Australia's National Competition Policy: Possible Implications for Mexico[*]

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Table of contents

1. Introduction 4
2. Australia's National Competition Policy Reform process 5
   2.1 Why was there a pro-reform environment? 5
   2.2. What did the National Competition Policy reforms involve? 6
   2.3 Key steps in developing and implementing the reform program 8
      2.3.1 Developing a political consensus (1990-1993) 9
      2.3.2 Formulating the detailed agreements and establishing the formal institutions (1993-1995) 12
      2.3.3 Implementing the agreements 18
3. The outcomes of the National Competition Policy process 23
   3.1 Economic outcomes 23
   3.2 Measures of the internal competitiveness of the economy 29
      3.2.1 Impact on investment 30
      3.2.2 National Competition Policy payments 31
      3.2.3 Distributional impacts of the reforms 36
   3.3 Implementation of the reforms 36
      3.3.1 The incentives to reform – possible lessons 39
      Source: Author's analysis 40
      3.3.2 An enduring focus on improving competition 41
   3.4 Increasing the transparency of regulatory change 42
   3.5 Timing 46
      3.5.1 Duration of the process 47

Appendix A: Dairy market reform under NCP 51

1. Dairy market regulation pre-NCP 51
   1.1 The industry structure 52
2. National Competition Policy reviews 53
   2.1 The adjustment package 54
   2.2 On-going competition issues 55
   2.3 Other regulation 56
3. Outcomes for consumers and the industry 56
   3.1 Industry adjustment 59
4. Lessons from the reform of the dairy sector 59

Bibliography 61

Boxes

Box 1. Executive Summary 3
Box 2. Overview of National Competition Policy program 7
Box 3. Estimating the benefits of reform 14
Box 4. Models of Federal/State fiscal flows and National Competition Policy 16
Box 5. Options for strengthening the incentives for pro-competitive reform 17
Box 6. General versus industry-specific pricing and access regulation and regulators 21
Box 7. Reforms of the Australian labour market 27
Box 8. Early outcomes from competition policy reforms 28
Box 9. Outcomes of the reform of anti-competitive regulation 29
Box 10. Key institutions in the implementation of NCP 40

Box 1. Executive Summary

- The 1950s, 60s, 70s and 80s saw Australia's growth and productivity languish. The country fell from a ranking of 5th in the OECD in terms of GDP per capita in 1950, to 15th by 1990 (OECD 2005, p.98).
- From the mid-80s an economic reform-minded centre-left national government introduced an array of economy-wide pro-competitive reforms. Reforms at the State level were more limited, with improved governance of many state-owned utilities, and some pro-competitive reforms in some States. In the early 1990s, more fundamental pro-competitive reforms were launched by the two centre-right State Governments, in New South Wales (1988–1995) and Victoria (1993–1999), while less economic reform occurred in other States. The exceptions were some privatizations that occurred in almost every State.
- In 1995, under the auspices of the National Competition Policy Agreements, the Federal and all State and municipal governments agreed to begin a decade-long process to systematically reform key sectors and revise regulation to remove anti-competitive arrangements and strengthen pro-competitive regulation and institutions. Independent estimates were produced of the likely benefits in terms of growth, and thus tax revenues, and the Federal Government agreed to share the fiscal dividends with the States if they met their commitments, with the payments schedule outlined in the agreements.
- Progress at the implementation of the reforms was independently monitored by the National Competition Council (NCC), which was established under the auspices of all Governments, The Federal Government and all State Governments reported annually to the NCC, which rigorously examined their progress and then provided its assessment to the Federal Treasurer (Finance Minister) who published the assessment.
- The comprehensive nature of the reforms also assisted. Opponents of reforms needed to justify why they warranted special treatment when the process was being applied across all sectors and all States. Moreover, the scope of the changes meant that many stakeholders experienced both the transitional costs of reform, but shared in benefits of reforms in other sectors, for example those that lowered key input costs.
- Incentives for each jurisdiction to undertake the agreed reforms (that is, to comply with the agreement) were substantially strengthened by the prospect of being publicly criticized by an independent agency (which applied to all levels of government) and a financial incentive for the States, whose national competition policy payments were at risk if they were assessed by the NCC as non-compliant. These incentives aided each State's central agencies (its Premier's Department and its Treasury Department, and their Ministers) to get more closely involved in scrutinizing anti-competitive regulation that was the responsibility of other Ministries. The financial payments, over A$800 million in the last years of the agreement, were relatively modest in terms of total Federal/State transfers (about 1.3 per cent of total transfers per year), and share of State revenues (about 0.6 per cent), but sufficient to motivate reformers.
- Implementation of the National Competition Policy Agreements is widely recognized to have substantially enhanced the competitiveness of the Australian economy through fostering competition, although more could still be achieved. The OECD noted, "In the last decade of the 20th century, Australia became a model for other OECD countries in … the tenacity and thoroughness with which deep structural reforms were proposed, discussed, legislated, implemented and followed-up in virtually all markets."(OECD 2005, p.11)
- Like Australia, Mexico is a federal country, where important functions are undertaken by both State and municipal governments. States and municipal governments both legislate their own regulation and play an important role in administering Federal regulation. And as the World Bank *Doing Business* Project has highlighted, there is scope for some States to make substantial improvements that would help foster competition and thus improve the competitiveness of the whole Mexican economy.
- The purpose of this paper is to identify the lessons from Australia (both what went right, and what did not) that might be relevant in the very different Mexican context.

1. Introduction

1. This discussion paper examines the Australian experience with a comprehensive program of pro-competitive regulatory reforming involving three levels of government: federal, state and municipal. The aim is to identify any lessons from this experience and to see whether there are any insights that might be relevant to Mexico. The analysis might also be relevant to other OECD member countries where regulatory functions are split between levels of government.

2. The paper has two parts. First, the process of developing and agreeing the National Competition Policy in 1995 is described, with an emphasis on the reforms that were implemented, and the institutional arrangements that supported implementation. Second, the outcomes of this process are outlined, including what went well, and lessons learnt.

3. Clearly the challenges facing Mexico, including the political and economic context, are very different to those faced by Australia in 1995. Mexico and Australia have some similarities – particularly that important regulatory functions are undertaken at all three levels of government, and substantial fiscal transfers occur from the Federal government to the States – but in other respects are very different countries (table 1). Moreover, in Australia in the 1990s the majority of the infrastructure sectors where there were clearly competition issues (gas, electricity, railways, telecommunications, water, and ports), were state-owned. In Mexico, while there may be competition issues in similar sectors, many of the key firms were privatised in the late 1980s and early 1990s.

Table 1. Comparing the Australian and Mexican Federations

	Australia	Mexico
Size	7.7 km^2	2.0 km^2
Population	21 million	111 million
Average per capita income	US$39 300 in PPP	US$14 400 in PPP[1]
Year of independence	1901	1810
States (and territories)	8 States and Territories	32 States (including the Federal District)
Population of smallest State/Territory	221 000	500 000
Population of largest State/Territory	7 100 000	14 000 000
Municipalities	667	2453
State own-source revenues	~50 per cent	~ 10 per cent
Municipal own-source revenues	~ 83 per cent	~65 per cent
Political system	Parliamentary	Congressional
Frequency of elections		
- legislature	3 years[2]	3 years
- President/Governor	Not applicable	6 years
Re-election	No restriction	Prohibited

1. PPP ~ purchasing power parity terms

2. The Federal Parliament's lower house (which determines the Government) has an electoral term of up to three years, whereas the upper house's Senators have terms of up to six years. Each State has a somewhat different system but six of the State Parliaments' lower houses have terms of up to four years (Electoral Council of Australia undated).

Sources: Australian Bureau of Statistics, PC 2008b, Ahmad et. al. 2007

2. Australia's National Competition Policy Reform process

4. This section of the discussion paper has three key elements. First, the factors contributing to a pro-competitive reform environment in Australia in the early 1990s are discussed. Second, the scope of the reforms is briefly described. And finally, the key steps in developing and implementing the reform program are analysed.

2.1 Why was there a pro-reform environment?

5. By 1990, Australia's level of growth in per capita incomes, and thus living standards, had been disappointing over a long period (Kelly 2000). As the OECD has highlighted, Australia fell from being ranked 5th among 22 selected OECD countries in 1950, to 15th by 1990 (OECD 2005, p.97). Federal Government bodies like the Industry Commission, Bureau of Industry Economics and the Economic Planning Advisory Council,[1] and private sector commentators, argued persuasively that insufficient competition in the domestic economy accounted for much of the slippage in the growth in Australia's productivity and living standards in the 1970s and the first half of the 1980s.

6. The sense that Australia must reform was highlighted when the then Treasurer, Paul Keating, commented on radio in May 1986 that:

> *"We must let Australians know truthfully, honestly, earnestly—just what sort of an international hole Australia is in ... once you slow the growth under 3 per cent unemployment starts to rise again ... then you're gone ... then you're a banana republic."*

7. The Industry Commission subsequently noted that Australia's growth was falling far behind that of other regional economies. Australia averaged annual GNP per capita growth of 4.3 per cent between 1980 and 1989 in US$ terms, while in contrast Japan, Singapore, Hong Kong and Korea were all growing at average rates of more than 10 per cent per year (IC 1990, p.6).

8. The initial economic reform focus of the Hawke Labor Government, which came to power in 1986, had been on external barriers. But as the financial and the tradeable sectors became much more exposed to international competition in the mid-1980s, the poor productivity record of government (usually State government) owned infrastructure industries received more attention: for example, the OECD reported that in 1990, productivity levels in ports, railroads and electricity generation were less than one-half of those of Australia's trading partners, and productivity in Australia's telecommunications industry was the lowest in nine countries examined by the OECD (2005). Corporatisation reforms had led to some improvements, but a significant performance gap remained. In addition, there were extensive regulatory controls on prices and other competitive activities throughout the private sector economy.

9. The Federal Government and individual States[2] had been undertaking reviews of particular sectors and industries and implementing more pro-competitive arrangements. These included state-based reforms affecting sectors as varied as egg marketing, intrastate air freight, licensing of long-distance bus routes, electricity and liquor licensing, as well as Federal reforms in telecommunications and coastal

[1] These three economic policy research bodies were in the Treasury, Industry and Prime Minister's portfolios respectively. All three were merged into the Productivity Commission in 1998.

[2] The Australian federation is made up of six States (whose leaders are Premiers) and two Territories (whose leaders are Chief Ministers). In this report, the term States refers to both the States and Territories, and Premiers to both Premiers and Chief Ministers.

shipping (IC 1990). However, the individual reforms were not connected, and the pace of reform varied across States.

10. At the Federal level, there was also support for a more pro-competitive stance from key political figures. Both the Prime Minister, Bob Hawke, and a key Minister, Simon Crean, had been involved in earlier careers as union officials in establishing a union-supported competitor to the oil companies operating in Australia, as had a key supporter, Bill Kelty, still a senior union official. Solo Petrol imported cheap petrol from Asia, and under-cut what was widely considered to be an oligopoly of mainly multi-national oil companies which controlled both refining and retailing of petrol (Allan Fels, pers. com.).

11. The Government was also fortunate in that the Federal Liberal/National Party Opposition strongly supported many of the broader economic reforms, if anything arguing that the Government was being timid and should move faster (Kelly 2000). The political and economic environment was conducive to pro-competitive reform, and as will be discussed shortly, there was support from across the political spectrum, with a Federal Labour Government and pro-reform State Governments, particularly the Liberal Governments in New South Wales (led by Premier Nick Greiner) and Victoria (led by Premier Jeff Kennett). That said, other State Premiers were reportedly less enthusiastic about specific reforms or the prospect of greater Federal Government control over State activities (Painter 1998).

12. Key opinion leaders also supported broad-based reforms, particularly in the leading newspapers and some think tanks, while industry associations were particularly keen on reform of the government enterprise sector that provided key inputs, such as energy, telecommunications, rail and port services.

13. Senior bureaucrats were also strongly supportive of microeconomic reform, particularly in the Premiers' Departments of key States, and in the Prime Minister's Department.

2.2. What did the National Competition Policy reforms involve?

14. The National Competition Policy (NCP) agreements covered all sectors of the economy and formed a package based on consistent principles. The agreements involved:

- A presumption in favour of competition;
- Reform obligations on National, State and Municipal Governments;
- A sharing of fiscal benefits of reform between levels of government; and
- Agreed reforms, new institutional arrangements and commitments to transparent processes.

15. The National Competition Policy program involved 5 key economy-wide elements, and specific reforms in four key sectors of the economy (box 2).

16. Some of the elements of the program could only be successful if States cooperated with each other. National markets in electricity and gas required investments in interconnecting infrastructure and agreed national rules. The road transport reforms were also intended to reduce barriers to inter-state road freight, while the water reforms were a mixture of reforms that could have occurred unilaterally in each State (for example, urban water reform) and those which related to water flows that crossed four States.

17. Other elements of the program included reforms that did not require coordinated national action, and indeed drew on prior experience of individual State reforms (relaxing liquor licensing and shop trading

hours, for example). However, these reforms had more chance of widespread adoption as part of a comprehensive reform agenda.

Box 2. Overview of National Competition Policy program

General reforms

- Extension of the anti-competitive conduct provisions in the *Trade Practices Act* (1974) to unincorporated enterprises and government businesses.
- Reforms to public monopolies and other government businesses:
  - structural reforms—including separating regulatory from commercial functions; and reviewing the merits of separating natural monopoly from potentially contestable service elements; and/or separating contestable elements into smaller independent businesses; and
  - competitive neutrality requirements involving the adoption of corporatized governance structures for significant government enterprises; the imposition of similar commercial and regulatory obligations to those faced by competing private businesses; and the establishment of independent mechanisms for handling complaints that these requirements have been breached.
- The creation of independent authorities to set, administer or oversee prices for monopoly service providers.
- The introduction of a national regime to provide third-party access on reasonable terms and conditions to essential infrastructure services with natural monopoly characteristics.
- The introduction of a Legislation Review Program to assess whether regulatory restrictions on competition are in the public interest and, if not, what changes are required. The legislation covered by the program spanned a wide range of areas, including: the professions and occupations; statutory marketing of agricultural products; fishing and forestry; retail trading; transport; communications; insurance and superannuation; child care; gambling; and planning and development services.

Sector-specific reforms

- Electricity: Various structural, governance, regulatory and pricing reforms to introduce greater competition into electricity generation and retailing and to establish a National Electricity Market in the eastern States.
- Gas: A similar suite of reforms to facilitate more competitive supply arrangements and to promote greater competition at the retail level.
- Road transport: Implementation of heavy vehicle charges and a uniform approach to regulating heavy vehicles to improve the efficiency of the road freight sector, enhance road safety and reduce the transactions costs of regulation.
- Water: Various reforms to achieve a more efficient and sustainable water sector including institutional, pricing and investment measures, and the implementation of arrangements that allow for the permanent trading of water allocations.

Source: Productivity Commission (2005a), p.XV

18. A comprehensive reform program can have three benefits: a package of reforms can exploit complementarities and thus the growth generated is greater than the sum of the separate reforms;[3] adverse

[3] Bean (2000) noted that a plausible argument for Australia's recent good productivity performance was that the product market and labour market reforms complemented each other. The OECD also noted that easing product market regulation may have additional positive effects on employment by inducing job-friendly reforms of labour market institutions (2009, p.181).

distribution effects are reduced as losers from one reform benefit from other reforms[4]; and reforms in one sector can highlight the need for reform in related sectors.[5]

19. The Industry Commission noted the complementarities of the Hilmer and related reforms in its exercise to estimate the likely benefits. It gave the example of how broadening the application of the general competition law to unincorporated entities (including many family farms) could affect monopoly agricultural marketing arrangements. The impact would depend on whether the marketing arrangements were mandated by government legislation, for example, where a law provides for compulsory acquisition or vested monopoly marketing powers in a single body, or by private anti-competitive agreements between growers. The former would not be affected by extension of the general competition law. However, if the NCP's legislative review program led to the removal of mandatory schemes, then the extension of the law could become important for ensuring that arrangements under mandatory regimes were not continued through private arrangements (IC 1995).

20. Robert Kerr, the then head of staff of the Industry Commission's Canberra office, noted that the momentum of the policy reform process depended in Australia on the fact that all sectors were being asked to contribute. From that flowed the expectation that everyone would capture some benefits and incur some costs, for example, with job losses in some sectors being offset by expansions elsewhere as the economy became more flexible. Also, while not measurable, the dynamic gains were thought to be available from enhancing competition, and these might be lost if reform was too narrow (Robert Kerr, pers. com. 26 February 2009)

2.3 Key steps in developing and implementing the reform program

21. The reform of Australia's competition policy in the 1990s had three distinct phases:

- Developing a political consensus on the need for reform and establishing the institutional settings that fostered cooperative and coordinated action (1990-1993);
- Formulating the detailed agreements (including the financial arrangements) and legislative changes, and establishing the formal institutions that would play key roles in implementing the reforms (1993-1995);
- Implementing the agreements. Implementation spanned a ten-year period during which there was a change of leadership and ruling political party at the Federal level and in almost every State (1995-2005).[6]

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4 The merits of bundling reforms were implicitly acknowledged by the Mexican Government in its 18 December 2008 announcement of further trade reforms. The announcement included a commitment to address other 'competitiveness' problems in the economy to assist industry compete with enhanced international competition as a consequence of the tariff and other reforms affecting imports (Mexican Government 2008).

5 The ACCC noted in its review of dairy re-regulation that the artificial price controls in the dairy industry became increasingly hard to justify following the removal of government price interventions in other agricultural industries, which occurred in part due to the NCP reviews of those industries (2001, p.1).

6 The one exception was the Premier of New South Wales, Bob Carr, who took office on 4 April 1995, one week before the agreements were signed. He resigned one month after the payments ceased, on 3 August 2005.

2.3.1 Developing a political consensus (1990-1993)

22. Prior to the 1990s, inter-governmental processes at the level of leaders had tended to focus very much on revenue issues, that is the level of transfers from the Federal Government to each State. And this was not an environment conducive to cooperation between levels of Government. As the then Premier of Queensland, Wayne Goss, recounted:

> *"I went to my first Premiers financial conference in April 1990. I had been in government for only three or four months. Bob Hawke was my good mate and he said, "Come to Canberra". At 7 o'clock on the morning of the Premiers Conference they pushed the [revenue] offer under the door. Partly because I have a bit of Irish heritage and am fairly stroppy most of the time anyway, afterwards I went off my brain at Hawke and so did Nick Greiner [then Premier of New South Wales] and Bob said he would have a look at it. He did have a look at it and at the Premiers Conference he made his speech. I think Bob was on the lookout for a new idea and the Special Premiers Conference was a positive idea." (cited in Federal-State Committee 1998, p 3.23)*

23. In the 1990s under the Hawke Federal Government, initiatives to re-shape Federal/State relations were prompted by the external economic pressures (Federal-State Relations Committee 1998). And according to Wayne Goss, the former Premier of Queensland, the goal of the Premiers at the time was to set in train processes that brought the States to the negotiating table as an equal partner with the Federal Government (Heyward 2004).

24. The Federal-State Relations Committee of the Victorian Parliament (1998) noted that many federal systems around the world have attempted to change how they manage intergovernmental relations in pursuit of the objectives of:

- creating a more integrated and cohesive single economic market;
- providing a more flexible and decentralised delivery system for economic and social programs;
- enhancing the ability of governments to make joint decisions;
- maintaining a balance between competition and co-operation between governments (p.3.13).

25. Advocacy groups representing areas of the economy most exposed to increased international competition, notably farmers (represented by the National Farmers Federation) and Australia's biggest businesses (the Business Council of Australia) were strong advocates of reform, particularly of government provided services such as energy and ports (Keating 2004). The then Liberal Premier of New South Wales, Nick Greiner, outlined a key theme of Australian proponents of change to the federation prior to the first special Premiers' conference in a speech entitled "Physician, Heal Thyself".

> *"For over a decade, government has been telling industry that it must restructure if Australia is to compete successfully in international markets. . . Now it is government's turn. Business leaders are asking why, after they have been forced to take the tough decisions, must they put up with failing infrastructure, uncompetitive utility charges and excessive and duplicative regulation? After more than a decade of being lectured by politicians, the nation is saying to the governments of Australia, "Physician, heal thyself!" (quoted in Federal-State Relations Committee 1998)*

26. The Federal, State and Territory Governments discussed a range of microeconomic reform[7] issues at the special Premiers' Conferences in October 1990 and April 1991 in a way that was described at the time as 'unprecedented' (IC 1991b, p.3). And they started to make tangible progress with in-principle agreement at the July 1990 conference to mutual recognition of regulations that affected trade in goods and services. The October 1990 meeting communiqué stated:

> *"Leaders and representatives acknowledged that past inefficiencies can no longer be tolerated and that changes are needed to make the Australian economy more competitive and flexible. An internal part of any microeconomic reform strategy is a more effective public sector. Leaders and representatives therefore declared their intention to use this unique opportunity to maximise co-operation, ensure a mutual understanding of roles with a view to avoidance of duplication and achieve significant progress towards increasing Australia's competitiveness."(quoted in Federal-State Relations Committee 1998)*

27. When internal Federal Government political issues led to the cancelling of a Special Premiers' conference scheduled for late 1991, the Premiers decided to meet anyway without the Prime Minister. This led to the Premiers (six Labour, one Liberal and one Country/Liberal) agreeing to adopt four specific principles intended to guide a review of Federal and State Government roles and responsibilities:

- **The Australian nation principle**: all governments in Australia recognise the social, political and economic imperatives of nationhood and will work co-operatively to ensure that national issues are resolved in the interests of Australia as a whole;[8]

- **The subsidiarity principle**: responsibilities for regulation and for allocation of public goods and services should be devolved to the maximum extent possible consistent with the national interest, so that government is accessible and accountable to those affected by its decisions;

- **The structural efficiency principle**: increased competitiveness and flexibility of the Australian economy require structural reform in the public sector to complement private sector reform: inefficient Commonwealth-State divisions of functions can no longer be tolerated;

- **The accountability principle**: the structure of intergovernmental arrangements should promote democratic accountability and the transparency of government to the electorate (Federal-State Relations Committee 1998).

28. In May 1992, the new Labour Prime Minister, Paul Keating, chaired his first special Premiers' meeting and it was agreed to create a more formal Council of Australian Governments (COAG), which included the President of the Australian Local Government Association. The Premiers' Conferences and subsequently COAG provided the necessary institutional setting for the nation's political leaders to work cooperatively on a reform agenda covering economic and non-economic issues. The political composition of these meetings was changing, but the process continued, albeit slowly. But previous in-principle agreements regarding setting up a national electricity market, and removing barriers to inter-state trade in gas, were getting bogged down and meeting resistance (Painter 1998). By Keating's third COAG meeting in June 1993, five of the eight State Premiers were from the opposition party, making negotiations even more difficult (Federal-State Committee 1998).

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[7] Quiggin (2004) defined microeconomic reform as "a systematic program of reform along market-oriented lines and focusing on microeconomic issues rather than macro-economic policy." (p. 3).

[8] This could be framed more generally as the principle of acting in the national interest rather than just the interest of one State.

29. Detailed and rigorous economic analysis had been building the case for change. Australian government research organisations had been publishing estimates of the direct gains from individual reforms and on the economy-wide gains from a broad program of microeconomic reforms (IAC 1989). This built on earlier modelling of the economy-wide impacts of trade barriers.[9] Estimates published in 1990 suggested that a package of reforms to shipping (both coastal and liner), rail, post and telecommunications, electricity and water supply, rural and manufacturing sector assistance, and contracting out of government services could increase Australia's GDP by up to 6.5 per cent in the long-term and create an additional 53 000 jobs (IC 1990).[10] Analysis was also undertaken that suggested that rural and manufacturing assistance was regressive. The taxing effect of assistance increases from 4 per cent of income for the highest income group to 12 per cent for the lowest and on the basis of estimated disposable income, (IC 1990, p.194).

30. The national significance of competition policy was recognised by the Prime Minister's establishment in consultation with State Premiers, of what became known as the Hilmer Inquiry in October 1992.[11] The States in particular were keen for a public inquiry, which could undertake the difficult engagement with industry associations and unions (and take the resulting flak), and allow Governments to keep some distance as a reform agenda was developed.

31. The inquiry consulted extensively, receiving nearly 150 written submissions from major business, industry, professional and consumer organisations, trade unions, small and large businesses and private individuals, and held discussions with all Australian Governments and a broad range of individuals and representative groups (Hilmer 1993). The importance of gaining the support of the States was highlighted when the Hilmer committee was given a three month extension to its reporting date to allow additional consultation with State Governments (Painter 1998). The report, which outlined the views of the key stakeholders as well as the Committee's recommendations, was published on 25 August 1993.

32. This report made the case (and the subsequent inter-governmental Agreement required) that legislation should not restrict competition unless it could be demonstrated that:

1. the benefits of the restriction to the community as a whole outweigh the costs; and
2. the objectives of the legislation can only be achieved by restricting competition.

33. The Productivity Commission noted that the presumption in favour of competition—and against regulation that restricts competition—could be seen as a logical extension of the approach taken in the competition law in relation to anticompetitive business practices. Competition law typically prohibits

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9 During this period the Federal Government's Industry Commission was commissioned to undertake public inquiries into many sectors where States played an important role, either as owners of firms (i.e. the inquiries into rail transport, energy generation and distribution, and ports) or as regulators (i.e. the dairy industry, statutory marketing arrangement for primary products, the sugar industry, intrastate aviation, and horticulture).

10 These estimates included two areas of pro-competitive reform that were ultimately out of scope for National Competition Policy - reductions in tariff barriers (which were already in phased decline) and the contracting out of government services.

11 The *Independent Committee of Inquiry into National Competition Policy* included respected private sector experts: business school academic and former head of the consultancy McKinsey & Co in Australia, Professor Fred Hilmer (Chair); Group Executive at mining company CRA Ltd, Mark Rayner; and partner in the law firm of Baker & McKenzie, Geoffrey Taperell. The committee's membership was jointly agreed by Federal and State officials. The Australian Treasury provided a secretariat of five full-time professional staff, supported by three administrative staff, with three other staff assisting during the course of the inquiry (Hilmer 1993).

anticompetitive conduct, but allows the competition agency to authorise such conduct where it can be shown to yield public benefits which exceed any anticompetitive detriment (PC 2005). However, requiring those advocating the retention of regulation that restricted competition to prove it was in the public benefit proved contentious as traditionally the onus of proof was on those seeking public policy change. But as the Commission noted: "requiring those who benefit from legislative restrictions on competition—and thus who typically have most incentive to see them retained—to address the wider community effects, can act as a counterweight to political pressure to ignore the less readily identifiable costs." (p. 136)

34. Overall, the Special Premiers' Conferences and COAG were useful institutions of inter-governmental dialogue and cooperation, which provided a forum to work through the issues and achieve a political consensus for reform, and in-principle agreement to go forward and develop specific proposals.

2.3.2 Formulating the detailed agreements and establishing the formal institutions (1993-1995)

35. The Hilmer Report outlined a package of pro-competitive reforms, but considerable work and difficult negotiations were necessary to turn these recommendations into agreements that the Prime Minister and Premiers could commit to.

36. Agreements were drafted jointly in a series of meetings involving very senior bureaucrats from the leaders' department from all Governments. COAG considering draft agreements on 19 August 1994. These were subsequently released for public comment including:

- draft legislation which would amend Part IV of the *Trade Practices Act* 1974 to apply it to all persons within State jurisdictions; establish pricing and access arrangements; and establish the Australian Competition and Consumer Commission[12] and the National Competition Council;
- the draft Intergovernmental Conduct Code Agreement, which included the procedures for extension of the *Trade Practices Act* and appointments to the Australian Competition and Consumer Commission; and
- the draft Intergovernmental Competition Principles Agreement, which included procedures and principles for those elements of the national competition policy which did not require a statutory basis and appointments to the National Competition Council (COAG 1994).

37. The reform program and the agreements focused on areas where there was a large degree of political and academic consensus. There was a lack of academic and ideological agreement about whether ownership (public or private) necessarily affected outcomes, but less dispute about benefits of competition (King and Maddock 1996). Consequently, the agreements focused on competition but did not require privatisation of government businesses or contracting out of government services. That said, the additional pressures on government business to perform that arose from measures to expose them to greater competition, and through the obligation to implement competitive neutrality arrangements, may have contributed to a subsequent increase in privatisations and contacting out of selected government services.

38. The commitment to review all regulation that affected competition and remove unnecessary restrictions would ultimately affect many private sector firms across most sectors of the economy. However, the winners and losers of such changes were far from clear at that stage as the reviews had yet to be undertaken. In contrast, there were specific commitments to actions that would affect State and Federal government infrastructure providers and other government businesses, and these changes had the broad support of the business community.

[12] The procedures that ensured State input into appointments to the Australian Competition and Consumer Commission were included in the Act that established and governed the Commission.

39. The National Competition Policy agreements were tightly targeted at anti-competitive regulation and institutional arrangements, and so did not involve any broader commitments to improve or reduce regulation more generally. The incoming Howard Federal Government commissioned a review of red tape (Bell 1996). But the Federal Government response to the recommendations (Howard 1997) was not linked to any specific implementation mechanisms[13] and progress in key areas was slow, while Federal and State regulation more generally continued to grow at a rapid rate (Berg 2008).

40. Hilmer's report outlined a package of pro-competitive reforms and regulatory institutions to administer and enforce the new legislation, but did not consider how to address the political economy issues that confront such a wide-ranging reform program. Microeconomic reform is all about improving the incentives faced by producers and consumers. But to successfully implement this reform program required improvements in the incentives of the various players in governments, with an institutional structure that assist them resist the pressure from interested parties who sought to maintain the status quo.

41. This issue was given a lot of attention by the senior bureaucrats from the Federal and State Governments that were drafting the reform agreements, and they identified the need to share the fiscal benefits of reform to strengthen the incentives for implementation. At its August 1994 meeting COAG agreed that:

> *"… all Governments should share the benefits to economic growth and revenue from Hilmer and related reforms to which they have contributed. An assessment of such benefits would be made by the Industry Commission on a brief provided by Heads of Treasury. This would be used to assist the Council in determining at its February 1995 meeting the increase in the Commonwealth [Federal Government] revenue which might be expected from these reforms and the appropriate percentage share which would accrue to the States, Territories and Local [Municipal] Government."*

42. The Industry Commission's estimates (box 3) informed the negotiations between bureaucrats and subsequently Federal and State leaders. The Commission's 'outer envelope' estimates were that the Federal revenues would increase by up to A$4.7 billion per year as a consequence of the proposed State reforms, and the States' revenues would increase by up to A$430 million per year from the Federal reforms. The analysis suggested that most of the benefits of the reforms came from action by the States, but most of the revenues accrued to the Federal Government. Ultimately a payment schedule was agreed that shared the benefits, rather than 'rewarding good behaviour' or compensating costs incurred. It reached A$600 million per year in each of the last five years of the agreements, although this was indexed to inflation and population growth.[14] This was sufficient to achieve agreement from the States to implement reforms that were acknowledged to, in any event, benefit each State.

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[13] The Federal Government response indicated that: "In cooperation with State and Territory Governments, the Commonwealth Government will be accelerating national reforms in the areas of food, agricultural and veterinary chemicals, building codes, occupational health and safety, workers' compensation and the environment. These reforms will reduce overlap and duplication, encourage greater national consistency and simplify processes. The result will be lower compliance costs for all businesses, large and small." (Howard 1997, p. vi). Although some progress was made, all six of these specific areas were still priorities on COAG's agenda in 2008. A$550 million in National Partnership payments to the States over five years are now linked to progress in these and other areas, with oversight by the independent COAG Reform Council (COAG 2008).

[14] Total national competition policy payments from the Federal Government to the States in 2005-06 were A$820 million, after adjustments for inflation and population growth. (Commonwealth of Australia 2006).

Box 3. Estimating the benefits of reform

COAG asked the Industry Commission (IC) to estimate the aggregate benefits from the proposed package of Hilmer and related reforms, assign these benefits separately to State and municipal government and Federal government reforms, and determine the likely increased fiscal flows to the different levels of government. As outlined in the terms of reference, no attempt was made to model the costs of the transition to greater competition.

The Commission had a lot of experience modeling the community-wide impacts of specific reforms as part of its inquiries into particular sectors. However, it noted that the Hilmer and related reforms, in 1995 at least, were more about concerted strategies to foster a climate for improved economic prosperity than they were about implementing specific, known and tangible changes. It noted that, for example, the proposals covered reviews of anti-competitive legislation rather than specify the nature of changes in legislative or regulatory restrictions on competition. A vast number of changes could be attributed to Hilmer and related reforms. As a consequence there was more than the usual level of uncertainty about the likely impact of the reform proposals, and the Commission was given less time than usual to develop their analysis.

The estimates (table 2) were described by the Commission as largely 'outer-envelope', and indeed, some of the reforms ultimately were not implemented (as discussed later) while some of the direct impacts were criticised by some commentators as overly optimistic. However, the Commission sought to make all its assumptions transparent and undertook sensitivity analysis on most of the key assumptions.

Table 2. Annual revenue impacts of Hilmer and related reforms (A$ million)

	State and local reforms	Federal reforms	Total
State revenues	$2 600 (3.8 per cent)	$ 430 (0.6 per cent)	$3 030 (4.5 per cent)
Federal revenues	$4 700 (4.8 per cent)	$1 200 (1.2 per cent)	$5 900 (6.0 per cent)
Total	$7 300	$1 600	$8 930
GDP contribution	1.0 per cent	4.5 per cent	5.5 per cent

Source: IC 1995, p.69

The Commission's modelling was very sensitive to the labour market assumptions. The modelling's base case assumed the reforms would lead to increases in real wages, but not affect the rate of unemployment, which was assumed to remain at the 8.5 per cent (the level the economy was forecast to achieve in the next year). However, the sensitivity analysis indicated that if unemployment was to fall to 7.25 per cent (an estimate of the natural rate at that time) or if the reforms decreased the natural rate by 1 percentage point (to 6.25 per cent), then the impact of the reforms would increase to 7.3 and 8.3 per cent of GDP respectively (p. 64). As it transpired, Australia's natural rate of employment has recently estimated to have fallen from a high of 8.5 per cent in 1992 to 4.8 per cent by 2001 (Lim et. al. 2008). The fall has been attributed to the implementation of industrial relations reforms commencing in the early-90s, and by some people, to other reforms including those that affected competition (Bean 2000). This would be consistent with recent empirical work suggesting that improved labour market outcomes come from reducing product market regulation that constrains competition (OECD 2006b, p.107).

The Industry Commission's successor, the Productivity Commission (PC), undertook a similar modelling exercise in 1999 as part of its public inquiry into its *Impact of Competition Policy Reforms on Rural and Regional Australia.* In that exercise, the Commission only modelled the subset of the reforms that it considered most affected regional Australia (statutory marketing arrangements, electricity, gas, rail, water, road transport and telecommunications).This analysis, based on updated data and a new dynamic model, produced similar results (a 2.5 per cent increase in GDP, compared to 2.8 per cent in the earlier modelling for these reforms). Again the results were very sensitive to labour market assumptions, and substantially higher economic benefits were estimated if the NCP reforms affected the natural rate of unemployment.

Sources: Bean (2000), IC (1995), Lim et. al. (2008), OECD (2006b), PC (1999b)

43. The Federal Government was already making very substantial payments to the States under various funding programs (box 4). After the change of Federal Government in March 1996, an update of the budget estimates identified a higher expected deficit for both 1995-96 and for future years. The new Federal Government made significant cuts to a range of programs (particularly payments to the States), but the National Competition Policy payments were not re-negotiated. This is despite the agreement to make the competition payments specifically stating in its first paragraph that "The Commonwealth's commitment is on the basis that the financial arrangements will need to be reviewed if Australia experiences a major deterioration in its economic circumstances." (COAG 1995, p. 1)

44. The *National Competition Policy and Related Reforms Agreement* outlined both the payment schedules and a timetable for the achievement of specific obligations. Hilmer's report had proposed a National Competition Council which would advise the Federal Treasurer on applications from firms which sought a declaration that particular infrastructure should be declared subject to the new access regime, and that this institution would be separate from the Australian Competition and Consumer Commission which would administer the associated access arrangements.[15] But the new funding agreement to share the benefits required an institution to assess compliance and thus eligibility for payments. COAG agreed that the task of advising the Federal Treasurer on the quality of the implementation of these obligations by each of the parties, an issue which relied on a high degree of judgement, would be delegated to the National Competition Council.

45. The National Competition Policy agreements also led to Federal legislation that conferred powers on the soon to be created Australian Competition and Consumer Commission, that its predecessor organisations had not had. These powers affected areas that were previously the responsibility of the States (powers over unincorporated entities, such as partnership, and over the activities of government businesses) and consequently the Hilmer Report recommended an explicit role for the States in appointments to this Commission. After much negotiation about the States' role regarding appointments to the Commission, the Federal Government agreed that the *Trade Practices Act* would include a provision that appointments could only be made with the support of the majority of jurisdictions (Section 7 (3) (c)).

46. The National Competition Policy agreements imposed obligations on municipal governments because municipal governments are created under State law, and so the States accepted a specific obligation under the Agreements to require municipal governments to comply. The representative body of municipal governments, the Australian Local Government Association, was also represented at COAG (but not a party to the agreements), and was also a participant in the Microeconomic Reform Working Group of officials that developed the agreements. Municipal governments play important roles in delivering services, regulating private business and individuals, and in running their own business. Nationally, approximately 700 municipal governments employ about 170 000 people and manage an estimated A$183 billion in assets (PC 2008b). While their functions and budget capacity differs widely, on average they raise about 83 per cent of their own revenue with the balance from Federal and State Government grants.

47. Australian Governments have used a range of funding options to strengthen the incentives and capacity of sub-national government to implement reforms. As outlined in box 5, some States distributed a share of their State's competition payments to municipal governments, based on an assessment of their compliance with the national competition policy obligations. In Victoria there was a focus on competitive neutrality and compliance with the *Trade Practices Act* 1974, as a range of government business activities—from childcare centres, to fitness centres, to cattle sale yards—competed with private businesses. These payments were based on high-level reviews of implementation, and municipal

[15] The separation of access declarations from the administration of access arrangements has similar benefits to the arrangements in Mexico where the CFC must declare a firm to be 'dominant' before another regulatory agency can subject a firm to the pricing and inter-connect requirements.

government responses to any complaints by private businesses. These comparatively small payments increased the motivation of municipal governments to comply.

Box 4. Models of Federal/State fiscal flows and National Competition Policy

Most of the large fiscal flows of federal tax revenues to the States are structured in two broadly similar ways in both Australia and Mexico – general budget assistance and tied grants. Moreover, many aid or foreign loan disbursements are structured in one of these two forms. However, the National Competition Policy payments differed from both these funding models in having a greater focus on tracking outcomes rather than expenditures.

General budget assistance. These payments are provided to the States without restrictions on the use of the funds. In Australia they account for about 60 per cent of transfers from the Federal Government to the States (Commonwealth of Australia 2006). Higher payments per capita are made to poorer States based on a distribution methodology developed, refined and published by the Commonwealth Grants Commission. In Mexico general budget assistance accounted for about 40 per cent of transfers in 2006 (based on data in Ahmad et. al. 2007).

Tied grants (or specific purpose payments). These payments are provided to be spent on a specific, but broadly shared objective of the Federal and State government. Examples in both Australia and Mexico are payments for education and health care services. Funding in this form requires extensive monitoring to ensure it both flows to the intended area of expenditure and that it is spent well. Financial data is required to demonstrate that the money not only went to the State health ministry, for example, but was spent on a specific program (for example, child health), and that when it reached the ultimate providers it was spent on delivering additional services through the recruitment of more nurses and doctors, rather than more expensive cars for health administrators. However, if all the parties in the supply chain shared exactly the same objectives and priorities of the Federal Government then a tied grant would be unnecessary (the funding could be provided as general budget assistance), so the fact that it is tied implies that there are conflicting objectives. Consequently, monitoring tends to be detailed and audited, adding to program delivery costs.

In Australia, many tied grants programs have also involved requirements for co-payments (typically additional expenditure) by the State Government, which raises the challenge of ensuring that the co-payments are actually made and are additional to existing spending in that area. This has led to even more demanding accounting of expenditures, with resulting administrative cost.

National Competition Policy payments. These payments were provided to meet a specific objective, that is, to improve competition. However, while the actual use of the payments was unrestricted, there was robust monitoring of whether the States had taken actions to meet the agreed objective. Essentially, the funding was tied to policy outcomes, not demonstrating expenditure on specific inputs. Consequently there was no need for monitoring of State expenditures, and the incentives outlined above that tend to impose significant monitoring costs were not present. Moreover, the additional untied funding stream enhanced the ability of the States to make unilateral spending decisions, in return for constraining the scope of some of their regulatory decisions. For the Victorian State Government in the 2005-06 financial year these competition payments represented an increase in general budget assistance from the Federal Government of 2.4 per cent, or another A$188 million of discretionary spending. Of course, the national competition policy payments were a smaller share of total Federal transfers (1.3 per cent general and tied assistance) and because States have substantial own-sourced revenues, they were only 0.6 per cent of total Victorian State income.

The Tasmanian Government noted that the competition payments gave each State government more flexibility to implement measures that improve their State's business competitiveness while benefiting businesses that may have been affected by a NCP reform. It gave the example of its the 2002-03 State Budget, which included A$9.4 million in tax relief targeted mainly at small- to medium-sized businesses, including the abolition of lease and hire duty, the abolition of stamp duty on public liability insurance and a reduction in land tax. It also noted that the process allowed each Government to determine how best to address adjustment and distributional issues.

Sources: Ahmad et. al. (2007), Commonwealth of Australia (2006),Tasmanian Government (2004), Victorian Government (2006b)

48. The Western Australian Government allocated about A$2 million from 1998-99 to its *Local Government Development Fund* to assist municipal governments with structural reform, improved efficiency and increased accountability. The Western Australian Government reported that the review of local laws by each municipal government proceeded well and led to an average of eleven restrictive local laws being repealed and two restrictive local laws being amended per municipal government (Western Australian Government 2001).

Box 5. Options for strengthening the incentives for pro-competitive reform

Governments can face many barriers to reforms, including lack of capacity, strong interests who wish to retain the status quo, or scepticism in the general community of the benefits of change, and concerns about potential costs. In addition to the National Competition Policy payments to the States that have been outlined earlier, Australian governments have implemented other schemes that use funding to encourage improvements in regulation.

- *Sharing of national competition policy payments with municipal governments* Three States – Queensland, Victoria and Western Australia – shared some of their payments with municipal governments as an incentive for them to implement national competition policy reforms. For example, Victoria's 69 municipal governments received nine per cent of the State's total national competition payments. In 2002, the funding program was revised and re-launched as the *Local Government Improvement Incentive Program* which distributed funds based on compliance with national competition policy (trade practices requirements, competitive neutrality and local laws not restricting competition) as well as policies on asset management and competitive tendering. These payments exceeded A$18 million in the 2004-05 financial year. All complying councils received a payment composed of a base grant of A$150 000 and a component that varied with population. Accordingly, councils with small populations (and small budgets) were more reliant on this revenue to fund their recurrent activities. For several small councils, this payment equated to five per cent of their rate revenue (MAV 2005, p. 5).
- *Regulation Reduction Incentive Fund* for municipal government (DIISR undated) In 2005, the Federal Government established a A$50 million fund with the objective of reducing regulatory burdens imposed by municipal governments on small and/or home-based businesses. Municipal governments, often as consortia, submitted proposals to the Federal Government outlining how much they required to implement their proposed improvements and the estimated costs savings to local firms. Most of the successful 31 proposals, involving 232 municipal governments, related to re-engineering administrative processes, including greater use of the internet and IT more generally, rather than any changes to regulatory requirements. Most projects related to planning approvals and licensing. While no evaluation has been published, anecdotally it was successful in assisting municipal governments implement changes, which otherwise would not have been a priority for budget-constrained organizations. This was essentially a competitive process to disburse tied grants as the funding was linked to the cost of undertaking specific projects.
- Victoria's *Reducing the Regulatory Burden* initiative involved a commitment to reduce the administrative burden of regulation by 25 per cent in 5 years (along the lines of similar programs in the Netherlands, Denmark and the United Kingdom). In 2006, the State Government announced it would be undertaking a program of reviews which it stated would be combined with incentive payments, akin to those under the National Competition Policy, to reward outcomes which reduce the regulatory burden. The initiative involved an additional A$42 million in funding, much of which was allocated to government agencies to projects which could demonstrate specific and measurable reductions in the administrative burden (red tape) of regulation.

In addition to the use of funding to strengthen incentives to improve performance there has also been a range of benchmarking exercises. These include COAG's performance project relating to the performance of government business enterprises (SCNPMGTE); benchmarking by the Bureau of Industry Economics of telecommunications, electricity, and rail freight; ACCC benchmarking of ports; and comparisons of State workplace safety and workers' compensation insurance schemes[1].

While all these programs may have an indirect effect on competition, by reducing barriers to new entry or the expansion of competitors, they were not directly focused on improving competition.

1. The Federal and State Governments have also been jointly reporting on the comparative performance of a broad range of mainly State government services (health, education, justice, housing assistance, emergency services etc.) through the Steering Committee for the Review of Government Service Provision.

Sources: Author's analysis, ACCC 2008a, DIISR (undated), MAV (2005), SCNPMGTE (1997), Victorian Government (2006a)

49. The Queensland Government provided A$150 million to its municipal governments under the *Local Government Financial Incentive Payments Scheme*. In order to receive funds, councils needed to nominate new business activities for National Competition and 736 nominations were received when nominations closed on 30 March 2002. Councils nominated businesses for reforms and resolved to apply the specific reforms. Once a council's business nominations had been accepted, they were required to undertake a series of reforms to be eligible for payments from the Financial Incentive Package (DITRDLG undated). The State's utility regulator, the Queensland Competition Authority, reported annually on the implementation of competition policy reforms by local governments, including their water supply businesses, and recommended the levels of payment to municipal governments. This included compliance with competitive neutrality requirements (and Queensland municipal governments run some substantial businesses), and review of anti-competitive regulation (QCA undated). Queensland noted that the application of legislation review process resulted in over 4000 superseded and anticompetitive municipal laws being repealed (Queensland Government 2004).

2.3.3 Implementing the agreements

50. The *National Competition Policy and Related Reforms Agreement* outlined tasks to be completed by specific dates. To be eligible for their share[16] of the first tranche of annual payments of A$200 million (indexed for inflation and population growth) that commenced in 1997-98, each State had to meet the requirements including:

- passing the required legislation so that the Conduct Code was applied within that State jurisdiction within 12 months of the related Federal legislation being passed;
- meeting obligations under the *Competition Principles Agreement*, which included:
  - when undertaking significant business activities or when corporatising their government business enterprises, to impose on those activities or enterprises: a) full government taxes or tax equivalent systems; b) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and c) those regulations to which private sector businesses are normally subject on an equivalent basis to the enterprises' private sector competitors,
  - publishing a policy statement on competitive neutrality by June 1996 and publishing the required annual reports on the implementation of the competitive neutrality principles,
  - developing a timetable by June 1996 for the review and, where appropriate, reform of all existing legislation which restricts competition by the year 2000,
  - publishing by June 1996 a statement specifying the application of national competition policy to their State's municipal government activities and functions (this statement to be prepared in consultation with municipal government); and
- effective implementation of all COAG agreements on: electricity arrangements through the National Grid Management Council; the national framework for free and fair trade in gas between and within States; and road transport reforms.

[16] The share of the total funds available to each State was based only on their share of the national population. This was in contrast to general assistance grants which were distributed based on a complicated formula that accounted for each State's revenue-raising capacity and social and other disadvantages.

51. The second tranche of annual payments of A$200 million (indexed for inflation and population) commenced from 1999-2000 and required that:

- the State continue to give effect to the Competition Policy Intergovernmental Agreements including meeting all deadlines;
- effective implementation of all COAG agreements on:
  - the establishment of a competitive national electricity market,
  - the national framework for free and fair trade in gas, and
  - the strategic framework for the efficient and sustainable reform of the Australian water industry; and
- effective observance of road transport reforms.

52. The third tranche of annual payments of A$600 million (indexed for inflation and population growth) commenced from 2001-02 and were paid on the basis of each State's progress on the implementation of the following reforms:

- the extent to which each State had actually complied with the competition policy principles in the Competition Principles Agreement, including the progress made in reviewing, and where appropriate, reforming legislation that restricts competition;
- whether the State had remained a fully participating jurisdiction as defined in the Competition Policy Reform Bill;
- the setting of national standards in accordance with the Principles and Guidelines for National Standard Setting and Regulatory Action and advice from the Federal Office of Regulation Review on compliance with these principles and guidelines; and
- continued effective observance of reforms in electricity, gas, water and road transport.

53. Each State Government was required under the agreements to submit an annual report to the National Competition Council which assessed each jurisdiction's progress, and the Federal Government voluntarily submitted a similar report. The Council then made recommendations to the Federal Treasurer on whether each State should get its full share of the competition payments, or whether some of these payments should be deferred or not paid at all. These recommendations were outlined in the Council's detailed assessment reports which were released when the Treasurer announced his decision.

54. The National Competition Council (NCC) had a critical role in creating the incentives for States to implement what in many cases were politically controversial reforms. The judgements as to whether a State had made adequate progress, while based on as much evidence as possible, were always going to be somewhat subjective. The agreements allowed for appointments to the Council to be jointly made by the Federal and State Governments, and it was important that the members (and the staff of the Secretariat) were both keen to advance reform, but also realistic about what was possible. It was also crucial that, as former Queensland Premier Peter Beattie explained, council members were seen to have been appointed to provide independent, professional and apolitical judgements, based on diverse experience of life across the country, rather than to represent particular States or other interests. He noted that while he had many many discussions about contentious assessments, with the Council's Chair, Graeme Samuel, he never contacted any Queenslander on the council (Peter Beattie, pers. comm.. 31 March 2009).

55. As different States did their legislative reviews (one of the most contentious areas of assessment), the National Competition Council was able to compare the rigour of the analysis, and the conclusions, and use this to query why the most pro-competitive solution was not feasible in other jurisdictions. The National Competition Council also proved to be a strong advocate of reform, both in its assessment function, and its public communications role, and as the Productivity Commission's 1999 report highlighted, this was an important function.

56. The Treasurers and State leaders, and their central agencies (the Treasury and Premiers' departments) in each State played an essential role in coordinating the implementation, but also as advocates for pro-competitive reform outcomes. In some States it had been more common for the Treasurer, and thus Treasury, to focus almost exclusively on budget issues (tax and expenditure matters), rather than general economic advice. But the national competition policy process both gave them an incentive, and a legitimate role, to become more involved in regulatory policy issues. And the process also encouraged and empowered Premiers' departments to take a more sceptical role in critically assessing arguments in favour of retaining anti-competitive regulation put forward by portfolio ministers and their departments.

57. The National Competition Policy package affected the portfolio of virtually every Minister in Government. Because any loss of the competition payments affected the budget flexibility of the whole Government, there was a collective interest by all Ministers in their colleagues' implementation of these reforms. Moreover, because the program affected so many stakeholders – both negatively and positively – it created an incentive for Governments to remain firm when individual stakeholders sought concessions. Stakeholders were challenged to provide solid evidence that would be credible when scrutinised by the National Competition Council that what they sought was in the public interest.[17]

58. State Governments sometimes sought to blame the National Competition Council and the Federal Government when the Council recommended that part of their national competition payments were either suspended or permanently reduced as a consequence of the particular Government not meeting an element of its commitments under the agreements. Sometimes it was hard to discern whether the Governments genuinely did not wish to remove a restriction on competition (for which there was insufficient evidence presented to support retention, in the National Competition Council's view) or just wanted someone else to blame for the need to undertake a difficult reform when confronted by stakeholders. Regardless, the existence of a formal review investigating an issue and proposing pro-competitive reform gave greater weight to those arguing for removal of unwarranted restrictions.

59. In some respects, the external constraint on politicians created by the payments system had similarities to the European Union (EU) constraints on State aid. As the Economist magazine reported:

> *"Marlo Monti, the former EU competition commissioner, recalls how finance ministers would often visit Brussels, begging him to rule against subsidies they had promised to some local company, perhaps in the heat of an electoral campaign. They were "delighted" whenever he promised to block state aid – with the understanding that, of course, they would condemn the Commission's move in public." (The Economist, 1 November 2008, p.54)*

60. The Hilmer report also recommended some institutional change at the Federal level, with the merging of the existing national competition regulator (the Trades Practices Commission) with an existing

[17] There was a high level of opposition to the implementation of NCP, particularly in regional areas which were being buffeted by a range of forces. This opposition led the Federal Government to ask the Productivity Commission to undertake a public inquiry on this issue in which it reported that every region bar two would, on balance, be better off as a consequence of NCP (PC 1999a).

pricing regulator (the Prices Surveillance Authority) to form the Australian Competition and Consumer Commission (ACCC). This involved a re-focus of the pricing activity from monitoring pricing of oligopolistic industries, to setting final prices for monopolies and access arrangements for nationally significant infrastructure providers. The ACCC ultimately took over the economic regulatory functions from the existing telecommunications regulator, Austel. The ACCC was subsequently given the task of providing the Secretariat to the new Australian Energy Regulator, which is gradually taking over the regulation of electricity and gas transmission and distribution from the State regulators. All the Australian economic regulators were general rather than industry-specific regulators (box 6).

Box 6. General versus industry-specific pricing and access regulation and regulators

The *Competition Principles Agreement* committed each jurisdiction to consider establishing 'independent sources of price oversight advice" where one did not exist. The Agreement also outlined that the Federal Government would legislate a general access regime for nationally significant infrastructure facilities, but that it would not cover services already covered by State regimes that conformed to the detailed principles and requirements outlined in the Agreement.

The Agreement required source of price oversight advice to have the following characteristics:

1. it should be independent from the Government business enterprise whose prices are being assessed;
2. its prime objective should be one of efficient resource allocation but with regard to any explicitly identified and defined community service obligations imposed on a business enterprise by the Government or legislature of the jurisdiction that owns the enterprise;
3. it should apply to all significant Government business enterprises that are monopoly, or near monopoly, suppliers of goods or services (or both);
4. it should permit submissions by interested persons; and
5. its pricing recommendations, and the reasons for them, should be published.

The merits of general versus industry-specific pricing and access regulators had been examined in the Hilmer report which started from the proposition that competition policy across all Australian industries should desirably be administered by a single body. In particular, the Committee noted that there were sufficient common features between access issues in the key network industries to administer them through a common body. As well as the administrative savings involved, there were undoubted advantages in ensuring regulators take an economy-wide perspective and have sufficient distance from particular industries to form objective views on often difficult issues (Hilmer 1993, pp.325-328).

More recently, in addition to highlighting the importance of the regulator being independent from vested interests and taking an economy-wide view, the ACCC noted that: "Effective institutional arrangements are underpinned by appropriate governance mechanisms that separate regulatory, policy and ownership responsibilities amongst different groups rather than combining any two of these within one entity." (ACCC 2003).

The primary reporting line for Australia's general economic regulators is to their respective Treasurers, while the policy responsibility for a sector, and in some cases individual decisions or recommendations about particular sectors may be considered by portfolio Ministers. This fosters the regulator's independence from the policy making process, and the key interested parties in each sector.

Source: ACCC (2003), COAG (1995), and Hilmer (1993)

61. Prior to National Competition Policy agreements some States had existing independent economic regulators, while others did not. The New South Wales Government established the Independent Pricing and Regulatory Tribunal (IPART) as a general pricing (and later access) regulator in 1992, to regulate the

maximum prices charged for monopoly services by government utilities and other monopoly businesses. The Victorian Government also established a general pricing (and later access) regulator with the Office of the Regulatory General in 1994, and this body subsequently became the Essential Services Commission of Victoria. Tasmania established the Government Prices Oversight Commission in 1996, Queensland established a general economic regulator in 1997, as did the Australian Capital Territory. The South Australian Independent Industry Regulator was established in 1999, the Northern Territory established its body in 2002, and finally Western Australia created its body in 2004. The Federal Government and all States now have general economic regulators whose scope covers pricing and access issues for multiple industries.

62. While the States all established generalist economic regulators, unlike the Federal Government they generally kept their consumer protection regulatory functions separate from the economic regulator. Typically, in each State this involved one economy-wide fair-trading regulator, and a range of other specialist regulators which also had over-lapping consumer protection functions (for example, State regulators of the building trades or health professions covered both technical competence and fair trading issues).

63. The National Competition Policy reforms explicitly acknowledged that governments have important equity and environmental objectives that need to be considered in the course of the reform process. The Australian reforms were also being implemented in an environment where considerable structural adjustment was already occurring due to other factors, including technological change, increased competition in traded goods, and changing preferences. And Australia, like other developed countries, had a well-developed social security safety net, subsidised training, and a government employment services network[18]. These general policies and services would reduce the immediate adverse impacts of competition reforms on social and distributional outcomes.

64. Government often faced pressure for payments to facilitate a reform. When considering any such payments the issue arose as to whether they were intended to facilitate sectoral adjustment, address equity issues or compensate for the loss of a property right. As Alan Johnson noted:

> *"Fundamental to this issue is whether a change in regulation governing entry is an attack on the property right in the licence. For example, the Australian Constitution provides that landowners have a right to 'just compensation' should their land be compulsorily resumed, whereas other government actions which also affect land values, such as changes in zoning or land use regulations, typically do not attract compensation. Liberalisation of entry into the taxi industry, while diminishing the value of licences, would not involve a resumption of a property right - the licences would continue to operate." (2000, p.177)*

65. In very limited sectors there were some industry-specific adjustment programs. The deregulation of the dairy industry was accompanied by a system of one-off payments based on the extent to which individual farmers benefited from the existing system, with this scheme funded by a levy on drinking milk that was borne by consumers (see appendix B). The Northern Territory Government compensated the owners of taxi licences when it deregulated. The Federal Government introduced a Sugar Reform Package in 2004, which included grants for farmers exiting the industry. However, many other industries were deregulated without the existing entrants being compensated.

18 The Labor Government introduced competition into this aspect of government services by contracting out the provision of some case management services for the unemployed in 1995, and this was extended to the majority of these services by the Howard Government in 1998 (Robinson 1999).

66. Moreover, as Alan Johnson noted, there were risks if governments sought to 'buy reform'. The provision of assistance can mute criticism from losers, thus helping to progress politically difficult reforms. But this can encourage those facing reform to agitate for compensation and thus stall reform or force changes that diminish the benefits to the community. This can encourage unproductive activity, including lobbying from 'rent seekers' seeking to preserve their current preferential position.

67. There is also a risk that an 'adjustment package' can involve significant costs without necessarily contributing sufficiently to adjustment. Following a National Competition Policy Review of the sugar industry the Federal Government removed tariffs on imported sugar in 1997, and the Queensland Government partly removed domestic price supports. This significantly reduced assistance to domestic cane growers and sugar millers. In July 1998 the Federal Government announced the Sugar Industry (Research) Assistance Package (of A$13.5 million), followed in 2000 by Sugar Industry (Cane Growers) Assistance Package (of A$65 million), and then in September 2002, the Sugar Industry Reform Program (SIRP) (of up to A$120 million) However, only A$26.7 million was paid out before the 2002 SIRP was superseded in April 2004 by SIRP 2004 (of A$444 million) (PC 2005b). However, as the Productivity Commission documented, it is difficult to design these programs, as the sugar programs did not generate the anticipated level of activity to either exit the industry or improve the sustainability of farmers in this sector.

68. The Productivity Commission's 1999 inquiry into the *Impact of Competition Policy Reforms on Rural and Regional Australia* looked closely at the issues associated with facilitating change and recommended that:

> *"Where governments decide that specific adjustment assistance is warranted to address any large, regionally concentrated costs, such assistance should:*
> - *facilitate, rather than hinder, the necessary change;*
> - *be targeted to those groups where adjustment pressures are most acutely felt;*
> - *be transparent, simple to administer and of limited duration; and*
> - *be compatible with general 'safety net' arrangements. (p. 395)*

69. The National Competition Policy process essentially concluded in 2005 when the Federal Government announced that it was making the final payments under the current agreement, and not proposing to continue making payments for on-going implementation and compliance with these agreements, although it would be considering new payments in return to meeting new commitments.

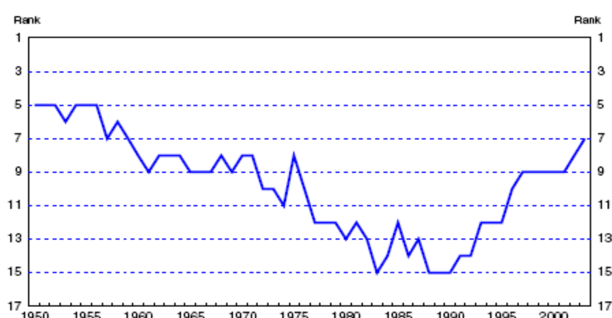
3. The outcomes of the National Competition Policy process

3.1 Economic outcomes

70. The Australian economy has been transformed in the period since the National Competition Policy agreements were signed and implemented. It has moved from being a laggard in the OECD, to often being cited as a model. Growth in per capita gross domestic product (GDP) between 1992 and 2006 was more than double the average for the OECD and nearly matched that of the USA, while the unemployment rate plummeted from 10.4 per cent to 4.4 per cent, a rate considered unachievable only a few years before (OECD 2008, p.19). And while the labour market boomed, with a 2 percentage point increase in labour market participation since 1995, and increased productivity, the labour price index remained relatively stable. Australia's economic ranking rose rapidly (figure 1).

Figure 1. The fall and rise of Australia's economic ranking

Selected OECD countries, per person GDP, purchasing power parity 1999 US$

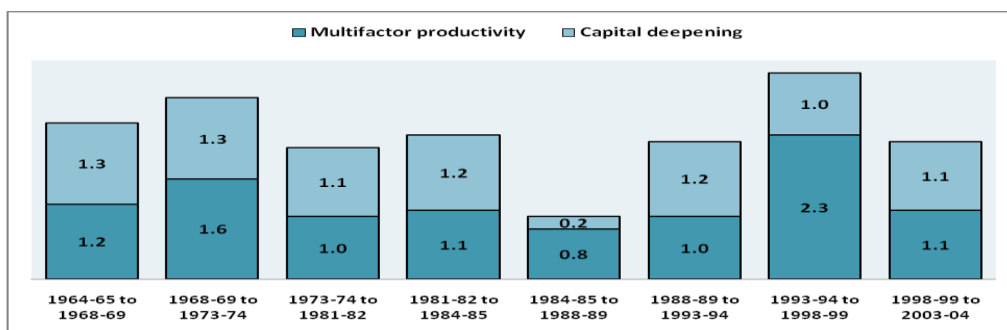


Source: OECD 2005, based on University of Groningen, GGDC Total Economy Database

71. Productivity growth also accelerated, particularly between 1993-94 and 1998-99 when both labour productivity and multi-factor productivity reached all-time highs (figure 2). Labour productivity, that is, the total output of the economy divided by hours worked, is not as good a measure of efficiency as multi-factor productivity because it does not account for productivity gains due to increased capital inputs. Multi-factor productivity measures the growth in economic output above that directly attributable to growth in measured capital and labour inputs. As such, it captures the influence of improvements in production-related factors such as skills, technology, and management practices that are not incorporated in official capital and labour measures (PC 2008a, p.3).

Figure 2. Growth in labour productivity, 1964-65 to 2003-04

Percentage change at annual rates



Source: ABS 5204.0 2007-0

72. Measured productivity growth subsequently slowed, but recent analysis suggests part of this was due to developments in the mining sector that meant that underlying productivity growth was not being adequately captured in the data (Topp et. al. 2008)[19], while the agricultural sector's productivity has been

19 Mining typically accounts for about 5 per cent of Australia's GDP. Topp et. al.(2008) found that while multifactor productivity in mining declined by 24 per cent between 2000-01 and 2006-07, one third of this decrease was due to a temporary effect of long lead times between the recent surge of investment in new capacity in mining and the associated output response (mining investment grew from 13 per cent of total investment in 1998, to 17 per cent in 2008) (ABS 2008). This resulted in a temporary fall in measured productivity, unrelated to underlying efficiency, as the data indicated an increase in capital without a commensurate increase in output. Topp et. al.'s study also noted that the ongoing depletion of Australia's natural resource base had contributed to this sector's measured rate of annual multifactor productivity growth being only 0.01 per cent. In the absence of observed resource depletion, the annual rate of mining multifactor productivity growth over the period from 1974-75 to 2006-07 was estimated to have been 2.3 per cent.

affected by a prolonged drought. The Productivity Commission noted that in 2006-07 alone, the drought subtracted 1.3 per cent from market sector multi-factor productivity (2008b). The Commission estimated that combined effects of the commodity price boom and depletion of oil and gas reserves on mining productivity have subtracted 1.7 percentage points from market sector multi-factor productivity over the five years to 2006-07.

73. There has been considerable analysis of why the gains during the early 1990s appear to have been a temporary increase in the rate of growth, and what factors might have contributed to growth rates subsequent falling back to historical levels. The Productivity Commission has noted that Australia is not alone in seeing labour productivity growth slow, as it also declined in the countries of the European Union. Australia's labour productivity grew from 88 per cent of the European Union average in 1990, to 95 per cent in 1995, but subsequently has only fallen back slightly to 94 per cent (PC 2008a). The Commission also noted that the slowing in productivity growth may, in part, have been due to the extraordinary terms of trade improvement experienced during the 2000s which contributed to a greater focus on expanding production, than on finding ways to improve efficiency by cutting costs.

74. Another possible explanation is the growth in regulation more generally. The National Competition Policy reforms were very focused on regulation that directly affected competition. However, during the period the volume of regulation (at least as measured in pages of legislation and regulation) continued to grow strongly and this may have imposed costs that offset the gains from more pro-competitive regulation. In addition, some of this regulation, while not directly restricting competition, would have indirectly affected competition by raising the cost of entry or of expanding a firm's operations.

75. However, it is not possible to directly attribute the improved economic performance, or its subsequent slowdown, to the competition policy reforms alone. Not only were the various elements of the National Competition Policy agreements complementary, these reforms were complementary to the broad range of other national reforms (including restructuring of public utilities, reforms to financial markets, phased reductions in barriers to international trade, labour market reforms, the introduction of mandatory private pensions, increased privatisation and fiscal consolidation at the Federal and State level—see table 11). Some commentators (for example, Quiggin 2004) argued that the gains attributed to National Competition Policy, and microeconomic reform more broadly, were significantly overstated, with much of the increase in measured productivity due to increased work intensity and a typical recovery in productivity following a recession, among other factors.

76. Improvements in the performance of the labour market clearly played a critical role in the change in Australia's economic fortunes. The Industry Commission's 1995 estimates of the likely benefits of the pro-competitive reforms were based on a conservative assumption that Australia's natural rate of unemployment was 8.5 per cent. The Productivity Commission's 2005 *Review of National Competition Policy Reforms* observed that there was an improvement in labour market outcomes (with a fall in both unemployment overall, and long-term unemployment, as well as increases in participation rates) during the period when the reforms were implemented. But the Commission only noted that these improvements occurred in parallel with the implementation of the National Competition Policy reforms, in part because of the complementary labour market reforms that occurred over the same period (box 7).

77. There now seems robust evidence that the competition policy reforms can make a crucial difference in improving growth, productivity, and even labour market outcomes. International studies, including those cited in the OECD's *Employment Outlook 2006* and the OECD's *Going for Growth 2007,* have suggested that easing anti-competitive product market regulation can contribute to increasing employment. *Going for Growth* noted three mechanisms by which this can occur: first, increased entry by new firms could increase activity levels and thus labour demand; second, more intense competition would be expected to lower prices of goods and services, thereby raising real wages; third, easing product market

regulation could be complementary to reforms to labour market regulation as increased employment and higher real wages reduce resistance to job-friendly reforms of labour market institutions (OECD 2009, p. 181).

Box 7. Reforms of the Australian labour market

As noted earlier, the performance of the labour market was fundamental to the extent of any gains realised from microeconomic reforms, including pro-competitive reforms. If those who become unemployed as a result of structural changes hastened by a reform do not quickly find alternative employment, the impact of reform will be reduced, or may even be negative (Quiggin 1996). Moreover, in identifying the contributions of the various reforms during the 1980s and 1990s, labour market reforms have played an important role, both by themselves, but also by complementing other reforms.

There were substantial changes in labour market regulation from 1983, right through to the end of the National Competition Policy process. The first changes in Federal labour market regulation in 1983 under the Hawke Labor Government increased the centralisation of wage setting. The Accord between the union movement and the Labor Government relied on national wage setting in national industry and occupational awards. An agreement was reached with unions not to seek additional increases in real wages, in return for increases in the 'social wage' through improvements in health and social welfare measures. This restrained real wage growth and contributed to employment growth between 1983 and 1989.

However, Wooden and Sloan argued that this highly centralised approach was not sustainable because it was incompatible with other government initiatives designed to increase the competitiveness of product markets and capital markets (such as reductions in tariffs, the floating of the dollar, and general deregulation of the financial sector), and other external competitive pressures. Gradually, initiatives designed to reward reforms implemented at the enterprise level were introduced, albeit arguably with limited success. Pressure was building for more fundamental reforms, including from the Business Council of Australia, and a study co-authored by Fred Hilmer (Hilmer et.al. 1993).

The industrial relations legislation was amended by the Labor Government in 1991, and then more substantially revised in 1993, to promote negotiation of working arrangements and wages at the enterprise level, including in worksites with few or no union members. Then in 1996, the new Liberal/National Party Government introduced new legislation that gave legal backing to agreements between individual workers and employers, without union involvement. By 1996, 64 per cent of workers covered by federal legislation were covered by enterprise agreements. However, many workers were covered by State industrial relations legislation, and during the early 1990s there had been a series of changes in State regulation. Wooden and Sloan argued that major legislative reforms had tended to occur at the State level in advance of Federal reforms, and the pattern at the State level had been towards more enterprise/workplace-based negotiations. In 2005, the Liberal/National Party Government introduced further significant changes to industrial relations legislation, extending the coverage of the Federal system to 85 per cent of the workforce (thereby substantially replacing existing State systems), substantially removing unfair dismissal provisions, and allowing individual agreements that provided for lower standards than the national award system.

Union membership was also in decline, from 50 per cent in 1976 to 31 per cent in 1996, to 19 per cent in 2007. This decline was in part due to structural change in the economy and labour force composition (particularly the increase in part-time employees) but also due to the decline in compulsory union membership. The decline also pre-dated compulsory union membership being outlawed in 1996 in workplaces covered by Federal legislation.

Industrial disputes also declined over the period from 242 days per 1000 workers in 1982-83, to 85.1 in 1994-95, to 28.8 in 2004-05. It subsequently fell to 17.6 in 2007-08.

In addition, during the period when National Competition Policy was being implemented, there were pro-competitive reforms to delivery of active labour market assistance, which moved this from a service delivered by a government monopoly to private (for profit and not-for-profit) providers who competed to deliver services to the long-term unemployed. In 1995 there were also changes to what the OECD has described as 'reasonably generous assistance benefits' to strengthen incentives for the unemployed to take up some part-time employment until they found full-time work. In 2000, the requirements to demonstrate that claimants were actively looking for work was also strengthened.

Source: Wooden and Sloan (1998), OECD (2001), ABS 6321.0.55.001 (Various years)

78. While there may be some debate about the aggregate outcomes, there are specific examples of improvements in key sectors, in both prices and improved choice for consumers. The National Competition Council was able to report a range of early outcomes from broader competition policy reforms as early as 1997-98 (box 8).

Box 8. Early outcomes from competition policy reforms

The National Competition Council's 1997-98 Annual Report listed the following early outcomes which it attributed to competition policy reform process:

- Electricity bills have fallen by around 23 to 30 per cent on average, and up to a maximum of 60 per cent, for those New South Wales (NSW) and Victorian businesses covered by the national competitive market. As well, wholesale prices in Queensland have fallen by 23 per cent since its internal competitive electricity market commenced.
- Gas prices for major industrial users fell by 50 per cent after deregulation of the Pilbara market in 1995, while gas distribution tariffs are set to fall by 60 per cent by the year 2000 in NSW.
- Rail freight rates for grain in Western Australia have fallen by 21 per cent in real terms since deregulation in 1992-93, while rail freight rates for the Perth-Melbourne route fell 40 per cent, and service quality and transit times improved, following the introduction of competition in 1995.
- Conveyancing fees in NSW fell by 17 per cent between 1994 and 1996, after the abolition of the legal profession's monopoly and the removal of price scheduling and advertising restrictions, leading to an annual saving to consumers of at least A$86 million.
- Prices for the outputs of government trading enterprises fell on average by 15 per cent, and payments to governments doubled, in the four years to 1995-96, due partly to competition reforms.
- In Queensland, ten of the seventeen largest municipal councils implemented two-part tariffs for water, resulting in an average saving in water usage of 20 per cent in the first year.
- Following a review of business licensing in NSW that found significant duplication and overlap, some 72 licences have been repealed and more were being scrutinized. Among other changes, 44 categories were collapsed into just three.

The National Competition Policy agreements mostly included reforms that had significant competition dimensions; some reforms related more to improving regulation of public utilities, for example, improved pricing of water, than competition per se.

Source: NCC (1998), p.3

79. The legislative review component of the NCP program was probably the most contentious (alongside water reform) and the aspect where the National Competition Council recommended the majority of the deductions from competition payments. However, as discussed below, while not all legislation was reviewed and reformed, the vast majority was not only reviewed, but more importantly, the reforms were implemented, and this produced gains for consumers both in terms of prices and increased choice (box 9).

Box 9. Outcomes of the reform of anti-competitive regulation

In addition to the removal of several statutory monopoly agricultural marketing schemes, there was a wide range of other reforms to regulation that had been assessed as unnecessarily hindering competition. While each of these reforms often only affected comparatively small sectors, or affected larger sectors at the margin, the cumulative impact was significant. In several cases these reforms were based on actions that had been taken by one State, but had not replicated elsewhere. An example was Victoria's 1988 deregulation of alcohol sales which reduced the barriers to entry faced by small bars and restaurants, allowing a much greater diversity of outlets (Nieuwenhuysen 2007).

Drinking milk prices fell following national reform of the dairy industry, despite the imposition of an 11¢ levy until 2009 on drinking milk to fund an industry adjustment levy (see appendix A).

Shop trading hours were deregulated by the Tasmanian Government in 2002, and while some commentators had predicted a net loss of employment, analysis by the Government had suggested employment would increase by 345 full time equivalent jobs. Since the legislation came into effect, employment in Tasmania's retail sector has increased by 9.1 per cent or 2 900 jobs. As the Government acknowledged, it is not possible to estimate how many jobs were created as a direct result of the removal of restrictions, rather than as a result of other favourable factors such as population growth, increased consumption from higher aggregate employment and the sharp increase in visitor numbers. However, there were also the less measurable gains to consumers in convenience.

Bakeries were deregulated The NCP Review of the New South Wales *Bread Act 1969* concluded that there was no net public benefit to restricting times for the baking and delivery of bread. The Act was repealed.

Choice of foot treatment increased following the NCP Review of the New South Wales *Podiatrists Act 1989* people now have the option of obtaining certain foot treatments from nurses and medical practitioners, instead of exclusively from podiatrists.

Veterinary services monopoly by the veterinary profession was removed in New South Wales and replaced with a specific list of veterinary practices that, on health, welfare and trade grounds need to be restricted to licenced practitioners, enabling a wider range of animal health care services to be provided by both vets and non-vets.

Taxi services This was an area where the National Competition Council found many jurisdictions non-compliant, although there was some progress compared to the recent past. For example, the Western Australian Government released new taxi licences following the NCP review, and while the numbers were modest (48 in 2003, 28 in 2004, and a further 40 between 2005 and 2008), these were the first licences released in 14 years.

Liquor licensing controls relaxed As a result of an NCP review, the Tasmanian Government removed a requirement that a minimum of 9 litres of wine be purchased in a single sale from specialist wine retailers, which had previously protected hotel bottle shops. New South Wales removed an anti-competitive 'needs test' that hindered the opening of new outlets, and replaced it in 2004 with a 'social impact test'. The Council expressed concerns the complexity and associated compliance costs of this new mechanism (2004, p. x), and this seems to have been borne out by experience with further reforms in New South Wales flagged in 2008, as concerns were raised about the lack of variety of small outlets that serve alcohol with or without food in Sydney compared to Melbourne.

Sources: NCC (2004), New South Wales Government (2004), Nieuwenhuysen (2007), Tasmanian Government (2004), Western Australian Government (2004)

3.2 Measures of the internal competitiveness of the economy

80. There is a range of studies that compare the domestic business conditions in a variety of countries. The OECD's measures of product market regulation released in 2009 showed that Australian regulation had become less restrictive between 1998 and 2003 to become the fifth least restrictive in the OECD. The 2008 measures indicated that Australia's ranking had moved down to eleventh (out of 27

reporting), as Australia's regulation apparently became more restrictive, while several other counties' regulation became less so.[20] Hawkins (2006) also demonstrated that Australia's ranking improved across all the relevant measures used by the World Economic Forum and IMD between 1999 and 2006. Australia ranked number seven among OECD members in the World Bank's *Doing Business 2009* indicators, and number nine overall (Singapore and Hong Kong are ranked higher).

Figure 3. Australia's ranking among countries in surveys of business opinion

	2005	1999
Intensity of local competition (WEF)	5th/117	9th/59
Rarity of market dominance (WEF)	15th/117	n/a
Regulatory framework encouraging competitiveness (IMD)	7th/51	n/a
Legislation preventing unfair competition (IMD)	2nd/51	8th/47
Effectiveness of antitrust policy (WEF)	2nd/117	3rd/59
Lack of price controls (IMD)	8th/51	14th/47
Days to start a business (IMD)	1st/51	n/a
Ease of starting a business (WEF)	1st/105	18th/59
Creation of firms supported by legislation (IMD)	8th/51	n/a
Absence of trade barriers (WEF)	20th/117	n/a
Absence of protectionism (IMD)	10th/51	23rd/47
Rarity of foreign ownership restrictions (WEF)	13th/117	n/a

1. Analysis by Hawkins, based on World Economic Forum and IMD annual publications.

Source: Hawkins 2006

81. The pro-competitive reform of the 1980s and 1990s not only contributed to higher productivity and growth, but also to the economy's resilience to shocks. This was particularly evident when the 1997-98 Asian financial crisis hit, and despite these countries being key export markets for Australia, the economy did not experience a substantial slowdown. As the Australian Treasury noted:

> *"…the ability of the Australian economy to adjust to the reduced export demand and lower commodity prices brought on by the Asian crisis illustrates the benefits of an economy made more responsive, flexible and resilient through microeconomic and regulatory reforms and a sound macroeconomic policy framework." (1998, p.21)*

82. More recently, OECD noted in *Going for Growth 2009* that "structural policy settings that have tended to be most supportive of high GDP per capita are generally the same as those that are usually most helpful for economies to rebound swiftly after negative shocks." (p.21)

3.2.1 Impact on investment

83. The reforms at the Federal and State level introduced higher levels of scrutiny of the pricing of monopoly infrastructure providers and created national and State access regimes. As outlined earlier, the ACCC was strengthened and new general economic regulators established in every State. These

[20] Mexico's product market regulation was among the most restrictive in the OECD in 2008, just above Turkey and Poland, although slightly less restrictive than 2003 (note, Greece, the Slovak Republic and Ireland did not report in 2008).

institutions had the potential to drive greater efficiencies and lower prices for consumers, or to discourage essential investment if they set prices too low or imposed overly onerous access conditions.

84. There are differing views on the impact of these infrastructure regimes on different sectors. During the Productivity Commission's public *Review of the Gas Access Regime* (PC 2004), the regulator (the ACCC) and representatives of users argued the regime and its administration had been beneficial, while regulated parties argued it had discouraged some investment, particularly that which is more risky.

85. However, overall analysis by Australian Treasury economists demonstrate that the share of private sector investment in infrastructure has markedly increased since the mid-1990s, to more than off-set a moderate decline in total public sector infrastructure investment during this period. They noted that as a result of rising private investment, the ratio of total Australian infrastructure investment to GDP rose from an average of around 3 per cent from 1987 to 2000 to almost 4.5 per cent by 2006 (Coombs and Roberts 2007).

3.2.2 National Competition Policy payments

86. During the life of the program, the Federal Government made a total of A$4.9 billion on National Competition Policy payments (table 3). These payments, and the associated assessment processes, were widely seen as a critical to the success of the program. However, while the amounts paid were large in aggregate, they only strengthened the other more powerful public policy basis for reforming, and for every jurisdiction represented a comparatively small proportion of total Federal payments to the States, and each State's available funds, given their own sources of revenue. For example, the A$179 million in payments that Queensland received in 2005-06 represented 2.3 per cent of general purpose payments it received from the Federal Government, and 1.4 per cent of total payments, including tied grants.[21]

Table 3. National Competition Payments 1997-98 to 2005-06

A$ million

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
New South Wales	$72	$73	$ 149	$ 156	$ 243	$ 252	$ 204	$ 234	$ 292
Victoria	$53	$54	$ 109	$ 115	$ 180	$ 182	$ 179	$ 202	$ 188
Queensland	$39	$40	$ 82	$ 73	$ 148	$ 139	$ 88	$ 143	$ 179
Western Australia	$21	$21	$ 43	$ 46	$ 71	$ 72	$ 34	$ 54	$ 67
South Australia	$17	$17	$ 35	$ 36	$ 56	$ 57	$ 41	$ 50	$ 51
Tasmania	$5	$5	$ 11	$ 11	$ 17	$ 18	$ 17	$ 20	$ 19
ACT	$4	$4	$ 7	$ 8	$ 12	$ 12	$ 11	$ 14	$ 13
Northern Territory	$3	$3	$ 5	$ 5	$ 8	$ 8	$ 6	$ 8	$ 8
Total[1]	$213[2]	$216	$ 439	$ 448	$ 733	$ 740	$ 579	$ 724	$ 816

1. Totals may not add due to rounding. Some payments differ slightly from Table 3 as adjustments were made for inflation and population between the Treasurer's announcement of his decision and the final payments

2. In 1997-98 and 1998-99, the States also received approximately A$200 million each year in total additional financial assistance grants (untied grants). Although these payments were not National Competition Payments, they were conditional on compliance with the *Agreement to implement National Competition Policy and Related Reform*. (PC 2005 considered these as payments associated with National Competition Policy compliance.)

Sources: The Treasury, various years

87. The National Competition Council completed its first assessment of compliance with the National Competition Policy agreement in June 1997, with positive recommendations of each State's progress leading to the Federal Treasurer to approve the National Competition Payments. The payments

21 To put this into perspective, in 2004-05 Federal Government tied grants to Queensland included $2 015 million for health, and $1 540 million for education (Queensland Government 2006).

were intended to recognise that the revenue dividend from economic growth accrued primarily to the Federal Government through the taxation system. However, as the Council noted, the prerequisite for States and Territories receiving NCP payments is satisfactory progress against the NCP obligations. If governments do not implement reforms as agreed there can be no reform dividends to share (NCC 2001). This left unclear whether the size of any reductions of payments should reflect an estimate of the foregone benefits of the specific policy areas, or whether larger reductions would be warranted to emphasis the importance of compliance, particularly with the legislation review process.

88. The National Competition Council had flagged its concerns with some reform actions in earlier annual assessment reports. But it only recommended limited payments be withheld, starting in the June 1998 report (NCC 1999, p.25). Two areas were particularly contentious – water reform and legislative reviews. The 2000 meeting of COAG (which followed the conclusion of the Productivity Commission's 1999 inquiry) provided an opportunity to review implementation and give the Council further guidance on the approach it should take to the assessment of progress.

89. There was concern from some States that the Council was being overly rigid is pushing what the States considered was a one-size-fits-all approach (or seeking the least restrictive approach to particular issues to be adopted by all States). In response, COAG advised the Council: "In assessing whether the threshold requirement of Clause 5 has been achieved, the NCC should consider whether the conclusion reached in the report is within a range of outcomes that could reasonably be reached based on the information available to a properly constituted review process. Within the range of outcomes that could reasonably be reached, it is a matter for Government to determine what policy is in the public interest." (COAG 2000, p. 7) But this was also accompanied by a greater focus on transparency and evidence, with COAG agreeing that when undertaking legislative reviews, governments should document the public interest reasons supporting a decision or assessment and make them available to interested parties and the public and give consideration to explicitly identifying the likely impact of reform measures on specific industry sectors and communities, including expected costs in adjusting to change.

90. There was also the contentious issue of the level of any withheld competition payments. At this November 2000 meeting, COAG advised the Council that:

> *"When assessing the nature and level of the reduction or suspension that it recommends for a particular State or Territory, the Council must take into account:*
> *the extent of the jurisdiction's overall commitment to the implementation of the NCP;*
> *the effect of one jurisdiction's reform efforts on other jurisdictions; and*
> *the impact of the jurisdiction's failure to undertake a particular reform." (COAG 2000, p. 8)*

91. However, even with these refinements, the States recognised that their reform payments could be at risk. The Western Australian 2003-04 budget was released in May 2003. The Budget papers noted that the National Competition Council had already indicated that failure to progress reform in a number of areas, including retail trading hours, liquor licensing regulations, the taxi industry and potato marketing arrangements, could put Western Australia's national competition payments at risk (Western Australian Government 2003, p. 153).

92. In 2003-04 the assessment process certainly got more serious when the National Competition Council recommended withholding 24 per cent of the total payments, and the Federal Treasurer accepted this recommendation. And funds were withheld from every State. Five States (New South Wales, Queensland, Western Australia, South Australia and the Northern Territory) had permanent deductions of a total of A$53.8 million imposed, of which over A$25 million was withheld from New South Wales. Western Australia had 55 per cent of its maximum available payments withheld, while 40 per cent of Queensland payments were withheld. A further A$127 million in payments were suspended, which meant that if a State remedied its non-compliance in the following year the money could be reimbursed (table 4).

93. Western Australia was advised by the Federal Treasurer in December 2003 that A$41 million of its 2003-04 payments would be withheld. While this was a significant amount, it represented 0.3 per cent of the total A$11 774 million in revenues expected during 2003-04 when the May 2003 budget was prepared. Moreover, Western Australian Government revenues at that time were increasing much more rapidly than expected, further reducing the impact of the penalties. This was reflected in the State ultimately receiving A$12 753 million in 2003-04 from all sources, nearly A$1 billion more than originally budgeted (Western Australia Government 2005).

94. Ultimately each Government had to consider its own circumstances and for each reform weigh up:

- the benefits of the reform in terms of: better economic (and sometimes social and environmental) outcomes in the medium term; demonstrating that the Government was committed to the National Competition Policy program; and additional Federal payments in the short-term; and

- the costs of the reform in terms of: the financial costs of implementing changes (typically not considered to be large) in the short-term; and the political costs as interested parties mobilise opposition (which will partly reflect the adjustments costs borne by members of the community).

95. Officials consulted for this paper noted that the ability of the Premier, Treasurer or the portfolio Ministers to argue to sectional interests that they needed to implement pro-competitive reforms to ensure the State received its competition payments was helpful when dealing with sectional interests.[22] But, as the Productivity Commission noted, this approach did undermine the message that the reforms were in the public interest in their own right, rather than being done purely for the revenue.

96. Suspending payments to strengthen the pressure for action achieved the desired results in many cases and ultimately A$85 million of these 2003-04 withheld payments were paid in 2004-05. For example, even with its strong fiscal position, Western Australia subsequently improved the transparency of its water pricing, and New South Wales removed restrictions on poultry farming. In 2004, the then New South Wales Premier introduced National Competition Policy Amendments (Commonwealth Financial Penalties) Bill 2004, noting that it was intended to reduce the likelihood of further deductions in National Competition Payments of A$51 million, noting "$51 million is a lot of money. It is double the value of this year's class size reduction plan or enough money to hire 750 new nurses." (Carr 2004, p. 6172).[23]

97. However, it is unclear whether permanent deductions or temporary suspensions were the most effective tool. The Western Australian Government (2004) argued that in the areas where deductions occurred they diminished the incentives for fruitful negotiations between the National Competition Council because the competition payments have been lost in that year irrespective of reform progress later in that year.

98. In the last three years of payments, a total of A$121 million of payments were permanently withheld, or 6 per cent of the payments made over that period. Western Australia had 34 per cent of its payments withheld (A$54 million), South Australia had 12 per cent (A$18 million), Queensland had 6 per cent (A$23 million), the Northern Territory 8 per cent (A$800 000) and New South Wales had 3 per cent

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[22] See for example, the New South Wales Parliaments' debates on the *National Competition Policy Amendments (Commonwealth Financial Penalties) Bill* and the *National Competition Policy Liquor Amendments (Commonwealth Financial Penalties) Bill 2004*. The latter Bill was introduced specifically to ensure that further deductions of $12.7 million in National Competition Payments did not occur.

[23] However, to put this in perspective, the New South Wales Government had total revenues of $37.4 billion in 2003-04.

(A$25 million). In contrast, Victoria, Tasmania and the Australian Capital Territory were not subject to any deductions.

99. As the Productivity Commission (2005) pointed out, the Federal Government was also notable for the extent and significance of its compliance breaches, but it was not subject to the financial penalties that could be applied to States. That said, the Federal Government did complete a large program of reviews, and implement their recommendations, just less than that of the majority of States (table 4).

100. The use of payments linked to pro-competitive reforms also had another effect on regulatory review processes within jurisdictions. Historically, many State Treasurers and Treasuries had been more budget focused, with less focus on promoting economic reform. However, the payments process not only provided an incentive for Treasurers and their Departments to be actively involved in applying economic analysis to regulatory reform issues, it also provided them with a legitimate role to do so within government. The level of Treasurer and Treasury Department involvement is reflected both in the choice of this Minister or Department to represent the State Government in negotiations with the NCC (in the 1999 assessment, half the jurisdictions were represented in negotiations by the Premier, and half by the Treasurer), but also ultimately in the re-assignment of the regulatory reform units, and 'gatekeeper' functions that oversaw the regulatory impact statement processes to the Treasury portfolio.[24] With Treasury involvement there was greater scope for the tools of economic analysis, particularly with a focus on competition, to be used to evaluate reform options, but also a greater focus on the community-wide impacts of reforms, rather than giving undue weight to sectional interests.

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24 The regulatory review gatekeeper function has moved from industry and small business portfolios to the Treasury portfolio in Victoria (2004), South Australia (2007), Queensland (2007), Western Australia (2008) and created in the New South Wales Premier's Department (2007).

Table 4. National competition payments 2002-03 to 2005-06, A$ millions

	New South Wales	Victoria	Queensland	Western Australia	South Australia	Tasmania	Australian Capital Territory	Northern Territory	TOTAL
2002-03 assessment									
Maximum available payments	$251.80	$182.40	$139.17	$72.00	$57.10	$17.70	$12.40	$7.50	$740.07
Permanent deductions			-$0.27						
Recommended payments	**$251.80**	**$182.40**	**$138.90**	**$72.00**	**$57.10**	**$17.70**	**$12.40**	**$7.50**	**$739.80**
2003-04 assessment									
Maximum available payments	$254.40	$188.10	$146.00	$74.60	$58.10	$18.10	$12.20	$7.40	$758.90
Permanent deductions	-$25.40		-$7.30	-$14.90	-$5.80			-$0.40	-$53.80
Suspensions	-$25.40	-$9.40	-$51.10	-$26.10	-$11.60	-$0.90	-$1.20	-$1.10	-$126.80
Recommended payments	**$203.50**	**$178.70**	**$87.90**	**$33.60**	**$40.70**	**$17.20**	**$11.00**	**$5.90**	**$578.50**
Proportion withheld	20%	5%	40%	55%	30%	5%	10%	20%	24%
2004-05 assessment									
Reimbursements from 2003-04	$25.40	$9.40	$29.20	$14.90	$2.90	$0.90	$1.20	$1.10	$85.00
2004-05 compliance									
Maximum available payments	$260.10	$192.20	$150.80	$76.80	$59.10	$18.60	$12.40	$7.70	$777.70
Permanent deductions			-$7.50	-$15.40	-$3.00			-$0.40	-$26.30
Suspensions	-$52.00		-$30.20	-$23.00	-$8.90				-$114.10
Recommended payments	**$233.60**	**$201.60**	**$143.30**	**$53.50**	**$50.40**	**$19.80**	**$13.60**	**$8.40**	**$724.20**
Proportion withheld	20%	0%	25%	50%	20%	0%	0%	5%	18%
2005-06 assessment									
Reimbursements from 2004-05	$26.00		$30.10	$15.40	$3.00				$74.50
2005-06 compliance									
Maximum available payments	$266.50	$197.90	$156.40	$79.40	$60.40	$19.00	$12.70	$8.00	$800.30
Permanent deductions			-$7.80	-$23.80	-$9.10				-$40.70
Recommended payments	**$292.50**	**$197.90**	**$178.70**	**$71.00**	**$54.30**	**$19.00**	**$12.70**	**$8.00**	**$834.10**
Proportion withheld	0%	0%	5%	30%	15%	0%	0%	0%	5%

Source: Costello 2002, 2003, 2004, 2005 and 2006, Commonwealth of Australia 2005, (Totals may not add due to rounding)

3.2.3 Distributional impacts of the reforms

101. The National Competition Policy reforms were driven by a centre-left Labor Federal Government, with strong support from several centre-right Liberal State Governments. The reforms were very focused on improving productivity, and efficiency more generally, rather than as a policy initiative to improve equity. However, as widely respected commentator Paul Kelly has argued, for the Hawke Government, social and economic equity was vital for the transition to market liberalism (2000, p.224). Equity objectives were to be achieved through the introduction of an array of other reforms intended to improve equity. And these welfare reforms were made affordable by higher productivity and growth. Subsequent research by Professor Ann Harding suggests that government policy in terms of the tax-transfer system during this period was highly effective in nullifying most of the income inequity arising from a more market-orientated economic system.

102. While the reform agenda was largely focused on improving efficiency, the reforms seemed to have some positive distributional consequences, and in some cases negative effects. Over the period, most commentators agreed that income inequality had worsened, but this trend had pre-dated NCP and given the multitude of factors affecting income and wealth distribution, including other reforms (see table 10), it was not possible to attribute it to competition policy reforms. For example, deregulation of the milk sector benefited the less well off consumers more than the higher income groups. In contrast, other reforms particularly affected some regional areas, such as labour shedding in areas where electricity generation was a big employer. Ultimately, the decline in unemployment, particularly long-term unemployment, and the increases in workforce participation had positive welfare effects, but as noted elsewhere in this paper, the factors contributing to improved labour market outcomes are subject to debate.

103. During the course of the reforms there was significant public concern with adverse developments in the broader economy, particularly in rural areas, which were attributed to National Competition Policy. Public disquiet was particularly acute in 1999, and the Federal Government commissioned an inquiry by the Productivity Commission (1999). The Commission received over 300 submissions, and visited over 75 rural and remote communities across Australia. The inquiry reported that many of the economic developments attributed to competition policy were due to on-going technical and demographic changes, other policy changes (such as tariff reforms), while overall the impact of the competition policy reforms were on-balance on all but one region of Australia. Even some critics of National Competition Policy noted that many of the adverse developments, such as bank closures in rural areas, were due to other factors (financial deregulation and demographic changes) (Quiggin 2004).

104. As a consequence of this rising community disquiet about the impacts of competition policy the National Competition Council, particularly its chair, Graeme Samuel, increased the effort devoted to explaining the consequences and particularly the benefits of competition policy reforms. This included speeches, simple and accessible brochures, meetings with State Ministers and Parliamentarians, and a range of other interested stakeholders. Several Australian bureaucrats consulted during the preparation of this report highlighted the importance of this communication activity and the role of the National Competition Council as an advocate for reform.

3.3 Implementation of the reforms

105. The Productivity Commission's 2005 *Review of National Competition Policy Reforms* concluded that most NCP reforms had or were being implemented.[25] This supported the National Competition Council assessment that most of the highest impact NCP reforms were largely achieved, including in the

[25] The Commission's report was finalised in February 2005, only four months before the National Competition Council was to complete its final assessment.

reform of public utilities that restructured their operations, subjected them to independent pricing oversight, and introduced competition where feasible. But the report also noted that in some areas, implementation of the agreed NCP initiatives proved to be not sufficient to achieve their underlying objectives, the notable example being electricity, where the reforms had not yet delivered a fully competitive national market. Further reforms in electricity are being implemented in the next wave of COAG reforms, and the Productivity Commission's 2006 report examining those reforms estimated they could result in further price declines of up to 2 per cent.

106. The Productivity Commission's 2005 report noted that the main areas of unfinished business involved the completion of the legislative review program and reform in the water sector. Areas where the National Competition Council considered that compliance with the NCP agreement was not achieved differed across jurisdictions (NCC 2005). This included Federal Government regulation relating to wheat marketing, health insurance, shipping, quarantine service, and postal services. Areas subject to national reviews and/or implementation processes included regulation relating to: agricultural and veterinary chemicals, travel agents, the legal profession, pharmacies, and trade measurement. Areas that were state-specific, but where reform was limited in several jurisdictions included: fisheries (Victoria, Queensland, Western Australia, South Australia and Northern Territory), liquor licensing (Western Australia, South Australia and Northern Territory), shop trading hours (Western Australia and South Australia), and taxis (Australian Capital Territory, South Australia, and Northern Territory). Examples of areas that the National Competition Council assessed individual States as not having adequately addressed included potato marketing and hairdressing (Western Australia), and plumbing (Tasmania).

107. The Productivity Commission's 2006 report noted that the competition payments from the Federal to State Governments had been an important motivator of reform. Of course, this motivation did not apply to the Federal Government, and this might partly explain why its level of review and reform activity did not match that of most States (table 4). In addition, Western Australia, the State with the lowest level of compliance, was also one of the main beneficiaries of the mining boom, and thus less budget-constrained than many of its counterparts.

108. In assessing whether the NCP process was an effective process to generate greater pro-competitive reform at the Federal level (a key issue for Mexico given the relatively greater importance of Federal regulation), it is important to be clear about the reference point. The elements of the NCP process that applied to the Federal Government—agreement to implement a comprehensive and cooperative reform program, and transparent and independent assessment of compliance—did seem less effective at motivating Federal reform, but there were still many important Federal reforms under the auspices of the NCP program during the period. The Federal Government implemented nearly two-thirds of its priority reviews. It seems reasonable to argue that more was achieved than would have occurred otherwise.

109. The National Competition Council's final assessment report in 2005 indicated that 22 per cent of priority legislation review and reform task remained incomplete and 15 per cent of the overall legislative. Had the program continued, with on-going assessments by the Council and associated payments, some of the difficult areas (such as taxis) may have been dealt with in the second round of reviews. These were scheduled to commence ten years after the first review in any area where restrictions on competition had been found to be justified by the public interest during the earlier review.

Table 5. Overall outcomes with the review and reform of legislation[26]

	Proportion of priority legislation complying (%)			Proportion of non-priority legislation complying (%)			Proportion of total legislation complying (%)[1]		
Government	*2003*	*2004*	*2005*	*2003*	*2004*	*2005*	*2003*	*2004*	*2005*
Federal	33	60	64	66	77	89	51	70	78
New South Wales	69	83	88	79	84	94	73	83	91
Victoria	78	84	84	83	86	91	81	85	88
Queensland	61	83	85	92	92	92	71	86	87
Western Australia	31	46	55	54	73	77	44	62	68
South Australia	37	60	69	82	90	94	63	77	83
Tasmania	77	82	84	90	95	96	84	89	91
ACT	59	81	82	97	98	98	85	93	93
Northern Territory	47	79	82	83	90	90	62	83	85
Total	**56**	**74**	**78**	**81**	**87**	**91**	**69**	**81**	**85**

1. Including areas of State regulation that were being subjected to national reviews and implementation processes.

Source: NCC 2004a & 2005

110. The consensus is that the NCP process led both to more reforms occurring than would have occurred in its absence, and to more rapid implementation of previously foreshadowed reforms.[27] The ACCC's review of the dairy reforms noted that the NCP process provided a "major fillip to deregulation" (2001, p. 5). Peter Beattie, Queensland Premier from 1998 to 2007, noted: "National Competition Policy undoubtedly brought about significant reform within Australia, and the independent evaluation of each State's progress and the payments were fundamental to helping overcome the short-term obstacles and reduce the political pressures not to reform." (pers. comm. 31 March 2009). However, it is impossible to establish the counterfactual – what reform would have occurred without NCP process?[28] Painter noted in his book *Collaborative Federalism: Economic Reform in the 1990s* (1998) that "In the National Competition Policy Agreements, a set of other agreements on electricity, gas and water, which had originally contained no enforcement mechanisms and no binding institutional commitments, were locked into a timetable of implementation by a set of financial inducements and penalties."(p.132)

111. The conclusion that most of the reform gains had been realised was supported by some economic modelling. The Victorian Department of Treasury and Finance undertook some preliminary modelling of the benefits of implementing the unfinished business of the National Competition Policy reforms. This modelling estimated that the outstanding actions would yield a modest increase of 0.2 per cent per capita GDP by 2015 (Victorian Government 2005).

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26 The National Competition Council advised against drawing conclusions from small differences in the proportion of complying legislation. It noted that: the estimates can reflect the differential treatment across jurisdictions—for example, a 'Chiropractors and Osteopaths Act' would be counted once, whereas separate legislation for each profession would be counted twice; and in some cases, a jurisdiction's review and reform activity for one issue might encompass several pieces of legislation—for example, reform of the Federal Government's private pensions legislation involved 10 pieces of legislation (NCC 2005, p.9.5).

27 Australia had existing Ministerial forums for Commonwealth/State cooperation for many portfolios but reform was typically very slow.

28 Some major reform of the electricity market did precede the NCP reforms (particularly in Victoria), and the gas market reforms required new investments in inter-state gas pipelines that were already occurring before NCP.

3.3.1 The incentives to reform – possible lessons

112. The focus of the legislative review program was mainly on reducing barriers to competition within each State's area of responsibility. While the reform of infrastructure industries focused on creating national markets, in other sectors, it was about improving each individual State market. As a consequence, in most areas each State undertook its own legislative review, often at different times. This allowed each jurisdiction (and their stakeholders) to learn from the experience of those who had gone before them. And it also allowed the National Competition Council to actively scrutinise the analysis of those jurisdictions which proposed to retain greater restrictions on competition in a particular sector than one of its inter-state counterparts.

113. A consequence of this state-by-state approach was arguably less restrictive regulation but also less consistent in many areas than would have occurred otherwise (more like the US market than the single market of the European Union).[29]

114. However, in some areas, national reviews were undertaken of sectors where several States had similar regulatory arrangements. While this might have been thought to encourage improved outcomes with the economies of scale allowing for more robust analysis, several officials consulted in the course of this report noted that in many cases the opposite result occurred. The National Competition Council noted that while national reviews might promote national consistency, "On the other hand, the Council has observed innovative approaches to reform in one jurisdiction being adopted by others. Reform in one jurisdiction can thus provide a catalyst for other jurisdictions to act in areas that seemed (politically) intractable (2005, p. xii). [30]

115. The Western Australian Government noted that with national reviews the "outcomes had been mixed at best." (2004, p.5) The problem was that when a national review was convened, it was often the Federal Government that chaired the process. And it has been argued that the Federal Government was less resistant to stakeholder pressure to retain restrictions because, unlike any individual State, it was not subject to the financial costs of not reforming. The most notable example was the national review of pharmacy regulation, where the then Prime Minister intervened to overturn the recommendations of the national review that would have relaxed some restrictions on competition (Queensland Government 2004).

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[29] Patrick Messerlin (2007) argued that 83 per cent of European Directives had the goal of establishing common norms, while only 9 per cent were aimed at improving competition, with the balance having mixed goals.

[30] The then Premier of Queensland, Peter Beattie, cited learning from other States as one of the factors that led his government to revise its position on increasing competition in electricity through introducing retail contestability (Beattie 2005).

Box 10. Key institutions in the implementation of NCP

National Competition Council

The National Competition Council was established under Federal legislation, but the legislation required that a member of the Council cannot be appointed unless a majority of the States and Territories that are parties to the Competition Principles Agreement support the appointment.

The National Competition Council's first annual report noted "A key implicit responsibility is to support and promote the National Competition Policy, and this is done in conjunction with all our other work. We both make and take opportunities to promote and explain the issues. Unless the National Competition Policy reforms and their benefits are understood widely in the community, there is a high risk that people will equate competition reform with job loss in particular sectors, rather than see key benefits such as increased employment opportunities overall arising from a growing economy. Accordingly, we see explaining and promoting competition reform as one of our most important tasks." (NCC 1996, p.1)

During the implementation phase of the National Competition Policy, the Council had responsibility for both assessing compliance with the National Competition Policy agreements, and issues relating to access to essential facilities. It is estimated that about 60 per cent of the time of its 20 staff was spent on the compliance assessment activities. The four Councillors and the Chair were all part-time appointments, and it is estimated that the Chair spent about 1 to 2 days a week on these issues, while for the rest of the Council it was about 10 days per year (Campbell pers. com.).

Australian Competition and Consumer Commission and its State counterparts

The ACCC was assigned broader responsibilities than its predecessors, the Trades Practices Commission (the then national anti-trust and consumer protection regulator) and the Prices Surveillance Authority. The ACCC gained coverage of the activities of State Government businesses and the unincorporated sector, and was involved in setting prices and access arrangements for significant monopoly activities. These new responsibilities affected the States, so in recognition of this, the States achieved agreement that the Federal legislation establishing the ACCC provided for the Federal and State Government to jointly determine the membership of the Commission. Each State established independent pricing and access regulators that dealt with natural monopoly activities within their State, such as electricity and gas distribution, intra-state rail, and ports. Some of these bodies subsequently became involved in other price setting, such as the taxi and public transport fares, water prices, and premiums of government-owned workers' compensation insurers.

Productivity Commission (and its predecessors, the Industry Assistance Commission, Industry Commission, Bureau of Industry Economics, and Economic Planning Advisory Commission). This organisation:

- undertook public inquiries at the request of the Federal Government of areas of both State and Federal regulation which highlighted the opportunities for reform, and the size of the performance gaps
- estimated the economy-wide benefits of individual reforms and packages of reforms (PC 1999a, PC 2005), and the associated fiscal flows to the Federal and State Governments (IC 1995)
- undertook some national reviews under the Legislative Review program on behalf of the States, and reviewed some areas of Federal regulation at the request of the Federal Government.

Federal and State Central agencies

Two departments played key roles in the implementation of the agreements. The first was the department that supports each Government's leader (i.e. Premier or Prime Minister). The second was the department that supports each Government's Treasurer (which combined the role of finance minister and minister for the economy in most jurisdictions). Both of these departments also worked in concert with the National Competition Council.

The NCP payments and associated assessment processes both required central coordination and provided a rationale for these central departments to take an active interest in the regulatory work of the line agencies. Governments in Australia also publish estimates of their revenues (and expenses) for the next four years in their annual budgets, and thus future NCP payments were already factored in, making any threat to them being paid an issue for each State's Treasury. Each State established a Competition Policy Unit, and this role was seen as extremely important, as they:

- compiled the schedule of legislation for review;
- monitored implementation of specific reform commitments, including facilitating necessary legislative changes through internal government approval processes;
- developed guidelines for the conduct of legislative reviews;
- coordinated reviews, and performed a quality control role;
- submitted annual reports to the National Competition Council on implementation progress;
- negotiated with line agencies to ensure timely implementation (and thus reduce the risk of payments being withheld) and with the National Competition Council; and
- briefed their government's leaders on progress, and any barriers to progress (Deighton-Smith 2001).

Source: Author's analysis

3.3.2 An enduring focus on improving competition

116. A major success of the NCP is that the implementation of the reform process continued for the full ten years, despite change of leader and ruling party federally and in almost every State[31], and significant stakeholder resistance. Moreover, these microeconomic reforms continued despite the different reform focus of the new Federal Government which came to power in 1996. Its economic reform focus was mainly in the areas of fiscal consolidation, privatisation, contracting-out of government services, taxation and labour markets. Indeed, some commentators argued that microeconomic reform pretty much ground to a halt under the Howard Government (Gittins 2008), although it is probably fairer to say that new economic reform initiatives involving cooperation with the States were a lower priority. It continued supporting the National Competition Policy, despite strong pressure from stakeholders to weaken the process.

117. Collective action on competition reforms has remained a priority for the States at COAG, and more recently for the Federal Government. As the end of the National Competition Payments approached, Victoria proposed a *Third Wave of National Reform,* based on the success of the National Competition Policy reforms, and the principle of sharing the benefits and costs. This reform agenda was broader, focusing on improving workforce participation and productivity through complementary health and education reforms, but also included further reforms in competition and regulation more broadly. It also noted that modelling by its Department of Treasury and Finance highlighted that under the current arrangements most of the fiscal benefits would again accrue to the Federal Government (Victorian Government 2005).

118. More recently, COAG has made progress in a number of areas where national NCP reviews had not been completed and/or implemented, including in the areas of: agricultural and veterinary chemicals; mutual recognition; food safety; trustee corporations; consumer credit; and trade measurement. This work has been coordinated by the COAG's Business Regulation and Competition Working Group (chaired by the Federal Finance minister). The Working Group has been working on 27 'hot spots', most of which are aimed at creating a 'seamless national economy', with a focus on removing inconsistencies among States in their regulatory requirements. The implementation work in these areas will be underpinned by a new national agreement relating to regulation reform, which again has an independent assessment process, and payments from the Federal to State Governments. The focus to date has been on consistency, rather than reducing regulation, including that which impedes competition. The focus on consistency could pose the risk of Governments settling on common, but more restrictive, regulation (at least more restrictive than that which currently exists in some States). This is a criticism that sometimes seems to be levelled at the European Union. The rigor of the regulatory impact processes for setting these new national standards and of the independent assessment of progress implementing reforms (which will not be undertaken by the NCC, but a new body, the COAG Reform Council), will affect the extent to which this risk is mitigated.

119. Concerns about rising food prices led the Federal Government to commission an inquiry from the general competition regulator, the ACCC, in 2008, which focused on ways to remove any remaining restrictions on competition in the grocery sector, including planning (zoning) barriers that affect new entrants. Further work in this area is likely to be undertaken by the Working Group, and this will likely lead to an examination of how planning regulation is implemented by municipal governments.

120. There have also been initiatives by individual States and the Federal Government to introduce greater competition since the end of the National Competition Policy program, including some progress in

31 Australian Governments are not time limited, as in Mexico (where there is no re-election). But, there were many changes of leadership and party over the 15 year period during which the National Competition Policy was developed and implemented, with 34 Federal and State leaders ultimately involved (table 12).

areas where reform was not achieved during the period of the NCP assessment and payment process. The Rudd Government has reformed the monopoly export wheat marketing arrangements,[32] commenced reviews of the restrictions on the parallel importation of books and of anti-dumping arrangements (although it will be some time before it is clear that the Government will implement any recommendations that may arise from these two reviews). And while liquor retailing was a contentious matter for many assessments of compliance by the National Competition Council, New South Wales has chosen to remove further restrictions on competition in this sector since the end of the NCP program (see box 9). The Victorian Government has also continued to look at ways of harnessing competition, including through introducing a new funding model for its vocational education and training sector which is intended to allow greater competition from private providers and encourage all providers to be more demand driven.

121. Since the conclusion of the arrangements to minimise the amount of anti-competitive regulation overseen by the National Competition Council there seems to have been very few, if any, reversals of specific reforms. There have been new licences introduced in some areas, for example, of solariums, but these have been subject to the regulation review arrangements designed to achieve the public policy objectives while minimising adverse affects on competition. However, without the annual assessment process overseen by the Council, there is no comprehensive overview of developments in terms of pro-competitive regulation.

122. The gains made in removing regulation that directly affected competition did not lead to reduction in the amount of regulation more generally. Indeed, the amount of regulation (at least, measured by crude measures such as pages of legislation) grew even faster. Some of this was as a direct consequence of measures to increase competition, as the new electricity and gas markets took on roles that were previously undertaken within government utilities through administrative means. Water trading required new rules to define property rights. However, the on-going growth in regulation in areas such as health and safety, consumer protection and protection of the environment, have led to more regulation, much of which would be expected to have some impact on competition, if only because it is typically harder for smaller firms to comply. That said, there is no comprehensive measurement of the impact of the stock of regulation. Some existing regulation would be expected to become less costly to comply with over time (for example, the costs of fitting seat belts or purchasing safer machines might fall as the technology becomes standard), while in other areas new regulation has been introduced. The net result is that there is no robust evidence regarding the absolute change in the costs of regulation.

123. There has been significant concern expressed by the main business groups about the growth of regulation, and this has led to major Federal (Banks et. al. 2006) and State (IPART 2006, VCEC various years) reviews, and the establishment of new bodies such as the Victorian Competition and Efficiency Commission (which is an independent body, and in many respects is similar to the Productivity Commission, but operating at the State level), and the Better Regulation Office in New South Wales (which sits within the Premier's Department), and the strengthening of regulatory impact statement processes, and the regulatory watchdog bodies generally. Four States, Victoria, South Australia, Queensland, and New South Wales have set targets to reduce the administrative and/or compliance costs of State regulation, and put in place mechanisms to report on progress.

3.4 Increasing the transparency of regulatory change

124. The Legislation Review element of the *Competition Principles Agreement* required each jurisdiction to review all legislation (including Acts, enactments, Ordinances or regulations) that restricted

[32] Previously, AWB, a private company partly controlled by wheat growers, had a statutory monopoly on exporting wheat. The previous Federal Government was not prepared to remove this restriction on competition despite critical assessments from the National Competition Council.

competition. Jurisdictions were required to develop a timetable by June 1996 for the review, and where appropriate, reform of all existing legislation that restricts competition by the 2000 (this was subsequently extended to June 2002). Ultimately, the Federal Government and the eight States identified about 1 800 Acts that required review, although on closer examination some were found to have no material impact on competition.

125. The National Competition Council recognised the burden on governments from conducting reviews and implementing reforms, and that the greatest community benefit would arise from prioritising legislation with the greatest impact on competition. The Council nominated 800 pieces of priority legislation which it scrutinised in more detail and monitored outcomes in a further 1000 non-priority areas (National Competition Council 2003).

126. The Agreement providing guidance on the analytical framework for the Reviews as it required that "Without limiting the terms of reference of a review, a review should:

1. clarify the objectives of the legislation;

2. identify the nature of the restriction on competition;

3. analyse the likely effect of the restriction on competition and on the economy generally;

4. assess and balance the costs and benefits of the restriction; and

5. consider alternative means for achieving the same result, including non-legislative approaches" (COAG 1995).

127. The Agreement did not specify the process by which these reviews were to be undertaken and was explicit that each jurisdiction was free to determine its own agenda for the resulting reforms of legislation. However, each jurisdiction was required to submit annual reports outlining its progress in removing unnecessary restrictions on competition. In its first Annual Report, the National Competition Council stressed that is was going to focus on on-time delivery of reform commitments and prioritising areas where there would be big gains (NCC 1996). The National Competition Council flagged in its first annual report that its judgment of satisfactory progress envisaged it would assess whether legislation reviews involved an examination in good faith of the community costs and benefits of reform by jurisdictions, and subsequent reform action consistent with review outcomes (NCC 1996, p.3).

128. All States published their own guidance for their Portfolio Departments on undertaking legislative reviews. They addressed the analytical and methodological issues, much the same way as the *OECD's Competition Assessment Toolkit* (2007a) does, though consistent with the National Competition Policy Agreements, the States' guidance included the strong presumption in favour of competition. They also focused on the important issue of establishing the right process to undertake the Review. For example, the Victorian Government published its *National Competition Policy: Guidelines for the Review of Legislative Restrictions on Competition* (1996), and outlined four review models (table 6).

Table 6. Review models

Review/model	Scale/priority	Independence	Consultation
1. Public review	- major scale - high or medium priority reviews	All reviewers not engaged in the area under review; & department/government agency reviewers constitute the majority of the review panel	Public notification and call for submissions that are available to the public; possible public inquiry process
2. Semi-public review	- complex-minor scale & high or medium priority reviews	All reviewers not engaged in the area under review; & non-department/ government agency reviewers majority on review panel	Public notification of review and call for submissions; targeted consultation with interest groups at the discretion of the panel
3. Combined review & reform	- simple-minor review scale & high or medium priority reviews	Reviews may be internal to department but must be independent of the activity under review and may use external consultants	Consultation at the discretion of panels; may focus on reform options rather than benefits of the status quo; consultation draft report may be considered
4. In-house Review	- all low priority reviews	As for 3. above	No minimum consultation requirement

Source: Victorian Government 1996

129. In 1999, at about the halfway point through the legislation review program, the National Competition Council asked respected consultants, the Centre for International Economics (CIE), to produce guidance on best practice reviews, drawing on the Federal and State guidance but also the experience to date (CIE 1999). Like the existing guidance, the Centre's guidance placed a lot of importance on the process of the review—selection of appropriate reviews, extent of consultation, publication of submissions—as this was seen as fundamental to achieving positive review outcomes that focused on the community benefit (figure 4).

Figure 4. Establishing a legislative review

Typical problems of review / Requirements or tasks to overcome problems	Task A *Assess importance*	Task B *Ensure independent steering committee*	Task C *Select appropriate review model*	Task D *Draw up detailed terms of reference*	Task E *Ensure independent, innovative and experienced review team*	Task F *Ensure transparent public process requiring stakeholder involvement*
1. Resistance from vested interests	✓	✓			✓	✓
2. Lack of data for analysis					✓	✓
3. Lack of independent analysis	✓	✓			✓	✓
4. Lack of resources and framework	✓		✓	✓		✓
5. Benefits of change				✓	✓	✓
6. Lack of incentive to comply		✓			✓	

Source: CIE 1999

130. The Centre noted that where the political sensitivities to implementation are strong, a comprehensive process of public debate may be crucial to educate the electorate of the need for change and to counter resistance from vested interests. There was a presumption that the final report, and the government's responses would be publicly released, and in many cases a draft report for comment. Often public meetings or hearings were held to discuss the issues, and possible options for reform.[33]

131. While this sort of structured public process had been common for public inquiries commissioned by the Federal Government from the Industry Commission (and its successor, the Productivity Commission), and is often the model used by competition and utility regulators for key aspects of their work, it was not common at that time for many reviews of legislative or substantial changes. Moreover, the standard analytical framework—focusing on tightly defining the policy objectives, and testing all the options to achieve that objective (with empirical analysis of the costs and benefits from the perspective of the community, rather than just the industry directly affected)—was also not explicitly used in many reviews.

132. The Tasmanian Government noted:

> *"NCP has brought about major changes to Government regulation. ... In the past, such legislation may have been adopted across all jurisdictions with little concern as to the potential impact on competition and, in many cases, without assessing the impact on business activities. Under the current NCP arrangements, whenever it is considered that proposed legislation contains a significant restriction on competition or a significant impact on business, the administering agency is required to prepare a regulatory impact statement (RIS) and conduct a mandatory public consultation process. This ensures that there is a systematic and transparent*

[33] The Tasmanian Government noted that it is not possible to measure the benefit of this change in public policy processes, particularly the impact of some new regulation avoided by such processes (2004, p. 3)

approach to assessing and documenting the impact of regulatory proposals on the community and acts as a deterrent to unnecessary regulation of markets within the State." (2004, p.2)

133. The National Competition Policy process did not require public processes, but *encouraged* public processes for regulation review and *required* that price oversight bodies consider public submissions. The National Competition Council *encouraged* transparency in its processes, advocating that States publicly release their annual reports (or failing that, it released them when it finalised its own assessment), and that they make their review reports publicly available. It also stated that when it was assessing whether a review of anti-competitive legislation was adequate, it looked for public participation, as well as a review panel that was independent from interested parties (NCC 2005). COAG's 2000 supplementary guidance on legislative reviews also *requested* that governments document the public interest reasons supporting their reform decisions and make this reasoning publicly available. The public processes were part of educating the community of the true cost and benefits of the status quo and reform options, and allowed external scrutiny of the arguments made in favour and against reform.

134. Submissions to the Productivity Commission's 2005 review of NCP emphasised the importance of transparency. The Western Australian Government (2004) noted:

"Transparent processes are crucial when assessing the public interest. Without transparency it is extremely difficult to gain the community's confidence that public interest considerations have been examined in an impartial manner and that it is the community's interest that is the overriding concern rather than any particular sectional interest group when deciding whether a reform should or should not be progressed."(pp.5-6)

135. The NCP presumption in favour of competition was reflected in the burden of proof and thus the level of public participation and scrutiny that the Council sought. In its 2005 assessment it noted that the agreements did not require a full public review process before reforming restrictions on competition. If preliminary scrutiny shows the legislation provides no public benefit, then repeal without further review or consultation would still be consistent with the NCP agreements.

136. However, many reviews, even those relating to controversial topics were not made public though they were provided to the National Competition Council. One of the recommendations of the Productivity Commission's 2005 review of NCP was mandating greater transparency in the review processes, although this needed to be targeted at the high impact reviews.

3.5 Timing

137. As indicated earlier (table 5), while the original legislative review schedules for each State were published in 1996, there was still a rush in 2003, 2004 and 2005 to complete the reviews and more importantly to implement those recommendations that were supported by Governments. The reviews were often largely public processes, with extensive consultation to develop recommendations. Often this was followed with further consultation associated with implementation, including any legislative changes. In some cases governments also sought to reduce the transitional costs either by providing a delay before implementation to allow firms and individuals to adjust to the forthcoming changes, or by phasing the implementation.

138. As noted earlier, the original legislation review timetable proved not to be achievable. It would seem that this target, with the benefit of hindsight, was overly ambitious, given the scope of the work that needed to done. There was apparently a lot of learning by doing, and so while a shorter timetable may have been feasible, the revised timetable probably reflected a more realistic timeline.

3.5.1 Duration of the process

139. The robustness of the National Competition Policy reform process is reflected in the fact that the process endured through 10 years, when almost every jurisdiction's leader and government changed. And while oppositions were typically very negative about national competition policy, reflecting the community disquiet about the impacts of change, these oppositions did not seek to withdraw from the process once in Government.

140. The States argued the National Competition Policy agreements were intended to be on-going, even though in the original agreement the Federal Government only outlined a schedule of payments until 2005-06.[34] The agreements envisaged both on-going monitoring within each State (new regulation, competitive neutrality compliance oversight, independent pricing agencies) and on-going reform (ten year cycle of reviewing anti-competitive regulation for continuing need).

141. When the payments ceased, so did the annual public reporting by States on national competition policy issues and the National Competition Council's rigorous monitoring role. So there is limited evidence on how much on-going activity has continued. The State watchdogs on new regulation have been strengthened, although their focus is broader as it is on better regulation (particularly implementation of the regulatory impact statement process) rather than just pro-competition. This encompasses analysis of any restrictions on competition, but with less focus on this aspect. The independent pricing agencies remain in place, and in some jurisdictions their roles have increased. The Productivity Commission continues to report on the commercial activities of government business enterprises. It notes that these businesses often continue to achieve below commercial returns, suggesting an issue with competitive neutrality compliance. There is no evidence that the ten year cycle of reviewing regulation that retains anti-competitive aspects is under way.

142. The National Competition Council's role as a strong public advocate for reform, which was prepared to make robust judgement of progress, undoubtedly contributed to the acceleration of implementation as the end of the program approached. However, antagonism from many States meant that the National Competition Council's assessment role was subsequently transferred to a new institution, the Sydney-based COAG Reform Council, which is to assess progress with COAG's new wave of cooperative reform that extends to human capital (health and education) reform as well as on-going work on competition and regulation.

143. The new COAG agenda in competition and regulation retains the key elements of the NCP process—common national agreements, independent oversight of progress, and untied payments that share the rewards. As noted above, the new agenda includes completing a significant amount of the unfinished business relating to the national legislative reviews. However, the new agenda does not at this stage seem to include commitments and processes to embed those parts of the early NCP agreements that could be seen as on-going, particularly those relating to the continuing cycle of reviewing regulation that continues to restrict competition every ten years to see if it remains in the public interest, nor retention of oversight of the competitive neutrality mechanisms.

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[34] Anecdotally there seem two reasons why the payments ceased, rather than being re-negotiated (probably at a lower rate) for a further period. First, some say the then Federal Treasurer did not agree with making payments to the States to undertake reforms he considered they should have done anyway (Willis 2003, Parliament of New South Wales 2004). Second, some States were highly critical in political forums of any reduction in payments due to the annual assessment process. The Federal Government saw little benefit in continuing to support a process which allowed these State Governments to criticise it, when the States were the ones not delivering on their commitments.

Table 7. Timeline for National Competition Policy

Date	Event
30 October 1990	Special Premiers' Conference establishes joint Commonwealth-State committee on microeconomic reform.
12 March 1991	Prime Minister Bob Hawke observed that expanding the scope of the Trade Practices Act would provide significant benefit (in *Building a Competitive Australia* statement to Parliament).
30 July 1991	Special Premier's Conference agrees that competitive markets would benefit Australia, and that a national approach to competition policy would be important.
4 October 1992	Independent Committee of Inquiry into a National Competition Policy for Australia established, chaired by Professor Fred Hilmer.
7 December 1992	First meeting of the Council of Australian Governments (COAG).
25 August 1993	Report of Independent Committee of Inquiry into a National Competition Policy for Australia released (Hilmer Report).
25 February 1994	Council of Australian Governments agrees to accelerate microeconomic reform, endorsing the Hilmer Report principles.
19 August 1994	COAG agrees in principle to competition policy reform process and releases draft agreements.
11 April 1995	COAG signs the agreements to implement national competition policy.
11 April 1995	Industry Commission's assessment of growth and revenue implications of Hilmer and related reforms published.
6 November 1995	National Competition Council (NCC), Australian Competition and Consumer Commission and Australian Competition Tribunal created.
30 June 1997	NCC finalises its first independent Assessment of State and Territory Progress with Implementing National Competition Policy and Related Reforms.
14 October 1999	PC report on *Impact of Competition Policy Reforms on Rural and Regional Australia* released
26 July 1999	NCC assessment report (second tranche) is released, and Treasurer accepts a recommendation to defer a A$15 million payment (25 per cent) to Queensland.
3 November 2000	COAG agrees: to provide further guidance to the NCC on how to interpret compliance with the legislative review requirements; that the timeframe for completing the National Competition Policy program should be extend to 2005; and that the NCC should undertake annual assessments of implementation progress.
14 December 2001	NCC's 2001 assessment report (third tranche) released.
6 December 2002	NCC's 2002 assessment report (third tranche) released.
8 December 2003	NCC's 2003 assessment report (third tranche) released.
25 June 2004	COAG's agreement on a National Water Initiative transferred the 2005 National Competition Policy assessment of progress with water reform to the new National Water Commission.
21 December 2004	NCC's 2004 assessment report (third tranche) is released.
14 April 2005	Productivity Commission's *Review of National Competition Policy Reforms* is released.
3 June 2005	COAG agrees to a new reform agenda.
15 December 2005	Federal Treasurer announces the final National Competition Payments to States and releases the NCC's final National Competition Policy assessment. This assessment contained a snapshot of outcomes from the National Competition Policy program over the period 1995-2005 and final payments recommendations.
10 February 2006	COAG agrees to the National Reform Agenda with the objective of enhancing Australia's human capital and to continue competition and regulatory reform. COAG agrees in principle to establish a COAG Reform Council (CRC) which would replace the NCC in reporting to COAG annually on progress in implementing the National Reform Agenda.
20 April 2006	The National Water Commission provided the 2005 National Competition Policy assessment of progress with water reform.
13 April 2007	COAG agrees that the CRC's role is to monitor progress in implementing National Reform Agenda reforms and to assess the costs and benefits of reforms referred to it unanimously by COAG. COAG also amends the Competition Principles Agreement.
20 December 2007	COAG establishes the Business Regulation and Competition Working Group to hasten progress on a new agenda of regulatory reform
29 November 2008	COAG agrees to National Partnership to create 'Seamless national economy' with A$550 million in payments linked to outcomes over six years

Source: King & Maddock (1996), Smith (1996), CRC (2008), NCC undated[35], Federal-State Committee (1988)

[35] http://www.ncp.ncc.gov.au/pages/timeline.

Table 8. Making Australia's economy more open, competitive and flexible[36]

- the key policy reforms -

	Macro-economic, monetary and taxation reforms	Labour markets	Pro-competitive regulation	Trade and industry policy
1970s			Loosening of interest rate controls Trade Practices Act	Reductions in protection, including move from quotas to tariffs
1980s	Currency floated and capital inflow controls removed Tax reform Compulsory contributory private pensions	Government, union and business industrial relations accord	Financial market deregulation Services and product market deregulation[1] *Corporatisation of national and state government owned utilities* *Water trading*	Foreign bank entry Systematic unilateral reduction in protection Car, steel and clothing sector plans Free trade agreement (New Zealand)
1990s	Central bank independence *Fiscal consolidation* *Goods and services tax and removal of selected state taxes*	Dismantling of centralised wage fixing Waterfront reform Building sector specific industrial relations reforms Contracting out of labour market assistance	Foreign provision of coastal shipping *Privatisation & contracting out*[2] *National Competition Policy (NCP)* *Reform of financial regulation*	On-going tariff reductions
2000s	Sovereign wealth fund	Federal takeover and deregulation of industrial relations	*Implementation of NCP* Wheat export monopoly removed	On-going tariff reductions Free trade agreements (Singapore, Thailand, USA, Chile)

1. Examples include: introduction of second phone company, eliminating price controls for domestic airlines, and barriers to entry to new domestic airlines, and removal of some protections of the post office.
2. Examples include: the sale of banks and insurance companies; airlines, electricity and gas companies; the introduction of privately operated prisons, rail and tram operations, labour market assistance, information technology, and municipal services.

Source: Forsyth (2000); Gruen and Stevens (2000); IC (1998c); McKinsey & Co. (2007); PC (1996); PC (2005); RBA (1997)

[36] Reforms in italics were implemented by States or both State and Commonwealth Governments.

Table 9. Political leadership during the consensus building and implementation phases[37]

	Federal	New South Wales	Victoria	Queensland	Western Australia	South Australia	Tasmania	Northern Terrritory	Australian Capital Territory
Special Premiers' Conference	*Hawke*	*Greiner*	*Kirner*	*Goss*	*Lawrence*	*Bannon*	*Field*	*Perron*	*Kaine*
October 1990	***ALP***	***Liberal***	***ALP***	***ALP***	***ALP***	***ALP***	***ALP***	***CLP***	***Liberal***
Special Premiers' Conference	Hawke	Greiner	Kirner	Goss	Lawrence	Bannon	Field	Perron	*Follett*
une 1991	**ALP**	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**ALP**	**CLP**	***ALP***
Special Premiers' Conference	Hawke	Greiner	Kirner	Goss	Lawrence	Bannon	Field	Perron	Follett
November 1991	**ALP**	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**ALP**	**CLP**	**ALP**
Premiers' meeting	Hawke	Greiner	Kirner	Goss	Lawrence	Bannon	*Groom*	Perron	Follett
April 1992	**ALP**	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	***Liberal***	**CLP**	**ALP**
Heads of Government meeting	*Keating*	Greiner	Kirner	Goss	Lawrence	Bannon	Groom	Perron	Follett
May 1992	***ALP***	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**Liberal**	**CLP**	**ALP**
Council of Australian	Keating	*Fahey*	*Kennett*	Goss	Lawrence	*Arnold*	Groom	Perron	Follett
Governments (COAG) meet	**ALP**	***Liberal***	***Liberal***	**ALP**	**ALP**	***ALP***	**Liberal**	**CLP**	**ALP**
Dec 1992									
COAG meeting	Keating	Fahey	Kennett	Goss	*Court*	Arnold	Groom	Perron	Follett
June 1993	**ALP**	**Liberal**	**Liberal**	**ALP**	***Liberal***	**ALP**	**Liberal**	**CLP**	**ALP**
COAG meeting	Keating	Fahey	Kennett	Goss	Court	*Brown*	Groom	Perron	Follett
February 1994	**ALP**	**Liberal**	**Liberal**	**ALP**	**Liberal**	***Liberal***	**Liberal**	**CLP**	**ALP**
COAG meeting	Keating	Fahey	Kennett	Goss	Court	Brown	Groom	Perron	Follett
July 1994	**ALP**	**Liberal**	**Liberal**	**ALP**	**Liberal**	**Liberal**	**Liberal**	**CLP**	**ALP**
COAG meeting	Keating	Fahey	Kennett	Goss	Court	Brown	Groom	Perron	Follett
August 1994	**ALP**	**Liberal**	**Liberal**	**ALP**	**Liberal**	**Liberal**	**Liberal**	**CLP**	**ALP**
COAG meeting	Keating	Fahey	Kennett	Goss	Court	Brown	Groom	Perron	Follett
November 1994	**ALP**	**Liberal**	**Liberal**	**ALP**	**Liberal**	**Liberal**	**Liberal**	**CLP**	**ALP**
COAG meeting	Keating	Fahey	Kennett	Goss	Court	Brown	Groom	Perron	*Carnell*
February 1995	**ALP**	**Liberal**	**Liberal**	**ALP**	**Liberal**	**Liberal**	**Liberal**	**CLP**	***Liberal***
COAG meeting	Keating	*Carr*	Kennett	Goss	Court	Brown	Groom	Perron	Carnell
April 1995	**ALP**	***ALP***	**Liberal**	**ALP**	**Liberal**	**Liberal**	**Liberal**	**CLP**	**Liberal**
COAG meeting	Keating	Carr	Kennett	*Borbidge*	Court	Brown	*Rundle*	*Stone*	Carnell
April 1996	**ALP**	**ALP**	**Liberal**	***NP***	**Liberal**	**Liberal**	***Liberal***	***CLP***	**Liberal**
COAG meeting	*Howard*	Carr	Kennett	Borbidge	Court	Brown	Rundle	Stone	Carnell
June 1996	***Liberal***	**ALP**	**Liberal**	**NP**	**Liberal**	**Liberal**	**Liberal**	**CLP**	**Liberal**
COAG meeting	Howard	Carr	Kennett	Borbidge	Court	*Olsen*	Rundle	Stone	Carnell
November 1997	**Liberal**	**ALP**	**Liberal**	**NP**	**Liberal**	***Liberal***	**Liberal**	**CLP**	**Liberal**
COAG meeting	Howard	Carr	Kennett	*Beatttie*	Court	Olsen	*Bacon **ALP***	*Burke*	Carnell
April 1999	**Liberal**	**ALP**	**Liberal**	***ALP***	**Liberal**	**Liberal**		***CLP***	**Liberal**
COAG meeting	Howard	Carr	*Bracks*	Beatttie	Court	Olsen	Bacon **ALP**	Burke	*Humphries*
November 2000	**Liberal**	**ALP**	***ALP***	**ALP**	**Liberal**	**Liberal**		**CLP**	***Liberal***
COAG meeting	Howard	Carr	Bracks	Beatttie	*Gallop*	Olsen	Bacon **ALP**	Burke	Humphries
June 2001	**Liberal**	**ALP**	**ALP**	**ALP**	***ALP***	**Liberal**		**CLP**	**Liberal**
COAG meeting	Howard	Carr	Bracks	Beatttie	Gallop	*Rann*	Bacon **ALP**	*Martin*	*Stanhope*
April 2002	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	***ALP***		***ALP***	***ALP***
COAG meeting	Howard	Carr	Bracks	Beatttie	Gallop	Rann	Bacon **ALP**	Martin	Stanhope
December 2002	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**ALP**		**ALP**	**ALP**
COAG meeting	Howard	Carr	Bracks	Beatttie	Gallop	Rann	Bacon **ALP**	Martin	Stanhope
August 2003	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**ALP**		**ALP**	**ALP**
COAG meeting	Howard	Carr	Bracks	Beatttie	Gallop	Rann	*Lennon **ALP***	Martin	Stanhope
June 2004	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**ALP**		**ALP**	**ALP**
COAG meeting	Howard	Carr	Bracks	Beatttie	Gallop	Rann	Lennon **ALP**	Martin	Stanhope
June 2005	**Liberal**	**ALP**	**ALP**	**ALP**	**ALP**	**ALP**		**ALP**	**ALP**

Sources: Federal-State Committee (1988), COAG website, various State Government websites

37 This table provides an indication of the level of political change, both of leadership and of the dominant ruling party, during the NCP period. Names in italics are new leaders.

APPENDIX A: DAIRY MARKET REFORM UNDER NCP

1. Dairy market regulation pre-NCP

1. The dairy sector was one of the sectors reformed as part of the National Competition Policy process. This case study illustrates the nature of the reform, and the process undertaken, including the transitional arrangements that were put in place to achieve this politically challenging reform.

2. In 1991 the Australian dairy market was highly regulated by both the Federal and all State Governments. The interventions included:

- regulated farm-gate prices for fresh milk[38] in all States;
- pooled proceeds from fresh milk and milk used for manufacturing, or supply quotas for drinking milk;
- regulated processing and distribution of fresh milk in most States, including set price margins for processors, distributors, retailers and vendors;[39]
- regulated retail prices for fresh milk in all States except Western Australia;
- restricted interstate trade in fresh milk between some States;
- a levy on all milk production which was used to subsidise exports of dairy products, thereby increasing the domestic prices of those products;
- a tariff quota which restricts imports of cheese;
- Federal Government underwriting of export returns on certain bulk dairy products; and
- export controls enforced by a Federal Government statutory body (IC 1991a, p. XIII).

3. The result was, as the Industry Commission put it, an "… industry [is] replete with government interventions. These cause inefficient resource use and increased consumer prices for fresh milk and dairy products. The result is a reduction in the total welfare of the Australian community." The Commission estimated the efficiency cost to the Australian economy of A$29 million per year.

4. Moreover, the Commission estimated that the industry arrangements resulted in annual transfers of A$280 million from consumers to the dairy industry in 1991, and subsequent analysis estimated it had increased to A$500 million by 1997, or about 20¢/litre for New South Wales consumers (IC 1997). And this most affected the poor as they spent a higher proportion of their income on milk products than the

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[38] The term used for fresh milk sold for domestic consumption was 'market milk', and milk used for other purposes was described as 'manufactured milk'.

[39] The Australian Capital Territory had controls which led to the home delivery sector being cross-subsidised by the retail sector by an amount equivalent to 2.5 ¢/litre.

wealthy—the poorest 20 per cent of Australian spent 1.9 per cent of their income on dairy products, whereas the wealthiest spent about 1.2 per cent.[40]

5. The objectives of these restrictions on competition were unclear, concluded the Commission's final inquiry report after an extensive public inquiry. The Commission noted that objectives appeared to include ensuring year-round supply of fresh milk, sourced within that State at stable prices, and to provide assistance to the dairy industry. Participants in the Commission's inquiry also argued that government pricing controls were necessary given the imbalance between small farmers and large processors.

6. The Commission noted that many State regulations dated from an era when refrigeration and transport facilities were inferior by today's standards, making local supply more critical. Moreover, the Commission noted that the issues of market power are best dealt with through the general competition law, recognising that some of the dairy regulation pre-dated the introduction of national competition law in 1974.

7. In the early 1990s, all governments, except the ACT, agreed to remove their post-farmgate arrangements, including regulation, price and margins, throughout the processing, vending and retail chain, but retained the other extensive regulation.

1.1 The industry structure

8. The dairy industry was Australia's fourth largest rural industry in 1999. It had developed on a state-based model, with very little trade across State borders. The Victorian industry accounted for more than 60 per cent of output, while New South Wales, the second largest, accounted for less than 15 per cent.

9. Each State had a statutory market authority which controlled domestic sales, as did the Federal Government for exports. States had had responsibility for the regulation and control of milk from vat to consumer, to ensure the quality and availability of milk supplies year round.

10. The industry, both at the farm level and the processors, had been gradually consolidating for decades, in response to technical and market changes. In 1986 the Federal Government reformed its assistance to make the dairy manufacturing sector more exposed to international market developments, and each firm more dependent on the success of their own production and marketing activities. This led to a process of rationalisation in the manufacturing sector, with the smaller cooperatives merging to achieve increased economies of scale in both processing and marketing. Cooperatives still play a large role in the Australian dairy industry, but they are significantly fewer in number and larger in size (Dairy Australia undated).

11. Australia and New Zealand were very low cost producers by international standards, even before the reforms (figure 5). But the complex regulatory arrangements somewhat dulled the incentives for farmers and processors to seek out further efficiency gains, and for processors to develop new markets and innovative products.

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[40] Author's calculations based on 1998-99 ABS data (ABS 2000).

Figure 1. International farm-gate milk prices (A$ per 100kg milk)

Country or region	1995	1996	1997	1998	1999
EU-15 average	55.58	48.09	45.20	52.82	45.76
United States	39.62	40.08	38.35	53.85	46.65
Canada	52.24	47.84	51.86	57.76	54.39
Japan	142.36	96.59	96.12	96.28	103.54
New Zealand	30.75	26.08	25.18	24.15	24.59
Australia	29.35	27.88	27.17	26.43	24.90

Source: Australian Dairy Commission 2000 cited in ACCC 2001

12. And Australia had become a more efficient producer as the sector consolidated to fewer larger farms.

2. National Competition Policy reviews

13. The Industry Commission's 1991 inquiry had not led to the wholesale reform it recommended. Consequently after the National Competition Policy agreements were agreed, the State and Federal Governments had to subject the various Acts that restricted competition in the dairy industry to National Competition Policy reviews starting in 1997 (see table below). New South Wales and Queensland undertook public reviews, receiving submissions from a range of interested parties, and developing estimates of the extent of the transfers from consumers to the producers due to the State regulation. However, these reviews were undertaken by joint government-industry panels, with the industry members perhaps not surprisingly recommending retention of the restrictions. Agriculture Western Australia conducted its review, overseen by the Treasury, but also supported by an industry working party, which recommended retention of regulation controls. In contrast, the Victorian Government's review was undertaken by an independent consultant, consistent with the Victorian *National Competition Policy: Guidelines for the Review of Legislative Restrictions on Competition* (Victorian Government 1996).

14. In its 1999 assessment of States compliance with the Legislative Review Requirements, the National Competition Council noted there was also perception within the industry that, of all of the States, Victoria was the most likely to fully deregulate its dairy industry arrangements following its current review.[41] If this occurred, it was widely understood to be likely to have ramifications for dairy regulation in other States, particularly on the Eastern seaboard (NCC 1999). Should Victoria deregulate, it would become increasingly difficult for other jurisdictions to sustain any remaining price and market restrictions, due to the competitiveness of Victorian producers, processors and manufacturers, the operation of the *Mutual Recognition Act* and the threat of inter-state trade.

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[41] Victorian and Tasmanian dairy farmers benefited the least from restrictions that increased the price of milk destined for sale as drinking milk as only 8 and 9 per cent of their production went to this market, whereas in the other States the share was between 31 and 49 per cent of milk production. In addition, more of Victoria and Tasmania's milk went into export products—about 66 per cent and 59 per cent respectively—whereas for other States it was typically only 20 per cent. Consequently it was not surprising that the Victorian dairy farmers supported 'orderly' deregulation. (United Dairy Farmers of Victoria, 1998)

15. The Victorian Government was one of the strongest advocates of competition policy, so it was not completely unexpected that it would be more receptive to reform. And, as the National Competition Council predicted, once it committed to deregulate, and thus remove controls on exports to other States (which were of questionable legality given the Australian Constitution's guarantee of free trade in goods between the States) the other adjacent States knew that their existing arrangements were unsustainable. (see ACCC 2001, p.6 for discussion of reviews and Victorian Government plebiscite)

Table 1. Dairy industry legislative reviews

State	Review Activity
New South Wales	Publicly reviewed in November 1997 by a joint government-industry panel. Chair (from the New South Wales Department of Agriculture) and industry members recommended retention of restrictions subject to review again in 2003. Other government members recommended removal of restrictions within 3 – 5 years if national reform did not occur.
Victoria	Publicly reviewed in 1999 by independent consultant. The review recommended the removal of all restrictions except those that safeguard public health. It further recommended third party auditing of dairy food safety subject to acceptance of importing countries.
Queensland	Reviewed in 1998 by a joint government/industry panel. The review recommended: retention of farmgate price regulation for five years to December 2003, but reviewed again before 1 January 2001; and extension of quota arrangements from South into Central and North Queensland for five years.
Western Australia	Reviewed in 1998 by officials, assisted by an industry working party. The review recommended repeal of the Act upon deregulation by Victoria.
South Australia	Price-setting restrictions publicly reviewed in 1999 by officials. The review recommended removal of these. Food safety provisions remain under review by officials.
Tasmania	Publicly reviewed in 1999 by a government-industry panel. The review recommended deregulation after five years subject to outcome of Victoria's dairy legislation review and national reforms.
ACT	Reviewed in 1998 by officials. The review recommended: separation of Authority's regulatory and commercial roles; retention of retail price controls until mid-2000; reform of home vending arrangements; and retention of compulsory acquisition of ACT milk.

Source: NCC 2001, p. 13.7

2.1 The adjustment package

16. In early 1999, as it became clear that deregulation was inevitable, the industry's peak policy body, the Australian Dairy Industry Council (ADIC), approached the Federal Government with a plan for an orderly, national approach to the deregulation of the drinking milk sector in conjunction with the end of manufacturing milk price support. The industry sought support during this adjustment period to ensure that uncertainties and short-term declines in income did not destabilise the industry and adversely impact on its longer-term growth potential (DAFF). The Federal Government was very conscious of the impacts of dairy industry deregulation on farmers and local dairy communities and it was clear from the Government's perspective that, once the State market milk regulations were removed, a considerable number of dairy producers would experience significant and abrupt income losses, and without assistance many would have difficulty adapting to the new market conditions.

17. On 28 September 1999, the Federal Government announced it would implement the Dairy Structural Adjustment Program (DSAP). On 1 July 2000, the Federal Government made available an

industry adjustment package worth A$1.78 billion to assist the dairy industry and dairy communities make the transition to a deregulated environment. In addition, in May 2001 a further A$159 million supplementary assistance package was announced, bringing the total amount of Government assistance for restructure of the dairy industry to A$1.94 billion. This was the largest amount ever provided by the Federal Government for rural adjustment (DAFF undated).

18. The industry proposal for transition assistance was based on five years of the estimated 1998-99 value of the regulations, with estimates of the initial income effects of deregulation ranging from around 10 per cent in the export sector to more than 25 per cent for producers focused on fluid milk sales (Harris 2005). DSAP grants were fixed amounts based on the amount of drinking milk (paid at 46¢/litre) produced in 1998-99. The initial effects of deregulation showed the industry proposal had underestimated the regulated component of the fluid milk price premium, and ultimately the grants were equivalent to the loss of 2-3 years of the income obtained from the regulations. DSAP grants were considerably higher in States where drinking milk sales were a high proportion of total milk output. The average per farm payment was worth A$196,000 in New South Wales and A$143,000 in Queensland, compared with A$97,000 per farm in Victoria.

19. The industry adjustment package was funded by a Federal Government (retail) Dairy Adjustment Levy of 11 cents per litre on retail sales of drinking milk which started on 8 July 2000 and is estimated to run until 2010.

20. The levy funds quarterly DSAP payments (over eight years) to Australian dairy farmers, to assist them to make the adjustments to a deregulated environment, with minimal social and economic disruption. Farmers could use the funds to exit the dairy industry, or to re-invest in improving the productivity of their dairy operations. At the outset, the dairy industry and Government agreed that it was most appropriate for the consumer to pay the levy given it was the consumer that was most likely to benefit significantly from lower costs for fresh milk and greater choice.[42]

21. As noted by Harris (2005), the levy arrangement was equivalent to a two step phasing out of the drinking milk price support mechanisms. The levy was set at a rate that would achieve a significant reduction in retail milk prices once deregulation had occurred. It was based on industry estimates about the extent of the decline in farmgate prices and the flow-on effect for supermarket prices of generic brand milk. When the levy is ultimately removed in 2010, consumers should see a second price fall.

2.2 On-going competition issues

22. As noted earlier, some industry participants argued that government price controls were needed due to the market power of the large processors, and the large supermarket chains. While the processors did have market power, they may have been reluctant to exercise it as they had strong incentives to promote continued investment by farmers to ensure the processors had secure supply for their plant. Moreover, and in many case the processors were cooperatives so exploiting their market power by buying milk at low prices would have been merely exploiting their owners.

23. However, one of the objectives of the National Competition Policy reviews was to remove duplicative or unnecessary regulation, and since 1995, the Australian Competition and Consumer Commission (ACCC) had capacity under the general competition law, the *Trade Practices Act* 1974, to

[42] While the levy was on retail sales, the final incidence depends on the elasticity of supply and demand. It would seem reasonable to assume that demand for drinking milk is very price inelastic at typical incomes in Australia (recent estimates suggest an own price elasticity of -0.17 for liquid whole and skim milks in the United Kingdom (Lechene 2000)), and has limited competition from imports (and thus relatively inelastic supply), so the final incidence of the levy has been largely on consumers.

grant permission for collective bargaining, which it did for groups of dairy farmers in 2002. The Federal Government then funded a series of workshops in 2003 to help dairy farmers understand the rules and the processes applying to the formation of groups and the potential benefits of collective bargaining as a farm risk management tool. A team of State and national dairy industry representatives, an ACCC representative and a consultant specialising in dairy pricing and marketing ran the two hour workshops using specific local and regional knowledge in 13 regional locations around Australia.

24. The second issue in terms of competition was the high level of market power of Australia's supermarket chains, which are a major distribution channel for milk[43]. The two major supermarket chains, Woolworths and Coles, account for around 30 and 25 per cent of total packaged groceries respectively, and collectively between 40 and 50 per cent of fresh product categories (ACCC 2008b). All supermarkets (which includes the smaller supermarket chains) share of milk sales increased from 49 per cent in 1999-00 to 55 per cent in 2007-08, with own-brand sales growing strongly over the period from 25 per cent to 56 per cent of their sales (Dairy Australia 2008).

2.3 Other regulation

25. The removal of restrictions on competition did not negate the need for arrangements to ensure the safety of milk, and other regulation relating to dairy production, particularly that related to the environment. The National Competition Policy reforms were very focused on removing unnecessary regulation that affected competition, but there was less focused attention to minimising the unnecessary imposts that were targeted at achieving the other policy objectives. The dairy industry's March 2008 submission to the Productivity Commission inquiry *Regulatory Burdens on Business - manufacturing and distributive trades* argues these imposts have grown subsequently (Australian Dairy Products Federation et. al. 2008) and this could be expected to affect the competitive position of the industry.

3. Outcomes for consumers and the industry

26. As Dairy Australia notes, Australian dairy farmers now operate in a completely deregulated industry environment where international prices are the major factor in determining the price received by farmers for their milk (Dairy Australia undated). However, in moving from the previously highly regulated arrangements to a deregulated market, there were three primary concerns:

- there would be a large reduction in supply;
- stability of supply throughout the year would be compromised; and
- the reduction in milk prices at the farmgate would be captured by processors or retailers.

27. The reform was essentially overnight rather than phased deregulation. But the impact on producers was reduced by the adjustment payments, while the benefits to consumers were phased as they initially bore the costs of the adjustment levy. However, as figure 6 shows, even with the 11¢/litre levy consumers received cheaper milk, particularly if they bought the generic milk that the large supermarket chains offered. Moreover, the generic share of sales increased after the reforms, further benefiting consumers.

28. The reform did not generate a substantial change in overall output, and indeed no more than typically occurred year-on-year due to weather patterns. Harris noted that the most dramatic farm level adjustment occurred in the first two years after deregulation, with some older farmers retiring, some

[43] ACCC analysis found that the Australian supermarket sector was more heavily concentrated that the UK, Ireland, Canada, but less than New Zealand and Austria (ACCC 2008b).

switching into alternative farm products and others finding jobs outside of agriculture. But he noted that the remaining farmers invested the adjustment funds in improving the efficiency of their farms, mainly by improving pasture and other measures to improve yields, rather than increasing herd sizes or land devoted to dairying (Harris 2006).

29. There were two reasons to be concerned about stability of supply. First and foremost was assuring a constant supply of fresh drinking milk to consumers. Second, was ensuring sufficient supply throughout the year to manufacturers using milk as a raw material. While there were significant reductions in the number of farms in some States in the first year after deregulation (falling 20 per cent in New South Wales and 15 per cent in Queensland), this did not affect drinking milk supplies, as it remained well over the amount needed for this market segment (Harris 2006).

30. Prior to deregulation, there were political concerns that the benefits of lower prices at the farmgate would not flow through to consumers. To address this issue, the Federal Government gave the ACCC (which has competition, consumer protection and pricing responsibilities) a monitoring function to see that the expected reductions in farmgate prices were not used to increase margins at the processor and retail level. The ACCC's report concluded that consumers were broadly better off, and the fall in prices at the farm gate had not been captured by processors or retailers. Indeed, it increased competition in the retail milk markets from the major retail chains as they discounted generic milk to increase traffic through their stores (Fels 2000).

Figure 2. Consumer milk prices before and after deregulation

	Regular whole milk				Reduced fat milk			
	Branded sales		Generic sales		Branded sales		Generic sales	
Year ending 30 June	A$/litre	% change	A$/litre	% change	A$/litre	% change	A$/litre	% change
1998-99 *	1.26	2.4	1.22	1.7	1.39	3.5	1.34	12.6
1999-00	1.33	5.6	1.26	3.3	1.47	6.1	1.37	2.2
2000-01 **	**1.27**	**-4.5**	**1.06**	**-15.9**	**1.49**	**1.4**	**1.20**	**-12.4**
2001-02	1.36	7.1	1.08	1.9	1.56	4.7	1.23	2.5
2002-03	1.40	2.9	1.11	2.8	1.62	3.8	1.27	3.3
2003-04	1.42	1.4	1.11	0.0	1.64	1.2	1.27	0.0
ACCC survey of quarterly price changes in 2000 ^								
March Qtr	1.34	..	1.25	..	1.66	..	1.30	..
June Qtr	1.36	1.5	1.27	1.6	1.68	1.2	1.31	0.8
September Qtr	1.30	-4.4	1.15	-9.4	1.65	-1.8	1.21	-7.6
December Qtr	1.19	-8.5	1.08	-6.1	1.63	-1.2	1.18	-2.5

National average price of supermarket milk sales. Source: DA, 2004; ACCC, 2001.
* Prior to 1999-00 prices of reduced fat milk were based on sales of modified milk.
** Deregulation on 1 July.
^ ACCC data series for 2 litre containers.

Source: Harris 2005

31. After 2000, prices increased, but far less so for the generic milk sold by supermarkets which were expanding their market share. These price increases in large part reflected the impact of the drought on supply, and the flow on of increased export prices (in large part due to increased demand from developing economies) as a consequence of domestic prices becoming more close linked to world market prices.

However, milk prices were expected to fall by 11¢/litre from February 2009 after the levy to fund the adjustment package was removed, while recent reductions in international prices should also flow through to the domestic market.

32. The ACCC also reported that price differences across States declined following deregulation. A few months after deregulation, a major retail chain announced standard nation-wide prices for its generic move, and the other main chains quickly followed suit (ACCC 2001, p.xvi). As the Commission noted, prior to this announcement there had been separate state-based markets for milk and significant price differences.

33. More recently, while the price of branded milk seems to be more closely linked to farmgate prices, competition among supermarkets has kept the prices of their generic milk more stable (table 16)

Table 2. National supermarket fresh full-cream milk prices (c/litre)

	Branded	Supermarket label
June 2008	1.83	1.19
January 2008	1.70	1.19
June 2007	1.53	1.16
January 2007	1.52	1.15
June 2006	1.45	1.15
January 2006	1.52	1.13

Source: DAFF (undated) Based on 2 litre containers

34. Farmgate prices fell in all States following deregulation (figure 7) but much less in those States with the lowest cost of production, and as a result prices converged. However, they remained higher in Queensland, reflecting the higher costs of production and the costs of transport and timing issues associated with bringing fresh milk from the lower-cost southern States.

Figure 3. Farmgate milk prices by State - all milk

State	Farmgate prices		Estimated post-deregulation change (%)
	1999–2000(p) (c/l)	2000–01(s) (c/l)	
New South Wales	36.0	25.4	-29
Victoria	26.0	25.1	-3
Queensland	39.3	30.0	-24
South Australia	28.0	24.2	-14
Western Australia	36.0	25.0	-30
Tasmania	25.9	24.0	-7
Australia (a)	28.8	25.4	-12

Note: (p) Projections based on information provided by farmers and major dairy companies in November 2000. (a) estimated prices are not adjusted for State and Commonwealth levies including adjustments related to the Domestic Market Support Scheme which terminated on 30/6/2000.

Source: ABARE and ACCC (cited in ACCC 2001)

3.1 Industry adjustment

35. The dairy industry has been consolidating for decades, in line with technological change and market developments. The number of dairy farms in Australia shrank by 30 per cent between 1980 and 1990, and a further 16 per cent in the decade to 2000. Since the 2000 reforms the rate of consolidation has accelerated, and the number of farms had shrunk a further 38 per cent by 2007 (Dairy Australia, *Cows and Farms*). The Australian dairy sector remains predominately owner-operated, with 18 per cent of farms operated by share-farmers (essentially renting) and only 2 per cent operated by corporations.

36. The number of cows per Australian farm has increased over the last three decades—from an average of 85 cows per farm in 1979-80, to over 200 in 2007-08. There are no readily available reliable data on the herd size distribution in Australia, but anecdotally the increase in herd size is a function of the smaller, less efficient producers exiting, as the more efficient producers farm their land more intensively and in some cases buy additional land. This process has apparently accelerated since deregulation.

37. However, the average herd size and the rate of change has been smaller than in New Zealand, another low-cost producer where milk production is largely based on cows grazing on pasture. In 1979-80 the average New Zealand dairy herd was 124 cows, and it has grown to 351 in 2007-08 (LIC and Dairy NZ 2008). This is partly explained by the growth in very large farms with over 1000 cows, with these farms now accounting for about 10 per cent of the New Zealand herd. These farms have been established in areas new to dairying on land formerly used for larger beef cattle and sheep on the South Island, and represent major investments in this sector.

38. The growth in the USA of very large herds has been even more dramatic with herds of over 1000 cows growing from approximately 10 per cent of the total dairy herd in 1992, to over 35 per cent in 2006. These large herds are largely based on dry-lot feedyards, often with purchased feed, rather than cows grazing in pastures (McDonald et. al. 2007). USDA data suggests that these larger herds are substantially more profitable, and indeed based on US production systems, costs and farmgate prices, on average only farms with more than 500 cows fully covered their costs. However, these intensive farming systems do pose environmental challenges with the manure having to be carefully managed.

39. The total number of cows has stayed relatively stable overall (with variations largely due to drought), but the geographic distribution of dairying and average farm size has changed. Victoria has continued to dominate the industry, in 2007-08 accounting for 68 per cent of farms and 65 per cent of the herd, compared to 60 per cent and 63 per cent in 1999-00. Queensland's share of farms has declined from 12 per cent in 1999-00 to 8 per cent (and from 9 per cent of the herd to 6 per cent). But the increase in average herd sizes has been largest in South Australia and Western Australia where herd sizes have almost doubled over the period to approximately 300 cows per farm, while in Victoria they increased only 15 per cent to remain about 200 cows. Larger farms have grown in importance, with the 8 per cent of farms with herds of over 500 cows accounting for 25 per cent of total milk production (Dairy Australia 2008).

40. Australia remains a major dairy exporter, but is now based on very low levels of government assistance. Around 45 per cent of Australian milk production is exported—primarily as manufactured products—at international market prices for a value of $A2.9 billion in 2007-08. Australian dairy products now account for about 11 per cent of world trade (Dairy Australia 2008).

4. Lessons from the reform of the dairy sector

41. Ultimately it appears that the anti-competitive regulation that characterised Australia dairy industry was brought down largely by commercial pressures. That is, the lower cost Victorian producers did not have an interest in pushing for the retention of that State's restrictions, and once the Victorian market deregulated, the existing model was unsustainable.

42. The national competition policy requirements provided a catalyst for reform, but were not critical to its achievement because of the strong commercial interests in deregulation in this sector.

43. The importance of ensuring robust review processes, with independent review panels, and arms-length engagement with key interests was critical.

44. A transitional package has eased adjustment for farmers and their local communities. It gave some of the benefits of deregulation to consumers in the short-term, while delaying them the full benefits for about a decade.

45. Harris has noted that the overnight policy change made the full impact transparent (2006). It sharpened the incentive for farmers to make decisions about their future. He suggested the package helped to speed up the gains in per farm performance that typically flow from policy reforms. The experience suggests transitional assistance works better if it's a transparent, one-off, unconditional grant that allows producers to make decisions that suit their circumstances. Moreover, the transitional package arguably ensured that producers that would be viable in the longer term stayed in the industry, thereby reducing the transitional costs to the community as a whole, as well as the political costs of reform.

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