

## ***Review of National Competition Policy Reforms: A Commentary***

### **Overview of CPDS Comments and Suggestions**

The Productivity Commission's (PC's) draft discussion paper on National Competition Policy (NCP) reforms is a reasonable proposal within the bounds of its assumptions. It certainly is important to tidy up the loose ends of NCP and also to find better ways to reconcile market mechanisms with government involvement in areas such as health care and natural resource management.

However there are other more important issues that need attention to continue the process of plugging the gaps in Australia's market liberalization reforms which NCP started. This is because the basic philosophy of market liberalization reforms has been unbalanced, ie emphasis has been given to competition but not to the capabilities require to compete, and to quantitative gains (eg in GDP) rather than to qualitative factors such as equity and the effectiveness of governments.

There are four key issues that should now be the centre a national reform agenda, namely:

- ensuring more realistic understanding (by business, community leaders and governments) of the global environment as the essential foundation for planning economic reform;
- boosting competitiveness (ie the ability of individuals, enterprises and regions to compete successfully) which competition alone does not ensure;
- identifying models whereby enterprises can be both competitive and also promote social equity;
- increasing governments' ability to govern effectively, including in particular ensuring their ability to manage infrastructure development.

The basis for these suggestions is that:

- there are reasonable grounds to doubt:
  - the adequacy of market liberalization reforms (including NCP) in raising enterprise competitiveness and economic productivity; and
  - the reality and sustainability of the major improvement in Australia's productivity and economic dynamism which is seen to have arisen from those reforms;
- social inequality has been increasing (eg because new organizational methods have reduced the role of middle management (and thus squeezed the middle class), and stronger competition has reduced the remuneration attainable by those who suffer various disadvantages);
- there have been adverse side effects from the ill-advised policies for public sector reform which complemented the simplistic view taken of economic reform including: a serious decline in administrative competencies and thus in

the ability of governments to govern; and increasingly unworkable machinery for managing infrastructure;

- the global background to the introduction of market liberalization policies two decades ago was more complex than was considered in developing Australia's policy response. Moreover that environment now poses questions which the PC's discussion draft has not touched upon - and which do not seem to be realistically evaluated as the basis for advice to community leaders.

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## **Introduction**

This document presents comments and suggestions in relation to the Productivity Commission's (PC's) draft discussion paper on National Competition Policy (NCP) reforms which is outlined below.

The PC had been asked by the Commonwealth Treasurer to report on NCP reforms because of a decision by the Council of Australian Governments (CoAG) to undertake such a review by 2005.

In brief the thrust of the PC's discussion paper is that:

- NCP has complemented other market liberalization reforms over the past two decades;
- those reforms were introduced as a result of Australia long term decline in international economic rankings;
- NCP has produced useful gains (especially in infrastructure), though the process has not been without difficulties;
- Australia has enjoyed significant economic benefits from market liberalization reforms;
- in spite of two decades of reform, new challenges exist which require further efforts;
- a new nationally-coordinated reform agenda incorporating competition policy principles should be undertaken to:
  - complete and reinforce the past NCP agenda by: overcoming various infrastructure problems; completing legislative reviews; and improving the way NCP impacts on various major areas of the economy; and
  - address two major new goals (ie health care and natural resource management);
- other significant reform agendas exist - but should be addressed in other ways.

## **A Good Structure Built on Weak Foundations**

Within the bounds of its assumptions, the PC's discussion paper is a broad ranging stocktake of issues related to Australia's economic reform which reaches sensible conclusions. It is an undoubted fact that:

- there are issues related to the NCP agenda which remain to be tidied up - and the discussion paper's view of these seems reasonable;
- in the case of both health care and natural resource management, there is a complex and costly relationship between market and government action and this might be significantly rationalized by analysis and coordinated management of reform; and
- there are many other economic reform issues - and other forums for dealing with them.

However, while much has been achieved through market liberalization (including NCP), much has been lost unnecessarily.

The original purpose of NCP was to 'plug the gaps' in the market liberalization reforms which Australia had adopted in the 1980s (eg reduced barriers to trade, financial deregulation). Unfortunately there are huge gaps which currently need to be plugged which are even more important than those suggested in the PC's draft discussion paper.

For example NCP has emphasized the development of productivity by changes to government operations. Though the latter are the easiest part of the economy for the political system to influence, they are also the ones where it is hardest to get productivity gains and where the side effects of seeking to do so are likely to be most severe. It has not been sensible to do this without doing everything possible to increase productivity in the mainstream market economy where the potential for such gains is greatest.

### **The Adequacy of Market Liberalization**

The basic philosophy of market liberalization reform (including NCP) is flawed because introducing competition does not in itself ensure that the capabilities to successfully compete will exist or be created. This limitation is discussed in *Defects in Economic Tactics, Strategy and Outcomes* which particularly highlights:

- the importance of systemic factors (eg support from an effective regional industry cluster) which must be in place if individuals / enterprises are to be successful but which the latter can do virtually nothing about if those supports do not exist;
- the critical role which knowledge plays in enterprise competitiveness and productivity, and potentially plays in leading the development of effective regional industry clusters.

The importance of systemic factors can be illustrated in relation to innovation. The PC's discussion paper correctly notes that competition provides the incentive for firms to innovate. But unfortunately competition is not sufficient to ensure their ability to do so, as success requires support from an effective innovation system (including, for example, financial institutions with appropriate skills, and a pool of persons with

experience in business development). In practice, despite massive competitive incentives for business to innovate, Australia innovation ranking has been in rapid decline (eg see Hart M., 'Our R&D left in the lurch', *Courier Mail*, 6/12/03).

The effect of market liberalization (including NCP) is thus to stimulate enterprises and individuals to seek to maximize their productivity as best they can within what may be an unsatisfactory environment - the overall effect of which must be:

- national economic underperformance compared with what should be possible; and
- increased inequality - especially between:
  - regions on the basis of the level of development of their economic systems; and
  - individuals / enterprises on the basis of their knowledge (which in turn boosts inequality based on factors which influence individuals' ability to acquire knowledge including socio-economic backgrounds, cultural assumptions and geographic location).

There is also considerable doubt about what has actually been achieved by market liberalization (see *Debating the Impact of Economic Liberalization in Australia*). The latter document:

- outlines the debate that has been occurring;
- mentions the PC's apparently valid and important conclusion about the reversal during the 1990s of Australia's long term decline in per-capita incomes by international standards;
- highlights various indicators of substandard performance including: diversification mainly into strategically-difficult capital intensive production; rapid decline in Australia's innovation ranking; under-employment due to poor quality job creation; and recent export stagnation; and
- concludes that because of the complexity of the issues involved it is difficult to be sure what has been achieved. In particular it notes the apparent failure of analysts to consider the effect on 'productivity' measures of substantial devaluation (and subsequent revaluation) of the \$A. Devaluation seems likely to have had a 'free lunch' effect for several years on the measured productivity of Australia's large commodity export industries.

It is also necessary to recognize that (as has in part been the foundation of a long boom in the US also) Australia's long period of growth has also been associated with:

- significant devaluation in Australia's case during the period when the 'productivity miracle' was strongest - and a productivity slowdown and export stagnation when devaluation was reversed;
- ongoing reduction of interest rates and significant expansion of credit (much of it imported in Australia's case) which escalated asset values as the foundation for high rates of economic growth based on consumer spending;

- cheap Asian imports to keep inflation under control despite the monetary expansion; and
- a high current account deficit - and rapidly accumulating foreign obligations.

There are reasons (related to a deflationary demand deficit which is implicit in the export-driven strategies that many producer-focused economies adopt) to suspect that current patterns of global growth can not be maintained (see *Structural Incompatibility puts Global Growth at Risk*).

In order to create a more supportive environment for individuals and enterprises in the face of intense competition there is a need to seek methods for economic development which are more likely to make a constructive difference than traditional practices have done. The types of issues involved (and alternative options) are suggested in:

- *The Economic Futility of Backing Australia's Ability 2* - which argues that traditional policies are stimulating only a 'toy' innovation capability and provide benefits in response to effective political lobbying rather than for proficiency in meeting market demand; and
- *About Queensland's Economic Strategy* - which highlights: deficiencies in typical traditional practices; the rapidly-growing pressures for better performance; and suggestions on how this might be achieved

## **Social Equity**

Not all have prospered in the more competitive environment which market liberalization policies have created.

Relative poverty has become a significant and self-perpetuating problem facing many individuals and families due to the limited availability of quality jobs as well as personal disadvantages (see *Minimizing Poverty*). This phenomenon, which threatens to perpetuate through the generations and create an underclass, seems to have been a consequence of the reduced protection of those suffering disadvantage which was needed for a more dynamic economy. The welfare costs of compensating those who have not prospered have become increasingly significant.

Inequality has been exacerbated by the shift from the hierarchical management models of the 'industrial' economy to the network management style of a 'post-industrial' economy - a trend which has reduced the role of middle management and contributed to a significant decline in the numbers of middle income earners - who traditionally have had an important role in ensuring social / political stability and in promoting social mobility.

Furthermore more flexible industrial relations systems have emerged (including enterprise rather than industry-wide bargaining and the growth of employment based on individual contracts) because productivity depends increasingly on firm's ability to respond to fast changing market and technological trends. This trend appears to have reduced the bargaining power of employees relative to employers, and thus to be a factor in increasing social inequality.

There seems to be a need for systematic efforts to identify a variety of practical business models which would:

- be commercially viable while giving better prospects to those suffering relative disadvantage;
- ensure both enterprise flexibility and the equitable sharing of business income;

### **Neglected Side Effects**

One side effect of the assumption that liberal market reform would be a sufficient basis for creating strong economic capabilities was the adoption of various forms of a 'new public management' approach to government. This has involved the assumption that governments' primary contributions should be: low taxes; and efficient infrastructure. It has come to incorporate NCP principles.

Unfortunately 'new public management' has downgraded, and led to an erosion of, governments' primary function (ie 'governing'). The latter can simplistically be thought of as creating a framework for community social and economic activities by: creating a system of law and order; providing leadership; setting standards; addressing social and environmental goals; and representing and acting in the public interest.

The PC's discussion paper has correctly highlighted the fact that in dealing with human services there are many social objectives which cannot be dealt with by competition, and pointed out that these issues require attention so that a policy solution can be tailor made to suit each function.

Similar constraints apply in relation to government - ie its core 'governing' function primarily depends on qualitative factors (eg accumulated knowledge, wisdom) rather than on operational efficiency.

However, in contrast with discussion paper's current suggestion for human services, there was no serious effort in 'reforming' governments to cope with what was seen as the new economic environment to consider how those qualitative factors might be reconciled with the search for quantitative improvement that competition introduces. 'Reform' was mandated without taking account of the knowledge of those with long experience of government, and administrations were politicized to ensure that 'reform' could not be 'resisted'. The result has been a serious decline in the effectiveness of governance in Australia (see *The Decay of Australian Public Administration*).

*The Decay of Australian Public Administration* refers to: the adverse effect which: politicisation to force through idealistic reforms has had on the professional competence of Public Services; the necessary inadequacy of centralized strategic planning; and the loss of capabilities to deal with government's primary role which has resulted from emphasis on pseudo-commercial service delivery.

In introducing NCP too little consideration was given to the character of public goods and services. The latter typically had become public responsibility because they suffer market failures (eg being natural monopolies, having large externalities or social policy implication, or suffering 'free-rider' problems). The same factors which led to market failures usually lead to complexity when attempts are made to introduce competitive arrangements to the delivery of public goods and services. This in turn translates into either significant cost in managing the complexity (which offsets hoped-for increases in production efficiencies), or eventual systemic failure if the complexity is neglected.

This phenomenon is well illustrated by the problems which have arisen in infrastructure management - an area for which the PC's discussion paper argues that there is a need for further policy development. In practice the major requirement for improved infrastructure is arguably to overcome the administrative mish-mash which has resulted from poorly conceived public administration changes over the past 15 years - including those resulting from NCP (see *Defects in Infrastructure Planning and Delivery*).

*Defects in Infrastructure Planning and Delivery* refers only to Queensland's situation - though similar problems seem to have arisen in other jurisdictions. It identifies areas of concern such as: the loss of relevant professional competencies in the politicisation of public administration; the fragmentation of responsibilities and the loss of the vital ability to manage infrastructure networks as a whole; and the complexities introduced by requiring competition for functions that are subject to market failures

The *Failure in Queensland's Electricity Distribution Network* illustrates the resulting problems.

In addition to dealing with the above unforeseen side-effects of public sector reforms intended to suit a competitive environment, there is an increasingly urgent need for national coordination of a solution to the most chronic defect in Australia's system of government, namely the Federal / State fiscal imbalances which:

- have long made it almost impossible for states and territories to take real responsibility, or be held accountable, for their nominal functions;
- lead to overlap of functions and 'buck passing'; and
- do not provide financial incentives for states and territories to take economic development seriously - which in turn results in significant national economic underperformance.

## **The Global Context**

The PC's discussion paper implied that NCP was introduced purely as a result of Australia's long-term drift backwards in international economic rankings. However there were factors in the global context which also contributed to the adoption of market liberalization policies - specifically

- the growing challenge by newly industrializing countries (NICs - initially Japan) to manufacturing industry in more developed economies in the 1960s and 1970s led, in the 1970s, to de-industrialization in Europe and North America and to a massive need for structural adjustment;
- influential economists concluded around the end of the 1970s (mainly because of the adverse effects of government attempts to orchestrate economic change in Europe) that change could best be achieved through market liberalization;
- the productivity slowdown and stagflation of the 1970s (associated with oil shocks as well as with NIC competition) caused public expenditures (which continued to grow without responding to the productivity slowdown) to become a significantly greater percentage of GDP - and this triggered a push for smaller government by the so-called New Right who saw high public

spending as the cause, rather than the consequence, of the productivity slowdown.

Policy concepts derived from these trends and ideas were imported into Australia with inadequate consideration of any differences in circumstances. For example:

- market liberalization has quite different implications in a well developed economy (eg in the US where there are strong economic infrastructures) and in one where economic infrastructures are weak, eg as in Australia generally and in One-Nation-Land (ie marginal rural, metropolitan and coastal regions) in particular;
- the 'smaller government' agenda originated in countries which had a greater level of public economic intervention (eg involving nationalized industries) than Australia;

Moreover de-industrialization in developed economies 'shifted the goal posts' for high productivity economic success towards knowledge-based functions, a factor which was not specifically considered in devising Australia's economic reform agendas.

Likewise there are significant elements of Australia's economic environment now which do not seem to have been realistically evaluated as the foundation for developing a reform agenda. For example:

- significant changes are emerging in leading business strategies - such as global outsourcing;
- Australia needs to compete / collaborate with East Asia which involves a radically different conception of the nature of a society and economy (eg see *China's development: Assessing the implications*). Amongst the implications of these differences (which have been most studied in the case of Japan) is a quite different conception of the nature of competition policy - involving state mercantilist measures to boost the competitiveness of national firms rather than promoting competition to benefit citizens as consumers;
- there is an increasingly widely expressed view that the US (which is the lynchpin supporting the current Western style global order) could be significantly weakened by the financial imbalances that have developed as a consequence of the mercantilist approach to competition policy.

Economic reform in Australia (by business, community leaders and governments) needs to be founded on a realistic assessment of the implications of dozens of currently under-evaluated factors, rather than on the basis of a view which is idealized and simplified to suit favoured theories.

### **An Alternative Agenda**

It is concluded that issues that should be of high priority in a national reform agenda include:

- review of the global economic environment to realistically identify requirements for economic competitiveness and productivity so that business, community leaders and governments can plan reform on a sound foundation;



- seeking economic development strategies which are likely to successfully promote economic competitiveness and thus raise productivity;
- identification of various business models which are both commercially viable and likely to promote social equity; and
- development of more effective governance.

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[Click here for outline of PC's discussion paper](#)