Review of National Competition Policy Reforms

We wish to raise one fundamental but generally ignored question, one that we cannot answer but suggest ought to be investigated.

The neglect of increased transactions costs consequent upon many reforms.

Transactions costs are one of the central concerns of modern microeconomic theory. Along with agency issues, these are a cause of market failure and the replacement of market mechanisms by organization in the form of firms and bureaucracy. The NCP has had a focus on introducing market forces to situations where bureaucracy and imperfect markets have resulted in evident inefficiencies. In these cases the market has not been able to assert its superiority, and therefore, intervention by an authority to impose market forces is justified. This imposition is not, by definition, an example of 'order out of chaos', as the unfettered market might be imagined, but is a judgement by authority, made with the inevitably imperfect deposit of relevant knowledge and reliant on information flows that may not be as timely and complete as required by the theory.

An example of this imposed order is the application of the purchaser-provider model to delivery of services that have previously been provided 'in-house' by agencies. The aim of the model is transparency and accountability, laudable aims that have been seen as requiring remediation after decades of administrative provision of services. However, anecdotal evidence suggests that transactions costs are increased, as agencies are forced to undertake stylised and often complex administrative actions to implement the model. The net gains from the model are reduced. If the gross improvement from the model has shrunk as other NCP reform measures has transformed agency behaviour, it may be that continued adherence to the model will result in a net deficit to agency productivity.

This is exactly as Ronald Coase suggested back in 1937 (The Nature of the Firm, *Economica* 4: 386-405). That is, organizations emerge to avoid transactions costs. So when authority imposes market forms, in the face of organisational choice, we would expect costs to be increased. NCP believes that organizations are not always adequately disciplined into efficient behaviour, and that in these cases the gains from such market-like discipline will outweigh the transactions costs imposed. Forgive me if I labour the point.

We suggest that the question of the magnitude of transactions costs of NCP-imposed regimes requires investigation, and if evidence that the model is imposing unnecessary costs, alternative methods of disciplining agencies that are protected from direct competition should be investigated. One alternative currently in use is the performance related contract, where relevant benchmarks are used to validate agency and agencies' contractors' performance. The requirement to let contracts via open tender imposes transactions costs that can be partially avoided by intelligent benchmarking. Already, in some administrations, even where there is a contested market for services, purchasers can extend existing contracts without the expense of open tender, where there is transparent benchmarking and performance criteria to ensure that the contractor delivers good performance. Statutory imposition of tendering on small agencies is an inflexible and potentially expensive method of ensuring high levels of performance. The further down the line this imposition is extended, for example, to minor maintenance works for government capital assets in regional centres, the more likely it is that transactions costs will swallow productivity gains. The more minor the outsourced service, the more likely it is that transparent benchmarking and performance criteria will be easily available to the service utilising organisation. The choice of in-house as against outsourced services is, therefore, easily made without much of the cost of implementing the purchaser-provider model in full.

As far as we know, there has been no systematic investigation of the transactions costs of the purchaser-provider model. We have no way of knowing, apart from the many anecdotes, how significant this might be. It does seem likely, given those anecdotes about the administrative burdens of the application of the purchaser-provider model, anecdotes emanating from government agencies in all parts of our country, that fine tuning might be appropriate, if proper investigation showed that there were significant empirical generalisations to be made about the limits of applicability of the model.

We stress that while the public interest test is available for many aspects of competition policy, the very micro nature of the situations to which our question applies means that such a test is, itself, too expensive to apply, due to the transactions costs involved.

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