Submission to the Productivity Commission Review of National Competition Policy Arrangements

National Competition Council

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1 Introduction

The Council of Australian Governments (CoAG) agreed to implement the National Competition Policy (NCP) in 1995 and established the National Competition Council (NCC) to oversee implementation of the program. The Council's authority arises from part IIA of the *Trade Practices Act 1974* (TPA) which, in conjunction with intergovernmental agreements to which all Australian governments are party, sets out the Council's role.

The Council's primary responsibility is to assess governments' progress in implementing the NCP, including making recommendations to the Australian Government on competition payments (see section 2). The Council also:

- recommends on the design and coverage of infrastructure access regimes under part IIIA of the TPA and the national gas code; and
- promotes awareness of the NCP to assist the community to be better attuned to reform outcomes.

The Council is a national body responsible to all governments. While funded by the Australian Government, the Council is independent of the executive arm of governments. It comprises five Councillors supported by a secretariat.

2 The National Competition Policy

Three intergovernmental agreements[1] establish the program of NCP and the four related reform areas of electricity, gas, water resource policy and road transport. To meet their NCP commitments, governments must:

- be party to the Competition Principles Agreement and consequently;
  - consider prices oversight arrangements for government businesses with the potential to engage in monopolistic pricing (clause 2);
  - apply, where appropriate, competitive neutrality (CN) principles to government businesses (clause 3);

[1] The Competition Principles Agreement; The Conduct Code Agreement; and The Agreement to Implement the National Competition Policy and Related Reforms (refer NCC 1998).

  - undertake, where appropriate, structural reform of public monopolies where competition is to be introduced and before a monopoly is privatised (clause 4);

  - review all legislation identified in 1996 as restricting competition and, where appropriate, remove the restrictions (clause 5(1));

  - undertake regulatory impact analysis of proposed legislation that would restrict competition (clause 5(5));

- have extended the TPA prohibitions on anticompetitive activities to all businesses (Conduct Code Agreement);
- ensure national standards meet with CoAG endorsed principles for good regulatory practice (Implementation Agreement);
- achieve (if a relevant jurisdiction) effective participation in the fully competitive national electricity market (Implementation Agreement);
- implement (if relevant) free and fair trading in gas across and within jurisdictions (Implementation Agreement);
- implement road transport reforms developed by the Australian Transport Council and endorsed by CoAG (Implementation Agreement); and
- implement the CoAG strategic framework for the reform of the water industry to better manage water resources, use water more efficiently and improve environmental health (Implementation Agreement).

2.1 An integrated reform package

To assess the impacts of the NCP and related reforms to date, it is important to appreciate what is (and is not) part of the NCP. Many competition-based reforms have been introduced prior to and concurrently with the NCP. Policies such as competitive tendering, industrial relations reforms and privatisation derive from the competition wellspring, but they are not formally part of the NCP. Using competition to provide for better economic, social and environmental outcomes may be the common objective, but non-NCP reforms are not subject to the NCP's public interest or assessment provisions.

Further, as the Productivity Commission (PC 1999) has shown, it is also necessary to disentangle influences and trends affecting regional Australia (such as urban drift and the decline in farmers' terms of trade) from the impacts of the NCP.

The Council considers that evaluation of the NCP needs to be conducted in a 'whole of program' way. This is not to diminish the validity of analysing discrete programs, but an acknowledgement that elements of the NCP are interlinked and/or mutually re-enforcing. For instance:

- there would have been little sense in exposing government businesses to CN (CPA clause 3) or structural separation (CPA clause 4) had they remained shielded from the TPA (Conduct Code Agreement);

- structural separation complements, and can be a substitute for, third party access arrangements (part IIIA of the TPA and CPA clause 6);

- the separation of water entitlements from land title (Implementation Agreement) provides an adjustment mechanism — the sale of entitlements to fund a capacity to remain domiciled on the land — for those whose viability may have been adversely affected by legislative reforms that removed unsustainable price support mechanisms (CPA clause 5);

- achieving a competitive road transport sector (NCP related reform) is not independent of the ability of rail users to access rail track;

- the authorisation of certain practices prohibited by the TPA can be sought from the ACCC on the grounds of net public benefits (Conduct Code), obviating the need for specific State or Territory legislation to sanction such practices (CPA clause 5).

In addition, the Council considers that it is essential to distinguish between individual reform successes (and failures) and systemic successes (and failures). For example, to evaluate the multifaceted legislation review program covering around 1800 pieces of legislation, it is necessary to look at the broad sweep of outcomes. If, say, an individual reform has resulted in a net cost to the community, this is likely to indicate a failure of the particular review to adequately determine the net transitional and long term costs and benefits, rather than a systemic failure of the review and reform program.

2.2 The presumption in favour of competition

Governments agreed to the NCP on the basis that reforms would enhance the performance of the economy through improved productivity, more efficient (typically lower) prices, better services and enhanced aggregate employment. Although environmental objectives, for instance, are at the forefront of water reforms, the NCP is predominantly based on a presumption in favour of competition — a presumption borne of practical experience. Ever since societies evolved from small community collectives to more sophisticated social structures, it has been evident that competition is generally the best way to allocate resources and ensure higher living standards.

While vigorous competition is the hallmark of economies that deliver high living standards, unfettered competition will not always serve the public interest — instances of market failure are well documented. Well-designed regulation, therefore, can promote the interests of the wider community. The case for intervention, however, needs to be made through rational and realistic analysis. The experience of nations is replete with instances where

well-intentioned government interventions have promoted outcomes that detract from community welfare, not only relative to a better thought-out intervention, but also, in some cases, to leaving a market failure untreated.

The lessons are twofold. First, a presumption in favour of competition must be the 'default'. Second, regulation that is well-meaning but ill-conceived, or which serves the interests of select beneficiaries only, represents a cost to the community. This can arise in several ways.

- Large benefits may be appropriated by concentrated, politically astute groups at the expense of a diffuse group of users and consumers. These arrangements endure because the cost to individuals may be relatively small and consumers lack direct input into making regulations.

- Regulation favouring particular groups results in the beneficiaries commanding more resources, which can impede direct competitors and providers of substitute goods/services. Users and consumers pay more for the goods/services conferred regulatory protection and have less to spend on other goods/services. Providers of other goods/services produce less and use fewer inputs (a negative multiplier).

- Protecting incumbents erects a barrier to new entrants, new ideas and to innovations. A further loss to the community is the diversion of entrepreneurial effort from undertaking core business activities to preserving (or seeking) a privileged position through legislation. Compliance and administration costs are further sources of loss.

While the NCP reforms are based on a pro-competitive presumption, competition is a means rather than an end in itself. As the NCP aims to serve the public interest, its reform elements are subject to safeguards to weigh the costs and benefits on a case basis. For example:

- the merits of proceeding with CN, the structural reform of public monopolies and the review of anticompetitive legislation are subject to the (non-exhaustive) public interest provisions in CPA clause1(3);

- a criterion for declaring infrastructure services for third party access is that access must not be contrary to the public interest;

- authorisation of anticompetitive practices prohibited by the TPA can be sought from the ACCC on the grounds of net public benefits; and

- the requirement to introduce consumption-based pricing for water, while delivering a benefit by encouraging water conservation, is predicated on its introduction being cost-effective.

Given that restrictions on competition typically have been (and continue to be) couched in terms of furthering the community's interests, the NCP places an onus of proof on proponents of such restrictions to subject their claims to analysis. Such public interest assessments should be based on real world comparisons of the likely range of outcomes with and without regulation. It is

inappropriate, for example, to compare an idealised regulatory solution with a market mechanism without recognising the reality of 'regulatory failure' (perhaps due to capture by vested interests) as well as market failure.

There will invariably be winners and losers from change, but the public interest provisions mean that, in principle, NCP reforms will provide a net community benefit. The extent to which this translates to practice is a function of the integrity of review processes (and the political will of Parliaments). For this reason, the Council places considerable emphasis on the link between high quality reviews and policy outcomes (see box 1).

Box 1: The Council's approach to legislation review performance

CoAG (2000) requested that the Council consider whether review conclusions are within a range of outcomes that could reasonably be reached based on a 'properly constituted review process'. The Council therefore looks for evidence that reviews:

- had appropriate terms of reference supported by publicly available documentation such as an issues paper;
- were conducted by an appropriately constituted review panel able to undertake an independent and objective assessment;
- provided for public participation through appropriate consultative processes;
- assessed and balanced all costs and benefits of restrictions on competition and considered alternative means of achieving the objective of the legislation;
- considered all relevant evidence and reached reasonable conclusions and recommendations based on the evidence before the review; and
- demonstrated a net public benefit when recommending that a government introduce or retain restrictions on competition.

3 Has the NCP delivered for Australia?

It is widely acknowledged that Australia's recent economic performance over the past decade has been amongst the best in the world. For example:

- Australia's economy is now in its longest sustained period of growth since the 1960s — despite global and regional crises, economic growth averaged nearly 4 per cent in the decade to 2001-02;
- Australia's per capita GDP ranking among OECD countries slipped to 15th in 1990 but had climbed back to 8th in 2002;
- Australia's productivity growth in the 1990s has been stronger and more sustained than ever — this productivity boost equates to an additional $7000 on average to Australian households;
- Australia's unemployment rate dropped from around 11 per cent in the early 1990s to less than 6 per cent; and
- Australia's inflation rate averaged 2.8 per annum over the 1990s, compared with 9 per cent per annum over the previous two decades.

The PC has reported on these outcomes in its annual reports and research papers (see PC 2003). While the data point to Australia reaping the dividends of *something*, causality and attribution is not easy. The literature generally only highlights a role for microeconomic reforms within a framework of stable macroeconomic policy settings.

In its 2002-03 annual report, the PC observed that 'the timing, strength and internationally atypical nature of the acceleration in Australia's productivity growth help to eliminate some of the "usual suspects" as credible principal causes of the turnaround' (PC 2004, p. 3). Its comparison with other countries indicated that the usual suspects that can be eliminated include: recovery from recession, technological 'leaps', increased work intensity and acceleration in workforce skills. While all of these factors are important, they fail to account for Australia's productivity surge.

3.1 Competition, productivity and living standards

The view that competition policy could contribute significantly to the outcomes experienced today is evident from the 1993 Hilmer Review which led to the development of the NCP. The report stated that:

> *Australia is facing major challenges in reforming its economy to enhance national living standards and opportunities. There is the challenge of improving productivity, not only in producing more with less and deploying scarce assets wisely, but also in becoming better at making and exploiting new discoveries, whether in technology, resources, fashion or ideas… Australia faces an additional complexity in tackling these challenges, as most reforms require action by up to nine governments. This is particularly true in competition policy, an area central to micro-economic reform which aims at improvements at the front line of the economy.* (Hilmer 1993, p. xv)

A decade on, observations about the success of microeconomic reforms, including NCP, emerged. In 2001, the OECD recognised that the NCP was helping to realise the benefits anticipated by Hilmer. It concluded that the main driver for Australia's improved productivity was the structural reforms undertaken during the past two decades (OECD 2001, pp. 13–14). Further research has more closely linked countries' productivity performance to pro-competition policies — the OECD determined that excessive product market regulation had a negative impact on productivity (see box 2).

By 2003, the OECD considered it had enough of an analytical basis to declare:

> *The implementation of Australia's ambitious and comprehensive National Competition Policy over the past seven years has undoubtedly made a substantial contribution to the recent improvement in labour and multifactor productivity and economic growth.* (OECD 2003, pp. 16–17)

Box 2: Employment and productivity improvements from competition

The OECD found a statistically significant relationship between product market regulation and employment in different countries. A study of 20 countries over 1982–98 found that competition tends to create jobs. Australia, the United Kingdom (UK) and the United States (US), which have a relatively low level of product market regulation, were found to have employment rates (ratio of persons employed to population) over 55 per cent. France, Italy and Greece, which have higher levels of regulation, have employment rates of around 45 per cent or less. The OECD also noted that tax and labour market policies are significant in explaining the differences in cross-country employment rates.

Further, the OECD observed that the countries that have taken most action to introduce competition have experienced the strongest employment gains. In Australia, the UK, New Zealand and Finland, employment rates rose by at least 2 percentage points between 1982 and 1998 due to product market liberalisation. Countries that did not focus as much on encouraging competition experienced smaller gains, with Greece, Italy and Spain adding only 0.5 to 1 percentage point to their employment rate (OECD 2002a, pp. 245–84).

The OECD also found that easing product market regulation and employment protection positively affected productivity and technological catch-up by raising the incentives to improve efficiency and lowering the costs of doing so. Relaxing competition restrictions reduces barriers to entry, and new entrants boost an industry's productivity by introducing new technology. Competitive product markets and flexible labour markets encourage resources to flow to innovative industries (OECD 2002b, chapter VII). In addition, product market regulation can inhibit research and development intensity (OECD 2002c, p. 30).

Given the undisputed relationship between productivity growth and higher living standards, an understanding of the determinants of productivity is important. A key aspect, therefore, of the OECD's work is the linkages drawn between competition policies and productivity.

Following on the heels of the OECD work is that of the McKinsey Global Institute (MGI). A recent book by Lewis (2004) draws on the MGI studies, which have, since 1990, evaluated the dynamics of industries in 13 countries. The work is based on detailed studies at the firm level — from street vendors to automotive plants. The key findings are that:

- productivity explains virtually all of the differences in GDP per capita;
- to understand the productivity of a nation's industries it is important to look beyond macroeconomic policy settings;
- competition promotes productivity — the primary explanation for differences in countries' productivity performance lies not with labour and capital markets but the nature of competition in product markets;
- the income level of a country is determined critically by the productivity of its largest industries — such as wholesaling, retailing and construction where most people work; and
- economic progress is a function of increasing productivity based on undistorted competition — where government policies limit competition, economic growth slows.

The thrust of Lewis's assessment is that it is incumbent on governments to consider competition as the default option and to put consumers ahead of sectional interests. In Australia's case, these findings seem almost

incontestable — at least with hindsight. As the Chairman of the PC observed recently in a speech explaining Australia's economic 'miracle' of the 1990s:

> *…Australian government policy throughout much of the 20th century has almost systematically, if unwittingly, undermined the economy's productive potential by distorting price signals and protecting producers from competition. It is not surprising that those policies took their toll. Equally, it should not be surprising that their reversal has yielded the benefits that economic theory would anticipate*. (Banks 2003, p. 6)

The work of MGI and Lewis (2004) makes similar assessments. The key contribution of this body of work is the definitive link drawn between competition and productivity. The factors at work, which accord with the OECD findings (box 2), are summarised as:

> *Firms become more productive through innovations. The innovations may be new products and services. They may also be new ways of manufacturing products and delivering services. … Valuable innovations allow the innovator to charge higher prices, make more profits, invest in more capacity, take market share away from competitors, make even more profits, etc. The process goes on until competitors react by copying the innovation or inventing something equivalent of their own. Profits for all competitors return to normal levels and the industry may very well be stable for a while. However, it is stable at a higher level of productivity. Consumers and workers have achieved a permanent gain. Investors in the original innovator enjoy high returns. However, through competition those returns soon become normal. They remain normal until the next innovation.*
>
> *Competition is what makes this process work. The more intense and evenly balanced competition is, the faster the process works. The faster the process works, the faster productivity increases. If conditions in the market exclude some potential competitors, then competition is less intense and productivity growth is slower. If conditions in the market favour less productive competitors, then innovators cannot expand and productivity growth is slower. Over and over again, we found markets where more productive innovators were excluded and where less productive firms were favoured.*
>
> *Even in rich countries this is a problem. In the United Kingdom, France, Germany and Japan, zoning laws and planning regulations prevent global best practice retailers from expanding as fast as they could. Sometimes these restrictions are for valid environmental reasons. Most times, they're not. …*
>
> *Most people consider the 'social objectives' motivating zoning laws and small-business subsidies to be 'good'. However, …these measures distort markets severely and limit productivity growth, and cause unemployment. …Such market distortions explain most of the difference between the GDP per capita of the United States and other rich countries.* (Lewis 2004, pp. 13-14)

An interesting dimension of the Lewis study is the contribution of retailing and wholesaling to the United States' productivity performance. Such observations appear relevant for Australia (box 3).

Box 3: Competition and productivity growth in wholesaling and retailing

United States

Retailing and wholesaling contributed 50 percent of the entire U.S productivity growth rate jump in the second half of the 1990s. Productivity growth in retailing jumped… from 2.0 percent to 6.3 percent. Productivity growth in wholesaling jumped… from 2.9 percent to 8.2 percent. These jumps came in huge economic sectors. … When almost 20 percent of U.S. employment has a productivity growth jump of 4 to 5 percentage points, the national productivity statistics take notice. …The productivity growth jump in general merchandise retailing was caused by the "Wal-Mart Effect". (Lewis 2004, p. 91)

Wal-Mart caused the national productivity statistics to move in the second half of the 1990s because it had gotten so good that its competitors faced the choice of becoming about as good as Wal-Mart or going out of business. In 1987, Wal-Mart had 9 percent of the general merchandise market. However, it had a 44 percent productivity advantage over the rest of this subsector. (Ibid, p. 92)

Japan

If the Japanese automotive industry represents what's best about Japan, then retailing represents what's worst. A combination of misguided zoning laws, taxes and subsidies have distorted competition and allowed the smallest, most inefficient retailers still to account for slightly over half of all retailing employment … Labour productivity in the retail sector in Japan is only 50 percent of that in the United States. Unfortunately for Japan, much more of the economy is like retailing than like autos…

Japan's productivity in retailing is only half that of the United States because the mix of store formats in Japan has evolved much less towards the modern, specialised (and high productivity) type of store. Moreover, the traditional mom-and-pop stores in Japan are especially small-scale, with productivity only one third of that of the traditional stores left in the United States. Fifty-five per cent of all workers in retailing in Japan are in mom-and-pop stores. Only 19 percent of the retail workers in the United States are left in traditional stores. (Ibid, pp. 30–2)

Australia

Australian evidence bears out the importance of wholesaling and retail to Australia's productivity performance and the contribution of competition policies. As PC research shows, the stand out contributor to Australia's productivity performance in the 1990s was the wholesale trade sector. The sector adopted new technologies (such as computer based inventory management) that transformed the sector from large storage warehouses to integrated rapid logistics management systems (Johnston et al. 2000). The PC found:

…it was the reorganisation of wholesale businesses that generated the greatest productivity gains — from reduced warehousing and handling — rather than the mere availability and acquisition of ICT. These organisational changes were driven in part by reforms which intensified competitive pressures in downstream activities. Australian automotive producers, for example, sought cost reductions all along the value chain, including wholesaling, as their protection against imports fell. (PC 2003, pp. 10–11)

Implications

Based on the country comparisons, Lewis asserts that retailing productivity has influences far beyond its boundaries because it is the sector in immediate contact with consumers. In the absence of regulatory distortions, the marketing knowledge of the sector has facilitated major consolidations — for example, bypassing wholesalers and encouraging consolidation of consumer goods and food processing industries (such as milk processing).

The conclusion that competition is *the* key to unleashing productivity growth is gaining acceptance in Australia. While the PC considers that formal proof of the factors accounting for Australia's productivity surge may be 'unattainable', it nonetheless has sufficient confidence in its research to describe the impact of the NCP as follows:

> *This multifaceted reform effort was neither seamlessly implemented nor without adjustment costs. Reforms kicked in at different times, involved a mix of industry-specific and economy-wide measures with varying degrees of gradualism and occasional slippages and backsliding. Nevertheless, the overall thrust was to set in place the mechanism to spur productivity growth by:*
>
> - *encouraging greater specialisation and incentives to apply up-to-date technology and know-how through opening the economy to global trade and investment;*
> - *creating stronger incentives for businesses to improve efficiency through a focus on cost control, innovation and responsiveness to customer needs by sharpening competition; and*
> - *providing greater flexibility for businesses to use managerial, production and distribution processes best suited to their workplaces* (PC 2003, p. 6).

Extensive details of governments' progress in implementing their agreed NCP reforms are contained in the Council's annual assessment reports (see for example, NCC 2003a,b,c) and legislation review compendiums (NCC 2004). This submission does not synthesise the Council's assessments, although a snapshot of some of the benefits arising from the NCP is provided in box 4.

Generally, however, apart from the economy-wide modelling conducted by the PC (1999a,b), there is a paucity of ex post evaluation of individual reforms. To help address this deficiency, the Council has engaged consultants to conduct case studies on the outcomes from the reform of grains and dairy legislation. This work will be available in September 2004.

3.2 A productivity 'gap'

Although Australia's economic resurgence is striking, the rest of the world is not standing still and Australian productivity levels are below that of other OECD countries. The Australian Treasury (2003, p. 101) notes:

> *Australia's impressive productivity performance since the beginning of the 1990s has only now restored our relative productivity and GDP per person to the position we held in the 1950s.*

The productivity gap (table 1) indicates that there is no room for complacency if Australia is to improve community living standards.

Box 4: A snapshot of benefits flowing from the NCP

- A national electricity market, currently operating in southern and eastern Australia, gives large consumers and some households a choice of electricity supplier. The net present value of these reform benefits over 1995–2010 is estimated at $15.8 billion in 2001 prices (Short et al 2001). In national market jurisdictions, labour and capital productivity have improved significantly and household electricity prices in Brisbane, Melbourne and Sydney fell in real terms by 1 to 7 per cent between 1990-91 and 2000-01 — a saving to households in 2000-01 of around $70 million (PC 2002g).
- Free and fair trade in gas has been instituted nationally and most jurisdictions, with others to follow, offer customers a choice of gas supplier. The reforms have stimulated gas production and pipeline developments. Since 1995 over $1 billion has been invested each year in upstream, transmission and distribution assets, and transmission pipeline infrastructure grew from 9000 to 17 000 kilometres from 1989 to 2001.
- Governments have removed legislative restrictions found not to provide a net community benefit. For example, NCP reviews have shown that restricting retail trading hours is not in the public interest and consumers have embraced the resulting introduction of more liberal arrangements. In Sydney and Melbourne around 35 per cent of consumers buy groceries on Sunday where supermarkets are permitted to open. In Perth and Adelaide[a], where only small food stores can trade on Sundays, the comparative figure is 7–8 per cent (Jebb Holland Dimasi 2000).
- The index of the price of public enterprise outputs increased unabated from the 1960s until the commencement of public sector reforms in the early 1990s. The introduction of NCP in 1995 (covering CN, prices oversight and reform of public monopolies) reinforced and intensified the subsequent fall in the price of government services.
- Setting water prices on the basis of the volume used is encouraging more efficient water use. For example, in NSW, demand for water by urban users fell by about 20 per cent when local water authorities introduced consumption-based pricing (DLWC 2002). This brings environmental and financial benefits (for example, as less water is used and costly investment in new dams can be deferred). Pricing to fully recover the costs of providing water services means businesses can maintain and replace infrastructure, so ensuring better quality service. Legally establishing water entitlements separate from land title and facilitating water trading means water can be used where it is most valued. For example, Victoria's Sunraysia region traded more than 4000 megalitres into South Australia in 2000-01, with water leaving lower-value horticulture, cropping and grazing. The increase in irrigation return in Victoria in 2000-01 was estimated at $12 million, and higher nationally because the traded water was used for higher-value activities (DNRE 2001). All jurisdictions are developing water management arrangements for rivers and groundwater basins that allocate water to the environment addressing environmental matters on an integrated catchment management basis.

[a] South Australia subsequently liberalised these restrictions.
Source: NCC 2003, vol1, p. x; DLWC 2002.

Table 1: International ranking of United States and Australia on average income and labour productivity[a]

	1950		*1960*		*1973*		*1990*		*2001*	
	Rank	*%US*	*Rank*	*%US*	*Rank*	*%US*	*Rank*	*%US*	*Rank*	*%US*
GDP per person (1996 US$[b])										
US	2	(100)	2	(100)	2	(100)	1	(100)	1	(100)
Australia	5	(78)	7	(78)	9	(74)	15	(74)	7	(78)
GDP per hour worked (1996 US$[b])										
US	1	(100)	1	(100)	2	(100)	5	(100)	5	(100)
Australia	4	(81)	5	(75)	10	(74)	15	(77)	14	(83)

[a] Rankings are among 22 of the 24 OECD pre-1994 member countries. [b] At purchasing power parity. *Source*: University of Groginen and The Conference Board, *GGDC Total Economy Database, 2002*, as reported by the PC (2002a).

4 Scope to build on the current NCP agenda

This section provides a brief summary of the progress of the NCP to date. In so doing, the Council has addressed questions in the PC's Issues Paper about areas for a future reform agenda, but has confined discussion to reporting on incomplete reforms and its views on extensions, or improvements, to the current agenda. Section 5 addresses the broader issue of reform possibilities outside the purview of the current NCP agreements.

4.1 Prices oversight (CPA clause 2)

The CPA commits governments to consider establishing independent prices oversight arrangements for government business enterprises with the potential to engage in monopolistic pricing. Although oversight arrangements now operate in all States and Territories, the relevance of this commitment will not diminish as long as governments own major businesses.

The commitments relating to prices oversight, while substantially advanced, remain relevant today.

4.2 Competitive neutrality (CPA clause 3)

The application of CN by governments is well advanced. In all States and Territories, major government business enterprises have been corporatised, other significant businesses exposed to CN principles and CN complaints units established. The performance of government businesses has improved as CN has promoted a more dynamic culture through greater transparency and accountability. The adoption of CN principles, including the capacity for private businesses to compete with government businesses on an equal footing, has improved businesses' efficiency, encouraged better services and more cost-reflective prices for goods and services and resulted in a more efficient allocation of (private and public) resources.

As governments are free to determine their own agendas for implementing CN, there is a wide divergence of approaches. This allows for a comparison of different models which, in turn, indicates that there is scope for improvement.

- **Coverage:** The coverage of CN falls short in some jurisdictions. For example, in one state, CN applies automatically to government businesses unless a case is made that the costs of its application would exceed the benefits. At the other end of the spectrum, another state does not expose sectors/businesses to CN until they have been subject to a 'coverage review' — consequently, the complaints mechanism cannot act until such a coverage review has occurred and the government subsequently deems that the activity is covered. Generally, the application of CN to the health sector is mixed and is minimal for universities.

- **Complaints handling:** Governments' complaints mechanisms are operating satisfactorily but there is scope for improvement. In some jurisdictions, Ministers decide whether complaints should be heard and this can create adverse perceptions about the independence of the process. In addition, the Council's experience is that resolution of some complaints has been drawn out.

- **Rates of return:** Performance monitoring of government trading enterprises (see PC 2002c) reveals that many have low rates of return on capital. This could reflect a range of factors, including failure to properly ensure appropriate pricing. For instance, government forestry businesses are yet to establish track records of earning adequate profits. (The Council considers that governments should require these businesses to disclose the timber prices that they assume for forest valuation purposes.)

The concerns identified above do not indicate widespread failures with the application of CN. They do, however, suggest that there would be merit in refining CN. The Council considers that the PC should investigate whether:

- a decade into the process, the CPA requirements set too low a hurdle;

- there are limits to the extent that private sector incentive structures can be grafted onto public agencies and whether divestiture might be appropriate in certain cases;

- governments should undertake CN audits to determine why their businesses appear generally to have low rates of return; and

- CN principles relating to corporate governance and commercial discipline have application to the provision of non-market goods and services (see section 5.3.3).

The Council considers that there is a need to re-define the CN commitments with a view to encouraging governments to adopt best practice principles.

4.3 Structural reform (CPA clause 4)

The NCP requires governments to relocate regulatory functions away from a public monopoly before introducing competition to the market served by that monopoly. In addition, before privatising a public monopoly or introducing competition to a sector supplied by a public monopoly, governments should review the appropriate commercial objectives of the public monopoly and the merits of separating potentially competitive elements from natural monopoly elements. Generally, governments have met these commitments. The exception is the Australian Government in relation to AWB Limited and Telstra (refer NCC 2003b, vol. 2, pp. 11.11-11.13). The relevance of this commitment will not diminish as long as governments own major businesses.

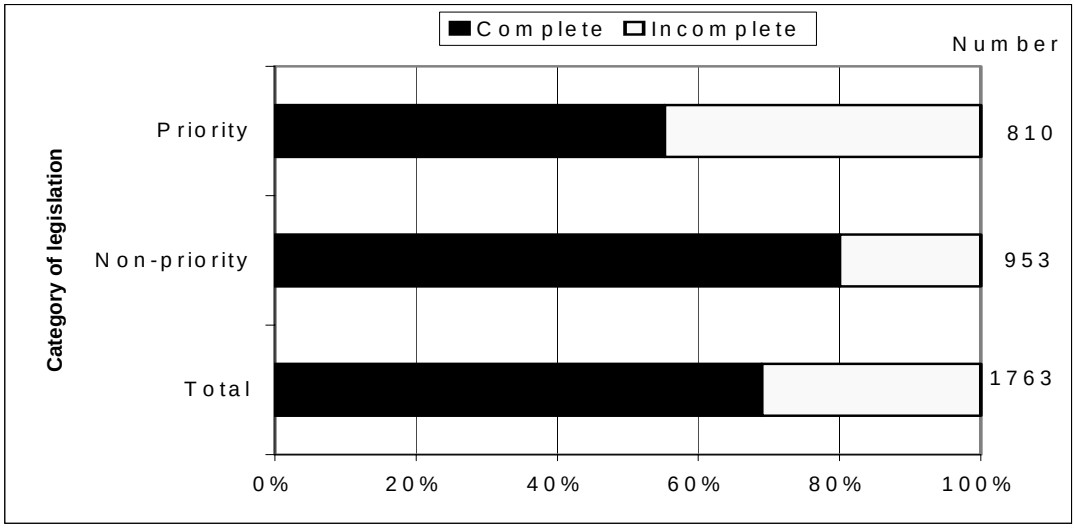
The clause 4 commitment has generally been adhered to with the exception of one government. While substantially advanced, this commitment remains relevant and some key omissions remain.

4.4 Legislation review (CPA clause 5)

4.4.1 Legislation review (CPA clause 5(1))

The legislation review and reform program requires governments to remove restrictions on competition unless they can demonstrate that restricting competition benefits the community overall and that objectives cannot be achieved in ways that do not restrict competition (clause 5(1)). The program encompasses around 1800 pieces of legislation.

Figure 1: Overall compliance with the review and reform of legislation 2001 to 2003 (excluding water and energy legislation)



No jurisdiction completed its review and reform commitments by 30 June 2002 — the date specified by CoAG for achieving closure of this element of the NCP.[2] However, many laws regulating significant areas of economic activity have been reviewed, and restrictions found not to provide a community benefit removed. In aggregate terms, by late 2003, around 70 per cent of governments' nominated legislation had been reviewed and, where appropriate, reformed. For priority legislation, the rate of compliance was

[2] Under the initial NCP agreements, CoAG set a target date for completion of the program by 2000. CoAG subsequently extended this to 30 June 2002. For reasons linked to the timing of the annual assessments, the Council provided a further extension to 30 June 2003.

substantially lower, at around 56 per cent[3] (see figure 1). Nonetheless, the compliance rate for priority legislation was only around 20 per cent in 2001, climbing to nearly 40 per cent in 2002. Early indications are that the penalties imposed in 2003 are having a significant 'incentive' effect, portending an improvement on 2003 levels of compliance. That said, progress in the legislation review program has fallen well short of CoAG's expectations. An illustration of some outstanding areas is shown in table 2.

Table 2: Unmet NCP legislation review commitments (at 2003)

	NSW	Vic	Q'ld	WA	SA	Tas	ACT	NT	Aust Govt
Primary industries									
Grains									
Rice									
Poultry meat									
Eggs									
Potatoes									
Pearling									
Fisheries									
Retailing									
Shop trading hours									
Liquor licensing									
Transport									
Taxis									
Tow trucks									
Professions									
Allied health professions		a							
Building related trades									
Communications									
Broadcasting and postal									

Dark shading denotes restrictions on competition. Light shading denotes restrictions on competition mainly removed or mitigated. (a) With the exception of pharmacists.

As the Council observed in its 2003 assessment, 'processes that subject restrictions on competition to public interest testing invariably generate opposition from incumbent beneficiaries'. For example, the liberalisation of retail trading hours has been fought on 'public interest' grounds in many jurisdictions. Proponents of regulation argue that, if consumers can choose where and when to shop, they may not frequent small stores thereby

[3] Recognising the burden on governments from conducting reviews and implementing reforms and that the greatest community benefit would arise from prioritising legislation with the greatest impact on competition, the Council nominated priority areas of regulation (NCC 2003a, ch. 4). It scrutinises around 800 pieces of priority legislation, and monitors outcomes in a further 1000 non-priority areas.

diminishing the viability of such stores with adverse social consequences. Independent NCP reviews have challenged the veracity of such assertions (see box 4).

Primary industries: There has been significant reform of unwarranted restrictions on competition in agricultural marketing following NCP reviews. For instance, all governments repealed price and supply controls on drinking milk; Queensland ended its export marketing monopoly for barley; Victoria deregulated its barley marketing arrangements and a recent NCP review of such arrangements in South Australia also recommended liberalisation; Western Australia is reforming grain marketing; Queensland and Tasmania removed supply and marketing restrictions on eggs; Western Australia and South Australia removed entry and pricing restrictions in bulk handling; and centralised price fixing for poultry growing services has been replaced in several jurisdictions. Outstanding commitments remain in grains, rice, poultry eggs, potatoes, and fisheries.

Retailing: Apart from Western Australia, all governments have substantially deregulated retail trading hours. The reform of liquor laws that contain restrictions on competition that go beyond the social objective of harm minimisation has proved far more difficult.

Professions and occupations: Review and reform activity by individual governments in many of these areas is nearing completion. However, reform outcomes are still to be implemented in important areas, including health and legal practitioners and some building related trades.

Taxis: The Victorian, Western Australian, ACT and Northern Territory reviews recommended removing restrictions on taxi licence numbers and compensating incumbents through licence buybacks. The New South Wales and Tasmanian reviews recommended transitional approaches involving annual increases in licence numbers. Apart from a compliant program in Victoria involving staged releases of taxi licences (and potentially Tasmania), progress in implementing review outcomes has been poor.

National reviews: Where a review raises issues with a national dimension, the NCP provides that it can be undertaken on a national basis. Although a national process can improve regulatory consistency across jurisdictions, in many cases progress has been unacceptable (refer section 6.2.4). Currently, areas where governments' review and reform activity is incomplete because of unresolved interjurisdictional processes include: agricultural and veterinary chemicals; drugs, poisons and controlled substances; trade measurement; and travel agents.

An important issue for the PC is where to take the legislation review program in future. The Council understands that the suggested polar approaches include: continuing with the process to fruition, and terminating the program on the pretext that the outstanding commitments relate to where the community gains may be negligible.

The Council considers that the program should be completed.

- First, the remaining unfinished legislation includes some significant areas of economic activity reflecting that some governments have left the harder areas for reform to last — often areas where sophisticated lobby groups operate (figure 2).

- Second, to the extent that the cost-benefit calculus shows that pursuit of negligible gains would be outweighed by a community detriment, then this can be accommodated by the NCP review process with its public interest emphasis — based on analysis rather than assertion.

- Third, terminating the program would set a poor precedent by:

  – jeopardising future reform programs by signalling that difficult reforms can be deferred until a program is terminated; and

  – providing succour to vested interests that there are still significant gains to be made from pursuing legislative-induced rents, rather than through vigorous competition and innovation.

  – being unfair to jurisdictions that have invested in substantial reforms.

No government met CoAG's timetable to complete the review and reform of legislation. Accordingly, for the 2003 assessment, the Council recommended penalties on all governments for failure to meet this commitment. The Council considers it essential that this program be completed in full.

The legislation review program was based on an initial screening of legislation for restrictions on competition. In some cases, this has been somewhat limiting. The Council has encountered instances where legislation appears to impinge on efficiency without restricting competition. The PC should assess whether some areas of the legislation review program should be re-addressed accounting for efficiency. (This is discussed further in section 5.)

4.4.2 New legislation (CPA clause 5(5))

CPA clause 5(5) obliges governments to ensure that new legislation that restricts competition is consistent with the clause 5(1) guiding principle. This aims to provide the community with an assurance that unwarranted anticompetitive restrictions are not removed from existing legislation only to resurface in new legislation.

The Council's approach to this commitment is to assess governments' regulation review processes (known as gatekeeping mechanisms), rather than to impose itself as a further tier of regulation review. Each government has established procedures for scrutinising new regulations. Some subject all primary and subordinate legislation to their gatekeeping requirements, others exclude direct amendments to legislation. This is a material omission, and there are other differences. For example many jurisdictions use Cabinet processes to implement gatekeeping mechanisms for primary legislation and

therefore may not require the final impact assessment to be made available publicly. Others lack rigorous monitoring and reporting systems.

An effective gatekeeping process is a necessary condition for guarding against the introduction of legislation that is not in the public interest, but does not, at least in the short term, obviate the need for some ongoing scrutiny of governments' new legislation to ensure that their gatekeeping mechanisms accord with NCP commitments.[4]

It is essential that gatekeeping mechanisms operate effectively. The Council has already found that some governments are under pressure from interest groups to reintroduce restrictions on competition, ostensibly to mitigate adjustment pressures. There is a need for a close watching brief over gatekeeping mechanisms, particularly once the scrutiny afforded the current legislation review is relaxed.

The CPA clause 5(5) commitment is ongoing. It is the primary safeguard against:

- *the 'backsliding' of reforms already introduced; and*
- *the introduction of new legislation with restrictions on competition that are not in the public interest.*

The Council considers that there is a need, at least in the short-to-medium term, for a close watching brief of the efficacy of gatekeeping mechanisms. Reporting requirements could be relaxed somewhat once robust processes, capable of inspiring confidence that beneficial community outcomes will arise, are operating in all jurisdictions.

4.5 Access to services (CPA clause 6)

Part IIIA of TPA establishes three pathways for a party to seek access to an infrastructure service: (i) declaration; (ii) using an existing effective access regime; or (iii) meeting terms and conditions set out in voluntary undertakings approved by the ACCC. The Council is not involved in the third pathway. To date it has assessed 16 declaration applications and 15 certification applications. A recent application for access to infrastructure owned by Sydney Water indicates the potential scope of declaration applications.

The commitments relating to access by third parties to essential infrastructure are ongoing and the importance of these arrangements is unlikely to diminish in the future.

[4] One government considers that it is not required to report to the Council on new legislation. The argument hinges on the fact that the CPA requires governments to meet the CPA clause 5(5) but does not contain an obligation to report on this.

4.6 Road transport (Implementation Agreement)

The NCP road transport reform program comprises 31 initiatives covering heavy vehicle registration charges, transport of dangerous goods, vehicle operations, licensing, and compliance and enforcement. CoAG endorsed a framework comprising 19 of the 31 reforms, criteria for assessing reform implementation and target dates for the 1999 NCP assessment, along with another framework comprising six reforms for the 2001 NCP assessment. There have been no subsequent additions.[5]

Governments have not listed several reforms from the original package for assessment under the NCP — notably, the speeding heavy vehicle policy and the higher mass limit reforms. They also have not listed the national road transport reforms developed subsequently to the original package (such as the second and third heavy vehicle reform packages) for NCP assessment. The PC should examine progress in the areas outside the NCP to determine whether there would be benefits from extending coverage to all of the road transport reform modules.

More generally, ensuring an effectively functioning land transport sector offers scope for substantial gains for Australia. Yet for rail, there has been only tangential and piecemeal, rather than co-ordinated, progress under the NCP — mainly through the certification of State rail access regimes. It appears that road and rail have different regulatory regimes, funding criteria and charging structures that potentially create model biases. For example, rail investment is typically made on a fully commercial basis with charging regimes reflecting a WACC framework. Investment in roads is based on cost-benefit frameworks that account for externalities (such as congestion) and charging involves under-recovery on heavy vehicles. The PC should examine whether a broader land transport agenda could be brought under NCP assessment to complement the wider role of the NTC.

Accordingly, the Council considers that it would be useful to explore the merit of an expanded NCP transport agenda — perhaps also including coastal shipping and ports — particularly in light of the announced AUSLINK initiatives.

The road transport reform commitments subject to the NCP are almost complete. However, some reforms lie outside the NCP assessment framework. The PC should consider all elements of the land and coastal shipping transport agenda with a view to determining the merits of establishing an integrated transport reform agenda within a co-operative, assessable framework.

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5 The National Road Transport Commission (NRTC) developed the initial road transport reform package. The National Transport Commission (NTC) commenced operation in January 2004 to build on road reforms and extend the approach to rail and intermodal transport.

4.7 Energy (Implementation Agreement)

4.7.1 Electricity

State and Territory governments' electricity commitments arise from electricity agreements (Implementation Agreement) and the CPA. The CPA commitments relating to structural reform and legislation review are relevant to all jurisdictions, while the electricity agreements apply specifically to jurisdictions that are part of the national electricity market (NEM): New South Wales, Victoria, Queensland, South Australia and the ACT. The commitments are also relevant to Tasmania, which intends to enter the NEM in May 2005.

The cornerstone of the electricity agreement reforms was a commitment to establish a fully competitive NEM. CoAG communiqués set out specific reform commitments intended to achieve this vision (see box 5).

Box 5: Electricity commitments

The CoAG electricity commitments include:

- implementing necessary structural changes to allow for the operation of a competitive NEM;
- allowing customers to choose the supplier (including generators, retailers and traders) with which they will trade;
- establishing an interstate transmission network and nondiscriminatory access to the interconnected transmission and distribution network;
- ensuring there are no discriminatory legislative or regulatory barriers to entry for new participants in generation or retail supply, and to interstate and/or intrastate trade;
- implementing cost-reflective pricing for transmission services with greater scope for averaging for distribution network services, and transparency and interjurisdictional consistency of network pricing and access charges; and
- facilitating interjurisdictional merit-order dispatch of generation and the interstate sourcing of generation where it is cost-effective.

A key component was the enactment of the National Electricity Law, which gave effect to the National Electricity Code in each NEM-participating jurisdiction. The National Electricity Market Management Company and the National Electricity Code Administrator were established as the market operator and the code administrator respectively. These arrangements formed the basic framework for the NEM, which commenced in December 1998.

In December 2002, a review panel chaired by the Hon. Warwick Parer reported on strategic issues for Australia's energy market and policy options that would generate the greatest benefit for the energy sector. The Ministerial Council on Energy reported to CoAG, its response to the findings and recommendations of the Parer Review together with its reform policy objectives and recommendations in December 2003 (2003 CoAG Communiqué and Report to CoAG).

The MCE agreed with the Parer Review's findings that substantial progress on energy market reform had been made in Australia and that significant benefits have arisen from that reform. The MCE also concurred with the Parer Review that substantial policy issues remain to be resolved if the full benefits of market reform are to be realised. The MCE considers that a second phase of market reform is required, involving a coordinated response from governments, to capture those benefits.

The MCE concluded that further reform should be undertaken to:

- Strengthen the quality, timeliness and national character of governance of the energy markets, to improve the climate for investment.

- Streamline and improve the quality of economic regulation across energy markets, to lower the cost and complexity of regulation facing investors, enhance regulatory certainty and lower barriers to competition.

- Improve the planning and development of electricity transmission networks, to create a stable framework for efficient investment in new (including distributed) generation and transmission capacity.

- Enhance the participation of energy users in the markets, including through demand side management and the further introduction of retail competition, to increase the value of energy services to households and business.

- Further increase the penetration of natural gas, to lower energy costs and improve energy services, particularly in regional Australia, and reduce greenhouse emissions.

- Address greenhouse emissions from the energy sector, in the light of concerns about climate change and the need for a stable long-term framework for investment in energy supplies (Ministerial Council on Energy, Dec 2003, p. 4)

The key elements of the reform package recommended by the MCE to CoAG as they relate to the electricity sector include the following:

- Governance – From 1 July 2004, the replacement of the NEM Ministers Forum by the MCE, thereby establishing a single energy market governance body.

- Economic regulation – Two new statutory commissions are to be established from 1 July 2004. The Australian Energy Market Commission (AEMC) will be responsible for rule-making and market development and the Australian Energy Regulator (AER) for market regulation. Initially responsible for electricity wholesale and transmission for the NEM, the responsibilities of the AEMC and AER will broaden to include gas transmission from 2005. By 2006, the AER will be responsible for the regulation of distribution and retailing (other than retail pricing), following development of an agreed national framework.

- Electricity transmission – A new NEM transmission planning function, regulatory test for transmission and process for assessing wholesale market regional boundaries are to be respectively developed, implemented and progressed by mid 2004. Inter-regional financial trading arrangements are to be evaluated and the review of transmission pricing arrangements is to be concluded for implementation by July 2004.

- User participation – Jurisdictions in which full retail competition is operating must align their retail caps with costs and periodically review the need for price caps. The MCE did not stipulate a date for the implementation of these reforms. The MCE is to examine options for a demand-side response pool in the NEM and consider the costs and benefits of introducing interval metering.

Most governments have met their specific commitments under the electricity agreements, although some have outstanding commitments. While considerable progress has been made towards achieving the goal of a fully competitive NEM, significant deficiencies in the electricity market have been identified and are not specifically addressed by the current reform program. The PC should evaluate whether the outcomes arising from the Ministerial Council on Energy's deliberations on a future reform agenda for electricity would benefit from inclusion in an assessable interjurisdictional framework.

4.7.2 Gas

The core elements of the NCP gas reform commitments are to remove all legislative and regulatory barriers to the free trade of gas both within and across State and Territory boundaries, and to provide third party access to gas pipelines.

Other objectives are to introduce uniform national pipeline construction standards; increase the commercialisation of the operations of publicly owned gas utilities; remove restrictions on the uses of natural gas (for example, for electricity generation); and ensure gas franchise arrangements are consistent with free and fair competition in gas markets and third party access.

The gas reforms are now largely in place with only a few outstanding issues for particular jurisdictions.

4.8 Water (Implementation Agreement)

CoAG agreed to a strategic water reform framework in 1994 which was subsequently incorporated into the 1995 NCP agreements. CoAG's main objectives were to establish an efficient and sustainable water industry and to arrest the widespread natural resource degradation occasioned in part by water use. The framework covers pricing, appraisal of investment in rural water schemes, specification of and trading in water entitlements, resource

management including recognising the environment as a user of water via formal allocations, institutional reform and improved public consultation.

CoAG originally set a timeframe of five to seven years for implementing the strategic framework. It set broad milestones: urban water pricing, the institutional reforms, trading of water entitlements, and allocations including to the environment were to be completed by 1998 and rural water pricing by 2001. In 1999, CoAG extended the timetable to 2005. In particular, governments are to substantially implement allocation and water trading arrangements for river systems and groundwater resources by 2005 (with arrangements for stressed and overallocated river systems determined by 2001). CoAG senior officials asked the Council to annually assess governments' implementation of the various elements of the strategic framework over the period 2002–2005, with the 2005 assessment to assess each government's implementation of the entire framework. Table 3 provides a snapshot of jurisdictions' progress with implementing the 1994 strategic reform framework at May 2004.

In August 2003, CoAG agreed there was a need to refresh the 1994 water reform agenda to increase the productivity and efficiency of water use, sustain rural and urban communities and ensure the health of river and groundwater systems. CoAG noted that investment in new, more efficient, production systems is being hampered by uncertainty over the long-term access to water in some areas. It recognised that fully functioning water markets can help to ensure investment is properly targeted and water is used for higher value and more efficient purposes, but noted that current arrangements are preventing water markets from delivering their full potential. CoAG also expressed concern over the pace of securing adequate environmental flows and adaptive management arrangements to ensure ecosystem health in Australia's river systems.

On 29 August 2003 CoAG recommitted to the 1994 strategic framework and agreed to extend the framework by developing a National Water Initiative (NWI). CoAG agreed to develop initiatives to:

- *improve the security of water access entitlements, including by clear assignment of risks of reductions in future water availability and by returning overallocated systems to sustainable allocation levels;*
- *ensure ecosystems health by implementing regimes to protect environmental assets at a whole-of-basin, aquifer and catchment scale;*
- *ensure water is put to best use by encouraging the expansion of water markets and trading across and between districts and States (where water systems are physically shared), involving clear rules for trading, robust water accounting arrangements and pricing based on full cost recovery principles; and*
- *encourage water conservation in our cities, including better use of stormwater and recycled water. (CoAG 2003)*

Table 3: Status of jurisdictions' progress in implementing water reform components of the National Competition Policy, as at May 2004

Reform	*NSW*	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*	*MDBC*
Pricing									
- urban[a]									
Full cost recovery[b]	✓s	✓	✓s	□	□	✓s	✓	✓	**na**
Two-part tariff	✓s	✓	✓s	✓	✓	✓	✓	✓	**na**
Cross subsidies removed, others made transparent	✓	✓	✓	✓	✓	□	✓	✓	**na**
- rural water[c]									
Full cost recovery	□	□	✓s	□	**na**	✓	**na**	**na**	□
Two-part tariff	✓	✓	✓	□	**na**	✓	**na**	**na**	✓
Cross subsidies removed, others made transparent	□	□	✓	□	□	✓	**na**	**na**	□
Investment appraisal (new rural schemes)	✓	✓	✓	✓	✓	✓	✓	✓	**na**
Entitlements and trading									
Legislation separating water entitlements from land title	✓	✓	✓	✓	✓	✓	✓	✓	**na**
Licences converted / allocations defined	✓s	✓s	✓s	✓	✓s	✓s	✓	✓	**na**
Trading in water entitlements	□	□	□	□	□	✓s	□	□	**na**
Environment[d]									
Environmental allocations									
Stressed and over-allocated rivers[e]	□	□	**na**	**na**	**na**	**na**	**na**	**na**	□
Other systems surface/groundwater	□	□	□	□	✓s	×	✓	□	**na**
Water quality management	✓s	✓s	□	□	✓s	✓s	□	✓s	**na**
Landcare practices (high value rivers)	✓	✓	✓	✓	✓	✓	✓	✓	**na**
Ecological appraisal (new rural schemes)	✓	✓	✓	✓	✓	✓	✓	✓	**na**
Institutional reform									
Separate roles	✓	✓	✓	✓	✓	✓	✓	✓	✓
Holistic approach to resource management	✓	✓	✓	✓	✓	✓	✓	✓	✓
Integrated catchment management approach	✓s	✓s	✓s	□	✓s	✓s	✓s	✓s	✓
Commercial business focus	✓	✓	✓	✓	✓	✓	✓	✓	✓
Performance comparisons	✓	✓	✓	✓	✓	✓	✓	✓	**na**
Irrigation scheme devolution of management	✓	✓	✓	✓s	✓s	✓s	**na**	**na**	**na**
Community consultation	✓	✓	✓	✓	✓	✓	✓	✓	✓

Note: The summary in the table is a broad indication of progress only. It does not purport to provide a complete picture of the details of reform implementation or of each government's compliance with the National Competition Policy water reform commitments.

[a] Urban reforms include water and wastewater. [b] Full cost recovery requires governments to set prices so water and wastewater businesses earn sufficient revenue to ensure their ongoing commercial viability (the lower bound) but avoid monopoly returns (the upper bound). The lower bound of full cost recovery requires water businesses to recover, at least, operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (not including income tax), the interest cost on debt, dividends (if any) and make provision for future asset refurbishment/replacement. The upper bound comprises operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes, provision for the cost of asset consumption and cost of capital (calculated using a weighted average cost of capital). [c] Rural water pricing commitments apply to government-owned irrigation schemes, government-owned bulk water suppliers, and commercial users (licensing charges for extraction of surface and groundwater using their own infrastructure). Progress in relation to licensing charges for commercial users is not reported in this table. [d] Jurisdictions established implementation programs in 1999 identifying river systems and groundwater resources (including stressed and overallocated river systems) for which they would complete programs to allocate water (including to the environment) by 2005. [e] Jurisdictions were to demonstrate substantial progress in implementing their allocation programs by 2001, where progress includes at least allocations in all river systems which have been overallocated or are deemed to be stressed.

✓ - implemented ✓s – substantially implemented □ - implementing × - little or no progress na – not applicable

Sources: NCC (2003c); various jurisdictions' 2004 NCP annual reports.

CoAG stated that it would detail the NWI in an intergovernmental agreement, which would also indicate the specific actions to be undertaken by each jurisdiction.

In addition, recognising the declining health of the River Murray system in particular, the Murray–Darling Basin member jurisdictions agreed to provide new funding of $500 million over five years to address water overallocation in the basin. Forty per cent of this $500 million is to be contributed by the Australian Government and 60 per cent by New South Wales, Victoria, South Australia and the Australian Capital Territory.

CoAG's consideration of a new water agreement overlaps with the implementation of the existing agreement, which includes commitments that extend to 2005. CoAG has signalled its commitment to the 1994 water reform agreement and building on that agreement. Any new agreement may therefore include elements that effectively recommit to the existing water reform agreement and others that extend or refocus the agreement.

Water reform is an ongoing reform program. The Council will conduct a final assessment of government's implementation of the entire water reform framework in 2005. However, water reform will not be completed by that time. As there will be a substantial body of work to be completed, the PC should assess whether the assessment arrangements should continue. CoAG stated that it would detail the National Water Initiative in an intergovernmental agreement. This work is scheduled for the CoAG meeting of 25 June 2004. The PC should examine whether this strand of the water program should be brought within the broad reform agenda.

4.9 Summary of scope to build on the current agenda

The brief survey of the areas within the ambit of NCP indicates a variety of outcomes consistent with a program covering nine jurisdictions all with differing innate characteristics undertaking reforms at different speeds.

Many areas of the NCP involve open-ended commitments. Some of these commitments have been substantially met. For example, all governments have appropriate prices oversight mechanisms in place and generally have removed regulatory functions from public monopolies where competition has been introduced. All governments have applied competitive neutrality principles to their large government businesses and have complaints mechanisms in place. Although substantially met to date, these commitments remain relevant as long as governments own significant businesses. In particular, the Council considers that CN needs to be reviewed to determine whether the 1995 commitments should be respecified.

The importance of the ongoing commitments relating to third party access to the services provided by essential infrastructure facilities is unlikely to diminish. Likewise, the commitments relating to the quality of new legislation (gatekeeping) remain important as long as governments introduce new legislation or modify existing legislation in ways that potentially restrict competition. In particular, the efficacy of government's gatekeeping should be closely assessed for some time to guard against backsliding.

The road transport reform agenda includes a mix of 'modules' some of which are subject to assessment under the NCP and others which are not. While the NCP obligations have substantially been met, the Council considers that the PC should assess the progress of the reform modules that have been excluded from NCP assessment to determine whether they should be brought within an assessment framework. More generally, the Council considers that the PC should assess land (and coastal shipping) transport more generally to determine whether there would be a net public benefit from establishing an integrated multi-jurisdictional transport reform agenda.

The legislation review and reform agenda is the only reform area in which the timeframe set by CoAG has demonstrably not been achieved As noted, for a number of reasons, the Council considers that this reform program should continue until the original commitment has been met.

Energy reform has progressed reasonably well in terms of the obligations set out in the Implementation Agreement. However, CoAG's objective of a fully competitive national electricity market has not yet been attained and significant deficiencies, not addressed by the current reform program, have been identified.

The water reform agenda is currently ongoing to 2005 but it is apparent that a substantial body of work will not be completed at that time. The potential benefits for Australia from an effective recommitment to the current water

reform agreement and indeed to extending and/or refocusing the commitments are substantial.

5 Towards a future agenda

The PC is to 'report on areas offering further opportunities for significant gains to the economy from removing impediments to efficiency and enhancing competition' (PC 2004). Whereas the Council is well placed to comment on how the current reform agenda could be improved and/or extended (see section 4), it is less suited to commenting on future reform areas extending beyond competition-based policies. To progress its understanding, the Council has engaged a consultant to examine the scope of reforms in other countries and to compare and contrast outcomes with Australia. This work will be available in September 2004.

At the outset, the Council proposes that the PC address two fundamental issues to meet the terms of reference. These are: the contextual framework for any new reform agenda; and the institutional processes that would govern the achievement of that agenda. After preliminary comments on these fundamentals, the Council has attempted to address the PC's questions about possible areas for reform in the future. (These should be considered in conjunction with the areas identified in section 4.)

5.1 The contextual framework

It is one thing to nominate areas where reform might deliver community gains, it is another to undertake, sequence and package reforms within a defined contextual framework. One contextual 'vision', for example, could derive from recent Australian research on intergenerational issues — such as the impact of an ageing population on budget funded services, government revenues and retirement incomes policies. Demographics alone provide a compelling case for Australia to continue to improve its productivity.

Another contextual approach could be to identify problem areas that arise from Australia's brand of federalism and then look to appropriate instruments to remedy identified problems. Such an approach would be in keeping with CoAG's ownership of the NCP agenda. Perhaps the most obvious candidate is the 'cost shifting-transparency-accountability' problem that dogs much of Australia's service provision.[6] It should be no surprise that some of these themes found expression in the Hilmer Report but were excluded from the NCP reform agenda — for example, labour markets and industrial relations; the impact on resource allocation of the system of

[6] At a lower tier, but still important, is the scope to use CoAG processes to address inter-state bidding wars designed to attract investment. These investment attraction polices can generate a win for a particular State (depending on the distortions generated by the package) but may result in a net loss for the nation.

Federal-State financial relations; and the impacts on competition and growth of State assistance to industry.

A further form of contextual scoping would be to consider any future agenda from a resource intensity perspective. Such an approach presumably would identify health and education.

It is useful to recall that part of the rationale behind the NCP was a desire to coordinate reforms across nine governments recognising Australia as a national market. All governments had introduced some pro-competitive reforms prior to 1995, but implementation was often piecemeal within and across the States and Territories. In adopting the NCP, governments embarked on a nationally coordinated reform program. That rationale has currency today. To the extent that this co-ordination remains a worthwhile objective, table 4 presents one possible way of thinking about how to further develop this objective.

Table 4: Where next?

	Current contexts	*Future contexts*
Co-ordination	Mutual recognition to promote commonality across jurisdictions	Continuous improvement through national best practice
Co-ordination	Recognition of local conditions	Emphasis on the value of national consistency
Means	Using competition/markets to allocate resources and to promote efficiency	Using competition and market-based mechanisms to solve complex problems (rather than recourse to demand and supply management)
Targets	Reforming regulations	Quality regulation; fully decentralised regulation impact analysis processes; structural reform
Scope	Production of goods and services	Provision of public goods and services

5.2 The institutional framework

A key issue is whether the NCP 'payments-leverage model' is suited to any identified new reform areas. That will depend on factors such as:

- the extent to which new areas have interjurisdictional implications;
- whether competition payments are to continue; and
- the suitability of any new reform to an assessment/payments process — for example, a tightly defined tied grants model may be less suited to external monitoring than, say, longer term goals with different governments operating at different speeds.

To assist the PC in this regard, the final section of this submission deals with process and institutional issues drawn from the Council's experience. Suffice

to say, that the achievements from the NCP would not have been attained in the absence of competition payments.

5.3 Possible areas for a new reform agenda

Table 5 provides sectoral shares of GDP in 2002-03. The data provide an indication of the relative magnitude of different sectors.[7] The table also includes commentary on the degree to which the sectors are exposed to NCP reform measures. From this, the Council has identified three broad groupings that seemingly warrant attention in scoping for a future reform agenda.

These (discussed, in turn, below) include the potential to:

- revisit some reform areas under the broader banner of efficiency — competition is a confined subset of efficiency;
- expand reform more broadly in the area of sustainable natural resource management, in particular the scope for market-related instrument approaches to environmental management — only the NCP water reform program addresses such matters at present; and
- apply greater competitive discipline on the non-market sector — this would be consistent with the intergenerational and cost-shifting themes identified above.

[7] While useful for comparative purposes, the data do not necessarily convey the relative importance of particular sectors. For example, communications and transport services together comprise around 8 per cent of GDP but are of significantly greater importance for the efficient functioning of the economy.

Table 5: Sectoral shares of GDP[a] and exposure to NCP reforms

Sector	*Share of GDP*	*Exposure to NCP*	*Efficiency beyond confines of 'competition'*	*'Externalities'– environmental and resource sustainability*
Agriculture, forestry and fisheries	2.8	Legislation review	No	Very limited
Manufacturing	10.8	Legislation review	No	No
Mining	4.6	Legislation review	No	No
Electricity and gas	10.6	Energy reform; access; legislation review	Yes. Efficiency and resource allocation	No
Water	0.6	Water reform agreement; legislation review	Yes. Efficiency and economic viability	Environmental sustainability. Limited progress on water prices reflecting external costs
Construction	6.3	Legislation review	No	No
Wholesale and retail trade	10.3	Legislation review	No	No
Accommodation, cafes and restaurants	2.1	Legislation review	No	No
Transport and storage	5.0	Legislation review, some road transport reforms, and access	Limited through access for rail. Partial treatment of road transport reform.	No
Communications	2.8	Legislation review; access	Limited through telecommunications access regime.	No
Finance, insurance and property	17.5	Legislation review	No	No
Education	4.3	Legislation review; CN	No	No
Health and community services	5.8	Legislation review; CN	No	No
Government administration and defence	3.9	No	No	No
Other[b]	21.6	..	..	..
TOTAL	100.0	..	..	..

[a] Industry gross value added at basic prices, chain volume measures adjusted for taxes less subsidies on products. [b] Includes cultural and recreational services; personal and other services; ownership of dwellings; and statistical discrepancy.
Source: ABS 2003, table 10, p. 34.

5.3.1 Efficiency is broader than competition

As the terms of reference for the inquiry broaden scoping for a future reform agenda beyond competition, it is useful to determine whether that wider remit could be applied to areas already under the NCP. For example, governments devised their legislation review schedules on the basis of their initial screening of legislation to identify restrictions on competition. The Council's experience is that some legislation adversely impinges of efficiency without necessarily restricting competition.[8] For example, some restrictions are justified on public interest grounds (such as quotas based on sustainability criteria) but the efficiency of the allocation method may be questionable relative to alternatives. Similarly, the Council has sometimes questioned the magnitude of compliance and administration costs imposed on parties and taxpayers to support restrictions on competition. But, if the burden falls equally on participants in the market, then even a manifestly inefficient process can be immune from CPA clause 5(1).

The Council considers that the PC could usefully revisit the NCP framework from a broader resource allocation/efficiency perspective to assess if further gains are on offer from expanding the target from competition to efficiency.

5.3.2 The natural environment

Future reforms could be developed by drawing together and building on programs designed to ensure and maintain sustainable environmental outcomes. Environmental degradation represents a drag on future growth, but may not be reflected in (or appear as a gain) in current GDP estimates.

Water reform has already made substantial inroads in this area and a national salinity program has supplemented NCP water reforms. There are also intergovernmental agreements on tree clearing. Nonetheless, governments are only beginning to tackle these issues and are grappling with methods of balancing community, environmental and economic needs. This is an area where further policy development and co-ordination is needed.

The legislation review program and the application of CN to forestry, fishing and other resource management questions has resulted in some reform to aspects of these sectors. However, the review and reform of fisheries management legislation, for example, raises informational difficulties akin to those in water reform (see box 6). In this context, the Council considers that there needs to be scope for greater flexibility than is possible under the timelines for legislation review and reform.

More generally, an integrated sustainability package could extend to matters such as land use planning (and clearing), and pollution (including greenhouse gas abatement). Environmental and sustainability matters could benefit from

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[8] For new legislation, appropriate gatekeeping processes should address efficiency issues, including business compliance costs and the like.

being addressed explicitly with a focus that emphasises national co-ordination whilst acknowledging regional variations. Having jurisdictions adopting separate approaches to national externality problems would not appear to represent sensible public policy. It may be feasible to bring these matters together into a national resource management reform package.

Box 6: NCP and fisheries management

The commercial fishing industry is Australia's fourth most valuable food-based primary industry, after beef, wheat and milk. The value of the commercial wild catch increased from $1.1 billion in 1989-90 to nearly $2.4 billion in 1999-2000. Australia's major harvested species are prawns, rock lobster, abalone, tuna, other fin fish, scallops, and edible and pearl oysters. Aquaculture is established in all States, with farmed species ranging from pearl oysters to trout. The majority of Australian production is exported. Fishing is also an important recreational activity. The domestic fishing tackle and bait industry has an annual turnover in excess of $170 million. The recreational boating industry (of which 60 per cent relates to fishing) accounts for a further $500 million in turnover. In addition to Australian fishers, international tourists spend over $200 million on recreational fishing in Australia each year (FRDC 2002).

Primary legislation for fisheries management makes available a 'toolkit' of controls, but generally does not of itself apply these controls. The application of fisheries management controls in combinations most suited to the circumstances of particular fisheries is usually the province of secondary or subordinate legislation and other regulatory instruments often referred to as management plans. This lower tier of regulation is extensive. It is necessarily subject to regular review and revision in response to challenges such as new information, natural stock variation and technological advances.

In this light, the Council adopted the following benchmark for assessing compliance with CPA clause 5 for fisheries management regulation in its 2003 assessment:

- the review of primary fisheries legislation is complete, and recommendations for specific reforms to this legislation implemented, except where declined on reasonable public interest grounds;
- where an NCP review recommends further review of a specific competition issue, that review has been completed and the government has announced a firm implementation timetable for reform (if any); and
- a public interest test is built into the normal processes of review and revision of subordinate fisheries legislative instruments.

From table 2 it is apparent that the review and reform of all of these elements of fisheries legislation is incomplete in most jurisdictions. Some governments have raised with the Council that further reviews are not scheduled for completion for some time owing to extreme informational demands (such as scientific research into fisheries stocks) and the need for effective management to have sufficient industry support, that can only be assured via a careful and consultative review process.

Notwithstanding the strength of such arguments and the Council's broad acceptance that, in some instances, the informational requirements and transitional issues revolving around switching from say, input controls (eg lobster pots) to output controls (eg integrated total catch) are complex and will require further research and consultation, the Council must assess jurisdictions as failing to meet their legislation review commitments. In essence, the compliance breach revolves around timing failures.

5.3.3 The non-market sectors

The non-market sector includes the provision of public goods by governments. One potential problem with the sector is that price signalling is not sufficient to ensure an efficient allocation of resources. As alluded to earlier, it is likely

that many such goods and services delivered by the non-market sector will be subject to substantially increased demand in the future. The PC could explore the extent to which reform strategies could have a role in improving the efficiency of funding and delivering public goods. It could also assess the extent to which the institutional model (section 6) could be used to address cost-shifting, standardisation or performance-based targeting of such goods and services in a multi-jurisdictional framework. As shown in table 5, the non-market areas represent a significant share of GDP and a large and growing call on the budget.

In terms of specific areas, the PC could investigate the potential to introduce policies to enhance efficiency and deliver better community outcomes in education, childcare, health and community services. To this end, the PC has, in its issues paper, provided a useful menu of instruments and areas for application (synthesised in box 7).

Box 7: Examples of market-based mechanisms in government service delivery

Performance benchmarking: most government service areas.

Performance-based funding: Home and community care services; case-mix funding for public hospitals; school funding; employment services (Job Network); housing.

User choice: Disability services; child care services; home and community care services; hearing services; Job Network; public schools; apprenticeship training organisations.

User charges: Higher education contribution scheme; home and community care services; aged care services; environmental services; court reporting services.

Competitive tendering and contracting-out: correctional centres; community services; health sector services; private sector provision of public hospital services; ambulance services; vocational education and training; Job Network; disability services; housing services; child care; defence support services; juvenile justice services; information technology; conservation and land management; foreign aid projects.

Property rights: Radiofrequency spectrum; biodiversity conservation; salinity mitigation; greenhouse gas emissions.

Source: Extracted from PC 2004.

Under the NCP, CN has application to government businesses, but not, by definition, the budget funded sector providing non-market services. While CN frameworks can be used to drive efficiency in certain areas of the provision of health and education, it has limited application outside competitive services. That said, CN embodies a range of principles that are equally germane to non-market agencies, such as strong corporate governance structures and mechanisms to impose surrogate market disciplines.

The Council considers that the PC inquiry should address the following:

- What is the scope to apply efficient valuation and charging structures for goods and services in the absence of price signals? Is there scope to foster competition disciplines and is this appropriate?

- What is the extent of inefficiency in service provision (including cost shifting) and can this be addressed by an integrated reform model? What are the expected benefits and costs of a nationally coordinated approach? What are the constraints (eg political, legal)?

Whatever the outcomes from this line of inquiry, it is apparent that the performance of the non-market sector must be subject to some form of benchmarking to ensure that it meets its goals effectively.

6 The NCP institutional framework

6.1 Why has the NCP been a success?

The success of the NCP can be attributed to three key interrelated attributes.

1. An agenda agreed by all governments that outlines the reform commitments with a practical degree of specificity.

2. An independent body responsible for negotiating, monitoring and reporting on reforms.

3. The provision of appropriate incentives, including financial payments.

6.1.1 An agreed agenda

The NCP is a product of all Australian governments. Adopted unanimously, it is the most extensive economic reform program in Australia's history. Governments' ownership of the NCP agenda has been a major factor in its success. This is particularly so in light of Australia's brand of fiscal federalism with constitutional powers and responsibilities residing with sub-central governments.

A major strength of the NCP agreements is their reliance on the 'spirit' of reforms and the flexibility afforded to governments in meeting their commitments and to the Council in assessing progress. The agreements extend over many years, yet are flexible enough to cope with changing circumstances and different approaches while remaining sufficiently clear to facilitate an objective assessment.

The Council has no doubt that rigid highly prescribed agreements set down in black letter law would have been an inferior model.

6.1.2 An independent assessor

Competition payments alone would not have been sufficient to bring about the observed benefits. An independent body is required to clarify reform commitments, focus governments' attention on those commitments and facilitate reform. The Council has a history of working with governments to progress reform. Using existing agencies to undertake such assessments would have run the risk of conflicts of interest with the regulatory policy roles of such agencies.

Each jurisdiction is obliged to submit to the Council an NCP annual report outlining progress in meeting their commitments. This (along with the incentive payments) also has helped to maintain reform momentum.

6.1.3 Appropriate incentives

Using competition payments to leverage reform outcomes in areas of State and Territory responsibility has proven highly effective. This effectiveness has been enhanced by the involvement of an independent body at arms length from the Australian Government which releases the funds.

Reform would have been far slower and less comprehensive without competition payments. These payments (now at around $800 million per year) may not be large relative to State and Territory budgets, but nonetheless represent a significant source of incremental funds. Apart from the magnitude of the funding, tying performance to financial rewards has enabled governments to eschew pressure from lobby groups by claiming that they have no option other to meet their NCP commitments. At the officials' level, the effect of competition payments has been to empower jurisdictional competition policy units to a far greater extent than otherwise. The benefits of strong competition 'watchdogs' at the coalface should not be underestimated.

The Council's approach, as is evident from its numerous assessments, is to encourage governments to complete their reform commitments. Penalties recommendations are instruments of last resort and are generally in the form of recoverable suspensions.

6.1.4 A model suited to nine governments

The introduction to section 6 noted that the key attributes that combine to make the NCP so successful are interdependent. This theme is conveyed in figure 2 which draws together these strands to aid exposition of the scope, nature and value of the NCP's institutional arrangements. These include:

- assessment frameworks and assessments with sufficient flexibility to facilitate reform progress rather than imposing rigid compliance targets. For example, suspensions allow for difficult reforms to be rolled over thereby raising the potential rewards from compliance and providing time to devise reasonable transitional reform programs;

- allowing for different mechanisms to meet different reform agendas rather than recourse to a rigid tops down model that may not be equally suited to different jurisdictions; and

- an independent assessor that can monitor and assess progress across nine governments that are introducing reform measures at different speeds, from different start points in highly variable environments (political, geographic, climatic etc).

Figure 2: NCP: scope, nature and value of contribution

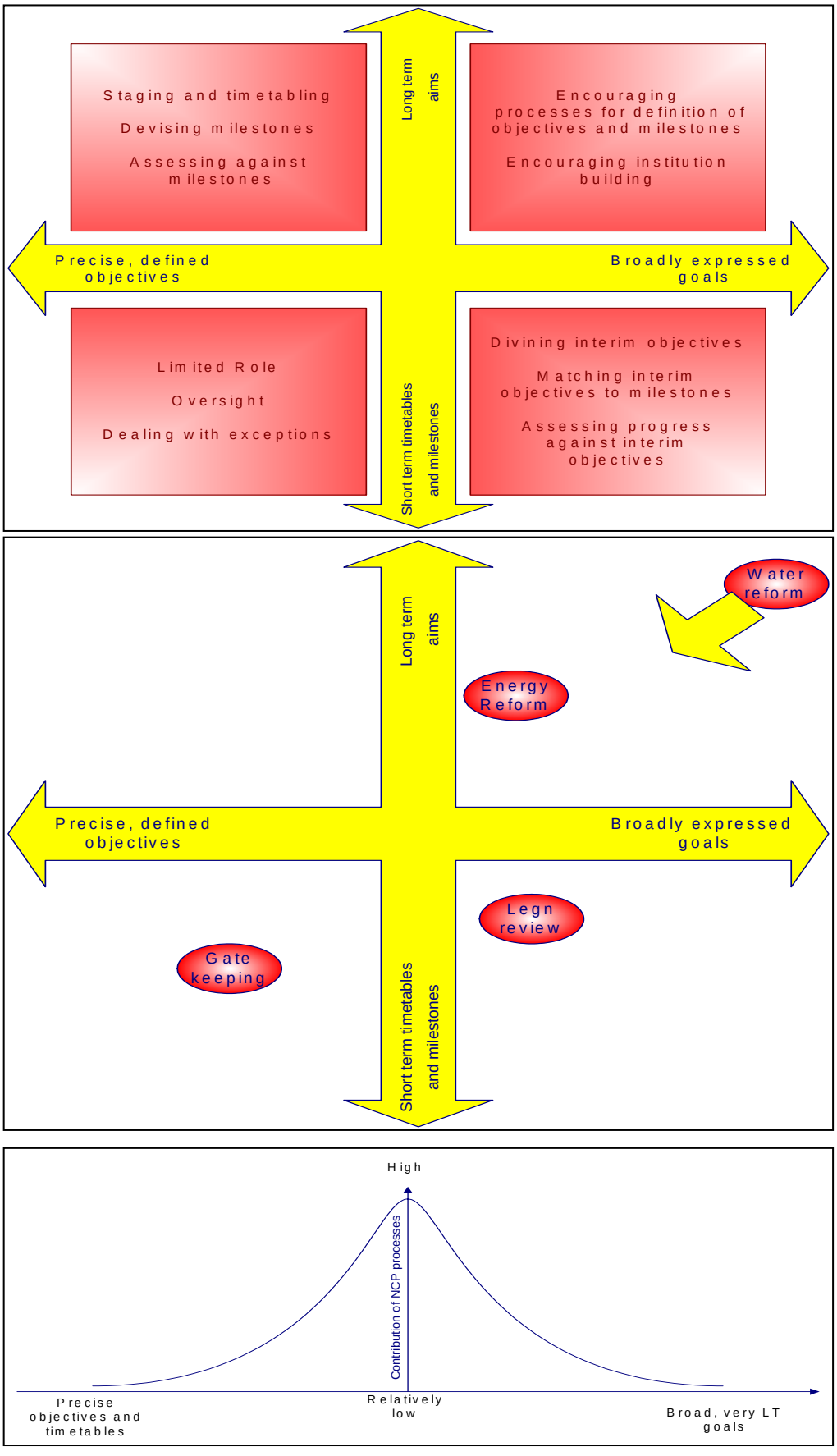

Figure 2 contains three discrete panels. Panel 1 describes the nature of reform goals on the x axis: from precise objectives to broadly expressed goals. The y axis introduces a time dimension: from short term timetables to longer term aims. Precisely defined objectives under short term timetables (south-west quadrant) imply a more limited oversight role for the assessment agency — essentially confined to 'ticking off" the milestones achieved. Conversely, broadly expressed goals with longer term aims (north-east quadrant) allow all parties, including the assessor, to do much more, such as encouraging processes and institution building to help shape achievable objectives and milestones. This process allows for the structured, incremental iteration to outcomes that improve community welfare. It is particularly useful for agendas where the problems vary in nature and intensity across jurisdictions all of which are working in different ways and with different instruments to achieve, often region-specific outcomes.

Panel 2 overlays some of the areas of NCP onto the four quadrants set out in panel 1. It illustrates, for example, that an iterative process can lead to a complex reform agenda such as water becoming increasingly specified over time. In contrast, the legislation review and reform program has a fixed timetable with relatively well defined goals.

Panel 3 depicts the relative contribution of the 'payments-leverage model' to various types of reform agendas. Hence, very precise objectives with rigid short-term timeframes are less suited (lower value) to the model than objectives that require a greater degree of flexibility. Hence, a simple check list process does not, of itself, require an investment in a dedicated assessment agency. Similarly goals that are overly amorphous may be of little value unless governments establish a broad objective context and allow the assessing body to interpret compliance according to those expressed objectives. The institutional framework, therefore, is best suited (highest value) to achievable goals where scope for flexibility is necessary.

Drawing on its experience, the Council considers that, looking forward, effective forms of intergovernmental agreements should include:

- *overarching principles that can be used to guide any flexibility in application to ensure the desired outcome is delivered;*
- *sufficient detail on the reform requirements to benchmark the assessment of performance. Because the assessment body should not be responsible for policy development, the agreements need to specify policy objectives;*
- *interim benchmarks (particularly where outcomes are longer term) and mechanisms for priority setting so the reform process does not stall;*
- *mechanisms to monitor reform implementation; and*
- *mechanisms to change and refine the agreements that avoid inappropriately winding back the obligations or exempting obligations from assessment. This can be avoided by;*
    - *requiring unanimous CoAG agreement to change the commitments,*

- requiring CoAG to endorse the work of other bodies (eg Ministerial councils) before that work becomes part of the agreements, or

- providing sufficient detail in the agreements and constraining other bodies to developing approaches consistent with the overarching CoAG agreements.

The work of other bodies (such as Ministerial councils or groups of officials) can inform the assessment of reform implementation and help develop performance benchmarks and best practice approaches, but risks diluting reform if it results in rewriting the agreements. (NCC 2003d)

6.2 Scope for improvement

With the benefit of hindsight it can reasonably be argued that some elements of the NCP would have benefited from greater clarity in requirements. This failure has provided opportunities for some governments to approach reform processes in a minimalist way.

6.2.1 Specificity

The independence of legislation reviews has been a source of concern because NCP does not detail the requirements of the review processes. The Council therefore has sought to encourage best practice based on CoAG (2000), as outlined in box 1.

From time to time, the Council has raised its concerns with some governments about the degree of direct stakeholder representation on reviews. Sometimes this dialogue has been sufficient to convince governments to convene independent reviews (with stakeholders represented through submissions or reference panels), on other occasions directly interested parties have had a seat at the table.

While the Council has pursued an active policy of constructive engagement with governments (at the executive and officials levels) in all reform areas, a formal consultative forum would have been useful. For instance, the Council has participated in informal and ad hoc meetings with officials on matters such as legislation review and competitive neutrality roundtables and this has been invaluable in sharing experiences and furthering understanding of the application of CN and the Council's assessment.

Finally, as noted in section 6.1.1, the flexibility provided by the NCP agreements is an asset, compared to a black letter template approach. But the balancing act can be a fine one. It is important to ensure that agreements do not contain ambiguities that can be used by governments:

- to excuse noncompliance;
- to readily introduce carve outs and exemptions; and

- to continually re-specify benchmarks.

6.2.2 Transparency

The NCP does not require that review reports be made public. In practice many reviews have been made publicly available, but there have been instances of reviews not being released where outcomes have been controversial or 'unpopular'. This is a major issue where a government seeks to argue for retention of restrictions on public interest grounds based on unseen review reports. As noted by Deighton-Smith (2001):

> *A requirement that all reviews be made public would have created an additional discipline on governments to ensure that their review processes were robust and a discipline on reviewers to ensure that their analysis and conclusions could withstand any scrutiny. It would also enhance stakeholder and public confidence that the outcomes were justified by preceding analysis.*

The water reform program contains formal public education and consultation requirements which are absent in other areas of reform. Governments are also required to explain the benefits of reforms. It is incumbent on governments to meet consultation obligations (beyond claiming that reforms are only being introduced to avoid unfair penalties). The education and consultation model for water reform may be applicable elsewhere.

6.2.3 Role of the Australian Government

The Australian Government is a party to the NCP and also disburses competition payments. While the Council assesses the Australian Government's progress in implementing the NCP program and reports publicly on its performance, the Australian Government does not receive NCP payments. This creates an inconsistency in how jurisdictions are treated when they fail to comply with their commitments. Apart from the opprobrium of being found not to comply, there are no incentive mechanisms operating on the Australian Government to progress reforms. Indeed, the Australian Government's relatively poor performance has been noted by States and Territories subject to penalty recommendations. The PC could usefully look at how this might be addressed.[9]

6.2.4 National reviews versus 'piecemeal' jurisdictional reviews

There are pros and cons associated with national reviews and State- and Territory-based reviews. The Council's experience is that outcomes depend on two main considerations. First, who conducts the national review and second

[9] For example, having a notional pool of payments allocated to the Australian Government, with penalties disbursed to the States and Territories. (Of course, who signs off on such an arrangement would be an issue.)

the relative costs and benefits of national consistency versus policy competition.

The robustness of a national review process is critically important. National reviews that are not independent of the executive arm of government provide potential for a race to the lowest common denominator by setting compromise reform targets that all jurisdictions can reach. This has been the experience of some of the national reviews conducted by Ministerial councils. National reviews, therefore, should be conducted by agencies with a track record for robust and independent processes (such as the PC review of architects). This is particularly important given that the review report sets the benchmark for the 'horse trading' that is likely to arise in any co-ordinated interjurisdictional response to the review's recommendations.

The potential benefits of national reviews are reduced duplication of effort and the scope for greater consistency. These benefits accord with the notion of Australia as a 'single market' in a global environment. Like mutual recognition, consistency in regulation can reduce business compliance costs and reduce search and transaction costs for consumers. The benefits can be stark when set against the possibility that two States could embark on reviews of the same area of regulation and arrive at quite different reforms. If one reform path is rejected by one review but considered compliant by another, this raises difficult questions about how the Council should assess outcomes.

On the other hand, policy competition can also provide benefits. A standardised national reform model carries an attendant risk of large scale regulatory failure, whereas a competitive model facilitates policy learning.[10] The Council has encountered areas where innovative approaches in one jurisdiction have been adopted by others. Indeed, often reforms in some jurisdictions have provided the spur for others to move in areas that were seemingly (politically) intractable. The NCP assessment process also provides a vehicle for encouraging jurisdictions that have lacked the will to progress reforms that have been seen to deliver benefits in other states without the claimed social costs suggested by the incumbent beneficiaries (eg reform of retail trading hours).

6.2.5 Phasing and transitional matters

There is a perception that the impacts of the NCP have been uneven with the benefits accruing to urban centres and the costs borne by rural and regional areas. As the PC (1999a,b) established, such perceptions are unfounded. Nevertheless, it is the case that removal of unsustainable agricultural price support mechanisms, for instance, can have differential geographic impacts

[10] Also, regional variations can mean that standardised regulations are inappropriate. For example, building codes for cyclone prone areas may be unnecessarily prescriptive for regions with more moderate climates.

— involving winners and losers. This raises issues about how best to manage the reform process.

When adjustment costs are likely to be significant, some form of assistance targeted towards people or regions may be appropriate. The challenge is to assist people to cope with change without unduly delaying or dissipating the benefits of reform. Change management can involve money (eg the dairy levy), planning and consultation before reforms are implemented, phasing reforms or simply ensuring awareness of general safety net measures. Ideally, adjustment assistance should be consistent with efficient outcomes, such as addressing short term transitional costs before they evolve into long-term structural problems.

The NCP is generally silent on the issue of adjustment assistance, other than noting that (for legislation review) a transitional reform program can extend beyond 30 June 2002 where this has been demonstrated to be in the public interest. In this context, the Council has generally sought to ensure that phasing is based on genuine public interest considerations. The lack of general principles has meant that the implementation process has diverged across jurisdictions and has not always been well managed.

Explicit recognition of the need for change management would be beneficial in any future reform agreements. However, forms of assistance should not be predetermined as this is best assessed by the relevant State and Territory government based on the circumstances of particular reforms. State and Territory governments are in the best position to assess the impact of change and the incentives and expectations that adjustment assistance in one sector might generate for reform in other areas. Governments may, nonetheless, be able to agree on broad principles to help guide the appropriate change management process.

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