
Productivity Commission Review of National Competition Policy Arrangements

NSW Government Submission

Preface

New South Wales has previously published detailed information on the implementation of specific reforms required under the National Competition Policy Agreements in its *Annual Reports on the Application of National Competition Policy* (NCP) to the National Competition Council¹. This submission does not seek to recount in detail those reforms, but to provide an overview of New South Wales' approach to NCP and the impacts of NCP reforms in this State. This submission also comments on a range of issues raised by the Productivity Commission in its Issues Paper, including the effectiveness of the current NCP framework in progressing competition reform, the public interest test and areas in which reform might be focussed in the future.

1. The impact of NCP and related reforms to date

1.1 Economic growth and productivity

NCP and other microeconomic reforms have been credited with marked improvements in Australian productivity in the 1990s. In the ten years to 1999, Australia enjoyed the second largest increase in trend multifactor productivity growth among OECD countries (behind Finland)².

This increase in productivity has translated to real increases in incomes. Average incomes grew at around 2.5 per cent throughout the 1990s compared to 1.4 per cent over the 1970s and 1980s – with greater productivity growth accounting for 90% of that acceleration.

The productivity gains have predominantly been passed on to consumers in the form of lower prices. The gains have also been reflected in direct increases in income to employees and entrepreneurs. In addition, labour market participants have benefited indirectly from the gains through higher real wages and lower unemployment³.

Real wages increased 16 per cent over the period 1991 to 2001. This represents the largest increase for any decade since World War II⁴. In dollar terms, average annual household incomes were approximately \$7000 more than they would have been without such productivity gains, providing a sustained increase in the living standards of Australians⁵.

¹ New South Wales' annual reports on the application of National Competition Policy are available at www.cabinet.nsw.gov.au

² OECD 2001, *The New Economy: Beyond the Hype – Final Report*, Report to Ministerial Council, OECD Publications, Paris.

³ Parham, D, Barnes, P, Roberts, P and Kennett, S 2000, *Distribution of the Economic Gains of the 1990s*, Productivity Commission Staff Research Paper, AusInfo, Canberra.

⁴ Speech by Premier Carr to CEDA "Productivity Growth and Micro-economic Reform" 27 February 2004

⁵ Parham et al, 2000

More broadly, NCP and other microeconomic reforms have contributed to the creation of a stronger, more responsive national economy. The resilience of the Australian economy was particularly evident in the context of significant change in the economic environment that occurred due to the Asian financial crisis. Australia maintained strong growth and exceptionally low inflation almost two years after the crisis emerged.

1.2 Prices oversight and structural reform

A significant source of the gains in Australian productivity can be attributed to the improved performance of government businesses, particularly those in the water, electricity and transport sectors. The NCP agreements required governments to adopt specific principles to enable the creation of competitive markets for public sector goods and services, where appropriate, including:

- independent oversight over prices set by government businesses;
- the structural separation of regulatory from commercial functions in public monopolies;
- provision of third party access to significant publicly-owned infrastructure;
- removal of anti-competitive restrictions which cannot be demonstrated to be in the “public interest”; and
- compliance with competitive neutrality principles to ensure that government businesses operate on an equal footing with private sector businesses where necessary.

The Agreements also extended the anti-competitive conduct provisions of the Trade Practices Act 1974 (Cth) to the government sector. In New South Wales, public monopolies, particularly utilities, have been systematically reformed to separate responsibility for industry regulation from commercial functions. All major businesses with monopoly characteristics are subject to independent price oversight by the NSW Independent Pricing and Regulatory Tribunal (IPART). All NSW Government businesses operate within a comprehensive commercial policy framework and significant businesses activities of the Government are subject to competitive neutrality requirements.

At the outset, such structural reforms were expected to improve productivity and lower costs, to improve the range and quality of goods and services produced and, importantly, to generate flow-on benefits for the competitiveness of Australian industries as a whole. The success of the structural reform policies can be seen in significant improvements in the labour productivity of NSW Government businesses since 1994-95 in the areas of electricity generation, electricity distribution, freight rail and metropolitan water services⁶ (Table 1.1 overleaf).

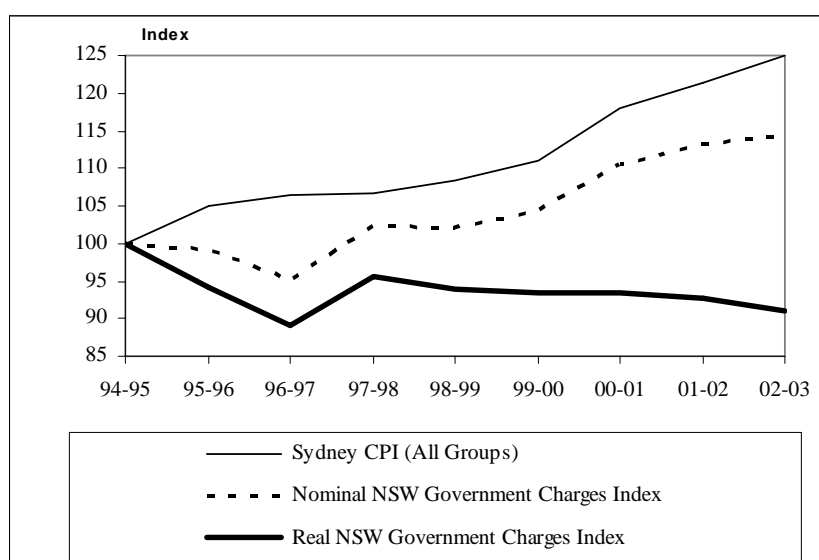
⁶ NSW Treasury’s series of *Performance of NSW Government Businesses* publications.

Table 1.1: Increases in labour productivity in electricity generation, electricity distribution, freight rail and water services since 1994-95

Sector/Government business	Labour productivity increase since 1994-95 (%) ⁷
Electricity Generators	245
Electricity Distributors	80
FreightCorp ⁸	219
Sydney Water Corporation	90
Hunter Water Corporation	56

The introduction of independent prices oversight and structural reform of government businesses has also produced significant real price reductions for consumers. The NSW Government Charges Index (GCI), a weighted measure of charges for goods and services provided by NSW Government businesses, has fallen by 8.9 per cent in real terms since 1994-95 (Figure 1).

Figure 1: The Government Charges Index 1994-95 to 2002-03



In reality, the savings are likely to be larger. The implementation of efficient pricing principles has led to many of the largest price reductions being experienced by those consumers who pay unregulated prices, which are mainly large consumers of electricity and water services. In the main, the GCI does not capture price changes for unregulated government business activities. Businesses in New South Wales have experienced average real reductions in charges for electricity of 17 percent, ports 31 percent and metropolitan water 44 percent in the eight years to June 2003.

⁷ NSW Treasury *Performance of NSW Government Businesses* (series) to 2002-03

⁸ FreightCorp was privatised in February 2002. Its labour productivity figure relates to performance up to 2000-01

The removal of unwarranted regulatory impediments on industrial organisation and investment also appears to have benefited the private sector. Capital productivity increased in the 1990s, suggesting that the nation's capital stock is now being used more efficiently⁹.

1.3 Impacts of NCP on key sectors

In addition to general structural/commercialisation reforms, the electricity, gas, water, and transport sectors have been subject to separate, sector-specific "related" COAG agreements. The broad objectives of these agreements were to, respectively:

- achieve a competitive national electricity market;
- establish a national framework for free and fair trade in gas;
- establish a strategic framework for the efficient and sustainable reform of the Australian water industry; and
- achieve national consistency in road transport rules and continued adherence to those reforms.

Some of the most significant benefits from the NCP program have been realised from the wide-ranging and historic reforms required under the related agreements. The benefits arising out of these "national" reforms have been underpinned by the cooperation of the States and Territories rather than being a result of a federal government policy. A brief overview of the reforms and benefits achieved in the energy, water and transport sectors follows.

Energy

New South Wales has been, and continues to be, a leading state in energy reform. In 2001, the Australian Bureau of Agricultural and Resource Economics estimated the likely value of electricity reforms across the period 1995 to 2010 to be \$21 billion in 2001 dollars (equivalent to approximately \$22 billion in today's terms), with around 60 per cent of that benefit already realised.

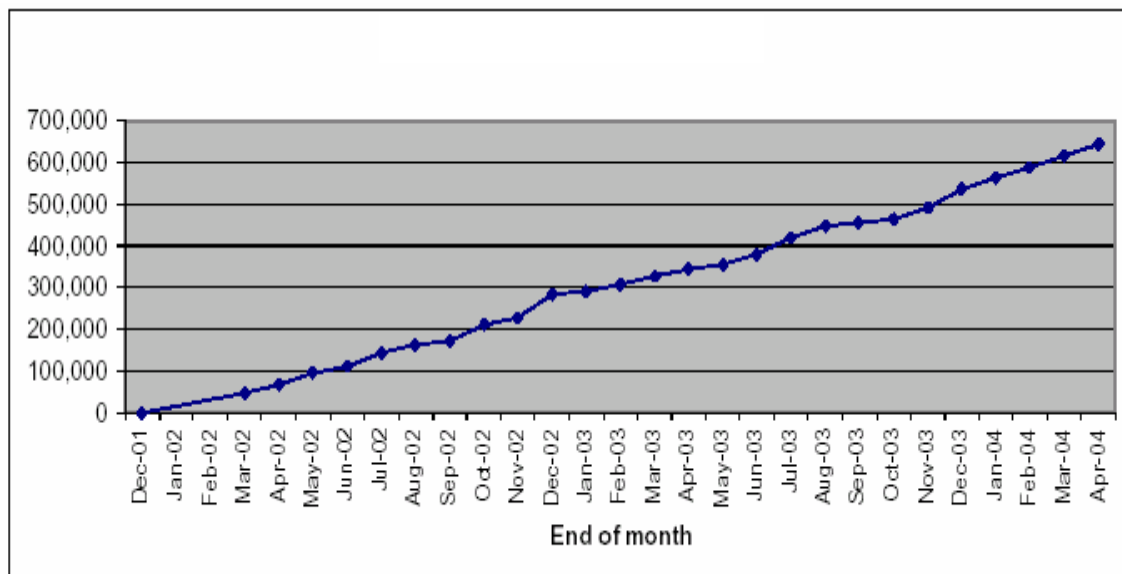
In New South Wales, electricity customers have saved around \$1.8 billion due to reforms made since 1994-95. Since electricity is a significant input cost for many businesses, the community in general has benefited to the extent that lower costs have been reflected in prices for goods and services.

One of the milestone achievements was the introduction of full retail competition for gas and electricity on 1 January 2002. Full retail competition gives all NSW gas and electricity customers their choice of retail supplier. Since the introduction of retail competition, over 644,000 small energy customers have entered into negotiated contracts with their existing retailer or a new retailer.

Chart 1 overleaf shows small energy customers' move from regulated tariffs to the competitive market. The numbers of customers who choose non-regulated contracts is expected to continue to grow in the future.

⁹ Productivity Commission 1999 Microeconomic reform and Australian productivity: exploring the links, Research Paper, AusInfo, Canberra

Chart 1: Growth in customers transferring to unregulated contracts



The 2002 COAG Energy Market Review of the Australian gas market found that the implementation of free and fair trade in gas has encouraged new pipelines to be built and the exploration for, and development of, new gas reserves. The length of Australia's transmission pipeline system nearly doubled from 9,000 kilometres in 1989 to over 17,000 in 2001. There has been a significant increase in pipeline infrastructure, including the Culcairn interconnect which allows gas to flow from New South Wales and Victoria, the Eastern Gas Pipeline from Victoria to New South Wales and the ACT, and the South East Australia Gas Pipeline between Victoria and South Australia.

The introduction of competition has also increased the number of suppliers in the gas and electricity markets. There are 20 licensed electricity retailers and 14 licensed gas retailers in New South Wales. Further reforms will include a focus on improving the operational and institutional arrangements of the electricity market.

Water

The COAG water reform agreement established principles to guide all governments' reform of water arrangements. These principles include:

- pricing reforms;
- the removal of inefficient cross-subsidies and making transparent remaining cross-subsidies;
- the requirement for new rural water infrastructure to be economically viable and ecologically sustainable;
- clarification of water entitlements and their separation from land title;
- explicit allocations of water to the environment;

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- the facilitation of water trading; and
 - various institutional and public education initiatives¹⁰.

New South Wales has adopted consumption-based pricing, full cost recovery for water, where appropriate, and eliminated or made transparent community service obligation payments. Consumption-based pricing has removed cross-subsidies between water users, improving both fairness and the efficiency of water use. Businesses have been key beneficiaries of these pricing reforms. The introduction of efficient pricing principles produced savings of around \$215 million on metropolitan water services for businesses in New South Wales over the period July 1995 to June 2003.

Cost-reflective and consumption-based pricing have an impact on water use by providing incentives to reduce waste. This, in turn, has a significant impact on future water supply capacity and the total amount of investment in the water industry. In New South Wales, 97 per cent of properties serviced by water utilities with 1,000 or more connections now face consumption-based pricing for services. Sydney Water Corporation will remove its remaining property-based charges as part of the price path expiring in June 2005. From June 2005, all four price-regulated water utilities (Sydney Water Corporation, Hunter Water Corporation, Gosford City Council and Wyong Shire Council) will charge for water services on a consumption basis.

NCP has also provided a framework for the efficient and sustainable management of water in country New South Wales. Under the framework, New South Wales has implemented a comprehensive water entitlements framework that, via water sharing plans, recognises and provides for both consumptive and environmental water needs, and also allows trading of water access entitlements, which have now been separated from land title. Thirty six water sharing plans have been developed to date through extensive consultations with regional-based communities. These plans account for 80 percent of water use in New South Wales.

Water trading is anticipated to facilitate the movement of water to its highest and best use. New South Wales has removed a range of inappropriate and anticompetitive restrictions to intrastate and interstate trade in water access entitlements. New South Wales is also looking at mechanisms to facilitate trade out of irrigation areas and to ease trading practice, such as reducing administrative hurdles and allowing leasing and other measures.

These major reforms will be furthered through:

- measures to enhance the security of water access entitlements, which will drive investment in sustainable agriculture and reduce regulatory risk and transaction costs for businesses; and
- measures to regulate against the over-proliferation of basic water rights, which will protect environmental flows and access entitlements.

¹⁰ National Competition Council (2003) Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2003, Volume 1

The water trading reforms under NCP are anticipated to increase the value of water licences and encourage investment in water saving technology. Where water sources are over-allocated, pathways have been established to move these systems towards more sustainable levels of extraction.

The NCP water reform framework also provides for institutional reforms including separation of responsibility for commercial/service functions from water regulation and water resource and environmental management. The most recent structural reform will see State Water, the supplier of bulk water services in rural New South Wales, corporatised on 1 July 2004. Corporatisation will separate conflicting water delivery and regulatory and policy responsibilities, improve pricing transparency, and clarify resource management and service delivery costs.

National approaches for further water reform will seek to harmonise operating environments across the states and territories. This should reduce compliance and regulatory costs for the industry and consumers.

Road Transport

The national road transport reforms commenced with the Heavy Vehicles Agreement and Light Vehicles Agreement in 1991 and 1992 respectively. Road transport regulation includes measures covering the registration, operation and charging of vehicles, the licensing of drivers and measures to ensure compliance with regulatory requirements. The two Agreements provided for the development of nationally consistent regulation of vehicles and establishment of the National Road Transport Commission (NRTC)¹¹ to develop the reforms. These agreements were brought within the ambit of NCP in April 1995 and largely implemented by 2000.

The Agreements were aimed at reducing the cost of complying with nine different sets of regulations, reforming charging systems that bore little relation to the costs users imposed on the road network and maximising the efficiency and productivity of the transport sector. The reforms also had as major aims the improvement of transport safety and minimisation of the adverse environmental impacts of road transport.

While the direct benefits to the community as a whole from safety improvements and better environmental outcomes are difficult to quantify and do not appear to have been fully estimated, a 2002 review of the *National Road Transport Commission Act 1991* (Cth) estimated the net productivity benefits from reforms between 1991 and 2003 to be approximately \$400 million. Qualitative benefits have been evidenced in the creation of national policies and laws for:

- *improved safety*: including national road rules, national standards for all vehicles in operation, a national driver licensing scheme, improved bus safety standards, a national policy to combat speeding trucks and buses and consistent driving hours laws, “chain of responsibility” laws to ensure that those in the transport chain who have control over certain tasks are liable where their actions result in an offence, reforms to the safe and efficient transport of dangerous goods and medical standards for commercial vehicle drivers. Nationally, since 1991, there has been a reduction in

¹¹ The National Road Transport Commission was replaced by the National Transport Commission in 2003

the fatal accident rate involving heavy vehicles. In 2002, Australia ranked in the top ten of OECD members for road safety performance¹²;

- *improved transport efficiency*: including a uniform towing limit for light vehicles, a national vehicle registration scheme, uniform heavy vehicle weight limits and registration charges that reflect the costs of road maintenance; and
- *reduced environmental impact*: including tighter vehicle emission standards and new, cleaner fuel standards with lower sulphur content.

The NRTC has noted the broader, unquantified benefits promoted by such outcomes, as nearly all products are transported by road at some stage in its production (savings in transport costs are passed down to consumers and also boost the competitiveness of industries). The objective of minimising the environmental impacts of vehicles also promotes and supports other policy objectives, such as greater use of alternative modes of transport, reduction of congestion and pollution in city centres and better management of related health and amenity issues¹³.

The initial road transport reform agenda begun by governments in 1991 has been largely completed. The Australian Transport Council has adopted a further National Heavy Vehicle Safety Strategy to 2010 to improve driver safety and speed management, achieve safer vehicles and roads and to build a culture of safety in the road transport industry. The agenda for reform has also recently been expanded to cover regulatory and operational reform of rail and inter-modal transport operations, in addition to road transport¹⁴.

1.4 Third party access to significant infrastructure facilities

NCP access provisions facilitate access to infrastructure by third parties where it would be too costly for that third party to construct another facility and access will promote competition and economic growth. Access regimes have generally been successful in increasing competition in both downstream and upstream markets, resulting in reduced prices to consumers. New South Wales examples include:

- *rail*: prior to the introduction of the NSW Rail Access Regime, the Hunter Valley Rail network enjoyed around \$80 million in monopoly rents annually (in 2002-03 dollars). The implementation of the new access regime, together with strong labour productivity for FreightCorp (a then government-owned business) removed these rents and delivered an average real price reduction of 44 per cent to freight rail customers between July 1995 and June 2001;
- *gas*: the primary benefit of the Gas Access Regime is that it has facilitated the introduction of retail competition. Prior to the introduction of the Regime, the New South Wales gas sector was dominated by three regional monopoly retailers. The number of suppliers in NSW is now 14. Although the transition to a fully competitive environment is still occurring, the introduction of full retail competition in gas has allowed customers more choice and the ability to shop around for the best deals. In

¹² Affleck Consulting Pty Ltd and Meyrick & Associated Pty Ltd *Review of National Road Transport Commission Act 1991*, Review Report July 2002

¹³ National Road Transport Commission *Submission to the 2nd Review of the National Road Transport Commission*, 2002

¹⁴ The national approach to reform of road, rail and intermodal transport was established by National Transport Commission Inter-governmental Agreement, October 2003

addition, a significant upstream benefit for New South Wales has been the diversification of supply sources. In 1996, the Cooper Basin, via the Moomba pipeline, supplied around 98% of NSW gas consumption. With the addition of the Eastern Gas Pipeline, the Cooper Basin now provides around 75 percent of New South Wales gas consumption. This increase in competition has increased security of supply and put downward pressure input costs for business and prices for consumers.

The NSW Government has previously provided detailed comments to the Productivity Commission on the need to improve the operation of the National Access Regime¹⁵.

Significant issues from New South Wales' perspective include the need for access to promote long run efficiency – that is, not simply the promotion of competition in itself but the efficient use of facilities as well as efficient levels of ongoing investment by ensuring a reasonable return on assets. The National Competition Council (NCC), when recommending the declaration of a service, should be satisfied that access to the service will promote a *substantial* increase in competition, which will also promote investment in infrastructure. In addition, the certification of the NSW Rail Access Regime (RAR) exposed serious deficiencies in the certification process, including the length of time taken to consider certifications and seemingly unstructured manner in which applications are considered. In the RAR case, negotiation of access took 2 ½ years, negotiations were delayed by the raising of objections by the assessor throughout the process and certification was eventually granted for only 13 months. This was a completely unsatisfactory outcome given the time and resources that went into the application.

1.5 Legislation review and reform

New South Wales listed 205 pieces of legislation for review and, if appropriate, reform¹⁶. The guiding principle of legislation reviews is that legislation should not restrict competition unless it can be demonstrated that the benefits to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition. This principle reflects the underlying rationale of NCP – that competitive markets generally provide the most effective means of enhancing community welfare (by increasing productivity, which supports higher economic growth and employment).

Since 1995-96, New South Wales has completed the review and reform of around 176 pieces of legislation (86 percent of the nominated stock). By the end of June 2004, it is anticipated that over 90 percent of legislation reviews will be completed. Remaining incomplete reviews are comparatively minor and include those that have been delayed due to national or inter-jurisdictional processes.

The reforms undertaken under the auspices of NCP have been extensive and diverse, ranging from the removal of restrictions on times for the baking and delivery of bread to the development of nationally consistent legislation governing the legal profession (these and other examples are outlined in Box 1 overleaf).

¹⁵ Submissions to the Productivity Commission Review of National Access Regime dated 2 February 2001 and 19 July 2001.

¹⁶ The original *NSW Government Policy Statement on Legislation Review* (June 1996) listed 192 pieces of legislation. This list was expanded in ensuing years.

Box 1: Legislation Review – examples of review and reform undertaken under clause 5(3) of the Competition Principles Agreement

- Bakeries are no longer regulated by the *Bread Act 1969*. The NCP Review of the Act concluded that there was no net public benefit to restricting times for the baking and delivery of bread. The Act was repealed;
- the requirement to be licensed for certain activities and professions and conditions attached to the holding of licences have been reviewed in line with the risks that those activities and professions pose. Reviews have resulted in the abolition of licensing for employment agents, replacement of the hairdressers' licensing system with a requirement that those who practice hairdressing for a fee must be suitably qualified and the streamlining of licensing requirements for driving instructors. As a result, it is easier for people to enter into these occupations and transaction costs have been lowered for businesses;
- NCP legislation reviews have delivered greater consumer choice and opened up new business opportunities. One area where this has occurred is in professional services. For example:
 - the removal of the legal profession's monopoly on conveyancing services has increased choice of conveyancing service providers. Consumers now pay lower conveyancing fees – conveyancing fees in New South Wales fell by 17 per cent between 1994 and 1996;
 - people now have the option of obtaining certain foot treatments from nurses and medical practitioners, instead of exclusively from podiatrists following the NCP Review of the *Podiatrists Act 1989*;
 - the monopoly held by the veterinary profession over all acts of veterinary science was recently replaced with a specific list of veterinary practices that, on health, welfare and trade grounds need to be restricted to licensed practitioners. This arrangement will enable a wider range of animal health care services to be provided by both vets and non-vets;
- the legislation review and reform process has prompted timely and strategic reviews of agricultural marketing arrangements in industries undergoing significant environmental, technological and structural change, such as grains and winery grapes. The reviews of grain marketing and Murrumbidgee Irrigation Area wine grapes recommended the removal of historical vesting and monopoly marketing arrangements that were imposing a net cost on the community. However, the Government provided for the staging of reforms over a number of years and put in place transitional measures to minimise adjustment costs for the industries. The reform of marketing arrangements has also alerted primary producers to other remedies, for example authorisation of collective bargaining arrangements under the *Trade Practices Act 1974*;
- the NCP process has allowed the streamlining and/or repeal of overlapping legislation, thereby eliminating any associated confusion and duplication. For example, the consumer protection provisions in the *Fair Trading Act 1987* were amended to mirror those of the *Trade Practices Act 1974* (Cth);
- the NCP review requirements have resulted in moves towards best practice regulation. Examples include the replacement of the prescriptive *Construction Safety Act 1912* with the performance-based, risk-management approach of the *Occupational Health & Safety Regulation 2001* and the replacement of outdated food safety standards with nationally-consistent and scientifically-based standards in the *Food Act 2003*;

continued overleaf

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- the NCP review process has required review groups to examine the objectives of legislation and identify whether the same goals could be met under less restrictive legislation. This process has allowed the objectives and provisions of numerous pieces of legislation to be clarified and streamlined. Examples of Acts improved under this process include the *Medical Practice Act 1992*, *Nurses Act 2003* and *Wool, Hide and Skin Dealers Act 2003*.

The NSW Government has approached the task of legislation review and reform from the perspective that it must promote the Government's economic, social and environmental policy objectives by supporting a policy environment in which the costs and benefits of government regulation are subject to transparent assessment.

The legislation review program recognised that many of the restrictions on competition targeted under NCP were originally put in place without awareness of the wider effects of the restrictions on the community. A benefit of the program in New South Wales has been the ability to, in many cases, not only review restrictions on competition, but to find ways to achieve more effective regulation where there are clear benefits in government intervention in the market.

Legislation reviews have also imposed disciplines on law-making by requiring governments to be satisfied that any new restrictions on competition are necessary and in the public interest. Exposing public policy to this kind of transparency fosters the efficient and effective allocation of resources for the benefit of the community.

1.6 Assessment of the public interest

Clause 1(3) of the CPA provides a list of matters that may be taken into account where the Agreement requires parties to assess a particular policy or course of action. This list is applied in a number of key areas, including the review and, where necessary, reform of existing legislation that restricts competition; the introduction of new legislation that restricts competition; structural reform of public monopolies; and competitive neutrality arrangements for significant business activities of government.

The public interest test is broad enough to enable all relevant matters to be taken into account when a particular matter is assessed. This includes economic, social and environmental factors and the impacts on consumers, businesses and other parties. Moreover, clause 1(3) does not limit the range of matters that may be considered.

Clause 1(4) further acknowledges that the ACCC may authorise anti-competitive conduct that it deems to provide a net public benefit and clause 2 of the Conduct Code Agreement specifies circumstances in which governments may choose to exempt legislation from competition laws in the public interest.

The NSW Government's objective in undertaking reviews has been to achieve appropriate regulation, not deregulation per se. As such, 'restrictive practices' deemed to be in the public interest may have been enhanced or further developed under competition policy. For example:

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- NSW Health requires that pathology services for private in-patients in public hospitals be provided by public pathology laboratories. This long-standing policy gives public pathology laboratories exclusive access to private in-patients in public hospitals, although competition potentially exists for such services through private pathology service providers. The Australian Competition Tribunal has authorised NSW Health's policy under the Trade Practices Act 1974 (Cth) on the grounds that it generates significant public benefits in the form of efficiency gains and funding of education and research, as well as the pathology service more broadly;
 - the NSW Government has moved to strengthen regulatory restrictions on the number of, and conditions attaching to, licences for gaming machines in recent years. There are presently caps on both total gaming machine numbers and the number that individual venues may hold, limits on operating hours, restrictions on advertising and other harm minimisation measures. These restrictions recognise the significant health, family, financial and personal harms associated with problem gambling and the strong public interest in limiting the availability of gaming within the community; and
 - the corporatisation of Sydney Water Corporation has allowed for a framework in which the objectives of protecting the environment and protecting public health have been given equal importance to Sydney Water's commercial objectives. The separation of regulatory from commercial functions has enabled significantly strengthened government oversight over the quality of water provided for Sydney's metropolitan areas.

Distributional impacts of reforms

The Productivity Commission's Issues Paper noted that policy change arising out of competition-related reforms can, and has, involved winners and losers, benefits and costs. Concerns relating to distributional impacts have largely focussed on the impacts on rural and regional areas, with many country people attributing declines in population, services and incomes to NCP-related programs. These concerns relate to a number of areas, including:

- a perception that public interest tests give insufficient weight to social and environmental areas;
- impacts of reform on employment; and
- structural adjustment issues.

The Commission has previously noted that the perception of bias against rural sectors is not well founded. In its 1999 study on the impact of competition policy reforms the Commission estimated that all regions in New South Wales will experience an increase in output of between 1.7 and 4 per cent due to NCP¹⁷. Employment in the majority of regions in Australia is anticipated to either rise as a result of NCP or to decline marginally in the short term¹⁸.

¹⁷ Productivity Commission (1999), *Impact of Competition Policy Reforms on Rural and Regional Australia*, Report no. 8, AusInfo, Canberra.

¹⁸ Banks G *Competition and the Public Interest*, 12 July 2001

These results do not dismiss the fact that certain NCP reforms, such as structural reforms in rail services, may have resulted in adjustment costs for particular regions. However, analyses undertaken to date show that the main drivers of change affecting rural and regional areas have not been NCP-related. Also, the costs of reform may be outweighed by the overall benefits. The biggest beneficiaries of rail reform are anticipated to be in rural Australia, where the competitiveness of commodity producers has increased due to the reduction in costs of goods transported. Rail reforms have also resulted in significant price and productivity benefits to the Australian economy in general.

The Commission's report *Impact of Competition Policy Reforms on Rural and Regional Australia* found that:

- the main drivers of change have been long term forces largely beyond the control of governments, such as technological advances, a downward trend in world prices for agricultural commodities and changes in consumer preferences, which have contributed to the change in the composition and nature of Australia's economic and social activity;
- the forces driving change have had different regional effects across Australia; and
- competition policy reforms have been a lesser influence, but have brought net benefits to regional as well as urban Australia. Australians as a whole will benefit from NCP reforms¹⁹.

It is clear that some agricultural sectors would have undergone or would have been required to undergo structural change whether or not NCP reforms had taken place. In some cases, NCP has helped industries to cope with long term external pressures and to manage the transition to a more competitive environment. For example, competition reforms have helped rural industries by reducing major input costs such as energy, rail, transport and communications. NCP has also assisted in focussing attention on structural changes occurring in rural industries and to pro-actively manage the consequences of such changes. The chance to review and update legislation has provided the opportunity to implement measures to help industries to become more competitive and to minimise the costs of adjusting to the new environment. The staged removal of single desk marketing arrangements of the NSW Grains Board is an example of such an approach (Box 2).

Box 2: Case study - NSW Grains Board

The *Grain Marketing Act 1991* ("the Act") constitutes the NSW Grain Marketing Board ("the Board") and provides for the legal ownership of declared commodities to be transferred to ("vested in") the Board at the time the commodity comes into existence. The Act empowers the Board to operate as the sole authority for the marketing of declared commodities and also provides it with wide powers to do all things necessary for the purpose of improving the marketing of commodities in NSW.

Prior to 2000, the Act provided for the vesting of coarse grains (barley, grain sorghum and oats) and oilseeds (sunflower, canola, safflower, linseed and soybeans) produced in New South Wales in the Board. The Board operated a "single desk" for export sales of vested commodities and a single desk for domestic sales of malting barley.

continued overleaf

¹⁹ Ibid

The NCP review of the *Grain Marketing Act 1991* was completed in mid-1999. The main recommendations of the review were to deregulate grain marketing in New South Wales and privatise the marketing functions of the Board.

The Board was the successor to three previous commodity-specific boards (for oats, grain sorghum and oilseeds, respectively). The powers of the Board reflected historical circumstances in which grain farmers had limited marketing options, thus less market power in comparison to the purchasers of their produce at both the domestic and export levels; poor access to information on market conditions; and were in a weak position relative to the sophisticated overseas markets in which their commodities were sold. They also recognised that aggregating produce through statutory single desk arrangements could enable growers to gain export price premiums or access to restricted overseas markets such as Japan, providing significant economic benefits.

Over the last 10-15 years, the range of marketing options for grain commodities has expanded considerably. Farmers are generally able to choose between the cash market and a range of other alternatives, such as forward contracting and futures. Real-time information on market conditions and opportunities has also become readily available due to growth in market advice and access to information sources such as the internet.

The grain handling and marketing sector as a whole has also undergone significant change due to ongoing pressure to increase efficiency and competitiveness. The principal strategy for achieving these gains has been through seeking economies of scale. The last few years have been characterised by the consolidation of companies and vertical and geographic integration of marketing and grain handling activity. Examples of consolidation in the market include the launch of a joint marketing venture by Grainco and Cargill Australia Ltd, the merging of GrainCorp and VicGrain (which then later acquired Grainco), and the joining of ABB Grain Limited and Ausbulk into a single handling and marketing company.

At the time of the review of the *Grain Marketing Act*, it was apparent that grain farmers no longer needed the extent of regulatory protections that were in place. It was observed that, in the domestic market, vested commodities were part of an array of substitutable cropping activities at the farm level and that the domestic market for each of the commodities was well developed and contestable. There was evidence that maintaining a single export desk for certain commodities, however, might produce a net benefit through export premiums or market access. It was clear that the Board itself needed to expand its business substantially or risk becoming marginalised in the market place. It is arguable that, despite it having interests in non-vested grains (wheat and rice), the Board was only viable as a separate entity at the time due to the monopoly rights it held over the vested commodities. The Board itself had also recognised its eroding position in the market and worked on growth and privatisation plans since 1994.

The process of reviewing the Board's powers under NCP principles provided a timely opportunity to objectively evaluate the need for government intervention in the grains market. The outcome of the review was a decision by the NSW Government to staged repeal of the powers of the Board, with immediate deregulation of the majority of the domestic market, followed by staged deregulation of exports.

The timing of the release of the NCP review broadly coincided with the Board's financial collapse in 2000. Due to the circumstances of the collapse, the Government decided to vary its decision on the removal of restrictions. It immediately removed restrictions on the sales of all commodities other than domestic sales of malting barley and export sales of barley, canola and grain sorghum (allowing those deregulated commodities to be traded freely), and legislated to remove the remaining marketing restrictions by 30 September 2005. The Grains Board at this time will be wound up and dissolved. The staged deregulation allowed arrangements to be put in place to ensure that grain farmers were paid monies they were owed.

The collapse of the Board varied the timing of reforms, but not their aim. Following the collapse, the NSW Government appointed Queensland based Grainco Australia Ltd to act as the Board's agent. Grainco was subsequently acquired by GrainCorp in October 2003.

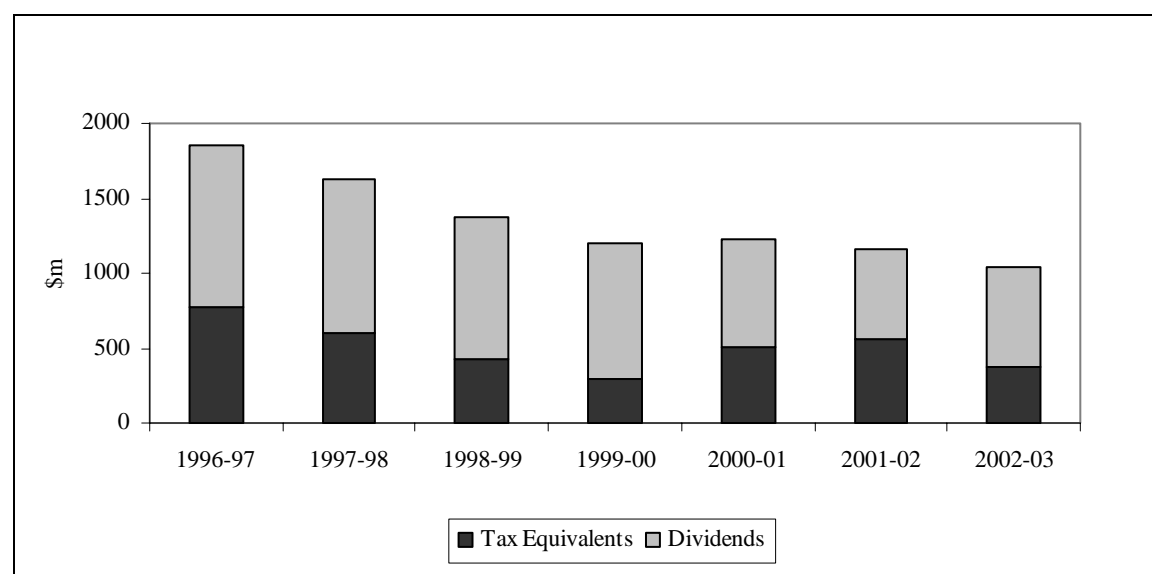
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It is relevant to note that, while GrainCorp's contract with the Board gives it guaranteed sole rights to the marketing of remaining commodities until September 2005, GrainCorp has recently expressed interest in further liberalising marketing arrangements by expanding the use of export permits and introducing permits for domestic sales of malting barley. The permits will allow third parties to participate in the sale of grains, which will generate downstream market competition as well as assist in an orderly transition to full deregulation in 2005.

At the time of the review, there were almost equally divided opposing views amongst farmers as to whether the Board should be maintained. Four years after the deregulation of the domestic market and with full deregulation imminent in September 2005, it is apparent that the industry has adjusted well to the new arrangements and that the NCP reform process has delivered desirable and timely reforms to grain marketing in New South Wales.

Reforms to public utilities in New South Wales provide an example of the weighing up of costs and benefits, and of the wide incidence and impacts of such costs and benefits. The principles of structural reform and independent prices oversight were anticipated to deliver significant benefits for consumers. However, they were also expected to reduce the financial returns from government businesses to the government. The real price reductions enjoyed by consumers came at a direct cost to government revenues (Figure 2).

Figure 2: Nominal Dollar Dividends and Tax Equivalent Receipts



Dividends and tax equivalents payable to the NSW Government decreased by 29 per cent and 35 per cent respectively over the period 1996-97 to 2002-03. The cumulative impact of these reduced returns is worth more than \$3.3 billion.

Ultimately, however, the reforms were pursued as the overall benefits to consumers and impacts on the long-term competitiveness of New South Wales industries were deemed to outweigh the overall costs.

In undertaking public interest assessments, it must be recognised that the costs of reform are often direct and concentrated while benefits are more widely dispersed (manifesting, for example, in reduced prices for consumers or lesser increases than would otherwise

have been, efficiency gains to government, and long term improvements in the dynamism and responsiveness of industries). Benefits may also flow through to the community through indirect means. For example, a rise in assets held by superannuation funds means that when ‘big business’ gains, these gains will flow through to the general community. In addition, the benefits of reforms may be ongoing and spread over a long term horizon while the costs may be more short-term or one-off.

Further, the wide incidence and forms of benefits makes it difficult to comprehensively measure the benefits and costs of direct NCP-related reforms. Specific reforms must be considered alongside the influence of other factors such as technological change and broader government policy initiatives. In addition, it must be recognised that ‘losers’ from one area of NCP reform may have received ‘wins’ from another area of reform.

Despite difficulties in measuring the impact of NCP, the total value of reforms needs to be taken into account in assessing whether the net outcomes have been positive or negative for sectors of the community, and the community as a whole. Many pro-competitive reforms have helped rural industries cope with external pressures by reducing the costs of major inputs such as energy, transport and communications. Lower costs of transport and communications are of particular importance for remote areas since the “tyranny of distance” imposes significant costs for businesses and individuals in such areas.

The improved competitiveness of businesses which supply small regional firms is likely to be of indirect benefit to country communities. Costs of adjustment, often short term, need to be weighed against benefits generated from other NCP-related reforms. Importantly, NCP will have enduring, economy-wide benefits on output, incomes and employment.

Distributional and adjustment implications

The NSW Government recognises that distributional and adjustment implications of competition-related reforms are important considerations in determining whether and how reform should be pursued.

Structural adjustment assistance packages have long been used by governments, when appropriate, to help individuals and communities adjust to large-scale changes.

For example, the Commonwealth Government has provided targeted adjustment assistance to the forestry industry; the dairy industry; sugar growers and groundwater users. It also provides assistance to farmers dealing with ongoing adjustment in the agriculture industry²⁰.

The NSW Government has also provided a range of structural adjustment assistance programs. This includes assistance for the Hunter and Illawarra regions; funding for the Regional Economic Transition Scheme (a general program for assisting regions and towns suffering from economic shocks); the Meat Processing Industry Restructuring Program; the Forestry Industry Structural Adjustment Package; assistance to dairy farmers and communities following the deregulation of the dairy industry; and assistance to groundwater users in the Namoi.

²⁰ The key elements of this assistance are the Farm Management Deposit scheme, Exceptional Circumstances assistance and a number of specific measures to provide incentives for ongoing farm adjustment and ensure that farmers have access to an adequate welfare safety net.

Example 1: Assistance for the sugar industry

In April 2004, the Commonwealth Government announced up to \$444.4 million of assistance for the Australian sugar industry under its Sugar Industry Reform Programme 2004. The assistance is aimed at helping the industry through a period of transition, rationalisation and diversification. A major component of the assistance package is a one-off “sustainability grant” to the Queensland, NSW and Western Australian sugar industries, worth \$146 million. This grant is being divided amongst the States according to their proportion of total raw sugar production, equating to around \$7.8 million for NSW, or 5.3 percent. Other assistance includes income support, funding to help farmers and mill businesses undertake business planning, re-establishment grants for those who wish to exit the industry and restructuring grants to assist those who stay. In putting together the reform and assistance package, the Commonwealth Government recognised the difficulties caused by a corrupt world market. This package follows previous assistance for the sugar industry, including \$120 million announced in 2002 to facilitate reform and provide welfare support for farmers in need.

Example 2: Assistance for the dairy industry

Following the deregulation of the dairy industry, the Commonwealth Government provided structural adjustment payments to eligible dairy farmers under the ‘Dairy Structural Adjustment Program’; tax-free payments of up to \$45,000 for dairy farmers choosing to exit agriculture under the ‘Dairy Exit Program’; and community assistance under the ‘Dairy Regional Assistance Program’.

The NSW Government’s ‘Dairy Do It’ program was also introduced to help individuals and families adjust to dairy deregulation. The program provided guidance on how to access the dairy industry structural adjustment fund; support to dairy families; and help for dairy farmers wishing to review and improve their management practices.

Example 3: Assistance for groundwater users

The NSW Government is providing \$18 million to a Groundwater Structural Adjustment Program to help groundwater users in the Namoi improve water use efficiency. Water users whose water entitlement under the *Water Sharing Plan for the Upper and Lower Namoi Groundwater Sources* is below their calculated history of use are entitled to financial assistance. The NSW Government has also allocated \$2 million to fund community infrastructure projects in the local area.

The Commonwealth Government has provided structural adjustment assistance of up to \$20 million to assist overall regional adjustment in the Namoi; to protect and expand existing enterprises linked to the natural resource base; and to build new capacities that will allow the region to participate in overall national growth. The State and Commonwealth Namoi assistance programs acknowledge the vulnerability of the Namoi region to additional shocks, given a trend of poor commodity prices in the 1990s and serious droughts conditions in both the mid 1990s and 2002-03.

Rather than ‘compensation’ for NCP-driven reforms per se, the provision of financial assistance has generally recognised the cumulative impact on individuals and communities of major changes affecting the viability of industries, including global commodity prices, droughts and increased awareness of environmental issues. Just as the benefits of reforms are felt at both local and national levels, the costs of such structural changes also impact both the specific industry and national growth. In this context, NCP reviews have assisted in providing information for both State and Commonwealth governments in considering whether, and what type, of transitional assistance might be required. The National Competition Council has acknowledged that adjustment assistance is a matter for each jurisdiction to decide.

1.7 Competition payments

Under the NCP Agreements, State and Territory Governments have been responsible for implementing many of the key competition reforms. State and Territory reforms have contributed to a significant and permanent increase in Commonwealth Government revenues by reducing costs for businesses, stimulating production and thereby increasing income tax receipts. At the same time, they have lowered State and Territory government revenues by exposing their government businesses to competition (see section 1.6 above).

COAG agreed in 1995 that all Governments should share the benefits to economic growth and revenue from NCP reforms. Competition payments return to the States and Territories a share of the Commonwealth's ongoing revenue benefits from NCP. NCP payments also play a practical role in giving a financial incentive for States and Territories to complete reforms in a timely manner. These monies are paid into government consolidated revenue and are re-distributed through State budgets for the general welfare of the community.

With the exception of financial year 2003-04, New South Wales has received its full NCP payment entitlement every year since the commencement of payments. In 2003-04, the Commonwealth Government, on the recommendation of the National Competition Council, deducted \$25.4 million and suspended a further \$25.4 million from New South Wales' competition payments because it deemed New South Wales not to have completed certain legislation review and reform activity by June 2003. The total penalty is worth 20 percent (\$50.8 million) of New South Wales' total competition payment entitlement.

New South Wales has implemented the vast majority of reforms required under the 1995 NCP Agreements, including all the important reforms – in electricity, gas, water and road transport – as well as the majority of legislation review and reform activity. These reforms have resulted in significant growth in GDP and household incomes. New South Wales is of the firm view that the few remaining incomplete matters under the legislation review program did not warrant, either due to the relative importance of the restrictions in terms of their impact on the economy or how the impacts of those restrictions manifest in the community, the imposition of the severe financial penalties that were recommended by the National Competition Council.

It is noted that while the National Competition Council assessed New South Wales to have completed reform of 73 percent of its legislation review as at June 2003, this was higher than the average of all jurisdictions. The Commonwealth Government only completed 51 percent of its legislation reform.

The imposition of competition payment penalties is entirely within the discretion of the Commonwealth Government. The imposition of such severe penalties was clearly contrary to the Council of Australian Governments' (COAG) intent in establishing the competition payments framework. COAG directed the National Competition Council, when assessing the nature and quantum of any financial penalty or suspension, to take into account the extent of the relevant State or Territory's overall commitment to the implementation of NCP, the effect of that State or Territory's reform efforts on other jurisdictions and the impact of the failure to undertake a particular reform. Given New South Wales' leadership in, and demonstrated commitment to, completing NCP reforms, a penalty of 20 percent of New South Wales' competition payments in 2003-04 for a handful of comparatively minor matters was excessive and inappropriate. The Commonwealth Government did not respond to New South Wales' petitions to it for a review of the decision on competition penalties.

The Productivity Commission's review is to inform COAG's own review of NCP arrangements that is due by September 2005. New South Wales will use the opportunity provided by this review to ensure that the focus is on reform that delivers real value to the Australian community.

Competition payments beyond 2005-06

The Commonwealth's revenue gains from NCP reforms will continue in perpetuity. So too should the Commonwealth's obligation to share these gains with the States and Territories. This is consistent with the common understanding expressed by senior officials of all jurisdictions (including the Commonwealth) in 2000 when the NCP Agreements were last reviewed and noted by the 1999 Intergovernmental Agreement on Reform of Commonwealth-State Financial Relations.

If COAG agrees to a new reform program, there should be a review of the nature of costs and benefits that will arise from the reforms, who will bear the costs of the new reforms and who will benefit, how those costs and benefits will manifest in the community, and when they will arise. COAG's decision on the distribution of gains from new reforms should be a separate consideration to NCP payments for past reforms, which should continue irrespective of the decision taken on new reforms.

2 Opportunities for further reform

2.1 Outstanding NCP reforms and extending NCP

Completing the current NCP program

With the exception of the energy and water sectors, which are now subject to separate COAG-led agreements, New South Wales has completed all major structural reform obligations under the NCP Agreements:

- public monopolies have been systematically reformed to separate responsibility for industry regulation from commercial functions. All major businesses with monopoly characteristics are subject to independent price oversight by the Independent Pricing and Regulatory Tribunal. All NSW Government businesses operate within a comprehensive commercial policy framework;
- New South Wales continues to observe specific, on-going reform commitments established by the CPA, including: the application of competitive neutrality principles to significant government business activities; structural reform commitments in relation to the introduction of competition into a market previously supplied by a public monopoly; the establishment of a regulatory environment that promotes the systematic and transparent assessment of the costs and benefits of all proposed government regulations and periodic review of all legislation that restricts competition; and the application of NCP principles to the local government;
- New South Wales has completed all road transport reforms to help establish consistent road transport regulation across Australia;
- trade in gas has been liberalised;
- New South Wales continues to meet its obligations under the Conduct Code Agreement; and
- the vast majority of the legislation review and reform program has been completed. The NSW Government remains committed to completing review and, where appropriate, reform activity in the few remaining incomplete areas.

All States and Territories are nearing the completion of their obligations under the NCP Agreements. According to the NCC, around 30 percent of reviews across all jurisdictions were incomplete by the deadline of June 2003²¹. However, the remaining incomplete legislation review and reform items are relatively minor matters that will not generate significant productivity gains in the future. As such, they should not be the focus of future competition-related reforms.

Similarly, the ongoing reform commitments are now largely embedded in the majority of States' governance regimes. This includes processes for the periodic review of the stock of existing legislation as well as "gatekeeping" arrangements for new legislation. It is worth noting that, to some extent, governments will continue to uphold obligations for ongoing reform as governments of all persuasions strongly support ongoing sensible microeconomic change and proponents of economic efficiency will continue to promote improvements to the regulatory environment. The NCP agreements in their current form are no longer necessary to 'lock in' such policies.

New South Wales notes that the effectiveness of the NCP framework has been hampered by the lack of an accountability framework for the Commonwealth Government. While the States and Territories are subject to significant penalties if they do not undertake reforms in a timely manner, there are no similarly transparent incentives to perform by the Commonwealth. In its 2003 assessment of governments' progress in implementing NCP and related reforms, the NCC found the Commonwealth Government to "(have) set a poor example" for other Australian governments in legislation review and reform. The Commonwealth completed 51 percent of its legislation review activity in comparison to the national average of 69 percent. The Commonwealth also failed to address major reform areas including export marketing of wheat, broadcasting restrictions and competition in postal services.

The Commonwealth Government withheld competition payments from the States and Territories in 2003 due to non-completion of reforms. Despite its own lack of compliance with NCP, the Commonwealth retained competition dividends generated by State and Territory reforms. The effectiveness of the national approach to competition reform established under the NCP Agreements has been undermined by a lack of a corresponding commitment to the Agreements from the Commonwealth.

Extending reform in areas already part of the NCP framework

The major gains to be had from future competition-related reforms relate to the energy and water sectors, specifically the establishment of an efficient national electricity market and the implementation of a nationally-consistent and efficient and sustainable water management framework. The focus should therefore be progressing reforms in these sectors.

The water reform and NCP agreements have played an important role in promoting the removal of inappropriate barriers to competition in water management in NSW. The job, however, is now largely done. New South Wales is of the view that the "one size fits all" NCP framework is no longer appropriate for the water sector, given the significant developments that have occurred in the sector since the NCP agreements were signed in 1995. The new National Water Initiative (NWI) articulates broader objectives, such as promoting water recovery to restore the health of the rivers of the Murray Darling Basin.

²¹ Productivity Commission Review of National Competition Policy Arrangements Issues Paper, April 2004

The NWI should be managed and monitored through the Natural Resource Management Ministerial Council and COAG.

The “one size fits all” approach is similarly considered no longer appropriate to promote and monitor future reforms in energy. The NSW Government, as a participating jurisdiction on the Ministerial Council on Energy and the National Electricity Market Ministers’ Forum, has agreed to a second stage of energy market reforms. These reforms include the separation of energy market rule making and rule enforcement with the creation of an Australian Energy Market Commission and an Australian Energy Regulator; and approval to develop a national framework for the transfer of retail and distribution regulatory functions to the Australian Energy Regulator.

This work was commissioned, and is being monitored separately, by governments under COAG. The work program being completed by the Ministerial Councils goes beyond the NCP Agreements and represent an entirely new stage of energy market reform. There has been no agreement by COAG that these further energy market reforms will form part of National Competition Policy. New South Wales will continue to report directly to COAG on its progress with these further energy market reforms.

New South Wales acknowledges that it is desirable in-principle to have consistency across jurisdictions in areas of reform as a way of enforcing process. In the energy and water sectors, however, it is appropriate that future reform be driven by COAG. All governments clearly recognise the absolute necessity for reforms in these sectors to continue on a coordinated basis and the significant benefits to be gained from the reforms. The continuation of reform in energy and water under the leadership of COAG will not risk the chance of ‘backsliding’ or loss in the momentum for reform.

Competition-related reforms outside the current NCP

Beyond the obligation to comply with NCP Agreements, there has been a wider consideration of regulatory and economic efficiency and effectiveness. In undertaking NCP reforms, New South Wales has also considered issues incidental to the NCP framework. For example, legislation reviews have served as a vehicle for improvements in governance and policy, resulting in better overall frameworks for achievement of Government’s policy objectives. New South Wales has also separately implemented market-based initiatives to improve environmental outcomes, such as emissions trading where parties buy and sell permits or credits for emissions of certain pollutants, and the Hunter River salinity trading scheme, where dischargers of saline share and trade credits as a means to control the level of total saline discharge and protect the Hunter region’s waterways. These initiatives have not been hampered by being outside of NCP framework.

2.2 The role of the National Competition Council

A strength of the NCP agreements has been the establishment of a framework in which governments are made accountable for implementing reforms and an external body is made responsible for monitoring governments’ compliance with the framework, particularly with agreed review processes. The decision-making framework under NCP implicitly recognises that the weights to be assigned to various social, economic and environmental factors in determining the overall costs and benefits of reforms are ultimately for the judgement of the government of the day. Governments must, in turn,

ensure that public interest reasons given for a particular outcome are transparent and subject to public scrutiny.

Despite the underlying soundness of the framework, there are a number of serious concerns about how the external monitoring body, the National Competition Council (NCC), has approached its role in practice. In recent years, the NSW Government has been concerned that the NCC has sought to impose its own weights in policy factors, implying preferred policy outcomes. This has been evidenced in relation to, for example, water reform, where the NCC has engaged scientists to advise it on the optimal environmental outcomes in water. It is considered that the NCC should examine governments' compliance with the reform requirements established under the NCP Agreements and the processes specified under those Agreements rather than pre-empt public policy aims. The NCC is not elected and, unlike governments, not accountable to the public. The NCC should not be allowed to pre-empt or supplant the policy decisions of elected and accountable governments.

The NCC has also specified requirements in excess of that required under the NCP Agreements. For example, in relation to new legislation "gatekeeping" requirements, the NCC has requested jurisdictions comply with specific gatekeeping arrangements that it has established as its preferred model of compliance with the Competition Principles Agreement, but which is not required of governments by that Agreement.

In respect of remaining NCP obligations, it should be clear that it is the role of governments to be responsible for the relative weighting of matters in decisions regarding the extent of reform that should be taken in the public interest. It is essential that the NCC objectively adheres to its task of monitoring compliance with agreed commitments without expressing views on what it regards as the preferred public interest outcome.

As noted in section 1.7, the NSW Government also believes that the NCC's recommendations on competition payments for 2003-04 were unwarranted in light of the NSW Government's commitment to, and extensive achievements under, NCP. New South Wales will pursue its concerns about how the NCC has acquitted its role in the 2005 COAG review of NCP arrangements.

2.3 Reforms outside the NCP

As outlined previously in this submission, most of the major NCP reforms have now been completed. These reforms have largely achieved their objective of generating significant productivity gains and improving the dynamism and responsiveness of the national economy. The main remaining areas for reform - energy and water - should continue to operate under the direction of COAG.

A major policy issue that has not been addressed includes social policy reform, such as education and training, health, community services and housing. The need for reform is clear. Demographic change, primarily through the ageing of the Australian population, and technological change are putting unprecedented pressure on government services, particularly in the human services area. What people need from governments is becoming more complex and the pace of change is increasing. The social policy area is a priority for reform that would benefit from a nationally coordinated framework.

The need for cooperation and efficiency in government service provision is more pressing than ever. The Productivity Commission has predicted that the ageing of the Australian population will account for \$1.2 trillion in government-funded health spending over the next 50 years²². Preliminary analysis by NSW Treasury suggests that the ageing of the New South Wales population, together with non-demographic factors, will have a significant adverse impact on the New South Wales public finances over the coming forty years. These pressures will largely arise due to escalating costs rather than a deterioration of revenues.

While economy-wide productivity measures would assist in increasing output growth, such measures will not substantially lessen the emerging fiscal pressures for States and Territories. Higher productivity and greater efficiency in service delivery will assist in meeting increasing demands for services out of the current resource base.

It is clear that governments must act to achieve the most cost-effective and efficient government service delivery possible. One of the most crucial elements in progressing reform is recognition of the increasing complexity in, and interaction between, areas of Commonwealth and State responsibility. Ignoring these factors leads to inefficiencies, poor outcomes and frustration at both levels of government and in the community.

Major reforms in social policy are likely to require re-definition of areas of jurisdictional responsibility between the States and the Commonwealth. They will need a genuinely cooperative model in which States and Territories are partners with the Commonwealth in formulating and implementing policy directions. By contrast, the NCP Agreements were not truly “cooperative” in so far as reforms were able to be undertaken by each government at a domestic state level, albeit on a coordinated basis.

It is the role of the Commonwealth to facilitate change and consistency at the national level. States and Territories would also expect the Commonwealth, given its overwhelming share of national revenue (81.8 percent, an increase of 4.4 percent since 1998-99 despite the introduction and pass-on of GST to the States and Territories), to provide substantial investments in any systematic improvements. Reforms in social policy will therefore not succeed solely on the basis of coordinated effort by the States and Territories.

The ‘dividends’ from reforms in social policy are likely to be different, and any improvements in outcomes in these sectors may not necessarily be directly or solely manifested in productivity growth. Any processes for managing change and achieving gains in this area will similarly need to recognise that the rewards and incentives for undertaking reform will be different (gains might include, for example, cost savings rather than higher income and improved long term health outcomes that reduce pressure on public hospitals, Medicare and the Pharmaceutical Benefits Scheme).

As both the Commonwealth and the States and Territories share responsibility for major policy areas that are subject to increasing pressures, there is a greater need for partnership in formulating policy directions and clarity in the roles and responsibilities for service provision. It is important that implementation of reforms is jointly considered and planned.

²² Banks, G. 2004 *An ageing Australia: small beer or big bucks?*, presentation to the South Australian Centre for Economic Studies, Economic Briefing, 29 April 2004, <http://www.pc.gov.au/speeches/cs20040429/index.html>