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Productivity Commission

COAG's Regulatory and Competition Reform Agenda: A high level assessment of the gains

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Publications Inquiries:
Media and Publications
Productivity Commission
Locked Bag 2 Collins Street East
Melbourne VIC 8003

Tel: (03) 9653 2244
Fax: (03) 9653 2303
Email: maps@pc.gov.au

General Inquiries:
Tel: (03) 9653 2100 or (02) 6240 3200

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Australian Government
Productivity Commission

GPO Box 1428
Canberra City ACT 2601
Telephone 02 6240 3202
Facsimile 02 6240 3300
www.pc.gov.au

From the Chairman's Office

29 June 2012

Mr David Tune PSM
Secretary
Department of Finance and Deregulation
John Gorton Building
King Edward Terrace
PARKES ACT 2600

Dear David

I have pleasure in submitting to you, as Chair of the COAG Taskforce, the Productivity Commission's 'high-level' assessment of reform areas specified in a request by the Secretary of the Treasury.

Yours sincerely

Gary Banks AO

cc. Dr Martin Parkinson PSM, Treasury

Foreword

The Council of Australian Governments at its April 2012 meeting agreed to the establishment of a cross jurisdictional Taskforce to advise on the development of a new regulatory and competition reform agenda. The Taskforce's report will inform development of a National Productivity Compact between governments (Australian, State and Territory) and business associations. COAG agreed that the Taskforce be informed by advice from the Productivity Commission.

The request to the Commission from the Taskforce was to undertake, by the end of June 2012, a 'preliminary high-level review' of the sixteen areas of reform identified by COAG.

In the six weeks available to complete this task, and consistent with the 'directions letter', the Commission has drawn on its existing reports and studies. Given the timeframe, it would not have been possible for the Commission to undertake the public processes that accompany a public inquiry or research study, nor to undertake new estimation and modelling. However, the Commission has been able to draw on a number of its public inquiry reports that are relevant to many aspects of this exercise.

The Commission's commentary is confined to the reform areas set out by COAG in its April communiqué. The analysis does not consider other reform areas.

The sixteen topics are diverse and range from 'best practice approaches to regulation' and 'energy market reforms' which would have broad ranging benefits for the economy, to more specific reforms that relate to specific sectors, such as 'explosives regulation'.

The analysis is far from definitive, reflecting among other things that not all topic areas have previously been examined by the Commission, and that some reforms are not well defined at this stage. Nevertheless, to assist the Taskforce and COAG, the Commission has provided indicative judgements about those reform areas likely to offer the biggest payoff.

Gary Banks AO
Chairman
29 June 2012

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The Commission's task

The request for the Commission to provide advice to the Taskforce was formalised through a letter from the Treasury Secretary on 11 May 2012:

> … the Taskforce has been asked to advise COAG on the likely costs and benefits of the reforms, drawing on high-level advice from the Commission … I would like to request that the Commission undertake, by end of June 2012, a preliminary high-level review of the areas of reform. (appendix A)

This review covers 16 topics nominated by COAG spanning an assortment of activities, markets, processes and practices (box 1). The six 'priority' reforms in group (a) originate from a submission by the Business Council of Australia to the recently convened Business Advisory Forum that held its inaugural meeting the day before the April COAG meeting. Matters in groups (b)-(d) had previously been identified by the Business Regulation and Competition Working Group (BRCWG) and the Standing Council for Federal Financial Relations (SCFFR). Four matters — occupational conduct (di), occupational licensing (dii), explosives (diii), and the National Construction Code (div) — emanate from COAG's Seamless National Economy (SNE) reform agenda.

The reform topics: a diverse collection

The nominated reform topics span several broad reform streams, including reducing regulatory burdens on business, reducing government administration costs, improving productivity, enhancing regulatory processes and guarding against backsliding of reforms already achieved. Reflecting this, the topics also vary considerably in scope. Best practice regulation (avi), for example, could affect most of the Australian economy, whereas the inclusion of gas fitting in the National Construction Code is of a different order of magnitude.

Box 1 **Areas specified by COAG for preliminary high level review**

(a) Six Priority areas for major reform to lower costs for business and improve competition and productivity …

(i) Addressing duplicative and cumbersome environmental regulation

(ii) Streamlining the process of approvals of major projects

(iii) Rationalising carbon reduction and energy efficiency schemes

(iv) Delivery of energy market reform to reduce costs

(v) Improving assessment processes for low risk, low impact developments

(vi) Best practice approaches to regulation

(b) Reforms … to reduce reporting burdens on business through the removal of overlaps in Commonwealth and State and Territory reporting obligations, including standard online reporting

(c) Reforms … as part of a new National Productivity Compact between the Commonwealth, States and Territories and business, to future proof national frameworks, including national regulatory principles, mechanisms to facilitate more consistent and efficient implementation and enforcement of regulation, and ex-post review of national frameworks

(d) Areas of reform identified by the Business Regulation and Competition Working Group and Standing Council for Federal Financial Relations

(i) Harmonisation of occupational conduct requirements

(ii) Further occupational licensing reform

(iii) Harmonisation of explosives legislation

(iv) Extension of the National Construction Code

(v) Land transport reform

(vi) Reforms to government services

(vii) Urban water reform

(viii) Tax reform

Source: Extract from the Treasury Secretary's 'directions letter'.

Notwithstanding supplementary material from COAG communiques and the BRCWG and SCFFR, some topics are not well defined at this stage. Reforms to government services (dvi), which potentially covers extensive government expenditures, could relate to better systems, data linkages and technology in order to reduce transactions costs; or, they could extend to more fundamental matters such as privatisation, contracting and procurement, pro-competitive legislation and competitive neutrality. For tax reform (dviii), the SCFFR material makes it clear that the intention in this reform agenda is not to extend much beyond administrative harmonisation of certain State and Territory taxes.

There are also some overlaps between reform areas and topics. For example, environmental regulation (ai) is germane to approvals for major projects (aii). And,

the demarcation between best practice regulation (avi) and 'future proofing' through more effective oversight mechanisms and institutions (c) is blurred. There are also close synergies between occupational conduct (di) and licensing (dii).

The Commission's approach

In the six weeks allotted to complete the task, and as indicated in the 'directions letter', the Commission has produced a paper based on its existing work. Given this limited scope, it has not conducted external consultations, nor has it provided any new estimates of costs, benefits or distributional impacts.

Reflecting this, coverage of the 16 topics is necessarily uneven. Some topics have benefited from recent comprehensive public reviews. For example, the Commission has been able to draw on its recent reports into carbon policies, urban water, planning and zoning, and SNE-related business regulation. Indeed, the Commission's 2006 report into road and rail provides a 'blueprint' for reform of land transport (dv). In other cases, the source material is more dated and often the Commission's reports only inform aspects of the topics — for example, its wide-ranging report on chemicals and plastics regulation raised governance issues in the broad rather than harmonisation of explosives regulation (diii) specifically.

The Commission also has reviews underway relating to the energy market (aiv) and regulation impact analysis (avi) and is yet to release draft reports. Further, the Australian Government has announced a forthcoming Commission inquiry into non-financial barriers to minerals exploration, and it appears that a review into assessment processes for major projects is also in prospect — such reviews would bear directly on (ai) and (aii).

For each of the topics the Commission has, to the extent feasible, briefly outlined:

- the nature of the problem and rationale for reform
- previously identified potential benefits of reform including, where available, quantitative estimates — in many cases, these estimates are partial and/or relate to 'slices' of the topic areas
- what has been achieved so far and what remains to be done
- the prospects and requirements for effective reform in the future, given transactions costs, implementation risks and political commitment across jurisdictions.

Interpreting the Commission's indicative judgements

To assist the Taskforce to identify areas likely to offer greater net gains and/or earlier opportunities from COAG's list, the Commission has endeavoured to offer broad qualitative judgements about the potential magnitude of the gains on offer and the time scale for these to be realised (table 1). These indicative judgements are shaped by perceptions of the significance of a prospective reform, the extent of clarity about its scope, the degree of confidence about the nature of the problem and the reforms required, and the prospects for effective remedial actions.

There is no pretence of precision in what is being provided. Rather, an ordinal scale of 'major', 'moderate' and 'minor' is used to indicate roughly the gains potentially on offer. Before a more quantitative estimation exercise might be contemplated, greater specification and evidence would be required, as well as time to obtain public input and feedback.

'Major' gains relate to areas where there are (potentially) broad and deep problems and commensurate scope for improvement. For instance, nationwide achievement of 'best practice regulation' would undoubtedly yield a significant boost to Australia's GDP. (For example, taking account of administrative burdens and also the costs arising from the effect of regulation on incentives, one estimate of the total cost of US regulations is around 8.5 per cent of GDP.) But if agreement to best practice were not reflected in actual regulatory practices, especially in key areas of regulation with pervasive effects across the economy, the benefits would obviously be much curtailed. As the judgements are to a large extent speculative, the Commission has not attempted to rank reforms.

The time scale for achievement of reforms in table 1 is denominated as 'short term' (5 to 10 years) or 'long term' (greater than 10 years). These judgements reflect the expected duration for realisation of gains *assuming effective implementation*. In relation to this, the experience of the SNE reforms suggests a cautious approach when contemplating the time taken to realise gains. Those reforms underscore the importance of recognising that implementation and transaction costs can initially loom large relative to the benefits over the longer term.

On balance, of the 16 areas identified by COAG, those that appear to offer 'major' prospective gains based on their breadth and scope — again assuming effective implementation — are:

- Energy market reforms (aiv)
- Best practice regulation (avi) and 'future proofing' (c)
- Land transport (dv)

- Government services (dvi).

Achieving genuine reforms in these areas would be a long term endeavour, requiring sustained action and oversight. That said, there is scope for staged implementation to deliver early incremental gains — for example, attaining commitment to improved regulatory practices [(avi) and (c)] and progressive introduction of pro-competitive reform, where warranted, for government services (dvi). There are also prospects for early 'down payments' (gains achieved in less than 5 years). For example, governments could proceed to rationalise those carbon reduction and energy efficiency schemes (aiii) that are clearly redundant or counterproductive under a carbon price regime — with positive outcomes for revenue.

Urban water reform (dvii) offers the prospect of significant net benefits. However, reforms may no longer have the scope to deliver as anticipated in the short to medium term, due to recent investments in capacity augmentation, notably desalination plants. Nevertheless, reforms to implement best practice institutional, regulatory and governance arrangements would still yield significant gains over time.

Achieving effective reform

Given that much 'front-end' work on defining and specifying the 16 areas remains to be undertaken, this paper tests the limits of how far the Commission can go in providing 'high level advice'. Based on the reviews that the Australian Government has announced recently, the need for more detailed preparatory work appears to have been recognised.

Abstracting from the 16 areas, the Commission has conducted reviews that provide more general insights into the conditions for successful reform and the also pitfalls in cross-jurisdictional agendas.[1] The critical success factors for the National Competition Policy (NCP) were agreement on: the main problem areas, the required policy approaches and, equally importantly, effective procedural and institutional mechanisms to implement them. In particular, the NCP highlighted the value of properly specified fiscal incentives and disciplines in securing reform milestones.

1 See: *'NCP and beyond: an agenda for national reform'* (Banks 2004); *Review of the National Competition Policy Reforms* (PC 2005d); *Potential benefits of the National Reform Agenda* (PC 2006a); *Identifying and Evaluating Regulation Reforms* (PC 2011e) and *Impacts of COAG Reforms: Business Regulation and VET* (PC 2012a).

Other salient lessons from past endeavours are that a manageable reform agenda should concentrate on areas where action is likely to bring substantial benefits and where achievement requires a COAG framework. These processes should be used sparingly given the downsides of overly cluttered agendas. Similarly, it is important to complete contemporary agendas before moving on to new ones — advancing cross-jurisdictional reforms places a heavy call on a limited pool of skilled people and the necessary public contributions depend on demonstrated achievement.

The Commission's more recent reports on identifying regulation reforms (PC 2011e) and the impacts of the SNE reforms (PC 2012a) reinforce these earlier assessments, pointing to the desirability of:

- having a coherent agenda focussed on significant reforms
- prioritising areas that are practical and achievable
- paying attention to the costs of developing and undertaking reforms and the timeframe required to achieve benefits
- recognising that harmonisation will not always be the right answer and that other options — such as opt-in regimes and mutual recognition — can yield gains earlier in some areas, without risking lowest common denominator compromises in model legislation.

Quantification of the costs and benefits of reform can provide useful information to policy makers. However, the information required for meaningful estimates on projections of likely impacts can be extensive. They include: having well defined reforms with broadly specified timeframes; comprehensive information on the affected sectors; an understanding of transmission mechanisms; and estimates of transitional, implementation and on-going costs. In reports where the Commission has included quantification, detailed and extensive consultation has been necessary to obtain this information, with judgements tested through public processes. The studies of the NCP, the National Reform Agenda (NRA) and the SNE each took around nine months to complete.

For those studies, computable general equilibrium modelling was used to assess the economy-wide impacts (including fiscal impacts) of reforms — this analytical approach is suited to substantial reforms, where there are flow-on effects to the rest of the economy, or where a number of sectors are directly affected. Quantitative studies of the SNE, NCP, and NRA suggest that, as a rule of thumb, around two-thirds of the fiscal dividend generated from structural reforms typically accrue to the Australian Government and one-third to State and Territory governments. The modelling generally assumes full and effective policy implementation and thus presents an 'outer envelope' for what gains might be achievable in practice.

Table 1 **COAG's 16 reform areas: 'judgements' on relative payoffs**

Reform area (scope adjusted)[a]	*Prospective gains (assuming reforms are well implemented)*[b]	*Time scale for realisation of gains (assuming effective implementation)*[c]	*Available quantitative estimates of relevance*[d]
Environmental regulation	Moderate	ST	• The investment pipeline over the next decade or so for the resources sector is estimated to be around $500 billion, of which $240 billion is at early stages and still subject to government approvals. • Previously the Commission cited a case where expediting the regulatory approval process for a petroleum project by one year would increase its net present value by 10–20 per cent. • The COAG reforms as announced are about streamlining processes with the same level of protection (no fundamental changes to the EPBC Act). • International benchmarking may identify greater opportunities for reform.
Major projects	Moderate	ST	• Compliance costs for large oil and gas projects can amount to 'millions of dollars'. More significant costs derive from delays, uncertainty, cost overruns, reduced flexibility, inflated capital costs, and difficulties financing projects. • The upstream petroleum sector accounted for around 2% of GDP in 2008. Reducing regulatory burdens could provide national income gains of billions of dollars per year.
Energy efficiency schemes	Moderate	ST	• Many of 230 identified policies, would not complement a carbon price — no benefit for significant budgetary outcomes. • Nine emissions reduction policies have acted to increase retail electricity prices by around 1-2%.

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Table 1 **(continued)**

Reform area (scope adjusted)[a]	*Prospective gains (assuming reforms are well implemented)*[b]	*Time scale for realisation of gains (assuming effective implementation)*[c]	*Available quantitative estimates of relevance*[d]
Energy reforms	Major	LT	• Investment in network infrastructure of about $42 billion in the National Electricity Market, and $3 billion in gas over the 5 years from 2009. • NEM's turnover in 2010-11 was $7.4 billion. • Even small price reductions would have significant impacts given the use of energy by all sectors of the economy.
Development assessment	Minor-Moderate	ST	• Benefits from completed development assessment reforms amount to $25 million per year, with prospective benefits of around $200 million per year. • Further benefits of $125 million per year are available if agreed code based templates are implemented.
Best practice regulation	Major	LT	• 'Best practice' reforms to reduce regulatory burdens were estimated in 2006 to lower business compliance costs by 20%, leading to a 0.8% increase in GDP or around $7 billion. • Full implementation of 17 of the SNE reforms aimed at reducing the regulatory burden on business could provide long run cost reductions to business of around $4 billion per year and increase GDP by nearly 0.5 per cent (around $6 billion per year). • Depending on the scope of reform, the gains would be larger.
Government reporting	Minor-Moderate	ST	• In 2009, record keeping requirements for OH&S (prior to harmonisation) imposed an average cost of around $900 per year on small and medium businesses. • The initial business case for implementing standard business reporting was based on cost savings of around $800 million. Despite substantial government investment, few gains have been realised. If scheduled implementation by the ATO proceeds successfully, take-up will build and gains could be in the order of $500 million per year.

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Table 1 **(continued)**

Reform area (scope adjusted)[a]	*Prospective gains (assuming reforms are well implemented)*[b]	*Time scale for realisation of gains (assuming effective implementation)*[c]	*Available quantitative estimates of relevance*[d]
Future proofing	Major	LT	• Potential gains linked to achieving best practice regulations. • Efficiency gains from previous reforms of regulation have been large — the Commission has estimated that real GDP was about 2.5% higher as a result of NCP reforms to utilities and infrastructure.
Conduct requirements	Minor	ST	• Conduct requirements can be a greater barrier to mobility than the need to obtain more than one licence.
Occupational licensing	Minor	ST	• Pro rata license costs for selected occupations ranged from $300 to $1000 per year in 2009. • Different licence categories, classes and sub-classes exist for some occupations.
Explosives	Minor	ST	• Industries affected by regulation include chemicals, mining, engineering and construction, and transport.
National Construction Code (NCC) — gas fitting	Minor on gas fitting — Moderate on the successful application of phase 1	ST	• Once the first phase of the NCC reform takes effect, business costs would fall by around $1 billion — or 1% of the value of residential and non-residential construction. Gas fitting would yield smaller savings. • In the first few years, the new code imposed transitions costs on business of around $30 million and governments were expected to incur transitional administration costs of around $5 million.

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Table 1 **(continued)**

Reform area (scope adjusted)[a]	*Prospective gains (assuming reforms are well implemented)*[b]	*Time scale for realisation of gains (assuming effective implementation)*[c]	*Available quantitative estimates of relevance*[d]
Land transport	Major	LT	• Productivity improvements and price changes in urban transport, ports and rail added 0.75% to GDP (2006). • More efficient road provision and regulatory improvements across road and rail could deliver a 5% improvement in transport productivity, leading to an increase in annual GDP of nearly 0.4% (2006). • A further 5% improvement in road transport productivity would be achievable from more fundamental pricing and institutional reforms, potentially leading to a further increase in GDP of 0.2%. • Harmonisation of rail safety regulations could deliver cost savings for rail operators of around $16 million annually (2012).
Government services	Major	ST/LT	• Expenditures on government services amount to around 8% cent of GDP. • For many services, some jurisdictions spend from 10-25% more than others in recurrent costs per unit of output. • A plausible 4- 5% improvement in total factor productivity in the delivery of health care services would translate to a cost saving of around $3 billion (2005-06) or 0.3% of GDP (2005-06).
Urban water	Moderate	ST— some potential benefits forgone	• Some recent investment decisions have impaired efficiency and reform scope. But adopting best practice in institutional, regulatory and governance arrangements and reforms to encourage the efficient use of existing water resources would still yield significant gains.
Business and State tax administration	Minor	ST	• There has been progress in harmonising the administration of payroll tax — with the potential to reduce business costs by around $30 million per year.

[a] Scope of topic adjusted based on the Commission's understanding of COAG's expectations — for example, 'tax reform' has been respecified as 'business and State taxes'. [b] Significance based on the scope given and a presumption that the full potential benefits on offer are achieved. [c] An expectation of whether the gains from reform might be achievable in the short term or long term. Such judgements can reflect inherent complexities, institutional rigidities, political will, whether 'rewards' are tied to milestones or outcomes, and track record of reforms to date. [d] Available estimates may reflect partial estimates or approximations of the scope of the potential reform. In some cases, only estimates of the magnitude of the activities in question are provided

1 Environmental regulation

1.1 Nature of problem and case for reform

Many large-scale investment projects in Australia are required to undergo environmental assessment and approval processes under both the Australian Government's *Environment Protection and Biodiversity Conservation Act 1999* (Cwlth) (EPBC Act) and relevant State or Territory environmental legislation. To varying degrees, these dual processes affect investments in key areas such as mining and exploration, transport infrastructure, residential and commercial development, and energy generation and supply.

Recent reports have highlighted inefficiencies that result from overlap and duplication between the EPBC Act and State and Territory environmental legislation (Hawke 2009; PC 2007a, 2009c, 2011f). Such overlap has been found to increase the administrative and compliance costs from meeting environmental standards, and contribute to delays in the progress of certain projects. These outcomes are despite legislative amendments in 2006 aimed at enhancing strategic approaches to environmental issues, and improving the efficiency of processing referrals under the EPBC Act.

COAG has committed to retaining the current level of environmental protection afforded by the EPBC Act and State and Territory laws. In considering changes to environmental impact assessments, its intent is to achieve the same level of protection at lower cost to proponents and the wider community. Related to environmental regulation, at its April meeting COAG also directed the Heads of Treasuries to scope possible benchmarking of major project development assessment processes against international best practice (COAG 2012).

Even small changes to investment costs and timing can appreciably impact on the returns to developments. Therefore, and given both the substantial amount of committed and prospective investment in large-scale projects in Australia, and the increasing number and complexity of referrals made under the EPBC Act, considerable economy-wide benefits could be realised from additional streamlining of environmental regulation.

1.2 Potential reform and possible gains

The Commission has previously identified an array of reforms that would help to streamline environmental regulation (PC 2004a, 2007a, 2009c, 2011f). While the Commission has not sought to quantify the potential gains from individual reforms, it has estimated that expediting the regulatory approval process for a major project by one year could increase its net present value by 10-20 per cent (PC 2009c). Although these calculations were made in the specific context of petroleum operations, they do suggest that the benefits from complete and successful reform would be substantial, especially considering the size of the investment pipeline in Australia. For the resources sector alone the investment pipeline is estimated to be close to $500 billion, of which $240 billion is made up of projects that are at an early stage and still subject to government (and business) approvals (BREE 2012).

In its response to the Hawke (2009) review, the Australian Government recently flagged a number of changes to the operation of the EPBC Act that, if successfully implemented, could deliver benefits to proponents and the economy more broadly (DSEWPC 2011). Of these, COAG has placed particular emphasis on:

- strengthening Australian Government accreditation arrangements for State and Territory environmental *assessment* procedures
- introducing bilateral agreements that accredit the States and Territories to make binding *approval* decisions on EPBC Act matters.

Assessment processes

Strengthening the accreditation arrangements for State and Territory environmental assessment procedures could help to streamline the regulatory process by increasing the robustness of current bilateral agreements. In particular, more comprehensive accreditation could reduce the number of instances where — despite the existence of a bilateral agreement — a State or Territory assessment procedure does not fulfil all EPBC Act requirements, requiring the action to undergo a second assessment (PC 2011f).

In a report for the Department of Sustainability, Environment, Water, Population and Communities, Deloitte Access Economics (2011) estimated that improved assessment bilateral agreements would deliver net benefits in the range of $400 million over 10 years. The Commission has not tested the assumptions underpinning this evaluation. As recognised by Deloitte, predicting benefits from these sorts of reforms is inherently difficult. For example, it is unclear whether strengthening accreditation arrangements would substantially lengthen State and

Territory assessment processes, and so limit the total amount of time saved from only undergoing a single procedure. The upshot is that these sorts of figures should only be viewed as rough indicators of the benefits from reform. Nonetheless, the relatively low costs involved, and the fact that assessment bilateral agreements have already been used, suggests that there would be net benefits from these changes.

Approvals processes

Bilateral agreements may be further extended by accrediting State and Territory governments to make binding approvals decisions in relation to EPBC Act matters — removing the direct decision-making role of the Australian Government. Such a 'one-stop shop' approach could streamline environmental regulation and reduce uncertainty for proponents. But in practice the scope to use bilateral approvals processes may be limited, especially given that the intent of the EPBC Act is to provide a final 'check and balance' on matters of national environmental significance (PC 2009c). In proceeding down this path, a number of factors merit consideration, including:

- the extent to which existing State and Territory procedures can be cost-effectively adapted to satisfy the Australian Government's obligations under the EPBC Act
- the possibility of greater legal action against approvals decisions under bilateral agreements, particularly if opponents to specific developments are unsatisfied with State and Territory processes
- the aim of the Australian Government to improve the processes for public participation under the EPBC Act (DSEWPC 2011).

Critically, although bilateral approvals processes are intended to decrease the level of uncertainty associated with environmental regulation, poorly designed agreements may increase uncertainty for proponents.

Despite these cautions, and as previously stated by the Commission (PC 2009c), there are likely to be circumstances where bilateral approvals processes could usefully be applied. These include where the relevant State or Territory has developed adequate local experience and knowledge, there are well-defined or limited environmental risks involved, or there is already a rigorous environmental management plan in place.

Other measures

Improved arrangements relating to bilateral assessment and approval agreements are unlikely to be panaceas for achieving full investment certainty and streamlining of environmental regulation. To this end, the Australian Government has also flagged a number of other areas for potential reform in its response to the Hawke (2009) review (DSEWPC 2011). The implementation effort required for these measures is likely to be similar to those required for bilateral agreements. Some of the proposed reforms that the Commission has previously commented on involve:

- an increased emphasis on strategic assessments and regional environment plans (PC 2009c, 2011f). Such processes can establish ground rules for what projects would be acceptable in a given environmental context, thereby negating the need (in at least some cases) for assessments of individual development proposals. For the greatest gains, strategic or regional assessments should be conducted before proponents begin assessing particular investments
- the further development of guidelines on matters of national environmental significance (PC 2007a, 2009c, 2011f). A long-standing confusion among proponents as to what constitutes a matter of national environmental significance (and hence whether the EPBC Act is likely to be triggered) suggests that extending the work already done in this area by the Australian Government would be a straightforward way to further improve the functioning of the Act. Related to this, the Commission notes that the Australian Government has announced its intention to make publicly available the departmental recommendation reports for the Minister's decisions under national environment law
- producing a single national list of threatened species and ecological communities (PC 2004a, 2011f). The need for all developers to consult two lists (one each for the Australian Government and the relevant State or Territory) creates unnecessary duplication and confusion.

1.3 What has been achieved

Changes to environmental regulation in Australia previously occurred in 2006, when amendments to the EPBC Act were made. These changes were mainly aimed at streamlining the regulatory process, improving the level of cooperation between the Australian and State and Territory governments on assessments and approvals, and increasing the capacity and incentives to undertake strategic assessments, regional environment plans and conservation agreements.

To date, these changes have not led to the widespread use of bilateral agreements or strategic assessments. Nevertheless, the previous amendments to the EPBC Act have provided the framework for increased use of these processes, making legislative change unnecessary for driving their wider adoption.

1.4 Achieving effective reform in the future

Effective reform to environmental regulation will partly rely on assuring concerned stakeholders that any associated changes to assessment and approval processes would not compromise conservation objectives. Otherwise, there is a risk of increased uncertainty for proponents arising from higher rates of appeal — a factor that is particularly pertinent in negotiating bilateral agreements that accredit the States and Territories on EPBC matters. In certain cases, using joint assessment panels may be helpful or necessary.

There is also scope to improve environmental regulation via reform to relevant State, Territory and local government procedures (see section 2). Indeed, the Commission has previously found that environmental approvals under State, Territory and local government planning arrangements have appeared to be a significant source of delays and complexity (PC 2009c). (The Commission will have further opportunity to examine such processes across all levels of government in its upcoming review into non-financial barriers faced by exploration companies (DRET 2011).) This suggests that any changes aimed at devolving responsibility to the States and Territories may best occur on an incremental basis, perhaps by initially allowing approval responsibility on simpler processes or smaller (and therefore less contentious) development proposals.

2 Streamlining the process of approvals for major projects

2.1 Nature of problem and case for reform

Businesses seeking approval for major projects continue to raise concerns about lengthy, uncertain and complex approval processes. The Business Council of Australia (BCA 2012a) recently cited the case of a member company seeking approval for a major resource project where the environmental assessment for the project took more than two years, involved more than 4000 meetings, briefings and presentations and resulted in a 12 000 page report.

A number of Commission studies have also found evidence of complex approval processes for major projects and unnecessary costs imposed on businesses because of duplicative reporting requirements.

- In the early 1990's, the Commission found that drawn-out approval processes imposed substantial costs, delays and uncertainty for major construction and mining/mineral processing projects (IC 1991a,c).
- The 2007 *Review of Regulatory Burden on Business: Primary Sector* and the 2009 *Review of Regulatory Burden on the Upstream Petroleum (Oil and Gas) Sector*, found evidence of unnecessary regulatory burdens and onerous reporting requirements for major primary industry and oil and gas projects. The oil and gas review presented a number of case studies to illustrate the number of approvals required, the complexity of the approval process and the number of agencies involved in various types of projects — one large liquefied natural gas project required around 390 approvals. Approval for building another gas production facility involved 35 separate agencies (operating at the Australian, State and local government levels).

The Commission found that while compliance costs for large and complex oil and gas projects could amount to millions of dollars, the more significant costs were those associated with unnecessary project delays and uncertainties that led to increased project expenditures, reduced flexibility for responding to market conditions, inflated capital costs, increased difficulty financing projects, and reduced present value from resource development (PC 2009c).

2.2 Potential reform and possible gains

The Commission found that reducing unnecessary approval delays for major projects in the oil and gas sector could have significant payoffs. While noting that it was impossible to quantify precisely the aggregate cost impact of unnecessary regulatory burdens delaying and discouraging investment in the upstream petroleum sector (as judgements are required about which procedures are necessary and which are not), the Commission estimated that expediting the average approval process for a major project by one year could increase the net present value of projects by 10-20 per cent by bringing forward income streams.

Given the size of individual projects in the sector at the time and the pervasiveness of regulatory delays, the Commission considered that the potential benefits from reform were significant. With the upstream petroleum sector accounting for around 2 per cent of GDP at that time, reducing the regulatory burdens in this sector were estimated to provide income gains for Australian residents in the billions of dollars each year (PC 2009c).

Any estimates of benefits from reducing delays are obviously sensitive to the number of projects being delayed unnecessarily and the additional costs incurred, as well as other parameters (such as the discount rate). Estimates accordingly vary considerably. The Business Council of Australia recently reported that there is a pipeline of $921 billion committed and prospective investment opportunities in large-scale projects in Australia (42 per cent of the projects are under construction, 7 per cent 'committed', 21 per cent 'under consideration' and 30 per cent 'possible' — BCA 2012b). For the resources sector alone, the Bureau of Resources and Energy Economics estimate the investment pipeline to be close to $500 billion, of which $240 billion is made up of projects that are at an early stage and still subject to government (and business) approvals (BREE 2012).

The Commission's 2011 benchmarking study on *Planning, Zoning and Development Assessments*, revealed differences in assessment and approval practices across jurisdictions (including variations in 'how' major projects are assessed, the criteria for triggering alternative assessment paths, the basis for referral to specialist government agencies, the way referral responses are coordinated and the time allowed for responses) and identified model practices for Australia's planning systems. While the benchmarking study did not identify detailed reform options, it suggested that if the following model practices were extended more widely there could be significant gains:

- early resolution of land use and coordination issues

  - determine as much planning policy as possible early in the planning-to-approval chain and obtain commitments to undertakings
- engaging the community early and in proportion to likely impacts
  - greater clarity around community preferences, and explaining plans in terms of optimising the overall community welfare is likely to gain greater acceptance
- broad and simplified development control instruments
- rational and transparent allocation rules for infrastructure costs
- improving development assessment and rezoning criteria and processes
  - through linking development assessment requirement to their objectives, using risk-based approaches for assessing development projects, facilitating the timely completion of referrals, adopting practices to facilitate the timely assessments of applications and access to relevant information, and providing transparent and independent alternative assessment mechanisms
- disciplines on timeframes
  - more extensive use of timeframes for planning processes to provide better discipline on agencies and give developers more certainty
- transparency and accountability in planning decisions (PC 2011f).

The Commission's draft benchmarking report on *The Role of Local Government as Regulator* also suggested that standardised templates that clarify the responsibilities of each level of government and guide local government involvement in the development and regulation of mining and extraction industries (previously recommended in PC 2009c) constituted leading practice and could be applied to other industries:

> This approach would appear to have general application to any area where more than one level of government is involved and the possibility of confusion over responsibilities is relatively high. (PC 2012d, p. 472)

2.3 What has been achieved

All jurisdictions have recently undertaken some planning system reforms (including revising and amending planning legislation) or continue to have some reform initiatives underway (PC 2011f). The Commission noted leading practice planning approaches being adopted by various jurisdictions including:

- a single agency to coordinate multiple agencies — South Australia's approach of having referral requirements collectively detailed and located in 'one place'

- applying binding timeframes, with limited 'stop the clock' provisions to the decisions made by referral bodies — New South Wales, Victoria, Queensland, South Australia and the ACT have all established timeframes in which referral bodies must respond to referrals
- having memoranda of understanding between referral bodies and planning authorities regarding what advice will be provided by referral bodies and how that advice will be dealt with by planning authorities (PC 2011f).

As discussed in section 1, some progress has also been made in streamlining environmental and approval processes by implementing bilateral agreements which allow for a single environmental assessment process (otherwise requiring the assessment at both the Australian and relevant State or Territory government level) and strategic assessments which allow potential impacts across an entire landscape to be assessed before development begins, rather than looking at individual projects on a case by case basis (BRCWG 2012; PC 2011f).

2.4 Achieving effective reform in the future

The challenge of improving the efficiency of major project approvals and providing more predictable timeframes and process certainty (without compromising the integrity of planning and assessment), should not be underestimated. Any reform conducted in a multi-level regulatory governance context is complex, and in relation to planning and assessment, the Commission said:

> The regulations and agencies involved in planning, zoning and development assessment constitute one of the most complex regulatory regimes operating in Australia. This regulatory system is not like most other regimes which have a clear delineation between policy making, regulation writing and administration. (PC 2011f, p. XXVI)

Also that:

> While COAG and its many ministerial councils may provide the best option for improving coordination, the challenge is major for both harmonisation of planning and its implementation. (PC 2011f, p. 390)

The Commission also pointed to the need for political commitment if reform in this area was to be achieved in the oil and gas sector:

> … strong political will and leadership will be essential if meaningful improvement in the way this sector is regulated across multiple jurisdictions is to be successfully implemented, and sustained. (PC 2009c, p. XX)

The scale and complexity of many major projects mean that approvals for such projects will continue to involve extended time periods and many agencies. The

assessment approval task also appears to be becoming more complicated, with a growing number of issues and policy agenda impacts on land-use considerations, and higher expectations relating to public and stakeholder involvement. COAG has tasked Heads of Treasuries with providing advice on a proposal to benchmark Australia's major project development assessment processes against international best practice. Should such a review occur, it could shed further light on necessary steps to advance reform in this area.

3 Carbon reduction and energy efficiency schemes

3.1 Nature of problem and case for reform

The introduction of the carbon pricing mechanism on 1 July 2012 brings into sharp relief the status and contribution of pre-existing policies that also aim to reduce greenhouse gas emissions and/or improve energy efficiency. The Commission identified around 230 such policies at the Australian, State and Territory government level in 2011 (PC 2011b). Many of these policies impose material costs on the community for little or no benefit.

These policies fall into three groups:

- Policies that could deliver abatement in addition to what would have been achieved through the carbon price, but at a higher cost than the permit price. (This could apply during the initial fixed-price period, or once the scheme is operating as an emissions trading scheme if policies lead to high-cost abatement in sectors that are not covered by the carbon price.)
- Policies that will deliver no additional abatement, but will change the mix of abatement and impose additional costs. (This will be the case for policies that apply to sectors covered by an emissions trading scheme.)
- Policies that may complement the effects of the price mechanism by:
  - addressing any particular lack of incentives to conduct research and development into low-emissions technologies beyond what generic assistance can ameliorate (not subsidies for demonstration or deployment stages)
  - providing information on energy efficiency opportunities
  - requiring disclosure of energy efficiency for some types of products
  - exploiting low-cost abatement potential in sectors not subject to carbon pricing (PC 2008d).

The policy objective should be to achieve abatement at the lowest possible cost (PC 2011b). Hence, in the presence of a systemic carbon price, policies in the first two groups should be terminated. Policies that fall into the third group should be

rigorously assessed to determine whether they deliver net benefits to the community.

3.2 Potential reforms and possible gains

Based on this taxonomy, there would appear to be material benefits from terminating schemes such as:

- mandatory renewable energy targets (RETs)
- feed-in tariffs
- support for low-emissions technology demonstration plants
- mandating minimum energy performance standards for products
- subsidies, incentives or mandates for investment in energy efficiency
- energy efficiency target schemes
- requirements for reporting energy use and energy efficiency opportunities (PC 2008d).

If contractual obligations prevent governments from terminating these programs, they should seek to 'minimise' the schemes, to reduce their costs to the extent possible.

Possible gains

Many policies in this area increase costs for electricity producers. Terminating these policies would flow through to lower retail prices with pervasive effects throughout the economy. The Commission (PC 2011b) analysed the effects of nine emissions-reduction policies on retail electricity prices.[1] It estimated that these policies increase retail electricity prices by around 1–2 per cent. This estimate is similar in magnitude to estimates published by the Australian Energy Market Commission (2011), but lower than recent estimates by IPART that around 7 per cent of NSW retail electricity prices in 2012-13 will be due to carbon reduction schemes (not including the carbon price) (IPART 2012).

Emissions-reduction and energy efficiency policies also impose material regulatory burdens on businesses. In its series of reviews of regulatory burdens on business,

[1] The Commonwealth Renewable Energy Target (RET), six State and Territory feed in tariffs for domestic solar panels, the New South Wales and ACT Greenhouse Gas Reduction Scheme and the Queensland Gas Scheme.

the Commission has identified a number of concerns (PC 2007a, 2008a, 2009a). The main concerns raised by stakeholders have related to the multiplicity and inconsistency of programs, and the costs of reporting greenhouse gas emissions and energy use. Terminating these schemes could reduce regulatory burdens.

Reform in this area could also deliver significant budgetary savings. Numerous schemes provide subsidies to low-emissions technologies and/or for expenditure on energy efficiency measures. It is likely that many of these schemes would not be complementary to the carbon price in the sense of 'buying' additional abatement.

3.3 What has been achieved

There has already been some rationalisation of programs in this area, through COAG and the actions of jurisdictions. It is likely that these reforms are delivering (or will deliver) material benefits. Recently terminated programs include:

- the Victorian emissions-reduction target
- the Queensland Solar Dawn project ($75 million), the Queensland Climate Change Fund ($430 million), Renewable Energy Fund ($50 million) and Smart Energy Savings Program ($50 million), along with other smaller schemes.

Other schemes have been modified:

- Some feed-in tariff schemes have been closed to new participants (in New South Wales, the Victorian 'premium' scheme, in Western Australian and the ACT).
- Some feed-in tariffs have reduced rates for new customers (Victoria's transitional tariff an in South Australia).

Some schemes are scheduled for termination:

- the New South Wales and ACT Greenhouse Gas Reduction Scheme (to be terminated on 1 July 2012 when the national carbon price scheme begins)
- Victorian requirements for greenhouse gas emissions reporting
- the Queensland Government has announced its intention to transition the Queensland Gas Scheme into a national emissions trading scheme.

Further options for reform

It is likely that the majority of the 230 policies identified by the Commission (PC 2012g) would not be complementary to a carbon price. An examination of the major schemes' relative cost effectiveness would identify those for abolition, or

reform if that is not possible (for example, due to long term contracts). Numerous smaller programs in this area are due to expire over the next 2–3 years. It would follow that their extension would need to be predicated on them being shown to be complementary to the carbon price and delivering net benefits to the community.

Many of the policies that impose the largest costs are presently scheduled to continue after the introduction of the carbon price (PC 2011b). A review of specific RET scheme issues has been conveyed by the COAG Select Council on Climate Change to the Climate Change Authority as an input into a statutory review of the RET. However, this review does not address the fundamental issue of complementarity.

The Australian Government Energy Efficiency Opportunities program also imposes significant regulatory burdens — the regulatory impact statement for the program suggested the annual compliance costs for an electricity generator could be as high as $200 000 (Access Economics 2011). It should be independently evaluated to assess whether it will deliver a net benefit to the community in the presence of a carbon price. Likewise, State-based requirements for emissions and energy reporting impose significant regulatory burdens (PC 2008a), and should be reviewed with a view to termination.

3.4 Achieving effective reform in the future

The most costly policies in this area have been identified and the case for reform largely established. These include the RET, the Energy Efficiency Opportunities program, State and Territory feed-in tariffs for solar power and various energy use reporting schemes. The proposed National Energy Savings Initiative (which would oblige energy retailers to identify and implement energy savings in homes and businesses) would also be likely to impose significant costs but would deliver no additional abatement under an emissions trading scheme.

Where reforms remove a benefit previously received by a section of the community, calls for compensation are common. For example, some State and Territory feed-in tariff schemes granted preferential tariffs for many years. While the ‘first best’ reform would be to terminate these schemes for all participants, some jurisdictions have continued to pay tariffs to existing participants, while closing the scheme to new participants (or paying them a lower tariff). This means that the scheme will only phase out over time, prolonging its costs, but governments can avoid up-front compensation.

4 Energy reforms to reduce costs

4.1 Nature of problem and case for reform

The prime concerns of stakeholders in energy, many of which were reflected in the Government's Energy White Paper (DRET 2011), are:

- the impacts of carbon abatement and renewable energy policies on electricity costs for customers
- regulatory barriers to the exploration for, and extraction of, new energy resources
- the efficiency of electricity network businesses — mainly comprising substations, poles, trenches and electric wires that transport power from generators to customers
- the extent to which there is sufficient investment in interconnectors, the high voltage transmission lines that allow trading in power between the regions in the National Electricity Market (NEM)
- continued price controls in energy retail markets
- energy security issues.

The carbon abatement (and associated energy efficiency) issues are discussed in section 3. The energy security issues have not been looked at by the Commission to date. The Commission is scheduled to undertake an inquiry into the non-financial barriers to minerals exploration in the second half of 2012 (DRET 2011) and accordingly, the nature and severity of the problem, and the options for reform have not been assessed. The Commission has undertaken previous work on the operation of retail markets. It is also currently undertaking an inquiry into aspects of electricity networks in the NEM.

Electricity networks have been identified as a potential reform area because of their substantial influence on electricity prices and their low recent productivity growth rates (as identified in a recent Commission staff working paper by Topp and Kulys (2012)). In 2009-10, the costs of network services represented between 40 and 50 per cent of a typical annual household electricity bill (AER 2011). Apart from Victoria and the ACT, network costs have been the largest recent contributor to

price increases (AER 2011; AEMC 2011). For example, in NSW, network costs accounted for 80 per cent of the price increase in 2010-11.

There are several conflicting explanations for the measured productivity changes and high prices.

On the one hand, these may originate from inefficient management of peak demand (noting that a substantial share of new investment is required to meet a few hours of high temperatures each year); excessive reliability standards that mean that systems have levels of redundancy that do not match customers' preferences; general incentives for over-investment; and high regulated payments for assets. The Australian Energy Regulator and user groups claim that there are flaws in the current national electricity rules that have led to these outcomes and are seeking changes. Two recent studies have also claimed that State-owned businesses are much less efficient than privately owned businesses, raising the issue of ownership as a factor (Mountain and Littlechild 2010; Mountain 2011).

On the other hand, significant investment may be required to replace infrastructure that is reaching the end of its economic life. Many network businesses also dispute that their demand management and reliability standards are inefficient. In this context, it should not be assumed that low prices are always desirable, since they can discourage needed investment and access to finance.

In the case of interconnectors, Ross Garnaut has claimed that there is inadequate investment, a result he ascribed to fragmented and parochial transmission planning, market design flaws and other regulatory failures (Garnaut 2011). If true, this would lead to excessive differences in prices in different regions and inefficient investment in higher-cost generation.

However, these matters have not yet been resolved. The Australian Energy Market Commission (AEMC) is conducting multiple reviews into the issues, while the Standing Council on Energy and Resources (SCER) has initiated an independent assessment of the limited merits review regime that applies to the AER's regulatory determinations (with the review process also influencing price and investment outcomes). The AER is reviewing the data needed to support better regulation. State regulators (such as IPART in NSW) regularly review retail prices. The Commission has received first round submissions in its inquiry into these issues. With its draft report due in September/October 2012, the Commission cannot comment at this point on whether the various claims about problems in electricity networks and the scope for reform have validity.

In the case of retail price regulation, the main concern is that price ceilings discourage retail competition, service innovation and the use of price menus to

reward customers that use power outside peak demand times. The Commission has recommended that, where the AEMC has found that a jurisdiction's retail energy market is fully contestable, the government concerned should remove all retail price regulation (PC 2008c). The Commission recommended that ensuring disadvantaged consumers could access affordable utility services should be pursued through transparent community service obligations and other, more targeted, mechanisms.

In relation to consumer protection, the Commission recommended that the (then) Ministerial Council for Energy should, in the long term, aim to agree to a single national consumer protection regime for energy services, and in the short term that new non-price regulatory requirements be implemented with minimal jurisdictional variation.

4.2 Potential reform and possible gains

If there are large network inefficiencies and excessive regulated prices, then there would be major resource savings and national benefits from lower electricity prices. This reflects that electricity is an important input into many industries, and accounts for a significant share of household spending, especially for poorer households.

A major Victorian distributor estimated that reform could increase network industry productivity rates by two per cent per annum (United Energy 2012). There might be scope for more efficient levels of network reliability across the NEM by taking into account the actual cost of outages to customers. Mountain and Littlechild (2010) estimated that Victorian network providers were twice as productive as their NSW counterparts, though this has been disputed. Either way, even small price reductions would have significant national impacts given the value of electricity demand (the NEM's turnover in 2010-11 was $7.4 billion) and the scale of investment in network infrastructure — some $42 billion in electricity and $3 billion in gas over the 5 years from 2009 (AER 2011).

To the extent that intra-jurisdictional network investment is too great, interconnector investment too low and average prices too high, consumers would gain overall from reforms. However, there would be losers from some reforms; for example, lower dividends from electricity network businesses were the AER to push prices lower. Moreover, were the price of power during peak periods to reflect the real costs of supply, then consumers who continued to use power during these periods would pay higher bills than those whose use was weighted to cheaper off-peak times.

4.3 What has been achieved?

The framework for reform is generally in place. The NEM (which excludes Western Australia and the Northern Territory) has been created. It comprises an independent rule maker (the AEMC), an independent regulator (the AER), an independent planner and operator (the Australian Energy Market Operator — AEMO), an independent review body (the Australian Competition Tribunal) and the determination of broad principles by the relevant ministers from all jurisdictions (the SCER). The AEMC has the capacity to investigate any matter put to it and to amend the National Electricity Rules without any requirement for parliamentary endorsement.

Broadly similar governance arrangements (including the involvement of the AEMC, AER and AEMO) apply to the gas market in eastern and southern Australia. In 2010, Western Australia became a limited participant under the National Gas Law.

Other reforms achieved in the gas sector include:

- substantial competition reforms under the National Competition Policy program, including the National Gas Access Code
- implementation of the National Gas Bulletin Board, the Gas Statement of Opportunities and the Short-Term Trading Markets (to improve the transparency and competitiveness of the eastern gas market)
- in response to the Commission's Upstream Petroleum report, the Ministerial Council on Mineral and Petroleum Resources agreed to 25 of the Commission's 30 recommendations (the implementation of which is now monitored through COAG). Separately, the Commonwealth established the National Offshore Petroleum Safety and Environmental Management Authority on 1 January 2012 which regulates Commonwealth waters and safety issues in all States except Western Australia.

In the case of retail pricing, the AEMC is conducting a series of reviews of the effectiveness of competition in retail markets. It has completed reviews into the electricity and gas retail markets in South Australia and Victoria, and the electricity market in the ACT. While Victoria has already deregulated its retail market, both South Australia and the ACT did not accept the AEMC's recommendation to deregulate prices. In June 2011, the SCER announced that future reviews would be: New South Wales in 2012, Queensland in 2013, South Australia in 2015, the ACT in 2016, and Tasmania no sooner than 18 months after full retail contestability is implemented. (The Tasmanian Government has responded to a 2012 report issued by an expert panel on the electricity supply industry by announcing full retail competition from 1 January 2014.)

Regarding consumer protection, the National Energy Customer Framework is scheduled to come into effect on 1 July 2012. This provides a framework for national energy retail regulation, with the AEMC obtaining responsibility for the national energy retail rules.

4.4 Achieving effective reform in the future

While the framework for reform of gas and electricity regulation is largely in place, reliability standards are still under the control of the relevant jurisdictions, and there is currently no common view on the direction of policy change in this area. Changes to State ownership is a matter for the jurisdictions concerned, and remains an area of considerable public debate.

However, the existence of the SCER provides an ongoing basis for discussion on these matters, and some issues relating to reliability are already under review by the AEMC. Moreover, the Productivity Commission inquiry and other reviews should also assist future reform. Given that these multiple reviews are under way, the Commission cannot yet draw conclusions about the desirable direction of reform in electricity network regulations and, therefore, cannot comment on the extent of potential benefits in this area.

It is important not to exaggerate the scope for achieving rapid reform benefits. There would be significant delays in realising any major gains from reforms, since many businesses are already covered by regulatory agreements that last five years, and lock in past determinations by the AER. Moreover, the regulatory arrangements are effectively structured as long-term contracts, so that the AER provides a regulated rate of return on existing assets for their full lives (often 40 years or more), regardless of whether those assets represented efficient and prudent investments at the time they were made, or remain economically viable. Even were that arrangement changed, it would increase the risks for network businesses and would push up the cost of capital for new investments (this could offset, to some degree, the gains available from other reforms).

However, changes to retail regulatory settings could be implemented more rapidly, and have impacts in the shorter term.

5 Improving assessment processes for 'low risk, low impact' developments

5.1 Nature of problem and case for reform

Delays in obtaining planning approval from the relevant assessment authority (typically local councils) have been of concern to developers and their representative bodies for a long time. Planning approval delays can lead to significant costs for business including increases in land holding costs, lost or delayed revenue streams, interest costs, higher input costs (on materials and labour) and contractual penalties for exceeding agreed delivery times (PC 2011f). In some cases, the likelihood of delays may even prevent certain projects from proceeding in some locations.

At the same time, any requirement to treat all planning applications equally, regardless of their complexity and risk/impact on the surrounding environment, would pressure the available resources of local councils. Importantly, the planning approval process ensures that the interests of the wider community (not just developers) are considered in making decisions about whether, and under what conditions, proposals should be allowed to proceed. Hence, the planning process seeks to protect existing residents and land holders from the adverse consequences that may arise from the proposed development.

The development industry argues that 'low risk, low impact' proposals should be considered against clearly defined codes and requirements as a way of speeding up the approval process of more straightforward developments and reducing compliance costs. In response, COAG has endorsed code-based assessment and internet-based electronic lodgment, assessment and tracking systems (eDA). At its April 2012 meeting, COAG discussed progress on these reforms and:

> Premiers and Chief Ministers agreed to consider adopting ambitious targets to improve development assessment processes for discussion at the next Business Advisory Forum. (COAG 2012, p. 3)

5.2 Potential reform and possible gains

The Commission's recent report on the *Impacts of COAG Reforms* (PC 2012b) found that greater use of code-based assessments and eDA processing has the potential to reduce costs to development assessment by:

- lowering compliance costs (costs associated with preparing, submitting and providing supporting material)
- shortening approval times and providing greater certainty about lead times for development (which can reduce holding costs associated with the time taken to obtain development approval).

The Commission estimated that national rollout of eDA processing and accelerated use of code assessment would provide ongoing cost savings to business of around $350 million per year (2010-11 dollars) and reduce costs to government by around $50 million per year (table 5.1). These benefits would be balanced against some additional system administration costs and one-off transitional costs of around $150 million (mainly to government).

Table 5.1 **Summary of estimated impacts from development assessment reforms**[a]

$ million (2010-11 dollars)

	Annual longer-run ongoing direct impacts				*One-off direct impacts (transition costs)*
	Realised	*Prospective*	*Realised and prospective*	*Potential*[b]	
Reduction in costs from lower compliance costs and shorter approval times					
Residential developments	25	75	100	0	(3)
Commercial and industrial developments	0	125	125	125	(7)
Total	**25**	**200**	**225**	**125**	**(10)**
Lower State government administration costs		50	50		..
Costs to State governments of developing and maintaining systems	..	(30)	(30)	..	(140)

[a] Estimates based on 5 day reduction in processing times from 50 per cent of applications lodged using eDA, 30 day reduction in processing times from extending code-based assessment to 50 per cent of applications and lower compliance costs from reduced fees and fewer submitted documents [b] Potential impacts relate to measures that are yet to be implemented, but which are sufficiently likely to be implemented in the future. Realisation of potential direct impacts will require continued commitment and sustained effort. These have been rounded to the nearest $5 m. Transition costs have been similarly apportioned, and round to the nearest $1 m. .. zero or none estimated. Estimates in brackets ( ) represent cost increases.

Source: PC (2012b).

The savings from the extended use of code assessment were found to most likely be achieved in the areas of low risk residential dwelling developments and minor residential renovations. These developments are likely to meet pre-determined standards, and code-based assessments for single residential dwellings have been implemented in all jurisdictions. As such, one quarter of the estimated $100 million of estimated savings for residential applications were classified as 'realised', while the remaining three quarters were considered to be in prospect.

Increasing the proportion of commercial and industrial applications processed as complying development is expected to be more involved. As there is no staged implementation plan for national code assessable templates covering low risk and model code developments for commercial and industrial development, the Commission estimated that cost savings of $125 million (accruing over 5 years) were potential savings because they were dependent on further policy development and regulatory reform.

5.3 What has been achieved

State and Territory governments have introduced code-based assessment frameworks to expedite approval of low risk, low impact developments (primarily for specific types of residential projects but some States have extended code-based assessment to specific types of commercial and industrial work).[1] Another initiative undertaken that independently seeks to expedite development applications broadly is the introduction of eDA for the spectrum of planning assessment from application to determination.

The States and Territories are also pursuing projects aimed at increasing the proportion of code-based assessments, and achieving greater consistency in the approach taken to development applications across councils. In *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments,* the Commission detailed a number of significant changes within each jurisdiction that apply to development assessment (PC 2011f).

Single residential developments that comply with prescribed standards, planning guidelines and overlays and do not trigger specified conditions in local planning

[1] Code-based assessment involves vetting proposals against set quantifiable metrics like building heights, setbacks from street and boundaries, open space and car parking. Code-based assessment is one potential assessment pathway or 'track' available in a 'track-based' assessment system that differentiates proposals according to the level of scrutiny required. Other potential tracks include exempt (from assessment) development, self-assessment, merit assessment, impact assessment and prohibited developments.

schemes are now treated reasonably consistently across most jurisdictions. This is an area where some benefits are being realised (PC 2011f).

The Commission (PC 2011f) found improvements in development application approval times over the period 2008-09 to 2009-10.

According to the COAG Reform Council, however, only some of the agreed reforms in the development assessment area have been completed and original outputs achieved.

> Two outputs have not been completed: the roll out of electronic DA processing nationally and the assessment of benefits accruing from Development Assessment reforms. The 19 August 2011 implementation plan does not contain any milestones beyond 2010–11 to guide or direct the completion of these two remaining outputs. (CRC 2012, p. 97)

At its last meeting, COAG (2012) discussed progress on development assessment reforms and acknowledged the need to ensure these processes operate efficiently and do not create unnecessary delays for development proposals.

Code-assessment for low risk, low impact developments

While some key elements of the reform framework have been adopted at the State and Territory level (in particular the use of code-based assessment for low risk/impact *residential* work), the implementation of that framework at local council level (the assessment authority) has been patchy (PC 2011f). A primary reason for this is the transitional basis on which the new arrangements were introduced in most jurisdictions, to allow councils time to adopt the new code-based processes. Only 43 per cent of local councils responding to the PC's 2009-10 local government survey reported using a track-based assessment framework.[2] Councils in New South Wales were the most advanced in the use of track-based assessment (55 per cent) whereas councils in Victoria were the least advanced (27 per cent).

Introduction of code-based assessment for low risk/impact *commercial and industrial* developments is less advanced. As discussed above, there is no staged implementation plan for national code assessable templates covering low risk and model code developments for commercial and industrial development so reforms are dependent largely on the jurisdictions. New South Wales introduced Stage 1 of the Commercial and Industrial Code (enabling a limited range of building work

[2] Track-based assessment systems differentiate and scrutinise proposals according to the degree of risk and/or complexity they involve. In order of the magnitude of risk and/or complexity, potential tracks include exempt (from assessment) development, self-assessment, code assessment, merit assessment, impact assessment and prohibited developments.

such as internal fit-outs for certain buildings to be approved within 10 days) in September 2009. In 2010-11, 33 per cent of commercial retail developments were approved within 10 days under the Code (up from 9 per cent in 2008-09). Victoria, on the other hand, does not have an equivalent framework for commercial and industrial work.

Electronic development application processing (eDA)

In 2008, the Australian Government committed $30 million from the Housing Affordability Fund for a national rollout of eDA. However, according to the CRC (2012), the roll-out of eDA processing nationally has not been achieved and primarily reflects major technical and resourcing issues and uncertain commitment by governments to its take-up. The Commission (PC 2012b) estimated that the total cost of rolling out electronic codes would be around $115 million. While the move to electronic lodgement and processing is expected to reduce approval times, the bulk of the potential gains in this reform area are being delivered *independently* through the move to code-based assessment (even in its paper form).

Availability and use of eDA services varies across jurisdictions and councils (National ePlanning Steering Committee 2011). The Northern Territory (all planning applications lodged electronically since July 2010) and the ACT (more than 60 per cent of applications lodged electronically in 2010-11) lead the way. In contrast, less than 2 per cent of planning applications have been lodged using the Victorian Government's ePlanning system. In New South Wales, the most recent estimate (2008-09) of the proportion of applications lodged electronically was 13 per cent (PC 2012b). New South Wales recently completed piloting an electronic version of the NSW Housing Code for complying residential developments with the next phase including an extension to the commercial and industrial code. The Commission's planning, zoning and development assessment benchmarking report (PC 2011f) also found that ePlanning systems were being used effectively by a number of Queensland councils.

5.4 Achieving effective reform in the future

The Commission noted in its report on COAG Reforms:

> The achievement of available benefits from the development assessment reforms requires, among other things, the extension of code assessment to commercial and industrial developments. It also would benefit from the maintenance of an effective inter-jurisdictional coordination framework and a body to drive reform. In this regard, the implementation of more efficient and harmonised development assessment

> procedures appears to have been put at risk by the winding up of the key ministerial reform council — the Local Government and Planning Minister's Council — and separate reviews across jurisdictions. (PC 2012b, p. 84)

The Commission concluded that:

> … with no milestones or clear end points, any substantive impacts remain in prospect and, at this stage, are dependent largely on coordinated action across administering jurisdictions, that is mainly local government. Concerted government action supported by high level coordination will be needed to achieve the efficiencies available from improved consistency of local governments' development assessment practices. Such action could also provide the impetus to lower impediments to operating across jurisdictions, affording opportunities for productivity improving organisational and other changes. Given the scale of residential and non-residential development activity in Australia, the potential for productivity gains is substantial. (PC 2012b, p. 314)

6 Best practice approaches to regulation

6.1 Nature of problem and case for reform

Australian governments have recognised that efficient and effective regulation is necessary and desirable to facilitate the smooth functioning of the economy and to ensure that social, economic and environmental aims are achieved. However, excessive, poorly designed and overlapping regulation place a significant cost burden on Australian businesses and consumers.

Best practice regulatory policy requires evidence and rigorous evaluation. It also requires institutional frameworks that encourage, disseminate and defend good evaluation, and that make the most of opportunities to learn. Where evidence is incomplete or weak, good processes for learning, and for progressively improving policies, become even more important (PC 2010e).

An integral part of an evidence based approach is developing and enhancing processes for regulation making and review. The Regulation Taskforce (2006) concluded that having rigorous Regulatory Impact Analysis (RIA) processes in place would ensure better regulatory outcomes:

> The pre-condition for achieving better regulation boils down to ensuring that the case for it is well made and tested, both at the outset and over time. (p. 182)

RIA is designed to improve the quality of regulatory decisions by providing relevant information to decision makers and the community about the expected consequences of different policy options. However, the Commission has found that RIA processes generally fall short in how they are applied in practice. There can be a lack of engagement with policy development, the process can be started too late to influence outcomes, public consultation is sometimes done in a perfunctory manner and regulatory oversight can be weak. Most importantly, the process can lack sufficient transparency and accountability to ensure that the incentives of participants in the process are aligned with those of the community (Regulation Taskforce 2006; PC 2009a, 2010a).

It is therefore not surprising that despite having processes in place to counter forces leading to excessive regulation, much regulation continues to be poorly justified and

implemented in Australian jurisdictions, and that the costs to business and the community are large.

There is also a lack of ex post evaluation of regulation in all Australian jurisdictions. Moreover, there is no systematic monitoring and reporting that would enable an assessment of whether reviews have been undertaken and of the outcomes (PC 2011e).

In response, in April, COAG agreed:

> … to consider concrete measures to lift regulatory performance, including reducing complexity and duplication and increasing transparency and accountability. This will be informed by the current work of the Productivity Commission on the efficiency and quality of Commonwealth, State and Territory and COAG Regulation Impact Assessment arrangements, due to be completed in late 2012. (COAG 2012, p. 4)

6.2 Potential reform and possible gains

Some costs are necessary to achieve the objectives of regulation, but poor quality regulation can result in excessive administration and enforcement costs for governments and impose 'unnecessary' regulatory burdens on business or consumers.

The Commission found that reforms to reduce regulatory burdens could lower business compliance costs by around 20 per cent, resulting in an estimated increase in GDP of close to 0.8 per cent— around $7 billion in 2005-06 (PC 2006a). However, there are larger gains to be made from reducing other inefficiencies caused by regulation that reduces competition and distorts incentives for investment and innovation. For example, based on a regression analysis of a World Bank indicator of regulatory quality, the United States Small Business Administration estimated the total costs of US regulations at US$1.2 trillion in 2008 (around 8.5 per cent of GDP) (Crain and Crain 2010).

A particular problem relates to regulatory overlap or inconsistency between jurisdictions. As an indication of the likely magnitude of such unnecessary costs, the Commission recently published estimates of the impacts of selected COAG business regulation reforms. The Commission found that the full implementation of 17 of the 27 Seamless National Economy reforms, aimed at reducing the regulatory burden imposed on businesses that operate across jurisdictions, could in the longer run provide cost reductions to business of around $4 billion per year and increase GDP by nearly one half of a per cent (around $6 billion per year). The Commission found that only $143 million of the benefits had been realised thus far (PC 2012a).

6.3 What has been achieved

A number of jurisdictions have established new regulatory assessment and review processes or fine-tuned existing processes. For example, Western Australia introduced RIA requirements for primary legislation in 2009 and then extended coverage to subordinate legislation with the introduction of revised guidelines in 2010. South Australia also released formal guidance material for its RIA process in 2011. Other jurisdictions have improved oversight mechanisms and applied compliance cost tools in an attempt to improve the quality of RIA.

In 2010, under the auspices of COAG's Business Regulation and Competition Working Group (BRCWG), jurisdictions assessed their RIA processes and agreed to consider opportunities to enhance current arrangements in five broad areas:

- to ensure implications for national markets are given appropriate consideration when new or amended regulation is proposed and/or proposals to remake sunsetting regulations are being considered
- the establishment of objective criteria for evaluating proposals to remake sunsetting regulation
- the publication of Regulation Impact Statements (RISs) or equivalent at or close to the time of policy decision
- fostering cultural change in regulation making
- the use of common commencement dates as a device for reducing the regulatory burden on business (PC 2012e).

In addition to the Commission's current RIA Benchmarking study, the New South Wales, Victorian, Queensland and Australian Governments have or are currently undertaking reviews of their regulatory processes. To date, concrete steps to improve processes as a result of these reviews have yet to take place in most of these jurisdictions.

In response to a Commission review of regulatory burdens (PC 2009a), in July 2010 the Office of Best Practice Regulation established an online RIS register. It now publishes both Australian Government and COAG RIS documents on the site as soon as practicable after public announcement of the relevant decision, or in the case of COAG, after their release by the policy making body. Prime Minister's exemptions and non-compliance are also made public on the website as soon as practicable after a regulatory decision is announced (OBPR 2010, 2011).

6.4 Achieving effective reform in the future

Against the objective of RIA to enhance the empirical basis for better informed government decisions, and to make regulatory processes more transparent and accountable, Australian jurisdictions have a considerable way to go.

In principle, RIA reforms could be implemented quickly and would be expected to have a significant cumulative impact over time. The biggest risk to the achievement of these gains is that governments will not be sufficiently supportive of the system to make it work as intended.

To strengthen the ex post evaluation of existing regulation, the Commission's recent report *Identifying and Evaluating Regulation Reforms* recommended:

- a formal review and performance measurement plan for those regulatory proposals that are assessed as having a 'major' impact
- the use of embedded statutory reviews where there are significant uncertainties regarding the effectiveness of impacts of the proposed regulation (PC 2011e).

And to ensure that the proposed reviews occur, it was argued that the Australian Government should establish a monitoring and reporting system that tracks reviews, monitors progress implementing recommendations, and makes this information publicly available (PC 2011e).

While these recommendations were directed to the Australian Government, they are equally applicable to the States and Territories. The public provision of such information would represent a significant advance in transparency. It would also promote greater accountability for effective management of the regulatory system.

Leading practices in regulation assessment will be highlighted in the Commission's forthcoming benchmarking report, which should provide an opportunity for further reforms to existing regulatory arrangements in all jurisdictions.

7 Government reporting obligations

7.1 Nature of problem and case for reform

COAG announced in April that it would begin the process of examining reform options that would help overcome costly overlaps in business reporting requirements across governments:

> COAG asked the Taskforce to report on specific ways to remove overlaps in Commonwealth and State and Territory reporting obligations, including the expanded use of online business reporting, for consideration at its next meeting. (COAG 2012, p. 4)

While limited information about this was released, COAG officials have informed the Commission that the intention is to investigate the extension of the Standard Business Reporting (SBR) functionality — a reform under the Seamless National Economy national partnership — to other areas of government reporting. In addition they will assess the potential to expand the scope of the Australian Business Account that is being delivered as part of the Registering Business Names reform.

7.2 Potential reform and possible gains

Businesses have raised concerns over the reporting burdens placed on them in complying with regulation. These costs can be substantial given the range of regulations and reporting and record-keeping requirements. Reporting to governments represents only part of the record-keeping requirements of regulations. However, for occupational health and safety regulations alone (prior to harmonisation reforms), small and medium sized businesses reported that record keeping requirements imposed total costs of around $900 per year (PC 2010c). With over 2 million such businesses, this equates to an annual cost of close to $1.8 billion. These are the total costs, however, and do not in themselves indicate the extent of unnecessary reporting costs and hence the savings that may be on offer.

The potential reform areas and gains from reducing government reporting burdens on businesses have been canvassed in a number of reports. In 2006, the Regulation Taskforce (2006) recommended the Australian Government adopt a business reporting standard (which later became known as Standard Business Reporting) —

a multi-agency program to reduce the reporting burden to business by providing consistent and streamlined government financial reporting requirements (PC 2012b).

Subsequent reports by the Productivity Commission have also noted possible merit in adopting reporting frameworks similar to SBR. In the *Annual Review of Regulatory Burdens on Business: Social and Economic Infrastructure* (PC 2009a) the Commission suggested extending the SBR methodology to help overcome some of the costs of reporting to governments:

> Many industries complained of overly burdensome, duplicative and redundant reporting requirements. Extending the SBR principles and methodology to many of the sectors covered in this review could substantially reduce the reporting burden. (p. xix)

Similarly, in its review of aged care, the Commission recommended that a streamlined reporting mechanism for all aged care service providers be developed:

> The Australian Government should introduce a streamlined reporting mechanism for all aged care service providers (across both community and residential aged care) based on the model used to develop Standard Business Reporting. (PC 2011c, p. 441)

COAG, as part of the first tranche of Seamless National Economy reforms, began the process of developing and implementing the SBR initiative (discussed in the following section). The initial business case developed to support the reform suggested that cost savings in the order of $800 million were possible (The Treasury 2007). However, the Commission's recent study on the Seamless National Economy reforms (PC 2012b) found that SBR reform has only achieved a negligible take-up by business in terms of lodging reports and forms with governments, such that the benefits being achieved are small relative to those potentially available. The Commission noted that strong action will be required to deliver:

> … cost reductions to business of a magnitude approaching the levels envisaged in the 2007 business case. These actions include:
>
> - directing the focus within government agencies to prioritise the SBR program.
> - providing greater certainty to businesses … regarding the progress and future plans of the SBR program …
> - increasing the number of SBR-enabled forms, based on volume and complexity, within participating agencies. …
> - at the right juncture, promoting SBR to encourage business demand. This would provide the incentive to software developers to hasten the development and use of SBR in their products.
> - providing, if required and cost effective, some incentives through funding or technical expertise to increase accessibility of SBR. (PC 2012b, p. 125)

The Commission estimated that the annual benefits from SBR could be increased by $500 million from around $50 million at present (PC 2012b).

7.3 What has been achieved

In August 2007, the Australian Treasury commenced the development of the SBR program through a process of consultation with government agencies, software developers, accountants, bookkeepers and the broader business community, drawing on earlier work by the Australian Taxation Office (ATO). The SBR program includes a whole of government authentication for secure access to lodgement (AUSkey) and a means to lodge reports directly from their accounting software.

Approximately $170 million has been spent on the development of SBR, including funding to the States to support their revenue offices to become SBR-enabled. Software developers (key independent players in the reform process), while expressing enthusiasm for SBR, have proven reluctant to invest heavily in developing SBR capability within their software platforms without firm dates for the switch off of existing electronic lodgement systems.

In 2011, around 300 000 businesses had an AUSkey but only 1000 were using the SBR Core Services to lodge forms and reports. As a result, little reduction in the burden of reporting to government has yet been realised (PC 2012b, p 115).

The ATO has recently committed publicly to adopting SBR technology for key reports to be lodged by June 2015. The Commission's consultations for its 2012 study suggested that large software developers were now responding positively to the Australian Government Superstream requirement for SBR and to the ATO's announcement.

7.4 Achieving effective reform in the future

The 2012 study found that although SBR offers a best practice method for business-to-government reporting, delivery of the SBR program had not provided the anticipated benefits, as the overly ambitious take-up rate outlined in the business case had not been realised. In a fast-changing regulatory environment, the program has not been treated as a priority by government, software developers or business. The Commission accordingly identified a number of implementation risks, including:

- a lack of incentives for government departments — many were slow or unwilling to transfer reporting systems across to SBR due to the costs they faced

in doing so and existing agency-specific reporting channels are considered familiar and reliable by many businesses

- a lack of public awareness of the new platform — limited effort was made to promote the new system resulting in many businesses being unaware of the new platform.

Given the much slower take up of SBR than anticipated, it would be beneficial to bed down the existing scope of SBR before extending it to other sectors of the economy. While in concept that extension should lead to reductions in the costs of business reporting, any such gains would most likely be maximised if they build on successful implementation of the original SBR program. Full implementation of the original program would provide a 'demonstration effect' that could greatly assist buy-in from departments and businesses for future extensions. This could, in turn, lower the costs associated with the implementation of future extensions because the need for incentives and public education would be reduced.

8 Future proofing regulatory reform

8.1 Nature of problem and case for reform

'Future proofing' in this context refers to the development of National Frameworks that will endure and deliver benefits over time. National Frameworks are usually underpinned by Intergovernmental Agreements in which governments commit to an approach that seeks to achieve some consistency in regulation and the administration of regulation. Approaches under the Seamless National Economy (SNE) agenda can include adoption of uniform legislation, use of template legislation, model acts, or a commitment to common objectives. The approaches vary in how prescriptive they are, and whether there are 'opt-in' or 'opt-out' options, as well as other features.

As discussed in the Commission's study on the impacts of the COAG reform agenda (PC 2012a), National Frameworks have particular value for businesses that operate across jurisdictions by providing uniformity in the regulatory requirements they face. To the extent that National Frameworks improve the quality of regulation and its administration, they can also be beneficial for businesses that operate in a single jurisdiction. They may also offer considerable savings in the development and administration of regulation, with flow-on effects in lower costs to taxpayers and business. There is, however, a down-side if the enforced consistency hampers innovation and improvements in regulation and its administration. This is a greater problem where jurisdictions face unique circumstances that require substantially different regulatory approaches. Hence, a balance has to be achieved between the scale advantages of consistency and encouraging innovation.

Three main concerns have been raised by the Business Regulation and Competition Working Group about National Frameworks:

- The process for developing reforms does not pay adequate attention to ensuring compliance, nor allow for innovation within such frameworks.
- The time taken and cost of negotiating the agreements is often considerable for all involved, including businesses.
- 'Backsliding' between what has been agreed and the reforms actually enacted and implemented in the individual jurisdictions is common. 'Backsliding' also occurs where subsequent regulation undermines the intent.

Lack of attention to implementation and innovation

National frameworks aim to improve the consistency of regulatory approaches across jurisdictions to promote a national market. However, there may be good reasons for jurisdictions to want to tailor a reform to better suit the majority of businesses in their jurisdiction, or to allow a lower cost of implementation. Failure to take these reasons into account during the negotiations may facilitate reaching agreement, but increase the likelihood of 'slippage' during implementation.

Moreover, there is an inherent tension between discretion and prescription in how agreed reforms are to implemented in a jurisdiction. On the one hand prescription can reduce slippage (and possibly backsliding), but on the other hand prescription leaves less scope for taking an innovative approach or allowing evolution in response to learning. There is a balance required between improving certainty and encouraging innovation. The ideal balance will be different for different frameworks and, more challenging still, that balance may well change over time.

Time and cost of negotiating agreements

The Commission's regulation reform study found that pursuit of agreement in areas identified in the SNE as worthy of reform (the 27 'hot spots') was often resource intensive (PC 2011e). In addition, the effort required was often as great for minor as for major reforms. Concerns continue to be raised that lack of focus adds to costs, stretches available resources, and reduces what was able to be achieved. The Business Council of Australia (BCA) and other industry bodies consulted as part of the regulation reform study informed the Commission that the cost to business of involvement in multiple consultations, often on overlapping issues, was considerable. In submissions to the study, they called for more efficient processes as well as better outcomes.

Backsliding

Where there are special interests in government agencies and the business sector, change can be resisted, resulting in delays and/or only partial reform, or reversals of regulation. 'Backsliding' increases uncertainty for businesses and reduces the return to the actual reforms relative to the expected return.

Currently, there is little in the COAG Reform Council monitoring that prevents backsliding, with the reform milestones for the SNE largely tracking progress in achieving agreements. The ex post evaluations of the COAG reform agenda undertaken by the Commission provide a source of information on the progress in

and success of the SNE and other reforms across jurisdictions. However, it is unclear that these processes impose much discipline on jurisdictions to complete reforms in a timely and consistent manner (PC 2011e, 2012a).

8.2 Potential reform and possible gains

COAG and the BCA have put improvements in regulatory processes at the heart of a National Productivity Compact (BCA 2012) to 'future proof' reform. The actual reforms that will support the Compact, covering both regulation and competition, have yet to be developed but will involve: developing national regulation principles to guide selection of priority areas for reform; following best practice in consultation and analysis; embedding ex post reviews; and improving regulatory processes to stem the emergence of regulatory burdens arising from inconsistencies across jurisdictions. The Commission's work on regulation reform (Regulation Taskforce 2006; PC 2011e, 2012a) identifies a number of potential reforms to the processes for developing, implementing and reviewing COAG National Frameworks.

Developing the agenda for National Frameworks

The proposed Compact is to include a set of national regulation principles to guide the selection of the areas for reform. Commission work (PC 2011e, 2012a) suggests that these principles should include:

- focusing on a small number of high return reform areas (27 is too many)
- drawing on detailed reviews (especially where these already exist) and ex ante cost-benefit evaluations to ensure high potential returns
- consultation to establish priorities and build support for the agenda.

The gains from a more tightly focused reform agenda come from bringing forward reform in areas with higher returns. Preparatory research that provides an evidence base for the likely gains not only guides the choice of priorities but helps to build support for the chosen reforms. Consultations must seek to confirm the analysis of the gains and test the options in order to ensure that the potential can be realised.

Implementing the reform agenda

The COAG Regulatory Impact Assessment (RIA) process, along with the RIA in all the jurisdictions, is under examination in a benchmarking exercise being undertaken for COAG by the Commission. This may well identify areas where the process can

be strengthened (see also section 6 on strengthening RIA processes). Previous work by the Commission has found that greater attention could be given to:

- consideration of the full range of options for improving consistency, including whether all jurisdictions need to participate, and other opt-in/opt-out types arrangements
- embedding reviews in the regulations, particularly where the effectiveness of the approach is uncertain due to lack of an evidence base (in which case consideration should be given to trialling approaches (PC 2011e)), or because of a changing environment
- encouraging a risk-based approach to the implementation of the resulting regulation across jurisdictions — this includes approaches to compliance and enforcement.

Implementing the National Frameworks can require considerable changes in legislation, regulatory arrangements, institutions and supporting infrastructure. Such changes can be costly and should be considered in designing the reform. For example, consideration should be given to including in National Frameworks only those aspects of regulatory requirements that need to be consistent to deliver the bulk of the benefits. Requiring fewer changes that can be implemented more efficiently and effectively should reduce 'slippage' and lower the cost of implementation. Jurisdictions should be given an opportunity to identify where innovation is possible so that Frameworks can provide the discretion to pursue new or improved approaches, including as part of a trial.

There is also a trade-off between providing flexibility and discretion to regulators to promote innovation and cost-effective administration and allowing too much scope for regulatory capture or gold-plating (PC 2011e). The Commission's study, *Identifying and Evaluating Regulation Reform* (PC 2011e), concluded that not enough is known about regulator performance and recommended a review to assess the take-up and effectiveness of the recommendations made by the Regulation Taskforce (2006) for greater accountability.

Review of the achievements of the National Frameworks

COAG have good institutional arrangements in place, with the monitoring of progress by the CRC and evaluation of the reforms by the Commission. But while the structure is broadly sound, the arrangements lack the financial rewards and sanctions of the kind that characterised the relatively successful National Competition Policy (PC 2005d). Monitoring of implementation and evaluating the success (or otherwise) of the reforms can provide some discipline on completion of

the reforms. It can also provide lessons about improving outcomes where different approaches have been allowed. Desirable features include:

- a formal review and performance management plan for all National Frameworks, with measures of results informed by the ex-ante cost-benefit analysis of the reforms
- milestones and reward payments based on results (outcomes) rather than process
- public independent reviews before a jurisdiction can depart from agreed arrangements
- review findings made public, with follow-up actions monitored and reported.

8.3 What has been achieved

The potential gains from improving the efficiency and effectiveness across the whole regulatory cycle (development, implementation, and review) for National Frameworks are considerable. For example, as noted in other sections, the Commission's recent report on the COAG reform agenda estimated the benefits of full implementation of reforms in 16 of the 27 COAG reform areas to be around $6 billion annually (PC 2012a). But most of these have yet to be realised and other areas remain unsettled, so completing the reforms underway would seem integral to the National Productivity Compact.

8.4 Achieving effective reform in the future

There is broad commitment in COAG to good process for developing and implementing reform. For a new National Productivity Compact and National Principles to achieve better outcomes from National Frameworks there also needs to be high level commitment to follow through, with accountability for the results, and rewards based on outcomes.

The National Principles should provide guidance on assessing the value that can be added by cross-jurisdictional coordination and the best approaches, reflecting issues such as: subsidiarity (PC 2012d); the natural experiments of competitive federalism (PC 2005a); approaches to risk-based regulation (Coghlan 2000; PC 2006b); and options for coordination such as harmonisation, 'opt-in' approaches, and when economies of scale can be realised (PC 2004b, 2012d).

Such principles need to be tested, and should evolve over time as more is learned about the best way to achieve national markets. The consultation strategy that can

efficiently and effectively engage with business also needs testing, as do review processes and incentive arrangements. There would be value in initially applying the new National Principles and National Compact to an important area of reform that is currently lagging, such as chemicals and plastics, as a test of their effectiveness.

9 Harmonisation of conduct requirements

9.1 Nature of problem and case for reform

Reforms to occupational licensing have been undertaken as part of the Seamless National Economy National Partnership in order to remove impediments to labour mobility for selected occupations. This has involved the development of the National Occupational Licensing System (NOLS) (discussed further in section 10) which furthers earlier mutual recognition reforms.

However, while national licences exist under the NOLS, the requirements placed on the manner in which licensees can operate their business — known as 'conduct requirements' — continue to vary between jurisdictions. These variations limit the potential gains from NOLS.

9.2 Potential reform and possible gains

In its 2009 research report *Review of Mutual Recognition Schemes*, the Commission considered that:

> … extending mutual recognition to some 'manner of carrying on' requirements warrants consideration. At the moment, individuals or businesses seeking to provide services into a second jurisdiction face having to duplicate their operations across the border in terms of: registration; principal office; trust fund; complaints process; and fidelity fund. This creates unnecessary compliance costs for service providers, particularly those operating in border towns, servicing customers via the internet or providing short-term services on a 'fly in, fly out' basis. The particular needs of these 'cross-border' businesses could be accommodated better within mutual recognition laws. (PC 2009b, p. XXXVIII)

The Commission noted that conduct requirements often acted as a greater impediment to the mobility of service providers than the need to re-register and obtain a second occupational licence:

> A real estate agent operating as a sole trader in Victoria and New South Wales, for example, currently needs to: maintain two registered offices; operate two, separately

> audited, trust accounts; contribute to two fidelity funds; and adhere to two sets of professional conduct regulations. (PC 2009b, p. 222-3)

This suggests that in order to effectively remove barriers to mobility for licenced occupations, and obtain the gains sought from reform, conduct requirements must also be harmonised in some way.

However, in its earlier review of mutual recognition schemes in 2003, the Commission had reservations about the benefits from mutual recognition of conduct requirements (PC 2003). It observed that the exception of such requirements from mutual recognition schemes:

> … ensures a government can regulate all those practising registered occupations in its jurisdiction effectively and consistently, using its own regulatory mechanisms. Applying mutual recognition obligations to those regulations would generate extensive complexity and could undermine the quality and reliability of service delivery. In addition, such an application would generate few benefits, given that the regulatory differences do not represent much of an impediment to occupational mobility. (p. 237)

Different views on the policy issues posed by jurisdictional conduct requirements relate back to questions surrounding which level of government is best placed to regulate these activities. As noted in the Commission's *2004-05 Annual Report*:

> There is no single 'best' model for assigning functions between governments … Moreover, changing circumstances may make it desirable to realign functions over time. Furthermore, however carefully functions are allocated, substantial interaction and cooperation among governments are likely to be necessary to ensure the effective funding and delivery of services. (PC 2005b, pp. 4-5)

The nature and assignment of functions between levels of government would need to be reviewed over time as changes in the economy (arising from both internal and external pressures) highlight constraints in economic activity.

While the Commission has not quantified the possible gains in this area, given the existence of mutual recognition of licences, and moves to a national licensing system (section 10), it is likely that the additional gains from this reform would be relatively minor in comparison to some other reform areas.

9.3 What has been achieved

Work on the harmonisation of conduct requirements has commenced through the Consumer Affairs Forum (CAF) Conduct Harmonisation Project. The CAF is a working group of Commonwealth and State and Territory Ministers which was

formed following the implementation of revised Ministerial Council arrangements in 2011.

For its part, the Commission has not been in a position to make any specific recommendations as to how conduct requirements for occupations should be regulated by various State and Territory Governments.

However, the Commission (2005c) found that the fragmented approach to the registration and accreditation of health professionals resulted in duplication and higher administrative costs; undermined geographical mobility of practitioners; and resulted in inconsistencies in the standards of registration and accreditation applying to practitioners. Subsequently, COAG implemented substantial reforms to the system of registration and accreditation in Australia. The Commission estimated that these reforms could lead to an increase in the productivity of health service provision, corresponding to annual savings of around $160 million in the long term (PC 2012b).

9.4 Achieving effective reform in the future

Current reforms of conduct requirements are closely tied to broader reforms of national occupational licensing.

The Commission's 2009 research report *Review of Mutual Recognition Schemes* suggested one option to enhance occupational mobility by reducing barriers created by differing conduct requirements — the mutual recognition of most aspects of conduct requirements:

> One option is to allow most aspects of 'service provider' requirements imposed by one jurisdiction to be mutually recognised by another. This would avoid the risk that regulatory duplication and heterogeneity create impediments to the mobility of services. Under this model, similar to the forthcoming EU framework for a single internal market for services, a business providing services across a border would continue to be regulated, in the main, by its home jurisdiction. However, host jurisdiction requirements would continue to apply in limited cases, justified by community interest. (PC 2009b, p. XXXVIII)

Given the continuing delays in implementing the first tranche of NOLS, associated delays in progressing conduct requirement reforms seem likely.

10 Further reforms to occupational licensing

10.1 Nature of problem and case for reform

Occupational licensing can ensure public safety, workplace safety and/or consumer protection. However, excessive and duplicative licensing requirements can act to inhibit workforce mobility, create barriers to entry and raise costs to business.

The cost and complexity of licensing requirements can be substantial. For example, in 2009 COAG estimated that pro rata license costs for some selected occupations ranged from $300 to $1000 per year (COAG 2009). COAG also observed that a large number of different licence categories, classes and sub-classes, licence levels and licence endorsements exist for some occupations, reflecting the complexity of the licence categories (COAG 2009).

Over the years in several reviews and inquiries, the Commission has identified occupational regulation as an area with considerable scope to reduce regulatory burdens and improve economic efficiency (see PC 2000, 2005c, 2008c, 2010a).

The Commission's *Review of Australia's Consumer Policy Framework* (PC 2008c), for example, found that there were several hundred laws, mainly State and Territory, covering a large number of occupations. Nearly 100 occupational licenses were found to have been devised for consumer protection reasons alone. In 30 or more of these cases, a licence was required in only one or two jurisdictions. The report stated that:

> While in some instances there are good reasons for this (eg. Aboriginal Health Workers), in others (eg hairdressing) the prima facie case for specific requirements seems very weak. (PC 2008c, p. 96)

In the context of this particular issue, the Commission recommended reform of occupational licensing, without reducing necessary protections for consumers.

10.2 Potential reform and possible gains

While there is limited information on the current intended direction and scope of reform, past Commission reports, together with the COAG Business Regulation and Competition Working Group consultation paper on further possible reforms (BRCWG 2011), point to a number of possible options. These include:

- further rationalisation of licensing for some occupations (for example, by removing the need to hold a licence when it is only required in one or two jurisdictions, unless there is a convincing case to the contrary)
- an extension of national licensing to other occupations that were not included in the initial stages of national licensing, and/or
- ongoing improvements to the operation of mutual recognition schemes.

The Commission has not attempted to quantify the extent of remaining gains possible from further reforms of this type.

10.3 What has been achieved

Reforms to occupational licensing have been undertaken as part of the Seamless National Economy National Partnership in order to remove impediments to labour mobility for selected occupations. This has involved the development of the National Occupational Licensing System (NOLS) which expands on earlier mutual recognition reforms.

Occupations covered in the first tranche of reforms include plumbers, electricians, air conditioning and refrigeration mechanics, gas fitters and property agents. The aim was to have national licences for the first tranche occupations in place by 1 July 2012 (BRCWG 2011).

The April 2012 COAG Communique stated that:

> Progress includes:
>
> - passage of the Occupational Licensing National Law in most jurisdictions;
> - appointment of the Board of the National Occupational Licensing Authority (NOLA); and
> - agreement between NOLA and the New South Wales Government Licensing Service to provide a national licensing register. …
>
> COAG agreed the need for a best-practice approach to regulation and committed to release the Consultation Regulation Impact Statements (RIS) that reflect this approach for electrical; plumbing and gasfitting; refrigeration and air-conditioning; and property

> occupations in the first half of 2012. This will enable stakeholders to comment on the options for the detailed licensing schemes for each occupation, which include the status quo, national licensing and automatic mutual recognition. COAG further committed to work toward agreement to the framing legislation and regulation by the end of 2012. Given the complexity of the reform, it will now commence from 2013. (COAG 2012, pp. 5-6)

As noted by the BRCWG at this time, delay had in large part been the result of the complex and resource intensive nature of the process of achieving the first tranche of reforms (BRCWG 2012).

Later inclusion of a second tranche of occupations was envisaged early in the reform process. This was to include building and building-related occupations, land transport (passenger vehicle and dangerous goods), maritime occupations, conveyancers and valuers. These were originally to be included by 1 July 2013 (COAG 2009) but, given the delays in implementing the first tranche of reforms, this will not occur on time.

There have also been some developments with respect to rationalisation of licences. In 2009, jurisdictions reported to the BRCWG on a review of the need for licences for occupations that require registration to perform work in only one or two jurisdictions. Some jurisdictions committed to removing licensing for some occupations. In other cases, commitment was given to review arrangements through other processes. However, some jurisdictions elected to retain unique licensing arrangements for a number of occupations — four in New South Wales, nine in Queensland and three in the ACT (CRC 2012).

Meanwhile, mutual recognition arrangements continue to have an important role to play. The Commission's review in 2009, found that mutual recognition of registered occupations was working reasonably well overall, but that a range of factors were preventing realisation of the full benefits of the schemes. The Commission found that:

- uncertainty about the types of occupational regulation covered by the schemes remained and should be clarified
- the legislation was ambiguous with respect to the conditions that can legitimately be imposed to achieve equivalence
- it was unclear whether ongoing requirements, for example, relating to continuing professional development, can be included as a condition of renewal for registrations granted under mutual recognition
- differences between jurisdictions in the scope of activities covered by licences have the potential to impede mutual recognition and labour mobility — although Ministerial Declarations have gone some way towards resolving this problem.

In regard to national licensing, the Commission stated that:

> National schemes will address many of the problems raised by study participants, including those associated with variations in the standards required for registration and in the scope of activities covered by licences. While there may be problems with the implementation of these schemes — such as defining a joint standard — these will not be mutual recognition problems. (PC 2009b, p. 109)

10.4 Achieving effective reform in the future

Adequate time should be accorded for the completion of the first tranche to ensure that institutional frameworks and expertise are in place before proceeding with further stages. It may also allow for some evaluation of the effectiveness of the initial reforms.

An extension of *national licensing* to other occupations would need to be based on a rigorous assessment of likely net benefits, including thorough targeted consultations with the occupations and industries concerned (as is discussed in the COAG Decision RIS for first tranche occupations (COAG 2009b)).

On the interaction between national licensing and mutual recognition, the Commission's 2009 report found:

> Because it will be some time before national licensing is implemented in some areas and because it will not have universal coverage of occupations, mutual recognition will still be needed. It seems unlikely that national licensing will be appropriate for occupations registered in only a few jurisdictions, or cost effective for small occupations or those for which cross-border relocations are not large. (PC 2009b, p. 110)

Given continued delays in implementing the first tranche of NOLS and the limited number of occupations included, effective and transparent mutual recognition mechanisms will continue to be necessary into the foreseeable future.

11 Harmonisation of explosives legislation

11.1 Nature of problem and case for reform

The regulation of explosives in Australia involves multiple instruments across a range of activities and uses. In regard to the land transport of explosives, a uniformly adopted national code — the Australian Code for the Transport of Explosives by Road and Rail — has applied since 2010 and is currently in its third edition (AEC 3). The use of explosives is also covered by various codes of practice and by separate legislation in most States and Territories.

A number of economically significant industries are affected by explosives regulation, including the chemicals sector, mining, engineering and construction, and transport. In 2008, as part of a broader review of the regulatory framework for chemicals and plastics, the Commission examined explosives transport regulation and the regulation of security sensitive chemicals (such as security-sensitive ammonium nitrate) (PC 2008b).

The report observed that there were considerable differences in regulation across jurisdictions in both areas and that these differences imposed unnecessary costs on firms, particularly those involved in transport across jurisdictional boundaries:

> Unlike dangerous goods, there is no national model to guide jurisdictional explosives legislation and regulations for the land transport of explosives and there is no formal commitment by jurisdictions to implement AEC uniformly. Hence, important regulatory differences remain. (PC 2008, p. 177)

At the time of the Commission's 2008 review, interjurisdictional regulatory differences in regard to transport of explosives included external signage requirements, restrictions on joint carriage of explosives and detonators, products defined as explosives and licensing regimes for trucks and drivers. Some jurisdictions also maintained requirements that seven days notice be given for the transport of explosives into the jurisdiction.

Mining industry participants observed during the Commission's 2008 review that the additional regulatory costs were particularly onerous because the industry's global competitors generally did not face multiple regulatory regimes.

Material provided by COAG officials to the Commission indicates that problems persist in the regulation of explosives across a range of activities and uses. These include:

- limited mutual recognition of authorisations of explosives products or explosives licenses across jurisdictions
- absence of an agreed definition of explosives, leading to problems in the application of international standards
- inconsistent use of regulatory tools such as Australian standards, the Australian Explosives Code and the Australian Dangerous Goods Code.

Reform in this area is made particularly difficult by the multiple objectives of regulation (including national security, occupational health and safety and environmental protection) and the diverse stakeholders involved.

11.2 Potential reform and possible gains

Potential further reforms include:

- further reform of explosives laws (whether by way of applied law, model law or harmonised law) to modernise controls on activities including import and export, manufacture, storage, transport, sale, use, disposal and destruction
- possible incorporation of explosives transport regulation into the broader dangerous goods regime
- further consideration of alignment with international regulations, particularly UN Model Regulations.

The Commission considered further reforms in regard to explosives transport in its 2008 report. It recommended that, as a first step, AEC 3 should be uniformly adopted. Subsequent further processes to develop uniform legislation and regulations were also recommended.

Improved governance arrangements and more nationally consistent regulatory outcomes in explosives transport regulation were seen to be needed before an amalgamation with dangerous goods regulation would be prudent. The report stated:

> … in view of the achievement of nationally consistent dangerous goods transport regulations, combining their policy development with the more problematic explosives regulations may place these benefits at risk at this time. Improved governance arrangements and more nationally consistent regulatory outcomes in explosives transport regulation are needed before an amalgamation with dangerous goods would be prudent. The potential benefits of such an amalgamation further emphasise the

> importance of the current review of the AEC, and the Commission's proposed review of the entire explosives transport regulatory framework, delivering consistency between jurisdictions. (PC 2008b, p. 194)

The Australian Forum of Explosives Regulators (AFER) is the lead body which provides recommendations to governments by way of the Workplace Relations Ministers Council (WRMC) through Safe Work Australia, on the development of a nationally consistent framework for regulating the safety and security of explosives in Australia. The Commission's report recommended that, following a review of the Australian Explosives Code by AFER:

> The AFER should then immediately undertake a review of jurisdictional legislation and regulations for explosives transport, with the aim of achieving nationally consistent legislation and regulations to complement the uniformly adopted technical code. Any technical code issues not adequately resolved in the current review of the Australian Explosives Code (AEC3), should also be considered. (PC 2008b, p. 194)

The Commission did not attempt to model the benefits accruing from further reform in this area as part of its 2008 review.

11.3 What has been achieved

Some progress has been made since 2008 in reforming the regulation of the transport of explosives.

Most notably, the uniform adoption of AEC 3 has occurred. AFER has updated the Australian Code for the Transport of Explosives by Road and Rail to AEC 3, and this was endorsed by the WRMC on 3 April 2009. The AEC became mandatory across jurisdictions in 2010.

11.4 Achieving effective reform in the future

As discussed in the Commission's 2008 review, further reform in this area is likely to hinge on having effective processes. Given the entrenched and long-standing nature of problems, some coordination at a national level will continue to be needed. Conducting a comprehensive review of explosives regulations and legislation with the aim of achieving better regulatory outcomes would appear to be the logical next reform step (PC 2008b).

12 National Construction Code

12.1 Nature of problem and case for reform

The construction of commercial, residential and public buildings has long been regulated in Australia on the basis that governments have responsibility to ensure the health, safety and amenity standards of buildings on behalf of the community. Under Australia's constitution, responsibility for such matters resides with State and Territory Governments. Over time, numerous variations in regulatory arrangements have developed across jurisdictions.

The National Construction Code (NCC) is a COAG initiative to incorporate all on-site construction requirements into a single national code suitable for use across jurisdictions. The first phase of the reform was completed in 2011 — three years after COAG's initial agreement to develop the NCC. The NCC followed a decade of relevant work prior to the settling of the Building Code of Australia. The Building Code of Australia was adopted by all States and Territories in 1998; however, it took an additional decade for all jurisdictions to adopt the next iteration of reform. The NCC integrated the building and plumbing codes and introduced a national performance-based approach to compliance for the plumbing code.[1] This has the potential to reduce compliance and other business costs for the building and construction industry and provide businesses with greater flexibility in meeting the regulatory requirements of the code.

The value of dwelling and non-dwelling building work affected by the first phase of this reform was around $83 billion in 2010-11, equivalent to approximately 6 per cent of Australia's GDP (ABS 2011a).

12.2 Potential reform and possible gains

The continuation of NCC reform aims to further reduce inconsistency and overlap in on-site construction codes and streamline regulatory approaches across jurisdictions. The Commission's assessment of the development of the first phase of

[1] Performance-based requirements outline the required level of performance and leave it to the designer or builder to decide how compliance is achieved. This allows the builder to develop alternative solutions based on new or innovative building products, systems and designs.

the NCC identified two main direct impacts on businesses of integrating the building and plumbing codes:

- improved consistency between building and plumbing regulation, and
- a more flexible compliance regime (PC 2012b).

The Commission noted that there was scope for the expansion of the NCC to other on-site construction activities, such as gas fitting, electricity, and telecommunications. In principle, these areas face the same need for streamlining and could benefit from the introduction of a performance-based standard. The Commission did not expect, however, for expansion of the NCC to yield benefits as large as those from the first phase of reform (PC 2012b).

The Business Regulation and Competition Working Group has noted that the Australian Building Codes Board (ABCB) is undertaking a preliminary scoping study to consider the possible inclusion of gas fitting into the NCC. The outcomes of the scoping study will be used to inform the Building Ministers' Forum of the relative merit and scope for such work to proceed.

12.3 What has been achieved

The ABCB released the NCC in 2011 and all States and Territory Governments have agreed to adopt the NCC by October 2012.

The Commission estimates that once the first phase of the NCC reform takes full effect, business costs are expected to fall overall by around $1 billion, approximately 1 per cent of the value of residential and non-residential building construction (PC 2012b). The cost savings, which are likely to accrue progressively over a half decade as businesses adapt to the new integrated building and plumbing code, stem from:

- improved consistency between building and plumbing codes: a cost saving estimated at 2 per cent for the non-residential sector ($696 million) and 0.5 per cent for the residential sector ($243 million)
- the adoption of a performance based plumbing code: a cost saving worth 3 per cent for the plumbing share (10 per cent) of the non-residential sector ($104 million).

Moving to the new code, however, was found to impose transitions costs on business — estimated to be $30 million in the first few years of its operation. Governments are also expected to incur transition administration costs of around $5 million during the first few years of the NCC operation.

12.4 Achieving effective reform in the future

The Commission's examination of the NCC highlighted a number of risks in seeking to advance reform in this area (PC 2012b). These include:

- Ongoing regulatory differences across jurisdictions — through the NCC, the ABCB has reduced some jurisdictional differences but many remain. Effective oversight in all jurisdictions will be required to address remaining variations as well as confining any new ones to *only* geographical, geological or climatic factors alone. The experience to date shows progress on the agenda can easily get delayed (for months and sometimes years) in resolving jurisdictional differences. Any new variations should be required to be subject to robust Regulatory Impact Assessment and Ministerial approval.
- A lack of harmonisation in administration processes — the Housing Industry Association's submission to the Commission's study of the Seamless National Economy reforms (PC 2012b) noted that expanding the NCC to other areas has merit. However, the ad hoc administrative approaches of State regulators and the lack of consistency in the application of standards at the State and local level were seen to create further complexity.

Local government regulations — local governments' specific building requirements beyond those related to geographical, geological or climatic factors have been shown to increase residential building costs without necessarily providing any offsetting benefits (ABCB 2008). In cases where local government requirements have generated benefits, these generally accrue to individuals and therefore decisions to adopt or otherwise would be best left to market forces rather than regulators.

13 Land transport reform

13.1 Nature of problem and case for reform

Land transport encompasses road and rail infrastructure in urban centres and regions and its use for public transport (trains, trams buses and taxis), private vehicle trips (cars, motor bikes and bicycles) and for business and freight. It also encompasses interconnections between transport modes.

Land transport facilitates both commercial and social exchange. Its efficiency is particularly important given Australia's dispersed population and production centres. Lower freight costs flow through to reduce domestic prices as well as improve the international competitiveness of Australian producers. A large number of issues have been identified by the Commission:

- inefficient road use and provision arising from road charging arrangements for heavy vehicles which set average prices, and the disconnect between road charging and road provision (PC 2006c)
- lack of rigorous assessment and transparency around infrastructure investment decisions, leading to relatively low (or negative) pay-off projects being undertaken ahead of high-pay-off ones (PC 2006c)
- infrastructure access and regulatory impediments for heavy vehicles and rail users increase freight costs (PC 2006c)
- potentially high-cost, prescriptive regulatory remedies for addressing land transport externalities such as noise and air pollution (PC 2006c)
- urban road congestion is estimated to impose gross costs on road users (mainly in the form of additional time and fuel costs) of around $30 billion by 2015. Road congestion can also impose negative spillovers (noise, ambient air pollution) on nearby communities (PC 2006a,c)
- poorly-planned, inadequate and high-cost public transport systems increase private vehicle use and road congestion and particularly disadvantage the aged, disabled and low-income groups (PC 2005, 2006c)
- barriers to competition, coupled with prescriptive regulation in the taxi industry, reduce efficiency and impose costs on consumers (PC 1999, 2005d)

- bottleneck intermodal freight connections detract from the seamless transfer of freight across modes raising costs overall (PC 2005d).

13.2 Potential reform and possible gains

Land transport freight and passenger services (including public transport) account for around 4 per cent of GDP. (The value of private vehicle trips is clearly also sizable, but not directly measured in GDP.) Significant economic gains could come from reforms that increased the productivity of commercial transport services. Additional benefits could also flow to the community from addressing externalities, or doing so in more cost-effective ways.

Potential reforms that have previously been identified include:

- Replacing prescriptive regulations that restrict particular types or configurations of heavy vehicles from using all or some roads with performance based regulations to promote flexibility and innovation, allowing higher mass limits for trucks.
- Development of nationally consistent and coordinated approaches to regulation of heavy vehicles.
- Rigorous application of regulatory impact requirements to all new road and rail transport regulation as well as systematic reviews of the appropriateness and cost-effectiveness of existing regulations.
- Nationally-consistent rail regulatory frameworks (safety, operational and technical standards).
- Stricter application of the corporatisation model to government-owned railways, including greater clarity of corporate objectives, improved transparency and a general strengthening of accountability.
- Implementation of a nationally-consistent approach to access regulation in the rail sector, including a single national rail regulator or regulatory regime.
  - Incorporation of an objects clause and pricing principles in all rail access regimes, including allowing multi-part pricing and price discrimination where they aid efficiency.
  - Winding back rail access regulation where market power is constrained and consider vertical re-integration on lines where operational efficiencies would outweigh the impacts on potential above-rail competition.
- Improving road, rail and intermodal infrastructure investment decision-making frameworks across all jurisdictions by inclusion of a clear project selection

process (including formal cost benefit analysis), greater stakeholder involvement and public transparency, including formal public consultation, and systematic post-project evaluation.

  - Greater transparency of funding of Community Service Obligations for road and rail infrastructure to promote transparency and ensure that enunciated objectives are achieved at least cost.

- Improvements to the PAYGO system including addressing under-recovery of total heavy vehicle road costs.
- A sequential approach to fundamental reform of road freight infrastructure pricing and provision including:
  - an initial phase of further research and feasibility studies to progress pricing and institutional reforms
  - a second phase implementing a system of incremental pricing (for certain trucks to use particular parts of the network) combined with institutional reforms (such as the establishment of road funds) to link road charge revenue with future road spending, supported by improved governance arrangements
  - a final stage extending location-based charging and where feasible more commercial provision of road infrastructure services.
- Promoting efficient, targeted responses to road and rail externalities, including researching the nature and extent of impacts, including the extent to which, and how efficiently, they are being addressed already (for example, vehicle and fuel emission standards).
  - Replace high-cost and ineffective measures to reduce greenhouse emissions in transport (such as ethanol subsidies and mandated targets, subsidies to produce green cars domestically, rail subsidies) with lower-cost, direct price-based mechanisms.

In its *Review of National Competition Policy Reforms* (PC 2005d), the Commission also identified potential reforms to address urban congestion and passenger transport issues. They included:

- competitive reform of taxi markets, albeit drawing on experiences domestically and overseas to avoid unintended consequences (such as reducing quality and safety)
- greater use of demand management policies to target road congestion (although noting that congestion pricing is currently a high-cost solution)
- reconfiguring and augmenting public transport systems to better meet passenger needs, including more innovative ways of providing transportation alternatives.

In its 2005 review of NCP reforms, the Commission estimated that productivity improvements and price changes in urban transport, ports and rail had added 0.75 per cent to GDP (PC 2005d).

In 2006, the Commission estimated that more efficient road provision coupled with further regulatory improvements across road and rail could deliver a 5 per cent improvement in transport productivity (resulting in lower prices for goods and services and, hence, higher consumption), generating an increase in annual GDP of just under 0.4 per cent (PC 2006c). It was considered that a further 5 per cent improvement in road transport productivity would be achievable from more fundamental pricing and institutional reforms, potentially leading to a further increase in GDP of 0.2 per cent. However, this scenario was considered more speculative as implementation and ongoing costs of direct road pricing would be high.

More recently, the Commission estimated that harmonisation of rail safety regulations could deliver cost savings for rail operators of around $16 million annually (PC 2012b).

Additional gains could come from better management of congestion in urban areas. However, it should be noted that the magnitude of the gains will generally be far less than the measured costs of congestion, for two main reasons. First, congestion costs typically are measured as the cost of impeded traffic flows (mainly time costs) relative to free-flow conditions, yet free flow is unlikely to be socially optimal (because under free flow there would be too *few* road users, given the benefits as well as costs of road use). Indeed, in 1996 the BTCE estimated that potential gains from 'optimal' congestion levels were of the order of 10 per cent of the then measured total costs of congestion. Applying this ratio today would suggest potential national benefits of around $3 billion (not the $30 billion often cited). Second, time and location-specific congestion pricing, which in theory is 'first-best', in practice is very costly to implement and administer, thus eroding these potential gains further, and quite possibly outweighing them. This is not to say that there are not cost-effective 'second-best' remedies. In similar vein to the Commission's 2005 NCP review, the Victorian Competition and Efficiency Commission has identified a number of options for that State including better management of existing road space and improving the operation of public transport (VCEC 2006).

13.3 What has been achieved?

Since its inception in the early 1990s, the National Transport Commission (NTC) has had responsibility for implementing nationally-consistent road, rail and

intermodal regulatory and operational frameworks and for assessing heavy vehicle charges under the PAYGO system. Major reforms have included the:

- development of a national system of heavy vehicle charging (PAYGO)
- revisions to PAYGO charging to reduce cross-subsidisation and increase heavy vehicle charges to promote full cost recovery
- agreement to establish a National Heavy Vehicle Regulator in 2013 to coordinate a national system of road access management
- nationally-agreed process of safety and infrastructure protection standards as an alternative to existing prescriptive regulation of heavy vehicles — the performance-based standards are intended to facilitate road access for new and safer 'innovative' heavy vehicles
- establishment of a National Rail Safety Regulator in 2013 to oversee regulatory harmonisation directed at improving safety outcomes and reduce the regulatory burden on industry.

In 2007, COAG established the COAG Road Reform Plan (CRRP) to progress the three-step pricing and institutional reform agenda recommended in the Productivity Commission's 2006 report on road and rail freight infrastructure pricing. The Project Board has undertaken initial research on issues such as externalities, Community Service Obligations and heavy vehicle road use. A final feasibility study assessing alternative forms of heavy vehicle charging and funding arrangements was to be presented to COAG in early 2012.

Infrastructure Australia (IA) was established in 2008 with the functions of providing advice to all levels of government and infrastructure investors and owners about matters such as future needs and priorities for nationally significant infrastructure, policy pricing and regulatory issues, and options for enhancing efficient use of infrastructure. IA is responsible for conducting infrastructure audits, developing lists of priority infrastructure needs and evaluating proposals for investment in nationally significant infrastructure.

13.4 Achieving effective reform in the future

The NTC and CRRP processes are transparent, consultative and evidence based, and accordingly provide a solid basis for policy reform in the freight transport sector. Notwithstanding these desirable features of the process, reform delivery has been slow to date, reflecting not only technical complexity but also jurisdictional, political and institutional challenges. Further work to build the evidence base in implementing specific reforms will be crucial, including through trials.

The evidence base for reforming urban transport systems, primarily passenger public and private transport, is much thinner, and would benefit from a comprehensive national review.

14 Government services reform options

14.1 Nature of problem and case for reform

The provision of services to the community by governments is pervasive and ranges from infrastructure to regulation-making and policing. Apart from the political influence over government service delivery, there is usually little competition and an inherent lack of incentives to promote cost effective outcomes. The Commission has noted that reform in this area has considerable potential to improve the efficiency of service delivery without undermining service quality.

Overall expenditures on government services such as defence; public order and safety; education and training; health and residential care and social assistance services (but excluding regulatory services and social security payments) in Australia are significant, and in 2007-08 amounted to 8.4 per cent of GDP (ABS 2011b). This suggests that even modest productivity improvements in this area could deliver material gains.

The *Report on Government Services* indicates that governments deliver services with varying levels of efficiency. For instance, the total recurrent cost per separation (casemix adjusted) varies considerably for public hospitals across Australia, with some jurisdiction spending over 25 per cent more per separation than others (SCRGSP 2012). While there could be a number of reasons for these differences, they suggest that scope exists to improve efficiency. Indeed, analysis undertaken as part of the Commission's research into *Public and Private Hospitals* suggested that in both sectors, average 'output' was estimated to be around 10 per cent below best practice levels (PC 2010d).

14.2 Potential reform and possible gains

Further work could be undertaken to investigate options in progressing reforms to government services. While specific reform areas are yet to be identified, approaches to reform identified by COAG officials in supplementary material provided to the Commission include:

- the extension of pro-competitive reforms into the government service sector

- better use of technology to reduce transaction costs between government and business and citizens
- improving the mechanisms used to more efficiently allocate government services both where economic and non-economic criteria are relevant.

The second approach is consistent with the 'overlaps in reporting obligations including standard online reporting' stream and is not (re)considered here. Further, as many of the other reform areas identified in the 'directions letter' could fall under this reform category, they have also not been considered here.

In general, the gains from reform could be characterised as *efficiency* improvements in the delivery of government services (delivering the same level of services for a lower cost) and gains from greater choice or improved *quality* for consumers of those services.

Such gains can be significant. For example, in 2006 the Commission estimated that a 4 to 5 per cent improvement in total factor productivity in the delivery of health care services was possible over the long term (PC 2006a). If this were to be achieved, it would represent a cost saving of around $3 billion.

Pro-competitive reforms

A number of Commission reports have made recommendations relating to adopting a more market-based approach to government service delivery. For example, The Commission's inquiry into *Disability Care and Support* (PC 2011d) made several recommendations to extend pro-competitive reforms to disability-related service delivery. (Similar themes were also explored in the Commission's *Contribution of the Not-for-Profit Sector* report (PC 2010b).) Recommendations were made to introduce market disciplines on service delivery by developing a system that moved away from 'block' funding for services towards self-directed funding.

While jurisdictions were already pursuing greater consumer choice (to varying degrees), disability care and support services continued to be underpinned, in large part, by some form of block funding. The Commission noted that the block funding model had considerable disadvantages compared to self-directed funding or other ways of giving people choice. And, as a result, service providers deliver services in response to the government rather than the specific needs of their clients. Block funding was also found to create a link between provider viability and their relationship with the funding agency (rather than with their customers). These factors were found to impede consumer choice and incentives for providers to deliver high value instead of low cost services.

The Commission (PC 2011d) found the block funding was warranted only in very specific circumstances to fund disability services. It was estimated that a change to supplier-centred delivery combined with complementary reforms to resourcing, employment policy and the Disability Support Pension would yield significant net benefits. Overall, the package of reforms would have welfare benefits of the order of $8 billion annually when fully implemented and, over the long-run, increase workforce participation, potentially adding around 1 per cent to GDP.

The Commission's study into the aged care system (PC 2011c) made similar recommendations. Central to creating better incentives for aged care service provision, including addressing the under provision of services, was a recommendation to remove caps on place numbers and shift funding from providers to individuals (thereby creating an entitlement system for individuals to operationalize choice).

The Australian Government's response to the report (DoHA 2012) noted that it would review, after five years, the option of adopting the entitlement principle.

Allocating government services

Over time, governments have increasingly outsourced the delivery of the services they fund under the presumption that non-government providers should be more efficient. Competitive tendering models have been adopted as a means of allocating service funding to deliver services at the lowest cost to government.

The Commission has noted, however, that such arrangements can have teething problems and may not be straightforward in all instances. The review of the Job Network (PC 2002) found competitive tendering had driven efficiency gains, but difficulties in assessing the quality of the services delivered ex ante, given the heterogeneous client base, meant it was not possible to determine tenders that generated the greatest net benefits.

Allied to this, in the Commission's study into the not-for-profit sector, not-for-profit organisations (NFPs) argued that for-profit providers were more likely to 'cherry-pick' contracts, leaving the more costly to service clients with the NFP (or government). In addition, where NFPs provide complementary services to clients in what can be an effective as well as efficient approach, there is little scope within competitive tendering arrangements to recognise this additional 'value' (PC 2010b).

In some instances, governments have also taken on funding services that had been provided by NFPs through supporting grants. Through this process governments have tended to impose greater reporting and performance requirements on NFPs.

The Commission found that such requirements often raised costs of service delivery without any commensurate benefit, reduced the scope for innovation through prescription, and on occasion put the NFP supplying partially funded services under financial stress (PC 2010b).

The Commission found that greater attention needed to be paid to choosing the service delivery mode and the contracting arrangements that best suited the nature of the service and the availability of potential non-government providers. The study provided some guidelines to assist agencies in determining the most suitable approach for outsourcing social services (PC 2010b).

Further issues arise where the line agency is both regulator and provider of services. The Commission's report on the *Schools Workforce* (PC 2012f) found that in most jurisdictions, the same government department is responsible for service provision and regulatory roles (including funding decisions). While not making specific recommendations, the report suggested that structurally separating the two functions should be examined to address potential or actual conflicts of interests.

14.3 Reforms implemented to date

National Competition Policy (NCP) resulted in a number of pro-competitive initiatives being implemented for government service delivery. Many of these focused on the provision of services by Government Business Enterprises, with the Competition Principles Agreement setting in place principles for competitive neutrality policy and reforms to public monopolies. Overall, the Commission estimated that, in 2005, NCP and related reforms increased Australia's GDP by around 2.5 per cent (PC 2005d). However, recent reports by the Australian Government Competitive Neutrality Complaints Office indicate that for two newly established government businesses — NBN Co and PETNET Australia — their business models would need to be adjusted to ensure compliance with competitive neutrality policy (AGCNCO 2011, 2012).

There have also been a number of reforms to other areas of government service delivery. For example, employment search and placement services were reformed under the Job Network — a managed market for the provision of subsidised employment services (PC 2002). While some refinements were recommended, the Commission found that the introduction of pro-competitive reforms such as these had improved the efficiency of service delivery and improved outcomes:

> The effects of Job Network programs on net employment outcomes are small, similar to past programs. However, the total costs are much less than previous programs. Competition between providers and the use of outcome payments have created

> incentives for improved efficiency and better outcomes. Job seekers have some choice of provider, and employers are more satisfied. (PC 2002, p. XX)

Individual jurisdictions have also completed reforms in various areas of government service delivery. Although dated, the 1997 and 1998 reports by the Steering Committee for the Review of Commonwealth/State Service Provision on *Implementing Reforms in Government Services* detailed a number of reform case studies. Reforms ranged from devolving decision making in Victorian Government schools to pricing court reporting services in federal courts. The common element for all was the change in the relationship between the government (as purchaser) and the agencies delivering services. Governments focused on specifying the appropriate set of services and monitoring service providers to ensure that high quality services are provided, with providers being left to choose the mix of inputs employed.

More recent examples include reforms to introduce demand driven funding for undergraduate university (DIISRTE 2012) and vocational education and training (VET) places (PC 2011g). For undergraduate places, public universities will decide how many places they will offer and in which disciplines. The purpose is to create a more responsive tertiary education system as universities will now be able to respond to student and employer demand. Demand driven places in the VET sector have initially been used in Victoria from 2009 and will be implemented in South Australia in 2012. However, in Victoria the Commission (PC 2012c) noted that a review of the system identified quality issues in some fields, prompting the Victorian Government to alter funding arrangements. This highlights the importance of the need to measure outputs.

14.4 Achieving effective reform

Continued reforms to promote more efficient and effective government service delivery have the potential to deliver substantial cost savings and benefits to clients. However, setting in place market disciplines or their equivalents can be difficult, requiring changes to both legislation and the way consumers of government services interact with service providers (PC 2011c). These may necessitate additional government outlays. Such factors can put at risk the implementation of such reforms. In relation to the recommended reforms to aged care (PC 2011c), the Commission accordingly suggested a staged implementation process.

15 Urban water

The Productivity Commission completed a major public inquiry into Australia's Urban Water Sector in 2011 and the material in this section is therefore based largely on that report.

15.1 Nature of problem and case for reform

The structural, institutional, governance and regulatory arrangements for the supply of drinking and non-drinking water, stormwater and waste water services varies across jurisdictions and between metropolitan and regional areas. This diversity means that the nature and significance of impediments to performance vary. However, some key impediments to efficiency and cost-effective provision are:

- Conflicting and inappropriately assigned objectives and policies — governments are assigning multiple objectives to their agencies, utilities and regulators, with inadequate guidance on how to make trade-offs among them.
- The conduct of and methodologies used by of some regulators do not represent best practice.
- Lack of clarity about roles, responsibilities and accountabilities — policies and decisions about pricing and supply are politicised and have not focused on providing services at lowest cost.
- Too great a reliance on using water restrictions, water use efficiency and conservation measures to manage demand — leading to reductions in demand being achieved at unnecessarily high cost. Based on economic modelling undertaken by the Commission, the reduction in welfare to the community from stage 3a restrictions in Melbourne is estimated to be between $0.4 and $1.5 billion over a 10 year period, depending on assumptions (PC 2011a).
- Unnecessary constraints on implementation of efficient water resource allocation and supply augmentation — governments have in some cases ruled out low cost supply sources (such as purchase of rural water for urban use), and made investments in supply capacity that is too soon or on too large a scale.
- Attempting to improve affordability of water consumption by distorting customer prices when there are lower cost ways of dealing with these concerns.

These impediments led to a drought response during the early 2000s that was socially more costly than it needed to be. For example, the Commission has estimated that recent supply augmentation investments in Melbourne and Perth could impose unnecessary costs of up to $4.2 billion over 20 years (PC 2011a). Further reform of the urban water sector could largely overcome these problems and the case for reform is strong.

15.2 Potential reform and possible gains

The Commission's inquiry report sets out a detailed reform program in two streams: 'universally applicable' reforms to be adopted across all jurisdictions as a high priority; and other structural reforms to be applied following case-by-case analysis of the costs and benefits.

The universal reforms entail:

- Setting an overarching objective of providing water, wastewater and stormwater services in an economically efficient manner to maximise net benefits to the community.
- Developing appropriate policies and principles that align with that overarching objective. For example:
  - removing 'policy bans' on sources of supply augmentation
  - ensuring the costs, benefits and risks of all options for supply augmentation and demand management are considered using a 'real options' approach
  - restricting provision of subsidies for urban water infrastructure to limited specified circumstances
  - promoting efficient pricing by allowing water retailer–distributors to offer different tariff structures to suit consumer preferences
  - developing appropriate consumer protection principles.
- Putting in place best practice institutional, regulatory and governance arrangements, including:
  - clearly defining the respective objectives for and responsibilities of elected representatives, utilities and regulators (economic, health and environmental), and where decisions are best made by consumers
  - assigning retailer–distributors with responsibility for meeting security of supply standards and procuring water supply and services based on a portfolio manager framework

- ensuring best practice governance by devising a charter that gives guidance to water utilities on obligations to serve and other matters
- phasing out regulatory price setting, and allow utilities to set their own prices subject to guidance in the charter regarding transparency of pricing and augmentation decisions, and adopting price monitoring where necessary.

Implementing the universally applicable reforms should be the highest priority as they are likely to yield the greatest efficiency gains (particular from better supply augmentation decisions). They would allow water utilities to focus on delivering water and wastewater services at least expected cost, without being subject to undue political and regulatory constraint, while being held accountable for pricing and augmentation decisions.

Various structural reform options have the potential to produce further benefits in some places. For example, in metropolitan areas, vertical separation of supply chains could produce competition-related benefits, particular in the supply of bulk water from dams, desalination plants and so on.

There is insufficient evidence to support competitive urban water markets analogous to the national electricity market. That said, many of the Commission's structural reform options would be necessary if a more market-based approach were to be pursued. In regional areas, some small utilities could be aggregated to exploit economies of scale. Alternatively, gains could be achieved through greater co-operation between council operated service providers.

Many of the costs associated with inefficient augmentation decisions are sunk and consumers and the community must now live with the consequences for decades to come. For example, in 2007 the Victorian Government committed to two major supply augmentations — a desalination plant with a 150 GL per year capacity (capable of expansion to 200 GL) and the pipeline connecting the Goulburn River system to the Sugarloaf Dam. Modelling by the Commission estimates the excess cost to the community of this plan relative to an optimal strategy to be \$2.7 to \$3.7 billion over a 20 year period (in net present value terms), depending on assumptions (PC 2011a).

Consequently, the gains to consumers and the community from implementing reform in the short term relate mainly to more efficient operation of existing infrastructure. These gains are accordingly smaller than otherwise. But they will increase over time as demand for water increases and new supply sources are needed.

15.3 What has been achieved

The Government released the Commission's report in October 2011. It indicated at that time that the report would contribute to 'further discussion with the States and Territories on the next steps in building a future national work program for water reform'. The Commission is not aware of steps taken by governments toward implementing the proposed reform pakage.

That said, it is important to recognise that significant reform of the urban water sector had previously been achieved, compared with the situation in the 1980s (National Water Commission 2011; PC 2005d), including:

- Institutional reform — separation of roles, and corporatisation and commercialisation of many government-owned utilities.
- Pricing reform — restructuring of water tariffs based on principles of full cost recovery, consumption-based pricing, including introduction of two-part tariffs, and reduction or elimination of cross-subsidies between customer groups.
- Structural reform — vertical separation of the bulk supply and retail-distribution functions of the supply chain in Sydney, Melbourne and south-east Queensland.

These reforms generated significant benefits. For example, labour productivity in the urban water sector increased by more than 60 per cent over the 1990s (PC 2005d). However, there remains significant scope for further gains.

15.4 Achieving effective reform in the future

The potential urban water reforms outlined above would require changing institutional and governance arrangements so that the roles and responsibilities of governments, utilities, and regulators are clear. This would not involve significant costs, but could be contentious and time consuming. There might also be (small) costs associated with utilities adopting a portfolio manager framework, and acquiring the skills to apply a real options approach.

Notwithstanding modest costs, achieving reform could be challenging. Governments may be reluctant to accept a reduced role in bulk water supply decisions. This might be exacerbated by lesser interest in undertaking reform in the near-term, given excess supply capacity in most metropolitan areas (meaning the gains from bulk water reform might not be realised for a number of years).

However, there would be value in implementing reform well in advance of any re-emergence of concerns about security of supply. For example, it would send an

important signal to potential investors about how future supply decisions would be made.

Structural reform would involve more significant challenges and costs, including loss of economies of scale and scope, and costs associated with setting up new entities. For example, horizontal separation of the monopoly retailer-distributor to create multiple geographic monopolies might reduce scale economies if disaggregation produces utilities that are below minimum efficient scale. The diverse circumstances of utilities means that the case for structural reform must be assessed on a case-by-case basis.

To encourage progress on the reform program, the Commission recommended that an intergovernmental agreement be formulated through COAG. However, agreement across all jurisdictions is not necessary for State and Territory Governments to proceed with nominated reforms, of which they will be the major long-term fiscal beneficiaries (PC 2011a).

16 Reforming business and State taxes

16.1 Nature of problem and case for reform

Taxation is an integral feature of the Australian economy. The revenue raised is used for a wide variety of purposes, ranging from funding the provision of government services, social welfare and infrastructure through to repaying government debt and improving a government's financial position. Despite changes in the mix of taxes over time, the overall tax take has remained relatively stable.

Taxation reform can reduce the cost to taxpayers of complying with their taxation obligations, improve economic efficiency and address equity objectives. Reform can also enable governments to fund additional services, repay debt or to reduce revenue raised from other taxes.

Thus, in assessing the impact of tax reform, consideration also needs to be given to the corresponding changes that accompany the reform (be they changes in government expenditure, revenue raised from other taxes or changes in a government's fiscal position). The overall impacts will depend on the impacts from the tax reform *relative* to the impacts from the accompanying changes.

The impact of a tax reform will depend, among other things, on the type of the reform (the tax being reformed and the type of change) and the nature and extent of economic activity affected.

16.2 Potential reform and possible gains

A range of taxation reforms are currently being explored for consideration by COAG. These initiatives fall into two broad groups — business tax reforms and State tax reform.

Business tax reforms

Potential business tax reforms are being developed by the Business Tax Working Group (BTWG). The BTWG has been asked to canvass a range of possible options to 'relieve the taxation of new investment' (BTWG 2012, p. 57). Its first report

focussed on the treatment of losses and suggested the option of 'loss carry-back' to 'provide benefits for businesses and the economy by supporting business investment and improving investment decisions in response to changes in the wider economy' (BTWG 2012, p. 19). Other potential business-related taxation reforms are being developed for a second BTWG report, which is due for release in December 2012. Other possible reform options being examined include changes to the corporate tax rate and a move towards a business expenditure tax system (BTWG 2012). The Working Group is also identifying possible off-setting cost saving measures to ensure that the reforms are revenue neutral. To date, the focus of the BTWG has been on Australian Government, rather than State, taxes.

In essence, loss carry-back arrangements allow companies the option to offset losses in the current year against profits in previous years, rather than necessarily carrying these losses forward and offsetting them against future profits. This reform will primarily affect the timing of business tax payments, as businesses will receive a tax offset in the year that the loss is incurred rather than a decrease in future tax obligations. However, where companies incur ongoing losses, the changes will result in a reduction in the revenue collected from company tax.

The possible gains from the business tax reforms being considered will depend on the nature of the changes made to these business taxes and the offsetting changes to other business taxes to ensure revenue neutrality. That is, the gains from reforming these business taxes need to be weighed up against the effects of the offsetting changes. For example, the *net* effect on economic efficiency will depend on the changes in the deadweight loss arising from each tax change. The net effects of such changes are likely to be relatively modest, unless the changes have a material effect on the production and investment decisions of business.

The Commission has not previously assessed the potential impact of the business tax reform options of the kind canvassed so far by the BTWG and is, therefore, unable to quantify the gains from such reforms and the effects of the accompanying changes.

State tax reform

The Council for the Australian Federation is separately identifying potential State tax reform options for consideration by COAG. These initiatives build on the harmonisation of payroll tax arrangements that formed part of the Seamless National Economy reforms agreed to by COAG in 2008 (COAG 2008).

One reform option under consideration is that of a single lodgement point for payroll tax across jurisdictions, to reduce the cost to businesses of complying with

different State payroll tax regimes and administrative arrangements. Legal, administrative and constitutional issues will need to be addressed before such a reform could take effect.

In a recent study on the impacts of 17 Seamless National Economy business regulation reforms, the Commission identified that further opportunities exist to improve the harmonisation of payroll tax across States (PC 2012b). One option put to the Commission was that elements of the Standard Business Reporting (SBR) framework could be used to develop a single web portal for the payment of payroll tax. The Commission did not assess the likely gains from such a reform. However, in assessing the potential gains from the SBR reforms agreed to by COAG, the Commission found the take-up rates to be low. The Commission concluded that, while the SBR reforms had the potential to reduce business costs by $560 million per year, take-up rates of SBR-enabled software needed to increase substantially for this to occur and that this would require continued commitment and sustained effort on the part of all governments and relevant government agencies (see section 7).

It is understood that the Council for the Australian Federation is also identifying other potential State taxation reform options.

Although dated, a Commission staff working paper (Gabbitas and Eldridge 1998) explored a range of State tax reform options. It assessed a range of State taxes against the criteria of economic efficiency; equity; administration and compliance; and stability. Payroll tax was found to be a relatively broad and efficient tax, with generally low administration costs. However, the paper identified scope to reduce the relatively high cost to businesses of meeting their payroll tax obligations and to reduce the range of exemptions so as to broaden the base on which the tax is levied. Subsequent reforms have addressed some of these suggestions.

This study also found that rates levied by local government were a relatively efficient form of taxation, while State land taxes were less so because of their much narrower base. It was concluded that removing exemptions, such as for owner-occupied housing, could improve the efficiency of State land tax.

The study also found certain State transaction-based taxes, such as stamp duty, to be less efficient and more inequitable than ownership-based taxes, such as land tax. One reform option identified was the abolition of stamp duty, with the foregone revenue made up through broadening the base and increasing the rate of land tax. Another possible reform option was to abolish some of the more distorting State taxes and replace them with a broad-based expenditure or income tax.

The Commission has not quantified the potential gain from State tax reform.

However, given the relatively high deadweight losses associated with many State taxes (see, for example, Gabbitas and Eldridge 1998 and Henry Review 2010), the net impact of State tax reform has the potential to improve the overall efficiency of the tax system and to deliver worthwhile gains.

16.3 What has been achieved

In light of the recommendations of the BTWG, loss carry-back arrangements for companies were subsequently adopted by the Australian Government as part of the 2012-13 budget measures (Australian Government 2012). These measures are due to take effect on 1 July 2012 and are expected to lead to a $700 million reduction in business tax revenue over the four-year forward estimates period. This will be funded by the Minerals Resource Rent Tax.

Recent reform of State taxes has focussed on harmonising the legislative and administrative arrangements across jurisdictions for payroll tax (but not the thresholds and tax rates that apply). These reforms formed part of the Seamless National Economy reforms (COAG 2008) and involved State Governments adopting common definitions and provisions and common payroll tax rulings.

In its 2012 assessment, the COAG Reform Council found that there had been substantial progress in harmonising the administrative arrangements for payroll tax (CRC 2012). In assessing the impacts of the Seamless National Economy reforms, the Commission found that the payroll tax reforms were worthwhile and had the potential to reduce business costs by around $30 million per year, of which two-thirds was assessed as having been realised by mid-2012 (PC 2012b).

16.4 Achieving effective reform in the future

In its assessment of the impacts of COAG reforms, the Commission noted that opportunities existed to further harmonise the administrative arrangements for payroll tax (PC 2012b). The Commission found that, given the remaining differences in administrative arrangements across jurisdictions and the size of the activities affected, the gains from further payroll tax harmonisation are likely to be relatively modest.

The Commission went on to note that scope existed for wider, more substantive reform of payroll tax, including replacing it with a more efficient broad-based tax, along the lines recommended by the Henry Review (2010). Such reforms would go some way towards reform of State taxes more broadly.

While the State tax reform options being developed are unknown at this stage, meaningful and material reform of State taxes has the potential to be worthwhile, depending on the corresponding changes that accompany the reform. Given the relative size of revenue raised through Australian Government taxes, broader reform has the potential to deliver even larger benefits than State tax reform alone.

A Directions letter

Dr Martin Parkinson PSM
Secretary

Mr Gary Banks AO
Chairman
Productivity Commission
GPO Box 1428
CANBERRA CITY ACT 2601

Dear Mr Banks

COAG REGULATORY AND COMPETITION REFORM

I am writing regarding the Council of Australian Governments' (COAG) request that its new regulatory and competition reform agenda be informed by high-level advice from the Productivity Commission.

On 13 April 2012, COAG agreed to progress six priority areas for major reform to lower costs for business and improve competition and productivity. COAG also agreed to consider other areas of reform, such as ways to reduce the reporting burdens on business. The new agenda will be supported by a *National Productivity Compact: Regulatory and Competition Reform for a more Competitive Australia*, which includes a high-level statement on principles for effective regulation.

To progress the reform agenda, COAG agreed to a cross-jurisdictional Taskforce, to be chaired by the Secretary of the Commonwealth Department of Finance and Deregulation. The Taskforce will provide advice to COAG for its next meeting on the detail of the specific reforms discussed at the Business Advisory Forum and included in the COAG communiqué on 13 April 2012.

As part of this, the Taskforce has been asked to advise COAG on the likely costs and benefits of the reforms, drawing on high-level advice from the Commission and an assessment against COAG's reform principles. The Taskforce will also provide advice on sensitivities, stakeholder views and implementation pathways and challenges. In addition, the Taskforce has been asked to consider the merit of potential areas for reform identified by the Business Regulation and Competition Working Group and the Standing Council on Federal Financial Relations.

Further to the outcome of the COAG meeting and my discussions with you, I would like to request that the Commission undertake, by end of June 2012, a preliminary high-level

review of the areas of reform, as outlined in more detail at Attachment A. I have also attached an extract from the COAG communiqué at Attachment B for your information.

It is possible that this work will be extended, with the Taskforce considering whether to request further advice from the Commission for COAG's consideration at the end of the year, as noted at Attachment A.

I understand the Commission has capacity to undertake this work within its existing work program. I have informed the Assistant Treasurer of this request and I have copied this letter to him.

I have also copied this letter to the Secretary of the Department of Finance and Deregulation and the Secretary of the Department of the Prime Minister and Cabinet for their information.

I would be pleased to discuss this request with you should you require further clarification.

Yours sincerely

Martin Parkinson
May 2012

ATTACHMENT A

REQUEST FOR PRODUCTIVITY COMMISSION ADVICE

The Productivity Commission is requested to undertake, by end of June 2012 for consideration by the Council of Australian Governments (COAG) mid-year, a preliminary high-level review of the following areas of reform:

(a) six priority areas for major reform to lower costs for business and improve competition and productivity, agreed by COAG on 13 April 2012 (as set out in the COAG Communiqué at Attachment B):

i. addressing duplicative and cumbersome environment regulation;

ii. streamlining the process for approvals of major projects;

iii. rationalising carbon reduction and energy efficiency schemes;

iv. delivering energy market reforms to reduce costs;

v. improving assessment processes for low risk, low impact developments; and

vi. best practice approaches to regulation.

(b) reforms that COAG agreed on 13 April 2012 to consider to reduce reporting burdens on business through the removal of overlaps in Commonwealth and State and Territory reporting obligations, including the expanded use of online business reporting;

(c) reforms that COAG agreed on 13 April 2012 to consider as part of a new National Productivity Compact to be developed between the Commonwealth, States and Territories and business, to future proof national frameworks, including new national regulatory principles, mechanisms to facilitate more consistent and efficient implementation and enforcement of regulation, and ex-post review of national frameworks; and

(d) the following proposed areas of reform identified by the Business Regulation and Competition Working Group and the Standing Council on Federal Financial Relations:

i. harmonisation of occupational conduct requirements;

ii. further occupational licensing reform;

iii. harmonisation of explosives legislation;

iv. extension of the National Construction Code;

v. land transport reform;

vi. reforms to government services;

vii. urban water reform; and

viii. tax reform.

The Productivity Commission's analysis should draw on past Commission reports and related existing materials, and outline matters such as the national significance of each reform area and the potential reform gains.

The cross-jurisdictional Taskforce, chaired by the Secretary of the Department of Finance and Deregulation, will consider whether to request additional analysis by the Commission for COAG's consideration at the end of 2012.

ATTACHMENT B

Council of Australian Governments Meeting
Canberra, 13 April 2012
Communiqué (extract)

Business Advisory Forum

Noting the speed of economic change, increasing globalisation and structural shifts in the economy, participants in the Business Advisory Forum expressed their confidence in the capacity of Australia to address change and secure prosperity. The Prime Minister, Premiers and Chief Ministers thanked the leaders of businesses and business groups for their constructive engagement on regulatory and competition reform at the Forum, and particularly welcomed the paper prepared by the Business Council of Australia (BCA).

Following discussions at the Business Advisory Forum, COAG agreed to progress six priority areas for major reform to lower costs for business and improve competition and productivity. The reform priorities are:

- addressing duplicative and cumbersome environment regulation;
- streamlining the process for approvals of major projects;
- rationalising carbon reduction and energy efficiency schemes;
- delivering energy market reforms to reduce costs;
- improving assessment processes for low risk, low impact developments; and
- best-practice approaches to regulation.

First Ministers reaffirmed COAG's commitment to high **environmental standards**, while reducing duplication and double-handling of assessment and approval processes. To achieve these commitments, our governments will work together to:

- fast-track the development of bilateral arrangements for accreditation of state assessment and approval processes, with the frameworks to be agreed by December 2012 and agreements finalised by March 2013;
- develop environmental risk- and outcomes-based standards with States and Territories by December 2012; and
- examine and facilitate removal of unnecessary duplication and reduce business costs for significant projects.

COAG acknowledged the Commonwealth's existing final approval responsibilities for projects within its current jurisdiction affecting world heritage sites and specific areas of action, including nuclear actions, defence development and developments affecting Commonwealth waters. The Commonwealth will work with the States and Territories to

improve the process for approvals of these categories, agreed bilaterally or collectively, for consideration by COAG at its next meeting.

The Prime Minister, Premiers and Chief Ministers tasked Heads of Treasuries to scope urgently the BCA's proposal to benchmark Australia's **major project development assessment processes** against international best practice, and to report to COAG through Senior Officials. COAG agreed that the construction industry is a significant contributor to Australia's economic and social wellbeing. COAG noted that Heads of Treasuries have been asked to undertake analysis of construction industry costs and productivity, and agreed to consider the outcomes of this work through Senior Officials. Both should occur within a month, including the possibility of referral of one or a combination to the Productivity Commission.

Premiers and Chief Ministers agreed to examine reforms that could be undertaken at the State and Territory level to improve the approval process for major projects, for discussion at the next Business Advisory Forum. All levels of government will work toward a range of additional approaches, including the creation of taskforces for major projects, so that approvals are administered by a single State agency and unnecessary duplication in Commonwealth and State processes is removed.

COAG recognised the need to prioritise the completion of a review of **unnecessary carbon reduction and energy efficiency schemes** and asked its new Taskforce (see below) to provide urgent advice in advance of the next COAG meeting on how to fast track and rationalise policies and programs that are not complementary to a carbon price, or are ineffective, inefficient or impose duplicative reporting requirements on business.

COAG reaffirmed its commitment to reforms to increase competition in interconnected **energy markets**. COAG will consider at its next meeting proposals to bring forward existing reviews in electricity and natural gas markets as key steps towards improving competition and the efficiency of electricity networks to ensure that energy regulation places greater weight on the outcomes for consumers.

COAG discussed progress by State and Territory governments on **development assessment reforms**, and acknowledged the need to ensure these processes operate efficiently and do not create unnecessary delays for development proposals. Premiers and Chief Ministers agreed to consider adopting ambitious targets to improve development assessment processes for discussion at the next Business Advisory Forum.

COAG agreed to consider concrete measures to **lift regulatory performance**, including reducing complexity and duplication and increasing transparency and accountability. This will be informed by the current work of the Productivity Commission on the efficiency and quality of Commonwealth, State and Territory and COAG Regulation Impact Assessment arrangements, due to be completed in late 2012.

COAG further recognised that small to medium enterprises are particularly vulnerable to unnecessary regulation and the accumulation of regulation. COAG agreed that the new Commonwealth Minister for Small Business, and the relevant State and Territory Ministers, would engage the Small Business Advisory Committee, the Council of Small Business of Australia and State and Territory Chambers of Commerce to identify examples

of burdensome or unnecessary regulations that frustrate businesses on a day to day basis, and to report back to First Ministers. COAG directed the Taskforce (see below) to prepare a comprehensive report on the red-tape challenge for its next meeting.

COAG committed to reduce reporting burdens on business. COAG asked the Taskforce to report on specific ways to remove overlaps in Commonwealth and State and Territory reporting obligations, including the expanded use of online business reporting, for consideration at its next meeting.

COAG agreed the new productivity-enhancing regulatory and competition reform agenda will be supported by a *National Productivity Compact: Regulatory and Competition Reform for a more Competitive Australia*. The Compact between the Commonwealth, States and Territories and business will set out a high-level statement on principles for effective regulation and reform. The Compact will be developed by COAG Senior Officials, in consultation with business, and finalised at the next Business Advisory Forum.

To develop the policy and timetable for this ambitious new reform agenda, COAG agreed to establish a cross-jurisdictional Taskforce, chaired by the Secretary of the Commonwealth Department of Finance and Deregulation, comprising a senior Commonwealth Treasury official and Deputy Secretary representatives from both First Ministers and Treasury departments in the States and Territories, reporting to COAG through First Ministers' Senior Officials.

The Taskforce will provide advice to COAG for its next meeting on:

- the detail of the specific reforms discussed at the Business Advisory Forum, outlined above;
- the likely costs and benefits of the reforms, drawing on high-level advice from the Productivity Commission and an assessment against COAG's reform principles; and
- sensitivities, stakeholder views and implementation pathways and challenges.

COAG noted the existing work on future regulation and competition reform, undertaken by the Business Regulation and Competition Working Group and the Standing Council on Federal Financial Relations, and asked the Taskforce to provide advice on the merit of these proposals in the context of a focused productivity-enhancing reform agenda. COAG agreed that the Business Regulation and Competition Working Group would see the completion of the existing Seamless National Economy reforms by the end of 2012 but would not continue beyond this, being replaced by the Taskforce.

COAG noted that the Forum will reconvene in the second half of 2012 to review and assess progress.

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