
1 Extending the reach of markets

Governments have been extending the reach of markets into areas of the economy where governments themselves once made all the resource allocation decisions. Competition, choice, property rights and cost-reflective pricing are proving to be effective instruments in delivering better economic, social and environmental outcomes. However, governments face challenges in ensuring that market mechanisms contribute effectively to achieving community objectives and need to pay attention to design details if unintended or adverse outcomes are to be avoided.

Markets in perspective

Markets are human constructs that have proved to be powerful drivers of economic prosperity and growth. Efficient markets transmit information between buyers and sellers necessary to facilitate decisions about what is produced, how it is produced and to whom the goods and services are distributed. Markets work most effectively when buyers and sellers are informed, property rights are well defined, competition exists and there is no harm done to third parties.

Though often overlooked, the functioning of markets rests on a foundation of culture and custom. Trust, networks and norms condition the behaviour of individuals and can encourage them to align their interests with those of the wider community. The strength of such connections within a community influences the extent to which government needs to provide regulatory and institutional support for the functioning of markets.

Efficient markets are never completely unfettered from government involvement. Without effective property rights, for example, existing owners of resources have little incentive to manage them in ways which yield the highest pay-off to the community. Even then, some markets may not be able to achieve economically efficient outcomes.

Much of the Commission's inquiry and research program has been concerned with assessing the efficacy of regulatory and institutional arrangements for market activities. A major thrust of its work has been to address the consequences for the

community of government regulations that impede entry to markets. A core part of this work in the last few years has been the evaluation of ‘pro-competition’ regulatory interventions in the markets for monopoly infrastructure services. The insights from that work were discussed in last year’s annual report, in individual inquiry reports (on rail reform, liner shipping, prices surveillance, telecommunications competition regulation, the national access regime for essential infrastructure, airport services and harbour towage) and in speeches over the past year by the Commission’s chairman (Banks 2002b, c, d).

This year’s annual report provides an opportunity to review some of the main messages emerging from another important stream in the Commission’s recent work: how governments can successfully extend the use of markets to sectors of the Australian economy where such forces have rarely been used before.

Tapping the potential of market incentives

Governments in Australia and elsewhere have been making greater use of market mechanisms where resource decisions were once determined administratively. These encompass areas of the economy where markets were traditionally seen as likely to fail. This could be because markets would provide false signals about the value of resources to society — typically when significant ‘externalities’ are present or there are ‘public goods’ that ought to be freely consumed by everyone — or where the primacy of access and equity objectives over efficiency was thought to preclude any role for market-type instruments. These areas include health, education, community services, the provision of social safety nets, conservation of biodiversity and natural resource management — all of which have an important bearing on Australian productivity and living standards.

Governments and communities have come to realise that determining resource allocations administratively may not guarantee good outcomes. In part, this is because the complexity of many service delivery options and alternative ways of meeting demand can place overwhelming information burdens on centralised administrators. Another complication is that at least some ‘public’ services — be they in higher education, health, or government information services — have significant private benefits. Administered systems have their own incentive structures and develop their own, often opaque forms of ‘competition’ for access to resources. While markets have limits, so too do such centralised approaches to resource allocation.

Market mechanisms — such as competition, choice, property rights and prices — are therefore being reassessed for their potential to achieve efficiency and innovation in service delivery. Efficiency does not mean cutting costs without regard to impacts on services. Properly understood, efficiency means more and better services for the same level of resources. Moreover, markets are not an all or nothing choice. Market incentives can be integrated with administrative systems and often structured to serve overarching community objectives, such as equity in service provision. And market incentives need not be incompatible with the cooperative ethos which characterises many areas of service provision. After all, even fiercely competitive firms can find it in their common interest to cooperate with each other in ways that are socially desirable — joint venture partnerships, information sharing, and research and community education programs are examples.

Governments have consequently begun introducing market competition where previously it was suppressed, empowering choice by consumers and providers, establishing new property rights, and using prices to guide production and consumption decisions. Some government initiatives, such as the current review of higher education, have placed an appropriate role for market-oriented incentives as a core policy consideration (Nelson 2002).

Recent public inquiries and research studies by the Commission have reviewed areas where governments have been pushing the boundaries of markets: ‘creating’ markets for employment services for the long-term unemployed, the radiofrequency spectrum and the supply of ecosystem services such as those promoted by biodiversity conservation (box 1.1). Its inquiry on cost recovery by government agencies looked at the pricing principles that should guide access to information with varying levels of public and private benefit. Through its conference and workshop program, the Commission has also been exposing for informed debate proposals to increase the use of market incentives in the health care system.

This work has enabled an assessment of the use of markets in those areas and brought out some useful lessons about how to harness market incentives. But it has also revealed limitations in the use of markets and the need for care in their implementation.

Box 1.1 Using markets to improve outcomes

Job Network, established in 1998, is one of the first comprehensive attempts internationally to apply market principles to the provision of active labour market assistance for disadvantaged job seekers. Mechanisms used to supply publicly subsidised employment services in this 'managed' market include:

- contracting the provision of training, client management and other services to competing agencies in the for-profit and not-for-profit sectors;
- flexibility in the way services are delivered, with reward for good providers;
- some degree of choice of provider for job seekers; and
- a mix of tendered and administratively set prices for services.

A series of evolutionary design changes to Job Network were announced in May 2002.

Radiofrequency spectrum is a valuable natural resource necessary for radio and television broadcasting, mobile telephones, navigation, defence and emergency communication services, and even remote controls for garage doors and toys.

- Significant signal interference under an open access policy would seriously compromise spectrum usefulness. Worldwide, governments have intervened to control access to the airwaves by issuing administratively prescribed, equipment-specific permits.
- Australia was one of the first countries to recognise the potential for market-based property rights to increase the efficiency of spectrum use in the face of rapidly changing radio-technologies, competing cable technologies and consumer demands.
- A key reform was to create an auction technology-neutral spectrum rights for prized parts of the spectrum. Where 'smart' technology allows many users to occupy the same spectrum space with minimal interference, wider use of free and openly available class licences for low power, local transmissions has brought additional flexibility.

Ecosystems contribute important services such as air and water purification, drought and flood mitigation, and climate stabilisation. In terms of biodiversity conservation, many ecosystems are poorly represented in national parks and reserves, and many are not large enough on their own to sustain biodiversity and other ecosystem services.

- With more than 60 per cent of Australia's land area under private management, privately held ecosystems should be important contributors of ecosystem services.
- Private suppliers of ecosystem services, however, are not likely to be rewarded for all the benefits they would provide. Similarly, those who degrade the environment do not bear all of the costs they impose on others.
- As a result, markets for ecosystem services rarely exist and there are fewer such services than is best for society as a whole.
- In principle, governments can create markets by defining a new property right that is both linked to the desired ecosystem service and that can be exchanged for reward. Australian examples are the use of tradeable emission permits to limit saline discharges into rivers and a trial of competitive tendering as a cost-effective way of encouraging landholders to supply conservation of biodiversity on private land for profit.

Sources: PC (2002a), PC (2002c) and Murtough et al. (2002).

Benefits in extending the use of markets

Assessments across a diverse range of activities are confirming the value of greater use of market mechanisms in achieving various economic, social and environmental objectives. Even where markets have not been given full rein, better outcomes are evident than from administrative systems. Moreover, extending the use of markets and market instruments has freed governments to concentrate on those issues that they are best placed to handle.

Managing the airwaves

The superior potential of market mechanisms over administrative processes is being demonstrated in the management of the radiofrequency spectrum. Australia has had a long history of governments issuing licences that prescribe the equipment to be used, its location, power and frequency. However, digital technology and new transmission techniques have revolutionised the way spectrum can be used to carry information and to configure the networks needed to supply services such as mobile phones. New consumer demands, new options for spectrum use and new possibilities for substitution with cable and other technologies require rapid responses.

The Commission's recent review of spectrum management in Australia found that the outcomes from extending market practices into the sector have been mostly favourable (PC 2002c). Market-based spectrum licences allocated through auctions:

- have made it easier for licensees to use whatever technologies best suit their needs and to aggregate licences into the service networks that meet customer demands;
- have given the community better information on the value of spectrum rights and the costs of locking in technology-prescriptive rights; and
- will allow spectrum to move readily to higher valued uses, once secondary markets become better established.

Nevertheless, government retains substantial roles in spectrum management. These include defining spectrum property rights; investigating signal interference problems; reducing search costs by maintaining a public register of spectrum rights; providing for defence needs; ensuring reasonable access for public and community users; and meeting Australia's international obligations in spectrum management and coordination.

Serving the unemployed

In its evaluation of the Job Network, the Commission found that benefits had arisen from government becoming a purchaser, rather than a provider, of labour market services for the unemployed (PC 2002a). Chief among these benefits is a focus on obtaining outcomes for clients. This has been achieved by rewarding providers directly for good performance, creating incentives for providers to be innovative so as to remain competitive in the marketplace, and allowing some choice for job seekers between competing providers.

Although Job Network programs have had only a very modest net impact on aggregate employment to date, this was not unexpected and accords with outcomes from previous programs in Australia and overseas. However, total program costs are much less — funding has been halved relative to previous programs such as those forming part of Working Nation. In addition:

- surveys of job seeker satisfaction paint a positive picture;
- employers generally see the Job Network as an improvement over previous programs; and
- the reach of service providers has expanded — more than 250 localities have an employment service where none existed previously.

Conserving environmental assets

A key feature of markets is their ability to signal the preferences of buyers and sellers. Well functioning markets generate such information in cost-effective ways that administrative systems can seldom match. Significant amounts of information are summarised in prices, which enable participants to respond individually to opportunities for gain. This function can be put to use in the pursuit of both private and community interests — even in complex areas such as the conservation of biodiversity.

A market mechanism — competitive tendering — is being used in the Victorian Government's BushTender trial to create a market for the supply of conservation of native vegetation on private land. Sealed bids were sought from private landholders to undertake conservation activities on their properties — such as excluding stock from sensitive areas, controlling pests and weeds and retaining large trees and fallen timber. The trial was initially conducted in the Bendigo–Ballarat and Wangaratta–Wodonga areas and is being extended to areas in east and west Gippsland in late 2002. The use of competitive tendering has:

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- provided better information to the community about biodiversity assets on private land — the presence of rare and endangered species increases the conservation value of a landholder’s bid and thereby creates incentives for landholders to disclose information previously likely to be concealed for fear of triggering restrictive land control measures;
 - resulted in the environmental agency revealing some of the weighting it attaches to various aspects of biodiversity conservation;
 - revealed information on the (previously hidden) costs of on-site conservation measures; and
 - enhanced the scope for achieving greater cost effectiveness in environmental expenditure (Murtough et al. 2002).

Market mechanisms are being used successfully to harness private conservation initiatives so as to complement public sector activities and the existing informal, voluntary and philanthropic conservation activities also undertaken privately.

Attention to detail is important

The design of appropriate incentive structures is pivotal when governments decide to introduce market mechanisms where none previously existed. New policy frameworks can result in unintended or adverse outcomes if insufficient attention is paid to their design features. As in most areas of regulation, the devil is in the detail. This applies to the way consumer choice is accorded, prices are established in these new markets, competition is introduced and property rights are defined.

Choices may need to be constrained

The benefits for consumers of being able to exercise choice are taken for granted in everyday markets. The lack of a guaranteed clientele ensures that providers target the quality, quantity and price of their goods and services according to consumer preferences. However, in ‘created’ markets, allowing unconstrained choice can bring complications.

In its evaluation of the Job Network, for example, the Commission found that existing arrangements tended to underplay the potential value of choice in empowering job seekers and providing incentives to service providers to improve performance. But options to enable more choice need to be designed carefully to avoid adverse incentive effects. For instance, allowing job seekers too much choice in changing providers or in moving to other programs such as Work for the Dole, could result in some clients seeking to avoid their mutual obligation and put at risk

providers' up-front investments in improving the employability of the long-term unemployed.

Payment incentives need watching

The design of incentive structures for service providers in created markets can also raise complex issues. For example, a high up-front service fee for Job Network providers, when job seekers come on to their books, reduces the financial incentive to direct additional resources to the very hard-to-place job seekers for whom a subsequent outcome payment is unlikely. On the other hand, high outcome-based fees can foster strategic responses by some providers — such as 'creating' unsustainable jobs. Payment structures have therefore had to be supplemented by contract monitoring and standardised comparisons of provider performance, to evaluate and adjust for unintended consequences.

Auction design can affect outcomes

The benefits of competition can be introduced into some sectors by replacing the administrative allocation of resources with auctions. However, some types of auction work better than others in ensuring that resources are allocated to their highest value uses.

In its inquiry on radiocommunications, for example, the Commission found the precise design of an auction is important (box 1.2). The Australian Communications Authority has been innovative in offering for sale relatively small parcels of spectrum in capital cities or regions, which bidders can choose to aggregate as they wish. In this way, firms with regional ambitions do not have to bid for national coverage, niche users can bid for just the amount of spectrum they require and mobile phone companies can bid for the vast tracts of spectrum (both spatially and in bandwidth) needed for their national networks. Australian spectrum licences have been relatively neutral with respect to technology and use and can be traded, thereby avoiding the inefficiencies associated with administered market segmentation.

Nevertheless, the Commission found that some design issues in spectrum auctions needed to be addressed. Although a clear advance on other ways of allocating spectrum, the current approach does not allow bidders to be sure they can win the complementary licences necessary to yield the highest overall value of spectrum use. The benefits of 'combinatorial' auctions, being trialed in the United States in 2003, should be reassessed by the Australian Communications Authority.

Box 1.2 Auction design issues for an efficient spectrum market

Auction design is particularly important in ensuring that market-based allocation secures the best use of spectrum in Australia because of the currently limited opportunities for subsequent trading. These spectrum rights are not perpetual and so far apply to only a small part of the spectrum. Stamp duties add to the costs of spectrum trades. Not surprisingly, the development of secondary markets has been limited to date.

Spectrum auction design needs to take account of the additional value that can accrue from owning adjacent licences, geographically or in bandwidth. Synergies in spectrum use arise from enabling the seamless roaming of mobile telecommunications, economies of scale (for example, from having fewer but more powerful base stations) and the productivity dividend from reducing the 'empty' space between adjacent bands which is needed to minimise unacceptable signal interference. Sequential bidding on individual lots of spectrum works against the realisation of spectrum synergies.

In a simultaneous ascending auction, bidders are free to bid on several lots at the same time and, while the auction is in progress, add new lots to the ones already held or switch between equivalent lots if one spectrum licence becomes too expensive. Design features of the simultaneous ascending auctions used for assigning spectrum have yielded additional benefits: they have generated more information about spectrum value, thereby promoting its efficient allocation and use; weakened incentives for overbidding through open, multi-round bidding; and discouraged collusive and predatory behaviour.

Nevertheless, while simultaneous ascending auctions permit bidders to achieve efficient aggregations of spectrum, they do not guarantee it. Combinatorial auctions would allow bidding on a package of spectrum lots on an all-or-nothing basis, thus allowing bidders the opportunity to acquire all the complementary licences they need to efficiently exploit synergies in spectrum use.

Source: PC (2002c).

Property rights have many dimensions

Commission research on the use of market-based mechanisms in the pursuit of environmental goals has demonstrated the importance of the design of property rights if such instruments are to be successful in generating desired outcomes.

In principle, governments can create a market for an 'ecosystem service' (such as salinity mitigation) by defining a new property right that is both linked to that service and can be sold. However, such a 'right' needs to be carefully defined. For example, 20 coal mines and two power stations have been allocated rights to discharge salty water into the Hunter River. These rights are conditional on river flow. At one extreme, no salty water can be discharged at 'low' flow times when

natural salt concentrations are highest. Conversely, there is no limit on saline discharge when the river is in flood, so long as protection limits for tributaries are observed. At other times, saline discharges are capped at the maximum set by the total (tradeable) salinity credits held by all participants in the scheme.

Property rights have varying attributes (box 1.3). The extent to which many of these approach the ‘ideal’ — such as for clarity of definition and enforceability of rights — will affect the efficiency of the particular market. However, some flexibility in property right design is necessary if markets are to evolve in response to improving technology and knowledge and changes in community preferences.

Box 1.3 Property right ‘ideals’ for market efficiency

- *Clear definition*: the nature and extent of the property right is unambiguous.
- *Verifiable*: use of the property right can be measured at reasonable cost.
- *Enforceable*: ownership of the property right, and the ability to exclude others from its use or enjoyment, can be enforced at reasonable cost.
- *Value can be established*: there are enough parties willing to purchase or sell the property right, there is no major imbalance in the information held by buyers and sellers and collusion is absent.
- *Transferable*: ownership of the property right can be transferred to another party at reasonable cost.
- *Manageable risk*: private interests are prepared to manage directly the risks associated with significant market, scientific or other uncertainties or can find ways of transferring all or part of the risk to other willing parties.
- *Minimal sovereign risk*: future government decisions are foreseeable or are unlikely to reduce significantly the value of the property right without compensation.

Introducing market incentives can be complex

Complex issues can arise when introducing market incentives into some other areas where resources typically have been allocated administratively by governments. In areas such as health, education, nursing homes and public housing, the aim is to ensure equitable access to services of acceptable standards as well as the efficient and effective provision of those services.

For example, a key consideration in assessing the scope for introducing ‘managed’ competition into Australia’s health sector — as some health experts have advocated — is whether the incentive structures for health service purchasers and providers can be designed to avoid them focusing on people with low health risks (so-called

cream-skimming) while people at high risk or with severe health problems fall between the cracks. (An analogous issue has arisen in the case of the Job Network.) Of course, current administratively determined health resourcing arrangements are already battling with their own set of perverse incentives — such as cost-shifting between the States and the Commonwealth and reward systems that have contributed to skill shortages, over-utilisation of already stretched resources, and over-provision of some services but rationing of others — all of which are working against efficient and equitable health outcomes.

Attention to the design and management of transitional arrangements are clear prerequisites for the successful introduction of market incentives. Given the uncertainties and community sensitivities, a series of incremental reforms may be more practicable than across-the-board change. Small-scale pilots can provide an opportunity for experimentation, appraisal and finetuning in advance of wider application. Australia's federal system lends itself to such experimentation, with jurisdictions learning from each other's experiences. Just as there are subtle variations in the workings of everyday markets, a 'one-size-fits-all' approach is unlikely to apply in the new areas.

Market mechanisms may need selective application

It may not always be either feasible or socially desirable to implement all the attributes of markets. For instance, the introduction of competition and choice may not require that prices be left entirely to market forces. Initially, some markets may be too 'thin'. Governments need to exercise care not just in how fast, but how far they move, especially where some impacts may be irreversible, as in the loss of biodiversity. The appropriateness of market approaches needs assessment case by case.

The delivery of active labour market programs, for example, has features that preclude the full operation of market forces and vitiate the role that competitive pricing and tendering normally play (box 1.4). Competitive tendering should enable the Government to choose suppliers that offer the best mix of price and quality. But in this market, price is not a reasonable guide to service quality as measured by the level of anticipated outcomes for the unemployed (PC 2002a). Moreover, the competitive tendering process has proved to be complex, disruptive to service continuity, time-consuming and expensive. Instead of persisting with the competitive price tendering element of a market approach to Job Network services, the Commission recommended that prices be set administratively and that licensing (based on accreditation criteria) be used to supplement normal market forces in the entry to and exit of providers from the Job Network.

In principle, the Job Network model could be extended to other labour market and social welfare programs delivered to individuals or community groups. Even if they cannot be applied comprehensively, payments based on outcomes, contestability among service providers and choice for clients could achieve better outcomes than systems managed administratively. However, case-by-case examination would be needed to weigh the advantages and disadvantages in particular applications. A prime consideration would be the extent to which a service was stand alone or part of a broader network of service provision.

Box 1.4 Challenges in adopting a market approach to employment services for disadvantaged job seekers

The Job Network does not operate like most normal markets because government must shape many aspects of the supply of and demand for job services. The government determines which services will be provided as well as which 'consumers' — unemployed people in receipt of welfare benefits — will 'purchase' these services. In this 'market':

- It is not appropriate or feasible for disadvantaged job seekers to exercise full sovereignty in their choice of labour market services. They are not free agents because they are required to abide by certain mutual obligations in order to access government benefits. Further, people experiencing long-term unemployment, or at risk of doing so, typically face disadvantages — such as poverty, low self esteem and poor motivation — that reduce their scope for fully informed choices. Some job seekers may face incentives to devote too few resources to looking for work or enhancing their employability because they receive welfare payments.
- Measurable outcomes do not incorporate all aspects of what an employment service should deliver. Contract specification is therefore incomplete, leaving open the possibility of strategic behaviour on the part of providers to focus their resources on job seekers who are most likely to achieve a payable outcome, but 'parking' (and further alienating) those whose probability of employment is low.
- Price competition cannot be given full reign. Job seekers are heterogeneous, with different skills, motivation and general readiness for work, many of which the existing diagnostic tool — the Job Seeker Classification Instrument — fails to pick up. Actual labour market outcomes depend on many factors, some random, beyond the control of service providers. Ex ante, the Government does not know exactly how much it is purchasing, what the overall quality of the service on offer is nor the trade-off between price and quality. To ameliorate this, the Government administratively set floor prices for the program which assists the long-term unemployed. Many providers have priced to this floor. Commission analysis showed that even those providers who won contracts with above-floor prices had much the same outcomes as those at floor prices, and some even had worse outcomes. In this market, price has provided little or no guide to quality.

Source: PC (2002a).

Charging for goods and services can provide signals to users about the costs of the resources involved in producing them, thereby ensuring efficient use. However, where the information products of government information agencies — such as the Bureau of Meteorology and the Australian Bureau of Statistics — have strong ‘public good’ characteristics or entail significant positive spillovers, cost recovery is inappropriate (PC 2001b). Such products should be funded through general taxation as part of an agency’s basic product set.

In the case of radiocommunications, some of the existing permits in the spectrum management regime have been difficult to re-design into exclusive rights to bandwidth and geographic space. Conversion of technically prescribed apparatus licences for transmissions between fixed points is complex, would lead to a reduction in the number of links that could be accommodated and would result in spectrum property rights of limited additional utility. Efficiency in spectrum use would be compromised. The Commission considered that some apparatus licences should be retained for the time being. In the longer term, it should be possible for a single spectrum licence to be granted over a broad geographic and frequency space, within which a private spectrum manager could coordinate multiple fixed links.

The costs involved in market creation can also constrain the reach of markets for biodiversity conservation and natural resource management. For example:

- Where environmental damage emanates from diffuse sources — such as in dryland salinity and terrestrial run-off from catchments — it may be impractical or very costly to monitor sources of pollution and establish a market for them. Likewise, a market instrument requiring property-by-property verification of biodiversity values would probably be too costly to implement on a large scale.
- Site-specific effects may cause difficulties in designing markets for dryland salinity, since the impacts of a given activity will vary according to factors such as soil type, slope, rainfall and location. The narrow definition of tradeable property rights to reflect site-specific effects could result in too few buyers and sellers for market efficiency.
- High scientific uncertainty associated with many aspects of biodiversity conservation can hinder effective market creation. For instance, tradeable offset schemes ostensibly allow one party to undertake activities that cause environmental harm, so long as this harm is offset against a credit earned by another party for increasing ecosystem services by at least an equivalent amount. However, the uniqueness of biodiversity, and often poorly understood biophysical relationships, make it costly to verify that like is replaced with like in offset schemes for biodiversity conservation. The experience with wetland offset arrangements in the United States is not particularly encouraging.

Governments can make better use of markets

Market mechanisms are not appropriate or feasible in all areas of the economy, and in others they take time to develop. However, the Commission's work shows that governments can do more to assist the development of new markets and to increase the effectiveness of existing market mechanisms. Given the complexities of introducing market dynamics into new areas, it is hardly surprising that things will not always be right first time round. Independent reviews provide an opportunity to check outcomes and assess the need for any finetuning of arrangements.

The Commission's evaluations have confirmed the value of the frameworks adopted in some non-traditional areas, but have also found ways in which governments can better harness market-based incentives by improving program design. To take two examples:

- The Commission considered that the effectiveness of the Job Network could be improved by enhancing a number of its market-like features. In particular, competition could be significantly increased, to the benefit of job seekers, by gradually removing the current quotas on the number of clients that can be serviced by providers. That way, the best Job Network providers would have ongoing incentives to promote themselves in ways which would increase their market share and better inform job seeker choice.
- Realisation of the dynamic benefits of market-based spectrum licences will be constrained eventually because the rights have a maximum duration of 15 years. Perpetual rights to these licences would increase their marketability. Competing users, new technologies and changing commercial opportunities would impose a market discipline on incumbents to use their spectrum rights efficiently, or to sell or lease them to others who can.

The Commission has also identified areas where markets and market mechanisms are being prevented from contributing as well as they might to the achievement of community objectives. Markets could play a much more important role, for example, in the conservation of biodiversity. But they are prevented from doing so by unnecessary constraints or uncertainties in Australia's land tenure arrangements, native wildlife and taxation frameworks and by the failure to apply competitive neutrality principles to public providers (PC 2001a, 2001c and 2002d).

- Pastoral lease arrangements that cover around 44 per cent of mainland Australia generally take a prescriptive approach to managing land use by, for example, specifying the type and level of stock that must be grazed. These arrangements constrain the emergence of non-pastoral land uses such as the conservation of native wildlife, the farming of livestock other than sheep or cattle, and eco-tourism.

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- Overly complex regulatory frameworks, ostensibly designed to conserve native wildlife, can mean that private interests have little incentive to undertake conservation. When they do, they operate under considerable management uncertainty and have increased operating costs. For example:
 - in most States, private sanctuaries have to obtain some wildlife licences not required of competing public providers and they face a broad range of regulatory controls on the keeping and trade of native wildlife; and
 - while public sector agencies and zoos have (limited) rights to undertake international trade in captive-bred native wildlife, commercial and private conservation bodies are excluded.
 - Taxpayers who manage their land solely for biodiversity conservation do not have access to a number of ‘up front’ tax deductions and concessions available to those who undertake conservation expenditures on land used for commercial purposes, including primary production.

A forthcoming Commission inquiry will provide an opportunity to review the impacts of native vegetation and biodiversity regulation on landholders and communities (Anderson 2002, Truss 2002b). The Commission is to assess the effects of State Government legislation and the Commonwealth’s Environment Protection and Biodiversity Conservation Act.

Further opportunities to examine appropriate roles for market mechanisms are likely to arise in the Commission’s research program. In the light of government priorities identified in the course of consultations on directions for its research, the Commission intends to give particular emphasis during 2002-03 to issues concerning:

- ageing of the Australian population — for example, connections with productivity, health, aged care and service delivery;
- environmental sustainability — for example, the appropriate design of policy to guide land and water management; and
- workforce transitions and dynamics — for example, education and training to meet the changing nature of work; the dynamics of job mobility, lifetime learning, productivity and workforce participation (PC 2002e).

The Commission already has a program of research in the health area. Following the Health Policy Roundtable, convened jointly by the Commission and the Melbourne Institute of Applied Economic and Social Research, the Commission organised a workshop of experts to discuss managed competition in health care (PC 2002f). A variety of similar proposals have been advanced to address perceived weaknesses in health care systems across a number of countries. The workshop examined practical implementation and transitional issues associated with the

‘Scotton model’ of managed competition for the funding and delivery of health care in Australia. Workshop participants were cautious about fully implementing this model, and suggested that a range of alternative, less ambitious approaches be investigated and assessed (box 1.5).

Box 1.5 Investigating options for health care reform

The general objective of the managed competition model proposed by Dr Richard Scotton is to use market incentives to increase economic efficiency, but within a framework which maintains equity and universal access in Australia’s health care system. Instead of governments both funding and providing services (such as hospitals), managed competition would separate the roles into: financing by government; competing public and private health service purchasers, bearing their own risks and organising health services on behalf of their clients; and competing providers of health care with whom purchasers would contract. The introduction of managed competition would therefore involve substantial and complex changes to current financing and delivery arrangements.

Many participants at the Commission’s workshop foresaw challenging implementation issues in such a ‘big-bang’ reform and considered that it would be preferable, at least in the short to medium term, to give priority to incremental reforms offering the prospect of clearer net gains and community support. Proposals for further investigation included:

- evaluating the merits of giving doctors, through the divisions of general practice, greater responsibility for purchasing medical services and pharmaceuticals for their patients;
- assessing the merits of giving regionally based, public non-competing purchasers the responsibility for purchasing a full range of health services for their residents;
- trialing managed competition by allowing people to opt-out of the current system to join a competing health care plan; and
- examining the scope to improve current re-insurance pooling arrangements for the elderly in the private health insurance sector by applying better approaches to risk management.

At a broader level, there would be value in undertaking a stocktake of existing and emerging problems within the health care sector and assessing the relative merits of different reform options in addressing these problems.

Source: PC 2002f.

In conclusion

Markets are powerful mechanisms for achieving efficiency and higher living standards. However, market instruments are unlikely to be suitable in some areas of the economy and may only become feasible in others over time, as technology and better information permit. That said, recent government initiatives illustrate how useful market-oriented approaches are proving to be in areas traditionally viewed as the preserve of government, either through allocating resources administratively or by direct service provision. Even imperfect market approaches can often deliver outcomes that are superior to the administrative systems they have replaced. Nevertheless, case-by-case assessment is needed.

As governments grapple with the imperative of improving the performance of Australia's education, health and community service systems, as well as meeting the challenges of salinity and biodiversity conservation, the Commission's work reveals a strong case for:

- removing unnecessary impediments to the development of markets;
- designing supportive institutional and regulatory arrangements necessary for market creation, where market approaches are suitable;
- experimenting with different forms of markets, adopting incremental reforms and small scale pilots, as appropriate; and
- periodically reviewing implementation and progress.

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