
Accelerating and Broadening Australia's Microeconomic Reform Agenda

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Abstract

Australia is undoubtedly a nation rich with opportunities, with extensive social and economic infrastructure, stable and responsible government, and abundant natural and developed resources.

But Australia also faces some significant challenges, including reducing unacceptably high levels of unemployment, managing environmental concerns, and responding effectively to global competition and structural and regional change.

To meet these challenges and make the most of our opportunities, we need to gain further leverage on our resources by improving our nation's productivity and, importantly, flexibility. Microeconomic reform plays an important role in this regard by improving the incentives, which govern the way we use our resources.

While Australia has certainly implemented some significant microeconomic reforms in the last decade or so $\frac{3}{4}$ the benefits of which are beginning to show $\frac{3}{4}$ the task is far from complete. For example, further reform is needed in transport, particularly rail and the waterfront; utilities; the labour market; resource access; and our tax system $\frac{3}{4}$ areas which impact on various sectors of our economy, not least of all our agricultural and resource sectors.

But setting the right incentives for the productive use of our resources needs to extend beyond these traditional areas of reform. We also need to be sure we provide efficient and effective education, health care and community services. The management of our environment is also of critical importance, particularly our waterways. How we manage these resources, in both rural and urban areas, needs to be subject to rigorous scrutiny and, where appropriate, reform $\frac{3}{4}$ in many of these areas the reform process has only just begun.

Introduction

Microeconomic reform has become an important policy focus over the last decade or so.

But what is microeconomic reform?

Microeconomic reform almost defies precise definition. Our understanding of microeconomic reform has broadened, as Australians have discovered additional impediments to the efficient operation of their society. I suggest that in the 1970s, microeconomic reform would have been described almost exclusively in terms of trade reform, and in particular, reductions in tariffs. In the late 1980s, it became associated with corporatisation and privatisation of public sector organisations. In the 1990s, it has become associated with a broader range of sectors and activities.

When I think about microeconomic reform, I think about reform of any part of our nation's economic activity which undermines or impedes the efficient allocation of its resources. Therefore, it embodies concerns about the efficient and effective use of our peoples' skills and capabilities; the efficient and effective use of our natural resources; and the efficient and effective use of our social capital — that is, our hospitals, our schools, our community services.

Microeconomic reform aims to ensure that we have efficient regulations, effective regulatory institutions, and that the incentives are in place to encourage people across our nation to use our nation's resources, human, physical and financial, wisely. As productivity growth slowed in Australia in the three decades to 1990, there has been particular interest in this important issue amongst policy makers.

However, for many in the rural sector, the need to remove impediments to increasing our wealth creating abilities has been only too obvious for decades. Bert Kelly, writing in the '60s and '70s as the 'Modest Member', and later as the 'Modest Farmer', attests to that.

Supporters of such reforms, including the Industry Commission, have long argued the case for improving the incentives and institutions which guide the use of our nation's resources. This is not to argue for reform for its own sake. But reform so that Australians can enjoy improved living standards and quality of life.

It seems appropriate therefore at the beginning of 1998 to remind ourselves of why it is important to pursue microeconomic reform, and indeed why it is important that such reform be broadened.

The main points I will make in this paper are:

- that Australia faces some very important opportunities and challenges over the next few years;
- that it will be improved productivity growth that provides the key to improving the living standards of Australians;

- that microeconomic reforms are going to be central to our ability to reach our productivity potential; and
- that while much has been achieved over the last decade or so by many dedicated people, microeconomic reform is never finished. As one reform to improve our living standard is implemented, it often discloses other long-standing impediments. The task for Australia is to continue with and broaden reforms, particularly regarding our economic and social infrastructure, our labour markets, and the environment, so that we continue to increase our productivity performance, and through improved productivity, create the possibility for sustainable improvements in the living standards of our people.

Opportunities and challenges: A context for reform

Without question Australia faces many opportunities and challenges.

In terms of opportunities, we have a strong democracy with stable governments and well functioning institutions—a point easily taken for granted but which recent events in Asia have shown to be very important. We have abundant natural resources including enviable reserves of high grade coal, iron ore and uranium and extensive farming land; an educated workforce; and good economic and social infrastructure. We have world competitive agriculture and mining organisations, growing services industries, and a manufacturing base which is, arguably, stronger today than in any previous period in our history and becoming increasingly competitive.

For our agricultural and resource sectors there are several key opportunities including:

- a growing world population with increasingly sophisticated tastes and preferences which will further stimulate demand for more innovative food products, as well as energy to support economic development;
- new technologies which will make more resource deposits viable and new products possible; and
- the opening up of access to overseas markets — one example of the potential scope of some of these opportunities is the estimate by the *Supermarket to Asia Council* (albeit prior to the current financial crises in Asia) that the Asian food market will approach \$1000 billion by the year 2000. The recent decision by APEC nations in Canada to include both food and energy sectors on a short list for early liberalisation is an encouraging sign for these sectors.

The dynamic changes in communications are also helping to bridge distance, not only between ourselves and overseas nations, but also within our nation. This offers the prospect of new business, social, educational and cultural possibilities, especially for some remote rural communities.

There is also little doubt that Australia faces some significant challenges.

Reducing Australia's unacceptably high levels of unemployment is certainly one of them. Continuing to improve the standard of living that Australians can enjoy is another, including the provision of quality health care and community services, education and training, and improved environmental and cultural amenity.

Making sure we have the capability to adjust rapidly and effectively to changes in the world around us and further integrate our economy with the rest of the world, while at the same time providing Australians with a sense of belonging and community, is going to be one of the more significant challenges of our lifetimes.

In facing these challenges, challenges common to many developed countries, Australia also has to overcome the fact that we have regions within our nation which are quite isolated from one another, making labour mobility more difficult. We are also a long way away from many of our markets. We have a small population with a small domestic market — making exports crucial for those firms where economies of scale and scope are important.

In our agricultural and resources sectors there remain some fundamental restrictions on performance (as there are in other sectors). The uncertainty with respect to resource access; land degradation and water supply issues; and transport inefficiencies are but a few. There is also a need for the right institutional framework from which the appropriate amount of research and development can emerge, and for the efficient and effective provision of essential social services especially in remote areas.

To meet these challenges and opportunities it is therefore critical that *all* sectors of our economy are performing at their very best — including our agricultural and resource sectors which have played such a critical role in Australia's development in the past, and will continue to do so in the future (see Box 1 below). To do so it is essential that we get the incentives and institutional arrangements that guide our use of resources right — and it is here that pushing ahead with microeconomic reform is important. It is here that microeconomic reform fits into the 'big picture' of improving the living standards and quality of life of Australians, by helping us to continually improve our nation's productivity.

Box 1: A snapshot of the importance of our agricultural and resource sectors (1995-96)

	<i>Agriculture</i>	<i>Mining</i>
<i>Production</i>	\$27,452 million	\$30,732 million
<i>Average Employment</i>	372,900	56,400
<i>Exports</i>	\$9,118 million	\$16,538 million

(Source: ABS, Catalogue Nos 7503.0, 8401.0, 6203.0 and 5422.0)

The importance of productivity

Productivity is often the forgotten part of the efficiency and equity story.

As Baumol et al (1988) said in introducing their book *Economics: Principles and Policies*:

“Economic issues such as inflation, unemployment, and monopoly are important to us all, and will receive great attention in this book. But in the long run nothing has as great an effect on our material well-being and the amounts society can afford to spend on hospitals, schools and social amenities as the rate of growth of productivity.”

In short, Australia's productivity growth is important because it is the major determinant of our economic growth and growing living standards. Recent research by the Industry Commission shows that since the 1960s, productivity growth has accounted for about:

- half the increase in Australia's real output, that is around \$140 billion of the \$285 billion increase; and
- two-thirds of the growth in real incomes, that is around \$6,750 of the \$10,400 increase (IC, 1997a).

Productivity growth therefore provides us with the wherewithal to provide on a more sustainable basis more education, health care, environmental and cultural amenity, social services, consumer goods and services, and leisure. (Box 2 below provides a few specific examples of productivity improvements and the benefits they bring.)

What makes efforts to lift our productivity performance particularly important is that even small increases, if sustained, can add up to significant improvements in living standards over time. Indeed, if Australia could lift its living standards over the next decade by half a percent over what we have achieved over the last 30 years, the next generation will be able to benefit from a standard of living around 13 per cent higher than would otherwise be the case (IC, 1997a).

At a time of high unemployment, however, there are understandably community concerns about the possible employment effects of increased productivity, and associated reforms.

Significantly, however, the best available evidence does not in fact suggest that productivity growth means lower employment or higher unemployment in the aggregate. There may be jobs losses in some firms, occupations or regions, but it can also mean job growth for others. For example, productivity improvements in motor vehicle production may reduce employment as well as costs in that industry, but if those cost savings are passed onto user industries, they may be able to increase their output and employment. Indeed, sustained employment growth has

coincided with productivity growth over long periods in Australia and other OECD countries (IC, 1997a).

Box 2: Examples of productivity improvements and the benefits they bring

- The move to mechanical harvesting of Australia's wine grapes over the past 30 years — which now extends to 80 per cent of the crop — has reduced the cost of harvesting grapes by \$1500 per hectare. It has also helped to meet demand for improved quality by enabling night time harvests when temperatures are cooler (CIWWI 1995, p. 45).
- Since 1950 productivity improvements in the dairy industry have seen average production per cow more than double (ABARE 1993, p. 79 and 1997, p. 164).
- Most surface irrigation systems for crops such as cotton and rice constructed in Australia over the past couple of decades have employed laser grading technology which has meant savings in water used, higher return and better crops. In horticulture the introduction of under tree micro irrigation systems is said to have achieved efficiencies in water use in the order of 85–90 per cent (IC 1992, p. 194).
- Rapid technological advances in book publishing and printing such as computer based type-setting, composing and image manipulation have increased the speed and output of printing presses and reduced manning levels (IC 1996a, p. 24).
- A 1992 study by Rolls Royce showed that the use of advanced ceramic components in aircraft turbine engines would provide a 10 per cent saving in engine weight, a 12.5 per cent increase in thrust to weight ratio and a saving of US\$7m per engine in life-cycle cost to the customer (IC 1995b, p. 175).
- According to a BIE study, more widespread application of high efficiency motors by industry has the potential to reduce energy consumption and costs. Current market share for high efficiency motors is currently only about 2 per cent but the introduction of energy efficiency labelling could see this rise to nearly a quarter, with potential savings to the manufacturing sector of \$39 million (BIE 1994, p. xi).
- The competitive tendering of a contract to maintain F-111 aircraft at Amberley RAAF base resulted in the successful tenderer (an in-house team) reducing costs by \$8m annually due largely to flatter management structures and redesigned work teams which reduced maintenance personnel from 356 to 214 (IC 1996b, p. 565–72).

(Source: Industry Commission, *Assessing Australia's Productivity Performance*, 1997)

Instead, unemployment is more likely to be affected by other factors such as:

- macroeconomic performance and the level of economic growth;
- labour market flexibility and mobility; and
- the interaction between our taxation and social security systems.

Indeed, the OECD in its *Job Study* released last year outlined nine recommendations to improve the conditions for job creation, all of which are consistent with improved productivity and further microeconomic reform (these recommendations are contained in Box 3).

Box 3: OECD Job Study recommendations

1. Set macroeconomic policy such that it will both encourage growth and, in conjunction with good structural policies, make it sustainable (that is non inflationary).
2. Enhance the creation and diffusion of technological know-how by improving frameworks for its development.
3. Increase flexibility of working-time (both short-term and lifetime) voluntarily sought by workers and employers.
4. Nurture an entrepreneurial climate by eliminating impediments to, and restrictions on, the creation or expansion of enterprises.
5. Make wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular for younger workers.
6. Reform employment security provisions that inhibit the expansion of employment in the private sector.
7. Strengthen the emphasis on active labour market policies and reinforce their effectiveness.
8. Improve labour force skills and competencies through wide-ranging changes in education and training systems.
9. Reform unemployment and related benefit systems — and their interaction with the tax system — such that societies' fundamental equity goals are achieved in ways that impinge far less on the efficient functioning of labour markets.

Microeconomic reform and productivity

Is microeconomic reform important in lifting Australia's productivity performance?

An appropriate starting point is to look at what drives productivity growth. The Commission addressed some of these in its report *Assessing Australia's Productivity Performance (1997)*, grouping them into three:

- new knowledge or 'technology' — which includes new products, new processes, new equipment and new production and marketing techniques;
- better organisation of production within firms and between industries — which involves the improved organisation of production within existing bounds of technology, such as adopting best practice, and the efficient allocation of resources between industries; and
- incidental effects — such as when a firm grows and therefore gains economies of size or scope.

Of course, the creators of most productivity improvements will be private, public and not for profit firms and organisations and their workforce. But it is also clear that government microeconomic policy can play an important role. For example, there is a role for government to ensure that market failures in the area of research and development are dealt with such that there are appropriate incentives to pursue and implement new knowledge and technology. Governments also play a role in providing and regulating education, which is almost universally acknowledged by economists as being a key driver of the development of new knowledge and the transfer of existing knowledge.

Governments can also influence the efficiency of capital markets and product markets by ensuring there is sufficient competition; by providing a robust set of anti-trust and pro-consumer laws; and by creating incentives for rewards to individuals and organisations from innovation and best practice.

Governments can also facilitate changes in workplace arrangements. These can both directly improve the way production is organised, as well as stimulate the contribution of employees to new ideas and their adoption at the enterprise level.

Governments also have a key role in maintaining the legal system, including allocating and enforcing property rights. This system needs to be clear and well defined if confidence and the capacity to productively use Australia's assets is to be achieved. It is not well understood within the Australian community how a lack of clarity about property rights combined with rigid enforcement of 'due diligence' laws rightly imposed on company directors and key decision makers, can create uncertainty and combine to undermine the capacity for investment.

While it is important not to overstate its role and effect, microeconomic reforms do play a central role in sharpening the incentives and institutions that drive Australia's productivity performance and assist in making our economy more flexible.

The progress so far

The last decade or so has truly been a remarkable period of reform, and I would argue, bringing with it significant benefits to the Australian community.

One of the most significant areas of reform has been our moves to liberalise and internationalise our economy, with key decisions to remove exchange rate controls, deregulate our financial system, and remove many of the impediments to trade with other nations. In particular, quantitative import restrictions and many export controls have been removed, and distortive import taxes reduced by over half. Foreign investment regulations have also been considerably reformed.

The process of improving the efficiency of our economic infrastructure has also begun, deregulating, corporatising and, in some cases, privatising in areas such as electricity generators; water suppliers; railway operators; telecommunication providers; and airports and airlines.

A landmark set of national competition reforms to inject competition into areas of activity previously sheltered from change has also been agreed to by state, territory and Commonwealth governments. These competition policy reforms will contribute to changing the economic landscape for many years to come. As part of these reforms, the states, territories and the Commonwealth have agreed to a fundamental review of regulations which restrict competition, many of these directly relating to the agricultural and resource sectors.

Labour market reforms have also been progressively introduced over the past decade by the states and the Commonwealth to restructure awards, support a move to enterprise-based agreements, and to improve the flexibility and skills of the workforce.

Policy makers have also turned their minds to the performance of our social infrastructure. Areas such as health, education and community services have undergone significant change, particularly at the state and territory government level. For example, more choice is being offered to the disabled in terms of where and how they access services, and to low income earners in terms of how they access housing support.

We have also recently seen a period of considerable fiscal consolidation at the Commonwealth level and by some state governments.

In the agriculture and resource sectors, we have seen the liberalisation of many export controls on our minerals sector, including on iron ore, and the restructuring of rural assistance measures. Effective rates of assistance have declined in the agriculture sector, falling from 28 per cent in 1970-71 to 12 per cent in 1995-96, and in the manufacturing sector falling from 36 per cent in 1968-69 to 6 per cent in 1996-97 (with a projected fall to five per cent by 2000-01) (IC, 1997b). We have also seen moves to a national food safety system, with national hygiene standards now in place for food premises.

As we look back over 1997, we see that progress was continued. Many aspects of the National Competition Policy were implemented, including establishing the first stage of the national electricity market in south-east Australia. Full deregulation of the telecommunications industry started on 1 July 1997, and further reform of the financial system was agreed to following the Wallace inquiry. Significantly, there were further moves to simplify the regulation of Australian workplaces through enterprise bargaining and the simplification of awards under the Commonwealth Government's new Workplace Relations Act. Tariff reductions continued with sugar tariffs removed, and the reduction in the tariff rates for the automotive and textile, clothing and footwear industries in line with the previously announced schedule of reductions to 15 per cent by the year 2000 confirmed.

The benefits of such reforms are now beginning to show.

While not wanting to overstate their importance, and accepting the difficulty of attributing cause and effect, it seems reasonable to argue that such reforms have contributed to a positive macroeconomic environment where we have seen:

- the longest period of low inflation since the 1960s;
- over 6 years of continuous economic growth in a low inflation environment;
- over 1.4 million jobs created over the past 10 years; and
- our trade orientation increase significantly, with both exports and imports up, allowing us to specialise in those areas we are relatively efficient as well as gaining access to the best the world has to offer. (Australia's exports and imports as a percentage of Gross Domestic Products have risen from 14.8 per cent to 20.1 per cent and from 16.1 per cent to 20.2 per cent respectively between 1984 and 1996 (ABSb).)

These positive macroeconomic achievements have assisted in creating an environment more conducive to long term planning and investment.

At the microeconomic level we have also seen some impressive gains.

The prices and charges of utilities have generally fallen. For example, the real price of telecommunications fell 16 per cent between 1989-90 and 1993-94, with international calls falling 40 per cent in real terms between 1989 and 1995. The real price of electricity has also fallen, declining an average six per cent between 1989-90 and 1994-95. Indeed, the prices of services provided by 58 Commonwealth, state and territory government trading enterprises fell by around 10 per cent in the first half of the 1990s (IC, 1996a).

There have also been some gains in transport. Road reforms have been introduced, including changes to the regulation of B-double vehicles along with Ministerial Council approval for changes to dangerous goods transport laws and heavy vehicle registrations. There have also been some gains in rail freight with a move to more cost reflective pricing — with non-urban passenger service prices rising by 18 per cent in real terms and average freight rates falling around 12 per cent in real terms

in the five years to 1994-95 (IC, 1996a). On the waterfront, while there is much left to do, some productivity improvements have been achieved. For example, a Bureau of Transport Economics review in 1995 indicated that stevedoring productivity improvements have benefited Australia by \$203 million in 1993 (Bureau of Industry Economics, 1995). Average crane rates across Brisbane, Sydney, Melbourne, Adelaide and Fremantle ports have increased from around 13.4 containers per hour in December 1989 to 22.8 in June 1997 (BTCE, 1997).

In the automotive industry, prices have been kept down with the productivity and quality of vehicle production improving as tariffs have fallen and quotas removed. Indeed, if tariffs had remained at 57.5 per cent, the rate which applied in the last years of the Fraser Government, consumers and businesses would be paying around \$4,600 more for a Ford Laser, or around \$8000 for a Honda Accord. Consumer choice has also expanded considerably, from 69 models in 1985 to 101 in 1995 (IC, 1997c).

Many of these gains are particularly important to the agriculture and resource sectors. These sectors depend for their long term viability on the cost, reliability and quality of our economic infrastructure, particularly transport, and operate in competitive international markets where costs cannot easily be passed on.

There have also been some significant changes in our management of the environment.

State governments have started to shift towards addressing environmental problems, including water scarcity, air pollution and waste dumping, with a mix of measures but now including market based instruments such as tradeable permits, environmental taxes and charges and user charges — a move consistent with world wide trends. The most recent example of this trend was seen at the Kyoto summit on greenhouse gas emissions where industrialised countries endorsed a regime of international tradeable greenhouse emission permits.

The Commonwealth, NSW, Victorian, South Australia and Queensland governments have also agreed to place a cap on water diversions in the Murray-Darling basin in order to assist the economic and environmental management of the river systems in the basin.

Significantly, and at least in part because of these and other widespread reforms, we are now beginning to see noticeable improvements in Australia's productivity. Australia's productivity has increased from an average of 1.5 per cent over the last three decades to around 2 per cent since 1990. Indeed, Australia's productivity growth over the 1990s has been around 50 per cent above the OECD average. Productivity gains have been particularly significant in the Transport, storage and communication sector, and the Electricity, gas and water sector, with these sectors experiencing multi-factor productivity growth of 3.6 per cent on average between 1988-89 and 1994-95 (IC, 1997a).

There are also anecdotal signs of a more competitive, diverse and rigorous economy. For example, Australia now exports fresh milk to Hong Kong on a daily

basis; wine exports reached 400,000 bottles per day in 1996-97; Australian computer software is being installed in Thailand; and BTR Nylex makes gearboxes for a Korean car maker. Many Australian firms are also starting to invest overseas as well as export, with the number of Australian firms investing overseas nearly doubling between 1975-76 and 1993-94 (IC, 1996b).

Some of the estimated benefits of microeconomic reforms are briefly summarised below in Box 4 (IC 1996a).

Box 4: Modelling the gains from reform

- The IC (1990a) modelled reform in transport, aviation, communications, water and electricity, contracting out by governments and the removal of rural manufacturing assistance. The results suggested long term annual gains in real GDP of 6.5 per cent and the generation of an extra 53,000 jobs.
- The BIE (1990a) estimated the benefits from reform over the seven year period from 1988-89 to 1994-95. In addition to those examined by the IC, the reforms modelled included the impact of investment incentives and labour market reforms assumed to result in large increases in labour productivity. The study found that reform would increase GDP by 9.5 per cent.
- For EPAC, Filmer and Dao (1994) analysed the effects of: the reduction in tariffs and subsidies; labour market reform; facilitation of the operation of markets; transport and communications reforms; GBE reform; gains from international trade negotiations; support for emerging exporters; and the efficient provision of government services. The model also projected the benefits of reducing the sustainable unemployment rate from 7.3 to 5.0 per cent. It estimated reform would increase GDP by 12.7 per cent. All of the model's 25 industries experienced growth.
- Reforms modelled by the BCA (1994) included: the replacement of the existing indirect taxation system with a broad based consumption tax; improvements in the level and efficiency of government services; further improvements in the efficiency of GBEs; and improvements to labour productivity in the private sector that were assumed to bridge the gap between Australian productivity levels and world's best practice (except where they were due to economies of scale). The model estimated reform could increase real GDP by 20.5 per cent over a 20 year period.
- The IC (1995a) estimated that the growth and revenue implications of the Hilmer and related reforms. Specifically, the IC modelled the impact of reforms in the transport, communications and utilities sectors, and to statutory marketing arrangements, government services, unincorporated enterprises and anti-competitive legislation. The IC results suggested that over time there would be a gain in real GDP of 5.5 per cent, an increase in real wages of 3 per cent and 30,000 extra jobs.

The case for further reform

Despite these impressive gains, much more can be achieved to increase Australia's productivity performance. This is partly because the reform process over the last decade remains incomplete in some areas; partly because our economic and social environment is continually changing; and partly because there is growing acceptance of the need to do more to tackle important areas such as health and education, and, very importantly, the level of long term unemployment.

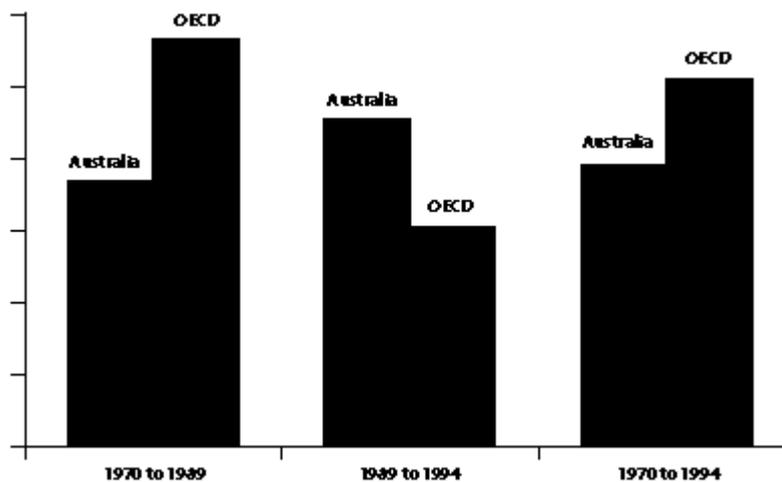
Before I outline what the Commission sees as important reforms for the next few years, it is instructive to look at what we know about Australia's recent productivity (IC, 1997a).

- Firstly, we know it has been a broad range of industry sectors that have contributed to Australia's productivity growth.
- Secondly, we know that Australia's productivity performance over the long term has been well below potential, being one of the lowest in the OECD since the 1950s — see Figure 3 (although very significant improvements have been made recently).
- Thirdly, we know that the gains from productivity growth have been more widely distributed throughout the community because they have been increasingly distributed through lower prices rather than retained as higher profits and wages.
- And fourthly, we know that productivity growth has had a more positive influence on employment when the benefits of productivity growth have been passed on in the form of lower prices.

What this highlights is the importance of *broad* ranging microeconomic reform which cuts across all sectors of the economy to remove impediments to increasing our nation's productivity.

Of course, there is only so much that can be achieved at the one time. In this paper I will highlight what the Commission argues are some of the priority areas. These include reforms to ensure the efficiency of our economic infrastructure, our labour markets, our social infrastructure, our tax system, and finding ways to efficiently and effectively care for our environment. I will also discuss some adjustment issues which are important to the microeconomic reform process.

Figure 3: Australia's comparative productivity growth rates, 1970 to 1994



Reform of our economic infrastructure

In terms of our economic infrastructure, significant work remains to be done in many areas, including:

- the national gas market;
- the waterfront;
- rail reform;
- road reform; and
- water reform.

In terms of the waterfront, the Australian Bureau of Statistics has estimated that days lost on the waterfront are currently around 800 per 1000 employees compared to an industry average of 131. While industrial disputation on the waterfront has improved considerably over recent years, this is clearly not yet best practice, and the fact alone shows the enormity of the task still required to create an efficient, effective and reliable 'waterfront'. Work the Commission has done in this area also indicates that labour productivity on the waterfront, measured by the number of container lifts per terminal employee, while again having improved over recent years, is considerably lower in Australia than overseas. The reliability of Australian container terminals is also poor, with about one in five ships calling at Australian terminals experiencing delays.

That said, measuring and accounting for performance on our waterfront is a difficult and complex problem. Performance is not universally poor. Some of Australia's bulk ports in fact perform well compared to other international ports. In

addition, the causes of poor performance vary, with a lack of competition, poor management and union actions all being contributors.

In terms of rail reform, while third party access regimes are coming on stream and track infrastructure in most states are now managed by authorities independent from rail operators, the process has been slow and protracted. Reform here could be accelerated, expanding incentives for increased productivity, removing cross subsidies between firms, and refining access regime arrangements to ensure competition can be effectively implemented.

In terms of road reform, charges faced by users need to better match the costs they impose; further contracting out of road maintenance could be considered; and progress made with the development and implementation of national road transport reforms.

While continuing with these transport reforms, it is important that governments aim to achieve neutrality between the different modes of transport, allowing each to compete on their merits rather than on explicit or implicit subsidies and cross subsidies.

Regulatory reform, competition policy, taxation reform, government assistance to business, trade reforms, and the labour market.

The reform agenda facing Australian governments should also encompass the above mentioned areas, particularly labour market reform.

Clearly, not all regulations are bad. However, regulations need to be necessary, efficient and effective, achieving their regulatory objective in the most cost effective way with the minimum of compliance costs. The current program of legislation reviews under the National Competition Policy need to be pursued rigorously and comprehensively. To this end the review process should be transparent and conducted as independently as possible.

We can, as a community, reduce the down sides of regulation if we consider in advance the reasons for the regulation and alternatives to new regulation. To achieve this aim new regulations need to be rigorously assessed from an economy-wide perspective before they are implemented. An important first step in this process would be to fully implement recent changes to the way regulation making is conducted at the Commonwealth level in response to the Small Business Deregulation Taskforce's report. The efficiency of other processes for regulation making, particularly in national forums through Ministerial Councils and national standard setting bodies, is also important. Of particular relevance to the agriculture and resource sectors is the establishment of the National Environment Protection Council and its process of regulation making. While welcome, this process needs to be sure it involves, and considers, a full assessment of all the costs and benefits of a variety of options. These options should include economic instruments such as tradeable permits, environmental taxes, user charges and performance bonds.

While the Commonwealth and the states and territories have a strong commitment to the principles of competition policy, competition policy also needs to be rigorously supported both in expanding its scope and in its implementation. The Commission's report, *The Growth and Revenue Implications of Hilmer and Related Reforms*, estimated that the benefits to the economy of implementing a comprehensive package of competition reforms would be a long run gain in real GDP of around 5.5 per cent. While there are clearly limitations to modelling exercises like this, it nevertheless clearly indicates that there is a lot to be gained from the effective application of competition policy across the Australian economy. Another important aspect of this work, while now dated, was that the gains came from an accumulation of a large number of reforms, rather than two or three major reforms. The lesson here is that improving the performance of the economy requires us to address a large range of what may seem small or insignificant reforms but which, taken together, make a significant difference to economic outcomes in the medium to long term.

In the area of taxation, there is significant scope for, and it seems widespread commitment to, reform. Our current system is distortive, inequitable and administratively complex. In our agriculture and resource sectors, as with other sectors, taxes are levied at different rates on different goods and exclude most services; concessions are given to some groups and not others; payroll taxes apply to medium and large sized business but not small businesses; and the cost of many inputs are inappropriately inflated by taxes. Crucial to these reforms is the need to clarify and improve the nature of the Commonwealth and state/territory fiscal arrangements, and in doing so address to the greatest extent possible distortive state and territory taxes.

There is also a need to gain greater consistency in government business programs, ensuring that they clearly meet their objectives and offer net benefits to the public as suggested by Mortimer (Mortimer, 1997), and accepted by the Commonwealth Government. New programs or incentives should be rigorously analysed before their implementation. Of particular importance are the various arrangements for research and development. To be most effective these need to be well targeted at market failures, and be effectively implemented and monitored with as few inconsistencies in the treatment between firms and industries as possible.

Continuing with trade liberalisation will ensure Australian firms and individuals gain access to the world's best products at world prices, and will further stimulate the efficient allocation of our resources across the economy.

Perhaps one of the greatest areas for reform relates to our labour market. But I am not just referring to the regulations that guide work arrangements, important though they are, but the whole relationship between employees and firms. In many areas there needs to be a shift in thinking. We need to improve the direction and relevance of education and training towards work outcomes. There also needs to be further encouragement of negotiations at the enterprise level with the focus on productivity improvement, and flexibility in work rules and arrangements. Australia has many hundreds of thousands of firms, each one different to some

extent with regard to products and services provided, and the processes and practices used. Some firms will use an enterprise level approach, some will follow an award. Some will have individual contracts. The important point is that they, that is the employees and their employers, should be free to choose, with minimal discomfort, the system which suits them best. Competition in the choice of system can be just as important as competition in the supply of goods or services in improving our productivity. It is also important that in re-adjusting our mind set to work relations that these are reflected in the institutional arrangements that we have in place.

There is also room for further reform of our many and varied workers compensation and occupational health and safety arrangements, and the interaction of our taxation and social security systems as they affect employment incentives. Further attention could also be given to labour mobility issues (which are discussed later). Overall, we need to remove the disincentives which our people face whether it be for improving output, safety, training, or service quality, with these incentives applying to management and professional occupations as well as others.

Industry reforms

Further reforms are also possible at the industry level.

Remaining statutory marketing boards should be reviewed to determine their continued relevance and contribution to national welfare. There are currently several marketing boards due for review under the National Competition Policy. One such review of the barley industry and its marketing board in Victoria and South Australia has recently recommended that the domestic market for feed barley and malting barley be deregulated and, significantly, that the Australian Barley Board abolish its single desk for exports.

There is also significant scope for reform of the dairy industry. In a submission to the recent review of the NSW dairy industry, the Commission estimated that existing farm gate controls on milk were costing NSW consumers around \$130 million per year (IC, 1997d).

Reforms to our social infrastructure

There is also scope for the reform agenda to be broadened to include Australia's social infrastructure. Such areas are important not only because of their direct importance to the lives of Australians, but also because they affect the productivity of our firms through improvements in the education and health of our workforce, and because they represent a significant proportion of our GDP — with government expenditure alone in 1996-97 in these areas being around \$54 billion, representing around 11 per cent of our GDP (ABS (c)).

In particular, we need to be continually improving our education and training systems because of their importance in helping us to address our long term unemployment difficulties.

Further development of social infrastructure in remote areas is particularly important. Research undertaken by the Commission for the Council of Australian Governments has indicated variations in the efficiency and effectiveness of some government services between rural and urban areas. For example, in secondary schools year 12 completion rates in remote areas have been around 58 per cent between 1991 and 1994 (years for which data are available) compared to around 69 per cent for Australia as a whole (IC, 1997e). There are also significant variation across the states and territories in some areas. For example, the average cost of an episode in hospital varies from \$2,113 in South Australia to \$3,506 in the ACT, and the administration of public housing varies from an average of \$633 in Queensland to \$1,666 in NSW (IC, 1997e). A recent study by the Australian Institute of Health and Welfare has also indicated that the health of rural Australians is behind that of urban Australians in many areas.

Environmental reforms

Broadening the reform agenda should also include our environment as a centre stage issue. Both land degradation and water supply issues are of great significance to Australia, as is Australia's response to global warming, particularly as a result of Australia's commitments at the Kyoto conference to cap emission rises to an average of 8 per cent above 1990 levels between 2008 and 2012 (Department of Foreign Affairs and Trade, 1997).

The greater use of market instruments could form an important part of Australia's response to these concerns. A report the Commission released in 1997, *The Role of Economic Instruments in Managing the Environment*, (IC,1997f) canvasses some of the opportunities in this area, indicating that market instruments, such as charges/levies and tradeable permits, can entail least cost solutions to environmental problems. What will help is a flexible system which rewards efficiency gains in environmental conservation and creates the right framework from which new technologies can emerge to further assist our environment, often at significantly reduced abatement costs.

At this point it is worth stressing the importance of reforms to our water resources which are scarce and yet so crucial to our agriculture, environment and economic viability. In particular, it is important that the reforms set out in recent years by COAG, including moves to beneficiary pricing and water trading, are implemented appropriately and on time. Cost recovery should be based on sound principles and take account of the various users of the our water systems. The establishment of a trading system should include clearly defined and readily tradeable property rights, which also allows for interstate trading. Moves to greater community responsibility for water resources is to be encouraged, but again appropriate incentives are

required before such moves can improve the efficient allocation of our water resources. Arrangements for allocating water to maintain environment values also needs to be progressed.

These reforms will have a profound affect on many rural communities and farmers, encouraging high yield crops as opposed to lower value, water intensive ones, and quite possibly reducing the amount of irrigated land. Adopting user pays principles for water will clearly increase costs for some farmers, particularly in the short term. That fact cannot be denied or hidden. At the same time, however, it is most likely to improve the quality and sustainability of our water infrastructure for the long term benefit of the farming community as a whole.

Further reform in all these areas will assist Australia is to get maximum leverage over our resources and maintain community support for further reform.

Of course, there will be some losers as well as winners from individual reforms. However, work by the Commission indicates that losses are minimised when reforms are wide spread throughout the economy (IC, 1995-96). Widespread reform has the effect of 'averaging out' the impact of reforms, with the important point being that *on average* the gains are positive. This will be the case in our agriculture and resources sectors as it is in others. It will also hold true for the many regional areas across Australia which by virtue of their relatively small size and isolation may find themselves particularly vulnerable to the effects of some individual changes.

This then raises the important question of adjustment to firms or individuals in the face of widespread microeconomic reform.

Adjustment issues

The question of adjustment covers several issues. Perhaps the most commonly thought of is adjustment assistance — which for the rural community makes up most of the total assistance received from government. But adjustment is also about labour flexibility, training and mobility; competitive firms; efficient regulatory systems; and efficient and effective economic and social infrastructure — many of the areas which I have already flagged.

Some of the more specific findings which the Commission has reported on in its automotive; textile, footwear and clothing; and industry regional adjustment reports regarding adjustment assistance may help to guide the thinking on this important issue (IC, 1997c, 1997g, 1993). These include:

- that workplace flexibility is central to adjustment, and this could involve allowing different employment remuneration and conditions to emerge for different firms in the same industry;
- that adjustment assistance can play an important role, often with assistance provided directly to individuals affected, although there is a need to ensure it

is appropriately targeted, well designed and efficiently administered with regular independent reviews;

- that the social security and taxation systems can act as a constraint on mobility, particularly stamp duties applicable to the selling of the home and high effective marginal tax rates (where social security withdrawals and marginal personal tax rates combine);
- that there can be an important role for governments in providing information and other assistance, sometimes in foreign languages, on opportunities for displaced workers;
- that maintaining solid economic growth is important to help assimilate labour, and other resources, into other productive activities; and
- that one of the best adjustment mechanisms for regional areas is to develop a portfolio of competitive advantages — making the most of technological advancements in production, transport and, importantly, communications.

Conclusion

The important point of this paper is that Australia, through the hard work of many dedicated people, has implemented a range of what is described as microeconomic reforms for over a decade, and the reforms in my view are paying dividends.

However, Australia still has a significant and extensive reform agenda which, if appropriately implemented, can help to reduce our high levels of long term unemployment, increase our long term productivity and increase our living standards. With such an extensive agenda of microeconomic reform it is important that Australia as a nation is focused on implementing it. It is also important that Australians are encouraged to understand and be supportive of the process — a challenge the Industry Commission, and others, are well aware and are attempting to address.

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