NATIONAL
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NCC Occasional Series

Microeconomic Reform in Australia
Comparison to Other OECD Countries

The Allen Consulting Group

November 2004

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Comparison to Other OECD Countries

September 2004

Report to National Competition Council

ISBN 0-9756705-8-1

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An appropriate citation for this paper is:
National Competition Council 2004, *NCC Occasional Series: Microeconomic Reform in Australia - Comparison to other OECD Countries*, AusInfo, Canberra.

The National Competition Council

The National Competition Council was established on 6 November 1995 by the *Competition Policy Reform Act 1995* following agreement by the Commonwealth, State and Territory governments.

It is a federal statutory authority which functions as an independent advisory body for all governments on the implementation of the National Competition Policy reforms. The Council's aim is to 'improve the well being of all Australians through growth, innovation and rising productivity, and by promoting competition that is in the public interest'.

Information on the National Competition Council, its publications and its current work program can be found on the internet at www.ncc.gov.au or by contacting NCC Communications on (03) 9285 7474.

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Foreword

In April 2004 the Australian Government Treasurer referred to the Productivity Commission (PC) a review of National Competition Policy (NCP). The objects of the review are to identify the impacts of NCP on the Australian economy and community and to examine further opportunities for reform that will be likely to produce significant gains for Australia.

Over the last ten years the National Competition Council (Council) has had a central role in promoting NCP reforms and assessing reform activity undertaken by the Federal, State and Territory Governments. As such it has a keen interest in the PC's review.

At an early stage in considering how it could contribute positively to the PC's review, the Council sought to identify areas of research that would complement and inform the PC's analysis. Three research topics emerged from that consideration.

One sought to assist in identifying possible areas of future reform activity by sketching the range of sectoral reforms that had been undertaken in a range of other economies. The aim of this research was to broaden the horizon against which future reform activities might be considered.

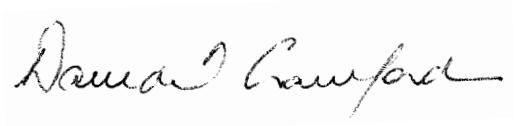
The other two projects sought to undertake an ex post examination of aspects of NCP reform in the dairying and grain production sectors. These were two sectors where claims of adverse results from reform were being made by some groups but where the Council was unable to find any independent or objective analysis to support or reject such views.

In commissioning this research the Council sought to sponsor high quality analysis that would genuinely contribute to the PC's review activity in this area. For each research area identified broad research briefs were prepared and proposals were sought from a number of experienced and professional consultancy organisations.

The commissioned research was conducted between June and September 2004.

This report and two others represent the output of this research activity. The reports present the analysis, judgements and conclusions of the various authors, the details of which may or may not be shared by the Council. Nevertheless the Council is very appreciative of the efforts of each consultancy in undertaking this work and of the contribution these reports can make to understanding of NCP reform activity to date and the scope for gains from similar reform going forward.

These reports have been provided to the PC as part of the Council's response to its draft report on NCP and are being published by the Council as the first three reports in an Occasional Papers series in order to further understanding of NCP and related microeconomic reform issues in Australia.



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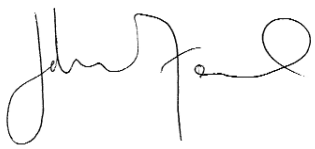
Acting President



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Suggested citation for this report:

The Allen Consulting Group 2004, *Microeconomic Reform in Australia: Comparison to Other OECD Countries*, Sydney.

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Contents

Introduction

The National Competition Council commissioned The Allen Consulting Group to examine the state of economic reform in a range of key sectors of the Australian economy against reforms in New Zealand, Canada, the United Kingdom, the United States, and the European Union.

This report is structured in the following way:

- *Part A: Report findings* — drawing on the analysis in the subsequent chapters, chapter 1 sets out a framework for a new microeconomic reform agenda;
- *Part B: Sectoral analysis* (chapters 2 to 12) — these chapters provide an overview of reforms in Australia and overseas, and identify key observations and further sources for reading;
- *Part C: Cross-sectoral issues* (chapters 13 and 14) — the sector-by-sector specific analysis from Part A is complemented by the analysis of a number of broader policy themes and trends in Australia and overseas; and
- *Part D: Appendices* — this part includes supporting material such as abbreviations and further reading on overseas experiences.

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Part A

Report findings

Chapter 1

A framework for a new microeconomic reform agenda

The purpose of this report is to assist in the determination of whether there are significant gains to be had through extending the current National Competition Policy reform program, either through taking reform further for areas already covered, by including new areas into the reform program, or by defining more broadly the scope of the National Competition Policy.

To aid in this analysis, this report examines the state of economic reform in New Zealand, Canada, the United Kingdom, the United States, and the European Union. While comparison of reform experiences across countries is a useful exercise in identifying lessons and areas for possible reforms, care needs to be taken when making such comparisons. That is, reform in any one country needs to be seen in light of the longer-term country-specific, social, political and economic environment in that and complementary industry sectors. Thus, rather than slavish copying,[1] cross-country reforms are best used to paint a broad picture of reform opportunities and trends.

1.1 The changing reform environment

Not surprisingly, the world has changed significantly since the precursor to the National Competition Policy reform program, the *Hilmer Report*,[2] was presented to the Council of Australian Governments in 1993.

In addition to the increased integration of the world economy, and the increased acknowledgement of the risks created by terrorism, there are a range of specific domestic factors that have emerged since the *Hilmer Report* that need to be taken into account in the development of any future microeconomic reform agenda.

The ageing population

As a result of the combination of:

- the aging of people born in the post World War II 'baby boom';
- relatively low fertility rates (see figure 1.1); and
- an increasing life expectancy (and the expectation that life expectancies will be maintained or increased);

Australia will have an ageing population.[3] Indeed, the 'aged dependency ratio' — i.e. the number of people aged sixty five years and over relative to the population aged between fifteen and sixty four — is forecast to fall from 5.25 to 2.4 in 2042.

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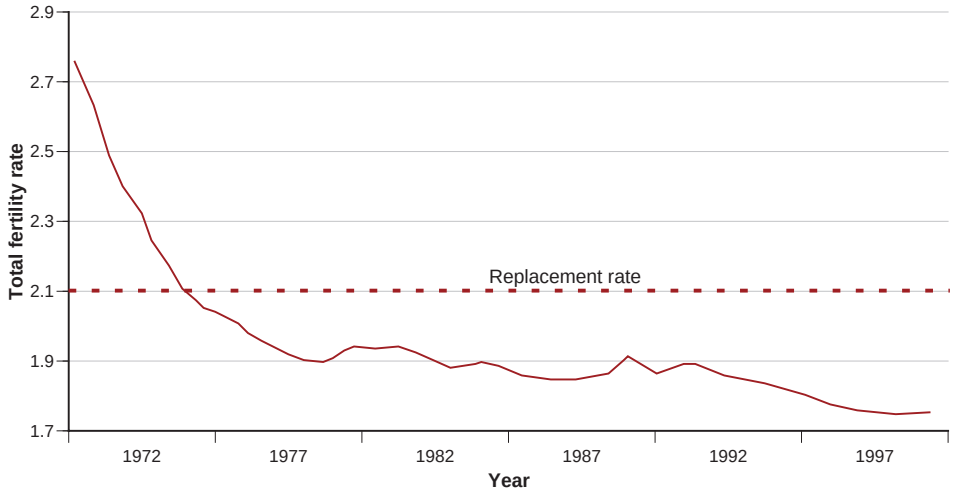
1 V. Koromzay 2004, *Some reflections on the political economy of reform*, Organisation for Economic Co-Operation and Development paper presented at the international conference, Economic Reforms for Europe: Growth Opportunities in an Enlarged European Union, Bratislava (Slovakia), 18 March, p. 1.

2 Independent Committee of Inquiry (Hilmer Inquiry) 1993, *National Competition Policy*, Canberra,

3 *Intergenerational Report 2002-03, 2002-03 Budget Paper No. 5.* Circulated By The Honourable Peter Costello, M.P., Treasurer Of The Commonwealth Of Australia, 14 May 2002.

Figure 1.1

AUSTRALIA'S HISTORICAL TOTAL FERTILITY RATE



Source: *Intergenerational Report 2002-03, 2002-03 Budget Paper No. 5.* Circulated By The Honourable Peter Costello, M.P., Treasurer Of The Commonwealth Of Australia, 14 May 2002, p. 21

This demographic shift will:

- influence the level of demand for government services — given that average spending per person for health and long-term care is significantly greater for older people,[4] and there are a range of welfare payments (e.g. old age pensions and disability pensions) and services (e.g. transport, housing, etc) that are subsidised by governments, the aging population will clearly have implications for spending across a range of portfolios; and
- reduce governments' capacity to tax income (to pay for the increased demand for services noted above) — while expenditure levels are likely to increase to meet the demands of an ageing population, governments' capacity to tax income may be squeezed if economic growth slows, due to a decline in the rate of growth in the labour force or if labour productivity does not increase.[5]

In effect, barring significantly improved workplace productivity (which should be a policy goal in itself), the ageing of our population will require governments to 'do more with less' across a range of policy and service delivery areas such as the health and aged care sectors. In effect, these sectors, which were not a focus of the National Competition Policy reform agenda, must be a focus of future microeconomic reform programs.

[4] The Allen Consulting Group 2002, *The Financial Implications of Caring for the Aged to 2020: A Report Commissioned in Conjunction with The Myer Foundation Project 2020 — A Vision for Aged Care in Australia*, Melbourne.

[5] Productivity Commission 2004, *Economic Implications of an Ageing Australia*. Issues and Questions. Adapted from An Ageing Australia: Small Beer or Big Bucks?

The supply and demand of information

While the 'dot com' era was certainly over-hyped, it has clearly changed the market dynamics and improved productivity in a number of industries where disintermediation has been possible.[6]

Possibly more subtly; however, the increasing use of information technology[7] has fuelled both public's demand for information, and the ability of governments and business to provide it in a timely and accessible manner. This has had, and will continue to have, a number of interrelated consequences, for example:

- reduced cost of information disclosure has resulted in increased expectations from government, private sector, and the community more broadly that performance-related information — such as, availability, prices, quality, and so on — will be made available, at least on the Internet, in a timely manner;
- where governments and businesses do not provide performance-related information, or provide it only in a partially comparable sense, the Internet has fostered the development of private sector alternatives for reviewing and comparing available information gaps (e.g. book reviews,[8] price comparisons for broadband packages,[9] reviews of new cars,[10] or a range of other goods and services[11]); and
- the availability of information, goods and services online has somewhat reduced the 'tyranny of distance' experienced by some regional and remote communities.

In effect, there is an increasing expectation for openness in the provision of information. Policy development and implementation is no different. Future microeconomic reform initiatives need to acknowledge this expectation, and should embrace new mediums for the provision of performance information to the community as an enabling and empowering mechanism.[12]

1.2 Characteristics of best-practice reform

Any new reform agenda should be:

- comprehensive;
- inclusive; and
- sustained.

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6 See The Allen Consulting Group 2000a, *E-commerce Beyond 2000*, NOIE, Canberra; Frontier Economics Group 2000, *E-Commerce and its Implications for Competition Policy*, OFT308, Office of Fair Trading, London; and Productivity Commission 2004, ICT Use and Productivity: A Synthesis from Studies of Australia Firms, Research Paper, Canberra.

7 Access to home computers has more than doubled and the use of home Internet has tripled since the National Competition Policy was agreed — Australian Bureau of Statistics (ABS) 2003a, *Household Use of Information Technology, Australia*, Cat. No. 8146.0, Canberra.

8 See, for example, *Amazon* at http://www.amazon.com.

9 See, for example, *Whirlpool* at http://www.wirlpool.net.au.

10 See, for example, *CarPoint* at http://carpoint.ninemsn.com.au.

11 See, for example: *Epinions* at http://www.epinions.com; and *Choice* at http://www.choice.com.au.

12 P. Grabosky 1994, 'Organisational Leverage and the Technologies of Regulatory Compliance', Administration, Compliance and Governability Program, Working paper No. 24, Research School of Social Sciences, ANU, Canberra.

These three characteristics of best-practice microeconomic reform are discussed in the following sections.

Comprehensive reform

While competition is now synonymous with microeconomic reform because of the National Competition Policy reform agenda, microeconomic reform should not necessarily be solely focused on competition.

As a first step in the development of a new microeconomic reform agenda:

> it is necessary to figure out what economic reform actually is. How can you spot a true economic reform, as opposed to an arbitrary change in policy? I am not aware of any agreed answer to this question, and the one I offer is no doubt incomplete: the best definition I can come up with is that economic reform is policy change directed at improving the static or dynamic efficiency of resource allocation in the economy.[13]

The National Competition Council has similarly identified that 'some legislation adversely impinges on efficiency without necessarily restricting competition' and that it is appropriate to 'revisit the National Competition Policy framework from a broader resource allocation/efficiency perspective to assess if further gains are on offer from expanding the target from competition to efficiency'.[14]

An efficiency focus would need to acknowledge efficiency's three constituent components:

- technical efficiency — the efficient organisation, production and distribution of resources within firms;
- allocative efficiency — the efficient allocation of resources between firms and industries; and
- dynamic efficiency — the ability of firms to innovate and respond to consumers' demands.

As a result, an efficiency focus provides scope for the inclusion of some of the factors that are currently in the 'public interest' test contained in sub-clause 1(3) of the *Competition Principles Agreement*:

- laws and policies relating to ecologically sustainable development;
- laws and policies relating to matters such as occupational health and safety;
- the competitiveness of Australian business; and
- the efficient allocation of resources.

The analysis in this report is based upon a broad understanding of 'reform', which has at its core an efficiency objective.

Inclusive reform

While the National Competition Policy was an intergovernmental agreement, in many instances there was actually little cross-government cooperation (particularly

[13] V. Koromzay, op. cit. p. 1. Koromzay goes on to suggest that such reform can be summarised as the taking away of rents. While this is a neat shorthand expression, it is in fact a somewhat narrower conception of reform than identified in the quote above.

[14] National Competition Council 2004, *Submission to the Productivity Commission Review of National Competition Policy Arrangements*, Melbourne, p. 32.

in the legislative review processes),[15] and even within jurisdictions the review processes tended to be carried out across traditional departmental lines rather than on an issues basis.

While 'whole of government' is now a mantra in public policy circles, it remains challenging for governments to coordinate their actions across departments and agencies, let alone to fully coordinate with other levels of government across all relevant activities. This is evident in a number of ways:

- it is not clear that a 'whole of government' approach by itself takes sufficient account of issues relating to the spatial impact of policy — policies with a sectoral focus (e.g. National Competition Policy) are particularly vulnerable to spatial blindness, with the policy impacting on a range of regulatory areas but applied on an industry-by-industry or sector-by-sector basis — further, while the policy was designed to benefit Australia's national interests, it did not include a structure to address the likelihood that the benefits of reform would be spread differently across the community; and
- there is a risk that it does not leave much of a role for the involvement of community, non-government organisations or business interests, among others.

Better policy outcomes cannot be achieved unless a 'whole-of-community' approach to policy development is taken. This means engaging stakeholders in the policy development process such as relevant tiers of government, the private sector, non-government organisations, local community groups and individuals generally. However, it also means placing the interests of the community as a whole over the vested interests of some individual sectors.

In a world where inclusion of business and civil society is increasingly the norm, the term 'governance' better defines the processes by which people solve their problems and meet the needs of the people using 'government' as one instrument.[16]

Integrated governance[17] is an acknowledgement that reforms need to be undertaken on an integrated basis with solutions that cut across traditional departmental lines, ministerial responsibilities, commonwealth-state regulatory responsibilities, and even sectors (e.g. government, community and business).

A narrow interpretation of governance — and hence microeconomic reform — that focuses simply on government's role in facilitating reform is no longer appropriate for describing how populations and regions are organised and administered. Increasing the capacity of public governance requires reforms based on new spatial alliances and partnerships between levels of governments, the private sector and the community.

Better governance arrangements and institutional frameworks would establish a mechanism to connect national polices with on-the-ground needs and implementation. It would include the community in the process through a consultative style that builds a shared vision or direction among policy-makers and

[15] R. Deighton-Smith 2001, 'National Competition Policy: Key lessons for policy-making from its implementation', *Australian Journal of Public Administration*, vol. 60, no. 3, pp. 29-44.

[16] For example, in many areas of social policy the success of reform depends upon the efficiency and effectiveness of the non-government sector, which is responsible for the delivery of programs through service contracts.

[17] Institute of Public Administration Australia 2002, *Working Together Integrated Governance*, A National Research Project, March.

the community. The broad aim is for 'distributed governance' arrangements which disperse power and influence through the community and over a wide variety of actors and groups.[18]

This concept of governance is now a key driver of policy analysis and formation in the OECD's vision of best-practice regulatory development and reform,[19] and it clearly provides some insight into how a new microeconomic reform agenda could be shaped.

Sustained reform

In the main, Australia has been at the forefront of competition reform initiatives, or at least on par with selected OECD counterparts. While reforms have resulted in permanent structural change to Australia's economy and specific sectors — e.g. energy or communications — change has occurred in an evolving economic environment. For example, and as already discussed, there are a number of issues that were not considered or fully anticipated at the time the National Competition Policy was developed but are now likely to have a significant impact on any future reform initiatives — such as the impact of technological change and demographic changes.

These emerging issues highlight the dynamic environment in which policy reform should be considered and that while it is always important to take stock, reform and the need for reform is not static. In fact, it would be counter productive to conclude that the completion of a reform initiative conceived ten years ago means that no further reform initiatives are needed.

When considering the policy initiatives in other countries, this point is made even clearer. If Australia was to do no more than complete the remnant aspects of the current National Competition Policy then relative to overseas countries Australia would fall back, potentially reducing economic development and reducing our relative standard of living.

To highlight this point, figure 1.2 presents a representation of Australia's economic reform progress since the introduction of National Competition Policy.

[18] P. Paquet 2001, 'The new governance, subsidiarity, and the strategic state' in OECD 2001a, *Governance in the 21st Century*, OECD, Paris, p. 188.

[19] For example, see: S. Holmes 2002, 'Regulatory Governance: The Rule of Law and Gains from Reform', OECD paper presented at the OHR/OECD Conference on Regulatory Governance, Sarajevo, 19 April; OECD 2001a, *Governance in the 21st Century*, Future Studies, OECD, Paris; OECD 2001b, *Citizens as Partners: Information, Consultation and Public Participation in Policy-making*, OECD, Paris; OECD 2002, *Regulatory policies in OECD Countries: From Interventionism to Regulatory Governance*, OECD Reviews of Regulatory Reform, OECD, Paris; OECD 2001c, *Government of the Future*, PUMA Policy Brief No. 9; and OECD 2001d, *Engaging Citizens and Policy-making: Information, Consultation and Public Participation*, PUMA Policy Brief No. 10.

Figure 1.2

AUSTRALIA'S RELATIVE REFORM PROGRESS — NOW AND IN THE FUTURE

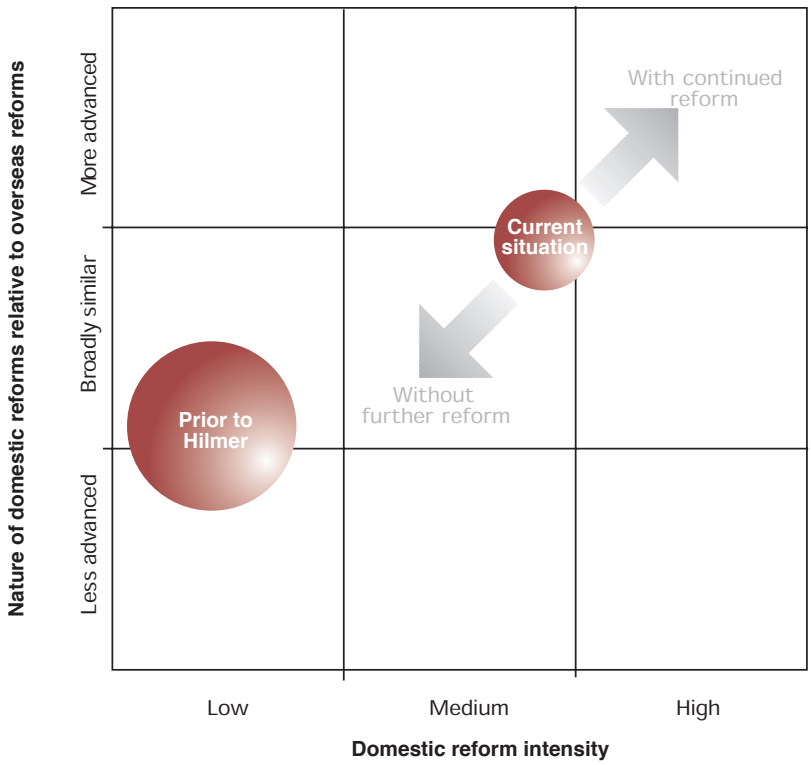


Figure 1.2 depicts reform progress across all sectors of the Australian economy — including those that were not explicitly included in the National Competition Policy, such as labour market and non-market government services. While somewhat stylised, figure 1.2 considers Australia's performance against three separate criteria:

- domestic reform intensity (position on the x axis) — in effect, this considers whether reform has been a priority (in theory and practice) for domestic policy makers. The challenge is that it must be acknowledged that:
  - reform agendas differ across jurisdictions;
  - policy activity and change does not necessarily equate with reform; and
  - timing, within and across jurisdictions, is important when considering relative progress — for example, while there was considerable energy market reform early in the National Competition Policy process, in recent years reform has stagnated;
- the progress of domestic reforms relative to overseas reform (position on the y axis) — the challenge here is that it must be acknowledged that the often very different nature of the reform agendas adopted overseas is influenced by different starting points; and
- the quantum of potential benefits associated with reform (considered in terms of size of the 'bubble'), for example, benefits may be: averted opportunity costs; and in monetary and non-monetary in nature.

Figure 1.2 highlights that Australia's reform progress is both dynamic and relative, with further reform (or no additional reform) moving Australia to the top right hand corner (lower left hand corner) while at the same time capturing the benefits associated with reform (or forfeiting the benefits of reform).

1.3 Emerging priorities for an Australian agenda

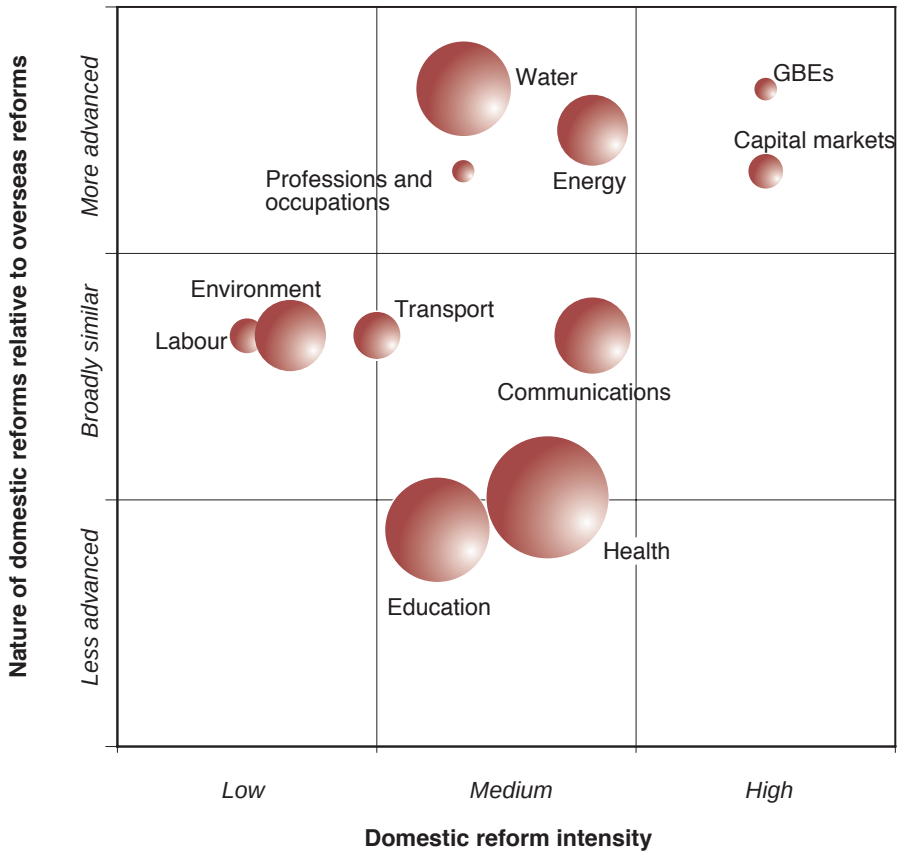
While the framework outlined in figure 1.2 highlights that Australian microeconomic reform has progressed significantly since the introduction of the National Competition Policy, the research presented in Part B of this report, suggests that:

- 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; and
- there are reform initiatives in other countries of relevance for Australia.

To aid the Productivity Commission — and ultimately the Council of Australian Governments — consider future reform initiatives, figure 1.3 separates out Australia's 'current situation' for each sector. The figure highlights each sector's performance relative to the selected OECD countries and in terms of potential benefit from reform.

Figure 1.3

SUMMARY CLASIFICATION OF SECTORS



The key observations from figure 1.3 are that:

- the greatest untapped benefits come from policy sectors in which our experiences are broadly consistent or less advanced relative to overseas experiences but which are growing in importance, such as:
  - health;
  - education;
  - communications; and
  - environment;
- there are considerable potential benefits from water reform, but because of our comparatively advanced policy development in this area there is little overseas experience that will shape our water reform agenda; and
- there remains a number of areas where reform has stalled (e.g. energy market reform) as a result of state and territory policy decisions.

Looking at specific sectoral reforms undertaken both in Australia and overseas, it is clear that Australia's pattern of reform has generally been similar to that overseas (see Part B of the report). This observation reflects the increasing understanding of policy transfer in shaping reforms — where policy transfer is a:

> process in which knowledge about policies, administrative arrangements, institutions and ideas in one political setting (past or present) is used in the development of policies, administrative arrangements, institutions and ideas in another political setting.[20]

Even with the harmonised nature of reform generated as a result of increased cross-jurisdictional policy transfer; there are a number of overseas reform initiatives that are not necessarily reflected in Australia. These reforms are outlined in table 1.1 and discussed in detail in chapter 2 through to chapter 12. While keeping in mind the caveat against slavish copying of reforms, overseas reform initiatives highlighted are of potential interest to Australia.

Table 1.1

KEY FINDINGS

Sector	Key issues for possible overseas experience transfer
Application of competition law and competitive neutrality (CN) principles to government business activity	Re-orientation of CN away from a focus on the status of the government business to focus on where governments distort the marketplace by favouring one business — public or private — over another (i.e. akin to the European Union's 'state aid' principle).

[20] D. Dolowitz and D. Marsh 2000, 'Learning from abroad: The role of policy transfer in contemporary policy-making', *Governance: An International Journal of Policy Administration*, vol. 13, no. 1, pp. 5-24, p. 5. Also see: C. Bennett 1991, 'What is policy convergence and what causes it?', *British Journal of Political Science*, vol. 21, no. 2, pp. 215-33; R. Rose 1993, *Lesson-Drawing in Public Policy*, Chatham House, Chatham; C. Bennett 1997, 'Understanding ripple effects: The cross-national adoption of policy instruments for bureaucratic accountability', *Governance: An International Journal of Policy Administration*, vol. 10, no. 3, pp. 213-33; C. Radelli 2000, 'Policy transfer in the European Union: Institutional isomorphism as a source of legitimacy', *Governance: An International Journal of Policy Administration*, vol. 13, no. 1, pp. 25-43; and K. Jacobs and P. Barnett 2000, 'Policy transfer and policy learning: A study of the 1991 New Zealand Health Services Taskforce', *Governance: An International Journal of Policy Administration*, vol. 13, no. 2, pp. 185-213.

Sector	Key issues for possible overseas experience transfer
Energy	Unlike Australia's centrally controlled National Electricity Market, the UK's New Electricity Trading Arrangements attempt to duplicate trading conditions in other commodity markets by facilitating bilateral trading between generators, suppliers, traders and customers.
Transport	The common objective in all countries has been to promote competitive and commercial outcomes in which price forms an accurate signal to transport users. Australia has undertaken a high degree of reform, but has further scope for improvement in road transport, with the need for reform and assistance to intermodal issues to be considered on a holistic basis — for example, despite the AusLink initiative, transport reform is not necessarily agreed or coordinated across jurisdictions.
Professional and occupational regulation	There has been considerable move towards harmonisation and mutual recognition across the jurisdictions although effort is still needed. While legislation reform allowing multidisciplinary practices has occurred in most jurisdictions the recent CLERP 9 legislation and ongoing debate about how best to deliver appropriate corporate governance suggests this area may not be settled. In fact the US has recently reversed the trend towards multidisciplinary practices and the EU has severe restrictions on it.
Labour market	Overseas experience demonstrates that continued policy vigilance required to provide: • effective activation measures and employment services, combined with enhanced monitoring of social benefits, while still maintaining an adequate safety net; • changes in taxes and benefits so that 'work pays'; • life-long job-related training that enhances career prospects and addresses skill mismatches; and • lower barriers to labour demand and improved functioning of labour markets so as to strike a balance between flexibility and security. Challenges faced by all OECD countries, and addressed in different ways, are to provide a suitable 'work-life balance', particularly in light of an ageing workforce (i.e. to encourage and provide for part time and temporary work, promote work to later ages, increase female participation, etc).
Capital markets	Substantial reforms are already implemented or in train domestically to strengthen market integrity and investor confidence. Potential to explore lessons from the 'Single Market' in the European Union if Australia and New Zealand were to revisit the possibility of integrating capital markets.
Health	There are a range of issues that overseas experience suggest we need to continue to focus on, including: • strengthening the position of purchasers; • reporting better information about health care, both to underpin effective purchasing and to enable consumers to make better informed choices; and • placing a greater emphasis on primary care. As primary care is usually the first contact with the health care system, its role and organisation is very important in the overall efficiency and effectiveness of health-care systems. Overall, a focus on the provision of health care (rather than, for example, its financing) is considered relevant to Australia

Sector	Key issues for possible overseas experience transfer
	to improve social outcomes.
Education	Eduction reform has been and continues to be focused on performance. Overseas experience highlights three strategies to improving student performance: • providing for a greater level of school choice and ensuring that choice is made within a nationally coherent education policy rather than in the haphazard way school choice has developed; • emphasis on learning outcomes, standards, testing, and accountability; and • making schools more responsive to rapid change, and to the needs of their students and the communities in which they live.
Water	Water prices in many of Australia's OECD counterpart nations still do not reflect the full capital costs of water supply, and progress towards that goal is slow. The key remaining challenge for Australia — and other OECD nations — is the reconciliation of economic goals with environmental and broader social and community outcomes.
Environment and planning regulation	Relative to overseas countries, Australia remains significantly exposed to future greenhouse risk. A national emissions trading scheme does not exist and is not supported at the Commonwealth level. Experience in Australia and elsewhere reveals that there are a number of instruments that have been devised, tried and tested and found to be effective that advance efficiency and environmental objectives. What is missing is the commitment to advance more market-oriented reforms, to apply effective market mechanisms on any but a small scale, or to attempt coordinated action on a larger scale.
Communications	There are areas where Australian reforms have not been undertaken to the same extent as in other OECD nations, for example: • Australia is yet to remove all government ownership of telecommunications operators; • Australia maintains foreign ownership restrictions on the telecommunications industry; and • Australia has never reviewed structural options for the sector including separation of telecommunications from pay TV services, nor structural separation between the fixed and mobile services of the incumbent been imposed. Issues concerning the regulation of 'voice over IP' services raised by the European Commission may warrant attention in Australia as use of the technology grows. Like Australia, the United States maintains a monopoly over postal services — although United States postal monopoly is considerably smaller in scope than Australia's postal monopoly. This is in contrast to New Zealand and the United Kingdom where postal services have been opened to full competition.

Clearly, overseas microeconomic reform experience suggests that there remains considerable opportunity for the extension of the National Competition Policy reform program to capture efficiency improvements across a broad range of sectors.

Part B

Sectoral analysis

Chapter 2

Application of competition law and competitive neutrality principles to government business activity

Recent decades have seen a concerted move by governments around the world to subject competition to many of those services that have traditionally been supplied by government enterprises. This has been part of a broader policy shift to improve the efficiency and quality of the services provided.

Merely subjecting public services to market forces however, is generally not enough to achieve these objectives because public providers often have advantages over their private sector counterparts. Where these advantages arise merely from being publicly owned, such as exemptions from some taxes or an absence of rate of return disciplines, an explicit policy approach to address this non-neutral competitive position is also required — this policy approach is called competitive neutrality.

Overall, the Organisation for Economic Cooperation and Development (OECD) supports the application of competitive neutrality in the provision of government services as evidenced in the *Best Practice Guidelines For User Charging For Government Services*.

> If an organisation is supplying a commercial service in competition with the private sector while retaining a monopoly provision of another service, care needs to be taken to ensure that the monopoly service is not subsidizing the commercial service. When pricing such services, care needs to be taken to ensure that their costing is accurate and that they incorporate all items of cost faced by private sector entities. For example, government organisations may be exempt from various taxes and enjoy free provision of certain support services provided by central agencies.[21]

The extent to which competition law and competitive neutrality are applied in OECD countries is discussed in the following section.

2.4 Major Australian reforms

The two major reforms affecting government business under the National Competition Policy framework are:

- the extension of the competitive conduct rules of the *Trade Practices Act 1974* to all businesses and professions in Australia, whether private or government;
- the application of competitive neutrality between significant government businesses and private sector competitors; and
- structural reform of government business enterprises and of government regulation.

[21] OECD 1998, *Best Practice Guidelines For User Charging For Government Services*, OECD Public Management Service, PUMA Policy Brief No.3, Public Management Service, Paris, p. 5.

These reforms have exposed government business activities to private sector competition and sought to remove any net competitive advantages they enjoyed simply as a consequence of their public sector ownership.

The competitive neutrality principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.[22] The Australian, state and territory governments are permitted some flexibility in how they implement the principles of competitive neutrality for the business activities belonging to them and their local governments. Accordingly, the rules of competitive neutrality vary between governments.

2.5 Overseas reform progress

Table 2.1 provides a snapshot of how government businesses are treated under competition laws in major OECD countries. It is followed by a discussion of specific policies and reforms in each country.

Table 2.2

APPLICATION OF COMPETITION LAW AND COMPETITIVE NEUTRALITY TO GOVERNMENT BUSINESSES IN OECD COUNTRIES

Question	EU	US	UK	Canada	NZ	Australia
Does the general competition law apply to publicly-controlled firms?	Yes	No	Yes	Yes	Yes	Yes
Publicly-controlled firms: Is there exclusion or exemption from competition law: cartel and other horizontal	No	Yes	No	No	No	No
Publicly-controlled firms: Is there exclusion or exemption from competition law: vertical and abuse of dominance (i.e. monopolisation)	No	Yes	No	No	No	No
Publicly-controlled firms: Is there exclusion or exemption from competition law : mergers	No	Yes	No	No	No	No
Is government business activity subject to competitive neutrality?	N/A	No	No	Yes	Yes	Yes

Source: OECD 2000, *International Regulation Database*, at http://www.oecd.org, accessed on 16 July 2004.

New Zealand

National government business activities became subject to competition law with the passage of the *Commerce Act 1986*. The *Commerce Act*, which applied to any government enterprise that engaged in trade, also included business activities of local governments.

[22] COAG 1995, *Competition Policy Agreements*, April 11, p. 17.

New Zealand adopted the principles of competitive neutrality through the process of corporatisation and the introduction of the *State Owned Enterprises Act 1986* in April 1987. The primary thrust of corporatisation in New Zealand was to encourage efficiency through competition and establish clear objectives and robust accountabilities. The *State Owned Enterprises Act* establishes State Owned Enterprises with the principal objective 'to operate as a successful business and, to this end, to be: as profitable and efficient as comparable businesses that are not owned by the Crown…'[23]

The Minister for Finance and the Minister for State Owned Enterprises hold equal shares in each State Owned Enterprise. The shareholding Ministers are not entitled to act as portfolio Ministers for sectors within which a State Owned Enterprise operates. The boards of State Owned Enterprises are accountable to the shareholding ministers and the chief executives of State Owned Enterprises are accountable to their respective boards. Directors are appointed by the shareholding Ministers on their ability to assist the State Owned Enterprise to achieve its principal objective.

State Owned Enterprises are required to add to shareholder value in their operations with a view to at least meeting financial targets agreed by the shareholding Ministers:

> The setting of appropriate financial targets seeks to: replicate the discipline that the threat of takeover would exert over the directors and managers of a company owned by the private sector; and provide an environment that is competitively neutral with the private sector.[24]

Importantly, the *State Owned Enterprises Act* does not restrict the government's pursuit of non-commercial goals via State Owned Enterprises. Rather, 'social good' outputs required by government are supplied by the State Owned Enterprises under contract, in a normal supplier/customer transaction.

Local governments transformed their public units into Local Authority Trading Enterprises, which had similar objectives as State Owned Enterprises. Local Authority Trading Enterprises are also publicly owned, but the private sector can own up to forty-eight per cent. They are expected to raise their own funds if that provided by their shareholders is insufficient, and are also expected to bear all the risks associated with their business activity — if they fail, their local government does not necessarily have to bail them out.[25]

Canada

Canada's *Competition Act 1986* governs the conduct of private, and government business activities in Canada. Government owned corporations are subject to the *Competition Act* to the extent they are engaged in commercial operations. The *Competition Act* ensures that the law would apply to government owned corporations that compete (or could compete) with private firms. In this regard it is broadly consistent with the application of the Australian *Trade Practices Act*.[26]

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23 The *State Owned Enterprises Act 1986*, Part 4 (1).

24 New Zealand Government 2002, *Government Business Owners Expectations Manual*, Wellington, p. 37.

25 It is noted that the State Owned Enterprise TeraLink did in fact go into liquidation in 2000 and was subsequently sold without government intervention or capital.

26 See section 2.1 of the *Competition Act*, at http://laws.justice.gc.ca, accessed 16 July 2004.

Policies designed to introduce competitive neutrality between government and private businesses also apply in Canada via the Treasury Board of Canada Secretariat's 'Contracting Policy'. This policy requires that:

> …government contracting shall be conducted in a manner that will […] stand the test of public scrutiny in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds.[27]

It is also necessary that:

> Where applicable, bid evaluation criteria must be established to address socio-economic factors in relation to the total cost of a contract before bids are solicited, and solicitation documents must give notice that socio-economic factors will be used to assess bids when they are received.[28]

The Contracting Policy requires that the prices on the submitted bids include allowances for taxation at all levels of government, overheads, contingencies and profit. The Treasury Board Secretariat enforces the Contracting Policy, although it is the responsibility of the individual departments and agencies awarding the contracts to ensure that the appropriate regulatory mechanisms are in place. Compliance is enforced through regular management reviews, evaluations and internal audits between the Treasury Board Secretariat and the public enterprises. Departments and agencies are also required to submit annual reports on all contracting activities.

United Kingdom

Competition policy is recognised in practice and in statements of principle by the United Kingdom government. General competition law (such as that embodied in the *Competition Act 1998*) applies to publicly-controlled firms. The position in the United Kingdom is thus comparable to that which applies in Australia (see table 2.1).

The United Kingdom was among the first countries to introduce the principles of competitive neutrality into its publicly administered enterprises — see the *Local Government Planning and Land Act 1980* — targeting manual services such as refuse collection and grounds maintenance. This was followed by the *Local Government Act 1988* which required that councils open designated services to competitive tender for private as well as public service providers.

One of the problems with the policy was that public providers were expected to compete with private enterprise while still being subject to the disadvantages of public ownership.[29] This was addressed in 1999 in the "*Modernising Government White Paper*". The focus shifted from compulsory competitive tendering to the *Best Value* initiative in April 2000. That initiative allows councils to select the bid they believe represents the *Best Value* for money, rather than forcing them to accept the lowest submitted price.

There are around twenty commercial organisations in the United Kingdom public sector. In most cases the customers of these are outside government and pay for the services they receive along normal business lines. While there does not appear to be any explicit government policy on competitive neutrality, its principles have been applied to government owned business activities in the United Kingdom. For

[27] Treasury Board of Canada Secretariat 2003, *Contracting Policy*. Part 2(a)

[28] Treasury Board of Canada Secretariat 2003, *Contracting Policy*. Part 4(1)

[29] S. Sachdev, 2001, *Contracting Culture: From CCTs to PPPs*, Report for UNISON, p. 14.

example, in a recent acquisition of a foreign private company by the Post Office, the government required the Post Office to be subject to the usual commercial disciplines. In particular, it required that the funding of the transaction be met from public sector borrowing at commercial rates of interest. The Government explained that:

> This was in part to assure competitors that the Post Office was not acting in an anti-competitive way and also because it wanted the Post Office to be subject to commercial disciplines.[30]

United States

Despite the strong support for the idea of competition in the United States, there is no single generally accepted authoritative statement of purpose for national competition policy. Further, while there are national competition laws, government entities, including those that are involved in commercial operations, are beyond the reach of competition law enforcement or private litigation. Entities that are owned and operated by the government are immune from antitrust liability. Those that are owned and operated by state and local governments may shield from antitrust liability under the state action doctrine.[31]

State Owned Enterprises and Government Sponsored Enterprises in the United States currently enjoy a variety of government-granted subsidies, privileges, and immunities not normally granted to private firms. These include: monopoly power; credit guarantees; freedom from paying investors an expected rate of return; exemption from bankruptcy; tax exemptions; direct subsidies; and regulatory exemptions. There are also a variety of privileges and immunities that are specific to particular State Owned Enterprises and Government Sponsored Enterprises.

There has been criticism from commentators that where a government firm competes with a private firm, it can use those advantages to diminish or eliminate a rival not enjoying the same benefits.[32] However, there are no Federal initiatives, policies or guidelines on competitive neutrality in the United States.

Individual state, county and city governments follow their own judgement on the competitive neutrality principles they wish to implement, and how they are enforced. To this end, there are competitive neutrality principles in some of the business activities of some of the United State's governments.

European Union (excluding the United Kingdom)

The European Union competition rules are contained in the *Treaty of Rome*. Article 86 of the *Treaty of Rome* confirms that activities of public undertakings and undertakings to which member states grant special or exclusive rights are also subject to the competition rules of the treaty. *Article 86* provides there should be no state protected monopolies unless such monopolies are in the public interest.

Most of the individual member countries went through a process of liberalisation in the 1980s, in the areas of telecommunication, postal services, transport and energy. Such sectors are referred to as 'service of general interest', and also include health

[30] House of Commons 2000, *Report by the Comptroller and Auditor General Department of Trade and Industry*, ordered by the House of Commons, 27 July 2000.

[31] OECD 1999, *The Role of Competition Policy in Regulatory Reform*, United States, Paris.

[32] M. Schuyler 1999, *The Anti-Competitive Edge: Government Subsidies To Government Businesses: Case Studies of the Postal Service, TVA, and Amtrak*, IRET Fiscal Issues, No. 11, Institute for Research on the Economics of Taxation, Washington, DC.

and education. The bulk of these services are administered by public authorities, but provided through public-private partnerships or purely private or public undertakings.

The objectives of liberalisation were achieved more rapidly by the formation of the European Union, and in turn the principles of liberalisation influenced the development of the European Union's policies.

An example of such a policy is the control of *State Aid* in the European Union. The concept of state aid, as defined in Article 92(1) of the European Commission Treaty is:

> any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between member states, be incompatible with the common market.[33]

Examples of state aid include:

- subsidies;
- interest-free or low-interest loans;
- guarantees on preferential terms;
- relief from taxes or fiscal charges;
- the supply of goods or services on preferential terms; or
- capital injections on terms which would be unacceptable to private investors.

There are two exemptions to *Article 92(1)* that allow aid from the state for pursuing social or cultural policy, or in order to stimulate economic activity in a region which is stagnating. However, these exemptions can only be allowed as long as they do not positively or negatively discriminate against the country the goods or services are sourced from.

The existence of separate national markets within the European community prior to the establishment of the European Union, and the persistence of competition between them and between state-supported firms within national markets, necessarily led the pursuit of integration to focus on state subsidies and aid as a way of eliminating obstacles to fair and effective competition. Trade liberalisation required an appropriate cross-border competition policy, which in turn called for control of subsidies. Overall, the European Commission's power to control subsidies by national governments is unique among the world's competition authorities.

2.6 Key observations

The application of competition law to government business activities in Australia is broadly consistent with the approach adopted in most OECD nations. With regard to the application of competitive neutrality to government business activities, Australia is in many respects at the forefront internationally in the application of this policy.

[33] European Commission 1997, *Competition Law in the European Communities — Volume IIB Explanation of the Rules Applicable to State Aid*, p. 7.

However, Australia appears to lag the policy stance taken by the European Union with regard to the provision of aid from state or local governments to selected business activities. While most Australian state and territory governments have agreed to stop bidding wars for business investment, Tasmania and Queensland (arguably the most aggressive perpetrator) are not party to it.[34] In addition, consideration of the non-neutral application of government policy to government and private businesses appears poorly applied or not formally part of government policy making among Australian jurisdictions.

[34] In August 2003, an interstate investment cooperation agreement was signed by New South Wales, Victoria, Tasmania, Western Australia, South Australia and the Australian Capital Territory. See '*Almost Altogether Now*', 4 November 2003, http://www.theage.com.au, accessed on 16 July 2004.

Chapter 3

Energy

Expenditure on energy in Australia in 2002-03 was around $50 billion. The energy sector directly employs around 120,000 people.[35] It is also a key input to other industries, particularly aluminium, cement and steel. Coal and oil comprise the majority of Australia's primary energy supply. Over 70 per cent of Australia's electricity is generated from coal and Australia is the largest coal exporter in the world. It is net importer of oil and petroleum products. This section focuses on the electricity and gas industries.

3.1 Major Australian reforms

Reform in the electricity and gas industries has been focussed on removing legislative and regulatory barriers to intra-state and interstate competition. It has involved structural reform, the restructuring of state-owned monopolies and the creation of third-party access regimes. In both electricity and gas, sector-specific agreements included in the National Competition Policy in addition to the general provisions of the Competition Principles Agreement have driven the reform process.

In 1991, the Council of Australian Governments agreed to electricity reforms aimed at improving the competitiveness and efficiency of the electricity industry based on experiences in the United Kingdom. The reform program contained industry restructuring and the creation of the National Electricity Market in Southern and Eastern Australia. In 1995, the reforms were reaffirmed and extended under the National Competition Policy framework.

Restructuring of the electricity industry has principally involved the separation of transmission, distribution and system operation activities from generation and retail. Previously these were almost entirely performed by government-owned vertically integrated monopolies.

In New South Wales, Victoria, Queensland and South Australia, distribution and transmission functions are conducted by discrete entities. Generation activities have been split to encourage competition over supply. Other States and Territories have restructured their industries to a lesser degree. Most entities remain in public ownership.

Accompanying these reforms was parallel process to establish the National Electricity Market, which commenced operating in December 1998 as a wholesale market for the supply of electricity to retailers and end-users in Queensland, New South Wales, Victoria, South Australia and the Australian Capital Territory. Representatives from these and the Tasmanian governments are members of the independent company — the National Energy Market Management Company — responsible for administering and managing the National Energy Market. The National Energy Market Management Company matches electricity supply and forecast demand in the pool through a bidding process.

[35] Commonwealth of Australia 2004, *Securing Australia's Energy Future*, Canberra, http://www.dpmc.gov.au/energy_future, accessed 27 June 2004, p. 1.

Market rules are set out under the National Electricity Code authorised by the Australian Competition and Consumer Commission for market operation, power security systems, network connection and access, and pricing for network services. The code is administered by the National Electricity Code Administrator.

Gas reforms progressed under similar arrangements. Commitments to reform the natural gas sector were established in Council of Australian Government agreements in 1994 and 1997 and the Competition Principles Agreement.[36] These have driven:

- the establishment of a national access regime, effective in all jurisdictions;
- the removal of legislative and regulatory barriers to competition; and
- the structural reform of gas facilities and utilities, with several transmission pipelines privatised and all government owned gas utilities corporatised or privatised.[37]

Energy market arrangements were reviewed in a report commissioned by the Council of Australian Government (the *Parer Report*) delivered in 2003.[38] The review found serious market deficiencies in energy markets, including:

- confused governance arrangements with excessive regulation;
- insufficient competition in electricity generation;
- flawed electricity transmission investment and operation; and
- ad hoc and poorly targeted greenhouse measures.

Following consideration of the Parer Report, energy Ministers in all jurisdictions have agreed to further reforms throughout 2004 and 2005. A major component of these reforms will be to consolidate regulatory responsibilities into national institutions such as the proposed Australian Energy Regulator.

3.2 Overseas reform progress

Table 3.1 provides a snapshot of the current state of play in major OECD countries. It is followed by a discussion of specific policies and reforms in each country.

[36] NCC (National Competition Council) 2001, *2001 Assessment of Governments' Progress in Implementing National Competition Policy and Related Reforms^*, Melbourne, http://www.ncc.gov.au, accessed 25 June 2004, p. 7.1.

[37] COAG (Council of Australian Governments) 2002, *Towards a Truly National and Efficient Energy Market*, Canberra, p. 6.

[38] Ibid.

Table 3.3

ENERGY REFORM IN OECD COUNTRIES

Question	EU	US	UK	Canada	NZ	Australia
Vertical separation in the electricity industry: degree of unbundling of Generation and transmission?	Some	Accounting separation	Separate companies	Integrated	Separate companies	Separate companies
Vertical separation in the electricity industry: degree of unbundling generation through supply	Some	Integrated	Unbundled	Integrated	Mixed	Mixed
Corporatisation/ privatisation of state-owned entities?	Some	Yes, mostly private	Yes, private	Yes, private	Yes, both	Yes, both
Establish wholesale market?	Some	No	Yes	Yes	Yes	Yes
Presence of third party access?	Yes	Yes	Yes	None	Yes	Yes
Bilateral trading?	No	No	Yes	Some	No	No
Restrictions on number of competitors allowed in markets?	Most	Yes	Yes	No	No	No

Source: OECD 2000, *International Regulation Database*, at http://www.oecd.org, accessed on 16 July 2004.

New Zealand

In 1987, the New Zealand government corporatised the monopoly, vertically integrated state owned electricity entity — the Electricity Corporation of New Zealand. Distribution, undertaken by local electricity supply authorities, was the only function not performed by the Electricity Corporation of New Zealand.

Transmission operations were isolated with the creation of a separate state owned entity (Transpower) in 1994. In 1996, some of the generation and retail functions of the Electricity Corporation of New Zealand were devolved into Contact Energy, which was privatised in 1999. The remaining functions of the Electricity Commission of New Zealand were further split into three competing state owned enterprises in 1999. These three corporations and Contact Energy generate the vast majority of New Zealand's electricity.

Originally, distribution companies had the sole right to distribute and retail electricity in an allocated region. These franchise rights were removed in 1993 and competition introduced for large commercial customers. New laws in 1998 required full ownership separation of distribution businesses from supply (retail and generation) businesses from 2004.[39] This was mostly achieved by 1999, and there has been competition for retail consumers since that time.

A wholesale electricity market was established in 1996. The market originally operated under a self-regulating structure but concerns over several issues

[39] Ministry of Economic Development 2002, *Chronology of New Zealand Electricity Reform*, Wellington, http://www.med.govt.nz/ers/electric/chronology/chronology.pdf, accessed 30 June 2004, pp. 1-20.

(including security of supply, transmission pricing and internal disagreement over self-governance rules) have driven a shift in this approach. Recently, oversight of the operations and governance of the electricity market reverted to a government agency (the Electricity Commission) with new governance rules and regulations applied.

Reform of the gas industry began over 1987-88 when the government sold PetroCorp, the corporation through which the government had managed its interests in the production, transmission and distribution of gas. Franchise areas for gas were removed in the same year as for electricity; that is, in 1993. In 1998, the industry successfully concluded a voluntary third party access regime for the natural gas pipeline network.

Canada

Jurisdiction over energy policy is shared between the provincial and federal governments. Provinces manage local resources, while inter-provincial and international trade is a federal responsibility.

Provincial electricity markets have developed individually. From the mid-1990s, however, governments have implemented measures to reform electricity markets (particularly Alberta and Ontario).

Restructuring in Alberta commenced in 1995.[40] The three private vertically integrated utilities were required to reorganise (but not divest) along the lines of generation, transmission and distribution functions. New generation of power was deregulated, and a competitive wholesale market introduced, including location-based rates and a power pool. Regulation of transmission and distribution was retained. The reforms of 1995 were refined in 1998 with measures to implement retail competition.

In Ontario, the publicly owned and vertically integrated monopoly was separated in 1998. Distribution, transmission and other services were each invested in different corporations that remain under public ownership. An independent market operator was created to organise an electricity spot market and ensure open access to the transmission system. Electricity generation was deregulated.

The federal government and gas-producing provinces developed the Western Accord and the Halloween Agreement in 1985. These permitted more exports, allowed all users to buy directly from producers and unbundled marketing and transportation services.[41]

United Kingdom

Reform of the electricity industry commenced in 1988-89.[42] The Central Electricity Generating Board was divided into a transmission company and competing generation companies. Distribution activities continued to be performed by twelve geographically based companies, renamed Regional Electricity Companies. Supply

[40] See Alberta Advisory Council on Electricity 2002, Report to the Alberta Minister of Energy, Alberta, http://www.energy.gov.ab.ca, accessed 30 June 2004, Appendix C.

[41] APERC (Asia Pacific Energy Research Centre) 2003, *Natural Gas Market Reform in the APEC Region*, Japan, http://www.ieej.or.jp, accessed 26 June 2004, pp. 54-63.

[42] OFFER (Office of Electricity Regulation) (now OFGEM) 1998, *Review of Electricity Trading Arrangements Background Paper 1: Electricity Trading Arrangements in England and Wales*, London, http://www.ofgem.gov.uk, accessed 26 June 2004, pp. 3-7.

of electricity to end-users was made contestable. Privatisation began with the public offering of the shares in the Regional Electricity Companies in 1990. Shares of the generators were sold in two tranches, beginning in 1991. Full retail competition was in place by the end of 1999.

The reforms also entailed the establishment of an electricity 'pool', in which trading commenced in 1990. This pool was similar to the current Australia model. Licensed generators and suppliers were forced to trade in the pool. The transmission operator would balance supply and demand by matching supply offers with demand forecasts.

This model was reformed in 2001 with the introduction of the New Electricity Trading Arrangements, which attempts to duplicate trading conditions in other commodity markets by facilitating bilateral trading between generators, suppliers, traders and customers.

The government owned, vertically integrated monopoly supplier of gas in Britain was privatised in 1986, and an open access regime applied. Industrial users were permitted to seek alternative suppliers of gas. In 1992, this was expanded to include commercial users. The entire domestic market was opened to competition in 1998. The privatised entity was not disaggregated until 1994, when transport and storage functions were separated from its other activities.[43] Retail and gas field businesses were further divided in 1997 as part of a company restructure.

United States

As in Canada, federal jurisdiction of energy policy is limited to inter-state and international commerce. Approaches to restructuring have differed across States, where electricity has typically been supplied by integrated, privately owned utilities and regulated by State bodies.

The major regulatory focus of the Federal Energy Regulatory Commission has been to ensure open and non-discriminatory access is available to transmission facilities.[44] In 1996, the Federal Energy Regulatory Commission issued orders requiring transmission-owning utilities to provide comparable transmission services to other parties. These were strengthened in 1999 with (voluntary) orders encouraging utilities to separate transmission from generation and distribution activities, by establishing independent transmission companies.

In 2003, further regulations on public utilities that own, control or operate transmission facilities in interstate commerce were established. These orders require such entities to have 'standard' procedures and agreements for interconnecting generators, with grid operations to be conducted by an independent organisation.[45]

Reforms in gas have proceeded with the intention to restrict pipeline companies from performing functions other than transporting gas. The Federal Energy Regulatory Commission effected orders in 1985 mandating for pipelines to provide

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[43] Monopolies and Mergers Commission (now Competition Commission) 1997, *BG Plc: A report under the Gas Act 1986 on the restrictions of prices for gas transportation and storage services*, London, http://www.competition-commission.org.uk, accessed 27 June 2004, pp. 61-65.

[44] APERC 2002, *APEC Energy Overview 2002*, Japan, http://www.ieej.or.jp, accessed 25 June 2004, p. 121.

[45] FERC (Federal Energy Regulatory Commission) 2003, *Standardization of Generator Interconnection Agreements and Procedures*, Washington, http://elibrary.ferc.gov, accessed 28 June 2004, pp. 1-2.

open access to transportation facilities. Any qualified entity could gain access to supplies and contract for transportation with the pipeline. A series of orders were issued over the following two years developing the principle and application of open access for transportation services. In 1992, the Federal Energy Regulatory Commission ordered pipelines to provide fully unbundle services for gathering and storage of gas as well as transportation.

European Union

The restructuring of the electricity industries in European Union member countries commenced in 1996. This involved deregulation of new generating capacity, open access to transmission and distribution systems, unbundling of the management of transmission systems from other parts of the network, and greater consumer choice over supplier.[46] Considerable discretion was allowed over how each member pursued these objectives; for example, access could be provided through three methods (regulated third party access, negotiated third party access or a single buyer model).

Shortcomings in this regulation led to the development of a further directive applying from 2004. In particular, the new regulations aim to ensure non-discriminatory access to transmission networks through legal separation of vertically integrated companies. This includes separation of management structures between distribution system operators, transmission system operators and generators.[47]

Member nations have progressed at different speeds along the path of electricity reform, usually from publicly owned and vertically integrated monopolies. Norway is one of the most advanced reformers. It liberalised access to all transmission and distribution networks and split its monopoly into separate publicly owned generation and transmission entities in 1990-91. Norway and Sweden formed a joint energy pool in 1996, with ownership shared between the public transmission system operators in each country. Denmark has also since joined.

Reform to unify the European gas market has proceeded similarly. A community directive adopted in 1998 encouraged the abolition of exclusive supply rights, non-discriminatory rights to build new gas infrastructure facilities, open access to transmission and distribution systems and the accounting separation of functions within vertically integrated companies. As in electricity, the regulation allowed a flexible approach that has led to inadequacies. A new directive was agreed in 2003 with emphasis on open access to gas networks through legal separation of entities.

3.3 Key observations

Energy reforms in the countries studied have a uniform objective to increase competition and efficiency. The particular reforms undertaken differ in accordance with initial market characteristics, political imperatives and legal constraints. Each jurisdiction, however, has recognised the importance to competitive outcomes of:

- independent transmission networks;

[46] European Commission 1999, Opening Up to Choice: the Single Electricity Market, Belgium, http://europa.eu.int, accessed 29 June 2004, pp. 4-5.

[47] European Commission 2003, *Electricity directive 2003/54/EC*, Belgium, http://europa.eu.int, accessed 25 June 2004, p. 1.

- well resourced independent regulators; and
- strong commercial disciplines — free from political direction — where utilities remain in government ownership.

As acknowledged in the Parer review, some Australian jurisdictions are yet to fully appreciate these lessons, especially in relation to governance arrangements. From an Australian perspective, the most relevant recent development has been the introduction of the NETA in Britain. This is a salient issue because Australia's electricity trading pool was broadly based on the model NETA replaced. The NETA represents a move away from a centrally controlled electricity pool similar to the NEM towards bilateral contracts between participants.

Chapter 4

Transport

The transport sector incorporates the modes of road, rail, sea and air. For the purposes of this analysis, road transport is not considered. Rail, sea and air transport businesses in Australia directly employed over 90 000 people in 2002. Their output forms just under two per cent of gross domestic product.[48] These services are also an important input to many other industries, especially in the traded sector.

4.1 Major Australian reforms

The general approach to Australian transport reforms has been to impose commercial disciplines on government-managed transport services, through disaggregation, corporatisation, privatisation, and open access to essential infrastructure. Engendering competition was seen as the key driver of efficiency. Within this overarching framework, specific reforms have been tailored to relevant industries, which vary depending on the appetite for reform in different jurisdictions.

Unlike electricity and gas, reform in the transport industry (with the exception of roads) has not been driven by a sectoral specific agreements as part of the National Competition Policy. The general provisions in the Competition Principles Agreement (requiring competitive neutrality, structural reform, access arrangements for rail, and legislative reviews) have been the only applicable policy instruments.

In rail, reform has consolidated interstate rail governance, separated rail functions and sought to increase competition through open access arrangements. Management of interstate services has been transferred to national bodies. The most significant structural reforms have focussed on the horizontal and vertical separation of monopoly public authorities, for the purpose of dividing potentially commercial services (freight) from the loss making services (passenger) and potentially competitive functions (provision of rail services) from the essential (track access). Reforms include:

- establishment of the National Rail Corporation and the Australian Rail Track Corporation in 1991 — the National Rail Corporation was subsequently privatised in 2002;
- disaggregation in 1996 of New South Wales's State Rail Authority into four businesses — freight operations (subsequently privatised), interstate and intrastate track access, track maintenance, and passenger operations (track access and maintenance functions were later reunited);
- disaggregation and then privatisation of Victoria's rail businesses between 1996 and 1998;
- subjecting state rail operations to access regimes in all states except Tasmania.

[48] Bureau of Transport and Regional Economics 2003, *Australian Transport Statistics 2003*, Canberra, http://www.btre.gov.au, accessed 28 June 2004, pp. 4-5.

- airport reform has been driven at the national level outside the National Competition Policy process. The prime method of engendering competition in this sector has been to transfer airport ownership or management to the private sector and deregulate prices, with all 22 airports in Australia sold and in 2002 price caps were replaced with price monitoring; and
- since the mid-1990s, all major Australian commercial ports have been corporatised and, in the case of South Australia and selected ports in Victoria, privatised.

4.2 Overseas reform progress

Table 4.1 provides a snapshot of the current state of play in major OECD countries. It is followed by a discussion of some specific reforms in each country.

Table 4.4

TRANSPORT REFORM IN OECD COUNTRIES

Question	EU	US	UK	Canada	NZ	Australia
Structural reform to remove vertical integration in rail?	Yes	Yes	Yes	Yes	Yes	Yes
Moves to establish open access to rail tracks?	Yes	Yes	Yes	Yes	Yes	Yes
Commercialisation, corporatisation, privatisation in rail?	Comm.	Mostly private. Some transfer to public	Privatisation	Mostly private. Some transfer to public	Privatisation	Corp. and privatisation.
… in airports?	Varied	Comm.	Privatisation	Comm.	Privatisation	Privatisation
… in ports?	Varied	Comm.	Privatisation	Comm.	Corp.	Corp. and privatisation
Restrictions on number of competitors allowed in markets?	Varied	Yes in airports and railways	Yes, in railways		No	Yes in all three

Source: OECD 2000, *International Regulation Database*, at http://www.oecd.org, accessed on 16 July 2004 .

New Zealand

Similar to Australia, New Zealand has separated rail functions and privatised sections of its publicly owned monopoly. This was originally divided into an above-rail entity (later privatised) and a below-rail entity. The below-rail entity remains state-owned and manages the lease between the monopoly service provider and the government. Access conditions are specified in that lease so that the government is able to allow access to other operators if service levels fall below set standards.

Airport reforms have also been similar to Australia. Major airports in New Zealand were all corporatised during the 1980s. Two of the largest three airports, Auckland

and Wellington, have since been privatised. Most of the remaining airports are jointly owned between national and local governments. New Zealand airports are not directly regulated but are subject to disclosure requirements and general competition laws. The government recently reviewed this framework and affirmed its position not to impose price controls on the three largest airports.[49]

Corporation of New Zealand ports commenced in 1987. Regional authorities and the central planning body previous governing port operations were abolished. In their place, independent port companies were established to operate the ports on commercial footing. At this time, local authorities were required to majority- own these companies. Although this limitation was removed in 1990, all ports remain in majority local government ownership.[50]

New Zealand is currently investigating the transport costs and charges associated with various modes of transport and the potential use of congestion pricing for roads. These works highlight an increasing emphasis on the improving the efficiency of the entire transport system, rather than individual modes. Another central theme of a recent review is better integrating different transport modes.[51]

Canada

In contrast to Australia and New Zealand, rail reform in Canada has targeted more efficient regulation and operators of incumbent private providers. First, passenger services were transferred from the entrenched duopoly to the public sector in 1977. They were previously funded through a direct government subsidy. Passenger services are now operated by an independent government corporation (VIA Rail), which operates in line with commercial principles. Most of VIA Rail's services use privately owned rail lines, for which access charges are paid.

Regulation of freight services was considerably deregulated under the *National Transportation Act 1987*. Among other things, this provided for independent 'shortline' railways, established a mechanism for settling disputes over rail rates and services (to the benefit of users), and introduced confidential contracts with prohibitions on collective ratemaking.

Compared to other countries, Canada has been slow to reform airport governance. Major Canadian airports began being commercialised in 1992 but are operated by airport authorities on a not-for-profit basis. In effect, airports have been 'privatised' to not-for-profit owners.[52] Authorities need only generate sufficient revenue to cover lease charges applied by the federal government.

Port governance has been similarly devolved. Since 1995, the federal government has progressively devolved port ownership and operation to local authorities. Its objectives have been to promote local management of port facilities and to replace

[49] See L. Dalziel (Minister for Commerce) 2003, *Airports Inquiry — Questions and Answers*, http://www.med.govt.nz, accessed 30 June 2004.

[50] Charles River Associates 2002, *Port Companies and Market Power — a Qualitative Analysis*, Wellington, http://www.transport.govt.nz, accessed 29 June 2004, pp. 12-14.

[51] See Ministry of Transport 2002, *New Zealand Transport Strategy*, http://www.beehive.govt.nz/nzts, accessed 8 August 2004.

[52] D. Gillen and W. Morrison 2001, *Airport Regulation, Airline Competition and Canada's Airport Policy*, Ontario, http://www.wlu.ca, accessed 1 July 2004, pp. 13-17.

federal subsidies with user-pays funding. Major public ports are now operated by public authorities on a commercialised basis.[53]

United Kingdom

British rail restructuring formed a model on which Australian reform was based; approaches therefore share considerable similarities. Restructuring commenced in 1993, with the objective of generating competition in all functions except the provision of infrastructure capacity. Accordingly, the publicly owned, vertically integrated monopoly corporation was divided into about 100 businesses. By 1997, most of these businesses had been either sold or franchised. More recently, rail operations have been rationalised — for example, two rail freight companies now dominate that market, whereas the original separation allowed for six companies.

The single entity owning and managing infrastructure capacity was retained in public ownership until 1996. It is now a private sector organisation operating under an access regime and accountable to its members, who are primarily drawn from industry.

Airports in the United Kingdom began being privatised in 1987 with the sale of the British Airports Authority. Other airports not owned by British Airports Authority have also been partially or wholly privatised. A major exception is Manchester airport, which remains under local government ownership. A two-tiered regulatory approach is utilised. Major ('designated') airports are subject to price cap regulation and other conditions, including information disclosure rules. Smaller airports are subject to price monitoring under the threat of more intrusive regulation (including becoming 'designated') if they are found to abuse their market power.[54]

Ports were traditionally owned and operated by the British government, public trusts or independent local statutory authorities. In 1983, nineteen government-owned ports were privatised. At the time, these ports accounted for a quarter of total port revenue. Other ports have remained managed by public trusts or local authorities under constituting legislation that usually requires a commercial focus. Seven of these ports have been privatised following the passing of legislation in 1991 by the government enabling this to occur.

In a recent white paper, the United Kingdom government has indicated that more accurate pricing and increased recognition of the trade-offs between different modes of transport are core transport priorities.[55] This incorporates road pricing as a means of making road travel more cost-reflective, and efficiency gains in rail to enhance its appeal as an alternative.

United States

As in Canada, recent reform of the United States rail system began from a starting point of private, vertically integrated rail companies. Again, responsibility for passenger services was largely transferred to a national, public corporation funded by Congress, and managed as a private entity.

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[53] See Transport Canada 2002, *National Marine Policy*, http://www.tc.gc.ca, accessed 1 July 2004.

[54] Productivity Commission 2002, *Price Regulation of Airport Services*, Canberra, http://www.pc.gov.au, accessed 30 June 2004, pp. 411-422.

[55] Department for Transport 2004, The Future of Transport: White Paper, London, http://www.dft.gov.uk/strategy/futureoftransport, accessed 8 August 2004.

Rail freight services were deregulated in 1980 and formed the model on which Canadian deregulation progressed. The key measures of the United States reforms were: reduced regulatory involvement in setting freight rates; legalisation of privately negotiated agreements between railroads and shippers; and elimination of most obligations to provide unprofitable lines.[56]

Federal jurisdiction over airport and seaport matters is extremely limited. Accordingly, there has been no national or consistent approach to airport or seaport reform. Local and regional authorities tend to operate each but with a strong commercial focus. Operations contain significant private involvement through extensive use of private contractors and via contractual arrangements with users. Most port authorities purely operate as landlords. In the case of airports, legal obstacles arising from local and federal interaction has impeded actual privatisation. In 1996, the federal authority attempted to facilitate the privatisation of airports through a pilot privatisation program. However, the requirement for carrier approval to exceed a threshold level severely undermined the program.

European Union

Rail reform under the auspices of the European Union has broadly matched the direction (and speed) of energy reform. The central objective has been to secure open, non-discriminatory access to bottleneck railway infrastructure by establishing independent infrastructure managers. A directive in 1991 encouraged the introduction of commercial principles to government owned rail enterprises and sought to guarantee rights of access through accounting separation of above and below-rail services. This was supplemented in 1995 by further regulations to promote uniformity in access conditions and in operator license requirements.

The looseness of these directives limited reform progress, and they were replaced in 2001 by three directives with more forceful approaches.[57] Accordingly, member states are now required to legally separate transport services from infrastructure management. The infrastructure-managing entity must develop and publish a statement outlining access conditions. Licensing conditions have also been refined.

There is no European agenda for airport reform. Individual member nations determine policy. Along with the United Kingdom, airports have been privatised to some degree in Germany, Italy, Austria and Sweden. The extent to which commercial objectives have been imposed on publicly owned airports has also differed.

Port reform has been primary directed toward establishing a legal framework allowing port access for providers of port services and self-handlers and clarifying the rights of port managing bodies. A directive to this effect was agreed in 2002.[58] This builds on longstanding concerns over different policies on pricing, accounting and State aid in relation to ports applied across the EU. Port owners are diverse and include national governments, regional governments and private enterprises.

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[56] See Federal Railroad Administration 2004, *Impact of the Staggers Rail Act of 1980*, http://www.fra.dot.gov, accessed 29 June 2004.

[57] See European Commission 2004, *Rail Transport and Interoperability — The New Package*, http://europa.eu.int, accessed 30 June 2004.

[58] European Commission 2002, *Common position adopted by the Council with a view to the adoption of a Directive of the European Parliament and of the Council on market access to port services*, Belgium, http://europa.eu.int, accessed 29 June 2004, pp. 1-2.

An ongoing issue of concern for the European Union has been transport pricing policies applied by members and consequent distortions in competition between modes and members states (particularly for ports). More recently, this has evolved into concerns over the expected growth in road haulage and the need to divert traffic to other transport modes. Accordingly, the European Union is embarking on various intermodal measures to increase the performance of shipping, rail and inland waterways.[59]

4.3 Key observations

Particular reforms across the rail, air and sea modes of transport differ according to the nature and industry characteristics in observed countries. For example, rail reform in the United States and Canada has addressed problems in the regulatory framework governing the operation of private firms. Australia, New Zealand and the United Kingdom have restructured public rail monopolies. The European Union is developing an overarching approach focussing on access that is capable of accommodating vastly differing constituents.

Nonetheless, the common objective in all countries of all reforms has been to promote competitive and commercial outcomes in which prices provide accurate signal to users. This is inherent in the imposition of commercial objectives in airport and seaport governance, various privatisations, and the creation of competition in eligible market segments. Of course, different countries have progressed such reforms to their own schedule. In comparison to observed countries, Australia has undertaken a high degree of reform, particularly in relation to rail and airports.

Ongoing transport issues in Australia relate to intermodal integration and the cross-subsidies that various advocates claim are embedded in current transport prices. This broadly reflects developments in comparable overseas jurisdictions. The central objectives have been to improve the efficiency and sustainability of the entire transport network, by removing price distortions and favouring modes with the least environmental and social impacts.

[59] See European Commission 2001, *White Paper: European Union Transport Policy for 2010: Time to Decide*, Belgium, http://europa.eu.int, Accessed 30 June 2004.

Chapter 5

Professional and occupational regulation

Reform of regulations governing professions and occupations is part of a wider microeconomic reform process, evident internationally since the late 1980s — particularly among OECD nations — and which gathered momentum in the 1990s.

Reform of these regulations is important for Australia because of the dominant and increasing size of the services sector in its economy, the role of the professions in supporting that sector, and their significance as inputs to the rest of the economy and in the delivery of services to the final consumer.[60]

5.1 Major Australian reforms

Major reforms to professional and occupational regulation have occurred under the National Competition Policy framework and through the move to mutual recognition of occupational qualifications between Australian jurisdictions.

Other significant developments in reforms in this area have been the move to embrace related health professions under umbrella legislation and to facilitate multidisciplinary practices of legal and other professions, such as accountants.

National Competition Policy

Reforms arising from the National Competition Policy agreements have embraced professional and occupational regulation through the agreement by jurisdictions to:

- extend the application of Part IV of the *Trade Practices Act 1974* which deals with anti-competitive practices, to individuals within the legislative competence of the State; and
- review legislation and remove all anti-competitive provisions, unless such provisions could be demonstrated to have a net public benefit and the purpose of the restrictive provisions could not be achieved other than by legislation.[61]

Since 1995 most of the legislation governing professions and occupations in Australia has been subject to review under the National Competition Policy and the amendments have been made to address anti-competitive provisions.

To assist the conduct of those reviews, the Council of Australian Governments produced guidelines for the process of examining legislative objectives, legislative impediments to competition, their public interest review and consideration of alternatives.[62] Notwithstanding those common guidelines, there has been significant divergence as each State and Territory implements reform specific to jurisdictional circumstances and the conclusions in their reviews.

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60 See general findings of the Productivity Commission's review of Australia's mutual recognition scheme: Productivity Commission 2003, *Evaluation of Mutual Recognition Schemes, Research Report*, AusInfo, Canberra.

61 Business regulation more generally (which would include the running of a professional practice) is also covered by the legislation review process.

62 Council of Australian Governments 1999, *Guidelines for the Review of Regulation of the Professions Under National Competition Policy*, Committee on Regulatory Reform, Canberra.

Mutual recognition and harmonisation

Australian Heads of Government signed an *Inter-governmental Agreement on Mutual Recognition* in 1992. In relation to occupations, the mutual recognition scheme is based on the principle that a person registered in one jurisdiction can be registered to carry out the equivalent occupation in any other jurisdiction, without the need for further assessment or qualifications. Since the scheme commenced, the anecdotal evidence is that mutual recognition is generally working well, and delivering the benefits which the participating parties anticipated.[63]

Umbrella legislation

In the reform of regulation governing health professions, some jurisdictions have adopted, where possible, a consistent approach for all those professions. This approach has common core provisions that establish the regulatory structures and requirements for the registered health professions contained in a single, overarching 'umbrella' Act, with profession-specific provisions in separate Acts or separate schedules attached to the umbrella Act.

Multidisciplinary practices

Reform in this area, which allows the expansion of professional services into the practice of law, has been characterised as 'the most important issue to face the legal profession this century'.[64]

In 2000, The Law Council of Australia called for lawyers to be allowed to go into practice with other professionals, a stance then considered one of the most progressive internationally. At the time New South Wales was the only jurisdiction, which had legislated to allow for this. Since then, Queensland with the recent passage of the Queensland *Legal Profession Act 2004* has also moved to allow multidisciplinary practices.

5.2 Overseas reform progress

New Zealand

New Zealand moved to replace detailed industrial and occupational regulations with a generic commitment to competitive markets in 1984.

New Zealand's general policy framework for assessing the regulatory controls governing occupations and professions is broadly similar to that applying under Australia's National Competition Policy legislative review framework. The Government's approach to occupational regulation also requires that it should be periodically reviewed to ensure that the regime in place continues to meets its intended objectives with minimal negative impact on competition and consumer choice.

Thus, while the New Zealand approach does not embody the compelling legislative review timetable featured in Australian reforms, its inclusion of periodic review helps to ensure regulation remains relevant in a changing environment.

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[63] Ibid, p. 47.

[64] American Bar Association 1999, *Background Paper on Multidisciplinary Practice: Issues and Developments*, http://www.abanet.org, accessed 23 June 2004.

Canada

Canada's *Competition Act* is a law of general application which governs the conduct of business activities in Canada. While some activities are specifically exempted from the Act, the activities of all professional associations are subject to the law.

With the increasing importance of service industries to the economy and the diminution of traditional border-based barriers to trade, Canada has recognised the importance of giving increasing priority to the application of competition law in the area of services, including the professions.

Canada — a federal country like Australia — introduced a model of mutual recognition (its *Agreement on Internal Trade*) in 1995. However, the case-by-case approach adopted there is considered inferior to the generally applicable approach adopted in Australia.[65] The Canadian experience does not therefore provide a useful guide for how Australia might improve its mutual recognition arrangements (other than as an example of what to avoid).

United Kingdom

The activities of most professional services were brought within the ambit of United Kingdom competition law with the introduction of the *Competition Act 1998*. Prior to this, professional services were essentially excluded from the application of the *Restrictive Trade Practices Act 1976* that preceded the *Competition Act*.[66] Commercial activities of professionals are now covered on the same basis as any other sector.

In March 2001, the Office of Fair Trading published a report — *Competition in Professions* — which highlighted restrictions on competition in professions arising from professional rules, statute or custom and practice.[67] In a subsequent progress report in 2002, the Office noted that while a concerted effort by the Government and the Office has resulted in the removal of many of the restrictions identified earlier, many still remained to be addressed.[68]

The experience of the United Kingdom indicates that reform of regulations governing the professions is a lengthy process, requiring continued commitment and reinforced with ongoing incentives for reform.

The British government has passed the *National Health Service Reform and Health Care Professions Act 2002* which establishes a new overarching Council for the Regulation of Health Care Professionals, to build and manage a coordinated and consistent framework for regulation across health professions and ensure open, transparent and consistent procedures within each regulatory body. In this regard, the United Kingdom's approach may have lessons for Australia as it pursues

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65 Productivity Commission 2003, op cit., p. 312.

66 OECD 2002, *Regulatory Reform in Gas and Electricity and the Professions*, OECD, Paris, p. 69, http://www.oecd.org, accessed 24 June 2004.

67 The report is available on the Office of Fair Trading website at www.oft.gov.uk — Office of Fair Trading 2001, Competition in Professions, A report by the Direct General of Fair Trading, OFT328, London.

68 Office of Fair Trading 2004, *Consultation on the future regulatory framework for legal services in England and Wales: Response from the Office of Fair Trading*, June, p. 1, http://www.oft.gov.uk, accessed 29 June 2004.

greater national consistency in regulation governing professions and occupations similar to that which is evident in some Australian jurisdictions.[69]

The reform issue of whether multidisciplinary practices should be allowed in the United Kingdom has yet to decided. However, a 2004 report of a review of the regulatory framework for legal services in England and Wales (the *Clementi Review*) has proposed reforms that would allow multidisciplinary practices, such a move has been supported by the Office of Fair Trading.

United States

Efforts to reform the regulatory process at federal level in the United States have generally focused on the following areas:

- use of cost-benefit analysis and cost-effectiveness analysis when developing regulations;
- use of risk assessment analysis to determine the probability of certain hazards occurring and their adverse effects;
- use of a regulatory budget to provide an overview of regulatory costs and set a cap on those costs;
- subjecting new regulations to review and possible disapproval by Congress;
- widening the scope of judicial review of regulatory actions;
- imposing a moratorium on new regulations while agencies review their existing regulations to determine if they should be revised or abolished;
- reducing and streamline the paperwork required by regulations;
- establishing a fair procedure for compensation of property owners when all or some of their property is 'taken' by a regulatory action;
- establishing a sunset mechanism whereby regulations or regulatory programs are terminated unless Congress or the agency determines otherwise; and
- restricting mandates imposed on state and local governments unless federal funds are provided to offset the costs of those mandates.[70]

Most of these are either already embodied in Australia's reform process (such as the first, second, fourth, seventh, and ninth dot point) or not applicable.

Prior to 2002, while there was no general consensus among state bar associations on whether regulators should allow multidisciplinary practices, it appeared that reform to facilitate multidisciplinary practice was the direction of the future.[71]

However, the fallout of corporate collapses such as Enron and WorldCom — perceived as partly caused by the integration of legal and accounting practices — has culminated in the introduction of the *Sarbanes-Oxley Act 2002*, which fortifies auditing independence standards and has reversed the trend to multidisciplinary

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[69] Victorian Government Department of Human Services 2003, *Regulation of the Health Professions in Victoria A Discussion Paper*, October, p. 39, http://www.dhs.vic.gov.au, accessed 24 June 2004.

[70] R. Garcia 2001, *Federal Regulatory Reform: An Overview*, www.thecre.com, accessed 29 June 2004.

[71] American Bar Association 2003, *Status of Multidisciplinary Practice Studies by State (and some local bars)*, April, accessed at www.abanet.org/cpr/mdp-state_action.html on 26 June 2004 and *MDP Information — April 2, 2003*, http://www.abanet.org, accessed 26 June 2004.

practices. The Chair of the American Bar Associations former Commission on Multidisciplinary Practice has noted that 'It will be a long while before multidisciplinary practice turns up again, if ever'.[72]

While Australia has recently introduced legislation with some similarities (CLERP 9), the flow-on effects of developments in the United States for any legislation reform of professions in Australia are not yet clear.

European Union

The approach to reform of professional and occupational regulation in the European Union has a clear emphasis on competition policy and mutual recognition.

The European Union is committed to improving competition for professional services within its market. Through its Competition Directorate General, the European Union is pressing member states to remove restrictions, such as price-fixing arrangements and advertising curbs that prevent competition in professional services.

A recent study of regulation in professional services in Member states has observed a high degree of 'system-stability', that is it did not find any complete system change (from a licensing model to certification model or in the other direction). It also found frequent change in the regulatory framework, particularly in the field of conduct regulations. In almost all cases these changes have taken the form of liberalisation (e.g. in respect of price regulation, advertising, form of firm, inter-professional co-operation). There is a trend to more pro-active forms of consumer protection and quality management, which implies a lower degree of anti-competitive effects.[73]

In a report on *Competition in Professional Services* the European Commission found that most restrictions are national in scope. Accordingly it calls on national governments, competition authorities and the professional bodies themselves to reform or eliminate such restriction unless duly justified.[74]

This approach is in line with the coming into force, next May, of new rules which decentralise the enforcement of European Union antitrust rules, therefore giving national competition authorities and national courts a more prominent role in assessing the legality of the rules and regulations in the professions.[75]

The European mutual recognition regime is established under the European Community Treaty, which lays down the principle that the self-employed may freely exercise an activity in two ways: the person or firm may set up in another Member State (freedom of establishment) or offer their services across frontiers in other Member States while remaining in their country of origin (freedom to provide services). The European Parliament recently approved a proposed Directive on recognition of professional qualifications which would further facilitate mutual

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[72] G. Rosenberg 2004, 'Big Four Auditors' Legal Services Hit By Sarbanes-Oxley', *New York Lawyer*, http://www.nylawyer.com, accessed 28 June 2004.

[73] I. Paterson, M. Fink, A. Ogus et al 2003, *Economic Impact of Regulation in the Field of Liberal Professions in Different Member States*, Research Report, Final Report — Part 1, Institute for Advanced Studies, Vienna, p. 4.

[74] Monti, M. Commissioner for Competition European Commission, March 2003 *Competition in Professional Services: New Light and New Challenges, p. 4.*

[75] Regulation 1/2003 on the Implementation of Article 81 and 82 of the EU Treaty.

recognition within the European Union. As a model for reform in Australia, however, the European approach has been considered and rejected as inappropriate.[76]

While multidisciplinary practices are permitted in some European countries, there are often severe restrictions on their scope.[77] Additionally, in a landmark judgment in February 2002, the European Court of Justice ruled against the creation of multidisciplinary practices between accountants and lawyers in the Netherlands, and by precedent other European Member States. The decision noted that the Dutch ban was a restriction on the ability to provide services, but held that this was justified in the public interest.[78]

5.3 Key observations

Australian jurisdictions have extensively reformed their regulations governing professions and occupations under the anti-competitive provisions of the National Competition Policy. A similar emphasis on regulatory reform under the banner of competition policy is evident in most OECD nations, as is a commitment to continue the reform process.

Australia has made significant progress in improving mutual recognition of occupational and professional licensing within its borders. This experience parallels international experience, particularly that within the European Union.

There are promising signs that some regulations, such as those for the legal professions, are moving to greater harmonisation across jurisdictions. This has proven to be a difficult task in other Federal countries like Canada and the United States and suggests considerable effort will be needed to make broader progress.

Australia's anti-competitive legislation reform however, has been essentially sector specific and primarily state and territory focussed. As such, it has resulted in significant differences between jurisdictions in regulatory regimes governing professions and occupations. Much still needs to be done to develop a genuinely national market for occupations and professions. There is also a danger that in future, without an ongoing institutional framework to foster legislation review, the state-based review process may languish.

While legislation reform allowing multidisciplinary practices has occurred in most jurisdictions, the recent CLERP 9 legislation aimed at improving the corporate governance practices of Australia's companies and ongoing debate about how best to deliver appropriate corporate governance suggests this area may not be settled.

[76] Productivity Commission 2003, op. cit., pp. 303-4.

[77] European Commission Competition Directorate 2003, *Stocktaking Exercise on Regulation of Professional Services: Overview of Regulation in the EU Member States*, http://europa.eu.int, accessed 29 June 2004.

[78] *Judgment of the Court of 19 February 2002*. (61999J0309). J. C. J. Wouters, J. W. Savelbergh and Price Waterhouse Belastingadviseurs BV v Algemene Raad van de Nederlandse Orde van Advocaten, intervener: Raad van de Balies van de Europese Gemeenschap. Found at http://europa.eu.int, accessed 10 August 2004.

Chapter 6

Labour market

Labour market conditions impact directly and indirectly on key economic indicators such as employment, economic growth, productivity, inflation and standards of living.

Labour market reforms are generally undertaken with a view to improving labour market efficiency and, increasing employment and real wages. In particular, international organisations such as the OECD, the European Commission, the International Monetary Fund and the European Commission consider that causes of high unemployment can be found in labour market institutions and therefore member countries have been encouraged to undertake comprehensive structural reforms to reduce labor market rigidities.[79] Initiatives tend to focus on:

- reforming wage and condition setting practices;
- easing employment protection legislation;
- improving the effectiveness of active labour market policies;
- reducing disincentives to work that stem from the welfare and tax systems; and
- enhancing labour mobility.

Economic growth is the main factor driving employment growth and the efficient matching of the demand for and supply of labour at the micro-level constitutes an on-going challenge involving appropriate skills and incentives and a high degree of flexibility.[80]

6.4 Major Australian reforms

In general terms, Australian governments have historically seen their role in the labour market as being to:

- maximise the scope for unemployed people and new entrants to the labour market to take up jobs;
- put in place policies to improve labour market efficiency and flexibility; and
- maintain a safety net while maintaining social and, if possible, economic participation.

Labour market regulations were explicitly excluded from the National Competition Policy reforms and remain outside the scope of the *Trade Practices Act 1974*.

> In determining whether a contravention of a provision … has been committed, regard shall not be had… to any act done, or to any provision of a contract, in relation to the remuneration, conditions of employment, hours of work or working conditions of employees…[81]

[79] OECD 1999, *Labour Market Performance and the OECD Jobs Strategy*, Economic Outlook 65, Chapter IV, June 1999.

[80] Ibid.

[81] *Trade Practices Act 1974*, Section 51 (2).

While the Hilmer report recognised the potential for labour relations to impact on competition:

> collective agreements between employees (or employers) on employment related matters could be found to be agreements that substantially lessen competition in the labour market… Where the agreement extended to remuneration the agreement could constitute a price-fixing agreement[82]

Hilmer however, recommended no change to the current exemption of labour agreements from the *Trade Practices Act* on the basis that such an outcome might infringe Australia's obligations under relevant International Labour Organisation Conventions which allow employees' freedom to organise and form trade unions.

Over the last decade, there has been a significant shift in the focus of the workplace relations system away from centralised determination of wages and conditions towards a largely decentralised and more flexible industrial relations systems whereby wages and conditions are set through agreements reached at the enterprise and workplace level. The introduction of the *Workplace Relations Act 1996* significantly increased the emphasis on agreement making through Australian Workplace Agreements and made it the focus of the overall workplace relations system at the federal level.

Importantly, agreements can replace awards and, subject to a 'no disadvantage' test, award entitlements can be traded off. This has provided the scope for employers and employees to make genuinely innovative and flexible agreements, including more flexible working time and leave arrangements as well as new remuneration arrangements.

The move to decentralised agreement making has been underpinned by substantial changes to the award system. The role of awards is now to provide a safety net of minimum wages and conditions of employment rather than (as previously) detailed prescription of actual wages and conditions and work organisation matters. Awards are also being simplified to contain only clauses relating to a set maximum number of allowable matters and have been made more flexible.

The Government introduced significant reform in the labour market assistance system in May 1998, with the aim of improving the quality of service to job-seekers and facilitating job placement. The centerpiece of the system is Job Network, a contestable employment placement market, with full competition between private, community and government contracted service providers. A differential fee structure applies, with the highest fees being paid for those who are most at risk and hardest to place in a job. Fees are paid on the achievement of outcomes and are generally available when a job-seeker gains employment that removes their reliance on income support for a sustained period. Australia was among the first OECD countries to introduce such market-type mechanisms into job placement and related employment services.

While Labour market policies are subject to ongoing debate in Australia, the current policy debate could potentially lead to 'back sliding' — while not necessarily inconsistent with National Competition Policy reforms — which reduces the role for markets in labour market outcomes.

[82] Independent Committee of Inquiry (Hilmer Inquiry) 1993, *National Competition Policy*, Canberra, Section 6, Scope of Application: Review by Sectors and Activity.

6.5 Overseas reform progress

New Zealand

The introduction of the *Employment Contracts Act 1991* represented a major reform of the New Zealand industrial relations system. The *Employment Contracts Act* abolished arbitration and introduced a highly decentralised wage-bargaining system of individual employment contracts to replace the existing system of collective coverage and compulsory unionism. In negotiating employment contracts, each employee could freely choose their own bargaining agent: a union, a private sector consultant, a lawyer, etc. Collective contracts were still allowed, but not encouraged: even where an individual worker had authorised such negotiation, and employers could not be compelled to negotiate a collective contract.

There has since been some regression in labour reform in New Zealand. The *Employment Contracts Act* has been replaced with the *Employment Relations Act 2000*. The *Employment Relations Act* 2000 has "good faith" as its central principle. Employers, employees and unions must deal with each other honestly and openly. Specifically, the *Employment Relations Act*:

- promotes good employment relations and mutual respect and confidence between employers, employees and unions;
- sets the environment for individual and collective employment relationships;
- sets out requirements for the negotiation and content of collective and individual employment agreements; and
- provides prompt and flexible options for resolving problems in employment relationships.

Canada

Labour market policy in Canada underwent a significant shift in the late 1990s from passive to active labour market measures with changes to public employment services and administration, labour market training, youth measures, subsidised employment and measures for the disabled. The accent of active labour market measures coincided with an overhaul of the *Employment Insurance* system in an effort to remove the disincentive to work while still providing adequate protection for the unemployed.

United Kingdom

The United Kingdom labour market is one of the least regulated among OECD countries. Since 1979, the United Kingdom government has placed significant emphasis towards improving the efficiency of the labour market. Significant labour market reforms include:

- reducing trade union power — for example through; abolishing statutory union recognition procedures, extending grounds to refuse to join a union; limiting picketing, banning of closed shops, prohibiting coercive actions concerning contracts with union employers;
- shifting away from collective bargaining and statutory wage setting towards locally orientated wage bargaining; and

- deregulating employment protection — especially with regards to restrictions on terms and conditions of employment, working times and hiring and firing rules.

The United Kingdom government has also introduced a series of reforms that are designed to increase employment opportunities and increase both incentives and abilities to take on paid work. These include:

- reform of tax system to encourage participation — though for example: decreases in the corporate and personal tax rate over the last two decades; and the introduction of the *Family Credit*, a low-income complement to increase the gap between work related income and unemployment benefits;
- social benefits have gradually decreased and eligibility conditions have been progressively tightened — through for example: the reduction of net unemployment benefits by abolishing the earnings-related supplement, suspending statutory indexation and making their taxation less favourable; the replacement of the Sickness and Invalidity Benefit with the *Incapacity Benefit* which introduced a tougher medical test to assess incapacity and; the introduction of *Jobseekers Allowance* which lowered the maximum period of non means-tested benefits; and
- introduction of active labour market policies — through for example: the *New Deal* initiative which is a compulsory reinstatement program for unemployed people based upon subsidies to potential employers; the *Welfare to Work Scheme* which is designed to give the unemployed help in finding work, and, if need be, provides subsidised jobs for the young unemployed and the long term unemployed; and the introduction of counseling and ensuring that claimants are actively seeking work.

The United Kingdom also introduced a statutory minimum wage that allows for a sub-minimum rate for young workers

United States

While the United States industrial relations systems provides for collective bargaining, the labour market has long been characterised by enterprise or plant level bargaining and is therefore considered practically unregulated.

Federal welfare reform legislation enacted in 1996 made major changes to the nature and provision of welfare benefits in the United States. As a result, there has been an expansion of social programs targeted at increasing the returns to work and requiring work for social assistance. For example, the *Temporary Assistance to Needy Families* program, seeks to eliminate the entitlement to government assistance, by requiring work for welfare recipients and introducing a lifetime five-year time limit for welfare receipt. Further, the increased use of in-work tax credits for low-income earners through the *Earned Income Tax Credit* program seeks to encourage people with low earnings capacity to enter the labour market

The *Fair Labor Standards Act* was amended in 1996 to provide a two-step increase in the (still comparatively low) minimum wage and a sub-minimum rate for youth.

European Union (excluding the United Kingdom)

There has been no uniform trend across European Union countries with regards to the liberalisation of employment protection legislation. While Denmark, Finland,

Spain and Sweden have decentralised or moved towards more uncoordinated collective bargaining, other countries, such as Italy, Norway and Portugal, have moved towards more centralised and or coordinated bargaining in recent years. In some cases, there have even been simultaneous movements in both directions.

Selected features of labour market reforms in some of the European Union countries have involved:

- reduction in labour costs for targeted groups — through for example reductions in payroll taxes for minimum wage earners (France, Belgium, Spain, Italy and the Netherlands); and, the formalisation of wage moderation in an agreement between unions and employers through the abolition of automatic price indexation (the Netherlands)
- encouraging the employment of low-wage workers — through the introduction or expansion of in-work benefits or tax credits to 'top up' low wages (Ireland, Belgium, Finland, Italy and the Netherlands);
- easing of employment protection legislation for temporary and/ or permanent workers — through for example: increasing number of permissible renewals (Germany, Belgium); reducing the restrictions on the use of fixed-term contracts (Belgium, Sweden); opening of temporary work agencies and increased use of fixed-term work arrangements (Italy); and, the introduction of new permanent contracts with reduced severance payments (Spain);
- modernising the work organisation — through for example: reducing working time arrangements (France); introducing gender mainstreaming legislation (Denmark, Germany); part time work and parental leave brought into legislation (Greece, Italy); introducing specific measures to promote the integration of women and to work to later ages (Austria, Portugal, Sweden); and
- reform of social benefits to increase work incentives — through for example: reduced unemployment support levels (Germany, Austria, Belgium, Denmark, Finland, Ireland and the Netherlands); tougher eligibility criteria for unemployment benefits and stricter enforcement of such criteria (Denmark, Netherlands, Ireland); lowering maximum duration of benefits (Germany, Belgium, Denmark, Iceland and Norway); and, pension reforms and raising effective retirement ages (France, Italy and Austria).

Since 1997 the European Union has developed and evolved the *European Employment Strategy*, which is aimed at achieving long-term economic growth, full employment, social cohesion, and sustainable development. The strategy advocates four common recommendations:

- increasing adaptability of workers and enterprises;
- attracting more people to the labour market and making work a real option for all;
- investing more and more effectively in human capital;
- ensuring effective implementation of reforms through better governance.

The strategy also has country-specific employment recommendations to steer Member States' policy reforms. There have been significant changes in national

employment policies, with a clear convergence towards the common European Union objectives set out in the policy guidelines.

The *European Employment Strategy* tends to emphasis the use of funded active labour market policies such as training, employment subsidies and job search assistance.

6.6 Key observations

The special treatment of labour law is a common feature of competition policy in most comparable countries, and exemptions equivalent to those in the *Trade Practices Act 1974* appear to exist in the United States, United Kingdom, Canada and New Zealand. While there have been developments that place a greater emphasis on individual action and responsibility, collective agreements remain an important feature of labour regulation in the OECD.

Labour market reform has generally lagged reforms in other areas — for example, the financial sector, product market and international trade. The International Monetary Fund found that while labour market reforms usually increase growth and lower unemployment in the long term, they often lower growth and increase unemployment in the short term.[83]

Notwithstanding this, over the last decade or so, a number of OECD countries have made considerable progress in reducing structural unemployment through, among other things, active labour market policies. The focus of these policies has generally been on: the tightening of benefit eligibility criteria; job-search assistance measures and 'making work pay', all of which have been implemented to some extent in Australia.

To further improve employment performance, OECD employment and labour Ministers have concluded that, in co-operation with all levels of government, employers, unions and civil society:

> A comprehensive strategy for more and better jobs is needed, including i) effective activation measures and employment services, combined with enhanced monitoring of social benefits; ii) changes in taxes and benefits so that work pays; iii) more equal access to lifelong learning; iv) job-related training that enhances career prospects and addresses skill mismatches; and v) lower barriers to labour demand and improved functioning of labour markets so as to strike a balance between flexibility and security. This should go hand-in-hand with appropriate macroeconomic policies and market reforms that support growth and job creation.[84]

Based on experience in other OECD countries there is scope for Australia to continue modernising the workforce through:

- flexible working arrangements;
- achieving a better balance between work and family life;
- encouraging and providing for part time and temporary work;
- promotion of work by older Australians; and
- increasing labour participation.

[83] International Monetary Fund, April 2004, *World Economic Outlook*. Chapter 3.

[84] OECD 2003, *Communique — Towards More and Better Jobs*, Meeting of Employment and Labour Ministers, Paris, 29-30 September 2003.

At the same time, changes in policy initiatives could inadvertently or deliberately involve 'backsliding' of positive labour market reforms.[85] Particular focus is needed to ensure that future reforms do not undermine previous competitive labour market reforms.

[85] Access Economics 2004, *Assessment of the Australian Labour Party Workplace Relations Policy Platform.* A report commissioned by the Business Council of Australia.

Chapter 7

Capital markets

The retiring Chief Executive Officer of the Australian Stock Exchange recently stressed that the more efficiently capital markets operate, the better the environment for job creation and economic growth:

> Capital markets exist for the efficient raising of capital at the lowest possible cost and where that is done well it will enhance economic activity and create jobs — feeding back into capital market growth and innovation. The greater the depth, the liquidity and the integrity of our capital market, then the greater the efficiency with which Australian companies, large and small can raise capital.[86]

A distinction is usually made between bank and similar financing, on the one hand, and the raising of capital via the issuing of securities. Capital markets include equity and bond markets, and at the boundary venture capital and other non-lending modes of capital provision — including both primary and secondary markets in the relevant instruments and their derivatives. Capital market reform thus refers to all measures related to improving the efficiency of capital raising other than via bank or other lending.

Reforms within this sector have, most recently, revolved around the minimisation of transaction costs associated with raising capital and the reduction of information asymmetries through improved disclosure by market participants.

7.7 Major Australian reforms

As capital markets have evolved, so has the need for new regulatory instruments to maintain market integrity and reduce inefficiencies in capital raising procedures. Australia has consistently remained at the forefront of capital market reform since the 1970s. At that time, Australia's equity markets were a series of small regional markets — the regulation for which was inadequate and inconsistent. The bond market was significantly distorted by 'captive market' regulations that required financial institutions to hold proportions of their capital in government and semi-government securities. A corporate bond market had yet to develop.

Over the last three decades, the Government has commissioned a series of major Financial Sector reviews aimed at removing distortions and inefficiencies within Australia's capital market as well as facilitating its integration globally. Box 7.1 highlights some key reform milestones within the landscape of Australian capital markets.

[86] R. Humprhy 2004, *Reflections on Australia's Capital Markets*, Finance Executives International of Australia luncheon, Sydney, 20 April 2004, page 3.

Box 7.1

HISTORIC REFORMS TO AUSTRALIAN CAPITAL MARKETS

- The creation of a national body, the Australian Securities Commission to regulate companies and securities — in effect, to supervise capital markets (Rae Committee, July 1974).
- The dismantling of institutional arrangements for fixing the exchange rate and dismantle exchange rate controls (Campbell Committee, 1981), which culminated with the floatation of the Australian dollar in 1983 and catalysed the amalgamation of regional exchanges into a single stock exchange in 1987.
- The abolishment of the 30/20 government security holdings rule for life companies, banks and superannuation funds as well as controls on lending and equity investment (Campbell Committee, 1981).
- The establishment of disclosure standards for life companies no less onerous than those applying under the Companies Act (Campbell Committee, 1981).
- The consolidation of legal frameworks and regulatory institutions (Wallis Inquiry, 1997). This led to the amalgamation of the Australian Securities Commission with part of the Insurance and Superannuation Commission as well as the creation of the Australian Prudential Regulation Authority to undertake prudential regulation within the financial system. The Australian Prudential Regulation Authority combining the then-existing prudential regulation functions provided by the Reserve Bank of Australia, the Financial Institutions Scheme and the Insurance and Superannuation Commission.
- The harmonisation of Australia accounting standards with international standards (recommended by the Wallis Committee, 1997 and implemented via CLERP).
- The creation of a single licensing scheme should be introduced for financial sales, advice and dealing (implemented via CLERP).

Australia's latest series of reforms are collectively referred to as the Corporate Law Economic Reform Program (CLERP), which was initiated in 1997 in the context of the Wallis Inquiry.[87]. The capital market reforms pursued within the bounds of CLERP can be categorised under three main headings:

- improving the efficiency of trade — which involved amendments to the Corporations law to allow for and facilitate electronic communication and regulation of comparable financial products including securities, derivatives, superannuation, life and general insurance;
- minimising transaction costs for investors and issuers — which requires disclosure of all relevant information by capital raising entities, allows ASIC discretion over profile statements on long prospectuses, reduces disclosure requirements fro venture capital and other investments in SMEs, and provides for personal liability for disclosure documents; and
- strengthening market integrity — this is mainly through the reduction of information asymmetries by increasing disclosure requirements.

7.8 Overseas reform progress

Overseas, developments within the capital market reform sector also revolve around the rebuilding of investor confidence by reducing information asymmetries.

[87] S. Wallis, B. Beerworth, M. Carmichael, I. Harper, and L. Nicholls 1997, *Financial System Inquiry* Final Report.

New Zealand

New Zealand has undergone significant capital market reform in recent years aimed at making the New Zealand markets attractive to overseas investors as well as cost-effective for local and international firms. Like other regions, New Zealand is increasingly concerned with corporate reporting and governance issues. It has passed new securities laws that focus on stock exchange activities, continuous disclosure requirements, director reporting requirements and the powers of the Securities Commission.[88] The new securities law strengthens its Securities Commission's powers to obtain information and enforce penalties for market abuses.

In other ways, however, New Zealand capital markets are catching up with reforms in other regions. For example, the New Zealand Stock Exchange has recently demutualised and is currently working in conjunction with the Sydney Futures Exchange to develop a futures market for the region. Similarly, there still exist some significant protectionist measures. For example, the New Zealand Stock Exchange enforces ownership limits: no person or entity can own more than 10 per cent of a company listed on the exchange.

Beyond the creation of a futures exchange, the possible synergies of a trans–Tasman capital market have also been floated. At the OECD's Fourth Round Table on Capital Market Reform in Asia in April 2002, there were discussions between the New Zealand Stock Exchange and the Australian Stock Exchange on the possibility of a merger; however, by 2003 it was decided by both parties not to proceed.

Canada

Like the US, within Canada a number of actions have followed in the wake of recent major corporate collapses. The main thrust of Canadian reforms has been to bolster consumer confidence in the capital markets while improving the efficiency and effectiveness of their governance. Canada, like Australia, has introduced a number of reforms aimed at improving the efficiency of capital markets. For example, Canada's *Criminal Code* already provides penalties for market abuses commensurate with those introduced with the *Sarbanes-Oxley Act 2002* in the US. Canadian markets also require continuous disclosure and disclosure of 'off-balance sheet' items.

Canada has used recent high profile corporate fraud — such as Enron — as a rationale for further review of capital market regulation. Recent actions have included:

- the development of a civil liability scheme aimed at making it simpler for investors in secondary markets to sue companies, directors, officers, underwriters and experts for misleading or untrue statements or failure to provide full and timely information;

[88] Registered exchanges must comply with a continuous disclosure requirement. The Securities Commission enforces these requirements and may pursue civil penalties within the New Zealand courts in the event of a breach. The new Securities law also requires directors and officers to disclose the trading of shares of their company within 5 days of the trade. It is worthwhile to note that New Zealand law notably does not require the registration of all securities markets. If a market is not registered, is cannot claim to be one. If it is registered, it is required to comply with rules approved by the Minister of Commerce on advice of the Securities Commission.

- the review of accounting standards, issuing new rules on speculative derivates, disclosure of financial guarantees, variable interest entities and stock option expensing;
- the establishment of the Canadian Public Accountability Board to provide oversight for public accounting firms and their auditors;
- the development of new auditor independence standards; and
- the tightening of the definition of 'independence'.[89]

United States

Unlike Australia's CLERP initiatives, which were initiated independent of specific market abuses (and with respect to HIH, years before its collapse), United States capital market reforms have been largely in response to a series of corporate scandals, the most prominent of which being the collapse of Enron. On 30 July 2002, the *Sarbanes-Oxley Act 2002* was brought into law, which imposes a host of new regulatory requirements on enterprises raising money in United States capital markets. Some of the most significant measures of the Act include:

- *Chief Executive Officer and Chief Financial Officer certification of financial disclosures* — under the *Sarbanes-Oxley Act*, the Chief Executive Officer and Chief Financial Officer of an issuer (including foreign issuers) are required to sign a written statement that will accompany each financial report (annual and quarterly) filed with the Securities Exchange Commission which renders them liable to criminal penalties in the event the certification is later shown to be false.[90]
- *Continuous, 'real time' disclosures* — the *Sarbanes-Oxley Act* requires issuers to continuously disclose any information concerning material changes in the issuer's financial condition or operations as may be required by the Securities Exchange Commission.
- *Requirements and restrictions on audit committees* — the *Sarbanes-Oxley Act* requires all issuers to have fully independent audit committees, where the definition of 'independent' has been expanded to prevent material conflicts of interest. Failure to secure an independent committee or non-compliance with other audit provisions will result in the delisting or refusal to list any security of the issuer by the United States national exchanges and national securities associations.[91]

In addition, the Securities Exchange Commission is also considering other initiatives to accelerate disclosure by United States issuers, including a proposal to 'increase the items reportable by United States issuers in current reports on Form 8-K (a material events report) and to shorten the permissible period for reporting most Form 8-K events.'[92] The compliance burden associated with these measures is

[89] Department of Finance, Canada 2003, *Fostering Investor Confidence in Canadian Capital Markets* and Department of Finance, Canada, 2003, *Key US and Canadian Reforms* available at www.fin.gc.ca/toce/2003.

[90] An issuer under the *Sarbanes-Oxley Act* is defined as companies that have securities registered under the *Securities Exchange Act* of 1934 or have an effective/pending registration statement. No specific exemption is provided in the Act for foreign issuers.

[91] See B. Mezger, J. Colihan, C. Stubblefield and S. Best 2003, *American Corporate Governance* and *Scandal, Reform and the Global Capital Markets*, Euromoney International Capital Markets Handbook.

[92] Ibid.

expected to be significant. To the extent that this burden becomes onerous to investors or issuers, it may reduce the attractiveness of United States capital markets.

The United Kingdom and European Union

Europe and the United Kingdom are undergoing a period of integration and this has brought with it a number of capital market challenges. In 1993, the Single Market was established; in addition to other economic reforms designed to ensure the free movement of goods, labour, services, the Single Market rules also provides for the efficient flow of capital throughout the European Union including the United Kingdom.[93]

These capital market integration issues however, are not currently relevant for Australia given the recent decision by the exchanges in Australia and New Zealand to not proceed with a merger. If these two markets were to amalgamate sometime in the future then the European experience in institutional and regulatory harmonisation could become highly relevant for the Australian context.

In response to the *Report of the Group on a Modern Regulatory Framework for Corporate Law in Europe*[94] the European Commission has developed an Action Plan. This plan was tabled for comments in 2003 and its currently being implemented. The Action Plan devotes special attention to a series of corporate governance initiatives aimed at boosting confidence on capital markets, including:[95]

- the introduction of an Annual Corporate Governance Statement;
- the development of a legislative framework aiming at helping shareholders to exercise various rights;
- the promotion of (independent) non-executive or supervisory directors;
- the adoption of a Recommendation on Directors' Remuneration, which includes detailed disclosure of individual remuneration;
- the creation of a European Corporate Governance Forum to help encourage coordination and convergence of national codes and of the way they are enforced and monitored; and
- increasing the disclosure requirements applicable to a series of limited liability legal entities existing at national level.

7.9 Key observations

Capital market reform in Australia has been significant and ongoing since the 1970s. In the thirty years hence Australia has either moved in step or ahead of its international counterparts in terms of improving market efficiencies, integrating with global markets and adopting technologies to facilitate capital raising and exchange.

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93 One of the final key barriers to full integration between the United Kingdom and the other member states relates to the United Kingdom's adoption of the euro. For more information about the impact of the United Kingdom adopting the euro, see http://www.bized.ac.uk; http://www.euro.ecb.int; http://www.euro.gov.uk; and http://www.hm-treasury.gov.uk.

94 European Commission, 2003, *A Modern Regulatory Framework for Company Law in Europe*, Financial Reporting and Corporate Law.

95 Ibid.

The clear focus of current reforms globally is on strengthening market integrity and rebuilding investor confidence. Australia has been proactive in this sphere, and continues to shore up regulatory mechanisms to protect market participants.

In general, few lessons are gleaned from international efforts. No other country appears to have introduced a measure that Australia has not implemented or considered.

Thinking laterally, it could be that consolidation of selected capital markets — such as the Australian and New Zealand exchange — would be advantageous for both Australia and New Zealand. This however, is unlikely to be developed specifically within the current National Competition Policy framework — although it is not incompatible with the general National Competition Policy principles.

Reforms to Australia's capital markets are, within current market and technological contexts, already at or exceed world best practice. Opportunities to further advance reform in this sphere in the National Competition Policy context appear limited.

Chapter 8

Health

The health sector is becoming increasingly significant in Australia's economy, as in other OECD countries:

> Health services seem destined to make ever-increasing demands on national economies. There are likely to be continuing expressions of concern about whether we can afford universal health care coverage, about whether the public sector is carrying too high a burden of the overall costs involved, whether the user ought not to be paying more at the point of consumption, whether the incentive structures for doctors can be improved to make them more efficient, whether the poor, in income and/or in health terms, are getting a fair deal.[96]

The fact that the real costs of health care have been rising faster than the rate of growth in the economy more generally means that the opportunity costs of health services are becoming more keenly felt in the economy. Estimated total expenditure on health in Australia in 2001–02 was $66.6 billion, or 9.3 per cent of national gross domestic product. By way of comparison, Australians spent 5.7 per cent of gross domestic product on health in 1971-72 and 8.1 per cent of gross domestic product in 1991-92.[97]

8.1 Major Australian reforms

Over the past decade, there has been significant micro-economic reform in the health sector in Australia with the objective of improving efficiency. However, two distinctive features of Australia's health system — the spilt between the Commonwealth and State governments for responsibility for health care, and the mix of public and private funding and provision of health care — have meant that the reforms have tended to be incremental and syncretic, consisting of a range of independent but interactive measures in different parts of the system.[98] Important reforms include:

- the introduction of casemix funding to improve efficiency in public hospitals, moving to paying hospitals a benchmark price for the mix of patients they treat, and away from funding on an historical basis;[99]
- attempts by state governments to harness private capital through a small number of public hospital privatisations, and the co-location of private hospitals on the campuses of public hospitals;[100]
- a series of measures by the Commonwealth Government designed to make general practitioners more efficient as gatekeepers, including the development

96 G Mooney 1998, 'Preface', in G. Mooney and R. Scotton (eds), *Economics and Australian Health Policy*, Allen & Unwin, pp. xiii-xiv.

97 Australian Institute of Health (AIHW) 1996, *Australia's Health Services Expenditure, 1982-83 to 1994-95*, Health Expenditure Bulletin No. 12, p. 25; and AIHW 2004, *Australia's Health 2004*, AIHW, Canberra, p. 230. Health expenditure covers expenditure on the range of health goods and services that are provided by governments, non-government organisations, and individual health service providers.

98 A. Bloom 2000, 'Context and lead up to health reform', in A. Bloom (ed), *Health Reform in Australia and New Zealand*, Oxford University Press, Melbourne, p. 22.

99 S. Duckett 2000, 'The evolution of the purchaser role for acute in-patient services in Australia', in A. Bloom (ed), *Health Reform in Australia and New Zealand*, Oxford University Press, Melbourne, p. 147.

100 M. Foley 2000, 'The changing public-private balance', in A. Bloom (ed), *Health Reform in Australia and New Zealand*, Oxford University Press, Melbourne, pp. 107-8.

of local general practitioners networks, the accreditation of general practitioners, and the introduction of 'blended payments' for general practitioners. Payments are now linked to performance on a range of quality and patient outcomes measures under the Practice Incentives Program, as well as fee for service;[101]

- agreements on price-volume caps negotiated between the Commonwealth Government and pathologists and radiologists to contain the growth in expenditure on diagnostic services;[102]
- a version of funds-pooling has been trialed through the Coordinated Care Trials funded by the Commonwealth and States. The trials focused on people with complex and chronic health needs. The aim was to test whether health care could be improved within existing resources, through better planning and coordination of health care, supported by more flexible funding arrangements;[103]
- amendments to the regulatory framework for private health insurance, encouraging the use of case payment rather than per diem reimbursements of hospitals and the introduction of contracts among insurers, doctors and private hospitals.[104] The changes radically altered the relationship between private hospitals and insurers, transforming the health funds from passive price takers to active purchasers of services;[105] and
- the introduction by the Commonwealth of measures to encourage the take-up of private health insurance (including the 30 per cent rebate on premiums and Lifetime Health Cover). The measures resulted in a large increase in the proportion of people with private health insurance coverage, and a consequential significant increase in access to private hospitals.[106]

8.2 Overseas reform progress

OECD countries are wrestling with similar problems in relation to the performance of their health care systems, despite the diversity in funding and service provision arrangements. Generally, they struggle to maintain macro-economic expenditure control and improve their performance in terms of efficiency and equity.[107] In response to these challenges, there has been an international trend towards the

101 Commonwealth Department of Health and Ageing 2003, *Submission to the Select Committee on Medicare*, Inquiry into the Access to and Affordability of General Practice Under Medicare, pp. 18-22.

102 Commonwealth Department of Health and Aged Care 1999, *Health Expenditure: Its Management and Sources*, Occasional Papers: Health Financing Series, Volume 3, pp. 51-6.

103 Commonwealth Department of Health and Aged Care 2001, *The Australian Coordinated Care Trials: Summary of the Final Technical National Evaluation Report on the First Round of Trials*, at www.health.gov.au.

104 Foley, op. cit., pp. 104-5.

105 Australian Competition and Consumer Commission (ACCC) 2000, *Report to the Australian Senate on Anti-Competitive and Other Practices by Health Funds and Providers in Relation to Private Health Insurance for the Period Ending 31 December 1999*, ACCC, Melbourne, p. 133.

106 Commonwealth Department of Health and Ageing 2003, op. cit., p. 6; and AIHW 2003, *Australian Hospital Statistics 2001–02*, AIHW, Canberra, p. 16.

107 A. Maynard 2002, 'Barriers to evidenced-based policy making in health care', in Productivity Commission and Melbourne Institute of Applied Economic and Social Research, *Health Policy Roundtable*, Conference Proceedings, AusInfo, Canberra, p. 13.

greater use of market mechanisms and incentives to organise the financing, purchasing and provision of health care services.[108]

A key argument put forward in favour of reforms involving a greater use of market mechanisms is that the increasing complexity of medical practice and health care organisation have diminished the capacity of government agencies to make efficient allocation decisions. Greater use of market and quasi-market relationships and incentives aim to introduce a degree of self-regulating capacity within health care systems.[109] However, the social welfare implications of competition in health care have long been the subject of heated debate on both theoretical and empirical grounds. The conventional wisdom is that both health care and health insurance are substantially different from the textbook case of perfectly competitive markets, mainly because they are characterised by adverse selection and moral hazard, as well as poor consumer information. Policymakers have to decide on the extent of competition they wish to see (and the implications for consumer choice), in what areas it should be encouraged (among health plans and/or providers), over which dimensions it should play a role (price and/or quality) and what sorts of restrictions (such as price floors or quality standards) should be implemented.[110]

This section looks at examples of market competition and other market-based reforms in health care in New Zealand, Canada, the United Kingdom, the United States, and Europe (Netherlands).

New Zealand

In 1993, the New Zealand Government introduced pro-market measures into the publicly funded healthcare sector. At the heart of this model was the full separation of purchasing and providing. It was hoped to increase efficiency, contain expenditure, and reduce waiting lists. Purchasing was undertaken by four ministerial appointed regional health authorities. Hospitals became publicly owned companies called Crown health enterprises subject to normal company law and required to earn a rate of return on capital comparable to that of a business in the private sector.[111]

The outcomes were disappointing. There was no clear evidence of improved performance in the hospital sector or of obviously greater efficiency gains. Purchasers and providers struggled to establish contractual relations, transition and transactions costs were high, and the expected savings were not made. There was little competition between providers, especially hospitals, and barriers to entry and exit limited contestability. Further, there was a crucial lack of 'buy-in' among both health professionals and the general public.[112]

The current Labour Government in New Zealand has returned to an integrated purchaser-provider structure, with strategies to guide the system based on objectives and priorities for improving health, and service specifications for care delivery.

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[108] Productivity Commission 2002, *Managed Competition in Health Care*, Workshop Proceedings, AusInfo, Canberra, p. xiii.

[109] R. Scotton 2002, 'Managed competition: the policy context', in Productivity Commission, *Managed Competition in Health Care*, Workshop Proceedings, AusInfo, Canberra, p. 83.

[110] E. Docteur, H. Suppanz and J. Wood 2003, *The US Health System: An Assessment and Prospective Directions for Reform*, Economics Department Working Papers No. 350, p. 59, at www.oecd.org/eco.

[111] N. Devlin, A. Maynard and N. Mays 2001, 'New Zealand's new health sector reforms: back to the future?', *British Medical Journal*, 322, 1171-1174, p. 1171.

[112] Ibid., pp. 1171-2.

The Government has also put a lot of focus on the importance of primary care, with the establishment of Primary Health Organisations as part of the Primary Health Care Strategy announced in 2001.[113] Primary Health Organisations are not-for-profit local groups of providers whose job it is to look after all the people enrolled with them. The group always includes a General Practitioner and may also include nurses, pharmacists, dieticians, mental health workers, community health workers and dentists. While primary health care practitioners are encouraged to join Primary Health Organisations membership is voluntary. The essential features of Primary Health Organisations are:

- they are required to provide at least a minimum set of essential population-based and personal first-line services, including population services to improve health, screening and preventive services, support for people with chronic health problems, and information, assessment and treatment for any episodes of ill health;
- Primary Health Organisations are required to work with other providers within their regions to ensure that services are coordinated around the needs of their enrolled populations;
- payments to Primary Health Organisations are based on a blended combination of capitation, management and other payments; and
- Primary Health Organisations enrol people through primary providers. Enrolment is voluntary and people are allowed to change their nominated provider. As of July 2003, 47 Primary Health Organisations have been established, covering a population of approximately 1.7 million New Zealanders (or nearly 50 per cent).[114]

Canada

Canada is an example of a country that has not relied on market competition to any meaningful extent in its reform of the organisation and delivery of health care.[115] The *Canada Health Act* regulates health care in all the provinces. Health care is publicly financed and citizens have universal access to care. Whilst some 30 per cent of expenditure is private, this pays for dental care, pharmaceuticals and other items not covered by provincial plans. There is no private health insurance for hospital and physicians services. One of the key features of the Act is its effective ban on user fees for hospital and physician services, and hence it is not possible for Canadians to purchase access to medical treatment from a private provider if it is covered under provincial plans.

In 2001, the Canadian Prime Minster established the *Commission on the Future of Health Care in Canada* to review Medicare. The review looked at the issues of extent to which the private sector should be involved in delivering health care services and whether people should be allowed to use their own money to purchase hospital and physician services from a private provider. The Commission opposed increasing the provision of health care services by the private for-profit sector:

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113 New Zealand Ministry of Health 2001, *The Primary Health Care Strategy*, at www.moh.govt.nz

114 Australian Institute for Primary Care, op. cit.

115 T. Rice, B. Biles, E. R. Brown, F. Diderichsen and H. Kuehn 2000, 'Reconsidering the role of competition in health care markets: Introduction', *Journal of Health Politics, Policy and Law*, 25(5), 863-73, p. 870.

> The Commission is strongly of the view that a properly funded public system can continue to provide the high quality services to which Canadians have become accustomed. Rather than subsidize private facilities with public dollars, governments should choose to ensure that the public system has sufficient capacity and is universally accessible.[116]

It also opposed the private funding of medical treatment:

> Some have described it as a perversion of Canadian values that they cannot use their money to purchase faster treatment from a private provider for their loved ones. I believe it is a far greater perversion of Canadian values to accept a system where money, rather than need, determines who gets access to care.[117]

In the recent election in which the Liberal Party was re-elected, the Prime Minister stated that his government would increase funding for health care and maintain the commitment to a publicly funded, universal system of health care, using the Commission's report 'as our blueprint'.[118]

United Kingdom

The Thatcher Government introduced an internal market of competing public-sector providers into the National Health Service in 1991. Purchasing was divided between the District Health Authorities (the main purchasers) and General Practice Fund holders (General Practitioners who volunteered to be the purchasers for most elective surgery for their patients).

Although the reforms led to many structural changes, overall they had little measurable impact on performance, whether defined in terms of volume, quality or unit costs. There was also a significant increase in administrative costs and a perception of greater inequality in access to care.[119] Of the reform elements, GP fund holding was more effective, with recent research suggesting that it reduced waiting times and referral rates, and had somewhat greater success in achieving cost savings through purchases of excess hospital supply where it appeared.[120]

The National Health Service Plan in 2001 set out the Blair Government's ten-year reform program for the health service. While moving away from many of the elements of the Thatcher agenda, nevertheless a major objective of the plan is to enhance market incentives on the provider side. Money will flow around the National Health Service in ways that support and encourage competition and the entry of new providers. This has been facilitated by allowing diversity of private and not-for-profit providers to compete for National Health Service contracts for secondary care and allowing greater choice of provider for patients waiting more than six months for elective surgery.[121] Significantly, competition is being encouraged on the basis of quality rather than price, since National Health Service providers must adhere to a national set of prices.

A key to this new approach is the setting up of newly constituted purchasers — Primary Care Trusts — with budgetary, performance and organisational responsibility for the health of a catchment population. In England, there are

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116 Commission on the Future of Health Care in Canada 2002, *Building on Values: The Future of Health Care in Canada — Final Report*, p. 9.

117 Ibid xx.

118 Martin, P, 2004, *Address by Prime Minister Paul Martin on the occasion of his visit to Winnipeg, Manitoba, March 26, 2004* at http://pm.gc.ca/eng/news.asp?category=2&id=153

119 C. Smee 2000, 'United Kingdom', *Journal of Health Politics, Policy and Law*, 25(5), 945-51, pp. 948-9.

120 J. Dixon, J. Le Grand and P. Smith 2003, *Can Market Forces Be Used For Good?*, Kings Fund, London, p. 10, at www.kingsfund.org.uk.

121 Ibid., p. 8.

approximately 300 Primary Care Trusts with responsibility for managing all health care for catchment populations. They negotiate standard medical service contracts with independent general practices and also agreements with National Health Service Trusts (acute health providers) to provide services for their catchment population. In 2002, Primary Care Trusts controlled around 50 per cent of the National Health Service budget; in 2004, 75 per cent of the National Health Services budget will be controlled by Primary Care Trusts.[122]

Primary Care Trusts are provided with funds from the Department of Health based on their catchment population characteristics. They in turn contract with primary care practices for services. Performance based payments based on the implementation of a quality framework and the achievement of patient outcomes comprise a significant component of practice income.[123] While patients do not have choice of Primary Care Trust, current policy is moving toward offering patients a choice of provider who will take the new National Health Service tariff rate — be they public, profit or not for profit.

The Blair Government's reforms have retained an internal market structure but placed much more emphasis on conscious performance management of the health care system, rather than relying on the market to improve performance.[124] Major changes in performance management introduced include:

- National Service Frameworks that specifies national standards of care for key conditions such as heart disease and diabetes;
- a health technology appraisal agency, the National Institute for Clinical Excellence that issues binding recommendations on services to be funded by local National Health Service; and
- independent inspectors award each National Health Service provider an annual 'star rating'. Providers that score well gain financial bonuses and greater operational freedom; providers that score zero are placed on 'special measures'.

United States

The United States health system is unique among OECD countries in its heavy reliance on the private sector for both financing and delivery of health care. The system is considered highly flexible, capable of evolving quickly to address the changing preferences of consumers and the incentives put in place by the requirements of payers and government regulation. It is also characterised by excellent access by the insured population to the latest advances in medical technology. However, 14 per cent of Americans lack insurance coverage, and the decentralised, multi-payer approach to financing and regulation provides relatively few levers to control spending. Instead, the system relies on competition among insurers and providers to increase efficiency. Although evidence is limited, it is not

[122] Australian Institute for Primary Care 2004, General Practice and Medicare: Options for Reform, draft report for the Victorian Department of Premier and Cabinet.

[123] Ibid.

[124] P. Smith 2002, 'Performance management in British health care: will it deliver?', *Health Affairs*, vol.21, no. 3, pp. 103-115, p. 104.

clear that the good clinical outcomes obtained are justified by the high relative spending levels, as other countries attain comparable outcomes for less.[125]

In the 1990s, under the impetus of rising costs of health care, the insurance system in the United States progressively moved from an indemnity model with free consumer choice of provider and ex post reimbursement of medical expenses towards policies that restrict patient choice of provider to varying degrees. Insurers selectively purchase care on the basis of price, aiming to do so without loss of quality. Patients are limited to those providers chosen by their insurers. Within this context, managed care plans go one step further by potentially restricting the level of care through gate-keeping, case/utilisation reviews, pre-authorisations and monitoring of doctor practice patterns.[126]

Managed care has taken on a variety of forms with differing mixes of risk cover, cost sharing and premiums. At one extreme, certain health maintenance organisations supply their own care, thus combining both the insurance and supply function. An alternative and currently more widespread form is through non-exclusive contractual relations with independent providers. Other forms allow greater individual choice over the provider — at a price of increased patient cost-sharing and higher premiums. But whatever the form, all but five per cent of the privately insured population was in arrangements of this type by 2002.[127]

After allowing for differences in health status associated with cream skimming and self selection, managed-care plans appear to have lower levels of hospital utilisation, both through lower admissions and length of stay. Total care costs tend to be 10 to 15 per cent lower than under indemnity plans, although transaction costs are generally high, with 20 cents and more of the health care dollar being used to fund marketing and administration. Cost reductions do not appear to have been accompanied by lower quality of care, although this is difficult to measure.[128]

Care restrictions however, imposed by managed-care plans have led to considerable public dissatisfaction. As a consequence, state-government regulations that restrict the capacity of managed-care institutions to limit access to care have become widespread. In addition, consumers have switched to larger, looser forms of managed care, which has weakened the capacity of managed care to sustain the efficiency gains so far achieved. The recent reappearance of strong upward pressure on health-care insurance premiums and spending suggests that managed care approaches may be reaching their limits in terms of expenditure control.[129]

One advantage for consumers, however, is that more attention has been paid to consumer information in the United States than elsewhere, in part because of its reliance on competing health plans. Much work has taken place on ‘report cards’ that evaluate health plan performance (usually) or provider performance (occasionally). There is now a considerable amount of information available about the quality of health plans, and increasingly, about the quality of hospitals and

[125] Docteur, Suppanz and Wood, op. cit, p. 2. In 2001, the United States spent 13.9 per cent of GDP on health care, compared to the OECD average of 10.6 per cent. AIHW 2004, op. cit., p. 449.

[126] E. Docteur and H. Oxley 2003, *Health Care Systems: Lessons from the Reform Experience*, Economics Department Working Papers No. 374, p. 35, at www.oecd.org/eco.

[127] Ibid., p. 35.

[128] Ibid., p. 35.

[129] Ibid., pp. 34-5.

physicians groups as well. The major concern is whether consumers are able to effectively use such information in a way that improves their decision-making.[130]

Europe (focus on the Netherlands)

In 1988 the Dutch Government began to implement radical market-oriented reforms in health care, introducing managed (or regulated) competition to replace central government planning. Managed competition seeks to use market incentives to increase economic efficiency, but within a framework which maintains equity and universal access for health care services. In essence, it involves the government funding — through a system of risk-adjusted payments — competing 'budget holders' to purchase health care services on behalf of their enrolees, negotiating prices and selectively contracting with competing providers.[131]

There is demand-side competition amongst public and private insurers, with private insurers obliged to accept certain groups of the socially insured. People have a free choice of health insurer and are able to switch to a different insurer once a year. Any form of risk selection by health insurers is prohibited.[132]

The transformation of a centrally planned health care system into managed competition has been politically, technically and institutionally complex. Workable competition requires prolonged investments in developing an adequate system of risk-adjustment, product classification and quality management, an appropriate consumer information system, and an effective competition policy.[133]

One of the biggest technical challenges faced has been the development of an appropriate health-based risk adjustment model. Good health adjustment is necessary to reduce the incentives for risk selection without reducing solidarity and efficiency, and without disturbing competition among risk-bearing funds. Since the introduction of managed competition, there have been five different risk-adjustment models applied in the Netherlands, indicating the technical and other difficulties involved in getting this right.[134]

The Netherlands approach is an attempt to balance efficiency and solidarity. Competition is seen to be the key to fostering efficiency, and solidarity is ensured by the formal ban on risk selection, by mandatory community rating, and by a risk adjustment scheme to compensate insurers for differences in risk profiles.[135] Despite the difficulties, the Dutch Government that took office in May 2003 gave a commitment to continue the implementation of managed competition.[136]

8.3 Key observations

A recent review of health care reforms in OECD countries concluded that efforts to introduce competition in countries starting from very different systems of

130 T. Rice 2002, 'Addressing cost pressures in health care systems', in Productivity Commission and Melbourne Institute of Applied Economic and Social Research, *Health Policy Roundtable*, Conference Proceedings, AusInfo, Canberra, p. 88.

131 Productivity Commission 2002, op. cit., p. xiii.

132 Maynard, op. cit., p. 18; and W. van de Ven, R. van Vilet and L. Lamers 2004, 'Health-adjusted premium subsidies in the Netherlands', *Health Affairs*, vol. 23, no.3, pp. 45-55.

133 van de Ven et al., op. cit., p. 45.

134 Ibid., p. 54.

135 H. Maarse 2002, 'Health insurance reform (again) in the Netherlands; will it succeed?', *Euro Observer*, vol. 4, no. 3.

136 Quoted in van de Ven et al, op. cit., p. 54.

financing, provision and supply from that in the United States have not achieved the expected results, and have often been substantially amended or reversed.[137]

Positive results from competition require establishing market conditions conducive to competition, better purchasing capacity, and the information base needed to appropriately set and monitor contracts.[138] The United States has a set of market and regulatory conditions that are probably unique. There is broadly unregulated local competition for health-care services in large urban areas and excess supply. Purchasing organisations have sufficient size and market power to collect and analyse complex information on cost and service use, thereby helping to bridge the information asymmetry inherent in health-care markets.[139]

Nevertheless, it has also been observed that while attempts at active competition in health-care markets have been curtailed in some countries, some of the underlying elements of these reforms remain.[140] Countries in particular have kept a focus on strengthening the position of purchasers. As a review of the role of competition in health care markets concluded:

> The enduring lesson from the U.S., British, and New Zealand experiences is the importance of *strong purchasing*. What drives good value, integrated care, high quality, and efficiency are purchasers who get their act together and pursue their agenda over several years' time.[141]

Countries have also kept the focus on developing and reporting better information about health care, both to underpin effective purchasing and to enable consumers to make better informed choices. Access to good data is essential for assessment of performance but a common characteristic of health care systems is that they are data rich, but information deserts. Most OECD countries have recently created or improved information systems used to assess one or more dimensions of health system performance. Many countries have also moved to providing additional information to consumers so that they can make decisions that are in their best interest with respect to choice of health plan, provider, and/or treatment.[142]

There are, however, numerous challenges, both technical and otherwise, in developing and reporting information on health-care quality, and results have yet to meet expectations in terms of influencing decision-making. In particular, health-care consumers have not proved a ready audience for comparative information on performance, as assessed by interest, propensity and ability to use such information.[143] Nevertheless, it is clearly the right direction to pursue and it is reasonable to assume that the quality of the information and its positive influence on decision-making will improve.

Another significant development in OECD countries is a greater focus on primary care, for example, with major reforms being implemented in the United Kingdom and New Zealand, and with Canada also signaling its intention to transform primary care. With primary care usually being the first contact with the health care system, the role and organisation of primary care is very important in the overall efficiency and effectiveness of health-care systems. Good access to effective

137 Docteur and Oxley, op. cit., pp. 34-7

138 Ibid., p. 47.

139 Ibid., p. 35.

140 Ibid., p. 37.

141 D. Light 2000, 'Sociological perspectives on competition in health care', *Journal of Health Politics, Policy and Law*, vol. 25, no. 5, pp. 969-74, p. 973.

142 Docteur and Oxley, op. cit., pp. 16-7.

143 Ibid., p. 16-7.

primary care can help control overall costs, through health care promotion and illness prevention and better disease management and integration of care, helping to avoid more expensive hospital care.[144]

These three elements of reform — strengthening the position of purchasers, developing and reporting better information about health care, and a greater focus on primary care — have in common an emphasis on providers. It has been noted elsewhere that markets have a much stronger role — and potential to improve social welfare — in the delivery than in the financing of health care.[145]

In Australia, Professor Scotton has been a keen advocate of a managed competition approach to health care financing and provision. The Scotton model has three main elements:

- the amalgamation of existing health programs into a single national program (including Medicare, public hospital funding, pharmaceutical benefits, aged care other community-based health programs);
- the specification of clear and separate roles for Commonwealth and State governments; and
- the integration of private sector funding and service provision into a national program.[146]

At a workshop on managed competition convened by the Productivity Commission, there was limited support among participants for the implementation of the full Scotton model. The model is complex and presents a number of challenging implementation issues.[147] Its introduction would involve substantial changes to Australia's health financing and service delivery arrangements. As such, it would represent a 'big-bang' reform. A majority of workshop participants considered that incremental reforms offered the prospect of clearer net gains to the community in the short to medium term. Alternative proposals put forward consistent with the reform objective of strengthening the position of purchasers included:

- evaluating the merits of giving doctors, through the Divisions of General Practice, greater responsibility for purchasing medical services and pharmaceuticals for their patients; and
- assessing the merits of giving regionally-based, public non-competing budget holders the responsibility for purchasing a full range of health services for their residents.[148]

144 Ibid., p. 28.
145 Rice et al., op. cit., p. 867.
146 Productivity Commission 2002, op. cit., pp. xiv-xv.
147 Ibid., pp. xv-xvi.
148 Ibid., pp. xvi-xvii.

Chapter 9

Education

Education is vitally important, and increasingly so, for the economic, social and cultural wellbeing of individuals and of nations:

> The pace of social and technological change has become so much more rapid that any citizen without a good education who is fortunate enough to find work today cannot have confidence that they will still be in work tomorrow. In the merging global market, every country will seek to match standards elsewhere as a means of attracting business as well as enabling its citizens to succeed in life. The distribution of good education in a population also crucially affects the distribution of income and the degree of social cohesion.[149]

This chapter examines policy reform aimed at improving the efficiency of resource allocation within education. There are large cross-country differences in educational performance which differences in expenditure per student do not explain.[150] By implication, the level of schooling productivity — the ratio of educational performance to resources used — differs widely across different schooling systems.

While education includes many different sectors and experiences, this chapter focuses on *school education* (years Kindergarten to Year 12), which provides the cornerstone of learning, and where change is most needed. It is noted though that Australia's higher education has recently undergone major reform as part of the Government's policy *Our Universities: Backing Australia's Future*.

9.1 Major Australian reforms in education

In 2001-02, Australian governments spent $25.3 billion on school education, or 3.5 per cent of GDP.[151] The roles and responsibilities for school education in Australia are split between the Commonwealth and State Governments. The State governments have constitutional responsibility to ensure the delivery of schooling to all children of school age. They determine curricula, regulate school activities and provide most of the funding. State governments are directly responsible for the administration of government schools, for which they provide the majority of government expenditure. Non-government schools operate under conditions determined by State government registration authorities and receive significant Commonwealth and State government funding. The Ministerial Council on Education, Employment, Training and Youth Affairs — comprising Commonwealth, State and New Zealand education ministers — is the principal forum for developing national priorities and strategies for schooling.[152]

The pace and scope of reform in school education differs among the States, although across jurisdictions there was been a greater focus on performance monitoring and reporting in recent years. This focus has also been reflected in the

149 M. Barber 2003, 'Deliverable goals and strategic challenges – a view from England on reconceptualizing public education', in OECD, *Networks of Innovation: Towards New Models for Managing Schools and Systems*, OECD, Paris, p. 114.

150 L. Woessmann 2000, 'Schooling resources, educational institutions, and student performance: the international evidence', *Kiel Working Paper No. 983*, p. 1.

151 Steering Committee for the Review of Government Service Provision (SCRGSP) 2004, Report on Government Services 2004, Productivity Commission, Canberra, p. 3.4.

152 ibid. p. 3.3.

work of the Ministerial Council on Education, Employment, Training and Youth Affairs, for example, in the establishment of the Performance Measurement and Reporting Taskforce which reports to each meeting of the Ministerial Council on approaches to reporting on activities and outcomes by schooling systems.

The Commonwealth Government has also undertaken a number of initiatives aimed at improving performance monitoring, accountability and reporting arrangements in education. Most recently, the Commonwealth has announced a number of new conditions with which the States must comply in order to receive Commonwealth funding for schools during the period 2005-2008, including:[153]

- achieving performance targets for Years 5 and 7 reading, writing, spelling and numeracy, augmenting the current Year 3 targets;
- reporting to parents their child's achievement in literacy and numeracy against the national literacy and numeracy benchmarks for Years 3, 5 and 7;
- publishing a range of performance information at the school level, with the aims of enabling parents to make more informed choices and improving accountability; and
- implementing common testing standards in English, mathematics, science and civics and citizenship, to achieve national consistency in curriculum outcomes across Australia.

A fundamental point to make in this context is that the performance of Australian school students is high by international standards. However, although the performance of Australian students is higher than in most comparable countries, there are no grounds for complacency. There is no evidence that the (absolute) performance of Australian students has improved over time and that this high standing is due to improvements in student learning over the last 30 years.[154]

9.2 Overseas reform progress

This section looks at examples of market competition and other market-based reforms in education in New Zealand, the United Kingdom, the United States, and the Netherlands.

New Zealand

New Zealand has a long history of education reform aimed at opening up school choice to parents. The *Private Schools Conditions Integration Act 1975* allows private schools to integrate into the state system. Integrated schools receive equivalent per-student operating funding rates to state schools in return for more regulation, but must fund some of their own capital expenditure. Integrated schools cannot charge fees, but can charge 'attendance fees' to fund capital works.[155]

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153 Department of Education, Science and Training 2004, *Learning Together: Achievement Through Choice and Opportunity, Australian Government Funding for Schools for the 2005-2008 Quadrennium, Discussion Paper*, at http://www.dest.gov.au, pp. 4-5.

154 G. Marks, J. McMillan and J. Ainley 2002, 'Policy issues for Australia's education systems: evidence from international and Australian research', paper presented at the *2002 Economic and Social Outlook Conference* of the Melbourne Institute of Applied Economic and Social Research and The Australian, University of Melbourne, 4-5 April, pp. 1-2.

155 In comparison, non-integrated private schools, which comprise only 5 per cent of private schools, receive government funding at a rate of about 30 per cent of the per pupil rate provided in state schools and can charge fees.

In 1989 New Zealand embarked on what is arguably the most thorough and dramatic transformation of a state system of compulsory education ever undertaken by an industrialised country.[156] Under a plan known as *Tomorrow's Schools* the Labour government abolished the Department of Education and turned control of its nearly 2,700 primary and secondary schools over to locally elected boards of trustees. Two years later, a newly elected National Party government abolished neighbourhood enrolment zones and gave parents the right to choose which school their child would attend. In 1996, the Targeted Individual Entitlement (TIE) scheme was introduced, under which a small number of vouchers were provided for children from low-income families to attend private schools.

An assessment of the New Zealand's reforms reported both benefits and problems.[157] On the benefits side:

- parental choice has become an integral part of compulsory education in New Zealand and is now widely accepted as appropriate;
- parents have not hesitated to make use of their extended right to choose among schools, and the choices they have made have had a large impact on enrolment patterns, especially in urban areas;
- Maori and Pacific Island families have made the greatest use of choice — in 1990, only 21 per cent of Maori and 18 per cent of Pacific Island families attended non-local schools. By 1995, this figure had increased to around 39 per cent and 38 per cent respectively; and
- schools have more autonomy with decentralisation of control over operational budgets.

The problems have included:

- reformers underestimated the extent to which self-governing schools, especially those serving the most disadvantaged students, require continued support from the state they serve as agents;
- the particular model of parental choice fell far short of the ostensible goal of offering choice for all students. Many parents, especially those with low incomes, are not in a position to exercise choice either because no alternative options exist where they live or because they cannot afford the transportation, fees and other costs of enrolling in a desirable school; and
- since oversubscribed schools have the right to designate which students they will accept, the system quickly changed in some fast-growing urban areas from one in which parents and children choose schools to one in which schools choose students.

Since 1999, under the Labour Government, there have been some reversals of the reforms. Parental choice of schools has been restricted and the TIE scheme has been abolished.

[156] E. Fiske and H. Ladd 2000, *When Schools Compete: A Cautionary Tale*, Brookings Institution Press, Washington, p. 3.

[157] Ibid.

United Kingdom

In 1988 the Conservative Government introduced the *Education Reform Act* which brought in a schools quasi-market in which parents can exercise choice of state school, provided there is a place available and, for certain schools, that their child meets selection criteria in terms of religious affiliation or ability. Schools are funded by formula largely according to the number of pupils enrolled and are required to manage fully delegated budgets for almost all resources, including teachers.[158]

The quasi-market reforms were progressively buttressed by increased 'performance regulation', through the establishment of a national curriculum, national tests at four stages of education, and the publication of school test and examination performance tables. In 1993 the Office for Standards in Education (OFSTED) was established, which overseas the national inspection at regular intervals of all schools.

The election of a Labour Government in 1997 further strengthened performance regulation. Local education authorities (LEAs) were placed firmly in the role of agents of central government in delivering school improvement. LEAs became subject to inspection and their services, if found inadequate, can be replaced by private sector provision. Although Labour Government policies give greater emphasis to co-operation between schools than did the Conservatives, the structural features that promote competition between schools are largely unchanged and are likely to be strengthened by new reforms.[159]

This trend is reflected in the Labour Government's recently announced *Five Year Strategy for Children and Learners*.[160] One of the identified goals of the strategy is 'More choice for parents and pupils; independence for schools'. At the heart of the reforms is the further development of independent specialist schools in place of the traditional comprehensive schools. Specialist schools were introduced by the Thatcher Government with 15 city technology colleges. Now almost two thirds of secondary schools — 1,955 schools — have achieved specialist status. Specialist schools are found in every setting, with as many in low as in high socio-economic areas. While still being required to address the national curriculum in key learning subjects, specialisations are encouraged in ten areas: arts, technology, languages, sports, business and enterprise, engineering, mathematics and computing, science, humanities and music.[161]

Under the new strategy, every school will be able to become a specialist school with a mission to build a centre of curriculum excellence. Specialist schools will be able to develop a second area of specialisation to develop their mission further. In committing his government to extending the approach, Prime Minister Blair drew attention to the finding that the number of students gaining high grades is higher in specialist schools than their non-specialist counterparts, 'a figure that holds for

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158 R. Levacic 2001, 'An analysis of competition and its impact on secondary school examination performance in England', *Occasional Paper No. 34*, National Center for the Study of Privatization in Education, Columbia University, pp. 3-4, at http://www.ncspe.org/readrel.php?set=pub&cat=58

159 Ibid.

160 Secretary of State for Education and Skills 2004, *Department for Education and Skills: Five Years Strategy for Children and Learners*, at www.dfes.gov.uk.

161 Ibid, pp. 44-7.

schools in poor areas as much as it does for those in wealthy ones'.[162] In a recent review of secondary schools, the Office for Standards in Education found that specialist schools, which were less than half of all schools at the time, made up 64 per cent of 'outstanding' schools.[163]

The new five year strategy also continues the Blair Government's focus on performance and accountability, noting that:

> 'Inspection, accountability and intervention to tackle failure are essential for independence to thrive properly'.[164]

The strategy extends the City Academies project. City Academies are independently managed schools that replace secondary schools which are considered to have failed their communities despite 'special measures' that have been taken to achieve improvement.[165] Academies are promoted and managed by independent sponsors, including philanthropic individuals, educational trusts, faith sponsors, and companies on a non-profit basis. They are free to innovate as they wish in order to transform standards in areas that have been persistently ill-served in the past.[166] Under the new strategy, 200 academies are to be open or in the pipeline by 2010 in areas with inadequate existing secondary schools.

The Academies are part of a broader framework for continuous improvement in England, which has been characterised as one of 'high challenge, high support'.[167] The main elements are summarised in table 9.1 below.

[162] Quoted in B. Caldwell 2003, 'A new vision for public schools in Australia', paper presented at the *2003 Economic and Social Outlook Conference* of the Melbourne Institute of Applied Economic and Social Research and The Australian, University of Melbourne, 13-14 November, p. 12.

[163] Specialist Schools Trust 2004, *Specialist schools dominate Ofsted's list of 'outstanding' schools*, Press Release, 4 February, www.specialistschooltrust.org.uk/news/pressrelease.cfm?ID=91.

[164] Secretary of State for Education and Skills, op. cit., p. 8.

[165] Caldwell, op. cit., p. 10.

[166] Secretary of State for Education and Skills, op. cit., p. 51.

[167] Barber, op. cit., p. 117.

Table 9.1

PERFORMANCE FRAMEWORK FOR SCHOOLS IN ENGLAND

Elements	Actions
Ambitious standards	High standards set out in the national curriculum National tests at age 7, 11, 14 and 16.
Devolved responsibility	School as the unit of accountability Devolution of resources and employment powers to schools Pupil-led formula funding Open enrolment.
Good data/clear targets	Individual pupil level data collected nationally Analysis of performance in national tests Benchmark data annually for every school Comparisons to all other schools with similar intake Statutory target-setting at district and school-level.
Access to best practice and quality professional development	Universal professional development in national priorities Beacon (best practice) schools Devolved funding for professional development at school level.
Accountability	National inspection system for schools and districts. Every school inspected every 4-6 years All inspection reports published Publication annually of school/district level performance data and targets.
Intervention in inverse proportion to success	For successful schools: beacon status and greater autonomy For all schools: post-inspection action plan; school improvement grant to assist implementation of action plan; monitoring of performance by district For under performing schools: more prescriptive action plan; possible withdrawal of devolved budget and accountability; national and district monitoring of performance; additional funding to assist turnaround For failing schools: as for under performing schools plus early consideration of school closure; district plan for school with maximum turnaround time of 2 years; national monitoring 3 times a year; possible fresh start or city academy. For failing districts: intervention from central government; possible contracting out of functions to the private sector.

Source: M. Barber 2003, 'Deliverable goals and strategic challenges – a view from England on reconceptualizing public education', in OECD, *Networks of Innovation: Towards New Models for Managing Schools and Systems*, OECD, Paris, p. 117.

United States

In the United States, the *No Child Left Behind Act 2002* has been recognised as landmark legislation that 'codified a developing policy view that standards, testing, and accountability were the path to improved performance'.[168] The crucial aspect of the legislation is not so much the funding available as the policy framework

[168] E. Hanushek and M. Raymond 2004, 'Does school accountability lead to improved student performance?', *NBER Working Paper Series*, Working Paper 10591, at http://www.nber.org/papers/w10591, p. 1.

imposed. Every state, to receive federal aid, must put into place a set of standards together with a detailed testing plan designed to make sure the standards are being met. Students at schools that fail to measure up may leave for other schools in the same district, and, if a school persistently fails to make adequate progress toward full proficiency, it becomes subject to corrective action. Local school districts must also make available public information about how well students are achieving.[169]

Another important development in US education over the past few years has been the trend to open up school choice. Traditionally, children have had little choice but to attend the local public school. Options for school choice include:

- some large school districts offer parents relatively unconstrained choices among public schools within the district;
- forty-one states have enacted legislation providing for charter schools;
- 'magnet' schools (specialist schools concentrating on foreign language, maths and science, or the arts) are now common in public education. According to the Education Commission of the States, 33 states reported in 1999-2000 that they contained more than 1,350 magnet schools;
- publicly funded voucher programs, intended to expand choices for low-income families in inner-city neighbourhoods, exist in Milwaukee and Cleveland. These encourage parents to enrol their children in private schools;
- State-funded voucher programs exist in six states (Colorado, Wisconsin, Ohio, Florida, Vermont, and Maine). Three states also allow income tax deductions for contributions to private voucher programs (Arizona, Florida, and Pennsylvania); and
- privately financed voucher programs for low-income children exist in more than 100 cities in the United States.[170]

The *No Child Left Behind Act* is likely to expand access to a wider range of schools as it requires school districts to provide choices, including charter schools and other alternatives, to children attending schools defined as consistently failing to meet performance targets. By states' own standards, more than 4,800 schools out of some 93,000 did not meet their performance targets during the 2002-2003 school year.[171]

Among the expanded choices available, charter school are a particularly interesting development. Charter schools are public schools that agree to meet certain performance standards in exchange for exemptions from most regulations other than those governing health, safety and civil rights. Charter schools accept accountability for results in exchange for autonomy in how those results are produced.[172]

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169 M. West and P. Peterson 2003, 'The politics and practice of accountability', in P. Peterson and M. West (eds), *No Child Left Behind? The Politics and Practice of School Accountability*, Brookings Institution Press, Washington, p. 1.

170 National Working Commission on Choice in K-12 Education 2004, *School Choice: Doing it the Right Way Makes a Difference*, Brookings Institution Press, Washington, pp. 14-5.

171 Ibid, p. 14.

172 D. Ravitch 1999, 'Student performance', *Brookings Review*, 12-6, p. 13.

By design, charter schools are supposed to be held accountable in two ways: by the market and by the charter authoriser.[173] Since charter schools are schools of choice, families can decide whether or not to enrol their children. Money 'follows the child' to the school. As a result, a charter school's financial viability depends upon its success in the marketplace. In addition, charter schools are held accountable by the charter authoriser. Authorisers are typically a governmental body of some sort, such as a board of education, a board of a public university, or, more rarely, a board created specifically to authorise charter schools or a non-profit board empowered by the state to do so. The charter school enters into a performance contract with the authoriser. This contract specifies the terms under which the school may continue to operate as a charter school. These terms include requirements that the school achieve certain performance targets and that it comply with applicable laws and regulations.

Reforms such as charter schools have seen the traditional public school system opened to greater competition and choice. There are some 2 700 charter schools, enrolling more than 500 000 children in the United States.[174] While this represents only about one per cent of the public school population, the trend has the attention of parents and schools.[175] For example, in a recent survey, parents with children in charter schools were twice as likely to give the charter school an 'A' grade overall than the school their child previously attended.[176]

Netherlands

The Netherlands is one of only two countries in the world with a universal school choice system and where private school choice is financed by public funds.[177]

The Dutch have had an effectively decentralised and demand-driven education system since 1917. One of the key features is freedom of education. That is, the freedom to found schools, to organise the teaching in schools, and to determine the principles on which they are based. Most parents can choose from a range of publicly and privately run schools, and there are no catchment areas. Almost 70 percent of schools in the Netherlands are administered and governed by private school boards.[178]

The school choice system in the Netherlands is made possible by the system of finance as public and private schools receive equivalent government funding. Funding follows students and each school receives for each student enrolled a sum equivalent to the per capita cost of public schooling. The school that receives the funds is then entitled to funding that will cover specified amounts of teacher salaries and other expenses. Private schools supplement this funding by charging ancillary fees, however this right is severely limited.[179]

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173 B. Hassel and M. Batdorff 2004, *High-Stakes: Findings from a National Study of Life-or-Death Decisions by Charter School Authorizers*, at http://brookings.edu/gs/brown/hassel0204.pdf, p. 2.

174 National Working Commission on Choice in K-12 Education , op. cit., p. 15.

175 B. Schmidt, 2001, *Reinventing Public Education in America*, at http://www.nzbr.org.nz, p. 32.

176 D. McCully and P. Marlin 2003, *What Parents Think of New York's Charter Schools*, Manhattan Institute for Policy Research, http://www.manhattan-institute.org/html/cr_37.htm

177 H. Patrinos 2002, 'Private education provision and public finance: the Netherlands as a possible model', *Occasional Paper No. 59*, National Center for the Study of Privatisation in Education, Teachers College, Columbia University, p. 10.

178 Ibid, p. 1.

179 Ibid, p. 10.

In general, schools in the Dutch education system have considerable freedom in terms of managing their own affairs as they are often funded on a block grant basis. Government policy, though, requires schools to disseminate information to the public and to produce annual accounts and to submit them to the Ministry.[180]

Recent debate in the Netherlands has focused on how market forces can make the education system more efficient and equitable, with discussion about deregulation, school choice, vouchers, information dissemination, increased parental input, and other market mechanisms. Developments have emphasised greater autonomy and decentralisation.[181] Many central government powers have been transferred to the level of the individual school. Central government control is increasingly confined to the area of broad policy-making and to creating the right conditions for the provision of quality education. Institutions are being given greater freedom in the way they allocate their resources and manage their own affairs, although they are still answerable to government for their performance and policies.

The Netherlands Government recognises that the shift to greater autonomy for schools entails a changing role for government:

> Maximum autonomy for schools means that central government would have to provide the right conditions and resources for them. Government would have to regulate less and co-ordinate, equip and stimulate more. As the freedom of the schools increased, so too would the differences between them. For this reason, it would remain essential for government to safeguard general standards of quality and access. It would have to set clear conditions in this respect and hold the schools accountable for meeting them.[182]

9.3 Key observations

A clear direction in educational reform has been, and continues to be, a focus on performance — the performance of educational systems, schools, teachers, and individual students. This has been portrayed as a shift away from the traditional focus on equality of educational opportunities for all, as measured by inputs (for example, number of school places, class sizes and teacher qualifications), to high standards and performance for all, with the consequent need for variable inputs to achieve improved outcomes.[183]

This overview of educational reform in four OECD countries has highlighted three strategies to achieve improved student performance. The first strategy is what has been loosely characterised as 'school choice'.[184] There is great debate about the advantages and disadvantages of school choice for student performance. Recently in the United States, the National Working Commission on Choice in K–12 Education was established to explore how choice works and to examine how communities interested in the potential benefits of new school options could obtain them while avoiding choice's potential damage.[185] The Commission examined the

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180 Dutch Ministry of Education, Culture and Science *Key Figures 1998-2002 Education, Culture and Science in the Netherlands*, at http://www.minocw.nl.

181 Patrinos, op. cit., p. 9.

182 The Netherlands Ministry of Education, Culture and Science 2003, 'Schools and governance in the Netherlands — recent change and forward-looking policy thinking', in OECD, *Networks of Innovation: Towards New Models for Managing Schools and Systems*, OECD, Paris, p. 142.

183 Ravitch, op. cit., p. 12; Barber, op. cit., p. 116.

184 National Working Commission on Choice in K-12 Education, op. cit, p. 4. Choice has been defined as 'any arrangement that allows parents to decide which of two or more publicly funded schools their child will attend'.

185 Ibid.

research on the links between choice and outcomes and found that the existing research paints a mixed and complicated picture. The Commission concluded that:

> …the effects of choice, both positive and negative, are less certain and more situation-dependent than advocates on either side acknowledge. One thing that is clear is that the results of choice depend on what options are available and how they are created, supported, and designed.[186]

The Commission identified a number of key factors that link choice with positive educational and social outcomes:

- funding: adequate funding per student which follows the student to the school of their choice is necessary to open up access and support school quality. Funding must also reflect the fact that certain groups of children — those from low-income families, children with disabilities, children from non-English speaking backgrounds and Indigenous children — typically cost more to educate. If funding does not reflect this, schools would have an incentive to avoid such students;
- student targeting: this may also be necessary to ensure that children from poor and disadvantaged backgrounds have access to schooling options;
- performance measurement: school performance measures are important for two reasons. First, parents choosing schools need a basis for comparisons. Second, school performance information allows government to exercise its responsibility to ensure that all children get an adequate education;
- parent information: if parents are to choose they need information about the options and how they differ, and about how to distinguish schools that will benefit their children from those that will not;
- student access: access implies that admissions processes are fair and open and that groups of children are not denied choice simply because their families cannot arrange transportation; and
- accountability: schools must be accountable to parents and government for outcomes.

In Australia there has also been an increasing interest in school choice, as demonstrated by the loosening up of the strict allocation of students to public schools based on geographic location, the expansion in some states of selective and specialist public schools, and the shift of students from public to private schools. The steady and apparently irreversible exodus of students from government schools has been significant:[187]

- the proportion of students in government *primary* schools declined from 79.4 percent in 1981 to 72.8 percent in 2000;
- the proportion in government *secondary* schools fell from 72.9 percent in 1981 to 64.1 percent in 2000;

[186] Ibid, p. 23. Similar conclusions are found in another recent review of the literature, H. Levin and C. Belfield 2003, 'The marketplace in education', *Occasional Paper No. 86*, National Center for the Study of Privatisation in Education, Teachers College, Columbia University.

[187] Caldwell, op. cit., p. 1.

- from 1991 to 2002, the number of students attending government schools increased by 1.0 percent while the number attending non-government schools grew by 20.8 percent; and
- projections point to a continuation of the trend, especially at the secondary level, so that by 2010, only 60.2 per cent of secondary students will be in government schools.

The size of the non-government school sector is Australia is large in comparison with other OECD countries, with only three countries having larger shares of enrolment in non-government schools.[188] However, this significant shift in enrolments to private schools in Australia has occurred in a haphazard way, not as part of a coherent educational policy. The debate around the issues has tended to focus on the different funding arrangements of the Commonwealth and State Governments, rather than the consequences for student performance.

Recently, Professor Caldwell has called for a resolution of the 'public-private divide' in Australia, raising for consideration abandoning the divide in favour of a national system of self-managing schools in a public sector defined by values rather than ownership.[189] In this new public education system, non-government schools would be required to cease charging tuition fees in return for full public funding, under the same regime of accountability as government schools. The new system would be supported by Commonwealth and State funding and a range of innovative public-private partnerships, with the objective of securing high levels of achievement for all students in all settings. While noting that resolution will not be easy, Caldwell warns:

> A continuation of the status quo is likely to lead to a further drift from the state system that may well become no more than a 'safety net' sector before the end of the decade, especially at the senior secondary level.[190]

One of the concluding observations of the United States' National Working Commission on Choice in K–12 Education is also very relevant to Australia: the discussion about school choice is not about 'whether', but rather about 'what kind' and 'how much'. The challenge is to structure and design choice so that publicly funded schools of all kinds work effectively for children.[191]

The second strategy to achieve improved student performance highlighted in the overview of educational reform is an increasing emphasis on learning outcomes, standards, testing, and accountability. 'Standards-based reform' has been described as:

> Develop state standards for student performance in key subjects; test all students on whether they attain the standards; hold individual schools accountable for rates of student progress on the tests; and eliminate demands and constraints on schools that make it difficult for them to focus on effective instruction.[192]

A recent cross-country review of the impact on student performance of an increased focus on outcomes measurement and accountability found that accountability is important and has a significantly positive impact on student

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188 OECD 2003, *Education at a Glance, OECD Indicators*, OECD, Paris, p. 270.

189 Caldwell, op. cit., pp. 3 and 16.

190 Ibid, p. 16.

191 National Working Commission on Choice in K-12 Education, op. cit., p. 36.

192 P. Hill and R. Lake 2002, *Charter Schools and Accountability in Public Education*, Brookings Institution Press, Washington, p. 2.

achievement.[193] However, the study also highlighted a very important caveat to the results: the positive impact holds only when consequences are attached to performance. As discussed in section 9.2, England provides an example of this approach, where every serious case of under-performance is identified and tackled through a range of interventions, from prescriptive action plans, to additional funding to assist turnaround, and to possible school closure for failing schools.

The third strategy to achieve improved student performance seeks to make schools more responsive to rapid change, and to the needs of their students and the communities in which they live. This is mainly achieved through the devolution to schools of more authority and responsibility, within a framework of centrally determined goals, priorities, frameworks, standards and accountabilities. Again, however, it has been pointed out is that it is not devolution per se that determines the impact on student achievement, but how schools use the capacity for local decision-making. Research shows that actions at the school level that have a direct impact on student learning are in the domains of professional development, implementation of the curriculum and standards framework, and monitoring.[194]

[193] Hanushek and Raymond, op. cit, p. 22. See also Woessmann, op. cit.

[194] B. Caldwell 2002, 'Autonomy and self-management: concepts and evidence', in T. Bush and L. Bell (eds), *The Principles and Practice of Educational Management*, Paul Chapman, London, p. 44.

Chapter 10

Water

Water is a critical asset underpinning the Australian economy. Consumed by a range of industries and households, the water sector supports the growth of nearly all other aspects of Australian life. Households are the second largest consumers of water (roughly 8 per cent of available supply in), behind agriculture, which accounts for around 70 per cent of all water consumed.[195] Water used for agriculture is devoted to irrigating crops and raising livestock, which helps Australian farmers produce billions of dollars worth of food per year. Additionally, the flow of water also supports key ecosystems, like marshes and river basins, which are home to a number of important species that help keep our environment in balance as well as providing significant public benefit in terms of tourism and recreation.

Water reform has been a critical element of the National Competition Policy reform framework. The absence however, of systematic reform to both the urban and rural water industries has the potential to limit continued economic growth. Furthermore, poor water industry regulation — in terms of allocation of entitlements and pricing — has given rise to excessive demand for water services and accelerated environmental degradation such as pollution and salinity.

10.4 Major Australian reforms

The Council of Australian Governments 1994 Water Reform Framework established the strategic direction of reform, with the key elements of the package being pricing reform, more rigorous investment appraisal, the creation of water entitlements separate from land title, trading in water entitlements, the allocation of water for use by the environment, measures to address water quality, improved natural resource management, and institutional reform.[196]

On 25 June 2004, the Council of Australian Governments announced a National Water Initiative. Significant elements of the initiative include:

- the separation of water entitlements from land and use;
- statutory recognition of the use of water for environmental and other public benefit objectives;
- ensuring water prices cover both water storage and delivery and water planning and management;
- enhancing commercial security and certainty — including assigning the risks of changes in the consumptive pool, and water planning to return extractions from over allocated systems to environmentally sustainable levels;
- developing water markets, including facilitating water trading;

[195] Australian Bureau of Statistics (ABS), *Australian National Accounts: National Income, Expenditure and Product 2002*, available at http://www.abs.gov.au/Ausstats, accessed 13 August 2004.

[196] Unlike the more competition-related focus of other elements of the National Competition Policy, the 1994 water resources policy and strategic reform set out to achieve an efficient and sustainable water industry. The package of reforms therefore included more elements than those listed. For more information see Council of Australian Government 1994, *Water Resource Policy*, prepared by the Working Group on Water Resources Policy, Hobart.

- institutional separation of water resource management from service provision;
- adoption of nationally compatible water accounting systems by the end of 2007; and
- establishing a new commonwealth statutory body, the National Water Commission to oversee implementation of the National Water Initiative.[197]

Reflecting the 1994 strategic framework there have been significant structural changes to the water supply industry, particularly regarding urban water supply. This has clarified accountabilities by separating policy, regulatory and commercial (operational) functions.

Key elements of urban water supply industry arrangements are as follows:

- *Sydney* — vertical disaggregation has resulted in the establishment of a catchment authority (Sydney Catchment Authority) while Sydney Water Corporation is responsible for water distribution and wastewater services.
- *Melbourne* — three government-owned companies, City West Water Ltd., South East Water Ltd., and Yarra Valley Water Ltd, function as retailers. The wholesaler is also a government-owned corporation, Melbourne Water Corporation. The wholesaler also controls the catchment for most of its supply.
- *Adelaide* — a privately owned water company, United Water International Pty. Ltd, provides water services under an agreement with the government authority, South Australian Water Corporation — which owns the water infrastructure.
- *Perth* — the Water Corporation is a government-owned corporation that provides urban water services (including to regional urban areas across most of Western Australia).
- *Canberra* — ActewAGL a public-private multi-utility partnership now provides services in Canberra (and the remainder of the ACT and the region at large.
- *Darwin* and *Alice Springs* — a government-owned multi-utility, the Power and Water Corporation, provides services to Darwin (and to the larger and less remote communities in the Northern Territory).
- *Brisbane* — is an example of local government in a major Australian city providing water services (Brisbane City Council). Bulk water is supplied to Brisbane and neighbouring councils by the South East Queensland Water Corporation.
- *Hobart* — twenty eight local councils provide water services in urban areas and most also provide wastewater services. Three bulk water authorities provide water to eighteen local governments. The other local councils take, treat, and reticulate water themselves.

It is worth noting that the major urban providers have achieved lower bound cost recovery pricing for water storage and delivery — consistent with the minimum 1994 pricing obligation — but most have some way to go to achieve a commercial rate of return on capital — that is, the upper bound of cost recovery.

[197] Council of Australian Governments' communiqué released in June 2004 available at http://www.coag.gov.au/meetings/250604/index.htm.

10.5 Overseas reform progress

Within OECD member countries there have been a number of reforms to the water sector. While member countries have shown significant progress in the procurement of adequate safe, affordable water, a 2003 survey of water reform strategies within the OECD shows that challenges remain, such as:

- improving the integration of environmental factors in sectoral policies; and
- correctly pricing water in a way that allocates resources efficiently, operates water services cost-effectively and ensures that water is available to all.

A strong tension between social equity, economic and environmental concerns has limited the adoption of full cost pricing[198] to domestic water services in most OECD nations. Examining recent literature shows there has been a general shift towards the introduction of economic instruments to provide incentives for efficient water use and its full cost recovery, including metering and the taxing of water use on a consumption basis rather than a flat charge. According to a 2004 OECD report, about two-thirds of OECD countries meter around 90 per cent of households.[199]

Although wastewater charges within the OECD have historically been calculated as a fixed percentage of water consumption some countries are moving towards the direct measurement of wastewater produced and, for industrial users, graduating charges based on toxicity. A few OECD countries have begun to implement charges for agricultural water pollution, based on a proxy of fertiliser use or nitrogen application.

Comparison with Canada, the United States, and other countries

By way of an overview, table 10.1 and table 10.2 compares the progress of reform in the relevant OECD countries and highlights that Australia is not alone in facing the challenges of water reform.

While Australia and United Kingdom are the only countries to allow for water charges to reflect the full capital cost of supply, limited progress has been made towards the incorporation of environmental costs into water charges in a number of OECD countries.[200] Progress continues to be made towards full cost recovery for the provision of urban and rural water services yet there would appear to be considerable challenges in incorporating environmental value into those costs.

198 This is equivalent to the upper bound cost recovery in Australia's 1994 water pricing obligation.

199 OECD 2004, *Environmental Strategy: 2004 Review of Progress*, p. 42.

200 While it is strictly correct to say that Australia allows for the reflection of full capital cost, many of Australia's water businesses have yet to achieve a return at the weight average cost of capital (the upper bound of the 1994 water pricing objective.

Table 10.5

SERVICE CHARGES FOR WATER SUPPLY, SEWERAGE AND SEWERAGE TREATMENT, SELECT OECD COUNTRIES

	Charge base		Charges cover	
	Water supply	Sewerage and treatment	Water supply	Sewerage and treatment
Australia	H, F, A: fixed (based on meter size or property value) and volume based	H: water usage FR/AM F: water usage, pollution load	Full-cost	Full-cost
New Zealand	H: mostly by value or uniform annual charges; one quarter is metered F: by volume when metered	H: mostly by value or uniform annual charges F: in proportion to the strength and quantity of the waste.		
Canada	F: volume based, decreasing blocks	H: water usage FR/AM F: water usage, pollution load FR/AM		
UK	F: connection and fixed and volume based H fixed and FR/AM	H: water usage FR/AM F: water usage, pollution load FR/AM	Full-cost	Full-cost
US	H: mostly FR F: connection fees, diversity of block structures, more increasing block rates A: area served	H: water usage FR/AM F: water usage, pollution load FR/AM	Full-cost	

Notes: A = agriculture; H = households; F = firms; FR = flat rate; AM = actual measurement; FR/AM = both FR and AM occur; Full-cost = total revenues required to cover operating expenditure, plus depreciation, plus a return on capital employed.
Source: OECD 2003, *Environmental Performance Reviews: Water*, OECD Publications, France, pp 30-31.

Table 10.6

POLLUTION AND ABSTRACTION CHARGES, SELECT OECD COUNTRIES

	Charge base		Use of revenue	
	Abstraction	Pollution	Abstraction	Pollution
Australia	Various license fees, volume of use charges	Various license fees, by volume	Administrative costs	Environmental administrative costs
New Zealand	No charge	No charge	-	-
Canada	Actual use	Charge for industrial effluents	Municipality	Province taxation
UK	By source, loss factor, seasonal	Environmental impact of effluent volume and toxicity	Environment, administration	Environment, administration
US	No charge	No charge	-	-

Source: OECD 2003, *Environmental Performance Reviews: Water*, OECD Publications, France, p 28-29.

New Zealand

Water supply and sewage disposal in New Zealand is predominantly a function of local government.[201] While the most frequent approach is for the function to be delivered from within a department which undertakes the asset planning and customer interface, there have been some reforms.

- Some Councils have introduced a business unit to undertake the function. Although not separate in a legal sense, these units involve a greater degree of commercial accounting and governance. It is common for the service delivery and maintenance to be contracted from another party, in some cases an independent private contractor. These separated service businesses often have to compete to provide these services.
- In one instance, a local Council has franchised its water operation to a private water company.
- There are some cases where the water business unit has been formed into a limited liability company, owned by local government These can be companies under corporation law and with special further provisions under Local Government legislation. Watercare Services Ltd is one of these. It is a bulk water and wastewater business owned by the local governments in the Auckland service area. The Councils hold shares in the business and appoint its directors.

The industry generally operates in a vertically integrated manner. There has been some reform in the major urban areas. Auckland has separation between bulk and retail operations in both water and wastewater. In Wellington there is a separation in the water supply sphere between the Wellington Regional Council and several local Councils, which it supplies.

Water metering is not common. Payment is typically by a uniform annual charge or a property value related tax, or a combination of both. However, universal metering has been implemented in the Auckland region. Charging is by a two-part charge of a connection charge and a volumetric charge. In Auckland City the volume used is also used to calculate part of a sewerage service charge.

There are no national service standards. Standards are set by local Councils. A few Councils have specific service contracts for their customers.

There is a national scheme for comparing performance indicators, but the information is kept private.

United Kingdom

The regional water and sewage authorities in England and Wales were privatised in 1989. Prior to privatisation there were 10 government-owned regional water authorities supplying water and sewerage services and 29 statutory water companies supplying water only.

An independent regulatory body was established (the Office of Water Services) over the water and sewerage industry in England and Wales. Its role is to:

- set limits on the prices that companies can charge;

[201] Details about the industry can be found at http://www.waternz.co.nz.

- ensure companies are able to carry out their responsibilities;
- protect the standard of service;
- encourage companies to be more efficient;
- help stimulate competition where appropriate; and
- make comparisons between the companies to raise the standards of those that need to improve.

Other regulatory bodies oversee the quality of drinking water (the Drinking Water Inspectorate) and waste water discharges (the National Rivers Authority, now the Environment Agency).

The prices regulator for Scotland is the Water Industry Commission for Scotland. In Northern Ireland the government provides water and sewerage services, which are funded by regional taxes (rates).

10.6 Key observations

Australia has made substantial reforms to improve water access entitlements and definitions as well as to adopt pricing structures that reflect the capital costs associated with water use — although it is noted that most water companies are yet to set prices that recover the opportunity cost of capital.

Water reform is not as advanced as reform in sectors such as energy. This probably reflects the greater complexities faced by water reform in a federal system — as is the case of several countries that share a water resource — especially when there are competing commercial, social and environmental interests

However, in comparison with other OECD countries, Australia's water from processes are relatively advanced.[202]

The key remaining challenge for Australia — and other OECD nations — is the reconciliation of economic goals with environmental and broader social and community outcomes.

[202] For example, water prices in many of Australia's OECD counterpart nations still do not reflect the full capital costs of water supply, and progress towards that goal is slow.

Chapter 11

Environmental regulation

Australia has been well endowed with a vibrant and diverse resource base, which has supported Australia's economic growth and community wellbeing. The ABS has estimated the total value of environmental assets to be $1 000 billion, though this ignores some of the intangible benefits of the environment (including its aesthetic appeal, heritage or existence values).[203]

As the environment cuts across many aspects of our day-to-day lives, it's almost impossible to estimate its true value to our economy and our lifestyles. Ecosystems like mangroves, wetlands, grasslands, shrubs, deserts, oceans, coral reefs, support our fishing, timber, agricultural and tourism industries and provide us with a clean supply of water. The environment is a source of medicine and a source of energy. Thus environmental outcomes are intimately linked with the continued growth of our industries and communities. Where the environment is inefficiently managed or degraded over time, it could serve as a limiting factor on future economic growth.

An emerging thrust of reform in environmental regulation is the use of competition and market forces to advance environmental objectives. As environmental issues cut across many areas of economic and social activity, it is a challenge to draw together a cohesive picture of reform measures in just a few pages.

11.7 Major Australian reforms

Climate change represents an area of national interest for Australia. The Australian response has been to support the development of more greenhouse-friendly technologies and to encourage abatement in industry. Key reforms include:

- *Kyoto Targets* — while the Government announced in 2002 that it not ratify the Kyoto Protocol, it is committed to achieve Australia's target agreed under the Kyoto Protocol — which limits greenhouse gas emissions to 108 percent of 1990 levels over the period 2008-12;
- *Securing Australia's Energy Future* — a package of measures to promote R&D in renewable and fossil-fuel supply technologies;
- *Greenhouse Challenge* — a voluntary program where participating organisations sign agreements with the Government that provide a framework for undertaking and reporting on actions to abate emissions;
- *Mandatory Renewable Energy Target* — a scheme that requires retailers and other large electricity buyers to source an additional 9500 GWh above 1997 levels from approved renewable suppliers by 2010;
- *Greenhouse Gas Abatement Scheme* — New South Wales has introduced a scheme which requires retailers of electricity to meet a target level of emissions per capita. Tradable compliance units, called NSW Greenhouse Gas Abatement Certificates are created and can be traded.

[203] Australian Bureau of Statistics (ABS) 2003, *Australian National Accounts: National Income, Expenditure and Product 2002*, available at http://www.abs.gov.au/Ausstats, accessed 13 August 2004.

Other environmental policy initiatives are aimed at integrating biodiversity conservation with natural resource use. This approach seeks to improve biodiversity outcomes at least cost, permit mixed use, or provide incentives to develop activity and industries that enhance biodiversity. For example, in the area of fisheries management, there has been a move from open access and excessive use to controls upon when and how fisheries can operate. This has led to the establishment of a total allowable catch with trading in quota rights, with the use of independent monitoring of the impacts.

A more recent reform involves more direct use of markets, such as Victoria's Bush Tender program, which involves payments from government to land owners to improve the quality and extent of native vegetation.[204]

In the area of land and natural resource management, major reforms have focused on:

- forestry — since 1995 government forestry businesses in New South Wales, Victoria, Western Australia, South Australia and Tasmania have been corporatised — and in some states privatised — thus introducing more transparent and efficient pricing arrangements; and
- integrated catchment management or regional plans — the underlying logic is to address problems within the boundaries of ecological or hydrological systems rather than be constrained by social and economic boundaries. The Natural Heritage Trust and the National Action Plan for Water Quality and Salinity are leading examples.

Resource allocation has also been promoted through the application of Competitive Neutrality principles to government owned resource businesses; for example, state forest businesses, particularly hardwood businesses, have focused (albeit to varying degrees of success) on ensuring a commercial basis for log prices, and in the area of crown land use competition policy has focused on assessing the basis for calculating lease charges.

The National Competition Policy has also focused on resource allocation and use in the area of planning. Despites the fact that planning legislation and processes across Australia have been reviewed under National Competition Policy, there are concerns that planning processes have reduce efficient use of land and environmental resources and add unnecessary costs to business and the community.[205]

Although not specifically related to the National Competition Policy, the National Packaging Covenant is the leading instrument for managing packaging waste in Australia, which aims to improve efficiency and promote best practice systems in terms of design, production and distribution for waste and recycling.

11.8 Overseas reform progress

OECD environment Ministers view that a shift in paradigm is occurring with respect to environmental policies, in particular the increasing interest in developing

[204] The Victorian Government, Department of Sustainability and Environment 2004, Conservation and Environment, BushTender, available at http://www.dse.vic.gov.au/, accessed on 10 August, 2004.

[205] National Competition Council 2003, *Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2003 - Volume two: Legislation review and reform*, chapter 10, AGPS, Melbourne.

market-based policies — see Box 11.1 — that combine environmental effectiveness with economic efficiency and social equity.[206]

Box 11.2

ECONOMIC INSTRUMENTS EMPLOYED BY OECD MEMBER GOVERNMENTS

Key instruments to encourage the preservation of biodiversity include:

- charges on non-compliance fees to forestry activities to ensure harvesting is undertaken at sustainable levels;
- liability fees for the rehabilitation or maintenance of ecologically sensitive lands;
- application of fishing and hunting license fees;
- use of levies for the abstraction of groundwater; and
- charges for:
  - use of sensitive lands,
  - hunting or fishing or threatened species, and
  - tourism in natural parks.

Source: OECD 2004, *Environmental Strategy: 2004 Review of Progress*, p. 49.

New Zealand

Although New Zealand has not adopted any market-based scheme for the mitigation of greenhouse gases, it has pledged to meet its target under the Kyoto Protocol and, staring in 2007, will levy a carbon tax on emissions.[207] The New Zealand government has also developed the *Projects to Reduce Emissions Program* with an aim to support initiatives that will reduce emissions of greenhouse gases. Implemented via public tender, private parties across a range of sectors — including wind farms, bio-energy, landfill gas schemes and hydro-electricity — bid competitively for emissions units.

New Zealand has also developed a regulatory framework designed to assess and price environmental impacts and negative externalities associated with economic activities.

The *Resource Management Act 1991* and the *Crown Minerals Act 1991* form the basis for New Zealand's resource management legislation. And continued reforms to New Zealand's environmental sector. This has included the widespread application of the user and polluter pays principles. For example, the 'resource consent' process under the *Resource Management Act* is a practical application of the polluter pays principle. The resource consent process requires industry to obtain permission to use or develop a natural or physical resource and/or carry out an activity that affects the environment; the activity in question can proceed provided any adverse effects on the environment are avoided, remedied or mitigated to an acceptable level.

[206] See for example, OECD, Chair's Summary — Meeting of the Environment Policy Committee at Ministerial Level, 20-21 April 2004, downloaded from http://www.oecd.org accessed on 26 June 2004.

[207] The Government has decided to introduce an emissions charge (on fossil fuels and industrial process emissions, i.e. carbon dioxide and fossil methane) from 2007 to create an incentive to reduce emissions. The charge will approximate the international emissions price, but be capped at NZ$25 a tonne of carbon dioxide equivalent. Revenue will not be used to improve the Crown's fiscal position but will be recycled, for example through the tax system or into funding climate change projects and programs. The Government retains the option of introducing emissions trading as an alternative to an emissions charge if the international carbon market is functional and the price is reliably below the NZ$25 cap. See: http://www.climatechange.govt.nz/policy-initiatives/emissions-charge.html.

Similarly, building on the principles of the *Resource Management Act*, the *Fisheries Act 1996* applies the user pays principle, imposing a quota to manage fisheries resources and requiring a substantial proportion of the costs of managing the fisheries resources to be met by the quota holders.

Canada

On17 December 2002, the Government of Canada announced its ratification of the Kyoto Protocol to the United Nations Framework Convention on Climate Change. To date, Canada's experience with emissions trading consists of analysis and consultations, voluntary trial programs implemented as public-private partnerships, and private sector trades. Canada has sponsored research on emissions trading over the past three years.[208]

To date, however, Canada has not announced a clear emissions trading framework, though it appears the aim is to design a scheme that would be operational by the start of the first Kyoto commitment period (2008).[209]

Where species habitat crosses political borders international agreements have been reached to manage issues relating to exploitation and free rider problems. For example, table 11.1 sets out when Canada — along with other OECD countries — entered into various international agreements for sustainable fisheries.

Table 11.7

STATUS OF MAJOR INTERNATIONAL INSTRUMENTS FOR SUSTAINABLE FISHERIES MANAGEMENT — SELECT OECD COUNTRIES

	UN convention on the Law of the Sea	Agreement to Promote Compliance with ICMMFVHS[a]	Agreement on the Conservation and Management of Straddling Fish Stocks and highly Migratory Fish Stock s	
	Entered into force: Nov 1994	Entered into force: Apr 1994	Entered into force: Dec 2001	
	Ratified	Acceptance	Ratified	Acceptance
Australia	5.10.94	—	4.12.96	23.12.99
Canada	07.11.03	20.05.94	4.12.96	3.08.99
New Zealand	19.07.96	—	28.06.96	18.04.01
UK	25.07.97	6.08.96	27.06.96	10.12.01
US	—	19.12.95	4.12.96	21.08.96

Source: OECD 2004, *Environmental Strategy: 2004 Review of Progress*, p. 51. Note: as of late 2003. Note: [a] ICMMFVHS = International Conservation and Management Measures by Fishing Vessels on the High Seas.

Canada has made almost no use of environmental taxes or trading systems. It has, however, introduced a Individual Transferable Quota system, in which the federal government establishes a total allowable catch for a specific fishery and then

[208] See Law and Economics Consulting Group 2003, Emissions Trading Market Study, Report to the Ontario Ministry of Environment found at http://www.canadianenvironmental.com accessed on 2 August 2004.

[209] IETA 2004, *IETA Canadian Working Group on the Carbon Market*, http://www.ieta.org/.

distributes the quotas to individual entities based on historical catch data. Parties may trade their fishing rights.

At the province and municipal level, there is more reform work underway. Some provinces collect excise taxes related to batteries, solvents, tires, water use and forestry preservation. Further, British Colombia has recently enacted Environmental Management Act has been broadly constructed as to allow for the introduction of environmental instruments — including modified fee structures based on environmental performance and discharge trading systems.[210] The Winnipeg municipality has also introduced pay-per-use environmental taxes as part of its 'New Deal' tax reform, introducing taxes on gas, electricity and garbage disposal.

United States

In early 2001, the United States announced that it will not ratify the Kyoto Protocol. While the United States has announced a voluntary domestic greenhouse gas intensity target that would hold emissions growth to 12 per cent by 2012, it has not established any mechanism for ensuring that this target will be met.[211]

Despite a reluctance to enter into a global agreement, domestically there are several trading schemes currently in operation within the United States. Specifically, there are three primary markets for emission reduction trading:

- the United States Environmental Protection Agency's Acid Rain Program for Sulphur Dioxide (SO_2), a cap-and-trade program that applies to SO_2 emissions from the utility sector;
- southern California's RECLAIM program for Nitrous Oxide (NO_x) and Sulphur Dioxide (SO_2); and
- the federal NO_x Budget Trading program as implemented by the states.

In 1999, Texas passed legislation to create the Renewable Portfolio Standard scheme, which set a standard of 2000 MW of renewable capacity by 2009. Energy providers can meet the standard by developing renewable energy capacity or by purchasing Renewable Energy Credits.

The United States often features when the OECD points to examples of schemes designed to use market mechanisms to promote environmental outcomes. For example, table 11.2 highlights a number of market creation schemes used in the United States and Australia, which are commended by the OECD.

[210] A review of British Colombia's *Environmental Management Act.*

[211] Pew Centre on Global Climate Change 2004, *Climate Change Activities in the U.S.: 2004 Update*, http://www.pewclimate.org.

Table 11.8

MARKET CREATION SCHEMES

	No offsets	Offsets
Non-tradable	BushTender (Australia); Conservation Reserve Program (US)	South Creek Bubble Licensing Scheme (Australia)
Tradable	Hunter River Salinity Trading Scheme (Australia); Regional Clean Air Incentives Market (US)	Native vegetation offsets proposal (Australia); Wetland banking (US); Carbon sequestration credits

Source: OECD, 2004, *Environmental Strategy: 2004 Review of Progress*, p. 51.

The United States' Environmental Protection Authority has also introduced a competitive grants program to promote the improvements of water catchments (watersheds). Nominees were required to set clearly articulated goals and objectives that include strong monitoring components. The Environmental Protection Authority has announced for its 2004 Targeted Watershed Grants Program that strong emphasis is placed on proposals that incorporate market-based incentives and manage nutrient loading of the Mississippi River basin.[212]

Deposit refund schemes are also prevalent at state and local levels to promote the recycling of beverage containers and other consumer products.

United Kingdom and European Union

The United Kingdom emissions trading scheme constituted the world's first economy-wide greenhouse gas emissions trading scheme.[213] Introduced in 2001, the scheme is a variation of the classic cap and trade scheme, similar to the United States *Acid Rain Program*. The United Kingdom's emissions trading scheme is not sector-specific, as with the European Union's emissions trading scheme, and is voluntary to enter. Companies that enter the scheme are eligible to enter into a 'descending clock auction' where they may win compensation from the Government for their abatement (first distributed January 2002).[214]

This scheme was intended to facilitate the transition of the United Kingdom into a Pan European emissions trading scheme, and then into a global emissions trading scheme. However, the scheme is marked by some significant design flaws, and the United Kingdom, which is entering into the European Union emissions trading scheme in the 2005-2007 period, is generally finding the transition difficult. Nevertheless, the United Kingdom will participate in the European Union scheme from 1 January 2005.[215]

[212] US Environmental Protection Authority 2004, *Targeted Watersheds: Encouraging Successful Partnerships to Protect and Restore Water Resources*, found at http://www.epa.gov accessed 2 August 2004.

[213] First ETS scheme was in Denmark, launched in 2001. UK registration started in August 2001, with trading commencing in 2002. See OECD 2002, *Implementing Domestic Tradeable Permits: Recent Developments and Future Challenges*, p 74 .

[214] Ienco Group 2001, *UK Emissions Trading Scheme*, http://www.emissions-trading.info/.

[215] Department for Environment, Food and Rural Affairs 2004, *EU Emissions Trading Scheme: Consultation Paper on the UK Draft National Allocation Plan* 2005-2007.

The European Union has announced trading will begin as of 1 January 2005, regardless of whether the Kyoto Protocol comes into force or not.[216] At that time, companies from sectors covered by the scheme, in all European Union-15 and its ten newest members must limit their CO_2 emissions to allocated levels in two periods, from 2005-2007 and 2008-2012 (to match the first Kyoto commitment period). European Union member state governments are required to set an emission cap for all sectors covered by the scheme; participants are required to meet their cap.

Agriculture has a major impact on the environment in OECD countries, particularly Europe, of which the United Kingdom is apart following the establishment of the Single Market. According to a 2004 report by the OECD,[217] most member nationals attempt to limit environmental damage by the application of regulatory requirements supported by education and environmental awareness programs. This includes requirements relating to the availability and use of certain products to farmers through registration of pesticides and other agrochemicals, farm practices (such as stocking levels), or mandatory processes and procedures. These requirements are often not uniform across countries and furthermore are often inconsistent across jurisdictions within countries. Of significant concern is that Europe maintains significant agricultural support policies and that these have unintended environmental implications. There are some initial steps away from support payments based on outputs produced (or inputs used) towards payments that are cross-compliant with environmental targets or directly target environmental outcomes.

There are also examples of new programs aimed at raising incentives for improved natural resource management on private land — including Examples include the European Union's Natura 2000 program. However in general, the broad thrust of natural resource management reforms have been piecemeal and varied. Some examples of European countries have advanced their land management policies in such a way to require economic agents to internalise externalities include:

- a levy on estimated losses of nutrients beyond a legislated threshold (Netherlands, Belgium and Denmark);
- taxes applied to pesticides (Finland, Norway, Sweden, Belgium and Denmark);
- taxes on nitrous oxide emissions from agriculture (France); and
- taxes on fertilisers (Sweden).

Like land reform, many of the remaining work within the environmental sphere has pivoted on the imposition of environmental taxes. Examples include the United Kingdom's graduated vehicle excise tax, Dutch energy taxes, Swedish taxes on diesel, and the Irish plastic bag tax.[218]

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[216] In October 2001, the European Commission proposed the establishment of an EU emissions trading system to tackle greenhouse gas emissions. On 23 October 2003 the arrangements for the EU emissions trading system came into force under Directive 2003/87EC. See Department for Environment, Food and Rural Affairs, Department of Trade and Industry, and Devolved Administrations for Scotland, Wales and Northern Ireland 2004, *EU Emissions Trading Scheme: Consultation Paper on the UK Draft National Allocation Plan* 2005-2007, Chapter 2.

[217] OECD 2004, *Environmental Strategy: 2004 Review of Progress.*

[218] See Stratus 2003, *Economic Instruments for Environmental Protection and Conservation: Lessons for Canada*, found at http://www.smartregulation.gc.ca.

There has been limited experimentation with trading schemes focused on managing environmental risks (apart from greenhouse gas emissions). Some innovations with respect to tradeable rights have included tradeable development rights for land preservation in France; transferable quotas for fisheries conservation in the Netherlands; and non greenhouse gas pollution trading in Denmark.

A more recent trend has been the shift in focus towards a holistic, ecosystem approach to improve natural resource management outcomes. One example is the European Union's Water Framework Directive[219], enacted in December 2000, which coordinates European Union government actions to improve water sector outcomes. The Directive introduces a number of instruments, including the creation Member State River Basin Management Plans, water quality standards and attendant Member State water quality maps.[220]

Several European countries use container deposit laws to encourage reuse and recycling. The most notable of these is Germany's *Ordinance on the Avoidance of Packaging Waste* (Verpackungsverordnung), which makes industry responsible for its packages to the end of their life cycles, including the costs of collecting, sorting, and recycling packages after consumers discard them. Although, industry is exempt if they participate in a 'Dual System' where consumer product manufacturers pay fee an authorised company to collect and sorts the packages on their behalf.[221] Other examples include return of vehicles to manufacturers (Norway); collection of waste oil (Norway); return of electric bulbs (Austria) and reduction in the use of CFCs (Italy).[222]

11.9 Key observations

There is an increasingly wide selection of approaches to advance environment outcomes and reduce environmental degradation. The key observations are as follows.

- Australia is not behind other OECD countries in micro-economic reforms to raise efficiency while advancing environmental outcomes. In some areas, such as competition friendly biodiversity conservation, Australia is among the leaders. Despite the initial steps Australia has made, this remains an open frontier for additional reform work.
- Australia remains largely exposed to future greenhouse risk. While NSW has an operational emissions trading scheme within the electricity sector, a national program has not yet been established and is not supported at the Commonwealth level.
- Considering the United Kingdom experience with emissions trading, it is important for Australia to ensure that if it chose to adopt some sort of emissions trading scheme that it carefully plan and design the scheme so that it does not incur future costs making that scheme fungible with other international regimes.

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219 Directive 2000/60/EC of the European Parliament and of the Council of the European Union, 23 October 2000, *Establishing a framework for Community action in the field of water policy*.

220 For a detailed analysis of this legislation and associated political options see European Environmental Bureau 2001, *EEB Handbook on EU Water Policy under the Water Framework Directive*, http://www.eeb.org.

221 Inform 2004, *Germany, Garbage, and the Green Dot: Challenging the Throwaway Society*: Fact Sheets & Summaries, available from http://www.informinc.org accessed on 10 August 2004

222 Stratus, op. cit.

- Experience in Australia and elsewhere highlights that there are a number of instruments that have been devised, tried and tested and found to be effective in advancing efficiency and environmental objectives. What is missing is the commitment to advance more market-oriented reforms, to apply effective market mechanisms on anything but a small scale, or an attempt to coordinate action on a larger scale.
- There remains considerable scope to review and reform environmental policies. This could include:
  - relying on self-regulation to minimise the deficiencies in command and control regulation; or
  - the adoption of a resource consent process analogous to that observed in New Zealand, which has facilitated the wider implementation of the user and polluter pays principles.

Chapter 12

Telecommunications and postal services

The communications industry has played an important role in assisting general productivity growth and technological diffusion in OECD nations over the last decade. The industry supplies the supporting infrastructure for electronic commerce and the diffusion of the Internet. As such, the industry has been a critical component in the growth and development of the new economy.

Across OECD nations, the percentage of final consumption expenditure that households allocate to communication services has increased from an average of 1.6 per cent to 2.3 per cent between 1991 and 2000.[223] This reflects wider geographical coverage and the advent of new services. The increased uptake also reflects the fact that services have become more affordable and pricing structures have been tailored to better suit different types of customers.

To achieve continued growth in the telecommunications industry requires that ongoing efforts be made by telecommunications regulators to enhance conditions of market access.

12.10 Major Australian reforms

Telecommunications

Broadly speaking, reform of the telecommunication industry in Australia commenced with the establishment of a general carrier duopoly in 1990. The part sale of Telstra Corporation also commenced at around the same time. Over time, sales of shares in the company have reduced government ownership of the company to 51 per cent. Foreign ownership of Telstra remains limited to 35 per cent of listed capital.[224]

The *Telecommunications Act 1997* brought about the removal of all restrictions on the issue of carrier licences. Consequently there is no limit on the number of telecommunications carrier licences which may be issued.

Characteristics of the Australian market

To allow comparison with other OECD nations, current regulatory regimes of the telecommunications market in Australia are summarised below.

- Interconnection charges are generally set by commercial agreement. Disputes between network operators are resolved through arbitration which is handled by the Australian Competition and Consumer Commission. In cases of dispute, interconnection charges are generally based on some form of long-run incremental cost methodology. The Australian Competition and Consumer Commission recently announced the adoption of a similar cost-oriented approach to the regulation of fixed to mobile interconnection charges.

[223] OECD 2003, *Communications Outlook 2003*, OECD Publishing Service, Paris, p. 32.

[224] Other foreign ownership restrictions include the requirement that the Telstra Chair and majority of Directors are Australian. Telstra's head office is also required to be located in Australia. The establishment of new entrants or investment into the Australian telecommunications market requires prior approval by regulators.

- To promote competition in the sector, network operators are required to sell retail services to other carriers at wholesale rates. Regulators use a cost-based pricing approach to be adopted if negotiations between parties fail to reach a suitable pricing outcome.
- The telecommunications incumbent (Telstra) has not been structurally separated, instead regulatory safeguards are used to restrict the misuse of market power.
- Telecommunications carriers in Australia are required to contribute to a universal service fund. While Telstra is the most prominent universal service provider in Australia, other carriers are able to tender to undertake the provision of universal service in some areas.

Postal services

Australia Post was corporatised in 1989 thus making it a fully-publicly owned government business with commercial objectives. Further reforms undertaken in 1994 created greater competition in the letter market by reducing Australia Post's monopoly to mail services valued up to $1.80 and weighing up to 250 grams. The carriage of letters within organisations, outbound international mail, newspapers, magazines, books and catalogues was also opened to competition.

12.11 Overseas reform progress

Telecommunications reforms

Access and interconnection arrangements for new entrants

One of the key aspects to the opening up of the telecommunications network to competition is the interconnection arrangements. It is now typical for interconnection requirements in OECD nations to stipulate that telecommunications incumbents are required to allow new entrants to interconnect with their network.

Interconnection charges

Most OECD nations take similar approaches to Australia in that they involve some form of regulatory oversight or consent regarding the setting of interconnection charges.

The concept of determining the incumbent's interconnection charge using the long-run incremental cost methodology has gained much ground among regulators in recent years and is now the common approach taken with regard to price regulation in OECD countries.

Fixed-to-mobile interconnection charges

The last several years have seen increased regulatory concern regarding fixed-to-mobile interconnection charges across most OECD nations. Mobile network operators have little incentive to keep the price of calls from fixed networks to mobile networks low because there is no means by which fixed line callers can substitute for other services if they are trying to contact a particular mobile handset. Given this lack of substitutes, mobile network operators effectively have a significant degree of pricing power. As a result of this market structure, fixed to mobile interconnection rates are commonly well in excess of the connection costs

involved.[225] These charges are ultimately passed on to consumers who call from fixed to mobile networks.

Within the European Union, the designation of mobile operators as having significant market power has led to the imposition of cost-oriented interconnection charges for fixed-to-mobile services.

In an effort to increase transparency and consumer awareness of the issue, mobile operators in the United Kingdom are required to publish their interconnection rates. While there has been evidence of increased transparency leading to lower call prices there is no evidence that it leads to competitive outcomes.

Canada and the United States operate under a system whereby the mobile user pays for the cost of incoming calls. This system circumvents the interconnection problem by placing an incentive on mobile network operators to minimise interconnection charges. The lower the interconnection charges enforced upon the fixed network operator by the mobile operator, the lower will be the charges to the mobile user. Countries adopting this approach have found that interconnection charges for fixed-to-mobile services are broadly equivalent to those for fixed-to-fixed services. However, it has been observed that the user pays system tends to hold back call volumes and suppress mobile subscriber growth.

Reselling arrangements

In many OECD nations, network operators are required to sell retail services at wholesale rates. In the United States, regulations require that wholesale rates equal the retail rate minus the cost that the exchange carrier avoids by not having to retail the service itself; a similar approach has recently been adopted in New Zealand. The OECD has expressed caution when basing wholesale pricing determinations on retail prices as the retail prices themselves often contain distortions.[226] Until recently, regulations in the United Kingdom did not provide for the resale of retail services at wholesale rates. This approach is designed to create incentives for new entrants to enter the market as carriers rather than resellers. However, in response to limited competition in the fixed-services telecommunications market, the United Kingdom regulator recently mandated that the incumbent, British Telecom (BT), provide wholesale line rental on cost based terms to anyone wishing to offer access to BT's public telephone system or publicly available telephone services.

Structural separation

Structural separation is commonly used to promote competition within the telecommunications industry by allowing competition to take place in areas of the market where it is considered feasible.

The separation of an incumbent into regional operators has been successfully adopted in the United States. When viewed as a whole, the European Union effectively operates under a similar scenario to that of the United States as the traditional telecommunication incumbents tend to dominate their own geographical market. In this case, the promotion of separation between these regional operators is primarily a matter of preventing integration. To this end, the European Commission has acted to prevent integration between regional incumbent

[225] In 2001, the average interconnection charges for fixed to mobile interconnection in the European Union was ten times as high as the interconnection charges associated with fixed to fixed services, see Electronic Communications Committee 2002, *Fixed to Mobile Interconnection*, Luxembourg.

[226] OECD 1999, *Regulatory Reform in the United States*, OECD Publication Service, Paris, p. 18.

telecommunications operators by disallowing proposed cross-country mergers of incumbent operators.

In the United Kingdom, Italy and Japan, incumbents have been required to legally separate their fixed and mobile operations. The result of this approach is that mobile services are provided through a partially-owned subsidiary of the incumbent.

Pricing regulation

Despite increased competition within the telecommunications sectors around the world, regulators still identify a need to regulate final consumer prices so as to protect against misuse of market power. Most nations now use price cap regulations whereby maximum allowable price increases are determined by a formula that considers costs increases (such as inflation and taxes) and productivity improvements. The OECD notes that as competition increases, price cap regulations should be streamlined and ultimately removed.

Government ownership

Many OECD nations, including Canada, the United Kingdom and the United States, have adopted a model of complete privatisation of the main network operator. Where privatisation has occurred, governments have often maintained some form of control over the operator through the provision of special rights arranged at the time of sale, this is the case in New Zealand. Most governments in the EU-15 maintain majority ownership (or minority ownership with special voting rights or powers to direct the incumbent.

Foreign ownership

As at 2003, 16 OECD countries had no foreign ownership restrictions in the telecommunications industry. Some countries only apply foreign ownership restrictions to the incumbent public telecommunications operator, as is the case in New Zealand. Canada applies more widespread restrictions on foreign ownership in that they touch upon all telecommunications carriers.[227] Further details of restrictions in New Zealand and Canada are outlined in table 12.1

Table 12.9

FOREIGN OWNERSHIP RESTRICTIONS IN TELECOMMUNICATIONS

Country	Restrictions
New Zealand	No single foreign entity is permitted to own more than 49.9 per cent of shares of Telecom New Zealand and government permission is required for any single foreign investor wishing to own more than 10 per cent of Telecom New Zealand. No restrictions on other operators.
Canada	Foreign ownership is limited to a maximum of 20 per cent of voting shares in any facilities-based carriers. At least 80 per cent of the board of directors of facilities-based carriers must be Canadian and these carriers must be Canadian controlled.

Source: OECD Communications Outlook 2003, p.45.

[227] Canada is in the process of reviewing its foreign ownership restrictions.

The United Kingdom and the vast majority of nations in the EU-15 have no restrictions on foreign ownership.

Universal service obligations

The importance of universal service obligations has been recognised by all OECD governments and most have taken policy steps to ensure adequate provision of services. The creation of special funds to underwrite the delivery of telecommunications services has gained popularity in the last decade. These funds may be physical funds administered by the regulator or may be virtual funds in which designated operators make payments to the universal service provider. Table 12.2 outlines universal service policies in selected OECD countries.

Table 12.10

UNIVERSAL SERVICE OBLIGATION POLICIES

Country	Policy
New Zealand	A 'virtual fund' is used whereby carriers are required to make payments to the designated universal service provider, Telecom New Zealand.
Canada	All carriers are required to make contributions to a universal service fund. Contributions are calculated as a percentage of gross telecommunication revenues. Incumbent operators are required to provide universal services using revenue from the fund.
United Kingdom	BT and Kingston are designated universal service providers and as such bear the costs of providing these services. The UK regulator is of the view that there is insufficient competition in the retail telecommunications market to warrant the costs of providing universal services being classed as an unfair burden on BT or Kingston. The regulator also states that the two universal service providers stand to gain significant benefits accruing to their brands given their status as universal service providers.
United States	All carriers are required to make contributions to a universal service fund according to end-user revenues. Carriers are able to access the fund provided they are able to offer services throughout a defined geographic area.
European Union-15	European Union member states are required to designate at least one operator, typically the incumbent, to provide universal services. Member States have an option to set up a fund to compensate the designated operator, should the Universal Service obligations be considered to represent an unfair burden.

Sources: International Telecommunication Union 2003, *Trends in Telecommunication Reform 2003,* pp. 38-44; OECD 1999, *Regulatory Reform in the United States*, pp. 20-21; OECD 2002, *Regulatory Reform in Canada; from transition to new regulation challenges*, pp. 30-32; Office of Telecommunications, www.oftel.gov.uk; European Union, http://europa.eu.int.

Number portability and carrier selection

The implementation of carrier number portability policies has become more common over recent years. Twelve OECD countries, including Australia, have now implemented mobile number portability with a number of others planning to do so in coming years.

The implementation of carrier selection and preselection has also been implemented in the majority of OECD countries.[228] However, Australia, along with seven other OECD nations, does not have carrier preselection for local calls. The

[228] Carrier selection allows customers to select a carrier on a call by call basis, usually by entering a code that has been designated to each carrier. Carrier preselection involves consumers making a deliberate choice to change carriers, that is, to no longer take services from a carrier (usually the incumbent) and registering with a new service provider.

OECD identifies carrier preselection as being indispensable to the achievement of full market liberalisation and the development of effective competition.

Local loop unbundling

Most OECD nations, including Australia, have now implemented some form of local loop unbundling. Local loop unbundling fosters competition in the telecommunications sector by allowing new market entrants to lease telecommunications infrastructure such as copper-wire networks from incumbents. In terms of regulatory requirements regarding the costs of access to unbundled loops, most countries have adopted some form of long-run incremental cost method to set prices; this method is used in Australia.

Cable Television

By introducing cable television in 1995, Australia started much later than many other OECD nations and consequently developments in the Australian industry have generally lagged those of other countries.[229] According to the OECD, recent growth in subscriber numbers has meant that cable networks are providing significant competition to traditional telecommunication carriers in most OECD nations. In 2001, the percentage of homes passed by cable television networks in the OECD was 51 per cent on average, while the figure in Australia was around 19 per cent.[230]

The OECD notes that structural separation of cable television activities from incumbent telecommunications operators — something that has not been done in Australia — may help in growing the cable industry as well as providing alternate infrastructure to traditional telecommunication services.[231] Failing structural separation, the other key policy alternative is the establishment of an efficient interconnection regime.[232]

Voice over Internet Protocol

There are an increasing number of regulators in the OECD that have now taken the position that Voice over Internet Protocol should be made subject to the same conditions and obligations as those applied to traditional telephone services. This has been the approach adopted in New Zealand, the United Kingdom and Australia. However, several OECD countries, including Canada and the United States consider Voice over Internet Protocol services as value-added services that are not subject to the obligations of licensed telecommunications carriers.[233]

In the European Union, Voice over Internet Protocol services are subject to conditions that apply to publicly available electronic communication services which are less stringent than the conditions applied to publicly available telephone services.[234] The European Commission recently released a discussion paper on certain regulatory issues surrounding the use of Voice over Internet Protocol technology. The discussion paper raises issues that include:

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229 OECD 1996, *Current Status of Communication Infrastructure Regulation, Cable Television*, Paris, p. 11.

230 OECD 2003, *OECD Communications Outlook 2003*, OECD Publication Service, Paris, p. 30.

231 OECD 2003, *OECD Communications Outlook 2003*, OECD Publication Service, Paris, p. 30.

232 OECD 1996, *Current Status of Communication Infrastructure Regulation, Cable Television*, Paris, p. 6.

233 The regulatory framework surrounding VoIP services in the United States is currently being reviewed with a view of determining whether regulation of VoIP services is necessary.

234 However, VoIP providers with significant market presence are not exempt from potentially being required to contribute to the costs of universal service obligations.

- The potential to implement requirements on Voice over Internet Protocol providers to inform customers on how the Voice over Internet Protocol supplier deals with access to emergency services and caller location information (access to emergency services is required to be offered by telephone service providers).
- Potential changes that may be required to the regulation of interconnection of networks, particularly Internet-to-Internet network connections, given the expected growth in Voice over Internet Protocol traffic.
- Legal aspects surrounding the regulation of extra-terrestrial Voice over Internet Protocol providers (given that Voice over Internet Protocol providers do not have to have to be established in the country in which the service is being consumed).

Postal services reforms

Postal incumbents in many OECD countries have now been corporatised and given commercial objectives. The OECD recognises this as the first stage of reforming the postal industry. Typically those countries where corporatisation has taken place have also taken steps to open up certain segments of the postal market to competition by removing monopoly rights on the delivery of certain types of mail. In Canada, the European Union and Australia, legislation has been passed allowing competition in certain segments of the mail delivery market, for example, mail weighing or costing more than a specified amount.

New Zealand and the United Kingdom have taken more advanced measures to reform their postal services. Both nations have completely removed the monopoly rights of the postal incumbent thus allowing full competition in the delivery of mail services while at the same time maintaining universal service obligations on the postal incumbent; which in both cases is a government-owned corporation. As part of the deregulation process, New Zealand Post signed a Deed of Understanding with the New Zealand Government that establishes, among other things, that New Zealand Post upholds certain service standards and maintains a specified number of postal outlets. Other postal operators in New Zealand are also required to comply with other basic regulations primarily designed to protect the interests of consumers. In the United Kingdom, the Postal Services Commission uses a licensing system to ensure that universal service obligations are maintained by both the incumbent and other postal operators.

12.12 Key observations

Telecommunications

Reforms in Australia's telecommunications industry have been recognised as being successful in introducing at least some form of competition to the industry.[235] The regulation of network interconnection arrangements, recently modified in Australia, is generally on a par with other OECD nations. Australian reforms implemented in the areas of number portability, carrier selection and local loop unbundling are similar to those implemented in other OECD nations.

There are areas where Australian reforms have not been undertaken to the same extent as in other OECD nations, for example:

[235] International Telecommunication Union 2003, *Trends in Telecommunication Reform 2003*, Geneva, p. 229.

- Australia is yet to remove all government ownership of telecommunications operators;
- Australia maintains foreign ownership restrictions on the telecommunications industry; and
- Australia has not imposed any form of structural separation between the fixed and mobile services of the incumbent.

The roll out of cable television services in Australia is noted as generally lagging that of other OECD nations. The OECD notes that structural separation of cable television activities from incumbent telecommunications operators — something that has not been done in Australia — may help in growing the cable industry as well as providing alternate infrastructure to traditional telecommunication services.[236]

Issues concerning the regulation of Voice over Internet Protocol services raised by the European Commission may warrant attention in Australia as use of the technology grows.

Postal Services

Relative to the United States — where a limited monopoly on postal services is maintained — Australia has not opened the postal market to full competition. This is in contrast to New Zealand and the United Kingdom.

[236] OECD 2003, *OECD Communications Outlook 2003*, OECD Publication Service, Paris, p. 30.

Part C

Cross-sectoral issues shaping microeconomic reform

Chapter 13

Significant technological and demographic changes since the Hilmer Report

The focus of the sectoral analysis in Part B (chapters 2 to 12) has been to identify reforms in selected OECD countries that may be of interest as potential areas for future reforms in Australia.

While the appropriateness of OECD reform initiatives for Australia should be considered in more detail than has been possible in this report, there are a number of cross-sectoral issues that should be raised regardless of the scope of any future National Competition Policy initiative. The issues that are likely to have the greatest impact on Australia are:

- the rise of the information economy; and
- an increasing awareness of the policy and economic implications of an aging population.

These are discussed in turn.

13.13 The rise of the information economy

While the use of computers was reasonably widespread at the time the *Competition Principles Agreement*, the potential impact of the information economy on business, consumer demands, and government regulatory actions was not fully appreciated at that time.

Access to home computers has more than doubled and the use of home Internet has tripled since the National Competition Policy was agreed, and in 2002 it was estimated that more than 60 per cent of Australian households had access to a computer at home and 46 per cent of Australian households had home Internet access.[237] In fact, in a recent survey by the then National Office for the Information Economy it was estimated that three out of every five Australians aged 14 years and over use the Internet as at the end of June 2003.[238]

From a commercial perspective, and of relevance for initiatives that attempt to engender greater levels of competition, it should be noted that there has been growing use of computers and the Internet for business-to-business and business-to-consumer transactions over the last few years — as shown in figure 13.1. Internet shoppers spent around $1.9 billion in 2001, which rose to at least $4 billion in 2002, with travel and accommodation was the most common purchase via the Internet.[239] It is predicted that business to business transactions over the Internet will contribute an average of 0.24 per cent annually to Australia's growth over the next decade.

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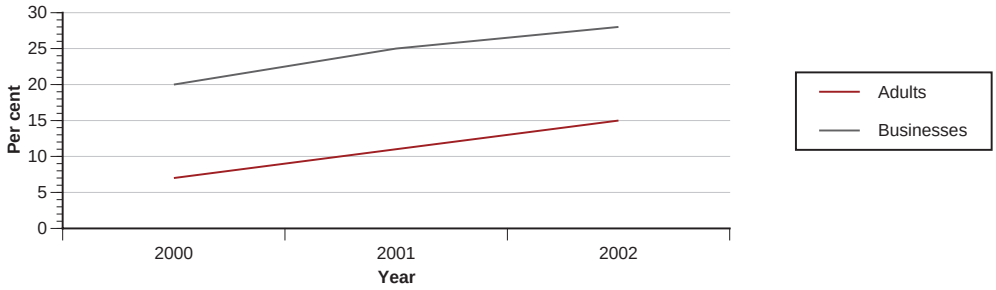
[237] Australian Bureau of Statistics (ABS) 2003a, *Household Use of Information Technology, Australia* Cat 8146.0, Canberra

[238] National Office for the Information Economy (NOIE) 2003, *The Current State of Play*, NOIE, Canberra, December.

[239] ABS 2003a, op. cit.

Figure 13.4

PROPORTION OF ADULTS (B2C) AND BUSINESSES (B2B) SHOPPING VIA THE INTERNET



Source: Australian Bureau of Statistics 2003a, *Household Use of Information Technology*, *Australia* cat. no. 8146.0, Canberra; and Australian Bureau of Statistics 2003b, *Business Use of Information Technology*, *Australia* cat. no. 8129.0, Canberra; and

There are a number of important observations that can be drawn about the impact of the increasing importance of the Internet and information economy on microeconomic reform.

Firstly, the process of disintermediation — i.e. the reduction/removal of intermediate production processes (e.g. transport, retailing, etc) and their associated margins — has a number of potentially profound impacts:

- more efficient delivery of goods and services improves efficiency in those sectors that are able to use ecommerce;[240]
- we are seeing the emergence of new products (e.g. electronic information products), services (e.g. comparison-shopping search engines) or marketplaces (e.g. online exchanges and auctions).[241] As a result we are seeing traditional notions of what a market constitutes changing as electronic delivery increasingly competes with physical delivery;
- electronic service delivery provides opportunities for businesses to reach out to markets not normally accessible through traditional channels. As a result established market boundaries are expanding (e.g. while the mortgage market was traditionally seen as a state-based market, Internet and telephone offerings now mean that the market has national boundaries. That is, as a result of the developing information economy the barriers created by our relative geographical isolation are being removed.[242]

While these developments suggest an increasingly competitive marketplace, in a recent report for the United Kingdom's Office of Fair Trading it was noted that uncertainties associated with the future developments of e-commerce make it difficult to predict its likely impact on market competition.[243] As noted above, certain characteristics of e-commerce might be expected to facilitate entry and reduce costs, with the benefits of greater competition being passed on to

[240] See The Allen Consulting Group 2000a, *E-commerce Beyond 2000*, NOIE, Canberra; and The Allen Consulting Group 2000b, *E-commerce Across Australia*, NOIE and the Department of Communications, Information Technology and the Arts, Canberra.

[241] See Frontier Economics Group 2000, *E-Commerce and its Implications for Competition Policy*, OFT308, Office of Fair Trading, London.

[242] Productivity Commission 2004, *ICT Use and Productivity: A Synthesis from Studies of Australia Firms*, Research Paper, Canberra.

[243] Frontier Economics Group 2000, op. cit.

consumers. On the other hand, first mover advantages, network externalities, switching costs and other barriers to entry may encourage or facilitate certain types of anti-competitive behaviour.

Secondly, the rise in the use of and access to information technology has led to an increase in the demand for information from consumers and citizens:

- consultation and access to decision makers, decision processes, and decision rationales is increasingly being undertaken via the Internet; and
- the Internet has also seen the development of private sector benchmarking such as web sites that provide commentary on government or firm's quality of service and prices.

The issue for National Competition Policy is to ensure competitive forces are free to operate in the fast-changing e-commerce environment while at the same time protect consumers from companies' anti-competitive behaviour without stifling new and innovative forms of competition.

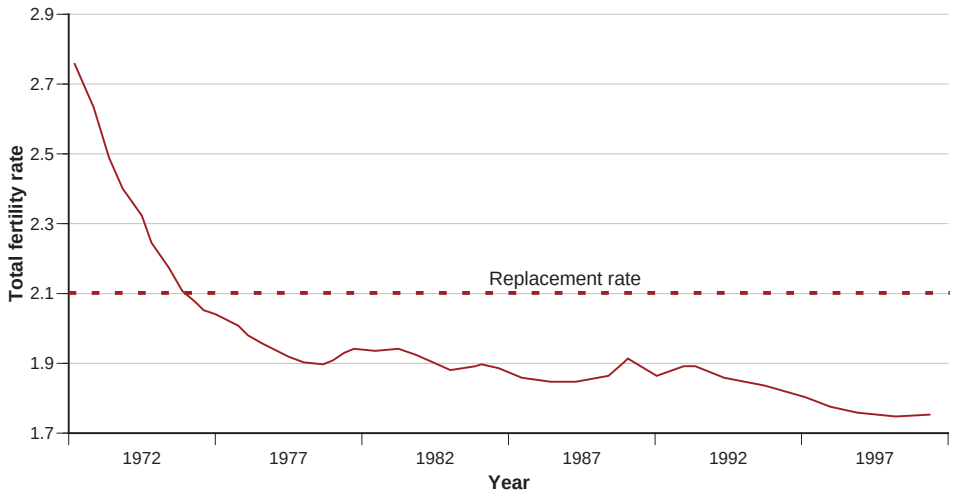
13.14 The ageing population

While the impact of Australia's demographics on the economy, society, and government policy has been marked, it is only recently that the policy implications have been explicitly considered as part of longer term policy planning — see the Intergeneration Report released by the Treasurer in May 2002.

An aging population — due mainly to the aging of people born in the post World War II 'baby boom' and relatively low fertility since 1961 (see figure 13.2) — has significant implications for future reform initiatives.[244]

Figure 13.5

AUSTRALIA'S HISTORICAL TOTAL FERTILITY RATE



Source: *Intergenerational Report 2002-03, 2002-03 Budget Paper No. 5.* Circulated By The Honourable Peter Costello, M.P., Treasurer Of The Commonwealth Of Australia, 14 May 2002, p. 21

[244] *Intergenerational Report 2002-03, 2002-03 Budget Paper No. 5.* Circulated By The Honourable Peter Costello, M.P., Treasurer Of The Commonwealth Of Australia, 14 May 2002.s

The aging of Australia's population will influence the level of demand for government services as will society's expectations that today's standard of living and increased life expectancies will continue. Moreover, mortality rates have fallen across all age groups, and this is expected to continue for the next four decades. Based on recent trends, men born in 2042 are projected to live to 82.5 years, an average of 5.3 years longer than those born in 2002 and women born in 2042 are projected to live to 87.5, 4.9 years longer on average (see table 13.1).

Table 13.11

AUSTRALIANS' PROJECTED LIFE EXPECTANCY AT BIRTH (IN YEARS)

	2002	2012	2022	2032	2042
Males	77.2	79.3	80.7	81.7	82.5
Females	82.6	84.4	85.7	86.7	87.5

Source: *Intergenerational Report 2002-03, 2002-03 Budget Paper No. 5.* Circulated By The Honourable Peter Costello, M.P., Treasurer Of The Commonwealth Of Australia, 14 May 2002, p. 21

The shift in Australia's age structure means that, the 'aged dependency ratio' — the number of people aged sixty five years and over relative to the population aged between fifteen and sixty four — will change significantly over the next forty years. Currently, there are 5.25 people aged between fifteen and sixty four for every person aged sixty five or more years. By 2042, this will have fallen by more than a half, to 2.4.

Given that average spending per person for health and long-term care is significantly greater for older people, the aging population will have implications for health, aged care, and income/tax policies. Analysis by The Allen Consulting Group suggests that if the current aged care system were to continue broadly unchanged, then the total cost of providing aged care could rise by almost 60 per cent by 2020.[245] That is, from 1.17 per cent of gross domestic product in 2000 to 1.84 per cent of gross domestic product by 2020. This equates to a increase from $7.5 billion in 2000 to $12 billion (in today's terms) in 2020.

Our report also noted that existing cost pressures in the system (nurse wages and capital costs) suggest that the rise in aged care costs could be even sharper. As the population ages there will also be increased needs and costs for other services, notably acute health care.

It is also expected that while demand for some social welfare payments will decline as the population ages (such as family payments and unemployment benefits), others will rise (old age pensions and disability pensions). At the local government and state and territory levels, there are many government-funded services — ranging from housing to transport — that may be affected by ageing.

While expenditure levels are likely to increase to meet the demands of an ageing population, governments' capacity to tax may be squeezed if economic growth slows, due to a decline in the rate of growth in the labour force.[246] The extent to

[245] The Allen Consulting Group 2002, *The Financial Implications of Caring for the Aged to 2020: A Report commissioned in conjunction with The Myer Foundation project 2020 — A Vision for Aged Care in Australia*, Melbourne.

[246] Productivity Commission 2004, *Economic Implications of an Ageing Australia*. Issues and Questions. Adapted from An Ageing Australia: Small Beer or Big Bucks?

which this occurs will be influenced by future trends in labour force participation and Australia's net overseas migration.

Labour participation rates of people aged 55 or more are currently lower than those of younger people. As the population ages, more people will shift into these older age groups, and, all other things being equal, aggregate labour participation will decline. This presents policy issues for government in terms of how best to encourage older workers to remain in the workforce longer.

Other aspects of labour supply may also be affected by ageing — such as average hours worked and unemployment rates. These collectively will determine the number of hours worked in the future. And the contribution to Australia through unpaid work — such as volunteering — may also be affected as the population ages.

It is clear that Australia's demographic changes will influence future government policies, and as such should be considered as part of any future National Competition Policy initiatives, particularly in terms of identifying priority areas, such as engendering greater levels of efficiency and/or competition in the health sector, aged care, the labour market, and so on.

Chapter 14

The increasingly important concept of governance in microeconomic reform

14.15 Government in Australia

Regardless of the nature of policy reform in Australia, the separation of powers and responsibilities of the different tiers of government have shaped policy development and outcomes, and created barriers to policy coordination in Australia.

While the words of the *Constitution* — which sets out the roles and responsibilities of the Commonwealth — may be clear, the actual allocation of roles and responsibilities between the three layers in practice is not.[247] Overlap, duplication and ambiguity abound. Other factors have contributed to the complexity of policy responsibility between different levels of government. Most notably:

- vertical fiscal imbalance — the fact that the Commonwealth raises more revenue than it spends and the States spend more than they raise — gives the Commonwealth significant policy influence over areas that are the Constitutional responsibility of the States (e.g. health and education); and
- the development of Constitutional arrangements in Australia, for example, the use by the Commonwealth of the external affairs power (sub-section 51(xxix)) has seen it extend its legislative reach into policy areas that have historically been the responsibility of the States.

Despite the difficulties posed by federalism, the different levels of government have successfully collaborated on many issues. In fact, the development of National Competition Policy is a strong example of intergovernmental cooperation in Australia. The National Competition Policy can be characterised as top down co-operation — with agreement reached at the national level and payments for reform flowing from the Commonwealth to the states and territories.

In considering the future of direction for the National Competition Policy, it is important to review whether such as top-down approach remains appropriate. By way of contrast, there are other policies that take a bottom-up approach — such as the National Action Plan for Salinity and Water Quality. This plan establishes a program through which substantial investment could be made to address the issues of salinity and water quality.

While momentum for the National Action Plan was driven by the Commonwealth, the states are expected to match the Commonwealth contribution and be involved in detailed processes. Plans are to be constructed at the catchment level involving catchment authorities which draw upon the expertise of farmers, environmental scientists and the community. It is a responsibility of catchments to develop rolling investment strategies to implement their plans. Actions under the plan are expected to include public sector projects, as well as activities on private land.

[247] The territories are a legislative creation of the Commonwealth Government pursuant to section 122 of the *Constitution* but are broadly the equivalent of States in terms of their position in Australia's governance framework.

In addition to consideration of the appropriate approach for future competition policy initiatives, consideration should also be given to the impact of policy outcomes of one level of government which are felt across the other levels of government — sometimes called 'spatial blindness' of policy.

Policy makers tend to seek to address unintended consequences and the issue of lack of coordination between government policies through so-called 'whole of government' approaches. While 'whole of government' is now a mantra in public policy circles, it remains challenging for governments to coordinate their actions across their various departments and agencies, let alone to fully coordinate with other levels of government across all relevant activities.

It is not clear that a 'whole of government' approach by itself takes sufficient account of issues relating to the spatial impact of policy. Even within a single layer of government, policies can lead to conflicting outcomes. In transport for example, progress is being made in terms of looking at mobility. Governments are thinking more about the complimentary roles that different modes can make (eg, road and rail) and involving different layers of government in planning for different modes. The problem is that policy makers still focus on single portfolios. Looking at transport in isolation without regard to why mobility is needed and how this is changing over time is a situation ripe for unintended consequences.

A further concern with a 'whole of government' approach is that there is a risk that it does not leave much space for the involvement of community, NGOs or business interests, among others. Better policy outcomes cannot be achieved unless a 'whole-of-community' approach to policy development is taken. This means engaging all stakeholders in the policy development process such as the private sector, non-government organisations, local community groups and individuals generally.

Policies with a sectoral focus — such as the National Competition Policy — are particularly vulnerable to spatial blindness, with the policy impacting on a range of regulatory areas but applied on an industry-by-industry or sector-by-sector basis. Further, while the policy was designed to benefit Australia's national interests, it did not have a structure to address the likelihood that some places would be winners and some losers.

In the Productivity Commission's assessment of the National Competition Policy for example, it was found that there were different impacts in metropolitan and country areas of Australia.[248] In particular, the direct costs of some competition policy reforms have tended to show up more in country areas than in the cities and there has been more variance in the incidence of benefits and costs of competition policy reforms in rural and regional Australia compared with metropolitan areas.

Following the Productivity Commission's review of the National Competition Policy, governments undertook to consider identifying the likely impacts of reform measures on specific communities, including the expected costs of adjusting to change. Such place-based policy analysis (i.e. policies focusing on the distribution

[248] Productivity Commission 1999, *Impact of Competition Policy Reforms on Rural and Regional Australia*, Report No. 8, AusInfo, Canberra.

of benefits) is a major element in policy reform development in the United States and the United Kingdom.[249]

14.16 The broader concept of 'governance'

In a world where inclusion of business and civil society is increasingly the norm, the term 'governance' better defines the processes by which people solve their problems and meet the needs of the people using 'government' as one instrument.

A narrow interpretation of governance — and hence microeconomic reform — that focuses simply on government's role in facilitating reform is no longer appropriate for describing how populations and regions are organised and administered. Increasing the capacity of public governance requires reforms based on new spatial alliances and partnerships between levels of governments, the private sector and the community.

Better governance arrangements and institutional frameworks would establish a mechanism to connect national polices with on-the-ground needs and implementation. It would include the community in the process through a consultative style that builds a shared vision or direction among policy-makers and the community. The broad aim is for 'distributed governance' arrangements which disperse power and influence through the community and over a wide variety of actors and groups.[250]

Governance is now a key driver of policy analysis and formation in the OECD,[251] and it clearly provides some insight into how a new microeconomic reform agenda could be shaped. The following sections address governance in two particular contexts:

- regulatory reform; and
- integrated governance.

Regulatory governance

Over the last 20 or so years the international regulatory reform agenda has evolved from a simplistic focus on deregulation to subsequently acknowledge that unmanaged deregulation has the potential to result in under-institutionalisation and regulatory gaps that can mislead or limit markets and harm consumers.[252] Figure 14.1 provides a pictorial representation of this change.

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249 See the Allen Consulting Group, May 2002, *Recapitalising Australia's Cities: A Strategy in the National Interest*, A discussion paper for the Property Council of Australia.

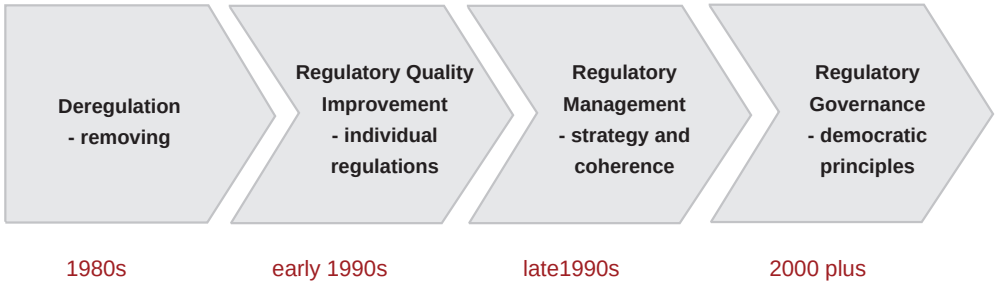
250 P. Paquet 2001, 'The new governance, subsidiarity, and the strategic state' in OECD 2001a, *Governance in the 21st Century*, OECD, Paris, p. 188.

251 For example, see: S. Holmes 2002, 'Regulatory Governance: The Rule of Law and Gains from Reform', OECD paper presented at the OHR/OECD Conference on Regulatory Governance, Sarajevo, 19 April; OECD 2001a, *Governance in the 21st Century*, Future Studies, OECD, Paris; OECD 2001b, *Citizens as Partners: Information, Consultation and Public Participation in Policy-making*, OECD, Paris; OECD 2002, *Regulatory policies in OECD Countries: From Interventionism to Regulatory Governance*, OECD Reviews of Regulatory Reform, OECD, Paris; OECD 2001c, *Government of the Future*, PUMA Policy Brief No. 9; and OECD 2001d, *Engaging Citizens and Policy-making: Information, Consultation and Public Participation*, PUMA Policy Brief No. 10.

252 See Holmes 2002, ibid.

Figure 14.1

THE FOUR STAGES OF REGULATORY POLICY DEVELOPMENT



Source: S. Holmes 2002, 'Regulatory Governance: The Rule of Law and Gains from Reform', OECD paper presented at the OHR/OECD Conference on Regulatory Governance, Sarajevo, 19 April.

Given these observations, two responses followed over the 1990s:

- criteria were put into place to improve the quality of new regulations — this is characterised by case-by-case analysis through the Regulatory Impact Statement process; and
- mechanisms were established to ensure the systematic coverage of all regulations — this is characterised by the legislation review program overseen by the National Competition Council.[253]

While there is a temptation to see these responses as best practice, as implied by figure 14.1, we are now seeing best practice regulatory policy development move into a phase that has come to be termed 'regulatory governance'. Behind this change lies the recognition that the success of economic and social regulations fundamentally depends on governments' capacities to produce, co-ordinate, implement, and review regulations. At the end of the day these elements require the trust of the community.

Although there does not appear to be a definitive definition of regulatory governance, the types of principles that the phrase implies include:

- transparency;
- accountability;
- results focused rather than instrumentally focus (i.e. outcomes rather than means);
- efficiency;
- inclusive participation in decision-making;
- management of change; and
- coherence.[254]

[253] These trends are discussed more broadly in S. Argy and M. Johnson 2003, *Mechanisms for Improving the Quality of Regulations: Australia in an International Context, Staff Working Paper*, Canberra, Productivity Commission.

[254] See M. Minogue 2001, *Governance-Based Analysis of Regulation, Working Paper No. 3*, Manchester, University of Manchester Centre on Regulation and Competition; M. Minogue 2002, *Public Management and Regulatory Governance: Problems of Policy Transfer to Developing Countries, Working Paper No. 32*, Manchester: University of Manchester Centre on Regulation and Competition.

Where this probably departs from the two middle phases of development shown in figure 14.1 is the focus on openness and the integration of stakeholders to:

- identify problems, options for reform, the costs and benefits of alternatives; and
- promote understanding and trust in both regulation and its enforcement.

In effect, the aim of regulatory governance is to move progressively up the ladder shown in figure 14.2:

> Starting from the position that governments do not always have to be central to resolution of differences between business and the community, commentators … have drawn attention to what some call the new regulatory paradigm. This approach pushes the role of consultation between business and community and the resolution of issues or conflicts further from government fiat to business and community stakeholders. This serves as both an illustration of the increasing role of structured community consultation from the business perspective and is also relevant as a substantive example of government sponsored community consultation … Recognising the importance of rebuilding trust, the regulator steps back to enable greater flexibility to the company in return for an increased role for the community in dialogue and performance monitoring to underpin corporate accountability.[255]

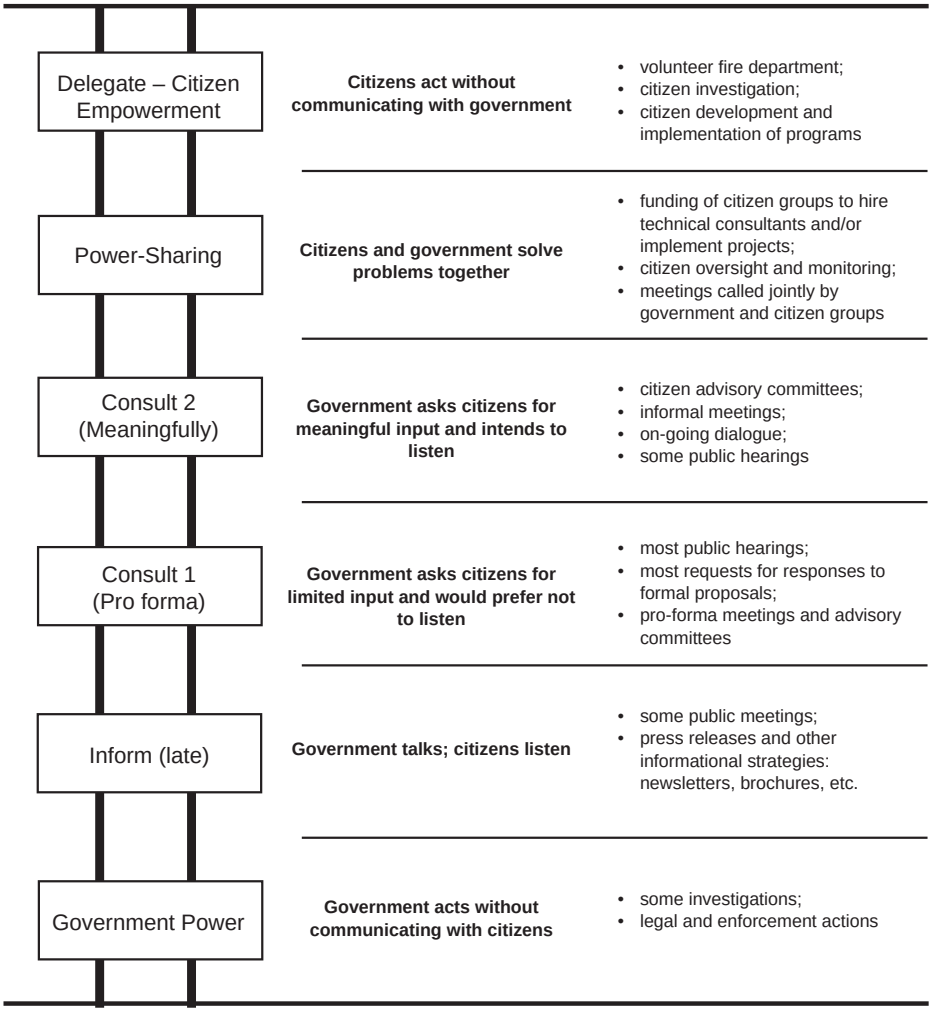
It is important to stress that improving regulatory governance is not an objective in itself; it is always a means to an end, or a series of ends such as:

- improving economic performance;
- improving government effectiveness and efficiency; and
- enhancing democratic values such as government openness, self-reliance, public participation and responsiveness.

[255] The Allen Consulting Group 1999, *Stakeholder Relations in the Public Sector — Innovation in Management: A Collaborative Study*, The Allen Consulting Group, Melbourne, pp. 26-27.

Figure 14.2

LADDER OF CITIZEN PARTICIPATION



Source: B. Hance, C. Chess, and P. Sandmaan, *Improving Dialogue with Communities: A Risk Communication Manual for Government*. New Jersey Department of Environmental Protection, Trenton NJ.

Integrated governance

Integrated governance is an acknowledgement that reforms need to be undertaken on an integrated basis with solutions that cut across traditional departmental lines, ministerial responsibilities, commonwealth-state regulatory responsibilities, and even sectors — government, community and business.

For example, in many areas of social policy the success of reform depends upon the efficiency and effectiveness of the non-government sector, which is responsible for the delivery of programs through service contracts. The Allen Consulting Group's work on child protection highlighted that preferred policy options require a coordinated response from mental health professionals, community welfare agencies, maternal and health care nurses, schools, and so on.

The concept of integrated governance incorporates some element of 'mutuality', as opposed to individual action. The focus on individual actions by government in recent years is being modulated by a resurgence in the use of collective action. A subset of collective action is mutuality. This means mutuality at any point in terms

of shared responsibility for policy development, planning, implementation and evaluation. Activities which fall under the concept of integrated governance can include: pooled budgets; triple bottom line analysis; partnerships with the private sector; partnerships with other levels of government; coordination of service delivery; broad policy frameworks; integrated planning; 'one stop' shops; summits/roundtables/visioning; networks; and, joint databases and indicators. Fundamentally, the concept incorporates an acknowledgment of mutuality and a movement away from a silo mentality.[256]

Moving away from a command and control mode of governance to governance through multiple stakeholders is an emerging policy paradigm which is not unique to Australia. The concept of 'integrated governance' has been adopted in the United Kingdom (inelegantly called 'joined-up government') and in the United States ('networked government). Collaboration and partnership have become common parlance in policy documents.

14.17 What it means for the National Competition Policy

There is little doubt that micro-economic reform is challenging — for example, a recent OECD article highlights the particular resistance to the strengthening of competition policy:

> Such a move is generally accepted to improve market functioning, but the immediate target is the rents that accrue to companies with market power, and probably also for the workers who share in these rents. It is thus not only the capitalists, but also the workers who are likely to feel threatened.[257]

Further still:

> if competition policy or regulatory reform creates new market opportunities, one can predict that these opportunities will be exploited; but one cannot identify ex ante who it is that will exploit them (they may not know themselves at the time of the reform!). On top of that, in many cases the rent reductions that are the consequence of the reform may be seen, and indeed felt, as unfair in that it is not the beneficiaries of the rent who bear the cost of its reduction. It is, in my view, this nexus that makes reform so difficult.[258]

It is clear that where vested interests are greatest — whether they be industry, business, regions, or individuals — the resistance to reform will be strongest.

Tackling change on an industry-by-industry or sector-by-sector allows for effected parties to coordinate opposition and align challenges to reform. One of the advantages of the Nation Competition Policy was that by linking sectoral reform under the umbrella of competition policy the National Competition Policy proved to be a far more successful policy than had reform been undertaken solely on a sector-by-sector basis. Future competition policy initiatives should continue to draw on the benefits of collective reform and explicitly draw on the concepts or regulatory governance and integrated governance.

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256 Institute of Public Administration Australia 2002, *Working Together Integrated Governance*, A National Research Project, March.

257 Koromzay 2004, op. cit, p.2.

258 Ibid, p. 3.

Part D

Appendices

Appendix A

Abbreviations

ACCC	Australian Competition and Consumer Commission
CLERP	Corporations Law Economic Reform Program
EU	European Union
NCC	National Competition Council
OECD	Organisation for Economic Co-operation and Development
VoIP	Voice over Internet Protocols

Appendix B

Further reading on overseas experiences

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