
NCP and beyond: an agenda for national reform*

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Introduction

It is a pleasure to be able to talk on this important topic to this particular forum. CEDA has a proud history of facilitating public discussion on the big issues confronting this country, including economic reform. The Productivity Commission and its predecessors have helped inform the public debate, by providing information on what is at stake in economic reform and advice about the best way forward.

It is easier to discuss reform when the need for it is readily apparent. The Australian economy has been doing rather well for quite a while. Many younger members of our society will not have even experienced a significant economic downturn in their adult lifetimes. It is worth briefly reminding ourselves of the earlier, contrasting experience.

The backdrop

The strength of Australia's economic performance over the past decade is a marked turnaround from a lengthy period of economic malaise. During the 70s and 80s, growth slowed, inflation and unemployment rose, and our productivity performance was poor by international standards.

While external developments contributed to this economic deterioration, high barriers to trade and foreign investment, and various regulatory and institutional restrictions on competition in the domestic market, sustained growing inefficiencies

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across the economy. They also created a business culture that focussed on securing government preferment rather than on achieving a competitive edge.

In recognition of the policy-related inhibitors on growth, from the early 1980s, Australian governments embarked on broad-ranging economic reforms. These began with the floating of the exchange rate and opening of our borders to foreign goods and services — and hence to international best practice. As local suppliers sought to meet the new competitive challenges, the spotlight was thrown onto various other, home grown impediments to their performance.

The two stand-out impediments were our inflexible labour market institutions and inefficient public utilities. Reforms in these areas commenced. But, like peeling an onion, each successive layer of reform revealed additional needs and opportunities. In particular, it became plain that, in many areas, separate jurisdictional reforms lacked the coherence and consistency needed to build an efficient *national* market.

Hence, in April 1995, Heads of Governments committed themselves to the National Competition Policy (NCP).

This ambitious program has been a landmark achievement in nationally coordinated economic reform. It has yielded benefits across the community. However, it has also involved some costs and the implementation process has not been without defects. Moreover, most of the reforms originally agreed to are now in place, raising the question of what should happen next.

The Commission was asked by the Australian Government to conduct a public inquiry into the impacts of NCP and future areas ‘offering opportunities for significant gains to the Australian economy from removing impediments to efficiency and enhancing competition’. The Commission’s report is intended to help inform a forthcoming CoAG review of NCP and possible future reforms. As you know, we released a Discussion Draft in October. Our final report will be forwarded to Government at the end of February 2005.

NCP’s ambitious agenda

NCP was based on recognition that competitive markets will generally best serve the interests of consumers and the wider community, and (more radically) that arrangements that detract from competition should be retained only if they can be shown to be in the public interest.

The scope of NCP is very wide, and more ambitious than anything previously attempted within our Federal system. The agenda is familiar to this audience. Specifically, NCP provided for: the extension of the Trade Practices Act (TPA) to previously excluded businesses; governance and structural reforms to government businesses to make them more commercially focussed and expose them to

competitive pressure; regulatory arrangements to secure third-party access to ‘essential’ infrastructure services and, more generally, to guard against overcharging by monopoly service providers, especially in the infrastructure area; and a process for reviewing, and where appropriate reforming, a wide range of legislation which restricted competition. NCP also incorporated previously agreed reform programs for the electricity, gas, water and road transport sectors.

However the ambition of NCP knew *some* bounds. NCP did not encompass industrial relations regulation, for example. And, contrary to perceptions to the contrary, it did not mandate asset sales and privatisation, compulsory tendering or contracting out of government service provision or removal of community service obligations.

Its core feature was a set of guiding principles and processes that provided disciplines on all governments while allowing differential responses across jurisdictions. Among its institutional innovations was the creation of the National Competition Council (NCC) to monitor progress and advise on the so-called competition payments from the Australian Government to the States and Territories.

Moreover, the architects of NCP understood that it would not be desirable (or practical) to promote competition in every activity. Explicit provision was made within the NCP’s procedural framework for recognition of social, environmental, equity, regional and adjustment objectives when assessing particular reform options.

What has NCP delivered?

Australia’s economic performance over the last decade stands out, not only by our own standards, but also among OECD countries. The headline expression of this is the past 13 years of uninterrupted growth that Australia has experienced — one of the longest expansion phases on record.

Underpinning this strong performance has been a surge in Australia’s rate of productivity growth, effectively yielding an additional \$7000 to the ‘average’ Australian household’s income. In contrast to the 1970s and 1980s, Australia’s productivity performance has also been very strong by international standards, and was achieved despite a decade of economic stagnation in Japan and the financial crisis which struck our Asian trading partners in 1997.

While many factors can influence productivity growth, various studies indicate that microeconomic reforms — including NCP — have been a major contributor to Australia’s productivity surge in the 1990s, and to our economy’s increased resilience in the face of economic disturbances (slide 1).

That NCP and other microeconomic reforms would have yielded a significant payoff in productivity and income growth should not surprise. After all, that is what

they were designed to do. Taken as a package, the reforms operated on two fronts: enabling competition to spur *incentives* for enterprises to seek performance improvements, while enhancing their *capacity* to do better through industrial relations and infrastructural reforms.

Previous model-based projections by the Industry Commission suggested that NCP could generate a net benefit equivalent to 5½ per cent of GDP. This provoked some controversy at the time, but it is consistent with the subsequent record. More selective analysis, undertaken for this inquiry, indicates that the productivity and price changes actually observed in key infrastructure sectors in the 1990s — to which NCP and related reforms have directly contributed — have served to increase Australia's GDP by 2½ per cent, or \$20 billion.

It has delivered price benefits, especially for businesses

Not only have the reforms provided a means to improve productivity and thereby lower costs, they have created competitive pressure for those cost savings to be passed on to users in lower prices.

It has not been possible to separate with any precision the impacts of NCP from the myriad of other factors influencing prices in the market place. But it is telling that in a number of areas targeted by NCP and related reforms, there have been significant price reductions, including in electricity, rail freight and telecommunications

While technological advances clearly contributed in the case of telecommunications, the entry of new players — made possible by the removal of previous barriers — undoubtedly accelerated the uptake of new technologies and helped to ensure that users shared in the cost savings.

At face value, businesses generally appear to have benefited more than households (slide 2). Indeed, in some cases, price increases for households or consumers were an intended consequence of the reform process.

- For services such as electricity, there has been significant price rebalancing to reform previous arrangements whereby businesses had borne a disproportionate share of the costs of service delivery.
- There was a widely accepted need to increase levels of cost recovery for services such as water and various publicly provided passenger transport services.

However such direct price effects are only part of the story. Many households will have benefited from lower prices for other goods and services made possible by cheaper infrastructure inputs for businesses, as well as from the longer term stimulus to employment and wages provided by NCP.

It has provided a range of other benefits

The more competitive market environment created by NCP and related reforms has also helped to improve service quality and reliability in some sectors, and led to an expansion in the range of products and services available to consumers. And consumers have not been the only beneficiaries. For example:

- relaxation of controls on the marketing of some grains and lamb has boosted returns to many producers, with flow-on benefits for surrounding communities (though clearly this is not uncontested!); and
- water reforms have encouraged more efficient use of this scarce resource and generally improved environmental outcomes (though clearly there is more to do).

The benefits have been widely spread

Though varying in magnitude, the benefits of NCP and related reforms have been spread across the community. Contrary to some perceptions, this includes most of rural and regional Australia. For example, the Commission's modelling of productivity and price changes in key infrastructure sectors during the 1990s suggests a consequent increase in regional output (and thus income) in all but one of the 57 regions modelled across Australia.

Our report, and its modelling supplement, set this out in some detail. Slide 3 is not based on that modelling and is obviously high aggregated, but it does demonstrate that the post-NCP period has seen economic growth across Australia generally, even if somewhat more rapid in metropolitan and coastal regions.

The facts are that many of the negative influences on activity and employment in country Australia, such as declining terms of trade and population drift from smaller rural communities (often to larger regional centres), are of a long term nature and unrelated to NCP. Indeed, by putting downward pressure on the cost of services such as power and transport, NCP and related reforms may well have helped to ease the adjustment burden associated with these broader pressures.

NCP has not been an unqualified success

In some cases, even though agreed reforms were implemented, they have proved insufficient to achieve underlying objectives. For example, the electricity market reforms have as yet failed to deliver a fully effective national market. While considerable progress has been made in water reform, there is still much more to do to achieve efficient and sustainable water use across Australia. And, apart from the failure to proceed with some legislation reviews, the outcomes from several key reviews that have been undertaken have been problematic.

For some businesses and communities, the adjustment burden has been considerable. For example, reforms to improve the efficiency of public utilities have seen sizeable reductions in employment in those industries, some of which have been regionally concentrated (East Gippsland stands out). While rarely large from an economy-wide perspective, such costs have added to other pressures already facing particular communities.

Some of the NCP reforms have also been costly to administer. This has been a particular issue at the local government level and for smaller State and Territory Governments in dealing with more minor items on the legislation review program.

However, such transitional costs, and the fact that NCP has not delivered on every goal, do not detract greatly from its overall benefits. Moreover, though many of the costs have now been incurred, the benefits can be expected to be ongoing.

What reform lessons emerge?

Several factors have underpinned the success of the NCP, but three broad ones stand out:

- recognition by all governments of the need for reform;
- agreement on the main problem areas and policy approaches needed; and
- effective procedural and institutional mechanisms to implement them;

with effective political leadership underlying all three.

The flexibility afforded jurisdictions in how to implement many of the reforms, and the transparent and independent monitoring of progress and outcomes, have been particularly important. It is also apparent that the provision of financial incentives to the States and Territories as a fiscal dividend from meeting reform commitments played a critical role in keeping the reform process on track.

But some aspects of the procedural arrangements have been found wanting.

- Implementation of parts of the package, especially the legislation review program, has been hampered by the lack of prioritisation.
- Public interest test requirements have not always been rigorously applied.
- The independence of some legislation reviews has been questionable, and the conduct of reviews and basis for the outcomes have not always been transparent.
- The reform framework provides no guidance on the circumstances in which governments should provide additional support to aid adjustment or address adverse distributional consequences from the reform process.

Replicating the strengths and addressing the weaknesses observed in the NCP process will obviously be important to the success of future nationally coordinated reform efforts. “But do we *need* more reform?” some of you may be thinking.

Why further reform is needed

NCP can be seen as the culmination of more than two decades of reform. Not surprisingly, after such a prolonged period of policy-induced change to economic rules, institutions and ways of doing business, there is evidence of ‘reform fatigue’.

The reality, however, is that there is a pressing need for further reform to enable higher living standards across Australia in the face of some major challenges — some old, some ‘new’.

- While increasing integration of the world’s economies will provide new opportunities for Australia, it will also pose further competitive threats (think of China, India).
- The growing emphasis on preferential trading arrangements has created a much more uncertain trading world, with significant potential downsides.
- There will be pressure both domestically and internationally to improve environmental outcomes and to achieve more sustainable resource use.

But perhaps the biggest foreseeable challenge facing Australia in the next 50 years is the ageing of our population. The challenge can be summarised in three pictures from our recent report, showing:

- a pronounced decline in the share of the population over 15 available for work (slide 4);
- a consequent halving of per capita income growth (slide 5);
- combined with a rise in government outlays equivalent to 7 per cent of GDP, to which healthcare contributes the lion’s share (slide 6).

Further competition-related and other economic reform will be important for meeting these challenges and improving standards of living more generally. Apart from helping to sustain Australia’s productivity performance, such reforms can directly assist in offsetting the economic impacts of population ageing.

Fortunately (?) the scope for further gains is large

Notwithstanding the improvement in Australia’s economic performance in recent years, there are still sizeable inefficiencies and performance gaps. For example, if Australian industry could achieve the same productivity levels as in the United States, average household income would rise by 20 per cent (some \$22 000 a year).

Looked at from a purely domestic angle, if Australia could sustain just half the improvement in the rate of productivity growth achieved during the 1990s boom, real cumulative GDP from 2003-04 to 2044-45 would be some \$1900 billion higher than if average productivity growth rates slipped back to the levels of the preceding two decades.

What criteria for nationally coordinated reform?

To devise a manageable agenda for CoAG out of a wide array of opportunities for further reform, the Commission adopted a screening process with three tiers, to identify areas where:

- reform is likely to bring substantial benefits for the Australian community;
- competition-related measures could usefully form part of the reform package required to deliver those benefits; and
- there is likely to be a high return from using a nationally coordinated reform framework overseen by CoAG or another national leadership body.

Key elements of a proposed agenda

The two page attachment summarises the Commission's preliminary agenda. Most of the agenda items would come as little surprise to this audience. However, there are a few areas that I would like to elaborate briefly on.

Infrastructure reform must continue to be a high priority

Notwithstanding the performance gains secured through NCP, impediments to competition and efficiency remain evident in several infrastructure areas. Many of these would be most effectively addressed within a nationally coordinated reform framework.

The Commission considers it important that governments follow through with implementation of the new *energy and water programs*, including by recommitting to the National Water Initiative. In addition, it has identified other reform issues that need to be progressed in these areas.

- In the energy sector these include: ensuring that the exercise of market power, especially in generation activity, does not undermine the potential gains from the national electricity market; and reducing regulatory fragmentation and policy uncertainty in relation to greenhouse gas abatement.
- In the water sector they include developing ways to achieve more effective management of adverse environmental consequences of inappropriate water use.

In both sectors there is a need to ensure that oversight arrangements post-NCP provide sufficient discipline on all governments to progress agreed reforms. (Currently this is not clear.)

The Commission also considers that nationally coordinated reform frameworks should be developed for *freight and passenger transport*. While both of these areas were encompassed by the general provisions of NCP, reforms have tended to be developed and implemented in a piecemeal fashion within transport modes and jurisdictions. Australia still has a long way to go to achieve a transport system that encourages an efficient mix of transport modes, allows for the seamless movement of freight along the logistics chain, and meets the needs of commuters in a cost-effective and sustainable fashion.

Finally, though a matter for the Australian Government, further pro-competitive reform in the communications sector remains very important, both for business and the wider community.

- Addressing the still significant constraints on competition in broadcasting — including restrictions on the number of commercial free-to-air TV stations, multi-channelling and datacasting — should be an immediate priority.
- And, consistent with NCP requirements, prior to any sale of the Government's remaining share in Telstra, there should be an examination of the appropriateness of the company's structural configuration.

Not all anti-competitive regulation has been properly addressed

As noted, there are some important outstanding items on the legislation review program, including the anti-dumping and cabotage regimes. Also, the Commission is proposing that a more targeted program of legislation reviews be retained beyond the current NCP. Priorities for this new program would include 'second round' reviews of wheat marketing, compulsory third party and workers' compensation insurance and the pharmacy sector.

Australia's competition and regulatory architecture can be further improved

While much of the 'systemic' regime put in place under NCP to promote competition across the economy appears to be operating effectively, there are some shortcomings. Three areas are especially important.

- Legislation review can continue to play an important role, but as noted it should be better targeted towards significant anti-competitive legislation, and involve increased transparency and independence of review processes.
- Processes for monitoring new and amended regulation should be strengthened to prevent unwarranted restrictions on competition from resurfacing.

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- More should be done to ensure that pricing regimes for regulated infrastructure services give appropriate incentives for new investment.

Also, a national review of consumer protection regulation would be a natural follow-on to recent reviews of other aspects of trade practices regulation, and would provide an opportunity to examine whether such policies are continuing to meet the needs of consumers in a more competitive environment.

Coordinated national reform should extend beyond the current NCP

Arrangements for the provision of human services such as health, education and aged care, and natural resource management (other than water), have been largely outside the purview of NCP. Non-economic objectives are very important in these areas and the scope for competition is more limited than in infrastructure provision. Even so, it is clear that these areas will need to feature prominently on future reform agendas. For example, over the next fifty years, expenditure on health care is projected to increase from around 10 per cent to between 16 and 20 per cent of GDP and will drive a gap in government budgets of some 5 per cent of GDP.

Health care and natural resource management are the highest priorities

Australia's health care system performs well against a number of aggregate cost and outcome indicators. But the aggregates hide widespread and growing problems. Rising costs, inefficiencies in resource use, poor outcomes for some community groups and increasing difficulties with access are all indicative of scope for significant improvement.

Overlapping roles and responsibilities between the Australian and State and Territory Governments either cause or contribute to many of these problems. To be effective in the longer term, reform needs to address these underlying service interface and funding issues.

While performance deficiencies are generally acknowledged, there is little agreement evident across jurisdictions about either their causes or the best way forward. A circuit breaker is needed. In the Commission's view, the first step would be for CoAG to convene an independent public inquiry into Australia's health system, akin to the Hilmer inquiry that preceded NCP. Based on the findings and recommendations of this broad inquiry, CoAG would then need to work towards a coordinated reform program, a timetable for implementation, and mechanisms for monitoring and reporting on progress.

For similar reasons, the Commission considers that CoAG's role in improving natural resource management should extend beyond the water sector. Many environmental issues transcend our geographically arbitrary state boundaries.

Native vegetation and biodiversity is a case in point. The Australian Government has recently signalled that this conflicted area will be addressed within CoAG. A second important area requiring national coordination is greenhouse gas abatement policy — where we are already seeing the cost of fragmented responses across jurisdictions.

Other human services areas are important, but not priorities for CoAG?

Two other human service areas where the gains from reform are potentially large are aged care, and education and training.

In the case of aged care, the Hogan review has put a number of useful reform options on the table. The immediate priority is to monitor the impacts of changes already made in response to that review, and to address the longer term options proposed, including greater user contributions.

Education is critical to the future wellbeing of Australians, both economically and socially. Compared to health, however, the need for a nationally coordinated education reform program, and hence for CoAG involvement, appears less urgent. That said, adding aspects of education and training at some future date should not be ruled out, especially if reform progress in areas like VET continues to be slow.

Reform elsewhere is also needed

The agenda proposed for CoAG consideration also leaves out a range of other areas where further reform could be of major benefit to the community, including taxation policy and labour market arrangements.

In the Commission's view, the key tax policy reform issues are primarily within the domain of the Australian Government. And, while there are benefits in greater national uniformity in some areas of labour markets, CoAG is unlikely to be the most effective forum for advancing industrial relations reform. That said, building on the labour market reforms of the past two decades is important to sustain Australia's economic performance, including through easing emerging age-related constraints on labour supply.

Robust institutional arrangements to underpin reforms

The agenda mapped out by the Commission is a challenging one — in some respects even more so than the original NCP. Its successful implementation will depend crucially on government leadership and inter-governmental cooperation. Governments will need to establish robust arrangements that:

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- spell out objectives and principles to underpin the reform frameworks and programs (including public interest and adjustment provisions);
 - facilitate the analysis required to develop specific reform options and provide for public input to that process;
 - provide for independent monitoring of progress in implementing changes; and
 - embody mechanisms to lock-in the gains of past reforms.

Given the economic and social significance of most of the areas encompassed by the proposed agenda, and the scope for performance improvement, the potential pay-offs from ‘getting it right’ are likely to be large. In the Commission’s view, the challenges facing Australia make it imperative that we get on with it.

Attachment **The Commission's preliminary future reform agenda**

Enhancing performance in infrastructure and services encompassed by the LRP

Energy	Complete outstanding elements of the NCP and implement the MCE package to further the development of the national energy market. Other reform priorities include: resolving whether market power in electricity generation is still excessive; assessing whether processes for screening the competition implications of reintegration in the electricity industry need to be strengthened; contributing to the development by CoAG of a more effective process for reducing regulatory fragmentation and uncertainty in relation to greenhouse gas abatement (see below); improving the efficiency of, and outcomes from, retail price and access regulation; and establishing a process to monitor the implementation and outcomes of the energy reform program.
Water	Complete outstanding elements of the NCP and recommit to the National Water Initiative. Other reform priorities include: developing ways to manage environmental externalities more effectively; exploring new opportunities for cost-effective water recycling; and ensuring that monitoring arrangements post-NCP provide a discipline on all governments to progress agreed water reforms.
Freight transport	Complete outstanding matters under the NCP, including the review of cabotage (see below). In addition, CoAG to sponsor the development of a longer-term strategy for achieving a national freight system that is 'neutral' across transport modes; and as an immediate priority, the development of a national reform agenda for the rail sector that integrates and augments current work in this area and imposes specific time frames for implementation.
Passenger transport	CoAG to initiate an independent national review of the impacts of recent reforms in the sector and what is now required to deliver further performance improvement in both urban and regional areas.
Telecommunications and broadcasting	<p>Broaden the scheduled review of the telecommunications conduct code regime to examine the appropriateness of the structural configuration of Telstra in the light of technology changes and the recently introduced ring fencing arrangements. Consistent with NCP requirements, conduct that review prior to any sale of the Government's remaining share in Telstra.</p> <p>Unless the reviews currently in progress provide a good case to the contrary, remove restrictions on the number of free-to-air broadcasters, multi-channelling by them, and datacasting. Any future relaxation of cross-media ownership rules to have regard to these and other preconditions set out in the Commission's previous review of broadcasting.</p>
Priority legislation reviews	Undertake the scheduled reviews of anti-dumping regulation and cabotage (unless the latter is addressed as part of a wider review of coastal shipping). Give priority to second-round reviews, using a modified arrangement (see below), of pharmacy, insurance and wheat marketing (unless already handled through other appropriate review processes).

(continued)

Improving competition frameworks and the regulatory architecture

Application of the TPA to government businesses	Investigate the need for legislative changes to ensure that some government businesses do not inadvertently escape coverage.
Consumer protection policy	The Australian Government in consultation with the States and Territories to initiate a national review of consumer protection policy and administration.
Assistance-related impediments to efficient competition	Use the periodic review provisions under AUSFTA as a means to examine whether government purchasing preferences continue to be in the public interest. Extend the recently signed State and Territory agreement aimed at preventing cross-border bidding wars to include all governments, and strengthen provisions to ensure compliance.
Competitive Neutrality	Continue with current arrangements beyond the life of NCP.
The Legislation Review Program	Complete remaining items on the current legislation review schedule. Retain a more targeted mechanism, focussing on areas where reform of anti-competitive legislation is likely to be of significant benefit to the community, with modifications to: provide greater flexibility in the timing of second round reviews; increase the transparency and independence of review processes; give explicit recognition to distributional and transitional issues in the public interest test; provide for national reviews where legislation in individual jurisdictions has a significant impact on the scope to develop national markets; and give more emphasis to monitoring whether review outcomes are within the range of those 'that could reasonably have been reached'.
Gate-keeping for new regulation that could have anti-competitive effects	Ensure that each jurisdiction has effective independent monitoring arrangements in place. Consider widening the range of regulations covered by these arrangements and strengthening independent monitoring of gate-keeping measures in place in each jurisdiction.
Oversight of regulated service providers	Explore opportunities to improve price setting arrangements for regulated infrastructure providers, giving particular emphasis to enhancing incentives for investment to maintain and augment service capacity.

Extending nationally coordinated reform to new areas

Health	CoAG to initiate an independent public review of Australia's health care system as a whole, as the first step in the development of an integrated health services reform program. The review should include consideration of: the future determinants of demand for and supply of health services; health financing (including Federal/State responsibilities and their implications); coordination of care (including with aged care); the interaction between public and private services; and information management.
Natural resource management	Extension of CoAG's current and foreshadowed responsibilities in this area. An immediate priority is greater involvement in the national coordination of greenhouse gas abatement policies. CoAG should also initiate a review to identify other areas where the pay-offs from nationally coordinated reform could be high.
