

Review of NCP Reforms
Productivity Commission
PO Box 80
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Re: Review of National Competition Policy Reforms, Discussion Draft

CCI would like to take this opportunity to respond to a range of issues raised in the discussion draft Review of National Competition Policy Reforms.

CCI congratulates the Productivity Commission on a thorough report that provides a comprehensive summary of the achievements and shortcomings of National Competition Policy, and of the important areas of reform that are still outstanding. CCI stands by the comments it made in its original submission to this inquiry, while this response to the Discussion Draft focuses on those areas of outstanding reform identified in the report, along with some factors that might act as impediments to further reform.

Outstanding Reforms Under National Competition Policy

Western Australia has a longer list of reforms outstanding under National Competition Policy than any other state. Completing this reform agenda is in the interests of the state's residents (who have missed out on the benefits of reforms enjoyed in other jurisdictions), and of the State Government, which has lost millions of dollars in competition payments forgone as a result of its failure to implement agreed reforms.

NCP Payments

CCI is also concerned that the Commonwealth Government has indicated that competition payments will not persist beyond the period of the current National Competition Policy processes. Our concerns are both practical and in principle.

CCI's in-principle concerns are twofold. First, this is a breach of trust with the states, which understood that payments would be ongoing. Second, it is not consistent with the economic rationale for competition payments under National Competition Policy, which was based on returning to the States some of the increase in Commonwealth Government tax revenue arising as a result of the states' reforms. This increase in revenues arose from expansion of the Commonwealth's tax base because of stronger economic activity. As this expansion of revenues is permanent, the dividends returned to the states should be permanent too.

On a practical level, this decision has unfortunate and undesirable consequences.

Co-operative federalism has hardly flourished in Australia in recent years, in part because of ideological and artisan differences - that all state governments are Labor controlled, while the Coalition controls the Commonwealth Government. The states may be more suspicious of entering joint policy initiatives if they believe that the Commonwealth Government cannot be trusted to adhere to its promises and commitments. This could have serious implications for ongoing policy development, whether a new round of competition policy reforms, or the many other policy issues that cut across jurisdictional boundaries (see below). The Commonwealth Government's own poor record in implementing National Competition Policy reforms - worse even than Western Australia's - has also been unhelpful in this respect.

Further, it means that the key source of leverage for inducing the State Governments to complete their outstanding National Competition Policy commitments is lost.

This will have the most serious consequences in Western Australia, where there is a real possibility that a newly-elected government (a State election is expected in February, or possibly March, 2005) might move to implement outstanding elements of the National Competition Policy agenda.

The extent of further reforms in WA will depend on a range of sensitive and unpredictable political factors, including most obviously who wins the election, but also whether the new government has a majority in both houses of Parliament, or whether the Legislative Council (upper house) remains inclined to block pro-competitive legislation; and also on the outcome of a plebiscite on shopping hours to be conducted in conjunction with the election.

In this context, the diminished possibility of recovering forgone competition payments reduces the political incentive for the incoming government to re-attempt reform, and is likely to strengthen and encourage those interest groups that have successfully lobbied against key reforms so far.

Outstanding Reforms

CCI's submission to the Inquiry described its priorities for the key reform areas outstanding in Western Australia, and need not be detailed again here. The main areas of unfinished business are legislation review and structural reform. Western Australia's sub-standard record is documented by the National Competition Council's progress reports, which clearly highlight WA's dismal performance in progressing reform compared to the other states. This has not been entirely the WA Government's fault – in the case of the energy market, for example, key reforms were blocked by a hostile Parliamentary upper house – but many of the uncompleted legislation reviews reflect nothing more than a lack of political and bureaucratic will, as does the failure to implement deregulation of retail trading hours.

A key recent development in trading hours reform has been the Government's announcement of a plebiscite on trading hours to coincide with the upcoming state election. CCI has a number of concerns about this process:

- The decision to hold a plebiscite reflects a lack of leadership and decisiveness on behalf of the government, which should have followed the examples of the other states and removed anti-competitive regulations long ago.
- The questions to be asked are loaded, thanks to the intervention of minor parties holding the balance of power in the Legislative Council.
- Partly as a result, the linkage between the plebiscite's outcome and any subsequent change in regulations is not clear – the newly-elected Government could choose to interpret the outcomes in a variety of ways that may not reflect the electorate's intention.
- Total deregulation is not being offered as an option – only various partial forms of deregulation are being canvassed.
- CCI has reservations about whether this is a suitable question to be determined by plebiscite or referendum¹.

¹ These mechanisms are best suited for resolving fairly straightforward questions (typically with yes/no answers), where the range community sentiment about the issue is adequately captured in the question, with the view to determining a single set of simple rules common to the whole community (e.g. should aboriginal people have the vote, or should we adopt daylight saving).

In the case of WA's shopping hours plebiscite, the question to be posed is not straightforward, and the options canvassed do not comprehensively encompass the range of community views (those who want total deregulation and those who want all Sunday trading banned, for example, cannot express these preferences). Most importantly, the liberal critique of this legislation is that shopping hours are not an appropriate subject for regulation, even regulation with majority backing, but should be left to the choice of shop-keepers and shoppers.

- CCI also has reservations about whether such a plebiscite could, even in principle, constitute an acceptable proxy for a public benefit test under National Competition Policy. For the reason outlined above, this particular plebiscite could not perform that function. Nonetheless, the political reality is that any incoming government will feel bound to at least appear to act on the results of the poll.

Despite these reservations, CCI nonetheless welcomed the announcement because it offered the best chance of breaking the paralysis of political will induced by rent-seeking businesses opposed to the loss of their relative trading privileges; and also because, however loaded the questions, the WA community is at least to be asked its opinion on trading hours.

While Western Australia has by far the worst record of the states in implementing National Competition Policy reforms, the Commonwealth's record is arguably worse. It is imperative that the Commonwealth accelerate the implementation of its own competition reforms, both because of the economic benefits they will bring, and in order to restore its credibility in negotiating and often leading the complex cross-jurisdictional initiatives that comprise the next phase of the reform process in Australia.

A New Reform Framework

The outstanding items on the National Competition Policy reform agenda are a higher priority in WA than the other states because WA's list of outstanding issues is longer. However, the more important section of the Discussion Draft focuses on the future, especially on new areas in need of reform and the mechanisms by which those reforms might be introduced. CCI supports the approach taken by the Commission, of identifying areas where²:

- reform is likely to bring significant benefits for Australia as a whole;
- competition-related measures could usefully be a part of the package required to deliver those benefits; and
- as for NCP, there is likely to be a high return from using a nationally coordinated reform framework oversighted by CoAG or another national leadership body.

Key areas identified as in need of reform include health care, natural resource management, infrastructure provision, utilities operation, transport, human services, and industrial relations.

Two aspects of this future reform agenda are particularly important.

Firstly, the issues addressed are complex and diverse, with competition policy considerations being an important part of the reform needed, but not the whole of it.

Secondly, many of the reform issues cut across government jurisdictions, either because they are activities for which state governments have prime responsibility but a policy response affecting more than one state is required (such as water and electricity) or where there is an overlap or duplication of funding responsibilities, service delivery, and policy development between the Commonwealth and the states (such as industrial relations and health).

Looking forward, any reform process needs to be based on a framework which enables a consistent but comprehensive approach to policy matters to be applied, and also allows for effective policy development across jurisdictions. Such a framework must be capable of dealing with both these characteristics of the reform agenda. The following sections outline principles that might be incorporated into such a framework.

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A Framework for Multi-faceted Policy Development

Any framework for future reform should build on the key principles of National Competition Policy.

Fred Hilmer's 1993 Report³ on National Competition Policy did not initiate Australian competition policy – local, state and Commonwealth governments were already instituting pro-competitive reforms – but it did make a vital contribution to its evolution. Its key contributions were to propose a co-ordinated, systematic and uniform approach to competition policy across all government jurisdictions, and to recommend mechanisms designed to address the institutional and political factors that can lead governments and regulators to adopt anti-competitive measures that are not in the public interest. These principles are no less important to the future reform agenda than to the one initiated in 1993.

In particular, the Hilmer report proposed the establishment of clear principles guiding reform processes. On Hilmer's recommendation, competition policy was based on the principle that anti-competitive regulation and legislation should be permitted only when it can be demonstrated to be in the interest of the community, and cannot be achieved by other means. This public benefit principle and the presumption in favour of competition should be incorporated into any framework for review and evaluation of future reforms.

Other key principles and tools that CCI would like to see built into the evaluation of future reform programs include:

- **Cost-benefit analysis:** all policy proposals should be subject to consistent, systematic, transparent and rigorous appraisal of their expected economic, environmental and social returns against expected direct and external costs. Cost-benefit analysis is conceptually similar to the public benefit test of National Competition Policy, and should take into consideration social and environmental as well as economic and financial costs and benefits, where relevant. It is also consistent with some interpretations of sustainability assessment, although the latter is subject to a variety of interpretations, and so caution must be exercised in seeming to endorse it.
- **Opportunity cost:** investments and other public expenditures should be undertaken only if they deliver higher net returns to the community than alternative proposals competing for public funds. The real cost of any project or program is the benefit foregone by employing resources in that particular use rather than the most valuable alternative use. It is vital to establish priorities among competing projects and policy options.
These twin processes – of cost-benefit analysis and opportunity cost evaluation - should move some way to establishing a link between value and cost essential to ensuring that public policy actually benefits the community.
- **Inter-generational equity:** In some cases it may be appropriate to share the cost of some policies with generations if those future generations will benefit from them – for example, in the construction of long-lived assets such as railways and sewerage systems, or environmental improvements. However, increasing debt is only justifiable if the total value of the long-term asset base is increasing. There is no justification for borrowing to finance construction of, say, a school in Bunbury if it is replacing a school closed in Busselton.

Another feature of Hilmer's recommendations that should be incorporated into the framework for a future reform agenda is the establishment of 'arms-length' bodies to oversee, evaluate and advise on the general implementation of policy. Whether or not the National Competition Council is maintained and Australian Competition and Consumer Commission retains its

³ "National Competition Policy: Report By The Independent Committee of Inquiry" August 1993. Chaired by Professor Fred Hilmer, and commonly referred to as The Hilmer Report".

current functions, some equivalent institutions are necessary to provide an independent and objective critique of the reform agenda.

A Framework for Progressing Policy Across Jurisdictions

As well as the principles guiding and monitoring reform outlined above, any framework for reform needs to be designed to accommodate the political stresses of co-ordinating policy across jurisdictions, both horizontally between states, and vertically between the three tiers of government.

The Discussion Draft places heavy emphasis on the use of CoAG to achieve inter-jurisdictional co-ordination. Unfortunately, CoAG has a mixed record in this regard, and lacks the resources to conduct the detailed and exhaustive analysis necessary to develop good policy on complex, multi-faceted issues. In part, this is because CoAG's activities have tended to be issue-specific, reactive and pragmatic, and not always informed by an in-principle framework for analysing inter-jurisdictional issues and for aligning political incentives with desired outcomes. Perhaps an independent body to research, evaluate and critique cross-jurisdictional policy developments is necessary to supplement and critique the work of CoAG, analogous to the National Competition Council's arms-length role in evaluating and monitoring National Competition Policy.

Following the format outlined above, CCI advocates that policy development across jurisdictions should occur in a framework of principles that address inter-jurisdictional conflicts and rivalries. These principles should include:

- Subsidiarity, which requires that power should be exercised at the lowest level that produces efficient results;
- Competitive federalism, which emphasises the benefits of diversity, experimentation and a degree of rivalry between the States' policies and practices;
- Co-operative federalism, which identifies the benefits of a co-operative, consistent and co-ordinated policy approach on some issues, especially those which have effects beyond the jurisdiction of the government with authority to legislate on the issue, or where there are significant benefits from a unified approach;
- Financial adequacy, which requires that governments have secure access to the funds necessary to implement their programs, which in turn demands that the drawbacks of vertical fiscal imbalance be addressed; and
- Appropriate redistribution, which demands an appropriate means of distributing funds between jurisdictions, and requires a fresh look at the objectives and processes of both horizontal fiscal equalisation and the provision of tied grants from the Commonwealth to the States in particular.

Before moving to address the competition agenda set down in the Commission's draft report, the principles outlined above raise the issue of the appropriateness of intergovernmental arrangements in Australia. In recent years there has been a disturbing deterioration in these arrangements, especially between the Commonwealth and the States and Territories.

Principal features of this trend have included a large increase in vertical fiscal imbalance, and a significant increase in the conditions associated with tied grants or specific purpose payments. The size of both the fiscal imbalance and the tied grants are large compared with most issues faced in the competition reform agenda, and the consequences of both for the economically efficient management of the resources involved are highly problematic and the potential for productivity enhancement from reform considerable.

CCI believes these issues require attention urgently and should be an integral part of any CoAG agenda in the period ahead which addresses measures to enhance Australia's economic performance.

Addressing the Agenda

The general principles outlined above guide CCI's specific policy recommendations for the key areas outlined in the Discussion Draft.

Infrastructure

CCI agrees with the Commission's recommendations on infrastructure enhancement. CCI released a policy paper addressing both an analytical framework for the evaluation of infrastructure investment, and a policy agenda outlining key policy issues, in December 2003. This policy is attached as an addendum to this Response.

That noted, CCI is concerned that the recent public commentary around the adequacy of public infrastructure in Australia has lacked structure and focus. It is necessary for any assessment of the adequacy of infrastructure to be undertaken rigorously and that any commitment of resources to enhance infrastructure is undertaken on the basis of comprehensive cost benefit analysis.

Transport and Utilities

The efficient, reliable and cost-effective provision of essential services such as transport, water and energy is essential for both the community's well-being and the efficiency and competitiveness of business. Because parts of these industries or their infrastructure are natural monopolies, and because what they supply may be public goods or open access resources, Government has an important role in regulating – and in some cases, providing or financing - these activities to ensure efficient, sustainable service provision.

CCI supports an ongoing reform agenda for these sectors, overseen by independent regulation.

Although the natural monopoly status of some essential services infrastructure precludes efficient competition, government should try to foster competition in those markets and parts of markets where effective competition is possible. CCI endorses the Commission's recommendation that governments should complete outstanding NCP reviews.

Looking forward, it is vital that National Competition Policy principles are incorporated into any reform agenda. Regulation of essential services, when necessary, should be light-handed and consistent with established competition policy principles.

Further reform is necessary in the energy market – in particular, deregulation and disaggregation of the electricity sector. This is part of the Western Australian Government's unfinished competition policy agenda, but the Australian reform agenda also needs to better reflect the fact that WA and the other remote states are not part of the integrated eastern states market, and will be reluctant to accept any putative national regulation that in fact is designed only to cater for this partial market. So while CCI agrees with the Commission's recommendation that future energy reform should improve the efficiency of retail price and access regulation, with particular emphasis on achieving nationally consistent principles, it is important that those principle are genuinely national in application, and not focussed only on the east coast market.

In a similar vein, the WA Government refused to sign up to supposedly "national" water standards under the *National Water Initiative* when it became clear that it was designed mainly to address problems with highly stressed eastern states river systems. As WA's rivers do not suffer problems of the same severity or urgency, WA's government deemed it inappropriate to sign up to the measures proposed.

Under the principle of subsidiarity, the main responsibility for water and sewerage services should remain with the State governments, although nationally consistent reform principles

could be developed. In the longer term, governments should act to ensure that long term water needs are met, and move towards cost-based pricing of water services.

With these proviso in mind, there is a case for national co-ordination of some water policy issues. CCI endorses the Commission's call for the water reform process to give close attention to developing ways to achieve more effective management of environmental externalities, and to ensure that monitoring arrangements post-NCP provide a discipline on all governments to progress agreed water reforms.

Although states also have prime responsibility for many transport policy issues, there is a growing need for national co-ordination and consistency in developing transport infrastructure. There is also a need to ensure that state governments and industry have more meaningful input in future infrastructure planning, e.g. in Commonwealth initiatives such as AusLink.

CCI agrees with the Commission's view that there should be cross-governmental co-ordination and integration of the national freight system that is neutral across transport modes, and the priority of a national reform agenda for the rail sector.

As with other infrastructure, transport infrastructure that is government funded should be subject to stringent cost-benefit analysis before being granted approval. Transport infrastructure is particularly attractive to the advocates of grand, uneconomic, 'nation building' projects such as a fast rail links and the Adelaide-Darwin railway.

Applying subsidiarity and user-pays principles to these projects – that is, requiring their customers, or at least the state governments of their customers, pay for them – might also act to dampen extravagant proposals. Launceston residents might justifiably be asked to subsidise transport and energy infrastructure servicing Tasmania, but not Darwin.

Human services

Industrial Relations

As CCI argued in its original submission, there has been some progress in the deregulation of labour markets in Australia, but this has been patchy, and in some cases (notably in Western Australia), pro-competitive reforms have been unwound on change of governments.

The Discussion Draft rightly emphasises the importance of productivity growth to sustaining Australia's economic future. Deregulation of the labour market aims to improve Australia's productivity growth – and consequently, the living standards of its workers and consumers - by decentralising wage settings and removing legislative impediments to employment. The benefits of decentralisation include:

- flexibility and the ability to adapt to local market conditions and employees' needs;
- fostering co-operation, mutual respect and industrial harmony;
- win-win negotiation of more productive and more lucrative working conditions (wages are typically higher under decentralised than centralised bargaining arrangements); and
- a fairer and more acceptable pay structure, reflecting the employee's skill, effort and contribution to the business.

The case for more labour market deregulation lies in the expectation that it will result in more of the benefits already enjoyed as a result of the more flexible labour market. Despite the reforms to date, Australia's labour markets remain highly regulated.

There are, of course, many good reasons why aspects of the employment relationship – and indeed other human services policies - should be subject to regulation. What has long been missing in the confrontational and quasi-judicial processes of determining industrial regulations, however, is a comprehensive and impartial consideration of their impact on the

wider community, through a public benefit or similar test. For example, raising minimum wages may benefit employees paid the minimum wage, but if the cost is higher unemployment, this may not be a net benefit to the community as a whole.

Labour market deregulation need not lead to widespread abolition of employee protections, but it would broaden the evaluation of the costs and benefits of those regulations beyond the self-interest of directly affected parties and their representatives, and ensure that regulations are more carefully evaluated.

CCI's priority for ongoing Industrial Relations reforms is that it should be conducted mainly within the remit of existing jurisdictions – the Commonwealth should review its unfair dismissal and Federal award and agreement provisions, and states similarly should review their own provisions. While the case for national co-ordinated Industrial relations regulation has merit, not least in reducing businesses' compliance costs, it also has risks. The current system allows for diversity and for improvements through the rivalry and demonstration effects that flow from competitive federalism. For all the drawbacks of the inconsistencies of the current system, a consistently bad industrial relations framework would be worse. Removing the checks and balances inherent in the current system may increase the opportunities for future governments to implement excessively onerous, productivity-impeding regulation. It may well be worth examining in more detail the benefits and drawbacks of moving industrial relations responsibilities to a single jurisdiction; but caution is needed because the consequences of a bad decision could be severe.

Skills, Training and OSH

Western Australia's booming economy and 27-year unemployment low have generated pockets of severe skills shortages, especially in the booming resource and related construction sectors, prompting a renewed focus on the issue of vocational training and alternative sources of skilled labour (such as migration).

Applying the principle of subsidiarity, much of the responsibility for training development should remain with the states, which are best placed to identify local industry and occupational skills demand. It should also become more diverse, flexible and competitive, with the balance of the delivery of employment-based training shifting away from institutional based programs delivered through TAFE, towards more diverse arrangements including competing training providers and more flexible and demand-driven workplace-based training.

However, the fact that the labour market for many occupations is not national or even international in scope, and the Commonwealth's role in funding training and in other areas of human capital development, both suggest a role for strategic national co-ordination of skills development. Government should fully implement user choice, where public funding for training flows to Registered Training Organisations selected by employers involved in apprenticeships and traineeships.

This strategic role should encompass a comprehensive strategy on the re-skilling of mature-aged persons who wish to change career direction.

Consistent with competition policy principles and the public benefit test, Government should also commit to a third party access arrangement to allow access to public training infrastructure on a commercial basis.

The highly cyclical and sometimes highly specialised nature of local labour demands means that it is not appropriate and probably not possible for the demand for labour at the peak of the cycle to be met only by Australian residents. The Government should actively support the migration of skilled labour into Australia. As part of these arrangements, the criteria for obtaining a temporary skilled visa under the Employer Nomination Scheme should be

relaxed, allowing easier access for skilled labour to be brought in during periods of high demand to complement the resident skilled labour workforce.

Similarly applying the subsidiarity principle, CCI opposes moves to impose a single uniform OSH regulatory system throughout Australia, believing that the current system of differences allows for improvement through rivalry and demonstration effects (competitive federalism) and reflects differences in industrial structure and culture.

However, there are efficiency benefits from compatibility and consistency in regulations across jurisdictions – OSH regulatory systems can and should be consistent without being uniform. Consistency relates primarily to outcomes while uniformity applies primarily to application. Consistency provides the basis for national programs while allowing flexible arrangements for jurisdictional and industry differences (co-operative federalism).

Health

The growth of health expenditure has been one of the most pressing issues facing state Treasurers in recent years, as the demand for and cost of health services consistently outstrips growth in revenue. In the long term, this is unsustainable.

In Western Australia, health expenditure has increased on average by 7.7 per cent a year since 1993-94, well above the annual increase in other general government expenses of 5.0 per cent. Health has become the largest single component of the budget – projected to increase from just over 20 per cent of the State's budget in 1993-94 to 27 per cent by 2006-07, according to the forward estimates in the 2004-05 budget.

Policy and funding management has been complicated by overlap, duplication, blurring of responsibilities and blame-shifting between state and Commonwealth authorities for publicly-perceived problems with the health system. Poor articulation with related services, such as aged care, complicates these processes still further.

The evidence indicates that the public health system in Australia is under pressure.

Health costs are rising rapidly.

Private health insurance membership has declined substantially over the long term, placing more pressure on the public health system.

The demographic trends of an aging population suggest the pressure on health services will increase, while the impact of advanced medical technology contributes to both higher use and higher cost per capita.

Current arrangements allow for few constraints on the level of, or growth in, demand for health services, and costs can be restrained only through blunt constraints on the supply of services which do not promote efficiency, and which appear increasingly unacceptable to the community.

The health system is in need of reform before the cost of supporting the current system becomes overwhelming or the effects of supply side restrictions in the face of increasing demand result in deteriorating service quality.

Some pricing mechanisms will almost certainly be needed to restrain the growth in demand. Fundamental constraints in the system, such as community rating and the role of private sector health insurance, should be addressed.

There is scope to introduce more competition in the supply of medical services to the hospital system in Western Australia – for example, by abolishing the fixed rate scale for Visiting

Medical Practitioners (or Visiting Medical Officers as they are known in other states), and hence improve efficiency and possibly reduce costs.

Demand management is also an area which needs reform, but the efficient supply of services can be equally important in determining the appropriateness, efficiency and costs of delivery of health services.

Clearer accountability, more transparent funding of community service obligations and increased competition for health services are key elements of any health reform package.

The importance of health services to the community, and its political sensitivity, adds to the political muscle of key players. Health reforms have sometimes been opposed or blocked by powerful provider lobbies –pharmacists, doctors, nurses and ancillary workers, for example.

In Western Australia, the Department of Health has a poor record of keeping expenditure within budget, and in the late 1990s and early 2000s a pattern emerged of hospitals announcing in the later months of the financial year that stringent and politically unacceptable service cuts would be necessary unless their budgets were topped up with additional funding.

Reforms are complicated by the severity of the consequences if changes fail, creating a degree of risk aversion in regulating and financing authorities.

State governments are aware of the problems they face in health funding, and are taking some steps to address them. WA's government established a Health Reform Committee in 2003-04 with the objectives of improving both the quality and effectiveness of clinical services and ensuring that expenditure growth is sustainable within the fiscal restraints set by government. The final report of the Committee made many useful and constructive suggestions for reform, but more needs to be done at both a State level and in reform of cross-jurisdictional conflicts and funding issues to ensure that the growing demand for health care can be financed sustainably.

Conclusions

CCI believes the Commission's Discussion Draft provides a comprehensive description of the achievements of competitive policy reforms in Australia and on the need for a renewed, and broader, reform agenda. We endorse the priority areas for further reform identified in the report, and look forward to the publication of the final report in 2005.

Yours sincerely,

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