Institutions for Economic Reform in Asia

Edited by
Philippa Dee

ROUTLEDGE

Routledge Studies in the Growth Economies of Asia

6 The policy determinants of structural reform in Australia

Gary Banks and Bernard Wonder

Introduction

The transformation in Australia's economic performance since the early 1990s has generated much interest overseas as well as within Australia. The contribution made by microeconomic reform in this country has been of particular interest to officials from foreign governments, national research institutes and international economic agencies, not least in East Asia. This interest reflects the magnitude of the reform requirements and the manner in which the reforms were introduced and sustained, including the institutions associated with reform.

The chapter begins with an overview of the turnaround in Australia's economic performance, before outlining the broad nature of the microeconomic reform programme and associated outcomes, as well as the key elements of the reform 'strategy' and its institutional underpinnings.[1] Particular attention is given to the contribution made by the Australian Productivity Commission (and its direct predecessors). This is not to over-account the significance of the Commission – it is, after all, only an advisory body, not a policy decision maker. However, the Commission's track record in promoting greater public awareness of reform's benefits and ultimately having much of its advice accepted by government demonstrates the potential for such an agency to make a difference to policy development and reform.

Australia's reform experience

Australia began the twentieth century with the highest per capita income in the world. However, being blessed with abundant natural resources was not sufficient to guarantee continuing prosperity. Indeed, Australia managed to devise some institutions that, whatever their initial merits, ended up significantly handicapping the country's economic performance.

Australia's structural policies following Federation in 1901 were shaped by a social compact that came to be known as the 'Australian settlement' (Kelly 1992). Four of the elements were:

- *industry protection* – protection of domestic industry against imports;
- *wage arbitration* – protection of labour through centralized wage regulation;
- *White Australia* – protection against foreign labour through restrictive immigration policies; and
- *state paternalism* – protection against the 'market' through state monopoly provision of public utility and other services and extensive intervention by the state.

Extensive intervention by government through anti-competitive regulation and redistribution policies – captured by the logically flawed expression 'protection all round' – had bipartisan support and wide community acceptance for most of the twentieth century. For many years the economic costs of this regime were masked by the performance of our broad-acre agricultural and mining industries. Until the early 1970s, Australia was still managing to 'ride on the sheep's back'. The terms of trade favoured our primary commodities, and we had benefited from a world-wide expansion in demand following the Second World War. Australians enjoyed close to full employment with incomes still higher, on average, than those in most other OECD countries. But this did not last.

During the 1970s, the prices Australia received for commodity exports began a long decline, while the costs of imports began to rise. The resulting terms of trade deterioration (Figure 6.1) would, in turn, expose the underlying problem of Australia's poor productivity performance.

Even in the post-war 'boom' years, Australia's productivity lagged. Between 1950 and 1973, annual productivity growth in Australia averaged 2.6 per cent, compared to 3.9 per cent for OECD countries as a group (Figure 6.2).

The reasons for Australia's relatively poor productivity performance can be found in the economic consequences of the Australian settlement:

- a fragmented, high-cost manufacturing sector, focused on the domestic market;

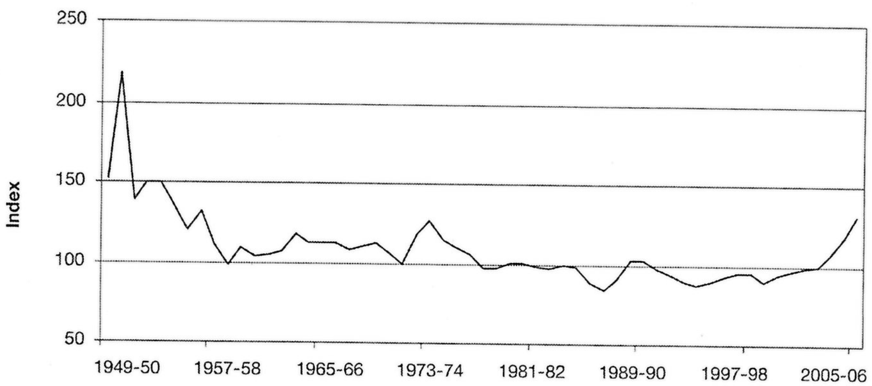

Figure 6.1 Australia's terms of trade index

- indulgent, inflexible work practices, powerful unions and lacklustre management;
- outmoded technologies, low rates of innovation and skill development; and
- high-cost government-owned infrastructure services such as power, transport and communications, which effectively taxed business users, while cross-subsidizing households.

This poor productivity performance, together with the declining terms of trade, translated into a relative decline in living standards. In terms of GDP per person, Australia was still ranked fourth out of twenty-three OECD countries in the wake of the Second World War, but its position fell to ninth by the early 1970s and to sixteenth by the late 1980s.

This realization forced a rethink of institutional and policy frameworks and eventual acceptance of the need to embark on a sustained and comprehensive programme of trade liberalization and other structural reforms. A 'then' and 'now' comparison of policy frameworks in Table 6.1 shows the extent of the changes (Henry 2006). In essence, the reforms freed up markets, promoted competition and generally sought to ensure that prices did their job of signalling costs and relative returns.

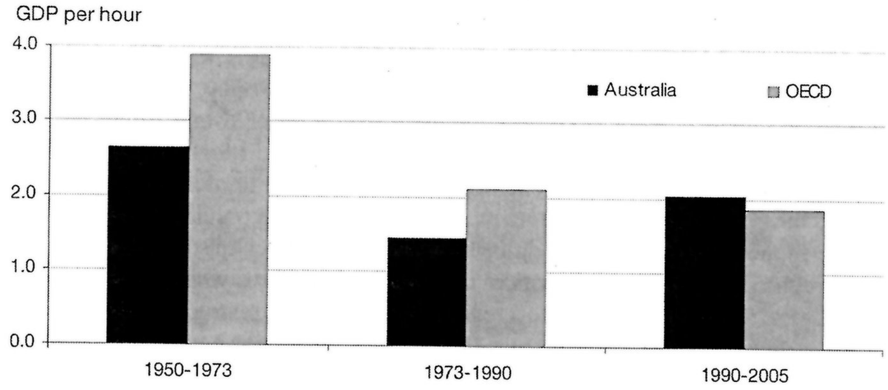

Figure 6.2 Australia's relative productivity performance

Table 6.1 Sea change in Australia's policy frameworks

1970s	*2000s*
Fixed exchange rates	Floating exchange rates
Capital controls	Capital and interest rate controls liberalized
High trade barriers	Low trade barriers
Weak competition policy	Stronger competition policy
Centralized labour market	Decentralized labour market
Macroeconomic policy not anchored	Macroeconomic policies credibly anchored to medium-term targets

Such a multifaceted reform effort was not implemented seamlessly. Nor was it without adjustment costs. For example, the 25 per cent across-the-board tariff cut of 1973 turned out to be a one-off. In conjunction with other events, the cut precipitated a reversal of reform in key industries and there were only 'piecemeal' further reductions in tariffs for over a decade. But with Australia's relatively mediocre economic performance becoming increasingly apparent, the early 1980s saw the floating of the Australian dollar (facilitating subsequent adjustment to tariff liberalization) followed by significant liberalization of the finance sector, including the removal of exchange and interest rate controls. The reform of border protection arrangements was also reinvigorated – with the conversion or elimination of import quotas as well as reductions in tariffs themselves. By 1996, virtually all tariffs (other than for autos and textiles, clothing and footwear, which were on their own liberalization paths) had fallen to 5 per cent or less.

A consequence of increased international competition in Australia's traded goods sector was pressure for reductions in input costs, notably in labour markets and (non-traded) public utility services. The option for local firms to pass on excessive input costs to user industries and consumers was no longer possible once accommodating 'made-to-measure' increases in border protection stopped.

The various 'spot fires' of microeconomic reform – especially in different sectors of economic infrastructure and in different jurisdictions – began to coalesce. In 1995, various strands of the structural reform process were consolidated and extended in a coordinated National Competition Policy, agreed to by all governments in Australia's federal system. Among other things, the National Competition Policy programme entailed: an extension of anti-competitive conduct laws to cover previously exempt government and unincorporated enterprises; the review of some 1800 items of anti-competitive regulation; reforms to public monopolies, including 'competitive neutrality' mechanisms, certain structural reform requirements and prices oversight mechanisms where public monopolies were retained; and an access regime for network infrastructure (PC 2005a).

Thus, towards the end of the twentieth century, Australian governments were committed to an increasingly broad-ranging programme of domestic microeconomic reform. The reforms ultimately embraced all product (goods and services) markets, factor markets (including the labour market), and the public and private sectors (Box 6.1). This 'microeconomic' story overlooks the important and complementary role of macroeconomic reforms – whose outcomes were low inflation, greater flexibility to respond to internal and external shocks, and reduced distortions and improved business incentives from tax reforms. But that is a subject in its own right.

While no single indicator can adequately summarize the extent of structural reform in Australia, one that comes closest is the downward trend in net assistance to Australian industry. The effective rate of assistance for manufacturing has declined from 25 to 5 per cent over the past two decades, while agricultural assistance has also fallen.

Box 6.1 Two decades of economic reform in Australia

Trade liberalization – reductions in tariff assistance (that began in 1973) and the abolition of quantitative import controls – mainly in the automotive, white goods and textile, clothing and footwear industries – gathered pace from the mid-1980s. The effective rate of assistance to manufacturing fell from around 35 per cent in the early 1970s to 5 per cent by 2000.

Capital markets – the Australian dollar was floated in March 1983, foreign exchange controls and capital rationing (through interest rate controls) were removed progressively from the early 1980s and foreign-owned banks were allowed to compete – initially for corporate customers and then, in the 1990s, to act as deposit-taking institutions.

Infrastructure – partial deregulation and restructuring of airlines, coastal shipping, telecommunications and the waterfront occurred from the late 1980s. Across-the-board commercialization, corporatization and privatization initiatives for government business enterprises were progressively implemented from around the same time.

Labour markets – the Prices and Incomes Accord operated from 1983 to 1996. Award restructuring and simplification, and the shift from centralized wage fixing to enterprise bargaining, began in the late 1980s. Reform accelerated in the mid-1990s with the introduction of the *Workplace Relations Act 1996,* further award simplification (through limiting prescribed employment conditions in enterprise bargaining agreements) and the introduction of individual employment contracts (Australian Workplace Agreements).

Human services – competitive tendering and contracting out, performance-based funding and user charges were introduced in the late 1980s and extended in scope during the 1990s; administrative reforms (for example, financial management and programme budgeting) were introduced in health, education and community services in the early 1990s.

'National Competition Policy' reforms – In 1995, further broad-ranging reforms to essential service industries (including energy and road transport), government businesses and anti-competitive regulation were commenced by all Australian governments through a coordinated national programme.

Macroeconomic policy – inflation targeting was introduced in 1993. From the mid-1980s, fiscal policy targeted higher national saving (and a lower current account deficit) and, from the mid-1990s, concentrated on reducing government debt, primarily financed through asset sales (privatization).

Taxation reform – capital gains tax and the dividend imputation system were introduced in 1985 and 1987, respectively. The company tax rate was lowered progressively from the late 1980s. A broad-based consumption tax (GST) was implemented in 2000, replacing the narrow wholesale sales tax system and a range of inefficient state-based duties. And income tax rates were lowered at the same time.

Source: Adapted from Banks (2005).

Other aggregate indicators of the extent of structural and behavioural change are found in the coincident rise in the trade intensity of Australia's economy, from around 22 per cent in the mid-1980s to 40 per cent now, and the sharp increase in business R&D spending as a share of GDP, from around 0.4 per cent in 1970 to almost 0.8 per cent in 2000 (Banks 2005).

Reform outcomes

At the aggregate level, Australia experienced a surge in multifactor productivity (MFP) growth during the 1990s, averaging 2.3 per cent, more than double its previous rate (Figure 6.3). Australia's MFP performance was also among the best in the OECD and its labour productivity growth exceeded even that of the United States.

Accompanied by rising labour utilization, this translated into annual growth in per capita incomes of around 2.5 per cent in that decade, well above the previous average and that for the OECD as a whole (1.7 per cent). As a consequence, Australia has seen its position on the international per capita GDP scale rise from sixteenth to sixth over the past decade or so (Figure 6.4).

The productivity story was also repeated at the industry level. For example, MFP growth in electricity, gas and water jumped by 60 per cent in the 1980s; and the MFP growth rate in transport/storage and communications doubled in the 1990s. Empirical analysis by the Productivity Commission found that the price reductions and productivity gains in the infrastructure sector alone yielded a 2.5 per cent gain in GDP (PC 2005a).

The reform programme also contributed, indirectly, to sharp productivity improvements in wholesale trade and the finance and insurance industries, where business reorganization involving the innovative use of information and communication technologies was driven by the heightened competitive pressures on customers as well as within the industries themselves, facilitated by a more accommodating industrial relations framework (Johnston et al. 2000, Gretton et al. 2004).

The Commission has investigated the sources of Australia's productivity turnaround and, like others, concluded that microeconomic policy reforms have played a central role. (For a summary of the evidence, see PC 2003a.)

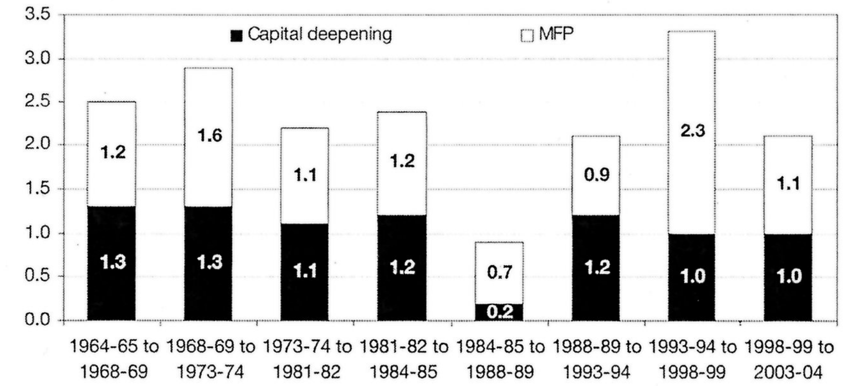

Figure 6.3 Australia's productivity turnaround

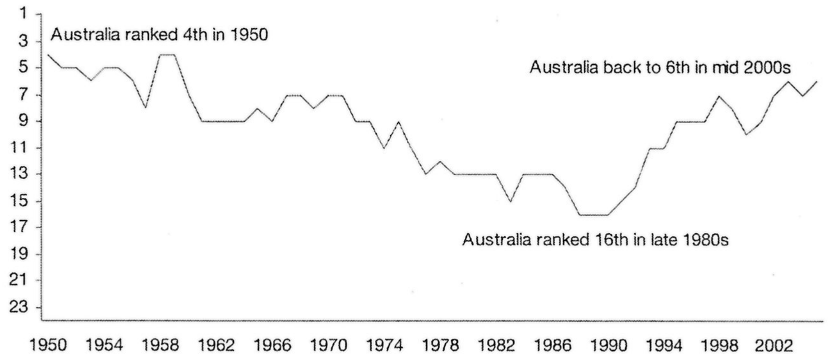

Figure 6.4 Fall and rise of Australia's economic ranking

These reforms, with their focus on openness to foreign trade and investment and enhanced domestic competition, were the drivers and enablers of productivity growth. Together with stable macroeconomic settings for monetary and fiscal policies, the productivity surge allowed Australia to pursue higher economic growth and living standards with fewer fears of inflationary pressures.

Reform strategies that worked

While many of Australia's structural reforms followed standard economic prescriptions, the way the reforms were implemented had some features that are perhaps more distinctive (Banks 2005).

'Opening the borders' became the first domino

Opening the borders to foreign goods, services and capital played a critical role in exposing inefficiencies elsewhere in the Australian economy, as well as building a constituency for reforms in government utility service provision and in labour market regulation. The prospect of adjustment costs provided the motivation as well as a constituency for further reforms that, together with a gradualist approach (see below) and a floating exchange rate, ultimately served to contain those costs.

A key lesson from Australia's experience is that external liberalization has distinct advantages as a first-mover strategy.

We liberalized unilaterally

Unlike other OECD countries, most of Australia's trade liberalization has been undertaken unilaterally, rather than in exchange for reciprocal concessions by other countries. With agricultural trade – at that time Australia's main export interest – effectively quarantined in the then GATT (now WTO) system, Australia had little incentive to do reciprocal deals. This brought into sharp focus the question of whether reducing our own import protection would yield national gains, regardless of what other countries chose to do. Moreover, Australia generally got 'credit' for its liberalization measures in subsequent rounds of multilateral trade negotiations, while benefiting from the reciprocal liberalization of the larger trading powers through application of the non-discrimination rule.

We hastened slowly

Australia adopted an incrementalist rather than 'big bang' approach to reform. The experience with the 25 per cent across-the-board tariff cut may have reduced the appetite for big bang approaches. The cut was not pre-announced by the government, was immediate and was explained more in terms of constraining inflation rather than its microeconomic benefits. It surprised the inefficient manufacturing sector and was soon followed by reversals of protection for 'sensitive' sectors and thus a widening of disparities in industry assistance. Later tariff liberalization programmes involved pre-announced and graduated reductions and made special transition provisions for sensitive sectors.

Australia has also taken a gradual or incremental approach to reform in the other key areas.

- The reform of public-owned utilities that initially began with commercialization and then corporatization initiatives in the 1980s was followed by the 'stronger medicine' of structural separation, removal of entry restrictions against new competitors, privatization (in some jurisdictions), and, for network infrastructure, regulated provision for third-party access.
- Labour market reforms began with a gradual transition from the traditional, highly centralized prescriptive arrangements. Award restructuring and an 'accord' between the government and the unions to limit wage demands gave way to enterprise bargaining, and later to the introduction of individual employment contracts constrained by limited core requirements.

We acted on a broad front

While Australia's structural reform began at the border, the programme evolved to encompass reforms across much of the economy. Notwithstanding the substantial challenges involved, undertaking reform on a broad front not only can generate larger gains, it can also reduce resistance to change. Those adversely affected by one reform may receive offsetting benefits from reforms in other areas, thus avoiding undue adjustment and making reform more 'palatable'. For example:

- The Commission's modelling of the economy-wide impacts of reducing trade barriers while also implementing reforms to energy, communications and the public sector, demonstrated that although trade liberalization alone would reduce manufacturing employment by 0.3 per cent, reforms across all the areas would increase employment in the manufacturing sector by 1.3 per cent (IC 1996).
- While reforms to public utilities have seen apparently regressive price rises for households, modelling of the indirect effects on other prices and factor incomes has demonstrated net benefits across all household income bands (though greater at higher income levels) (PC 2005a).

We 'oiled the wheels' in sensitive sectors

In the main, Australia used the phasing of reforms to minimize adjustment costs, relying on general retraining schemes and the (relatively generous) welfare safety net to address the needs of displaced workers.

However, particularly in sensitive sectors, governments also introduced some specific measures to deal with adjustment issues. For example:

- The post-2005 plan for textiles, clothing and footwear includes $50 million for this purpose and automotive tariff reductions to 2010 have been accompanied by assistance of around $600 million annually under the Automotive Competitiveness and Investment Scheme (PC 2002).
- When price support mechanisms in the dairy industry were abolished in 2000, existing farmers were provided with a substantial direct compensation financed from a levy on milk consumers, to reflect the reduction in the value of their dairy holdings and to facilitate adjustment within (or out of) the industry.

Governments have also provided specific support for regions in which the costs of reform were concentrated. For example, the energy reforms of the early 1990s led to significant labour shedding from electricity generation in the Latrobe Valley in Victoria, which in turn led to a severe downturn in the region. Support has ranged from grants to encourage industry relocation to the region, to retraining, and social and development initiatives. These measures have contributed to strong employment growth since the mid-1990s (PC 2005a).

Institutional underpinnings for Australia's reforms

Structural reforms of the kind Australia has implemented have long been recognized as economically desirable by most economists, but have typically faced strong opposition. Various obstacles to reform outlined in Box 6.2 are undoubtedly not unique to Australia, although its federal system of government posed additional challenges in securing nationally beneficial reform.

The international experience is that for such obstacles to be overcome, a range of factors has often come into play: these notably include a sense of crisis, political commitment and leadership, reform champions within the bureaucracy (particularly in central agencies) and pro-reform lobbies in the broader community.

However, Australia appears to differ from other countries in fashioning domestic institutional arrangements expressly to promote and sustain reform, by both neutralizing the power of vested interests and building wider political and community support for reform. The institution that is arguably the most distinctive of the Australian approach in this respect is the Productivity Commission, and its direct forebears, the Industries Assistance Commission and the Industry Commission.

The role of 'the Commission'

While the Commission today is identified with the microeconomic reforms in Australia over the past few decades, it paradoxically had its origins in an institution that had underpinned the industry protection element of the Australian settlement for much of the proceeding fifty years (Banks 2005; PC 2003b). The Tariff Board's remit since 1921 was to offset local industry's 'margin of cost disadvantage' against imports while avoiding 'excessive' protection, for

Box 6.2 Obstacles to structural reform

1 The costs of reform are concentrated on particular groups, whereas the benefits are more diffuse.
2 The potential winners from reform tend to be (rationally) poorly informed about the tradeoffs.
3 Bureaucratic structures are typically aligned with particular sections of the economy or community.
4 The costs of reform tend to be front-loaded, whereas the benefits arise over time.
5 Multiple jurisdictions increase the difficulty of achieving nationally consistent approaches.

Source: Adapted from Banks (2005).

which its statute provided only vague guidance. Nevertheless, it embedded the role of an independent inquiry and advisory body in Australia's institutional framework, albeit restricted to tariff policy. At the government's request, the Tariff Board would examine the claims of particular industries for increased protection through a public inquiry process, and issue public reports with formal recommendations.

In the mid-1960s, under the combined influence of new leadership, a separate public inquiry into Australia's economic policies (the Vernon Committee) and academic work providing an intellectual basis for protection reform (notably by Max Corden), the Board began to question the effects on the wider economy of its long-standing practice of granting protection to individual industries according to need. This was the genesis of an approach that made advancement of the overall interests of the Australian community paramount over the interests of particular firms, industries or sectors.

All this came together in the blueprint commissioned by the government for a new organization providing for the development of coordinated policies for improving resource allocation and public scrutiny of industry assistance measures and their costs (Crawford 1973). The Industries Assistance Commission was designed to provide a counterweight to the sectional and other political pressures that militated against liberalization.

There are three features of the organization's design that collectively distinguished its contribution:

- *Independence*. The Commission operated under the protection and guidelines of its own legislation. It had an arm's-length relationship with government which could tell it what to do but not what to say. Its role was purely advisory, having no judicial, executive or administrative functions. Members of the Commission were appointed for fixed (renewable) terms and could not be removed by the government of the day.
- *Transparency*. The Commission was required to hold public hearings and release draft reports before finalizing its recommendations to government. The Commission was also required to prepare an annual report covering its operations and analysing the structure of assistance to Australian industry and its effects. And the government was obliged to release publicly all Commission reports within a specified period.
- *Community-wide mandate*. Guidelines in the legislation stated that the Commission should be concerned with improving the efficiency with which the economy uses its resources and to take account of the wider interests of consumers and users of products affected by its proposals.

With some variation, these three features remained fundamental to the role and operations of the two organizations that succeeded the Industries Assistance Commission; namely the Industry Commission (from 1990 to 1998) and today's Productivity Commission, which was established in April 1998. (For a short history of the Commission, see PC 2003b.)

The main differences between the organizations have been in their coverage, which has been progressively extended beyond industry assistance matters to cover structural reform issues across all sectors of the economy, and in social and environmental as well as economic spheres. Around 80 per cent of the inquiry reports of the Industries Assistance Commission concerned assistance for manufacturing industries. These days, around 80 per cent of Productivity Commission inquiries relate to cross-sectoral, infrastructure, social and environmental policy issues. Box 6.3 illustrates the breadth of matters that the Productivity Commission has addressed in recent years.

How the Commission contributes

The Commission has assisted the reform efforts of governments in a number of ways.

- The Commission provides well researched advice on structural reform that is impartial and concerned with the longer-term interests of the community as a whole. The Commission's processes ensure that the arguments of vested interests are subjected to scrutiny, weakening their influence if they do not hold up. Moreover, the robustness of the Commission's final analysis and advice is increased through its own processes and draft reports, which test its preliminary views through public input and feedback.
- The Commission's transparent inquiry processes – including public submissions, hearings, draft and final reports – allow governments to gauge at arm's length the likely reactions of the community and interest groups to different policy approaches. This can reduce the prospect of unanticipated responses from these groups forcing policy reversals.
- Governments can use the Commission's reports and analyses in making the case for policy changes, or in resisting pressures to introduce policy measures that would be costly nationally.
- The Commission's public inquiry processes and reporting can in themselves engender a wider awareness within the community of the costs of existing policies and the benefits from reform. In effect, the Commission helps enfranchise those interests who would benefit most from reform, by alerting them to the costs they are currently bearing, and by providing a ready public forum in which to put their case.

The Commission's impacts on government policy can be demonstrated across a range of policy areas. Such a review is necessarily selective and abstracts from much of the 'drama' along the way. The Productivity Commission's predecessors went through some difficult times, facing strong opposition from sections of industry and the union movement, as well as within government itself. At the same time, it had its supporters. They included some industry groups that did not always like its findings, but valued the transparency and consultative nature of its processes. And, as noted above, successive governments from both

Box 6.3 A selection of Productivity Commission studies

Trade liberalization/industry assistance

- Review of Australia's general tariffs
- Review of automotive assistance
- Review of textile, clothing and footwear assistance
- Pig and pigmeat industries: safeguard action against imports
- Review of the pharmaceuticals industry investment programme
- Multilateral liberalization of services trade
- Trade and investment effects of preferential trading arrangements
- Removing tariffs on goods originating from Least Developed Countries
- International air services

Productivity studies

- Productivity in Australia's wholesale and retail trade
- ICT use and productivity
- Microeconomic reforms and Australian productivity: exploring the links
- R&D and Australia's productivity

Infrastructure reform issues

- Review of the gas access regime
- Price regulation of airport services
- Telecommunications competition regulation
- Progress in rail reform
- Road and rail freight infrastructure pricing

Labour market issues

- Australia's health workforce
- Independent review of the Job Network
- National workers' compensation and OHS arrangements
- Non-traditional work in the Australian labour market
- Work arrangements in container stevedoring
- Role of training and innovation in workplace performance

Environmental issues

- Rural water use and the environment
- Energy efficiency
- Waste management
- Conservation of historic heritage
- Pricing of irrigation water
- Impact of a foot and mouth disease outbreak in Australia
- Water quality in the Great Barrier Reef
- The environmental performance of commercial buildings

Box continued on next page.

Social issues

- Australia's gambling industries
- Indicators of indigenous disadvantage
- Social capital
- Review of the Disability Discrimination Act
- Nursing home subsidies
- Inquiry on first home ownership

Regulatory reviews

- Broadcasting
- Impact of native vegetation and biodiversity regulations
- Reform of building regulation
- Radiocommunications
- Liner cargo shipping
- Regulation of the taxi industry
- Review of the Prices Surveillance Act
- Review of mutual recognition
- Review of legislation regulating the architectural profession

Other studies

- Impacts of medical technology in Australia
- Report on government services
- Cost recovery by Commonwealth agencies
- Resourcing universities
- Impact of indirect taxes on exporters
- Public liability claims management
- GTE financial performance

sides of politics have seen sufficient value in the institution to renew and expand its mandate over the last thirty years.

Reforming industry protection and assistance

At the time of the formation of the Industry Commission in 1989, the then treasurer stated:

> The new Industry Commission (IC) will further the important role that the Industries Assistance Commission has played in the structural adjustment process in Australia. It will build on the Industries Assistance Commission's earlier work which was instrumental in awakening the community to the enormous costs of many industry assistance policies. ... As an institution, the Industries Assistance Commission has been an important force, building

> community awareness of the need for Australian industry to be outward looking and internationally competitive.
>
> (IAC 1989, p. 15)

In 2003, the Prime Minister made the following observations about the Commission's long term contribution to trade and industry assistance policy formulation:

> The dynamic supporting trade liberalization in democracies will only succeed if communities in each country believe it's in their interests to liberalize. In the Australian context, the work of the Productivity Commission and its predecessors ... has been fundamental to building and maintaining Australian public understanding of the benefits of greater openness to international competition.
>
> (Howard 2003)

Nevertheless, the realities of tariff reform were of slow and chequered progress following the 25 per cent tariff cut of 1973 through until the general tariff reduction programme of 1988. The Commission had to work in a world of piecemeal assistance inquiries – often only parts of industry were referred to it at any one time. Strong substitution possibilities in production and/or consumption and adjustment considerations constrained the pace at which assistance levels could be lowered. And the Commission's assistance recommendations, even when (typically) implemented by the government, could be quickly overtaken through rounds of 'temporary' safeguard action against imports, often in the form of import quotas. (The main institutional mechanism for this, the Temporary Assistance Authority, focused on 'injury' to domestic producers, not the wider effects of temporary protection on user industries, consumers and the community at large.) Although average levels of assistance for manufacturing industries declined gradually in the decade after the 25 per cent tariff cut, disparities in assistance levels, and thus potential resource misallocation costs, increased.

Arguably, the Commission's most important contribution during this period was its educative role – quantifying levels of assistance to industry and explaining to the broader community how assistance provided to one industry can harm producers in other Australian industries, as well as consumers and taxpayers.

How did it do this? Among other things, the Commission developed the use of effective rates of assistance, building on the pioneering work of Australia's Professor Max Corden. Tariffs, quotas and subsidies on inputs *and* outputs were assessed so as to show the net effect on an industry's level of assistance and the overall structure of protection in Australia. Over the years the Commission extended its assistance measurement framework to encompass agricultural and mining industries and budgetary assistance to services. The reporting on assistance to Australian industries continues to the present day in the Commission's annual *Trade and Assistance Review* which, as the WTO's *World Trade Report 2006* observed, is one of only three such reports world-wide.

Emboldened by improved economic conditions in the early 1980s, the government sent the Commission a broad reference asking for options for general reductions in protection. While the report had no impact when the Commission reported in 1982, it became a key reference later in the decade in the lead-up to the 1988 announcement of general phased tariff reductions. A further general reduction programme was announced in 1991. The fact that a government may not initially accept or act on key recommendations in a particular Commission report does not mean that that report has no influence in the longer term.

The most contentious of the Commission's industry assistance reports down the years have typically concerned Australia's highly assisted manufacturing industries – passenger motor vehicles and textiles, clothing and footwear. A measure of the Commission's ultimate success in helping to shape long-term assistance policy for these industries was government endorsement of the Commission's findings on post-2005 tariff reductions and transitional assistance for the automotive industry (following the Commission's 2002 inquiry report) and the acceptance of the Commission's preferred tariff option for the textiles, clothing and footwear industries and quantum of transitional assistance post-2005 (following the Commission's 2003 inquiry report).

Assistance to Australia's rural industries has varied considerably, from little or no assistance (as with beef), to substantial assistance to industries such as tobacco and market milk. The policy instruments of choice in agriculture in the post-war period were regulatory – domestic pricing arrangements, anti-competitive statutory marketing arrangements and restrictions on substitute products – supplemented by various tax concessions, output and input subsidies and assistance for promotion activities, with tariffs playing a relatively minor role.

Around one fifth of the inquiries conducted by the Commission during the 1970s and 1980s concerned assistance arrangements for agricultural industries. As with manufacturing protection, the reform process was incremental and spanned decades, but few remnants of the original industry-specific policy settings remain – the statutory monopoly on wheat exports being the most significant.

Against this background of reform, assistance issues for Australia's manufacturing and agricultural industries have not figured prominently in the Productivity Commission's recent work. Nevertheless, its influence is evident in government acceptance of Commission recommendations:

- for the automotive and textile, clothing and footwear industries (noted above);
- for a substantial liberalization of the regulatory regime for international air services (though not to offer unrestricted access to Australia's major airports or to abolish cabotage restrictions);

- to eschew tariff and quota options for safeguard action against pigmeat imports in 1999 and to opt, instead, for adjustment assistance for pig producers;
- not to provide special assistance to citrus growers under competitive pressure but to address the trade negotiation, market access, export control and other issues identified by the Commission; and
- to reorient pharmaceutical industry assistance to R&D, where spillover benefits would generate net benefits for Australia as a whole.

Nevertheless, tariff reform remains incomplete. In 2000 the Australian government deferred implementing the Commission's recommendation to reduce the remaining general tariffs of 5 per cent to zero, preferring to delay removal until a time 'consistent with trade and fiscal objectives'.

Reforming economic infrastructure

With Australia's tariff walls falling, policy impediments in other parts of the economy began to attract the attention of governments and industries under increased competitive pressure. The Commission's 1989 report on government (non-tax) charges highlighted the significance of government-supplied inputs to industry and the adverse effects of inefficiencies in service provision on business competitiveness. The report had the long-term impact of widening the microeconomic reform agenda beyond industry assistance and initiating a series of references to the Commission on economic infrastructure services covering energy generation and distribution, water, rail, ports and postal services. The Commission helped establish a widely adopted reform programme for government business enterprises, encompassing:

- the removal of barriers to competition (for example, legislative barriers to entry) and structural separation of activities to promote competition;
- institutional and administrative reforms designed to enhance commercial focus and accountability;
- privatization, when appropriate, to promote ongoing cost reductions; and
- other measures, such as pricing reform.

The Commission was the secretariat to a committee of all governments (Commonwealth, State and Territory) which began monitoring the economic and financial performance of government enterprises providing economic infrastructure services so as to provide benchmarks against which their performance could be assessed. The Productivity Commission has maintained this regular benchmarking, latterly enhancing it with analysis of the scope to improve external governance frameworks and capital management practices. This work continues to be supported by governments in all jurisdictions, and the benchmarking outcomes are used in political, media and community debate on the performance of these service providers.

Governments have embraced one of the principal policy messages arising from a series of Productivity Commission reports on the regulation of economic infrastructure – the need to rebalance the emphasis in the regulatory frameworks away from achieving immediate gains for users and consumers to also facilitate efficient investment in new or augmented facilities. More specifically, the Australian government:

- broadly endorsed Commission recommendations on rail reform in areas of Commonwealth responsibility but deferred consideration of other recommendations relating to state or joint responsibilities, preferring to see whether existing reform initiatives could be progressed within existing institutional settings;
- endorsed the thrust of the Commission's recommendations to retain telecommunications-specific parts of the competition policy regime, speed up dispute resolution processes and provide greater upfront certainty for investors (though rejecting other recommendations);
- endorsed, together with the states and territories, the majority of the Commission's recommendations on the national access regime for essential infrastructure;
- implemented all major elements of the Commission's preferred approach for a light-handed regulatory regime for airport services involving a probationary period of price monitoring;
- accepted all the Commission's recommendations on the economic regulation of harbour towage services, with only minor modifications to the suggested price monitoring regime; and
- with the agreement of the inter-jurisdictional Ministerial Council on Energy, supported the Commission's key recommendations for reforming the gas access regime.

Improving the functioning of the labour market

In the early 1990s the Industry Commission's first direct foray into industrial relations issues was its inquiry on impediments to regional industry adjustment and on what needed to be done to help people and businesses within regions adjust to pressures for change (IC 1993). A central theme of the Commission's report was the difficulty that uniformity in policy and regulation can pose for regional adjustment and development, given the diversity among Australia's regions.

The Commission focused its analysis on arrangements that were amenable to government or community action, including aspects of labour market regulation; social security and taxation systems; problems with government provision of infrastructure services; and confused responsibilities across tiers of government. It was the Commission's findings on labour adjustment that were most contentious, provoking a strong negative reaction from unions and welfare groups in particular. Nevertheless, the government considered the report

in the context of its white paper on employment and growth and the Commission's report provided a focus for continuing public debate on enterprise bargaining and labour force flexibility.

One of the early tasks given to the new Productivity Commission was to identify restrictive work practices that added to the cost of doing business. The first of these reports – on container stevedoring – highlighted the productivity-sapping nature of the complex, inflexible and prescriptive work arrangements on Australia's waterfront. The key impediments identified by the Commission were subsequently addressed in waterfront enterprise bargains. Similarly, the Commission's analyses of productivity-restricting work practices in coal mining and meat processing were addressed in subsequent decisions by the Australian Industrial Relations Commission and government legislation on the meat 'tally' system.

The Commission has also influenced government policy-making on broad labour market issues. For example:

- The Job Network, established in 1998, is one of the first comprehensive attempts internationally to apply market principles to the provision of active labour market assistance to disadvantaged job seekers. The government credited the Commission's 2002 review as being 'authoritative' and implemented a range of its recommendations but also deferred addressing some key ones until employment services policy further evolved.
- A 2004 Productivity Commission review into national frameworks for workers' compensation and occupational health and safety identified clear net benefits in creating a national framework, but this was not fully supported by the Australian government at the time. Nevertheless, it has since set about creating an opt-in nation-wide alternative to state-based regimes.
- And in 2007, all Australian governments (through the Council of Australian Governments, COAG) announced substantial agreement with the institutional, regulatory and funding measures the Commission proposed to improve the efficiency and effectiveness of Australia's health workforce and to improve its distribution. In addition, COAG decided that the Commission should be asked to conduct another review in five year's time.

Reforming regulation

Almost all of the matters referred to the Commission for investigation involve some form of regulation. However, an important element of the Commission's workload following the 1995 inter-jurisdictional agreement on National Competition Policy was a stream of inquiries reviewing anti-competitive regulation. Many of these involved economic infrastructure, discussed above, but also included:

- radiocommunications, where the government accepted most of the Commission's recommendations for reform of radiofrequency spectrum regulation, although it postponed consideration of issuing licences with perpetual tenure and rejected some other recommendations;

- broadcasting, which the Australian government largely ignored even though the Commission's 2000 report continues to be used extensively in political, media and community debate on foreign ownership of print, radio and television media, cross-media rules and the regulation of digital and analogue television;
- regulation of the architectural profession, where the states and territories rejected the Commission's preferred option to repeal the Architects Acts and remove statutory certification, but supported a range of recommendations to remove anti-competitive elements from their legislation regulating architects; and
- prices surveillance legislation, where the government accepted the recommendation to repeal the Prices Surveillance Act but decided to retain more extensive price controls in the Trade Practices Act than recommended by the Commission.

In conjunction with these inquiries related to National Competition Policy, the Commission has been asked to report on a wide range of other regulatory issues. For example, the Australian government:

- accepted all of the Commission's recommendations on native vegetation and biodiversity regulation and indicated that it would pursue implementation of them by the states and territories though COAG processes;
- agreed to implement the Commission's principal findings on building regulation reform through a new intergovernmental agreement on the Australian Building Codes Board and the Building Code of Australia;
- together with the New Zealand government, endorsed the Commission's work programme to more closely integrate the competition and consumer protection regimes of the two countries.

In addition to its inquiry role, for many years the Commission has had within it a separate unit responsible for improving regulation-making processes. The Office of Regulation Review provided advice to government departments and regulatory agencies on the development of regulatory proposals and monitored compliance with the government's mandatory requirements for the preparation of a Regulation Impact Statement (RIS) for major proposals affecting business or restricting competition. In 2006, this body's role was upgraded as the Office of Best Practice Regulation. Following the appointment of a Cabinet Minister with responsibility for good regulation under the incoming Labor government in late 2007, it was moved to the finance portfolio.

Contributing to environmental and social policy formulation

The Commission has a long history of addressing environmental and natural resource issues in its inquiry programme. Examples pre-dating the Productivity Commission include reports on mining and mineral processing, fisheries, water, recycling, the discharge of pulp and paper wastes, greenhouse gas emissions, ecologically sustainable land management and urban transport.

The Productivity Commission has continued this focus through, for example, its 1999 inquiry report on the implementation of ecologically sustainable development by Commonwealth departments and agencies – in response to which the government agreed to integrate ecologically sustainable development principles into decision making and agency reporting and to improve data collection – and its 2003 report on the impacts of native vegetation and biodiversity regulation (noted above). The Commission's report on industries, land use and water quality in the Great Barrier Reef was jointly acknowledged by the Commonwealth and Queensland governments as a valuable contribution to policy development and implementation for what is the world's largest World Heritage Area.

More recently, the government announced agreement with all of the Commission's recommendations on the private cost effectiveness of improving energy efficiency and that it would work with the states to consider the Commission's findings and analysis. Major reports – on the conservation of Australia's historic heritage, on waste management, and on the feasibility of establishing market mechanisms to provide incentives for greater investment in rural water use efficiency and for dealing with environmental externalities – have only recently been completed and are yet to have a government response. In addition to its inquiry work, the Commission has a strong research programme that has contributed, inside and outside government, to environmental policy development.

There has been a growing recognition that the economic analytical tools and community-wide focus of the Productivity Commission and its predecessors can contribute to policy issues with important social dimensions. Early examples in this regard include rural adjustment, charities and private health insurance. The Commission's 1997 inquiry into private health insurance, for example, led to changes to regulation that prevented health funds discriminating on the basis of age. Though this regulation was thought by many to be sacrosanct, the Commission showed that it led to adverse selection problems and ultimate inequities, with younger people not contributing to the pool, causing premiums for remaining (generally older) members to spiral up, resulting in further exits.

The Productivity Commission's 1999 report on Australia's gambling industries broke new ground. It provided an analysis not only of the regulatory framework for the gambling industries, but also the social costs and benefits of these industries, including a comprehensive assessment of the extent and impacts of problem gambling. The Prime Minister commented:

> I commend to all people who are concerned to achieve a balance in social policy a careful study of the Productivity Commission's final report ... it represents the first really comprehensive analysis of the gambling industry in Australia. I think it's a very balanced attempt to strike the right pitch ... I think it makes very interesting and very compelling reading.
>
> (Howard 1999, p. 2)

A further recent example of the Commission's contribution to social policy formulation was its 2004 review of the Disability Discrimination Act. The government subsequently accepted the majority of the Commission's recommendations, including many of the more significant ones.

Through performance monitoring, the Commission also helps governments achieve their social objectives. Since 1993 the Commission has been providing the secretariat to the Steering Committee for the Review of Government Service Provision. The Committee is charged with monitoring the equity, effectiveness and efficiency of a wide range of government services including hospitals, schools, community services and public housing. The annual *Report on Government Services* is widely used by governments at all levels, service agencies and the wider community. It has improved accountability and enabled more analysis by governments and agencies of variations in performance, with consequent benefits in the effectiveness and efficiency of service delivery. Since 2002 the Commission has also assisted in the preparation of a series of reports for COAG titled *Overcoming Indigenous Disadvantage: Key Indicators*. A key task of this reporting is to identify indicators that demonstrate the impact of programmes and policies on outcomes for one of the most disadvantaged sections of the Australian community. The three reports to date are acknowledged within government and among Indigenous leaders as creating the framework in which progress in reducing the disparities between Indigenous and other Australians can be assessed.

Improving the information base for policy-making

The Commission's contributions to government policy also encompass those of its analytical and modelling outputs, which influence the policy agenda rather than specific policy outcomes. The role played by the Commission's early use of effective rates of assistance to industry in helping to reshape the tariff debate in Australia has already been noted. The Commission's promotion and use of general equilibrium modelling to demonstrate interdependencies between industries and the importance of taking the indirect effects of policy into account was another means of advancing the reform agenda. Examples of a range of the Commission's contributions include:

- Commission modelling in the late 1980s suggested that across-the-board tariff liberalization and some other microeconomics reforms could increase Australia's GDP by some $16 billion, or $1600 per household per year (1988 dollars). These headline-grabbing numbers proved important in the subsequent successful implementation of reforms.
- In seeking to reach agreement on National Competition Policy in 1995, state and territory governments expressed concern about whether they would share adequately in the gains from the reforms that they would undertake. As a result, the Commission was asked to quantify the impact of implementing a range of reforms, including the impact on government revenue. The findings of this research reinforced the emerging consensus on proceeding with competition policy reforms, and laid the basis for a fuller understanding of the gains from those reforms and for competition policy payments by the Commonwealth to the states and territories.
- Claims by opponents of national competition policy that depopulation and other problems in regional Australia were attributable to the policy were examined by the Commission in 1999. The Commission found that longer-term factors – including technological advances, changing consumer tastes and lifestyle preferences, and declining prices for agricultural commodities – were primarily responsible and that National Competition Policy should not be made the 'scapegoat'. Further, modelling undertaken as part of the inquiry indicated that National Competition Policy was likely to increase net income in all but one region.
- Various streams of Commission research provide analysis and information that help governments both promote the benefits of reform and respond to the critics of reform. The Commission's widely cited analysis of productivity trends and the links to microeconomic reform, and the Commission's analysis of the role of non-traditional employment in today's labour market are two examples. (See Dee 2005 for other examples of the contribution of Commission modelling to policy impacts.)

After more than two decades of seemingly relentless microeconomic reform, some might have supposed that little more by way of structural policy remained to be done. In April 2004 the Australian government asked the Commission to review National Competition Policy and report on further opportunities to remove impediments to efficiency and enhance competition. The Commission showed that productivity and price changes in key infrastructure sectors during the 1990s had increased Australia's GDP by some 2.5 per cent and that the benefits had been widely spread across the community (PC 2005a). But the Commission also highlighted known challenges facing Australia, including the economic and fiscal pressures arising from an ageing population, with its implications for workforce growth and public spending on health and aged care (PC 2005b). Notwithstanding improvements to Australia's economic performance in recent years, the Commission's review of National Competition Policy pointed to performance gaps in a number of areas where further nationally coordinated reforms could provide substantial pay-offs to the community (Box 6.4).

COAG drew on the Commission's analysis of the benefits of past National Competition Policy reforms and important elements of COAG's new National Reform Agenda reflect the Commission's recommendations and approach. Further, the Commission was asked to assist COAG progress its reform agenda by reporting by the end of 2006 on:

- the implementation of efficient pricing of road and rail freight infrastructure, given concerns that current charging arrangements might be

Box 6.4 The Productivity Commission's proposed agenda from its review of National Competition Policy

- In a number of reform areas, national coordination will be critical to good outcomes. These areas – some of which were encompassed by National Competition Policy – should be brought together in a new reform programme with common governance and monitoring arrangements. Priorities for the new programme include:
  - strengthening the operation of the national electricity market;
  - enhancing water allocation and trading regimes to better address scarcity and negative environmental impacts;
  - delivering a more efficient and integrated freight transport system;
  - addressing uncertainty and policy fragmentation in relation to greenhouse gas abatement policies;
  - improving the effectiveness and efficiency of consumer protection policies; and
  - introducing a more targeted legislation review mechanism, while strengthening arrangements to screen any new legislative restrictions on competition.
- An 'overarching' policy review of the entire health system should be the first step in developing a nationally coordinated reform programme for this sector to address problems that are inflating costs, reducing service quality and limiting access to services.
- National action is needed to re-energize reform in the vocational education and training area.
- A future review could identify areas of natural resource management (beyond water and greenhouse gases) where the pay-offs from new nationally coordinated reform could be high.

Source: Adapted from PC (2006a).

resulting in distorted modal choices and inefficient infrastructure investment decisions; and

- the potential economic and revenue impacts of the National Reform Agenda so as to help governments better understand the scale and distribution of the pay-off from competition, regulatory and human capital streams of reform to which all Australia's governments are now committed (PC 2006b).

Conclusions

As noted at the outset, these observations on the Commission's contribution to government policy should not be interpreted as suggesting that the Commission has been the sole, or even main, driver of trade liberalization and

wider microeconomic reforms. Besides the role of other review bodies – particularly for financial, tax and competition policy reforms – governments and ministers have championed and taken forward the reform agenda. Moreover, as for all such bodies, the Commission's role is informational and advisory. It is reliant on others to initiate much of its work and to consider and implement worthwhile reforms.

Nevertheless, it is generally accepted in Australia that the Commission has made a difference to the direction and pace of microeconomic reform over the last two decades. Whether elements of the Commission's role and operations could be effectively translated into the differing institutional and policy settings of other countries in the region is, of course, something for others to judge.

Note

1 This chapter draws on an assessment of the Australian approach to structural reform by Banks (2005).