Submission to the Productivity Commission on the discussion draft 'Review of National Competition Policy Reforms'

National Competition Council

November 2004

1 Introduction

The National Competition Council (NCC) commends the Productivity Commission's comprehensive discussion draft on the *Review of National Competition Policy Reforms*. The Council endorses the key themes that:

- NCP has delivered substantial net benefits for Australia
- Australia has the potential to reap further significant benefits by meeting the productivity benchmarks achieved by other countries
- Continued reform is imperative because Australia confronts challenges, including an increasingly competitive global environment, domestic pressures (such as an ageing population), and a Federal-State financial system that promotes cost shifting and blurred lines of accountability.

To this end, the Council supports the Commission's identification of areas for a new reform agenda including, as priorities:

- a review of Australia's health care system as a step to developing an integrated health services reform program
- extension of natural resource management reforms, including greenhouse gas abatement policies
- renewed energy and water programs and coordinated reform frameworks for freight and passenger transport
- improving competition and regulatory architecture through a more focused legislation review program, strengthened monitoring of gatekeeping arrangements, improved oversight of infrastructure providers, and continuation of competitive neutrality policies
- further reform to promote competition in telecommunications, communications and broadcasting (although this is essentially the sole province of the Australian Government).

The Council also endorses the other areas identified as offering the prospect of net community benefits from reform, including:

- improving the quality and responsiveness of education and training systems and enhancing the performance of aged care services delivery
- extending the scope for workplace flexibility and removing inefficiencies in the work-incentive effects from taxation and social support programs

- promoting the efficient development of cities and regions through appropriate urban planning and regional development policies

- cost-effective mechanisms to address market failures in technological innovation.

Whereas the Council generally endorses the areas identified for a future reform agenda, it considers the Commission needs to provide the Council of Australian Governments' (CoAG) 2005 review with further advice on the institutional arrangements needed to realise a viable future reform program.

The success of a future reform program will depend on two discrete but mutually supporting factors — a reform agenda and institutional arrangements capable of delivering that agenda, despite the challenges posed by federalism. The Council considers that the discussion draft too narrowly confines its analysis of implementation issues. This is discussed in section 2. (An annex provides the Council's comments on suggestions by governments to improve the current institutional arrangements.)

Section 3 discusses the forward agenda outlined in the discussion draft. It draws on a report prepared by the Allen Consulting Group that identifies candidates for reform based on the experiences of other countries. The submission includes two further case studies on the impact of dairy and grains reforms sectors (section 4). These studies complement the Commission's broader economic modelling.

2 Institutional arrangements

The Council emphasises that while the reform agenda is more important than any particular institution (including the NCC), the institutional framework drives the content, and determines the success, of the reform agenda.

The inquiry terms of reference note that CoAG is to conduct a review of "NCP arrangements" (part 2) and that "[i]t is therefore timely to undertake an independent review of these arrangements" (part 3). These 'arrangements' encompass three pillars.

1. An agenda based on commitments to be met by those governments that agree to participate.

2. An independent agency to monitor progress and assess the extent to which governments have met their commitments (supplemented by specialist jurisdictional units within central agencies).

3. Competition payments to provide an incentive for governments to implement reforms that, although in the public interest, can be politically difficult.

There should be no doubt that had the NCP relied only on the first pillar, the Commission's discussion draft would have described the outcomes as falling disappointingly short of those envisaged in the Hilmer report.

The practicality of Australian federalism is that a reform agenda will deliver the greatest benefits by primarily embracing reforms that require intergovernmental coordination. And, while the reality of nine sovereign governments is the key factor shaping the agenda, achieving the cooperation of many governments requires objective timetables with sufficient flexibility to accommodate the iterative judgements that arise through changing circumstances, and having jurisdictions moving at different speeds from different starting points.

A unique aspect of the NCP is that it is an embracing program — the 'glue' that binds a disparate set of reform agendas within a consistent framework of monitoring and assessment. That framework reaches across competitive neutrality, structural reforms of public monopolies, legislation review (covering of 1800 separate pieces of legislation from agricultural marketing through to occupational licensing), national standards setting, electricity, gas, water and road transport. While the NCP may have been better specified and/or implemented, without its institutional framework the reform task would have been disjointed, protracted and incremental with little capacity to exert an effective discipline or incentive on the parties to meet their agreed obligations to promote the national interest.

The Council's views on the elements of a well-functioning institutional framework are outlined in box 1 which draws from its initial submission.

Box 1: Institutional arrangements

The success of the NCP can be attributed to: an agenda agreed by all governments that outlines reform commitments with a practical degree of specificity; an independent body responsible for negotiating, monitoring and reporting on reforms; and the provision of appropriate incentives, including financial payments. These attributes are interdependent and allow for:

- assessment frameworks and assessments with sufficient flexibility to facilitate reform progress rather than imposing rigid compliance targets. For example, suspensions allow for difficult reforms to be rolled over thereby raising the potential rewards from compliance and providing time to devise reasonable transitional reform programs;
- different mechanisms to meet different reform agendas rather than recourse to a rigid tops down model that may not be equally suited to different jurisdictions; and
- an independent assessor to monitor and assess progress across nine governments that are introducing reform measures at different speeds, from different start points in highly variable environments (political, geographic, climatic etc).

Looking forward, effective forms of intergovernmental agreements should include:

- overarching principles that can be used to guide any flexibility in application to ensure the desired outcome is delivered;
- sufficient detail on the reform requirements to benchmark the assessment of performance. Because the assessment body should not be responsible for policy development, the agreements need to specify policy objectives;

Box 1: continued

- interim benchmarks (particularly where outcomes are longer term) and mechanisms for priority setting so the reform process does not stall;
- mechanisms to monitor reform implementation; and
- mechanisms to change and refine the agreements that avoid inappropriately winding back the obligations or exempting obligations from assessment. This can be avoided by;
  - requiring unanimous CoAG agreement to change the commitments,
  - requiring CoAG to endorse the work of other bodies (eg Ministerial councils) before that work becomes part of the agreements, or
  - providing sufficient detail in the agreements and constraining other bodies to developing approaches consistent with the overarching CoAG agreements.

The work of other bodies (such as Ministerial councils or groups of officials) can inform the assessment of reform implementation and help develop performance benchmarks and best practice approaches, but risks diluting reform if it results in rewriting the agreements.

Source: NCC (2003, 2004)

2.1 The approach of the discussion draft

The Council endorses the Commission's principles for a robust institutional framework:

> *The institutional framework(s) used to progress future nationally coordinated reforms should be underpinned by:*
>
> - *clearly enunciated objectives and reform principles;*
> - *effective preparatory work detailing the benefits of reform in particular sectors and the specific changes required within jurisdictions to reap those benefits;*
> - *some flexibility for jurisdictions to determine how to implement reforms, but with sufficient specification of desired outcomes to allow for effective monitoring of reform progress;*
> - *transparent and independent assessment processes, incorporating a comprehensive public interest test and providing scope for consultation with, and input from, interested parties;*
> - *a timetable for the implementation of the review and reform program including, as appropriate, interim targets and provision to refine targets as new information emerges, or if circumstances change;*
> - *independent monitoring and public reporting on progress made in implementing the program; and*
> - *robust mechanisms to lock-in the gains of past reforms and prevent backsliding.* (PC 2004, p. 297)

These principles are evident throughout the discussion draft. For example:

> *Independent and transparent review and assessment processes are critical to secure good outcomes, especially on contentious issues; prevent backsliding; and promote public understanding of the justification for reform.* (PC 2004, p. xxiv)

> … *in both* [the energy and water] *sectors, the next phase of reform is outside current NCP arrangements and will require the development of effective independent review mechanisms.* (PC 2004, p. 161)

It is evident that the Commission appreciates fully:

- the critical interrelationships between a reform agenda and the integrity of the implementation process
- that the success of the NCP is attributable to its three pillars approach.

However, the discussion draft avoids elaborating on how the desired principles should shape the practical application of the institutional arrangements. It is silent, for example, on how the current arrangements — which could be a default option — should be improved. The Commission's reticence to extend its analysis from principles to application derives from a view that this could be interpreted as pre-empting the 2005 CoAG review.

> *The terms of reference are … concerned with reform impacts and opportunities rather than institutional or procedural arrangements. In practice, these elements are interrelated as the achievement of specific reform objectives will depend on a well designed and functioning institutional framework. Hence, the Commission has commented on the strengths and weaknesses of institutional settings in the NCP and the implications for any future reform process. However, it considers that options for future institutional arrangements, including specifically the role of the National Competition Council and financial transfers, are matters outside the terms of reference and most appropriately addressed by the CoAG review.* (PC 2004, p. 4)

It is debateable whether this view is necessarily shared by governments. Certainly, institutional arrangements have been raised by governments in their submissions to the Commission (see annex). New South Wales, for example, submitted that:

> *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…* (sub.99, p. 21)

In addition, most governments made specific comment about competition payments. Given that all three 'pillars' of the NCP have been raised by the parties to CoAG, it would seem unreasonable to adjudge that the Commission

would be exceeding the inquiry's terms of reference if it advised the CoAG review on, not only an agenda, but also the means to achieve it.

The Council considers that the public interest would be served by the Commission addressing more explicitly how a forward agenda will be implemented. In particular, there is a need to:

- clarify the relative costs and benefits of a 'silos' approach to assessing reforms (involving disparate sectoral institutions) versus integrated 'whole of-program' monitoring — section 2.2.

- offer more detailed commentary on the pros and cons of continuing with the incentive-leverage approach of the NCP. For example, if there are to be competition payments, this implies a need for an assessor that can come to a view about each jurisdiction's overall performance. If there are not to be competition payments, what alternatives might be implemented to lock-in the reforms achieved to date and provide an incentive for new ones? — section 2.3.

2.2 An integrated agenda or multiple silos?

The discussion draft provides no broad institutional options, apart from listing the following possibilities for CoAG stewardship of future reforms:

- *A formal successor to the NCP;*
- *Some other broadly-based CoAG reform agenda and framework;*
- *A series of CoAG sponsored sector-specific reform programs, or some combination of all three.* (PC 2004, p. 294)

The Commission goes on to note that:

> *... a successor to the NCP could be limited to competition framework and regulatory architecture issues, with reforms in other areas … pursued through sector-specific, nationally co-ordinated, frameworks and programs.* (PC 2004, p. 294)

The Commission adds that, because competition measures will be a relatively small part of a new agenda, including other areas in an 'NCP-type framework' "could send the wrong signal that competition measures are the mainstay of reforms in areas such as human services and resource management" and could also 'overload' a competition policy reform program and thereby divert attention from core competition issues*"* (PC 2004, p. 294).

The Council considers that these arguments are not compelling. First, the NCP already accommodates 'non-competition' criteria — the water reform program includes a range of environmental objectives. Moreover, appropriate use of the NCP's public interest provisions can accommodate non-competition costs and benefits. Second, competition is a 'proxy' for efficiency and the latter

is relevant to promoting the public interest (including quality) in the provision of human services. Third, 'pure' competition matters could be one component of a wider reform agenda under a more embracing name (a semantic consideration).

The Commission's list of institutional options includes a 'silos' approach involving multiple bodies (for example, Ministerial Councils and other CoAG entities) undertaking monitoring and assessment roles independently of each other. This would contrast with the current integrated 'whole of program' assessment model with its foundation of transparency (involving publicly available assessment reports), adherence to timelines and most importantly, frank assessments conducted independently of the parties being assessed.

The Council has no reservations about relevant expert bodies being responsible for policy matters, agenda setting and implementation. In the same way that the National Transport Commission has carriage for road transport reform modules that feed into annual NCP assessments, so too could such a model be employed for areas such as water (a National Water Commission) and energy (the Ministerial Council of Energy). The Council, does, however, have strong reservations about such bodies also undertaking an assessment role.

Experience with national legislation reviews involving Ministerial Councils and associated standing committees and working groups indicate some of the shortcomings of these processes — drawbacks that would be exacerbated by the potential conflicts inherent in also undertaking an assessment role. As the Victorian Government noted:

> [national reviews] *have tended to be protracted and often difficult exercises. The slowness of inter-jurisdictional reviews and processes, and the overlaps between related processes have delayed the delivery of reforms and, therefore the anticipated benefits. … Some have taken considerable time while others have suffered from multiple attempts to reach common ground.* (sub. 51, p. 14-5)

Perhaps cognisant of these considerations, the Commission considers that Ministerial Councils may be suited only to a limited role in progressing a new reform agenda "where specific reform programs have already been developed and where those reforms are basically on-track, meaning that only 'high level' oversighting is required" (PC 2004, p. 294). The Council considers that the progress in key reform areas such as energy, water and transport are not yet at the stage where high level oversighting would suffice.

It is imperative that the assessment process is sufficiently at arms-length to be able to independently gauge governments' outcomes in meeting the obligations of a new reform agenda and to deliver sanctions (whether in the form of withheld payments or opprobrium) where appropriate. Regardless of the form of the institution, having a committee of the parties assessing their own performance (and potentially re-specifying targets) is almost always problematic. Based on its experience with the NCP, the Council considers that the prospect of jurisdictions setting, monitoring and reconfiguring their

own benchmarks — perhaps in a charged environment of partisan politics — is far less likely to deliver appropriate outcomes.

In sum, a silos approach involving multiple expert bodies may be an appropriate feature of a new reform agenda, but this should be assessed against the current integrated whole-of program approach that demonstrably has delivered beneficial outcomes. Accordingly, the Council urges the Commission to advise CoAG on the types of institutional arrangements that are most (and least) likely to advance integrated and consistent implementation of reforms — and in particular, the need to separate agenda setting from the assessment role.

2.3 Competition payments

The Council understands the Commission's reticence to comment extensively on competition payments, despite its acknowledgement that the payments have been instrumental in securing the implementation of NCP reforms. The Council accepts that the (non)provision of competition payments is a matter for negotiation between governments. It also acknowledges that it is not immediately evident that there is a clear efficiency rationale for paying governments to implement reforms that are in their own, and the national interest. That said, the benefits of incentive payments in overcoming some of the difficulties of federalism have been evident and acknowledged in the discussion draft (see pp. 140-1). The Council concurs with the Commission's finding that "competition payments have clearly played a pivotal role in maintaining reform momentum within the states and territories" (p. 140).

Accordingly, the Council urges the Commission to consider the implications of a reform program without the 'third pillar' of competition payments. For instance, the most recent outcome from withholding a quantum of each jurisdiction's competition payments in 2003 (mostly retrievable suspensions) has been a marked improvement in compliance. The compliance rate for completion of governments' priority legislation review and reform has increased from 56 per cent in 2003 to nearly 75 per cent this year (table 1).

Given the possibility that a future reform program will not include competition payments, the Commission should provide CoAG with options for alternative mechanisms to lock-in the reforms to date and to provide an impetus to continue reforms. Recent experience suggests that this may be challenging. The following extract from the South Australian Premier indicates a possible impact of terminating incentives.

> *Following State Cabinet today, Agriculture Minister Rory McEwan and I have resolved that we will not reintroduce the Barley Marketing bill unless the Federal Government continues to insist upon enforcing the National Competition Policy penalties.*

> *The Howard Government threatened to penalise South Australia financially if we did not dismantle the single desk. We faced losing millions of dollars in competition payments…*
>
> *For some time now the State Government has been operating with a gun to its head. If that gun is unloaded I'm more than happy to shelve the bill indefinitely. If there's no threat, there will be no legislation. It's as simple as that.* (Rann 2004)

Table 1: Overall outcomes with the review and reform of legislation[a]

	Proportion of priority complying (%)		*Proportion of non-priority complying (%)*		*Proportion of total complying (%)*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*
Australian Government	33	***60***	66	***77***	51	***70***
New South Wales	69	***83***	79	***84***	73	***83***
Victoria	78	***84***	83	***86***	81	***85***
Queensland	61	***83***	92	***92***	71	***86***
Western Australia	31	***46***	54	***73***	44	***62***
South Australia	37	***60***	82	***90***	63	***77***
Tasmania	77	***82***	90	***95***	84	***89***
ACT	59	***81***	97	***98***	85	***93***
Northern Territory	47	***79***	83	***90***	62	***83***
Total	56	***74***	81	***87***	69	***81***

[a] Includes the stock of legislation identified by jurisdictions in their original legislation review schedules, jurisdictions' periodic additions, and legislation containing restrictions on competition identified by the Council. Excludes legislation specific to water, electricity, gas and road transport (except where, for example, it also relates to professions such as electricians and gasfitters).

The following press report outlining the views of the Western Australian Minister for Agriculture (Mr Kim Chance) is similarly illustrative.

> *Mr Chance said the [Grains Licensing Authority] concept was based on an NCP imperative, but if it was no longer effective due to lack of funds, the pressure to keep the GLA would be reduced if it was found to be a cost to the state… "Beyond 2006, NCP is not getting any more money" Mr Chance said. "It's all over in my opinion".*
>
> *Mr Chance said South Australia had received a $3 million NCP penalty because it had not implemented a GLA. "I would not have thought about it unless there was NCP" he said.* (Henderson 2004)

During its nearly decade long operation, the Council frequently encountered instances where tensions between the public interest and political interests have arisen. In recognition of such tensions, clause 5(1) of the Competition Principles Agreement and the CoAG 2000 communiqué are framed specifically to encourage governments to independently and transparently establish that policy (in)actions claimed to be in the public interest actually

are, and not a function of the lobbying capacity of vested interests. More generally, there are also welfare-reducing parochial aspects of Australian federalism to consider. For instance, the long history of cost and blame shifting and blurred lines of accountability in the provision of health and related ancillary services demonstrate that, in this area, the public interest has not prevailed.

The Council considers that governments have had a stronger incentive to pursue outcomes consistent with the public interest where competition payments are available and that, therefore, the potential for 'backsliding' is heightened without these payments. It therefore, requests the Commission to consider alternative methods to lock in and advance reforms.

One approach, for example, may be to 'rule off' completed reform agendas and bind the parties to outcomes at that time. Further reforms in the public interest would remain apposite, whereas reversion to non-competitive outcomes would need to be subject to some sanction. Of course, it is difficult to envisage what instrument, other than some other form of intergovernmental transfer, could be used. (Such an approach would also require monitoring and assessment).

2.4 Lessons from alternative approaches

The Commission's final report is likely to be a critical stage towards advancing a national agenda to secure continued Australian productivity and growth. Such an agenda will require a strong commitment by nine sovereign governments to advance the national interest. The strength of this commitment will hinge on effective institutional underpinnings.

Australia can learn from experience — the outcomes for NCP and ecologically sustainable development (ESD) illustrate the relationship between the 'road' and the 'goal'. The environmental management literature contains some insights on these matters. Dovers (2002), for example, contends that:

> *ESD policy has been poorly implemented, has not received adequate resources, lacks a whole-of-government framework, and has not been supported by institutional arrangements to move sustainability questions from the margins to the centre of the policy landscape. … By way of contrast, National Competition Policy has been implemented vigorously, across all policy sectors, with significant financial incentives provided by the Commonwealth to the states and territories, and a solid legislative and institutional basis.* (p. 292)

Similarly, Curran and Hollander (2002) consider that:

> *NCP and Ecologically Sustainable Development (ESD) share a number of common characteristics. They are both meta policies, broad in their scope and sweeping in their ambitions. Both emerged in the early 1990s and both depended on high levels of political commitment*

> *and co-ordination for their success. However, while NCP prospered, ESD stalled.* (p. 158)

A summary of Curran and Hollander's findings are presented in box 2.

Box 2: A tale of two programs— ESD and NCP

The National Strategy for Ecologically Sustainable Development (NSESD) in 1992 addressed the economic, environmental and social dimensions of ecologically sustainable development. … Through its guiding principles, it sought to outline a policy approach that would guide all levels of government in the formulation and implementation of effective environmental policy… Supported by CoAG, NSESD encouraged governments to improve the effectiveness of their ESD related policies, integrate ESD into their decision-making processes, and create effective intergovernmental ESD cooperation and coordination. … Most governments accepted that the successful application of ESD principles depended on effective intergovernmental coordination. This was because of the complexity and interconnectedness of many environmental problems. To this end, another key plank of ESD became the 1992 Intergovernmental Agreement on the Environment (IGAE). An initiative of CoAG, the IGAE sought to promote a more coherent and coordinated approach to achieving ESD. (p. 159)

The Intergovernmental Committee on Ecologically Sustainable Development (ICESD) was tasked with the role of monitoring progress and reporting directly to CoAG. ICESD, however, was an unwieldy organisation consisting of a large membership with diverse views. It reported once, in 1996, and was then dissolved (p. 160)

From its inauspicious beginning, NCP has emerged as a powerful, pervasive and practical strategy for change reaching into a diverse array of public, private and community activities… While much legislation now incorporates ESD principles … NCP's contrast with ESD remains salutary (p. 161)

ESD has been characterised by comparatively weak monitoring and compliance mechanisms coupled with limited incentives. NCP principles, by contrast, were given considerable policy effect through formidable institutional support, rigorous monitoring and compliance measures and an attractive compensation package … Implementation was further secured through the establishment of specialist units within central agencies (p. 163)

[the NCP Agreements] were largely statements about process and principle and not strong on detail and as a consequence, provided for considerable diversity in implementation. The NCC took up the task of rendering these general concepts into concrete procedures. (p.164)

Transplanting the institutional, political and financial clout of NCP into ESD would go a considerable part of the way towards injecting ESD with the more robust commitment it needs (p. 166)[1]

In this light, the 1999 Productivity Commission review of the implementation of ESD by Australian Government agencies seems particularly prescient. At that time, the Commission observed that one of the reasons for the stalled

[1] The authors note that NCP's success also derives from a political environment that attached more weight to economic liberalism than sustainability. To the extent that this is true, it highlights the relative emphasis placed on the institutional arrangements to carry forward these agendas. The authors also note that the *Environmental Protection and Biodiversity Conservation Act 1999* (framework environmental legislation for Australian Government agencies) commenced in 2001 and its effectiveness is yet to be demonstrated.

progress in implementing ESD could be "the absence of an ongoing organisation or group to monitor and encourage implementation and to periodically report on progress" (PC 1999, p. 139). The Commission considered that the "continuing challenge is to translate the guiding principles and core objectives of the NSESD into specific actions and outcomes" (PC 1999, p. 140).

2.5 Conclusion on institutional arrangements

The NCP unites a range of reform agendas under a consistent framework. Its success is built on its foundation of three pillars — an agenda, independent assessment, and incentives. It is the default model against which other options should be measured. The efficacy of approaches that deviate from the NCP model needs to be determined; otherwise the potential gains from a new reform agenda could be compromised.

The Commission recognises that "the achievement of specific reform objectives will depend on a well designed and functioning institutional framework". However, its commentary on institutions for a new program lacks specification.

- What are the relative merits of various approaches in ensuring an "effective and independent review mechanism"? or "robust mechanisms to lock-in the gains of past reforms and prevent backsliding"?

- Can a multiple-assessor model match the success of the whole-of-program approach of the NCP?

- If there are no competition payments, what other mechanism might be implemented to lock-in the reforms achieved to date?

- If there are competition payments, what assessment processes will be capable of coming to a view about each jurisdiction's overall performance in achieving the agenda?

The recent statements by some governments underscore the need to consider carefully the implications of not having incentive payments. A reticence to accede to reforms found to be in the public interest by open and independent reviews does not augur well for a future reform program founded solely on a premise of congruence between jurisdictional and national interests. There must also be doubts about whether any entity comprising the 'players' is sufficiently at arms length to 'referee' outcomes.

The lessons from the comparison of NCP and ESD provide a salient caution about the need for principles to be matched by institutions.

The Council urges the Commission to take greater account of these matters in its final report. This need not involve proposing that CoAG adopt a 'one size fits all' institutional arrangement. Specialist bodies such as the Ministerial

Council of Energy, the mooted National Water Commission and (perhaps) a body to develop national health reforms can have a role in policy development, agreement making, target setting and implementation. They should not, however, also undertake an assessment role.

3 The proposed reform agenda

The Council contracted the Allen Consulting Group (ACG) to prepare a paper on *Microeconomic reform in Australia: Comparison to other OECD countries* (attachment 1) to help inform discussion on a forward reform agenda. The aim of the Allen's study is to assist in the determination of whether there are significant gains to be had through extending the NCP. It examines the case for taking reform further in areas already covered and/or by defining more broadly the scope of the NCP. To this end, it looks at economic reforms in New Zealand, Canada, the UK, the US and the European Union.

The ACG study's key conclusions are that:

- reform has not been uniform across all sectors
- large gains are to be had in some sectors if reform promotes economic efficiency as well as competition
- there are reform initiatives in other countries of relevance for Australia.

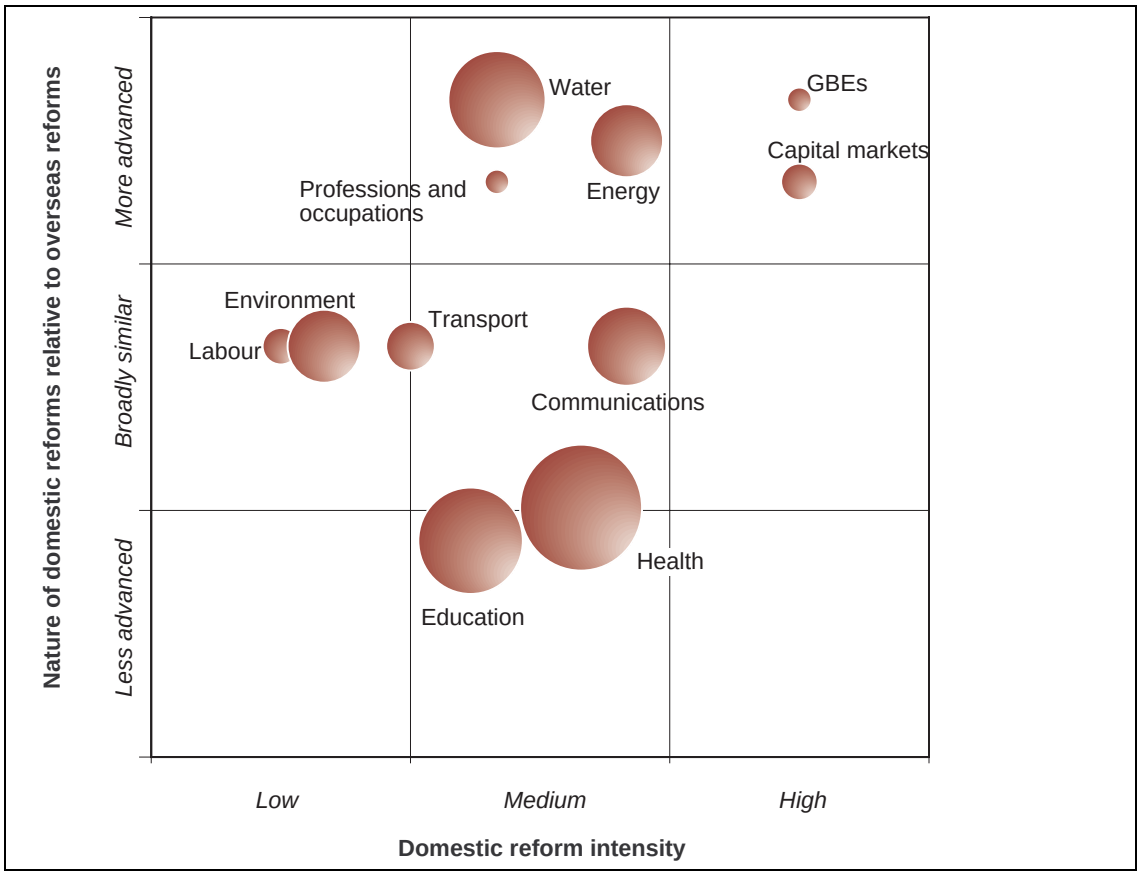
Figure 1 shows Australia's situation for key sectors, its performance relative to the other countries and the potential benefits from reform.

The ACG study finds that:

- the greatest untapped benefits come from sectors such as health, education, communications and the environment
- there are considerable potential benefits from water reform
- there are many areas where reform has stalled (for example, energy market reform) as a result of state and territory policy decisions.

Overall, there is a strong congruence between the areas identified by the ACG study and those nominated by the Commission as priority reform areas (see table 2) with the notable exception being the relative emphasis placed on education reforms. The Commission finds that further reform is required in the education and training sector but considers that "the need for CoAG to sponsor and oversee a nationally coordinated framework appears less pressing than in the health sector" and that effective implementation of agreed reforms is required, rather than a new reform agenda that could overload CoAG (PC 2004, p. 275).

Figure 1: Summary classification of sectors



Source: ACG 2004, p.

In relation to labour market reform, the Commission:

> *… questions whether CoAG involvement in labour market reform would be helpful at this time. Views on the extent and significance of impediments to the effective operation of the labour market differ, as do ideas about potential solutions. These differences are particularly apparent at the political level and lessen opportunities for pursuing a cross-jurisdictional reform agenda.*
>
> *Moreover, the value of nationally coordinated reform frameworks and programs is likely to vary across different aspects of the labour market.* (PC 2004, p. 283)

Indeed, there are several areas identified as important, but which may not be well suited, "at this time", to an intergovernmental agenda:

> *Continuing reforms in other human services such as aged care, vocational education and training, and primary and secondary education, as well as in the labour market and tax policy areas, are also crucial to Australia's future prosperity.*
>
> – *It is not clear that CoAG involvement is needed or would be helpful in progressing reform in these areas at this time.* (PC 2004, p. 241)

Table 2: Summary of proposed future reform agenda

Sector	*Proposal*
Energy	Complete outstanding elements of NCP and implement the MCE package and other additional reform priorities. Establish a process to monitor implementation and outcomes
Water	Complete outstanding elements of NCP and recommit to the NWI and address a range of other reform priorities. Ensure that monitoring post-NCP provides a discipline on all governments.
Freight transport	Complete outstanding elements of NCP. Develop longer-term strategy to achieve a national freight system and develop a national reform agenda for rail that imposes specific time frames
Telecommunications and broadcasting	Examine structural configuration of Telstra. Remove a range of competition restrictions in broadcasting.
Priority legislation reviews	Review anti-dumping and cabotage. Priority second round reviews of pharmacy, insurance, and wheat marketing.
Application of TPA to government businesses	Investigate need for legislative change to ensure government businesses do not escape coverage.
Consumer protection policy	National review of consumer protection and administration.
Assistance-related impediments to efficient competition	Examine government purchasing preferences. Extend coverage of agreements to prevent cross-border bidding wars.
Legislation review	Complete remaining items on review schedules. Retain a more targeted mechanism that provides more timing flexibility, increases transparency, gives explicit recognition to transitional issues and more emphasis on whether outcomes are reasonable.
Gatekeeping for new legislation	Strengthen independent monitoring of gatekeeping measures.
Oversight of regulated services	Explore scope to improve price setting arrangements for regulated infrastructure.
Health	Initiate a review of Australia's health care system in order to develop an integrated health services reform program.
Natural resource management	Extend CoAG responsibilities in this area. Immediate priority is greater involvement in national coordination of greenhouse gas abatement.
Education and training Aged care services Labour market arrangements Taxation policy and its interface with social support programs Urban planning and Regional development Technological innovation	Policy attention certainly required but additional benefits of a nationally co-ordinated approach may not be sufficient to make this the preferred approach, particularly given other demands on CoAG resources.

Source: Summarised from PC 2004.

3.1 Scope for an evolving agenda

The Council agrees that it would not be sensible to embark on an agenda so ambitious and wide ranging that it became unworkable. It also acknowledges that, whereas it has considerable expertise to comment on the institutional arrangements to progress a reform agenda, it is probably no better placed than others to comment on the content of a reform agenda. That said, in relation to the nominated agenda, the Commission states that it "welcomes feedback on these judgements" (p. xliv).

In response to this invitation, the Council observes that identifying reform areas as important, but noting that CoAG lacks the resources to address these areas begs the question of when it will be time to address these important matters. The 'lower priority' agenda items generally relate to areas where intergovernmental issues loom large[2] and where existing processes appear to have been slow and/or lacking effectiveness.

Accepting the need to prioritise any new reform agenda, the Council considers that, rather than leave the lower priority areas to some other (unspecified) time, it may be possible to contemplate a more far reaching reform agenda with the longevity to accommodate reform areas 'coming on stream' in the future. This could involve a forward program of scoping reviews — similar to that envisaged for the health sector — to be provided to CoAG. CoAG could then determine whether an intergovernmental agreement or some other instrument to progress and/or harmonise reforms was warranted. Any new reform-specific intergovernmental framework could be serially added to the national reform agenda. Such an approach potentially could sustain reform momentum for many years.

4 Consultants' reports on the grains and dairy sectors

As noted in its initial submission, the Council contracted the following consultancies to address informational deficiencies for this inquiry.

1. *Dairy: Now and then, the Australian dairy industry since deregulation*, prepared by RidgePartners.

2. *Australian Grain Market Reforms, A review of the of National Competition Policy grain market reforms*, prepared by ACIL Tasman.

[2] The exceptions are taxation policy and the interface with social support programs and measures to address market failure in technological innovation.

These studies go some way to addressing the paucity of ex post evaluation of individual NCP reforms. They therefore complement the Commission's broad modelling work on the prices, service quality, social, regional and environmental impacts of the NCP. Both studies control for non-NCP factors and therefore provide sectoral snapshots of the impacts of reforms on agents throughout the chain from the farm to the table and/or export markets. The grains study, in particular, addresses the view put by many participants to the inquiry that export single desks should be excised from review and reform commitments because they are, by definition, in the public interest.

A brief outline of the key messages from the reports is provided below.

4.1 Dairy

The study by RidgePartners into the Australian dairy sector addresses a number of misperceptions about the impact of reform (attachment 2). Its key findings include:

- At the national industry level, gross farm income is about $300 million per year higher than in the year prior to deregulation after accounting for the effect on farm income from: the loss of market milk premiums; better returns from manufactured products; and the industry's adjustment package.

- Retail milk prices on average remain below those prevailing before deregulation. Consumers have also benefited from greater choice including innovative products aimed at dietary and convenience needs.

- There has been a diverse range of regional impacts from the removal of farm gate regulation of the industry. Regions that were more dependent on market milk prices experienced the slowest adjustment with the changes in incomes coinciding with extended drought. Commercial changes in the dairy value chain will continue to put pressure on farm gate incomes in the subtropical region and other parts of New South Wales.

4.2 The grains sector

The study by ACIL Tasman into aspects of the grains sector provides valuable insights into the impacts of full and partial deregulation in some jurisdictions and compares outcomes with those states that retain restrictions (attachment 3). This study is particularly germane given the claims that have been made about the benefits of export single desks and the alleged inappropriateness of seeking to apply competitive disciplines to the sector. The key findings of the study include:

- The most significant effect of partial or complete deregulation of the barley and canola markets in Australia has been the development of cash or 'spot' grain selling alternatives for growers. In particular, more growers now receive payment on delivery.

- Prices are determined internationally — hence Australia is a price taker on world markets.

- There is no evidence of any general grain price decline (or handling cost rise) as a result of deregulation in any of the markets studied. It appears that deregulation has affected the timing but not the nominal prices received by farmers. However, as the terms of payment have become more flexible, this indicates that pre-deregulation some financial penalty was being suffered by participants.

- Strong competition to accumulate grain is a major feature of deregulated markets with buyers competing on price and terms and services. This has provided growers with a range of new products — for example, where there was one pool for barley per season in Victoria prior to deregulation, there are now at least five and most have a range of payment and finance options.

- Having available alternative grain selling options allows grain producers and traders to better match risk, payment timing and financing to their individual business needs. It puts farm firms in a better position to maximise profit. Growers are 'voting with their feet' and making use of these alternatives.

Annex: NCP institutional issues

The governments of New South Wales (sub. 99), Victoria (sub. 51), Queensland (sub. 119), Western Australia (sub. 117), Tasmania (sub. 109), the ACT (sub. 112) and the Northern Territory (sub. 130) made submissions to the Commission's inquiry. The submissions primarily focus on the benefits of NCP reforms and the opportunities for further reform, although some comment on institutional arrangements.

Costs of review and reform implementation

The ACT Government observes that given the ACT's small size, the ratio of gains to costs from NCP reforms is lower than for other jurisdictions. In a similar vein, the ACT notes the higher per capita costs of maintaining institutions like the Independent Competition and Regulatory Commission. The Northern Territory Government makes similar points.

Response

The Council recognises that smaller jurisdictions may incur higher per capita costs for review activity than larger jurisdictions. It is important to note, however, that because costs may be relatively higher for small jurisdictions, it does not follow that the costs outweigh the benefits. If net gains are on offer, it is worthwhile capturing such gains. Review costs are one-off whereas the ensuing benefits accrue year after year.

That aside, the Council appreciates the position of smaller jurisdictions and generally seeks to pursue strategies to address their concerns. For example:

- The Council made a decision in its 2001 assessment to prioritise legislation review commitments — this effectively relegated 1000 pieces of legislation to non-priority status. In these instances, the burden of proof on governments is relatively low. For example, the Council has often deemed simple desktop reviews as sufficient and has accepted governments' public interest arguments for retention of low grade restrictions without requiring extensive corroborative evidence.

- The Council has further indicated to governments that if reviews are not undertaken, it is prepared to accept policy actions similar to those applied in other jurisdictions that have been based on appropriate review processes. For example, the Council assessed Tasmania's *Electrical Industry Safety and Administration Act 1997* as compliant without requiring the state to conduct a review. Tasmania demonstrated that its restrictions were similar to those deemed to be in the public interest by appropriate reviews in other jurisdictions.

- The NCP provides that governments can remove competition restrictions without first conducting a review — presumably this would only occur where it is apparent that the restrictions do not serve the public interest.

- The NCP provides that governments can introduce phased transitional reform paths where warranted — this can significantly reduce adjustment costs and possibly obviate a need for compensation. Where compensation is deemed appropriate, governments can implement measures to recoup the initial outlay as occurred with national dairy reforms and the Northern Territory Government's taxi compensation package.

- The NCP allows for national reviews to address certain legislation review matters that affect all jurisdictions. Putting aside the issues of the effectiveness of national review processes, they can help defray the costs of reviews for participating governments.

In conclusion, the Council has often provided guidance to governments on what actions are required to meet NCP obligations. In doing so, it aims to provide practical advice that does not lead to unwarranted administrative, implementation and/or transitional costs. There may, however, be scope for the Council to engage further with governments to consider similarities/differences in (complying) legislative outcomes in other jurisdictions with a view to further minimising costs. Furthermore, the Council considers that governments may not have used the transitional reform provisions of the NCP to the extent that may be warranted. In particular, where adjustment costs can be addressed through measures such as phasing, the costs and benefits of such approaches should be explored fully.

Reducing future reform costs

The Tasmanian Government suggested that governments and the Council should determine on a bilateral basis which Acts require further review as part of the ten year review program. For example, Tasmania considers that legislation involving issues such as poisons and health services require an initial review to ensure an appropriate balance between social and competition objectives. Once this has been achieved, Tasmania argues that a full review of legislation of this nature, every ten years, may be unnecessary if there are no major external factors that warrant such a review.

The Western Australian Government (p. 5) proposed that the Commission should examine whether a materiality test could be introduced to determine if a legislation review is warranted.

The Victorian Government considered that, given the administrative costs of the annual reporting process, it would prefer that this be conducted on a 3-5 year basis in future, rather than the current annual NCP assessments.

Response

The Council sees merit in the Tasmanian Government's proposal. Subsequent reviews, for example, may not always need to revisit public benefit arguments, but rather focus on whether the cost-benefit calculus has changed or whether changes in circumstances have had a significant impact — for example, whether new ways of achieving objectives without restricting competition have emerged. The Council could advise governments of relevant developments in other jurisdictions.

To a large degree the Council conducted a 'materiality' screening process by assessing around 1000 out of 1800 pieces of legislation as nonpriority. Moreover, the Council has only recommended individual reductions in competition payments for legislative restrictions that are likely to have a significant impact. As is apparent from the 2003 NCP assessment, the Council is not overly concerned about individual breaches of obligations that have little discernible impact on the public interest (for example, retaining title registration for speech pathologists).

Looking forward, the Council sees benefits in jurisdictions applying a materiality threshold test to determine the extent of resources required for the cycle of second round reviews. Any future successor to the Council could, if requested, provide advice to jurisdictions in this regard. However it would be important to ensure this process was not used as a means of sidelining 'difficult' reforms.

The changes to NCP arrangements proposed by the Victorian Government (3-5 year reporting cycles) are at odds with the decision of the CoAG 2000 meeting that resulted in the parties moving to annual NCP assessments. A concern with longer reporting cycles is the potential for reforms to be 'back-loaded' to assessment years. Without ongoing reporting and monitoring it may be difficult for an assessment body to keep abreast of developments and to facilitate reform momentum.

Moreover, much of the success of the NCP can be attributed to the work of the specialist competition units within each state and territory. A 3-5 year reporting cycle could diminish the capacity of such units to progress reforms.

The assessment process and competition payments

The Victorian Government has concerns about the Council's review process, in particular a perceived lack of:

- transparency
- clearly defined formal process after the submission by governments of their annual reports
- a logical framework underpinning the decisions of the Council to recommend penalties.

In addition, Victoria considers it a deficiency that the states and territories receive draft assessment reports for factual comment, but not draft recommendations. It noted concerns about the lack of clear processes for demonstrating 'correspondence' between the Council's recommendations and NCP compliance benchmarks.

The ACT Government makes a similar point and seeks more explanation from the Council about its negative assessments. It considers that the quality, detail and transparency of the Council's assessments need to be enhanced.

Response

The Council considers that measures that improve the transparency of NCP processes should be encouraged. Accordingly, it aims to operate in a transparent manner and its reports, which are public documents, endeavour to explain the reasoning for assessments. While the Council seeks to keep governments apprised of areas where noncompliance may have payments implications and aims to explain its reasons for negative assessments and the framework for determining the magnitude of any suspensions or deductions, the above comments suggest that there is scope for improvement.

Currently, governments receive a draft assessment report (without payment recommendations) typically after bilateral meetings with the Council's secretariat. The purpose of these meetings and the 'exposure draft' is so that the Council can be satisfied about the factual basis for its assessments. Governments first see the Council's recommendations at the same time as the Australian Government Treasurer — although the bilateral discussions should ensure that there are no surprises. Jurisdictions then have a month in which to raise their concerns with the Treasurer. The Council considers it appropriate that it not engage in debates with assessed parties about its recommendations. These are matters that must be settled at the intergovernmental level as part of the process leading to the Australian Government determining whether to accept, reject or modify the Council's recommendations.

Ultimately, whether a jurisdiction's actions accord with CoAG requirements entails a judgment by the Council. It should be no surprise that, given the range of assessment matters across nine jurisdictions, differences of opinion arise. The possibility of an incorrect assessment leading to a competition payment penalty is reduced by the transparency of the assessment process and the provision for jurisdictions to put their views to the Treasurer.

The NCP agreements do not specify a 'formula' for competition payment recommendations. In the first instance, the Council assesses the extent to which competition restrictions:

- distort relative prices and hence (current and future) production and consumption decisions

- affect resource use and investment decisions — such as encouraging the inefficient relocation of mobile capital
- transfer income from users/consumers to incumbent beneficiaries
- impinge on consumers' convenience (such as the restrictions on when people can shop)

In addition to assessing the impact of a compliance breach, CoAG has advised the Council to take account of each jurisdiction's overall commitment to the NCP and the effect of compliance failure on other jurisdictions (CoAG 2000).

The Council interprets CoAG's guidance to mean that a single compliance breach in an important area of reform may be the subject of an adverse recommendation, particularly if it affects other jurisdictions. On the other hand, less significant individual breaches of reform obligations should not necessarily have adverse payment implications, especially if the responsible government has generally performed well against the total NCP program. For example, based on CoAG's guidance, the Council developed the concept of suspension pools to account for the raft of less significant compliance breaches that do not warrant an individual penalty — the pools reflect each jurisdiction's overall commitment to the NCP and hence, condition the magnitude of any recommended suspension. Indeed, where possible, the Council recommends suspensions, as the public interest is advanced through encouraging reforms, rather than penalising non-reform.

Social policy matters

The Tasmanian Government considers that social policy issues should be removed from legislation review because the Council may not be the appropriate body for assessing 'highly technical' issues where benefits are 'primarily non-economic.' The Northern Territory Government also contends that the Council fails to recognise the intractable social impacts associated with alcohol consumption in the Territory.

Response

In several areas of NCP such as liquor retailing, gambling, education and child care, significant social issues coexist with economic and regulatory issues. In other priority areas (such as taxi licensing) which at first glance appear to be primarily focussed on economic considerations, reforms have important social implications (for example, the availability of taxi services for mobility impaired people). The public benefit focus of NCP allows for an open, transparent and independent consideration of the extent to which social issues provide a public benefit rationale for restricting competition.

Where legislation involves social policy matters or highly technical issues, the Council looks for 'due process' in terms of the manner in which expert review

panels conducted their analysis. The Council does not see its role as being an expert on the technical and social policy aspects of every piece of legislation.

In relation to alcohol problems in the Northern Territory, the Council has made clear that restrictions on the sale of alcohol can be shown to be in the public interest. The compliance issue in the Territory relates to a decision to apply restrictions in a way that provides one group of sellers one day each week in which they do not face competition from other retailers of alcohol. The territory has not provided a robust public interest case that demonstrates that this is the least restrictive way to achieve its harm minimisation objectives.

Advocating reform and dictating outcomes

The New South Wales Government considers that the Council should adhere to the task of monitoring without expressing views on preferred outcomes. It further considers that the Council should assess compliance with reform requirements established under the NCP agreements and the processes specified under those agreements, rather than pre-empt public policy aims — for example, by employing a scientist to advise on environmental outcomes in water.

Response

As the Council is required to assess jurisdictions' reform progress, it is difficult to imagine how the assessment function could be performed without indicating its views on outcomes — typically, this involves a request to remove a restriction or demonstrate that it is in the public interest. In seeking to create a transparent assessment process, the Council makes its position public and provides opportunities for its position to be challenged. On occasion interest groups have engaged in misinformation campaigns designed to encourage support for a legislated privilege, and the Council has responded by indicating the benefits from reform in other jurisdictions. In these cases, the Council may take on the role of an advocate for reform.

The employment of technical experts is not designed to 'pre-empt' public policy aims but to enable the Council to carry out its assessment function in a more informed manner. In the case of water, for example, the Council's decision to employ a scientist was made to facilitate consideration of the evidence on whether governments had addressed the CoAG reform obligation to ensure appropriate allocations to the environment, based on the best available science and recognising the interests of other existing users.

The Council aims to provide a guidance and facilitator role through its assessment frameworks and bilateral discussions with officials. It has an open door policy and regularly meets with officials seeking early views about the compliance of proposed legislative reforms or interested parties concerned about the application (or lack of application) of NCP.

Attachments

In considering how best to contribute to the Commission's review, the Council identified areas of research that would complement and inform the Commission's analysis. Three topics emerged from that consideration. One sought to help identify areas of future reform activity, whereas the other two sought to evaluate NCP reforms in the dairying and grains markets — where claims of adverse outcomes have been made by some groups.

The commissioned research was conducted between June and September 2004 and the resultant reports (attached) present the views of the authors, which may or may not be shared by the Council. The Council considers that these reports add to an understanding of NCP reforms to date and the scope for gains from similar reform going forward.

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Attachment 1: *Microeconomic reform in Australia: Comparison to other OECD countries*, report to National Competition Council, The Allen Consulting Group, September 2004.

Attachment 2: *Dairy: Now and then, the Australian dairy industry since deregulation*, RidgePartners, October 2004.

Attachment 3: *Australian Grain Market Reforms, A review of the National Competition Policy grain market reforms*, prepared for the National Competition Council, ACIL Tasman, August 2004.

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