, Ministers have been responsible for reviewing legislation in their portfolios. This arrangement has in many instances reduced the probability of successful NCP outcomes where Ministers have been 'captured' by the industries affected by their portfolios, or government agencies have vested interests in maintaining the status quo.

The process and method for conducting and implementing reviews of legislation are detailed in Western Australia's Public Interest Guidelines for Legislation Review. The Department of Treasury and Finance liaises with the proponent agency or Ministerial Office to ensure that a review is conducted in a manner consistent with NCP principles and to advise on the scope and scale of the review. However the Minister/agency does not always accept this advice.

As a consequence, legislation review reports have not always been publicly available or easily accessible. They are often poorly written, show little understanding of the NCP principles they are supposed to be implementing, and either fail to provide evidence or provide evidence of questionable validity and independence.

On some occasions, genuinely independent reviews were conducted in accordance with NCP principles, generally concluding that pro-competitive reform was in the public interest. But when the government disagreed with these findings, it generally refused to implement the recommendations and in some cases failed to publish the review. There is an unfortunate consistency in a government keeping from the public the outcome of a pubic interest review that concluded that government policy is not in the public interest.

In hindsight, all NCP legislation reviews should have been the responsibility of one designated Minister (to champion NCP reform) and conducted by one designated central agency; or, at the very least, agencies should not have reviewed their own programs. Under this process other Ministers/agencies responsible for the legislation could have made submissions to NCP reviews but they would not have had direct control of the process. Such a

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model would have encouraged NCP outcomes more consistent with NCP principles delivered in a timely manner.

The key issue is how to maintain proper sovereign authority within the states' jurisdictions, and proper regard for democratic processes and accountability, while at the same time diminishing the tendency of the political process to produce outcomes that are not in the community interest. One approach that has been successful for gas access, is for jurisdictions to agree on a policy framework and uniform legislation to implement reform. The uniform framework and legislation must be introduced in each jurisdiction and can accommodate state-specific characteristics and concerns through transitional arrangements and derogations. Importantly, these arrangements must be agreed by all jurisdictions. Such an approach may have yielded superior NCP reform outcomes in areas like legislation review.

The NCP advisory body, the National Competition Council, has had a thankless task to oversee NCP implementation in many politically sensitive areas (electricity reform, trading hours deregulation, liquor licensing reform, taxi deregulation, statutory marketing). The opprobrium which the Council attracts was anticipated – its role was in part to act as 'whipping boy' to allow the states to deflect some of the hostility to competition reform. It has performed this function frequently – recently, for example, the New South Wales Minister for Gaming and Racing argued that[19]:

> The continued threat of a $51 million penalty every year gives New South Wales no choice but to comply with the Commonwealth's demands to change the way we regulate liquor, the health professions and other industries. The amendments made by these bills aim to ensure that penalties are not imposed on New South Wales in future years.

However, the Council's job was made tougher by having a fairly limited budget with which to promote NCP. The National Competition Council's job was also made more difficult by the extension of NCP timeframes, in particular for legislation review (i.e. being extended initially from 2000 to 2002 and then further to 2003). Extended timeframes in Western Australia were not used productively to implement NCP reforms. Instead the extensions were used cynically to gain more competition payments without actually implementing very much in the way of NCP reforms.

An example of the lack of commitment to NCP by the Western Australian Government is the Acts Amendment and Repeal (Competition Policy) Act 2003 which repeals two minor acts (Bread Act 1982 and the Wheat Marketing Act 1989) and amends a range of other relatively minor legislation. The Acts Amendment and Repeal (Competition Policy) Bill was first introduced by the previous Government in May 2000. However, the Act was only proclaimed (in part) on 20 April 2004. For such uncontroversial and minor NCP reforms to take so long to be implemented gives some indication as to the priority of, and commitment to, NCP in Western Australia.

However, it must be said that the Western Australian Government became more acutely focused on attempting to resolve at least some of the NCP issues when the threat of withholding competition payments became real. This occurred when the Federal Treasurer

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announced permanent deductions and suspensions of $40.7 million for lack of NCP reform progress on 8 December 2003. In a display of breathtaking disingenuousness, both the Premier and the opposition leader criticised this decision to refuse to compensate WA for reforms it never implemented. CCI's then CEO, Lyndon Rowe, responded to these comments through an article in The West Australian newspaper, commenting that "The fault here lies with the WA Government policy for pandering to vested interests at the expense of the wider community; not with the NCC's response to that policy" (see Appendix 2).

With weak political leadership on NCP in Western Australia it appears that the competition payments 'stick' is valuable and necessary, but not sufficient to induce reform. Perhaps a greater conviction that the penalties would indeed be applied if the state failed to reform, and a better explanation of why this is an entirely fair outcome, would have furthered the National Competition Council's effectiveness in this regard.

Appropriateness of Objectives

Are the underlying objectives of NCP still appropriate? If not, how could they be modified?

The underlying objectives of NCP are to raise the competitiveness and flexibility of the economy and improve living standards, and these remain entirely appropriate.

Under NCP, encouraging competition is not an end in itself. It is the means to an end that is effected by creating the incentives that lead to higher incomes, more productivity and a better quality of life for the community (i.e. greater convenience and more choice). Where the public interest is better served by restrictions on competition , NCP says this is acceptable as long as it can be transparently justified.

Without the continued pursuit of the unfinished NCP reforms it is unlikely that Australia can sustain the ongoing improvements in economic growth and productivity that have characterised the past decade of reform and that are required to raise living standards further in future.

The Commonwealth Government could set a better example in pursuit of unfinished NCP reforms. Past decisions regarding the NCP reviews of wheat marketing (i.e. Australian Wheat Board), postal services (i.e. Australia Post), the continued protectionist stance on pharmacies and the recent $444.4 million sugar industry assistance package do nothing for the Commonwealth's own NCP reform credentials.

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Public Interest Test

Is the current public interest test (see box 4) facilitating socially beneficial reform? Has it provided a means to avoid worthwhile reform in some areas?

A core principle of the NCP is that governments should retain (or introduce) restrictions on competition only where they can demonstrate that the benefits to the community exceed the costs. The factors relevant to making such an assessment – which have come to be known as the 'public interest test' – are contained in Clause 1(3) of the Competition Principles Agreement. They include:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or of a class of consumers;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources.

A requirement for governments to demonstrate that their regulatory arrangements are in the interests of the community would at face value seem unexceptionable. Nevertheless, this approach to evaluating government restrictions on competition has been contentious.

One of the main reasons for this is that the NCP has reversed the onus of proof in policy reform that generally requires proponents of change to demonstrate that change will be worthwhile. In the case of competition policy reforms, governments have essentially taken the view that reversing the onus of proof is justified on the grounds that both theory and evidence suggest overwhelmingly that removing restrictions on competition will typically be in the public interest, but will also be fiercely resisted (see page 14).

This was clearly the position advocated by the Hilmer Committee in the 1993 report to COAG that formed the basis for the NCP. It observed:

> "Competition provides the spur for businesses to improve their performance, develop new products and respond to changing circumstances. Competition offers the promise of lower prices and improved choice for consumers and greater efficiency, higher economic growth and increased employment opportunities for the economy as a whole." *(Hilmer et al, 1993, p.1)*

However it has been the distribution of the gains in and the transitional impacts of reforms on different groups, rather than the gains per se, that have attracted most political attention. Misplaced concerns that NCP and other micro-economic reforms have both the intent and the effect of damaging the interests of workers or regions have been used to create a popular backlash against reform.

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Understanding and analysing the distributional and adjustment implications of competition reform is a key issue for governments. This is reflected in COAG's changes to NCP arrangements in 2000 where it was made explicit that:

> "When examining those matters identified under Clause 1(3) of the CPA, Governments should give consideration to explicitly identifying the likely effect of reform measures on specific industry sectors and communities, including expected costs in adjusting to change." (COAG, 2000)

However, it has not always been done well (e.g. dairy deregulation) – in part because it is difficult to do. Nevertheless, such analysis is an important part of the assessments needed in making decisions about policy change under NCP. And while there are general assistance programs available to help people deal with change, there are circumstances in which more targeted compensation or assistance to address the adjustment consequences of reforms is called for.

However, adjustment assistance need not necessarily be financial. Transitional arrangements should be explicitly examined wherever a particular sector of the community loses out even though there is overall net benefits to the wider community by adopting a policy change under NCP.

On the other hand, transitional arrangements like phasing bring potential costs and risks. Not only does phased implementation delay the realisation of full reform benefits, it also provides vested interests with more time to mount a rearguard action to unwind the proposed reforms. In September 2003, the Western Australian Government indicated that a package of reforms to liquor licensing arrangements was being developed to come into effect on 1 July 2005[20]. Since then, and in response to strong lobbying by vested interests and Government backbench criticism, the package of reforms has been withdrawn.

In moving forward on competition policy it is fundamental that public interest considerations continue to be at the forefront of NCP reforms. In principle, the NCP makes abundant allowance for this.

Firstly, Clause 1(3) provides for a range of economic and social matters to be considered in weighing up the benefits and costs of reforms involving the structure of public monopolies, competitive neutrality, and reviews of legislation (existing and prospective) with anti-competitive effects.

Secondly, the decision-making framework under the NCP recognises that such weighing up ultimately requires political judgement. However, it also recognises that to be well informed, such judgement needs to be underpinned by impartial and transparent review processes, in which affected interests can have their say, and in which information relevant to political tradeoffs can be effectively brought to bear.

Public interest is a necessarily broad concept taking full account of social, environmental and regional impacts, as well as economic impacts. While this is the intent, the public interest test is often poorly applied. The major reason for this is that the sorts of economic, social and

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environmental factors that need to be considered in making a net benefit judgement can pull in different directions making any assessment of public interest contestable. The real difficulty therefore is in how the tradeoffs among any competing effects should be made – this task is inherently subjective and political and therefore ultimately requires strong leadership by governments.

It is also important to ensure that the NCP's placing of the onus of proof on defenders of anti-competitive arrangements does not preclude an adequate case being made for the removal of such arrangements. To use a legal analogy, the case should not be decided on the evidence of the defence alone. Short cuts should not be taken when government agencies are removing restrictions. History suggests that short cuts are most common when government agencies are intent on retaining restrictions and only going through the motions of policy review.

For this reason COAG (2000) said that, in applying the public interest test, "*Governments should document the public interest reasons supporting a decision or assessment and make them available to interested parties and the public.*" Western Australia's record in this area has not been convincing.

Procedural Issues

Are there procedural issues that need to be resolved for the future? For example, do current processes take appropriate account of adjustment issues? Have difference in the approach to legislation review and reform across jurisdictions had any significant impacts or outcomes?

In Western Australia a number of significant NCP reviews have suffered from a lack of independence and a lack of rigour in the review process. As a consequence there has not been a strong incentive for those agencies conducting reviews to ensure that the quality of the analysis undertaken is high since they did not have to withstand detailed scrutiny from a range of sources. Complaints have also arisen about the composition of review panels, particularly where vested interest group representatives have been prominent on those panels.

While many review reports have been published, there is no clear obligation on governments to publish them, or even make them available to the National Competition Council. This was an important oversight, particularly with regard to the National Competition Council's responsibility to assess whether review and reform complies with NCP. In Western Australia it is at the responsible Minister's discretion whether a review report is made public.

The importance of independent, transparent and rigorous processes when considering significant public interest matters cannot be overstated. Such processes are essential to maintaining community confidence that public interest considerations have been objectively examined and that it is the public interest that is paramount, rather than the concerns of vocal vested interests (or to a much lesser extent in Western Australia, reform proponents).

As the Productivity Commission (1999) said, "*The potential for legislation reviews to introduce important changes affecting people's lives and livelihoods highlights the need for integrity in the review process, including the operation of the 'public interest test' provisions of NCP.*"

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As reviews of existing legislation are nearing completion, now is an appropriate time to review gate-keeping processes for new legislation. Jurisdictions need to have an effective process in place to ensure that all new legislation restricting competition is reviewed.

In Western Australia, the gate-keeping process for new legislation depends on Department of Treasury and Finance officers identifying restrictions in legislation and then ensuring that a review is conducted of the identified restrictions. In a number of instances, reviews of new legislation have occurred after the legislation has already been enacted. A notable example is the case of fuel price regulation. The Petroleum Products Pricing Amendment Act 2000 and the Petroleum Legislation Amendment Act 2001 that impose fuel price regulation in Western Australia were only reviewed after they were passed by Parliament.

It is unlikely that the existing process is sufficiently robust to guarantee appropriate outcomes, given the WA Government's lack of interest in NCP reform. Unless more effective and transparent gate-keeping processes are introduced in Western Australia, the National Competition Council may need to scrutinise new restrictions on competition more vigorously in the future.

Another of the significant failures of NCP in Western Australia has been in the area of competitive neutrality. The major concern in Western Australia is the impotence of the competitive neutrality complaints mechanism. Western Australia would appear to have the most ineffective complaints mechanism of any jurisdiction in Australia.

It has never been fully tested since the complaints mechanism was established within the Department of Treasury and Finance in 1996. This is because not one competitive neutrality complaint in Western Australia has ever been subject to a full investigation by the Complaints Secretariat requiring a decision by Government (the Expenditure Review Committee).

The Western Australian complaints mechanism only applies to public sector agencies that are subject to competitive neutrality. An agency is subject to competitive neutrality if a competitive neutrality review is required, has been undertaken, and the review recommends that competitive neutrality principles apply.

Such a mechanism leads to potentially perverse, unfair and non-transparent outcomes. Moreover, it creates the perception that the Government is not serious about competitive neutrality reform in Western Australia. The following examples, from Western Australia's 2003 progress report to the National Competition Council, highlight the complete failure of the complaints mechanism to deal with the concerns of private sector competitors with public sector agencies.

> Kable Export Pty Ltd is an exporter of potatoes to Mauritius, and has been complaining for two years that the Potato Marketing Corporation of Western Australia (PMC) has been significantly undercutting its prices in this export market. Kable Export argue that PMC is able to undercut prices in export markets due to its monopoly status over the Western Australian domestic market, the pooling arrangements for payments to growers under the Marketing of Potatoes Act 1946, and a lack of transparent reporting by the PMC.

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> The competitive neutrality review of the PMC has not been completed, which is a prerequisite for complaints to be considered. As a result, the competitive neutrality concerns of Kable Export Pty Ltd cannot be dealt with until a competitive neutrality review is completed.
>
> The Eastern Goldfields Transport Board Act 1984 provides for the Board to undertake public transport services in the city of Kalgoorlie-Boulder and in any adjoining municipal districts. There is no competition for the Board for these services. Under the Act the Board can also carry out charter services to meet the needs of any district in which the Board is permitted to operate. The Board tenders for these services in competition with the private sector.
>
> A private competitor in the charter transport market has made repeated informal complaints to the DTF and the NCC regarding the competitive advantages enjoyed by the Board. As a competitive neutrality review has not been undertaken and endorsed by Government, a formal complaint cannot be made. The complainant considers that the Board is undercutting its competitors in the provision of charter transport services, due to its statutory authority status, its lack of transparency in reporting and its receipt of an annual subsidy equal to its total operating loss. The competitor claims that the Board cross-subsidises its charter operations with the public transport subsidy, to reduce their cost of service provision when tendering for charter work in competition with the private sector.

It would appear that Western Australia's competitive neutrality complaints mechanism needs a wider scope, a greater degree of independence and a substantial revision to its complaints handling processes for it to be deemed fair and effective. The complaints mechanism should be transferred to the newly established Economic Regulation Authority (ERA), which commenced operations on 1 January 2004.

The ERA is an independent specialist regulatory body that has assumed responsibility for a range of economic regulatory functions related to the gas, rail, water and electricity industries. The ERA is also provided with the capacity to conduct inquiries or reports on matters related to non-regulated industries. So the ERA does have the capacity to investigate competitive neutrality complaints already (albeit at the Treasurer's discretion). But making competitive neutrality complaints an explicit, separately identifiable function of the ERA would provide the complaints mechanism with more integrity, giving complainants more confidence in the system.

Adding an explicit competitive neutrality complaints mechanism to the functions of an independent economic regulator would not be a novel initiative. This approach has already been followed in New South Wales by the Independent Pricing and Regulatory Tribunal, the Queensland Competition Authority and Tasmania's Government Prices Oversight Commission.

Effectiveness of Payments

How effective have competition payment arrangements been in facilitating reform?

The National Competition Council has undertaken five assessments of State and Territory government progress in implementing NCP, in June 1997, 1999, 2001, 2002 and 2003. The assessments make recommendations to the Commonwealth Treasurer on whether States and Territories have met their commitments to implement the NCP reforms and, consequently, whether they should receive NCP payments.

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The Commonwealth Government, not the National Competition Council, decides the amounts of competition payments actually paid. The payments are dividends for actually implementing reform.

COAG (2000) asked the National Competition Council, when assessing the nature and level of a payment reduction or suspension recommended for a particular State or Territory, to account for:

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

The National Competition Council (2003a) has interpreted this to mean that individual minor breaches of reform obligations should not necessarily have adverse payment implications if the responsible government has generally performed well against the total NCP program. Nevertheless, significant breaches of obligations in priority areas may be the subject of adverse recommendation by the National Competition Council if they affect other jurisdictions.

The National Competition Council is of the view that the threat of payments loss has been a strong incentive for the States and Territories to implement reform. However, the evidence for Western Australia suggests that the threat of losing competition payments has not been as effective as hoped. For a number of years, the threat of payments loss seemed hollow.

A few years into the NCP process, the States and Territories seemed well aware of the Commonwealth Government's hesitation and reluctance to deduct payments for their lack of reform effort. Some jurisdictions, like Western Australia, did not appear surprised at the leniency afforded them regardless of the public criticism by the National Competition Council.

The Commonwealth Government, like State and Territory Governments, was feeling resistance to economic reform in certain sections of the community, as demonstrated by the electoral support for politicians (such as Pauline Hanson and Bob Katter) seeking to oppose a range of NCP reforms. As a consequence, the Commonwealth was lenient on the states and territories, for its own political ends.

The climax of this approach is described by Brenchley (2003):

> Right up to the Queensland and West Australian elections in early 2001, in which national competition policy was derided as 'out of control', Samuel was handing it back to the politicians. 'Those [politicians] who pursue political opportunism, deliberately calculated to misinform and mislead, when their communities need honesty and leadership, deserve disdain', he wrote in The Australian.
>
> Shortly after the elections, however, Samuel had a long session with Howard and Costello about his future style. Howard gave him two pieces of advice. 'First of all, Graeme, this is a very tough policy', Howard told him. 'You've got to take it one step at a time. You're on a rocky road and if you run you'll fall over and break your leg.' Howard was telling Samuel to

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> ease up on the publicity. But he had another message, as well: "Don't lecture governments publicly, it doesn't work'.
>
> Samuel and the two politicians decided to 'punch out the lights' of national competition policy – Samuel would go into his 'merchant banker mould' of achieving results by negotiation rather than public confrontations." (pp. 265-266)

Over time, the National Competition Council became more conciliatory in its approach and appeared reluctant to recommend suspensions or deductions of payments to jurisdictions, or make public criticisms of the states' reform records. Only in the 2003 NCP assessment did the Council seem serious in its threats to withhold payments. This was the first of the five NCP assessments that appeared to have affected the States to any great degree. Before that, the assessments seem to have been no more than minor irritants.

The payments threat would have been much more effective if payments penalties (in particular suspensions rather than deductions) were used much earlier in the NCP process, and the National Competition Council had consistently and plausibly indicated that the threat of further penalties was real. Some indication of the magnitude of likely penalties would also have been helpful – in WA, senior politicians expressed (or feigned) surprise at the magnitude of payments eventually deducted.

This tardy resort to 'sudden death' payment deductions was not optimal. Deductions are irrevocable reductions in governments' competition payments for a particular year[21]. Deductions give little incentive for negotiation in the deduction year; the money is lost for that year so there is little pressure to implement reforms quickly.

As a case study it is useful to examine whether the 2003-04 payments penalties to Western Australia affected the Government's attitude towards implementing significant NCP reforms. Western Australia's 2003-04 NCP competition payments were subject to the following specific penalties in 2003-04:

- a permanent deduction of 10 per cent for non-compliance in respect of retail trading hours legislation (estimated at $7.52 million);
- a permanent deduction of 5 per cent for non-compliance in respect of the regulation of liquor sales (estimated at $3.76 million);
- a permanent deduction of 5 per cent for non-compliance in respect of the marketing of potatoes;
- a specific suspension of 5 per cent for non-compliance in respect of egg marketing (estimated at $3.76 million);
- a specific suspension of 10 per cent for lack of transparency in water pricing (estimated at $7.52 million);
- a pool suspension of 20 per cent for failure to complete legislation reviews (estimated at $15 million).

For retail trading hours, the Government's decision on 24 June 2003 to extend weeknight trading (Monday to Friday) to 9pm from 2005, but retain the restriction on Sunday trading,

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has not changed in response to the Federal Treasurer's NCP payments announcement on 8 December 2003.

For the regulation of liquor stores, on 1 September 2003 the Government announced that it would deregulate by 1 July 2005. However, since that time the reforms have been overturned completely in response to vested interest pressure and lack of support from the Government's own back bench.

For the regulation of potato marketing, on 5 August 2003 the Government announced that it would retain the marketing powers of the Potato Marketing Corporation. There has been no change in the Government's position since then. On 10 September 2003 another review of the Potato Marketing Act 1946 was announced. An implementation advisory group is undertaking this review with a focus on improving 'efficiencies'.

For the regulation of egg marketing, on 12 August 2003 the Government announced that it would deregulate the egg industry by no later than 1 July 2007. The Government submitted a public interest test to the NCC arguing that it was justified in delaying egg deregulation but in June 2004 it received advice from the NCC that deregulation must take place no later than 31 December 2005 to avoid penalties. The Government accepted this, and is currently finalising the structure of the deregulation. Western Australia should have the suspended payments reinstated.

For the lack of transparency in water pricing, the Government established a working group to investigate ways to best address the issue. Subsequently the working group developed terms of reference, consistent with COAG pricing principles, for a pricing inquiry to be undertaken by the Economic Regulation Authority. These actions by the Government will allow this suspension to be lifted and reimbursed.

It would appear that NCP reform success is more likely where suspensions have been used rather than the less flexible permanent deductions. CCI believes that the use of suspensions earlier in the process might have led to more successful NCP outcomes in Western Australia. However, it is recognised that for some NCP issues, like retail trading hours deregulation, even the early announcement of a large suspension may not have been enough to achieve reform.

Extending Existing NCP Reforms

COAG energy and water initiatives

Are current COAG energy and water initiatives appropriate ways of extending reform in these areas? Are there other reform opportunities in these areas which need to be explored? What benefits and costs would they involve and what procedural arrangements would be required to implement them? What impediments are there to the timely implementation of additional reforms in the energy and water sectors?

The Chamber of Commerce and Industry of WA submitted comments on the draft Commonwealth discussion paper on the National Water Initiative. This section reproduces the key points.

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CCI regards the management of Western Australia's water resources as extremely important. Many industries, particularly those in the resource and energy sectors are dependent on reliable and certain access to water.

Water Entitlements

CCI believes that a two-tiered approach could be adopted to water entitlements. In the first case, where there are doubts about the effective operation of the market (for example the size of the resource cannot properly be determined), or there are a small number or a low diversity of users, the traditional approach of fixed term, non-tradeable water entitlements would be the appropriate approach.

On the other hand, when the catchment or aquifer is nearly fully allocated, and there are a large number and diversity of users, then it is appropriate to define water entitlements as an open-ended or perpetual share of the water resources available. This would ensure certainty of title while stimulating water trading to the maximum extent possible.

Dealing with drought

CCI notes that some stakeholders have argued that in times of drought, where the availability of water in a catchment or aquifer is reduced below its sustainable yield, that the allocation to the environment should remain unchanged – other users would meet the shortfall by reducing consumption. CCI believes however, that a more equitable approach that provides for the market to play a part is to reduce allocations on a pro-rata basis, and allow parties to trade amongst themselves to meet their individual water demands. In the case of the environment, the environmental agency or possibly Treasury could step in and look to purchase water from other uses if it was determined that the environment needed additional water.

Commonwealth funding of water resource management in WA

CCI understands that in the past the Commonwealth Government contributed financially to the investigation of WA's water resources. CCI believes that it would be appropriate if the Commonwealth Government reactivated this funding to meet the increasing requirements perceived by most stakeholders for additional funding towards water resource management.

Competition-related reforms outside the current NCP

Standards and Regulation

Voluntary and mandatory standards have extended and multiplied in recent years. Standards Australia has developed around 7,000 standards covering issues as diverse as termite management in new buildings (a separate standard covers existing buildings) to corporate social responsibility. At their best, standards have a number of advantages over legislated regulation:

- they are more flexible, less costly and less prescriptive;
- they can make detailed but non-binding recommendations on the optimal way to deal with specific situations;
- they are developed by practitioners, and can be improved incrementally;
- they can be a useful tool in achieving and demonstrating quality and standards.

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Standards were originally intended to be voluntary. However, in some cases, notionally voluntary standards have become increasingly like mandatory regulation, with businesses in under pressure from suppliers to customers to comply. In other cases, compliance with standards is actually written into legislation, so the standard is effectively mandated. This has been the case where compliance with standards is required under the Trade Practices Act, or occupational safety and health regulations.

CCI supports voluntary standards, with some qualifications. It is important that standards do not impede competition and innovation, or add undue costs to business operations. International standards can play an important role in facilitating trade, while incompatibility between national and international standards increases costs and potentially excludes Australians from competing in international markets. Conversely, domestic standards should not be manipulated to impede legitimate competition from imported products and services.

CCI is firmly opposed to mandating of standards, as it can lead to adverse unintended consequences, and turn the characteristics of flexibility and specificity from a benefit into a burden. It supports recent inter-government agreement to desist from writing standards into regulation, and remove existing standards from regulations.

Pressure Vessels

An example of the unintended consequences of mandating standards is the case of pressure vessels. In Western Australia compliance with tOccupational Safety and Health regulations requires that pressure vessels be design verified to ensure compliance with AS1200 – Pressure Equipment, which until January 2003 meant that pressure vessels had to comply with the supplementary Australian Standard AS1210 – Pressure Vessels. However, in January 2003, the regulations relating to pressure vessels were amended to call up a revised version of AS1200. Registration of pressure equipment for use in Western Australian workplaces now needs to comply with AS/NZS1200:2000. The revised version AS/NZS1200:2000 allows, for the first time in WA, the use of a number of overseas standards, including American and European standards, in the design and manufacture of pressure vessels in Western Australia. The dominant overseas standard is the American Society of Mechanical Engineers Boiler and Pressure Vessel Code Section VIII (ASME BPV-VIII.)

Since the change in January 2003, there has been a significant increase in overseas engineering companies specifying the exclusive use of ASME VIII for the design and manufacture of pressure vessels for projects in Western Australia. This prevents nearly all Western Australian companies, who are able to design and manufacture to AS1210, from competitively tendering for work in Australia, as they do not have a Certificate of Authorization and Code Symbol Stamp from ASME.

However, most overseas engineering companies, when they are aware that their own country standards are acceptable in WA, will be reluctant to approve the use of the Australian standard. This has already occurred on some equipment items for the Burrup Fertiliser Project.

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Safeguards

In order that standards-setting bodies do not become overly onerous in their requirements or prevent competition, a number of safeguards can be implemented, including:

- standards should ideally be developed according to the 'consensus principle', and there should be extensive consultation with relevant stakeholders before standards are created or extended;
- due consideration must be given to the costs of compliance with standards – including the likelihood that many businesses could be covered by several standards – and to the compatibility of the standards imposed. This should include comprehensive cost-benefit analysis of compliance with standards;
- Standards established in international jurisdictions should be recognised in Australia if they are compatible with local standards, and Australian standards should be adjusted to comply with internationally accepted benchmarks where this is a cost-effective way to compete internationally;
- standards should not be mandated or written into regulation;
- The cost of purchasing and complying with standards should be minimised.

Labour Markets

Background

Regulation of labour markets was explicitly excluded from the Hilmer report and subsequent NCP provisions, as politically contentious and unlikely to receive the assent of Parliament. Since then, labour market reforms have nonetheless proceeded at both Commonwealth and State levels, broadly in line with the style and intent of the reforms implemented under NCP.

The most significant national reform was the 1996 Workplace Relations Act, which allowed some degree of decentralisation of wage setting, albeit subject to a range of constraints on union representation and the relationship to Award terms and conditions (the "no disadvantage test"). In the Federal jurisdiction, employees and employers have the option of Australian Workplace Agreements, Non-Union Certified Agreements and Union Certified Agreements. While Union Certified Agreements are most prevalent, the number of Australian Workplace Agreements has grown rapidly in recent years.

Western Australia's Coalition Government introduced labour market deregulation in 1993, through the Workplace Agreements Act and the Minimum Conditions of Employment Act. These provided for more far-reaching reforms than were later implemented nationally, allowing for agreements whose content was much more at the discretion of employers and employees, with no automatic role for unions unless employees wished, and no restrictions on terms and conditions except the safety net provisions of the Minimum Conditions of Employment Act.

Labor was elected in 2001 on a platform that included abolition of Workplace Agreements. This was enacted in legislation passed in 2002, which prescribed extensive changes to Western Australian industrial and employment legislation. A key part of the legislation was the repeal of the Workplace Agreements Act, and the phasing out of already existing WA

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Workplace Agreements. An alternative form of individual work arrangements known as Employee Employer Agreements are now provided for under the terms of the Industrial Relations Act. An Employee Employer Agreement cannot disadvantage employees in comparison with applicable or equivalent awards. Other key changes under the legislation are:

- a legislative preference for collective over individual bargaining, and an emphasis on "good faith" bargaining;
- an increased role for the WA Industrial Relations Commission in dispute resolution, and in prescribing conditions of employment;
- increased rights for union officials to enter workplaces and/or inspect documents;
- enhanced minimum conditions of employment provisions;
- changes to the State unfair dismissal law, which will be of benefit to employees.

Since the legislation was passed, take-up of Employee Employer Agreements has been slow, but there has been a steady stream of employers leaving the State industrial system and registering under the Commonwealth system. Indeed, since the legislation was passed only 236 Employer-Employee Agreements have been registered, compared to 30,882 Australian Workplace Agreements. Indeed, the large take-up of AWAs in recent years is mainly due to the large number of WA employers switching to the Federal arena. Some WA employers fear that this option will also be closed down should Labor win the next Federal election.

Benefits of Reform

Deregulation of the labour market aims to improve Australia's productivity growth – and consequently, the living standards of its workers and consumers - by decentralising wage setting and removing legislative impediments to employment. The benefits of decentralisation include:

- flexibility and the ability to adapt to local market conditions and employees' needs;
- fostering co-operation, mutual respect and industrial harmony,
- win-win negotiation of more productive and more lucrative working conditions (wages are typically higher under decentralised than centralised bargaining arrangements)
- a fairer and more acceptable pay structure, reflecting the employee's skill, effort and contribution to the business.

The evidence shows that the partial deregulation of Australia's labour market over the past decade has been associated with a dramatic improvement in almost all measures of labour market performance. The unemployment rate has reached 22-year lows, the employment-population ratio is at 27-year record highs, industrial disputes are at record lows and real wages have grown steadily in tandem with rising productivity – in marked contrast with the declining trend of the 1980s. Average hours of work have fallen (although average full-time hours have been flat), and the incidence of a range of employee benefits such as paid maternity leave and superannuation has increased markedly.

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Case for Inclusion in NCP

The case for more deregulation, and for extending NCP to include labour market regulations, lies in the expectation that more deregulation will result in more of the benefits already enjoyed as a result of the more flexible labour market. Despite the reforms to date, Australia's labour markets remain highly regulated. Areas subject to regulation include:

- determination of minimum wages and a safety net of terms and conditions of employment (the award process);
- the regulation of employer and employee associations;
- equal remuneration for work of equal value;
- minimum leave entitlements, for such areas as annual leave, parental leave, sick leave and carer's leave;
- prescriptive working hours and overtime arrangements;
- minimum termination entitlements;
- regulation of workers' compensation and occupation health and safety;
- minimum entitlements to superannuation contributions;
- prohibitions against unlawful discrimination;
- prohibitions against unlawful termination of employment;
- a framework for collective bargaining and the compulsorily arbitrated resolution of industrial disputes;
- multiple overlapping and conflicting Commonwealth and State jurisdictions; and
- minimum notification and consultation entitlements in circumstances of redundancy or workforce restructure.

In addition to these regulations, the process of determining regulation is itself anti-competitive. For example, unions registered with the Industrial Relations Commission have near or total monopolies on representing employees in certain industries and occupations. By mutual agreement, unions do not seek to recruit or 'poach' members from industries and occupations allocated to other unions, and they are prohibited from representing employees from another union's approved remit at the Commission. While there are occasional (sometimes ferocious) border disputes in areas where the identity of the monopoly union representative is not clear or where potential memberships overlap, these are the exception. As a result, employees unhappy with the representation afforded by their union have no choice of opting to join a rival organisation. Similarly, unions do not have the competitive incentive to attract and maintain members by offering a better service than their potential rivals. CCI believes that the quality of representation, and the tenor of industrial relations discourse, suffers as a result.

There are, of course, many good reasons why aspects of the employment relationship should be subject to regulation. What has long been missing in the confrontational and quasi-judicial processes of determining industrial regulations, however, is a comprehensive and impartial consideration of their impact on the wider community. For example, raising minimum wages may benefit employees paid the minimum wage, but if the cost is higher unemployment, this may not be a net benefit to the community as a whole.

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Subjecting anti-competitive labour market regulation to the public benefit test would not result in widespread abolition of employee protections, but it would broaden the evaluation of the costs and benefits of those regulations beyond the self-interest of directly affected parties and their representatives, and ensure that regulations are more carefully evaluated before being passed into law and onto employers.

Competitive Federalism

In CCI's first (1995) response to the Hilmer Report, it argued that:

> "Perhaps the most disappointing aspect of the Hilmer Report is that it gives no consideration to the benefits to be gained from competition over the regulatory framework itself, rather than within that framework."

Competition reforms did not begin with the Hilmer report. They were being undertaken by both state and federal governments before the formal adoption of National Competition Policy, and continued in areas not covered by the agreed areas under NCP. It is important to remember that the NCP framework is neither necessary nor, alas, sufficient for governments to introduce reforms. Conceivably, it might detract from the reform agenda. Indeed, there was always a certain paradox in an approach to competition policy that tries to encourage innovation, deregulation and competition by imposing a uniform regulatory framework on previously diverse practices and jurisdictions.

"Competitive federalism" suggests that a major stimulus for reform might derive from the differences between governments' taxation and regulatory frameworks, the efficiency of their trading enterprises, etc. In this respect, the emphasis on national consistency and uniformity that have shaped some National Competition Policy reforms may have actually served to reduce competition.

While innovation arises because of differences, in the longer term, competitive federalism is likely to lead to quite a high degree of consistency between States' taxation, fiscal and regulatory stances, as each adopts the best practice innovations of the others. This is achieved through a process that is essentially competitive rather than prescriptive.

Admittedly, such competition can be destructive. Perhaps the most egregious example is the competition between state governments to outbid each other's subsidies on order to attract footloose or rent-seeking businesses. State treasuries are also nervous of being dragged into a downward bidding war on taxes, in which they have no choice but to match a competing jurisdiction's tax cuts even though it undermines their own revenue bases. Queensland's abolition of death duties and stamp duty on shares are sometimes cited as examples of undesirable competition. Whether their taxpayers view this as undesirable is another matter.

In WA, with its poor record of implementing NCP reforms, the top-down and coerced approach to trying to induce competition reform has not worked. Paradoxically, it may be that competitive federalism – the evident benefits enjoyed by consumers in jurisdictions where reform has been more widespread – could prove the more effective inducement to eventually disregard the pressure of vested interests, and implement reform in the community's interest.

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Appendix 1: Terms of Reference

Review of National Competition Policy Arrangements: Terms of Reference

The following terms of reference were received by the Commission on 23 April 2004.

PRODUCTIVITY COMMISSION ACT 1998

I, PETER COSTELLO, Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby refer the following inquiry to the Commission for inquiry and report within nine months of receipt of this reference. The Commission is to hold hearings for the purpose of the inquiry.

Background

1. In 1995 the Australian, State and Territory governments agreed to a program of competition policy reform. National Competition Policy (NCP) and related reforms provide a timely, coordinated and comprehensive approach to reform across all levels of government. There has been substantial progress in the implementation of NCP over the past eight years, including in the related reform areas of electricity, gas, road transport and water. This has delivered significant benefits to Australia. The States and Territories have shared in these gains, including through competition payments made by the Australian Government.

2. In November 2000, the Council of Australian Governments (COAG) agreed to a further review of NCP arrangements by September 2005.

3. It is therefore timely to undertake an independent review of these arrangements to consider the extent of the benefits the reform program has delivered to date and to inform an assessment of the most worthwhile competition related reforms that could be achieved in the future, including competition related reforms which could apply beyond current NCP arrangements.

Scope of Inquiry

4. The Commission is to report on:

- the effect of NCP and related reforms undertaken to date by Australian, State and Territory Governments on the Australian economy and the Australian community more broadly. To the extent possible, such assessment is to include:
- impacts on significant economic indicators such as growth and productivity, and to include significant distributional impacts, including on rural and regional Australia; and
- its contribution to achieving other policy goals at the Australian, State and Territory level, areas offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition, including through a possible further legislation review and reform programme, together with the scope and expected effect of these competition related reforms.

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Considerations

5. In conducting this review, and in recommending changes, the Commission should take into account the desire of the Government:

- to focus new review and reform activity on areas where there is clear evidence of significant potential gains, in particular where clear gains are possible in Australia's international competitiveness, in the efficiency of domestic markets or for Australian consumers; to ensure possible reform activity considers appropriately the adjustment and distributional implications and its contribution to achieving other policy goals.
- to take into account but not replicate significant current and recent review activity in areas such as the COAG work on energy and water and the review of the competition provisions of the Trade Practices Act.

6. In undertaking the review, the Commission is to advertise nationally inviting submissions, hold public hearings, consult with relevant Australian Government, State and Territory agencies and other key interest groups and affected parties, and produce a report.

7. The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's report. The report will inform the COAG review due to be completed by September 2005

PETER COSTELLO

[Received 23 April 2004]

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Appendix 2: Media Comments

Text of an article by Lyndon Rowe in The West Australian, 22 October 2003:

WA's parish-pump state political scene hit a low in the last few days with Government and Opposition seniors squabbling over news that the state is to forfeit more than $40 million a year in competition policy payments.

Their ranting, squirming and blame-shifting was excruciating to watch. In fact, all were responsible for this loss, including their front and back benchers, and for the poorer competitive climate that West Australians have been left with as a result of their individual and collective lack of policy leadership.

It is also regrettable that so many journalists – including the West Australian's editorial writer - should have been fooled by the outrageous spin being placed on this revelation.

The National Competition Council's recommendation that WA's payment be cut is neither surprising nor unfair. Indeed, it would be surprising and unfair if it had recommended anything else.

WA does not have an automatic entitlement to these payments. The conditions for payment were set in an agreement between the states and Commonwealth under which the federal government passes revenue to the states in return for their implementing competition reform. The conditions have been plainly understood for eight years.

The payments make up for the imbalance between the political responsibility for reforms, which rests largely with the states; and the tax effects of the higher incomes and economic activity that reforms generate, which flow mainly to the Commonwealth through, for example, higher income tax and company tax receipts.

The agreement also recognises the political reality that governments can be intimidated by vocal (usually narrow) vested interest groups determined to preserve anti-competitive regulations that line their members' pockets. So it was hoped that the payments would stiffen the spines of state cabinets and Premiers to act in the community interest. In many cases in WA, this hasn't worked.

Regulations restricting competition are allowed under National Competition Policy if they satisfy a public benefit test. All the WA Government had to do to avoid losing competition payments was to show that its policy yields a net public benefit. That it failed to do is hardly surprising – trading hours regulation clearly benefits a privileged group of retailers at the expense of the wider community.

So the National Competition Council (NCC) was bound to recommend that WA be penalised. The fault here lies with the WA Government policy for pandering to vested interests at the expense of the wider community; not with the NCC's response to that policy.

The WA Government argues that it should not be penalised for implementing its election policies. Why not?

Of course, any party is free to make and to keep any pre-election promises it likes, including wrong-headed ones that damage the community interest, such as Labor's commitment to retain retail trading hours regulations. But it has to accept the consequences.

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The consequence of not implementing National Competition Policy is to forego the payments WA would have been entitled to if it had enacted the agreed reforms.

This is not 'unfair', or 'blackmail', or the Commonwealth 'bludgeoning' the states with the 'blunt instrument' of the NCC. WA demonstrably has not been 'forced' to do anything, as retention of our archaic trading hours rules attests.

How could it possibly be fair for the Commonwealth to return to WA the tax dividend from reforms that its state Government has not actually implemented?

The West Australian's editorial calls the NCC's action an 'offence against true federalism'. Surely the real offence is that WA alone of the states should fail to abide by its promises, but nonetheless expects other states' taxpayers to reward it for policies it has not implemented.

The WA Government also argues that it should not have its competition payments cut because it has promised to implement partial deregulation in some areas after the next election. Having seen the pre-election promise not to raise taxes broken in each of its first three budgets, the community is entitled to be sceptical about the consistency of this government 's commitment to keeping its pre-election promises. In any event, the competition payments are linked to outcomes, not good intentions.

Yet even the outrageous spin of the Government's attempt to blame Canberra for its self-imposed losses is matched by the hypocrisy of Opposition leader Colin Barnett as he jumps on the bandwagon. He was, after all, a member of the Government that originally, and to its credit, signed up to implement National Competition Policy.

Furthermore, while in opposition the Liberal Party's position on competition policy has been even more reactionary and incoherent than Labor's. Mr Barnett is right to say that the WA Government only has itself to blame for its current predicament; but judging by his party's public policy positions, if he were Premier his predicament would be even worse.

The West's editorial argues that "it is a matter of judgement for the state government when shops should trade, when hotel and other bottle shops should open, whether there should be marketing boards for various goods, and so on."

Regrettably, this is an accurate description of the state of play in WA. So alone of the states, in WA it is politicians and bureaucrats not consumers and businesses that decide what can be bought, when and where. The community loses in this process through higher prices, reduced choice, and lost flexibility and convenience.

This is the real cost of the WA Government's failure to implement competition policy, and it is much greater than the $40 million annually that we look likely to forego in competition payments.

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Media Statement

CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

16 January, 1998

Potato industry regulation: Consumers the losers

Statement by CCI small business spokesman ROSS McLEAN

One of the public sector entities most highly deserving of review, and probably disbandment, is Western Potatoes – the statutory marketing board which regulates the production and sale of potatoes.

As a consequence of this body's control of the industry, WA consumers pay more than $12 million more per year for potatoes than they should.

The spectacle at Midland Markets this morning of a grower family giving away hundreds of tonnes of their hard-won crop while Western Potatoes filmed them for likely prosecution demonstrated the folly of government-sponsored regulatory bodies trying to manipulate the market place.

The exclusive powers given to Western Potatoes under an Act of Parliament - to determine who may grow potatoes, to fix the price they will be paid and to prosecute anyone who sells potatoes to a party other than itself – are anti-competitive and out of place in the current economy.

Growers of other every other vegetable are able to produce and sell their crops free of such regulation. Their returns are determined by the quality and competitiveness of their product in the open market place, as they are for virtually all other most commodities and goods.

The Chamber urged the State government two years ago to review Western Potatoes (formerly the Potato Marketing Corporation of WA) – but nothing has been done.

The government is running out of time on this question. It has an obligation under the national competition policy agreement to complete a review of Western Potatoes by this coming June.

CCI asks the government to assign an independent party to conduct this review as matter of priority. It is in the interests of consumers and for the advancement of the micro-economic reform process that some proper competition is brought to this long protected sector.

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Notes, References and Sources

List of Acronyms

In the interest of brevity and readability, this Submission uses the following acronyms:

Australian Competition and Consumer Commission	ACCC
Australian Chamber of Commerce and Industry	ACCI
Council of Australian Governments	COAG
Chamber of Commerce and Industry of WA	CCI
National Competition Council	NCC
National Competition Policy	NCP
Potato Marketing Corporation of Western Australia	PMC

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[2] Review of National Competition Policy Arrangements, Productivity Commission Issues Paper April 2004. Hereafter referred to as the Issues Paper
[3] An externality is the effect of an action by one agent or more agents on a third party who was not party to a transaction through with those effects are compensated. This can be either a production externality affecting production possibilities, or a consumption externality affecting another's utility function
[4] Department of Treasury & Finance (2002) p.19
[5] Winston (1993) p. 1266
[6] Winston, ibid. page 1267.
[7] Guasch and Hahn 1996.
[8] *"National Competition Policy: Report By The Independent Committee of Inquiry"* August 1993. Chaired by Professor Fred Hilmer, and commonly referred to as The Hilmer Report"
[9] Commonwealth of Australia 1994, *House of Representatives Hansard*, p. 1366, 28 February.
[10] Commonwealth of Australia 1995, *Senate Hansard*, pp. 2434-9, 29 March.
[11]Banks, G. 2001, *Competition and the Public Interest*, Presentation to the National Competition Council Workshop, Public Interest Test under National Competition Policy, Melbourne
[12] OECD 2003, *OECD Economic Surveys 2002-2003 Australia*
[13] http://www.docep.wa.gov.au/reviews/retailtradinghours/submissions/ RTHRC_Australian_Consumers_Association.pdf
[14] Victoria: Leading The Way: Economic Statement April 2004. p.28
[15] The nominal weighted average price of milk is calculated by averaging all milk prices sold from supermarkets using AC Nielsen's supermarket scan data. The weighting per litre is based on the average cost of 1, 2 and 3 litre containers weighted for the volumes sold in those containers. This can be simply described as an estimate of all milk sold divided by the litres of milk sold.
[16] See Press Release by Minister for Energy, *"WA electricity prices a handbrake on economy"*, 25 February 2004.
[17] ###add discussion of potato police here
[18] According to ABS cat. 6403.0, in March 2004 the price of a 285 ml glass of draught beer in a public bar was Sydney - $2.24; Melbourne - $2.69; Brisbane - $2.25; Adelaide - $2.96; Perth - $3.08; Hobart - $2.84; Darwin - $2.73; Canberra - $2.15. Previous surveys also showed Perth's prices as above average, and typically the highest of the capital cities
[19] Grant McBride, opening his second reading speech for the National Competiton Policy Liquor Amendments (Commonweatlh Financial Penalties) Bill National Competition
Policy Health and Other Amendments (Commonwealth Financial Penalties) Bill. NSW Hansard Articles : LA : 04/05/2004 : #41
Second Reading
Mr GRANT McBRIDE (The Entrance—Minister for Gaming and Racing) [9.27 p.m.], on behalf of Mr Bob Carr, in reply:
I thank honourable members for their contributions to the debate. I also thank members of the crossbench in the other
[20] See Press Release by Minister for Racing and Gaming *"Liquor stores get green light for Sunday trading"*, 1 September 2003.
[21] The NCC may recommend that permanent deductions not be imposed for competition payments in subsequent years where governments introduce appropriate reform.

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