

Productivity Commission
Level 3 Nature Conservation House
Corner Emu Bank and Benjamin Way
Belconnen ACT 2617

17 December 2004

Re: Productivity Commission Review of National Competition Policy

The Australian Industry Group welcomes this opportunity to contribute to the Productivity Commission's review of National Competition Policy. Ai Group is Australia's largest employer organisation, representing companies across a wide range of industries, in both regional and metropolitan areas.

Ai Group is not surprised the Commission found initial co-ordinated reform of competition policy had delivered substantial economic benefits to Australia. However, Ai Group is increasingly concerned with evidence pointing to a weakening in Australia's recent strong productivity performance, with implications for international competitiveness and the current account deficit, potential GDP growth and the improvement in Australian household living standards.

Ai group firmly believes a new round of co-ordinated reforms and policy initiatives are needed to address these issues. To this end, Ai Group believes the Commission's review of competition policy and its identification of other areas in need of reform is extremely timely.

Ai Group endorses many of the proposals put forward by the Commission in the Discussion Draft. Moreover, Ai Group believes intergovernmental financial relationships and responsibilities are an area which meets the Commission's criteria for additional action, and which it hopes the Commission will nominate for government consideration.

Ai Group looks forward to contributing to the ongoing review and debate of these important areas of economic policy.

Yours faithfully,

Heather Ridout
Chief Executive



Productivity Commission Review of National Competition Policy Reforms

Australian Industry Group Submission on the Productivity Commission Discussion Draft

Since its inception in 1995, the National Competition Policy (NCP) has contributed significantly to the revival in Australian productivity growth, and subsequently to improvements in Australian GDP growth and household living standards. The apparent success of the NCP arguably has been even more notable given the inherent difficulties in establishing agreement and co-ordination across a large number of jurisdictions (and sometimes with conflicting interests). It is therefore quite appropriate for an independent review of NCP, including a stocktake of achievements; identification of those areas where reform has been slow or has produced outcomes of dubious quality; and to establish an agenda outlining future directions and priorities for co-ordinated reform.

The Case for Further Reform

Indeed, in Ai Group's view, such a review is extremely timely. It is against a backdrop in which major global exchange rate re-alignments are seriously impairing Australia's international competitiveness. In 2004, the average level of the Australian dollar trade-weighted index was the highest since 1985, and over 25% higher than as recently as 2001. This abrupt appreciation has added to the pressures imposed on many sectors from the rapid economic development of low-cost international competitors. In such an environment it is imperative Australia at least maintain the same rates of productivity growth enjoyed through the second half of the 1990s.

If anything, however, there is growing evidence further economic reforms are needed to sustain these earlier gains. Although far from conclusive at this point, recent data published by the Australian Bureau of Statistics (*Australian System of National Accounts, 5204.0, 2003-04*) suggests Australia's productivity performance may be flagging in the early part of this decade.

The data reveal annual growth in multi-factor productivity (MFP) averaged an impressive 2.0% in Australia's previous economic 'growth cycle' (identified by the ABS as the six years between 1993-94 and 1998-99). This compares with an average annual growth rate of 1.2% since 1964-65 (the series chosen here excludes labour quality adjustments in order to facilitate comparisons with longer-term data). As the Commission noted in its Draft Discussion paper,

Australia's MFP performance in this period was the strongest in over 30 years and was surpassed only by two other members of the OECD.

Although the ABS has yet to identify a peak in the subsequent (current) growth cycle, and while output growth has been impaired recently by serious drought, nonetheless in the ensuing five-year period average annual growth of MFP is estimated at just 1.0%. That is, the ABS estimates MFP growth thus far in the current growth cycle is about half the rate of growth recorded in the second half of the 1990s, and is also currently a little lower than the longer-term average.

The story is similar for labour productivity growth. Growth in output per hour worked has averaged just 2.3% since 1998-99, compared with 3.2% between 1993-94 and 1998-99 and a longer-term average of 2.4%. Growth in labour productivity also would have been lower in the current cycle but for the recent strength of business investment and an increase in the rate of capital deepening (or the capital-labour ratio), to an annual average increase of 2.9% from 2.8% in the previous growth cycle.

Indeed, despite the effects of the drought, productivity growth in the current cycle has been strongest in the agricultural sector. Moreover, labour productivity growth has actually contracted in one sector experiencing substantial structural reform in the previous decade (electricity, gas and water), while growth has also slowed markedly in the two other sectors reporting the strongest gains last cycle (wholesale trade and communication services). Together, these developments provide *prima facie* evidence of the need for ongoing reform to sustain strong rates of productivity growth.

Reform Criteria

Ai Group is not surprised the Commission found co-ordinated reform of Australian competition policy had delivered substantial economic benefits. While much of the original NCP program focused on deregulating infrastructure services, which through lower costs and more efficient delivery have been crucial in enhancing productivity in other sectors of the Australian economy, changes to the competition and regulatory 'architecture' also have provided gains.

In reviewing progress of the original NCP, and assessing scope for broader future reforms by way of removing impediments to efficiency and enhancing competition, Ai Group acknowledges the Productivity Commission has established three tests. Specifically, any reform must:

- provide substantial longer-term benefits to the Australian community;
- involve competition-related measures delivering a useful proportion of the total benefits;
- benefit from a nationally agreed framework overseen by CoAG or some other multi-jurisdictional body.

Completing the Current Agenda

Against this backdrop, Ai Group urges the Commission to include as a central recommendation the need to press ahead with areas of 'unfinished business' in the original NCP agenda. In particular, Ai Group endorses the high priority the Commission has attached to continuing reform of infrastructure services. Ai Group has consistently argued the need to strengthen Australia's key infrastructure sectors, including by means of increased capital investment, and which remains pivotal to enhancing Australia's international competitiveness.

As the Commission has noted, however, some jurisdictions are lagging on agreed commitments and some earlier reforms have failed to produce intended outcomes. Indeed, the Commission appears cognisant of claims the current approach emphasises the elimination of excessive rents and more efficient use of existing services, often at the expense of providing appropriate incentives for asset maintenance and new investment. Ai Group believes the further reforms of the water, energy, communications and passenger and freight transport sectors (either already mapped out by CoAG or enunciated by the Commission), and including proposed changes to the pricing regimes applying to regulated infrastructure services, will go a long way to alleviating many of these issues.

Ai Group also broadly agrees with the Commission's initiatives to address apparent shortcomings in the Legislative Review Program (LRP), and other aspects of the Australian regulatory architecture. Ai Group strongly supports any measures to reduce compliance costs on business. Recent research conducted by Ai Group ("*Compliance Costs Time and Money*", *Australian Industry Group, November 2004*) suggests Australian manufacturers are spending the equivalent of almost \$700 million each year (4% of pre-tax profits) complying with taxation, environmental and other government regulations.

Ai Group thus believes there is merit in governments examining potential complementarities between competition and consumer protection law. Ai Group also concurs with the Commission's stance towards State government restrictions on the provision of compulsory third party and workers' compensation insurance – that these impediments be reviewed as a matter of priority. There is good reason to believe additional competition among providers could substantially lower the insurance premiums paid by employers.

Within the context of an economy becoming ever more globally integrated (and which is likely to be hastened further as Australia enters into new bi-lateral trade agreements), Ai Group also strongly endorses the Commission's recommendation that the Commonwealth establish reviews of Australian anti-dumping and cabotage regimes. Ai Group notes the strong support in government for an Australia-China free trade agreement (and also for agreements with other South East Asian economies). In the event of such an agreement, and particularly should China be recognised as a market

economy, Ai Group believes there will be a need to further clarify Australia's anti-dumping rights and the situations in which they may be enforced. Ai group also urges the Commission to recommend that such a review include an examination of Australia's countervailing legislation.

With respect to Australia's current coastal shipping arrangements, Ai Group notes shipping comprises a substantial proportion of total costs for many Australian exporters, and that reductions in international freight rates could also help lower overall input costs for many local producers.

While also applauding the Commission's recommendation CoAG establish tighter monitoring, independence and transparency provisions in the future legislation review process, and measures to prevent government 'backsliding' on reforms already implemented, Ai Group seeks to ensure the 'systemic' thrust of the original NCP is not compromised by the Commission's recommendation of a modified or 'targeted' approach to reviews of anti-competitive legislation. Ai Group agrees with the Commission's proposal to recommend 'second round' round reviews where previous outcomes are judged to have been 'problematic'.

Broadening the Ambit of National Competition Policy

Looking beyond the existing NCP agenda, health care and natural resource management (other than water) have been identified as the two other major priorities that meet the Commission's reform criteria. With the ageing of the Australian population, Ai Group recognises the need for substantially more efficient delivery of health care services. In the absence of such reforms, the pressure on Commonwealth and State budgets is likely to become overwhelming, curtailing the ability of governments to meet other priorities or resulting in substantially higher levels of taxation. Ai Group endorses the Commission's proposal that CoAG implement an independent inquiry into Australia's health care system. Ai Group urges the Commission to recommend a terms of reference that allows an examination of Commonwealth/State health care funding arrangements, with a view to eliminating duplication, overlap in service provision, and other current anomalies.

With respect to other key human services potentially benefiting from competition-related reforms, Ai Group also urges the Commission to recommend more assertive action on employment, education and training. While Ai Group acknowledges many reforms have only recently been introduced, and require monitoring before assessing their success or otherwise, such is the extent of current skills shortages that it is not unreasonable to question whether these earlier reforms will prove adequate over the long-term. It is Ai Group's view that substantial benefits would be derived from reforming the apprenticeship system, and the funding and incentive arrangements applied to education and training.

Ai Group notes water resource management is already overseen by CoAG under the National Water Initiative. However, Ai Group agrees there is a need

for greater co-ordination in the management of externalities from the use of other natural resources, in particular greenhouse emissions. As a means of promoting policy certainty, Ai Group concurs with the Commission's proposal that CoAG initiate a review to examine in which areas a co-ordinated approach to management is needed as a matter of priority.

Further Extensions of the Reform Agenda

In Ai Group's view, the Commission was right also to nominate other potential reforms which could deliver substantial benefits to the Australian community, but which may not necessarily meet each of the Commission's remaining two tests (i.e. there appears to be only a relatively minor role for competition-related mechanisms or there is no obvious scope at present for multi-jurisdictional co-ordination).

There is little doubt further reform of the two relevant areas identified by the Commission – the labour market and taxation – could contribute significantly to improving Australia's potential economic performance. Indeed, in a survey undertaken by Ai Group earlier in 2004, in which manufacturers were asked to both nominate the most important issues facing their companies and to rank Commonwealth government policy priorities, 40% of manufacturers indicated the taxation burden remained an issue of critical importance. Taxation compliance and reporting requirements were rated as critical issue by a further 15%.

Labour market issues also featured highly among responses. While industrial disputation was rated critically important by only 10% of manufacturers, the availability of skilled employees was a critical issue for 40%, and non-wage labour costs (which partly reflect other areas of government policy) were cited by over one third. Taxation and skills shortages were the equal second most critical issues behind only international competitiveness. Moreover, the taxation system was nominated as one of the two most important government priorities by 35% of manufacturers, and workplace relations issues were cited by almost one in five.

An Opportunity to Review Broader Intergovernmental Financial Relationships

In Ai Group's view, however, there is merit in considering taxation reform, along with reform of government service delivery (including infrastructure, health and education and training) within an overall review of Australian intergovernmental financial relationships and responsibilities.

The persistent reliance of the States and Territories on inefficient taxes – such as the Stamp Duties listed in the 1999 Intergovernmental Agreement – is ultimately related to the taxing rights of the States and Territories; the exercise of these rights; and the interplay between the exploitation of certain tax bases and the allocation of Commonwealth funds through the Commonwealth Grants Commission.

In many respects the existing allocation of taxing rights, their use by the States and Territories and the correspondence between these and the efficient allocation of spending responsibilities, is something of the unmentioned gorilla in the corner of economic reform. Ai Group believes the area of intergovernmental financial relations and responsibilities for service provision should not be regarded as a “no-go zone”, but should be the subject of extensive debate and review.

In this context it is difficult to see how the proposed thorough review of health service provision can be conducted without having regard to the broader questions of intergovernmental financial relations and service provision responsibilities between the Commonwealth, the States and Territories and local government. A similar case can be made in respect of the Commission’s proposals in relation to more efficient provision of infrastructure services.

Indeed, by allowing a more ‘strategic’ review of all government services, and underscoring the need to shift Commonwealth/State government funding arrangements away from a ‘needs-based’ system towards one that is more review ‘efficiency-based’, a broader examination of intergovernmental relationships sits well with several the Commission’s review criteria.

Ai Group acknowledges CoAG may not be the most appropriate institution to oversee comprehensive reform of the labour market, taxation and inter-governmental financial relations and responsibilities. Nevertheless, given the potential benefits to the Australian community, Ai Group believes the Commission should recommend CoAG begin consideration of a medium-term approach to co-ordinated reform of these areas. Multi-jurisdictional agreement to a reform process would be an important step in securing broader public support.

To this end, Ai Group submits that these areas should be given priority by the Commission.

December 2004