Federal-state relations and the National Competition Policy

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Australia has benefited from microeconomic reforms

The effectiveness of the economic reforms embarked on by Australia from the mid 1980's in enhancing productivity and economic growth is now universally recognised, as is the proposition that ongoing reform is needed if Australia is to retain hard won benefits and maintain adequate growth.

Recent assessments of microeconomic reforms in general and the role of the National Competition Policy (NCP) reforms in particular indicate that:

- NCP has delivered substantial net benefits for Australia, but it would be counterproductive to conclude that it is time to sit back and enjoy the dividends
- Australia has the potential to reap further substantial benefits simply by meeting the productivity benchmarks achieved by other countries
- Further reform is imperative to lock in the gains achieved over the past two decades and also because Australia confronts an increasingly competitive global environment, domestic pressures (such as an ageing population), and Federal-State arrangements that promote cost shifting and blurred lines of accountability.

A raft of work by domestic institutions such as the Productivity Commission and international bodies such as the OECD support these interpretations. A recent report by The Allen Consulting Group for the National Competition Council (NCC) indicates that if Australia does no more than complete the remnant aspects of the NCP, then relative to overseas countries, it will be left behind in living standards.

All the evidence suggests that we assume at our peril that that the reforms to date are sufficient to ensure that the Australian economy is now bullet proof.

The need for re-invigorated reform process

Last year the Australian Government directed the Productivity Commission to report on the effectiveness of the NCP and to outline a renewed reform program. The Commission concluded that further competition related reforms are needed to improve productivity and raise living standards. Its report will inform deliberations this year by the Council of Australian Governments on how best to proceed. The scene is therefore set for the substantive debate on a new agenda and the institutional arrangements that should underpin it.

The NCC's experience over the last decade of NCP confirms that institutional arrangements are instrumental to the success of the reform agenda. The success of the NCP is built on three pillars:

1. A formal and binding commitment of governments to an agenda.
2. An independent agency to monitor and assess governments' performance against those commitments.
3. Incentives for governments to progress reforms that, while in the public interest, are sometimes politically difficult to implement.

Had the NCP relied only on the first pillar, the Productivity Commission's draft report would have described the outcomes of the NCP as falling short of those envisaged at the outset.

The integrated three pillar model that centres on reasonable flexibility and iteration, is a pragmatic recognition of the difficulties in implementing a coordinated reform agenda in an Australian federation composed of nine sovereign governments.

The Agenda

The NCC supports the Productivity Commission's candidates for a new agenda to promote further productivity growth, and, importantly, maintain the benefits of reform to date, including:

- a review of Australia's health care system, extension of natural resource management reforms, renewed energy and water reform programs and coordinated reform frameworks for freight and passenger transport
- improving the quality and responsiveness of education and training systems, enhancing the performance of aged care services delivery, extending the scope for workplace flexibility and removing inefficiencies in the work-incentive effects of taxation and social support programs.
- improving competition and regulatory architecture through a more focused legislation review program, strengthened monitoring and gatekeeping arrangements, improved oversight of infrastructure providers and continuation of competitive neutrality policies

While acknowledging the importance of efficient social infrastructure services for productivity, the provision (and regulation) of 'hard' economic infrastructure is likely to remain at the forefront of a new policy agenda.

For a start, there is much unfinished business under the NCP — Australia is yet to achieve a fully competitive national electricity market and there is a need to move beyond the limited road transport reforms to a broader agenda that co-ordinates and integrates road and rail transport services with ports. Moreover, apart from assessing NCP reforms, one of the Council's other roles is to recommend on the design and coverage of infrastructure access regimes. This work reinforces that a new agenda must appropriately balance pro-competitive outcomes for users with infrastructure investment. As these important agenda issues will be raised by others, the Council has focussed on its key area of expertise — institutional arrangements to progress reforms in Australia's federation.

Independent assessment and monitoring

The reality of Federal-state relations is that a reform agenda will deliver the greatest benefits by achieving inter-jurisdictional cooperation. But there are enormous challenges — not least of which is implementing welfare enhancing policies given the practicalities of horizontal (between states and territories) and vertical (between the three tiers of government) coordination. As a starting point, it is imperative that the assessment process is sufficiently at arms-length to independently gauge governments' outcomes in meeting the obligations of a reform agenda. An independent assessor can clarify reform commitments and maintain governments' focus on implementing reform.

For example, the NCC has a long history of continual constructive engagement with governments at both the political and official levels to progress reform. Alternatives, such as using agencies within jurisdictions to monitor outcomes pose serious risks of conflict between the necessarily public interest perspective of the assessor and the political imperatives of governments. Such a decentralised assessment model also cannot properly compare and contrast differences in performance *across* jurisdictions.

Another alternative would be to have multiple bodies (for example, Ministerial Councils and other CoAG entities) undertaking monitoring and assessment for specific areas (such as transport and energy). While there may well be merit in relevant expert bodies being responsible for policy matters, agenda setting and implementation, the NCC has reservations about such bodies also undertaking assessments. The substantial problem with the multiple assessor model is that, unlike the NCP, it would be a disparate approach unsuited to 'whole of program' assessment.

Similarly, having inter-jurisdictional working groups or committees of the parties assess their own performance (and potentially re-specify targets) would also be problematic. Based on experience, the NCC considers that the prospect of jurisdictions setting, monitoring and reconfiguring their own benchmarks — perhaps in a charged environment of partisan politics — is far less likely to deliver appropriate outcomes. The protracted Ministerial Council process for national reviews, for example, has certainly dissipated the potential benefits through continual re-specification of timelines and shifting targets to meet the desires of particular jurisdictions.

More generally, as the Chamber of Commerce and Industry (WA) told the Productivity Commission inquiry:

> *CoAG… lacks the resources to conduct the detailed and exhaustive analysis necessary to develop good policy on complex, multi-faceted issues. In part, this is because CoAG's activities have tended to be issue-specific, reactive and pragmatic, and not always informed by an in-principle framework for analysing inter-jurisdictional issues and for aligning political incentives with desired outcomes. Perhaps an independent body to research, evaluate and critique cross-jurisdictional policy development is necessary to supplement and critique the work of CoAG….*

A major strength of the current assessment model is it foundation of transparency (involving publicly available assessment reports), adherence to timelines and most importantly, frank assessments conducted independently of the parties being assessed.

Incentive payments

Competition payments, the incentive aspect of NCP, are based on the view that states and territories should share in the increased government revenues that accrue, especially to the Australian Government, from the increased economic activity generated by the NCP reforms.

The Productivity Commission found that competition payments have been instrumental in securing the implementation of NCP reforms. Certainly the NCC can attest that competition payments overcome many of the difficulties of federalism and are pivotal in maintaining reform momentum within the states and territories. Tying performance to financial rewards has also enabled governments to argue that they have had no option other to meet their NCP commitments, thereby providing a circuit breaker to resist pressure from lobby groups to retain anticompetitive arrangements.

The existence of competition payments has also empowered jurisdictional competition policy units to a far greater extent than otherwise. The benefits of strong competition 'watchdogs' at the coalface should not be underestimated.

There can be no doubt that governments have had a stronger incentive to pursue outcomes consistent with the public interest because competition payments are available. Conversely, the potential for unwinding, or watering down, reforms would be a real threat without payments.

Interaction between the three pillars

The success of the NCP can be attributed to the interdependencies between the agenda, the assessor, and the incentives payments. These allow for:

- assessments with sufficient flexibility to facilitate reform progress rather than imposing rigid compliance targets. For example, suspensions allow for difficult reforms to be rolled over thereby raising the potential rewards from compliance and providing time to devise reasonable transitional reform programs
- different mechanisms to meet different reform agendas rather than recourse to a rigid tops down model that may not be suited to particular jurisdictions
- consistent assessment and monitoring of progress across nine governments that are introducing reform measures at different speeds, from different start points in highly variable environments (political, geographic, climatic etc) — these circumstances can be reflected in payments, suspensions, deductions and provision for transitional reform programs over time. .

The evidence of the benefits of the three pillars approach is clear. For example:

- The legislation review program of the NCP encompasses around 1800 pieces of legislation across nine governments. From 1996 to 2002, the NCC assisted governments to find ways to meet to meet their obligations. As the June 2002 completion date for this element of the NCP approached, the NCC forewarned governments that reductions in incentive payments were likely. The NCC provided a further year's grace period before imposing penalties in 2003. Since the imposition of penalties, compliance rates for priority legislation improved markedly — from 40 per cent in 2001 to nearly 75 per cent in 2004.

- In 2003 the NCC recommended 'pool suspensions' for every state and territory government. (These suspensions related to each government's pool of incomplete legislation review matters.) The following year the NCC recommended that, with the exception of two states, all suspended funds be released to reflect the substantial improvements in compliance.
- Also in 2003, the NCC recommended substantial suspensions be imposed on Queensland for the state's failure to meet electricity reform obligations and Western Australia for a lack of transparency in water pricing. These obligations were met the following year and both suspensions were lifted.
- Similar positive responses to penalties were evident for many difficult reform areas (eg poultry meat, egg marketing and liquor regulation).
- In seeking to progress reforms, many governments used the payments as a tool to leverage compliant outcomes by ameliorating the impact of vested interests.

The judicious use of constructive engagement and, as a last resort, suspensions and deductions to account for particular circumstances in each jurisdiction has been critical to the success of the program.

Where now?

It is the NCC's view that the institutional arrangements for any new reform agenda will be crucial to its success and that the three, interlocking, institutional pillars that have underpinned the effectiveness of the NCP should continue.

It is one thing to identify what needs to be done: it is another to establish the framework to ensure that reform objectives are carried through to fruition.

It would be a tragedy if in the future, a review of the new reform agenda found that it was a program of meritorious intent unmatched by outcomes because the institutional framework was insufficient to carry it through. Such a missed opportunity would be keenly felt by the Australian community.

Given the practicalities of Australia's brand of federalism, the nation cannot afford to experiment with institutional frameworks and hope that an alternative model will match the goals set by a new reform agenda. The three pillars model has been shown to work and this should set the benchmark for the new agenda.

Australia is at the crossroads. It has reaped substantial benefits from reform and is poised to embark on a renewed reform program at a time of favourable economic conditions. Australia can go forward with a new workable reform program or it can allow a long history of Federal-state tensions to put the nation on a low growth path.

The NCC considers that in light of Australia's brand of fiscal federalism, the high growth path will require effective forms of agenda-setting intergovernmental agreements that reflect:

- independent 'whole of program' monitoring of reform implementation
- incentives to meet obligations and sanctions for failure to meet obligations.

- overarching principles to ensure desired outcome are delivered
- sufficient detail on requirements to benchmark the assessment of performance
- interim benchmarks (where outcomes are longer term) and mechanisms for priority setting so the reform process does not stall
- mechanisms to refine agreements that avoid inappropriately winding back the obligations. This can be avoided by;

  – requiring unanimous CoAG agreement to change the commitments,
  - requiring CoAG to endorse the work of other bodies (eg Ministerial councils) before that work becomes part of the agreements, or
  - providing sufficient detail in the agreements and constraining other bodies to developing approaches consistent with the overarching CoAG agreements.